

THE STORY OF

MONEY



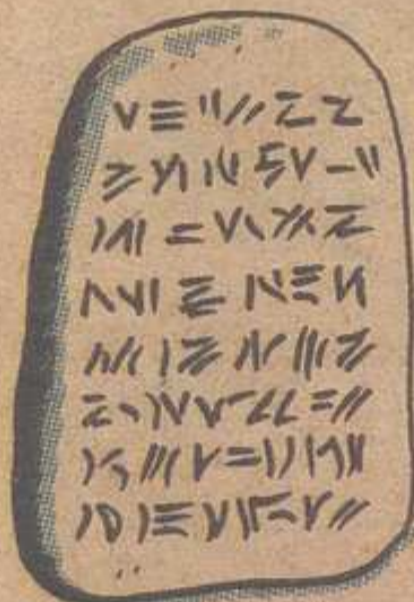
LYDIA 700 B.C.
(TURKEY)



CHINESE TAO
500 B.C.



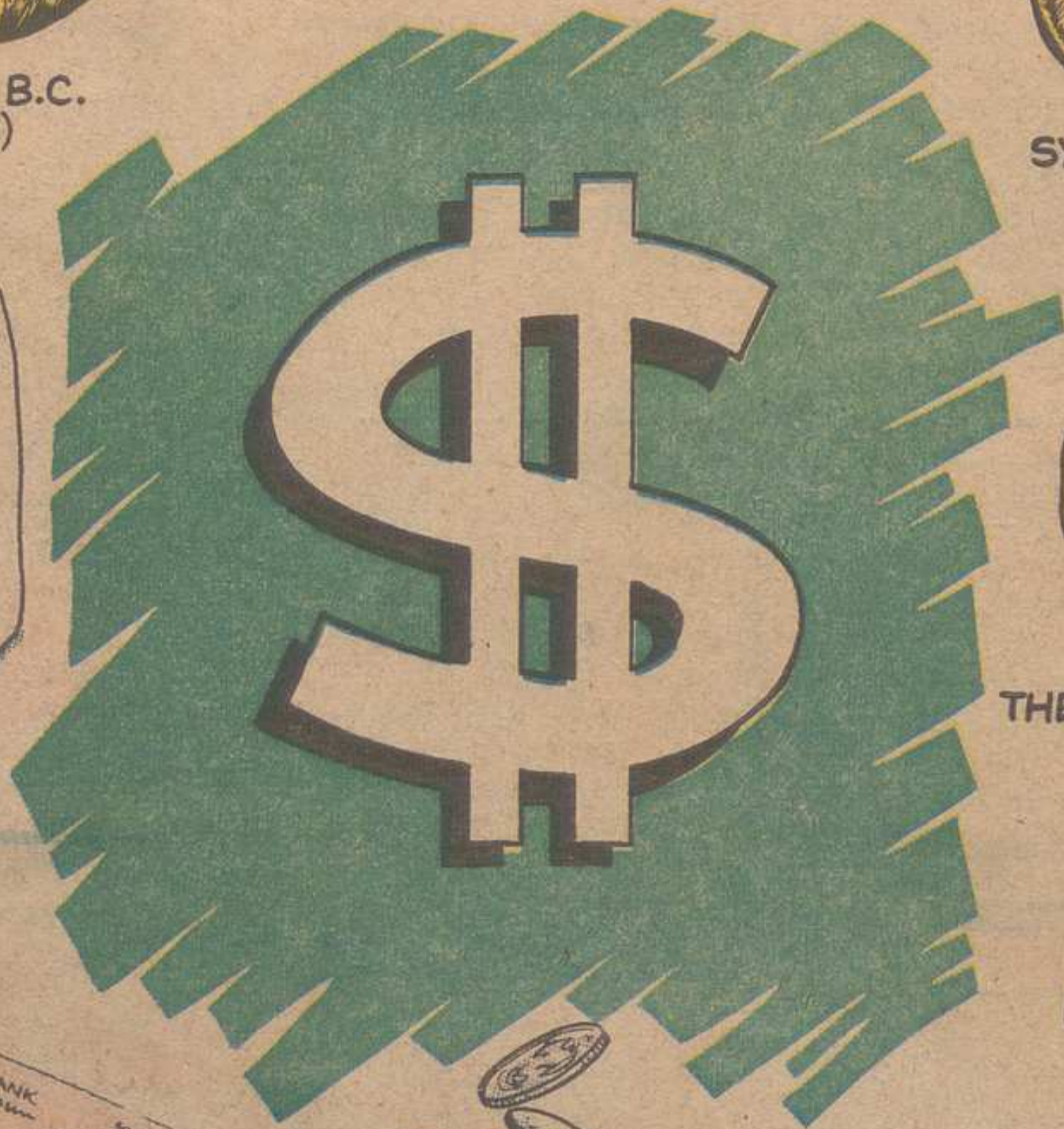
SYRACUSE 412 B.C.



BABYLONIA
2,500 B.C.



