

## SOME STUDY QUESTIONS ON THE YOUNG CHAPTERS

### **1. “The Mystery of Money”**

This chapter is about money and credit in the hierarchy of money; try to place all you read within the framework of lecture 2.

Young (also) uses the “means of payment” definition of money to distinguish it from credit and debt. Where does Young stand in the hierarchy, i.e. where does he draw the line between money and credit (p. 268-272)? Why is it difficult to decide whether bank notes\* are currency or credit (p.274, also p.294)?

The main headings in the course syllabus are banking as a clearing system, as market making and as intermediation. Pages 272-274 allude to each of these.

Use T-Accounts to represent the three ways of obtaining a bank deposits (p.273):

- 1) If I deposit cash, then I give up an asset (cash), to get another asset for it (deposit). The bank gets an asset (the cash I brought) and creates a liability (the deposit I now own).
- 2) If I deposit a check, that increases my deposit balance and reduces somebody else's.
- 3) The bank can create a deposit by making a loan (allowing the borrower to write checks on the deposit account the bank has created for that purpose).

When you do this in T-Accounts you will be amazed to realize that all it takes to create or destroy loans and bank money is book-keeping entries.

Young is quite strongly opposed to government-issued “fiat” money, but quite favorable toward bank-issued “credit money” (271-272). How is this consistent with the hierarchy of money framework?

### **2. “The Monetary System of the US”**

This chapter is mostly about different types of money (currency). There are several types of it discussed (gold, silver, greenbacks, bank notes...). How do you call the price(s) between them and whose responsibility is it to manage them?

Do people value these currencies at their commercial value, or at their legislated price? “Gresham’s Law” crops up several times; it refers to “the bad money driving out the good”, meaning the overvalued driving out the undervalued. What does this tell us about the last question?

What do the terms paper standard (p.281, p.291), irredeemable (p.282) and fiat currency(p.283) have in common?

### **3. “Mobilizing Banking Credits”**

This chapter is about credit and how to organize a banking system.

On page 294 the difference between the currency principle and banking principle is illustrated (see also p.308) with the example of bank notes\*, which is privately issued and elastic, yet also acts as money between non-banks. Can you see when elasticity is desirable, and when control/discipline is? You can read the chapter as a search for the right balance. (pages 298ff elaborate on the disadvantage of only having control/discipline).

Try to think of the organisations issuing emergency bank notes as precursors of the Federal Reserve. How do federal reserve banks help introduce elasticity into the system (p.303-4)?

### **4. “Dear and Cheap Money”**

This last chapter considers the experience of the Bank of England, the most sophisticated of all central banks at the time, and at the centre of the world financial system in the 19<sup>th</sup> Century. “Dear money” means that the short term interest rate for borrowing money is high, and cheap means a low rate. Those rates were strongly influenced by the Bank of England’s rediscount rate (Bank Rate), hence the chapter is about monetary policy. What price of money is the policy instrument? What is the objective? (p.312-313)

The chapter starts with a useful characterization of the currency versus banking principles; compare those to the lecture notes. Young explains how the Bank of England was constrained by the currency principle (Peel’s Act p.308), so that the elasticity of money and credit had to come from somewhere else (the four points, p.309).

Can you relate what the Bank of England did (p.311-313) with the lecture material on monetary policy, i.e. the artificial hierarchy?

The remaining pages (312-320) involve foreign trade and exchange rates; keep your eyes on the movements of gold and what they do to the balance sheet of the Bank of England. Given that the whole financial structure rested on gold (p.310) as in lecture 1, the way the discount rate influences movements in gold suggests how a central bank’s interest rate policy can influence the entire monetary hierarchy.

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\* What are bank notes? Our familiar green dollar bills are Federal Reserve Notes. Private bank notes no longer exist – if bank notes existed today they would be Citibank-dollars and Chase-dollars.