An Introduction to the Law of Money and Banking

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Overview

What Is Money and Banking?

How Is the U.S. System of Money and Banking Supposed to Work?

What’s Gone Wrong With the U.S. System of Money and Banking and What Should We Do About It?
What is Money?
The Neoclassical View

• Money is a thing—like gold or silver or paper—that people use as a medium of exchange to avoid the problem of the double coincidence of wants that plagues a barter economy.

• Money serves four functions:
  • It is a *medium of exchange* – people use it to buy and sell goods and services and tangible and intangible assets;
  • It is a *unit of account* – people use it to measure the value of goods and services and tangible and intangible assets;
  • It is a *store of value* – people hold it so that they can acquire goods and services and assets in the future; and
  • It is a *means of deferred payment* – people use it to create and discharge debts.

An LPE Approach

- Money is constructed.
- Key concept is the monetary unit.
- It is an abstract accounting entry in a ledger.
- It need not take any physical form at all.
- The hard part is getting people to accept units for goods and services and tangible and intangible assets.

How to Make Money That Works?

1. Tax and Spend In It
2. Tokenize It
3. Embed Collateral
4. Issue Judgments In It
5. Limit the Supply of It
6. Require Its Use/Prohibit Alternatives
Why Do States Make Money?

- To Extract Resources
- To Create More Resources
- To Influence Resource Production & Distribution
What is Banking?
The Neoclassical View

Banks as “Financial Intermediaries”

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>LIABILITIES</th>
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<tbody>
<tr>
<td>Loans ($80)</td>
<td>Deposits ($90)</td>
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<tr>
<td>Vault Cash ($20)</td>
<td>Equity ($10)</td>
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An LPE Approach

• Banks are a special type of lender: they do not need existing money to lend.
• Banks lend by issuing new money: deposits and certificated deposits known as notes.

![Diagram](image)

- Paper money (bank notes, cash)
- Account money (checks on deposits/wires)
Banks as Monetary Institutions

When a bank makes a loan, it expands its balance sheet on both sides going from $100 to $110:

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<tr>
<td>+ New Loan ($10)</td>
<td>+ New Deposit ($10)</td>
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Withdrawals

When a depositor withdraws cash, the bank shrinks its balance sheet on both sides:

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<tr>
<td>- Vault Cash ($10)</td>
<td>- Deposit ($10)</td>
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How Is the U.S. System of Money and Banking Designed to Work?
Banks Expand the Money Supply

• The U.S. banking system is an *outsourcing scheme*: banks expand the money supply.

• Congress *delegated* the power to expand the money supply to banks.
English Origins

• This approach comes from England where, in the 1690s, Parliament set up a new monetary system.

• This system had three pillars:
  1. Delegation
  2. Separation
  3. Monopoly
Hamilton’s Plan

- A national bank for paper money
- A national mint for metal money

Bank of the United States (1791)
Philadelphia, PA

United States Mint (1792)
Philadelphia, PA
The Bank Wars

• **Problem 1**: The directors and officers of the Bank of the United States were like an *aristocracy*.

• **Problem 2**: The directors and officers of the Bank of the United States were mostly *federalists*. 
The American Monetary Settlement

1. **Delegation**: privately-owned banks, not the government, expand the money supply.

2. **Separation**: bankers cannot engage in commerce and vice versa.

3. **Open Access**: anyone is eligible to apply for a charter to expand the money supply as long as they are willing and able to comply with the terms and conditions.

4. **Supervision**: special government officials, empowered to stamp out “unsound” banking, ensure that banks fulfill their public purpose.
The National Bank Act (1863/4)

- The NBA creates the Comptroller of the Currency to charter and supervise national banks.
- It allows anyone to apply for a charter.
- It authorizes national banks to expand the money supply, subject to oversight by the Comptroller.
- National banks, alongside state-chartered banks, are meant to have a monopoly on monetary elasticity.
The NBA is a Compromise

• There was an alternative: money known as Greenbacks directly issued by the legislature.