THESSALY 350 B.C.
(GREECE)



COLONIAL
PINE TREE
SHILLING
1652



CHECKBOOK
MONEY



MODERN COINS & CURRENCY

**FEDERAL RESERVE BANK
OF NEW YORK**

Part
2017.0814

U.S. MONEY 1977

COIN

AMERICANS HOLD COINS WORTH ABOUT \$10 BILLION. COINS ARE PRODUCED BY THE BUREAU OF THE MINT (PART OF THE TREASURY) AND ISSUED BY THE U.S. GOVERNMENT. MOST COINS CONTAIN METALS THAT ARE WORTH LESS AS METAL THAN THE FACE VALUE STAMPED ON THEM. COINS ARE A "CONVENIENCE" MONEY FOR SMALL, DAILY TRANSACTIONS.

PAPER CURRENCY

AMERICANS ALSO HOLD ABOUT \$85 BILLION OF CURRENCY, CONSISTING ALMOST ENTIRELY OF FEDERAL RESERVE NOTES. THE BILLS ARE PRINTED BY THE TREASURY'S BUREAU OF ENGRAVING AND PRINTING AND ISSUED BY THE 12 RESERVE BANKS WHICH ARE PART OF OUR CENTRAL BANKING SYSTEM. A VERY SMALL AMOUNT OF "U.S. NOTES"-- FIRST ISSUED DURING THE CIVIL WAR-- IS STILL IN CIRCULATION.

CHECKBOOK MONEY

WE HOLD MOST OF OUR MONEY IN CHECKBOOK FORM-- ABOUT \$230 BILLION IN 1977-- AND MAKE MOST PAYMENTS WITH CHECKS. CHECKBOOK FUNDS, BOOKKEEPING ENTRIES IN BANKS' LEDGERS AND COMPUTERS, ARE MAINLY CREATED BY THE LENDING ACTIVITIES OF THE NATION'S 14,700 PRIVATE COMMERCIAL BANKS. CHECKBOOK FUNDS ARE OFTEN CALLED "DEMAND DEPOSITS," BECAUSE THEY CAN BE WITHDRAWN ON DEMAND.



ART BY
AL WENZEL

SCRIPT BY
D.H. FRIEDMAN AND C.J. PARNOW

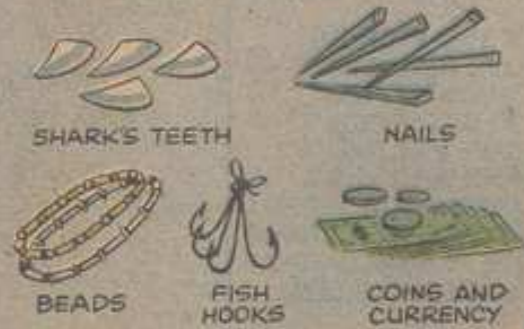
THE STORY OF MONEY IS ACTUALLY TWO STORIES IN ONE. IT IS THE STORY OF HOW OUR ANCESTORS DEVELOPED A "MEDIUM OF EXCHANGE" TO ENABLE US TO BUY GOODS AND SERVICES, MEASURE THEIR WORTH, AND SAVE FOR THE FUTURE. IT IS ALSO THE SAGA OF OUR SOCIAL EVOLUTION FROM RUGGED SELF-SUFFICIENCY, WHEN WE MADE WHAT WE NEEDED AND SWAPPED FOR ITEMS WE WANTED, TO INTERDEPENDENCE IN AN ECONOMY IN WHICH MONEY PLAYS AN IMPORTANT ROLE.

LET'S LOOK FIRST AT HOW MONEY WORKS!



2017.0814

THE CIRCULAR FLOW OF MONEY.
 ANY ITEM-- SHARK'S TEETH OR IRON NAILS--
 CAN BE MONEY IF IT IS WIDELY ACCEPTED
 IN PAYMENT FOR GOODS, SERVICES AND
 DEBTS. OUR SOCIETY USES COIN, PAPER
 CURRENCY AND CHECKBOOK MONEY.



MONEY MOVES THROUGH OUR ECONOMY IN
 A CIRCULAR FASHION OFTEN COMPARED TO
 THE CIRCULATION OF BLOOD.



TAX MONEY BUYS GOODS AND SERVICES FOR THE NATION AS A WHOLE.

