A History of Money and Banking

Lecture 4

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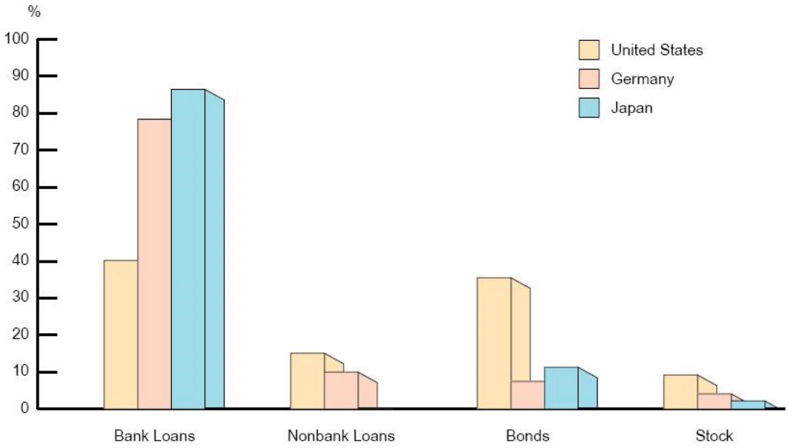
  - liquidity

Factors Influencing the Evolution of Money

How early forms of money emerged:

- barter –> double coincidence of wants –> expensive to transact
- occupational and regional division of labour –> a need to transact
  $\rightarrow$ **commodity money** as an institution facilitating transactions
- non-coincidence of wants –> store of value
  $\rightarrow$ coins in circulation: Greek, Roman, Byzantine, Carolingian empires
- trade –> **bills of exchange**: a promise from the debtor to pay the creditor at a specified point in the future
  –> modern banking: 1694 – Bank of England

What are we trying to explain?
Banking in the developed world



A Brief History of Banking in US

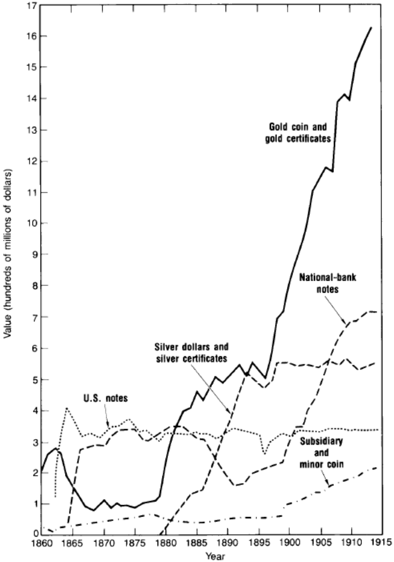
1. 1782: First bank is created; huge success; number of banks increase
2. Early 19th century: Banks issue their own bank notes; frauds increase
3. 1863: National Bank Act: Reallocation of funds to banks regulated by the Federal Government rather than the State Government
4. 1913: Federal Reserve Act creates the FED as a system
5. 1933: Federal Deposit Insurance Corporation is created
6. 1933: Investment in securities and banking are separated (Glass-Steagal Act)
7. 1994: Consolidation of banks across states is allowed
8. 1998: The first bank to have branches on both coasts
9. 1999: Repeal of Glass-Steagal
10. 2010: Dodd-Frank

Does Money Create Inflation?

Evolution of Money in the US

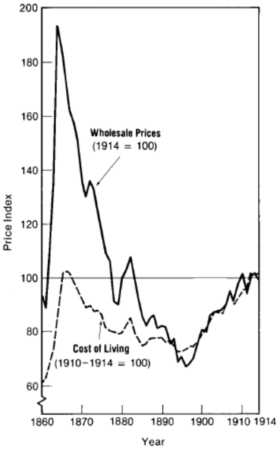
FIGURE 19.1
Forms and Values of Currency in the United States, 1860–1915

From the late 1870s to the early 1890s, substantial additions were made to the nation's monetary stocks of gold and silver, but it was not enough to prevent deflation. After 1895, however, the increase in the stock of gold became even more rapid, and deflation became inflation.



