# Money and the State

- Allyn Young's perspective:
  - Thinks that money was always a thing (it didn't just replace barter)
  - Thinks a good financial system is required for growth
  - Has critiques of the currency principle (because there has to be more elasticity in the financial system)
  - Doesn't think that the power of the state gives money its value
  - Opposed to speculation
  - Thinks that the central bank is necessary
- National banking before the fed:
  - Some banks (those in New York, Chicago, and St. Louis) were required by law to hold 25% reserves (i.e. money issued by the state)
  - Other banks in major cities also had to hold 25% reserves, but could hold some portion of that as deposits in New York
  - Country banks (i.e. small banks) have to hold 15% reserves, but could hold some portion of that as deposits in banks in major cities
- War finance (like the civil war):
  - Raise money through taxes
  - Conscription (i.e. take free labor)
  - Bond sales
    - The government sells bonds (which are liabilities) and receives deposits which it can spend on goods
    - The private sector is losing deposits and gaining bonds (both are assets)
    - The banking system is losing deposits from the private sector and gaining deposits from the government (both are liabilities)
    - If the government can't sell bonds (maybe because the private sector requires too much interest), the government might take a loan from the banking system
      - This is a swap of IOUs - the banking system has a deposit account for the government (so the banking system owes the government) and the government has a loan from the banking system (so the government owes the banking system)
      - During the civil war, the government did this but withdrew the deposits right away in the form of gold
        - This sucked most of the gold out of the banking system and allowed the government to buy foreign goods using that gold (which was key to the North winning the war)
        - Deposits in the banking system could no longer be converted to gold (because the banking system no longer had gold), so the US moved off the gold standard
    - This can't be done more than once (because the banks won't fall for it again)

            - So to finance the civil war, the government issued legal tender (i.e. paper bills) which could not be exchanged for gold
                - Government paid the private sector with legal tender to buy war goods
                - The private sector deposited the legal tender in the banking system - so, banks used the legal tender as reserves
        - Later, a third method of war finance was used during the civil war
            - The government issues 2% interest bonds to the banking sector for deposits
            - The government then pays the private sector with these deposits to buy war goods
            - The bank then gets the right to print bank notes which use the 2% bonds as collateral
                - People can exchange these bank notes for the 2% government bonds
            - This led to financial instability
                - Farmers withdraw money from their local bank at the time of harvest (which implies a withdrawal from the national bank)
                - National banks would have to call back overnight loans that they would have given to stock brokers
                - Stock brokers would have to sell stocks, dropping stock market prices
- During the financial crisis of 1907, J.P. Morgan created clearing house certificates

# The Federal Reserve (Plan)

- Three levels of the Fed
    - Member banks
        - Giving loans, but constrained because they are afraid that the deposits will be withdrawn and can't pay out many withdrawals all at once
        - In times of distress, these banks would borrow discount loans from the reserve banks (the collateral was the loans that the member banks had created)
            - Discount loans had a lower interest rate before 2003, higher after that (discount is a verb in this context - it doesn't mean cheaper)
            - The reserve banks would give Federal Reserve deposits in exchange
            - This eliminates the fear of the bank to not pay out
    - Reserve banks
        - If the member banks needed notes, the reserve banks took a rediscount loan from the Federal Reserve (which prints notes that the reserve banks can loan to the member banks)

    - Federal Reserve System (i.e. the central bank)
        - Founded because an agricultural country has a fluctuating demand for money, so the supply of money should be elastic

# The Federal Reserve (Actual)

- During World War I, the Federal Reserve only had lots of treasury bills
    - This was thought to be temporary, but it stayed that way forever
    - Instead of loaning to the banks and the private sector, the Fed mostly loaned to the government (by buying treasuries)

# Micro and Macro

- Discipline: Some transactions can't be made if the money supply is tighter
    - The payment system is a credit system to allow for enough elasticity which will maximize the number of mutually advantageous transactions that are made
- Survival constraint (i.e. reserve constraint)
    - Cash inflow must be greater than cash commitments
    - Banks are killed by liquidity (solvency is not as big of an issue)
        - For example, a bank that gets 10 dollars for 4 years and had to pay 5 dollars every year is fine
        - But, a bank that gets 10 dollars for 4 years and has to pay 20 dollars in the first year won't be fine
            - Financing using short-term debts can cause a liquidity problem
            - Debts need to be refinanced to prevent debts in the future from causing a liquidity problem
        - A company that has the same number of financial assets and liabilities as another company can have a very different liquidity situation (because of varying time patterns)
        - The more people that have a liquidity problem (so they absolutely need to borrow), interest rates can rise a lot (and credit becomes tight)
            - Fragility of the economy has todo with the balance between cash flows and cash commitments