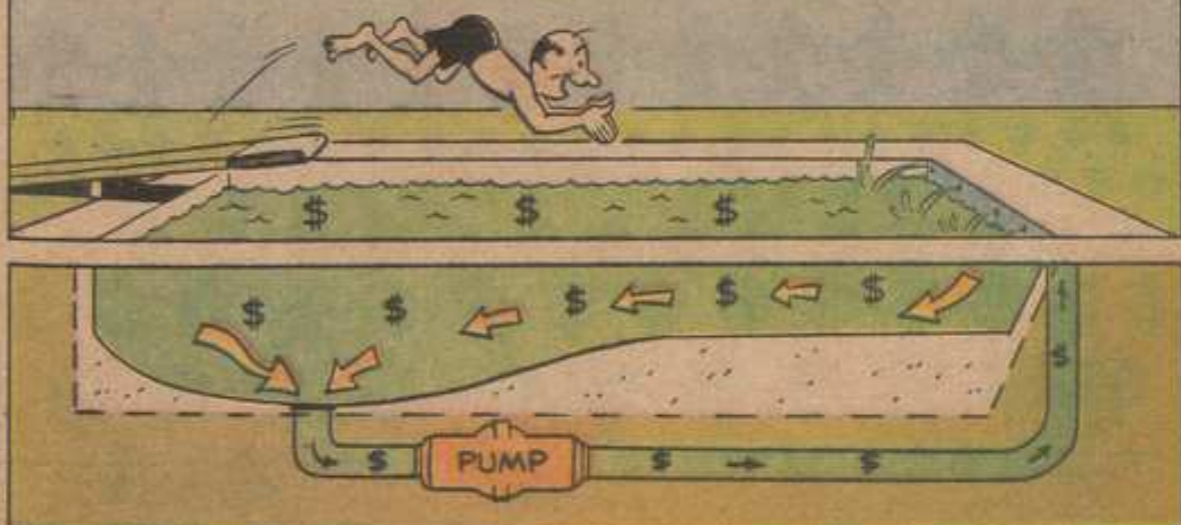


GOVERNMENTS BUILD ROADS AND HOSPITALS AND PAY SOLDIERS AND TEACHERS. THUS,
 THE MONEY CIRCULATES BACK INTO THE ECONOMY.

MANY OF US ALSO SAVE SOME MONEY, OFTEN DEPOSITING MUCH OF IT IN FINANCIAL INSTITU-
 TIONS SUCH AS BANKS, CREDIT UNIONS AND PENSION PLANS. THEY LEND IT TO WORKERS,
 PRODUCERS AND GOVERNMENTS SEEKING MORE MONEY.



AS LONG AS THE MONEY FLOWING INTO FINANCIAL INSTITUTIONS MATCHES THE OUTFLOW,
 THE TOTAL IN CIRCULATION REMAINS UNCHANGED.



MOST OF US GET MONEY BY WORKING.
 WE THEN USE OUR WAGES OR SALARIES
 TO BUY GOODS AND SERVICES.

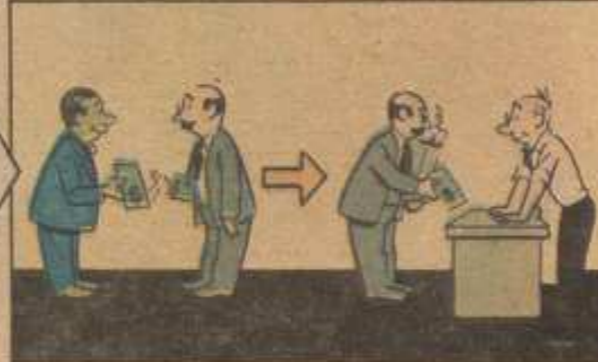


MONEY ALLOWS US TO MEASURE THE WORTH OF
 DIFFERENT ITEMS WITH A SINGLE STANDARD OR
 YARDSTICK.

WE CAN COMPARE THE
 COST OF AN AUTOMOBILE
 AND A MOTORCYCLE AND
 MEASURE THEIR WORTH
 IN TERMS OF THE HOURS
 WE MUST WORK TO BUY
 ONE OR THE OTHER.



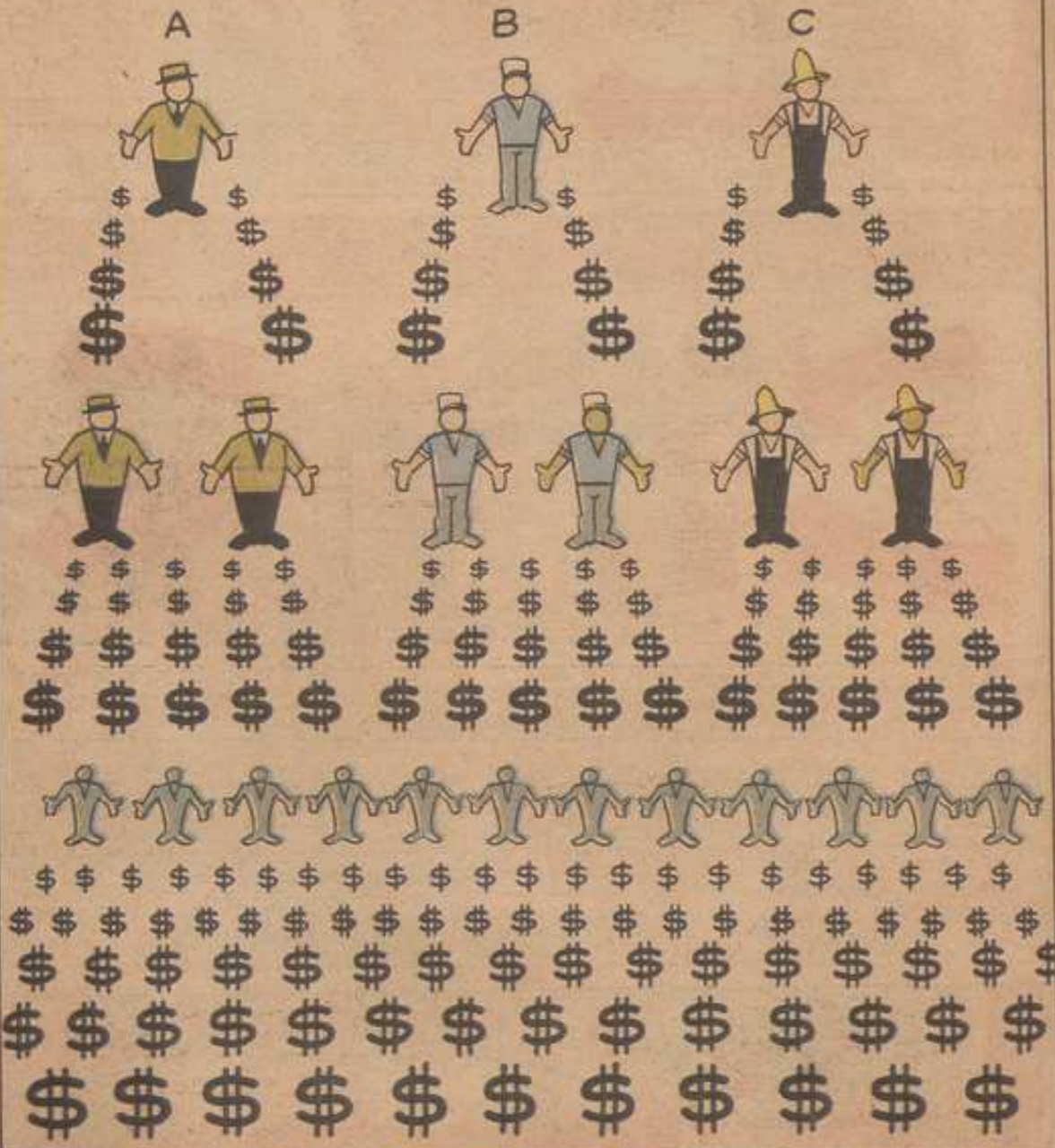
OUR PURCHASES PROVIDE PRODUCERS
 WITH MONEY TO PAY WORKERS AND
 OTHER EXPENSES.