• The NBA is an attempt to preserve delegation, and avoid Greenbacks, in order to (1) bolster confidence in money, (2) avoid government corruption, and (3) satisfy powerful constituencies.

How Do “Central Banks” Fit In?
What is a Central Bank?

• The term “central bank” is used to describe two distinct institutional arrangements:
  1. Privately owned bankers’ banks with a special position by virtue of their size or legal privileges.
  2. Monetary authorities that are part of the government.
The Federal Reserve Act of 1913

- The Fed is a *monetary authority*.
- It is designed to administer a system of privately owned and operated banks.
Three Problems with the NBA

1. Deflation
2. Maldistribution
3. Insufficient Public Accountability and Control
The Banking Acts of 1933 & 1935

- Created the Federal Deposit Insurance Corporation
- Redirected monetary elasticity
- Strengthened supervision

“There must be a strict supervision of all banking...so that there will be an end to speculation with other people’s money and an adequate but sound currency.” – F.D.R.
Who Wins?

Who Loses?

• Delegation entrenches existing hierarchies.
• It empowers *private actors* to decide who benefits from monetary elasticity.
• The Community Reinvestment Act (1977) attempted to reverse some of the most flagrant abuses (redlining, etc.).
• But private banking remains wildly unrepresentative.
First woman CEO of top U.S. bank ever – just added in 2021!
What’s Gone Wrong With the U.S. System of Money and Banking?
Shadow Banking

• Shadow banks = firms without banking charters that expand the money supply by issuing deposit substitutes.
• Shadow banks undermine the AMS.
• Shadow banks could not exist at scale without the implicit support of the Federal Reserve.
The Dollar Money Supply

See Morgan Ricks, The Money Problem (2016)
Universal Banking

- Shadow banking begot universal banking.
- Banks got into all sorts of nonbanking businesses.
- Banks combined into holding companies with nonbanking businesses.
Intellectual Shift

• OCC (1980): “Shift in emphasis” – “the marketplace normally is the best regulator of economic activity.”

• OCC (1987): Embraced “a modern concept of banking as funds intermediation”

Desupervision

- Shadow banking and universal banking undermined public sector oversight.
- Supervisors voluntarily disarmed.
- They argued that banks were intermediaries that should be disciplined by market forces not public officials.

Contractionary Panics

- 2008: a classic bank run on shadow banks.
- Fed forced to backstop shadow banks to prevent monetary system collapse.
- Cost = trillions in lost output.
- 2020: another classic run on shadow banks.
- Fed lent $1 trillion to stop the run and made $2 trillion in “market functioning purchases.”
Shadow Bank Run

Chart 5.3.19 Lehman Tri-party Repo Assets in 2008

Billions of US$

- U.S. Treasuries and Strips
- Other Fed Eligible Collateral
- Non Fed Eligible Collateral
- Agency Debt
- Agency MBS

Source: FRBNY, Copeland, Martin and Walker (2010)
The Monetary-Financial Complex

- Entanglement of monetary system and private financial activity.
- Massive transfer of wealth to financial system.
- Financialization of the economy.
What Should We Do About It?
## Four Approaches to Delegation

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<th>Technocratic Control</th>
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<td><em>Technocratic Welfarists</em></td>
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<td><strong>Private Elasticity</strong></td>
<td><em>Monetary Libertarians</em></td>
<td><em>The Corporatist Consensus</em></td>
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Alternatives to Delegation

1. Private Money (e.g., Bitcoin, Diem): non-state money without central bank or delegation.

2. Public Money (e.g., full reserve banking, CBDC): state-issued account money to augment or replace bank-issued account money.
Thank You!!

The accompanying slides draw on four forthcoming articles (in addition to the sources cited above):

• *Administering Money: The Federal Reserve System in Theory and Practice*
• *The Collapse of Banking Law*
• *The Monetary-Financial Complex* (with Morgan Ricks)