Does Money Create Inflation?
Evolution of Prices in the US

FIGURE 19.2
Prices, 1860–1914
Prices generally fell from the end of the Civil War until the 1890s and then rose until WWI.



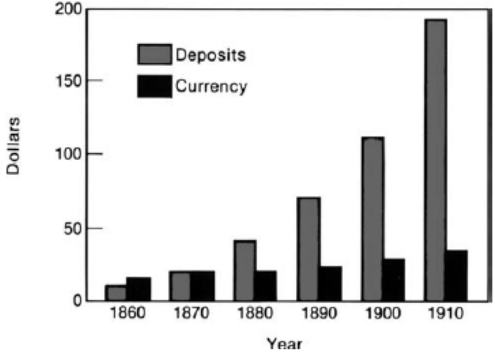
Source: Historical Statistics *1960, Series E1, 101, 157.*

Think: Use the quantitative theory of money (M*V = P*Y) to explain deflationary episodes.

One of the reasons for economic growth

Savings

FIGURE 19.3
Per Capita Deposits and Currency in Circulation

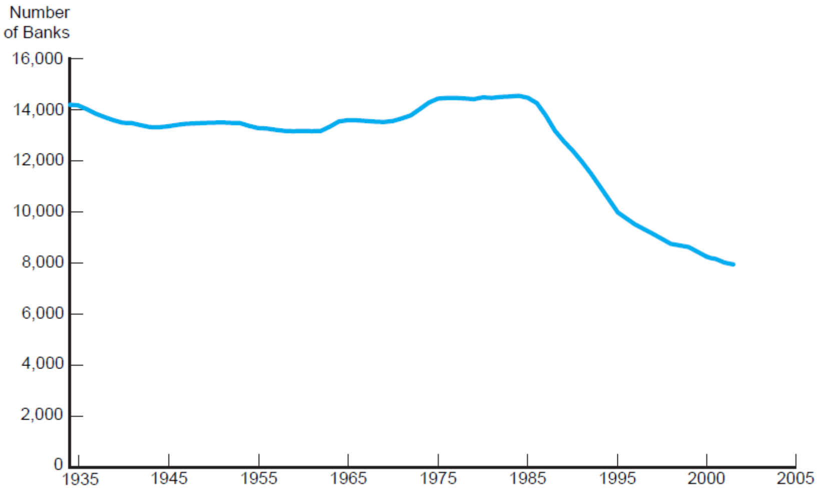


Source: *Data from* Historical Statistics of the United States *1947, 25, 262, 263, and 274.*

Think: Why more savings lead to growth despite the lack of more money?

Modern developments

Laws changing the structure of the US banking industry



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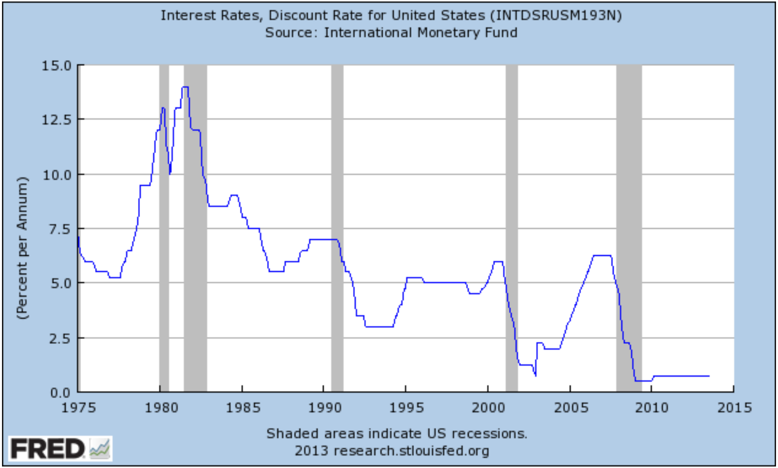
Disadvantages of Consolidation

- Lower competition
- Higher market risks
- ...