WORKERS AND PRODUCERS USE PART OF THE MONEY RECEIVED TO PAY
 FEDERAL, STATE AND LOCAL TAXES.

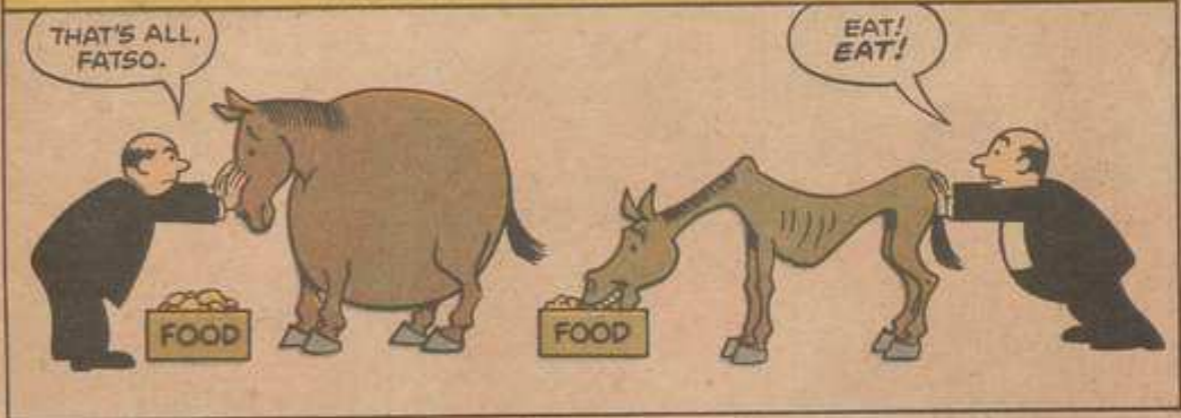


ONE INSTITUTION-- THE COMMERCIAL BANK-- CREATES NEW MONEY-- CHECKBOOK MONEY-- WHEN IT LENDS. PRODUCERS AND WORKERS BORROWING FROM COMMERCIAL BANKS PUT THIS NEW MONEY INTO CIRCULATION.



THE ABILITY OF BANKS TO EXPAND THE AMOUNT OF MONEY CIRCULATING ALLOWS OUR ECONOMY TO GROW, BUT MONEY MUST BE EXPANDED CAUTIOUSLY.

BY CONTROLLING THE COMMERCIAL BANKS' ABILITY TO CREATE NEW MONEY THE FEDERAL RESERVE TRIES TO ENSURE THE ECONOMY DOESN'T GET TOO MUCH MONEY-- WHICH CAN CAUSE "INFLATION," RISING PRICES-- NOR TOO LITTLE-- WHICH CAN CAUSE "RECESSION," DECLINING PRODUCTION AND RISING UNEMPLOYMENT.



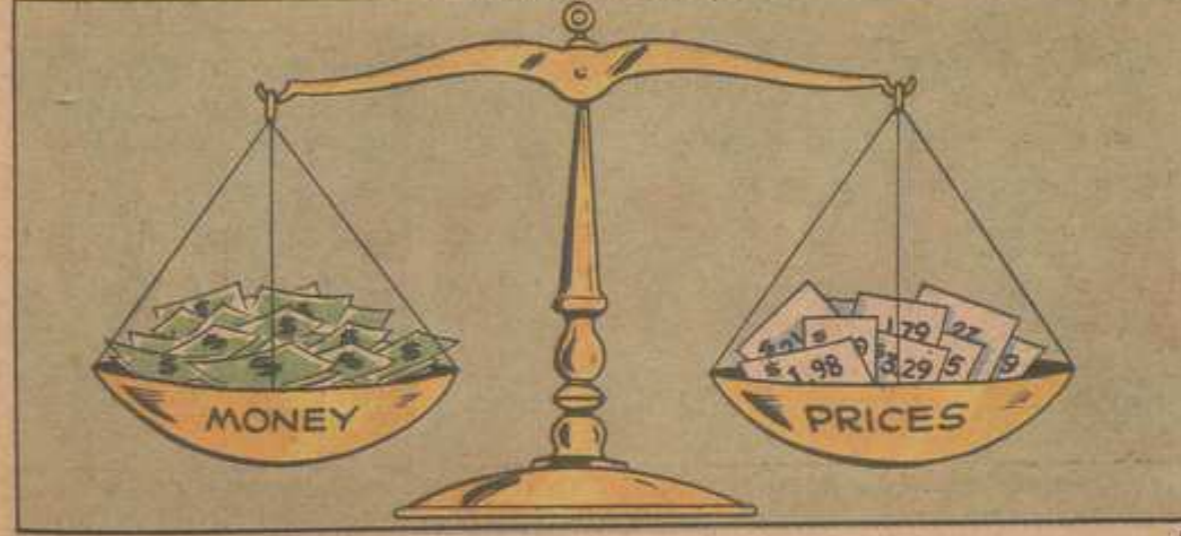
IF MONEY IS WORKING WELL, IT SHOULD PURCHASE THE SAME AMOUNT OF GOODS AND SERVICES FROM YEAR TO YEAR. MONEY MUST BE A GOOD "STORE OF VALUE."

	1978	1979
Television	\$ 350	\$ 350
Car	\$ 5,000	\$ 5,000
Shopping cart	\$ 50	\$ 50

AS YOU CAN SEE, THE CIRCULATION OF MONEY THROUGHOUT THE ECONOMY ENABLES US TO EARN, BUY AND SAVE. MONEY IS AN IMPORTANT ELEMENT WHICH TIES US TOGETHER AS A SOCIETY.



THE FEDERAL RESERVE TRIES TO PROVIDE JUST THE RIGHT AMOUNT OF MONEY TO KEEP PRODUCTION AND EMPLOYMENT GROWING AND PRICES STABLE. IF PRICES ARE STABLE, SO IS THE VALUE OF MONEY.



HOW IT ALL BEGAN
THE STORY OF MONEY BEGAN WITH ONE OF MAN'S MOST PRIMITIVE INSTINCTS--TO ACQUIRE SOMETHING HE DIDN'T HAVE AND COULDN'T FIND OR PRODUCE HIMSELF.



MOST THINGS PRIMITIVE PEOPLE WANTED WERE OWNED BY OTHERS, WHO ALSO WANTED ITEMS THEY COULDN'T PRODUCE OR FIND.



WHEN OUR ANCESTORS FIRST MATCHED MUTUAL WANTS BY EXCHANGING GOODS, **BARTER** BEGAN.



ARCHAEOLOGISTS BELIEVE EUROPEAN AND ASIAN TRIBES ROUTINELY MET TO EXCHANGE GOODS IN THE URAL MOUNTAINS ABOUT 12,000 YEARS AGO.



BARTER WORKED FAIRLY WELL FOR THOUSANDS OF YEARS BUT WAS TROUBLE-SOME. WANTS HAD TO MATCH EXACTLY. A FARMER OFFERING CORN FOR A MULE HAD TO FIND A MULE OWNER WHO WANTED CORN.



IF THE MULE SWAPPER WANTED AN AXE, RATHER THAN CORN, THE FARMER WAS OUT OF LUCK.



HE COULD SEARCH FOR AN AXE MAKER WHO WOULD TAKE CORN, THEN TRADE FOR THE MULE. BUT SEARCHING TOOK TIME, WAS INCONVENIENT AND DIDN'T ALWAYS WORK.



BECAUSE BARTER REQUIRED A "DOUBLE COINCIDENCE" OF WANTS, PEOPLE COULDN'T BUY MANY THINGS THROUGH EXCHANGE ALONE.

PRICE WAS ALSO A PROBLEM. ONE DAY, THREE AXES MIGHT BE EXCHANGED FOR A MULE OR A SMALL COW, BUT NOT FOR A BUSHEL OF CORN.



TWO WEEKS LATER, A HUNGRY TOOLMAKER MIGHT WILLINGLY SWAP AXES FOR CORN.



NO, THANKS, I BOUGHT A CHAIN SAW.

IT WAS TOUGH TO AGREE ON A "STANDARD OF VALUE" OR YARDSTICK FOR MAKING SWAPS.



ANY JACKASS CAN SEE WE NEED A STANDARD OF VALUE.

NOR WAS IT EASY TO SAVE--STORE UP PURCHASING POWER. APPLES MIGHT BE VALUABLE IN THE FALL, BUT IF HELD TOO LONG, NO ONE WANTED THEM.