Central Banking and Its Goals

Interest rates and recessions



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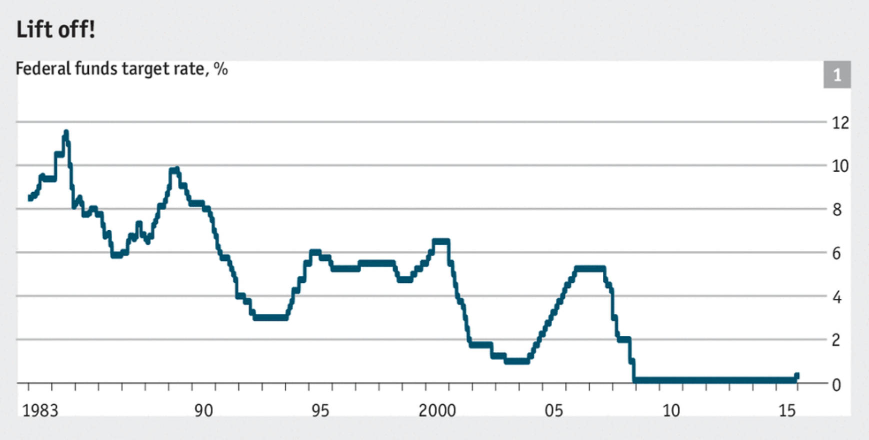


Inflation Targeting: Essence and Examples, 1990 - present

Inflation targeting

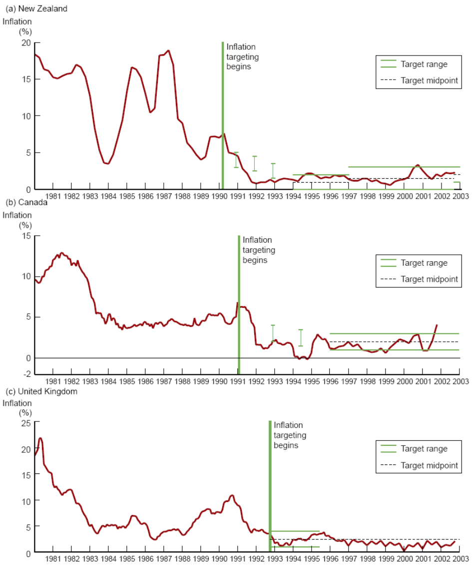
Inflation targeting: A MP rule in which the CB commits to an expicitly stated medium-term inflation rate (typically, 1-3%) which serves as a nominal anchor

Examples:

1. **New Zealand, 1990**: The pioneer of inflation targeting, a success story of controlling inflation with benefits on the production side
2. **Canada, 1991**
3. **UK, 1992**
4. **ECB, 1999**: The most independent central bank in the world
5. **FED, 2012**: Targeting inflation and unemployment, while playing with the FED Funds rate

In NZ,Can,UK cases, after a short recession due to restrictive monetary policy, the economy was on its positive growth path again.

Inflation Targeting: The Evidence



Advantages and Disadvantages of Inflation Targeting

Advantages

- domestic policy focus
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Disadvantages

- inflation not directly controllable
- can drive the economy into recession

Further reading

1. *** Persson, Karl, (2010). An Economic History of Europe. Knowledge, Institutions and Growth, 600 to the Present. Cambridge University Press, Cambridge, UK. [**Chapter 7: Money, Credit and Banking**].
2. *** Walton, Gary M., and Hugh Rockoff, (2010). History of the American Economy: Eleventh Edition. South-Western Cengage Learning, Mason, OH [**Chapter 19: Money, Prices and Finance in the Postbellum Era**; Chapter 27].
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