AS PERMANENT COMMUNITIES AND NATIONS DEVELOPED, BARTER ON A LARGE SCALE BECAME UNWORKABLE. BARTER HASN'T TOTALLY DISAPPEARED, THOUGH, AND WE STILL USE IT TO SOME DEGREE.



COMMODITY MONEY
 ONE AT A TIME, NATIONS SAW THAT SOLVING BARTER'S PROBLEMS MEANT ADOPTING A "MEDIUM OF EXCHANGE"--AN ITEM EVERYONE ACCEPTED.



AT FIRST, COMMON ITEMS WERE CHOSEN-- BASIC COMMODITIES LIKE SALT AND CATTLE.



THESE ITEMS WERE GENERALLY ACCEPTED BECAUSE THEY WERE USABLE AND USEFUL, WHICH MADE THEM VALUABLE IN THEMSELVES.

BUT MANY COMMODITIES HAD BUILT-IN DRAWBACKS LIMITING THEIR USEFULNESS AS MONEY. A GOOD MONEY MUST BE EASY TO HANDLE.



HURRY, OPEN THE CASH REGISTER!

IT MUST SERVE AS A "STANDARD OF VALUE"-- A UNIFORM MEASUREMENT OF RELATIVE WORTH.

ARE THESE \$4 COWS OR \$5 COWS?



IT SHOULD BE EASILY DIVIDED TO BUY FRACTIONS OF THINGS.



YOU SHOULD BE ABLE TO SAVE IT.

GOOD GRIEF! THERE GOES MY SAVINGS!



DESPITE THESE DRAWBACKS, COMMODITY MONIES HAVE BEEN USED FOR THOUSANDS OF YEARS. IN THE 1700s, GRAIN, FISH, GUNPOWDER AND SHOT WERE SOME POPULAR AMERICAN COMMODITY MONIES.



THE YAP ISLANDERS OF THE PACIFIC USED MASSIVE STONE "MONEY" WHEELS UNTIL WORLD WAR II.



EVEN TODAY, THE MASAI WARRIORS OF AFRICA USE CATTLE MONEY TO BUY BRIDES.



PRECIOUS METAL MONEY
 WE DON'T KNOW JUST WHERE, WHEN OR HOW PRECIOUS METALS WERE FIRST USED AS MONEY. WIDELY SEPARATED SOCIETIES AT DIFFERENT TIMES BECAME ATTRACTED BY THE GLITTER AND SPARKLE OF SILVER AND GOLD.



SOME EARLY USES OF GOLD AND SILVER WERE TO MAKE JEWELRY AND SACRED OBJECTS.



MERCANTILISM

IN THE 17TH CENTURY, EUROPEAN NATIONS FOLLOWED AN ECONOMIC PHILOSOPHY KNOWN AS "MERCANTILISM."

MERCANTILISTS BELIEVED THAT NATIONS REMAINED POWERFUL AND WEALTHY BY AMASSING GOLD AND SILVER BY SELLING MORE MERCHANDISE THAN THEY BOUGHT. THEY ESTABLISHED COLONIES AND TOOK RAW MATERIALS AND PRECIOUS METALS FROM THESE NEW LANDS WHILE SELLING THEM GOODS.

IN 1776, SCOTTISH PHILOSOPHY PROFESSOR ADAM SMITH PUBLISHED A BOOK, *THE WEALTH OF NATIONS*, WHICH ARGUED THAT THE SOURCE OF NATIONAL POWER AND WEALTH WASN'T GOLD AND SILVER BUT PRODUCTION OF GOODS.

SMITH'S BOOK BECAME THE CORNERSTONE OF A NEW SOCIAL SCIENCE—"ECONOMICS." HIS WRITINGS, AND THOSE OF HIS CONTEMPORARIES, SLOWLY TURNED EUROPE TOWARD IMPROVING PRODUCTION AND DEVELOPING INTER-DEPENDENT TRADE.



BECAUSE GOLD AND SILVER WERE USUALLY HARD TO FIND AND MANY PEOPLE WANTED THEM, SOMEONE OFFERING PRECIOUS METAL COULD COMMAND MORE GOODS THAN WITH MOST OTHER COMMODITIES.



THE CHINESE USED GOLD CUBES AS EARLY AS 2100 B.C., AND THE BIBLE MENTIONS PRECIOUS METALS.

THEY'RE GREAT! IF YOU DROP THEM THEY DON'T ROLL!



THE LYDIANS IN WEST TURKEY CAST THE EARLIEST KNOWN COINS AROUND 700 B.C. THESE WERE CRUDELY INSCRIBED GOLD AND SILVER PELLETS.

BUT GOLD AND SILVER COINS WEREN'T IMMUNE FROM PERIODIC PROBLEMS. PERSIAN KING ALEXANDER THE GREAT BROUGHT SO MUCH PRECIOUS METAL HOME FROM HIS CONQUESTS THAT THE VALUE OF GOLD AND SILVER IN PERSIA WAS CUT BY ONE-THIRD.

THE FORTUNES OF WAR ARE KILLING ME!



A NEW FORM OF MONEY EMERGED IN MEDIEVAL EUROPE BECAUSE LARGE QUANTITIES OF COINS WERE DIFFICULT AND UNSAFE TO TRANSPORT.



PEOPLE GOING ON LONG TRIPS BEGAN LEAVING THEIR COINS WITH GOLDSMITHS FOR SAFE-KEEPING...



...AND TOOK THE GOLDSMITH'S RECEIPT, WHICH WAS WORTHLESS TO A ROBBER.



AT THEIR DESTINATION, THE RECEIPT WAS EXCHANGED FOR COINS BY AN ASSOCIATE OF THE GOLDSMITH.



THE RECEIPTS BECAME SO POPULAR PEOPLE BEGAN PAYING DEBTS WITH THEM RATHER THAN DRAWING OUT COINS. THIS MARKED THE BEGINNINGS OF PAPER CURRENCY.

I'M GLAD YOU TAKE GOLDSMITH RECEIPTS.



AROUND THE SAME TIME, PEOPLE ALSO BEGAN PAYING BILLS WITH LETTERS INSTRUCTING GOLDSMITHS TO GIVE COINS TO THE HOLDER OF THE LETTER. THESE LETTERS BEGAN ANOTHER PHASE IN THE STORY OF MONEY--CHECKS.



PAPER MONEY, WHICH THE CHINESE WERE ALREADY USING AROUND 1200 A.D., GREW FASTEST IN COIN-POOR AMERICA.



COMMODITY MONIES SUBSTITUTED FAIRLY WELL FOR SCARCE COIN FOR THE COLONISTS BUT NOT THEIR GOVERNMENTS.



EVEN THOUGH CONGRESS KEPT THE POWER TO ITSELF AND PROHIBITED STATES FROM ISSUING PAPER MONEY, IT DIDN'T USE THAT POWER UNTIL THE CIVIL WAR.



EARLY PAPER MONIES WERE PROMISSORY NOTES THAT REPRESENTED PRECIOUS METALS. THEY COULD BE REDEEMED AT A GOLDSMITH OR TREASURY.



SEVERAL COLONIES IN THE LATE 1600S ISSUED PAPER MONEY TO PAY BILLS UNTIL ENOUGH TAXES COULD BE COLLECTED IN GOLD AND SILVER TO BUY THE PAPER BACK.



AS LONG AS THE COLONISTS BELIEVED THE PAPER WOULD BE BOUGHT BACK OR REDEEMED, IT WAS ACCEPTED. BUT IF THEY HAD DOUBTS, THE PAPER WAS SHUNNED.



BANK ISSUED MONEY IN THE U.S.



THE NEW U.S. TREASURY, FORMED IN 1789, LACKED ENOUGH PRECIOUS METAL TO ISSUE ALL THE COIN THE GROWING ECONOMY NEEDED.

ENGLAND LARGELY SOLVED ITS PRECIOUS METALS SHORTAGE IN THE LATE 1600S BY ESTABLISHING A PRIVATE BANK-- THE BANK OF ENGLAND, WHICH WAS EMPOWERED TO ISSUE PAPER MONEY. LATER, THE BANK BECAME BRITAIN'S "CENTRAL BANK."



ALTHOUGH PAPER MONEY PROBLEMS WERE WELL KNOWN THEN, THE CONTINENTAL CONGRESS HAD TO FINANCE AN ARMY AND, WITHOUT TAXING POWERS, TURNED TO THE PRINTING PRESS.



BUT CONGRESS ISSUED SO MUCH PAPER THEY CAUSED "INFLATION"-- A CONDITION OF SOARING PRICES-- WHICH MADE PEOPLE BITTERLY OPPOSED TO GOVERNMENT-ISSUED PAPER MONEY.



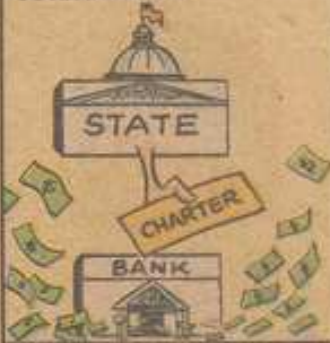
GRESHAM'S LAW

IN THE 16TH CENTURY, QUEEN ELIZABETH'S MASTER OF THE MINT, THOMAS GRESHAM, OBSERVED THAT WHEN TWO METALS, SUCH AS GOLD AND SILVER, CIRCULATE AS MONEY, THE CHEAPER METAL EVENTUALLY BECOMES THE DOMINANT MEDIUM OF EXCHANGE WHILE THE MORE EXPENSIVE METAL IS HOARDED, SOLD ABROAD OR MELTED DOWN.

THE PRINCIPLE THAT "CHEAP MONEY DRIVES EXPENSIVE MONEY OUT OF CIRCULATION" BECAME KNOWN AS "GRESHAM'S LAW." IN THE 19TH CENTURY, WHEN THE DOLLAR'S VALUE WAS FIXED AS REPRESENTING A CERTAIN AMOUNT OF GOLD AND SILVER, AMERICANS TENDED TO HOARD THE MORE EXPENSIVE AND SPEND THE CHEAPER ONE AS THE MARKET PRICE OF EITHER METAL CHANGED.



BY THE 19TH CENTURY, EVERY MAJOR NATION BUT THE U.S. HAD A CENTRAL BANK. U.S. MONEY NEEDS WERE MET BY PRIVATE BANKS CHARTERED TO OPERATE BY STATE GOVERNMENTS.



BANKS TOOK IN GOLD AND SILVER DEPOSITS AND MADE LOANS AND PAYMENTS IN THEIR OWN NOTES WHICH WERE REDEEMABLE IN GOLD OR SILVER.



BANKS HAD TO KEEP A PRECIOUS METAL "RESERVE" ON HAND TO MEET REDEMPTIONS.



DESPITE PANICS AND FAILURES, STATE-BANK NOTES WERE WIDELY USED DURING MUCH OF THE 1800S. BY THE EARLY 1860S, MORE THAN 10,000 SEPARATE ISSUES OF DIFFERENT SIZES, COLORS AND DESIGNS WERE IN CIRCULATION.



U. S. PAPER MONEY

THE CIVIL WAR PRODUCED CHANGES THAT SET THE STAGE FOR TODAY'S MONEY SYSTEM.



THE FEDERAL GOVERNMENT COULDN'T RAISE ENOUGH MONEY TO PAY FOR THE CIVIL WAR THROUGH BOND SALES AND TAXES.

AS RAPIDLY AS THE TREASURY PAID BILLS WITH GOLD AND SILVER COIN, THE METAL WAS HOARDED.



RELUCTANTLY, CONGRESS ISSUED PAPER MONEY--U.S. NOTES-- THAT WASN'T REDEEMABLE IN GOLD OR SILVER.



STATE-BANK NOTES WORKED WELL IN LOCAL AREAS IF PEOPLE WERE SURE THE ISSUING BANK WAS IN GOOD CONDITION AND ITS NOTES COULD BE REDEEMED.



OUTSIDE THEIR LOCAL AREAS, NOTES WERE OFTEN ACCEPTED ONLY AT A DISCOUNT (LESS THAN FACE VALUE) BECAUSE MERCHANTS DIDN'T KNOW HOW SOUND THE ISSUING BANK WAS.

IF DEPOSITORS FEARED A BANK COULDN'T REDEEM ITS NOTES, THEY RUSHED TO REDEEM NOTES AND DRAW OUT DEPOSITS IN GOLD OR SILVER BEFORE RESERVES DISAPPEARED.



THE WILDCATS

IN THE EARLY 1800S, AMERICA HAD MANY HONEST WELL-RUN BANKS, BUT OTHERS EARNED REPUTATIONS MORE FOR FRAUD THAN INTEGRITY.

"WILDCAT" BANKS GOT THEIR NAME BECAUSE THEY WERE LOCATED IN REGIONS SO REMOTE AND HOSTILE THAT WILDCATS, NOT NOTE HOLDERS, CAME TO THEIR DOORS.



BEFORE STATE LAWS REGULATED BANKS, BANKERS KNEW THAT THEY HAD TO KEEP A CERTAIN AMOUNT OF PRECIOUS METAL TO REDEEM NOTES AND TO PAY OUT COIN ON REQUEST. TO ASSURE THE PUBLIC THAT "RESERVES" WERE AVAILABLE, VAULTS WERE OFTEN LOCATED WHERE CUSTOMERS COULD VIEW THE PRECIOUS METAL.



BUT LESS SCRUPULOUS BANKERS WEREN'T QUITE TRUTHFUL. THEY WOULD SPRINKLE GOLD OR SILVER COINS ON TOP OF KEGS OF NAILS.

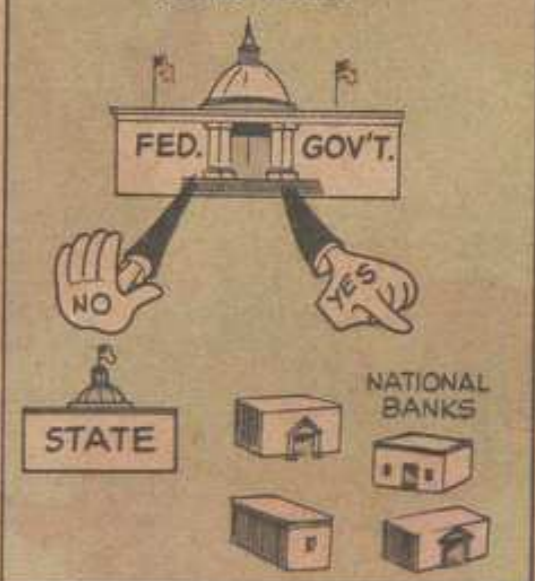
IN LATER YEARS WHEN STATE EXAMINERS CHECKED RESERVES, SOME SLICK OPERATORS SHIPPED RESERVES FROM BANK TO BANK MINUTES AHEAD OF THE EXAMINER.



CONGRESS TRIED MAKING THE NOTES ACCEPTABLE BY DECLARING THEM "LEGAL TENDER," WHICH MEANT THEY HAD TO BE ACCEPTED IN PAYMENT OF ALL PRIVATE DEBTS.



THE GOVERNMENT ALSO BEGAN CHARTERING "NATIONAL BANKS," WHICH WERE GIVEN PAPER CURRENCY THEY COULD ISSUE AS THEIR OWN. STATE BANKS WERE STOPPED FROM ISSUING NOTES.





NATIONAL BANKS RECEIVED CURRENCY IN PROPORTION TO THE AMOUNT OF GOVERNMENT BONDS THEY PURCHASED.

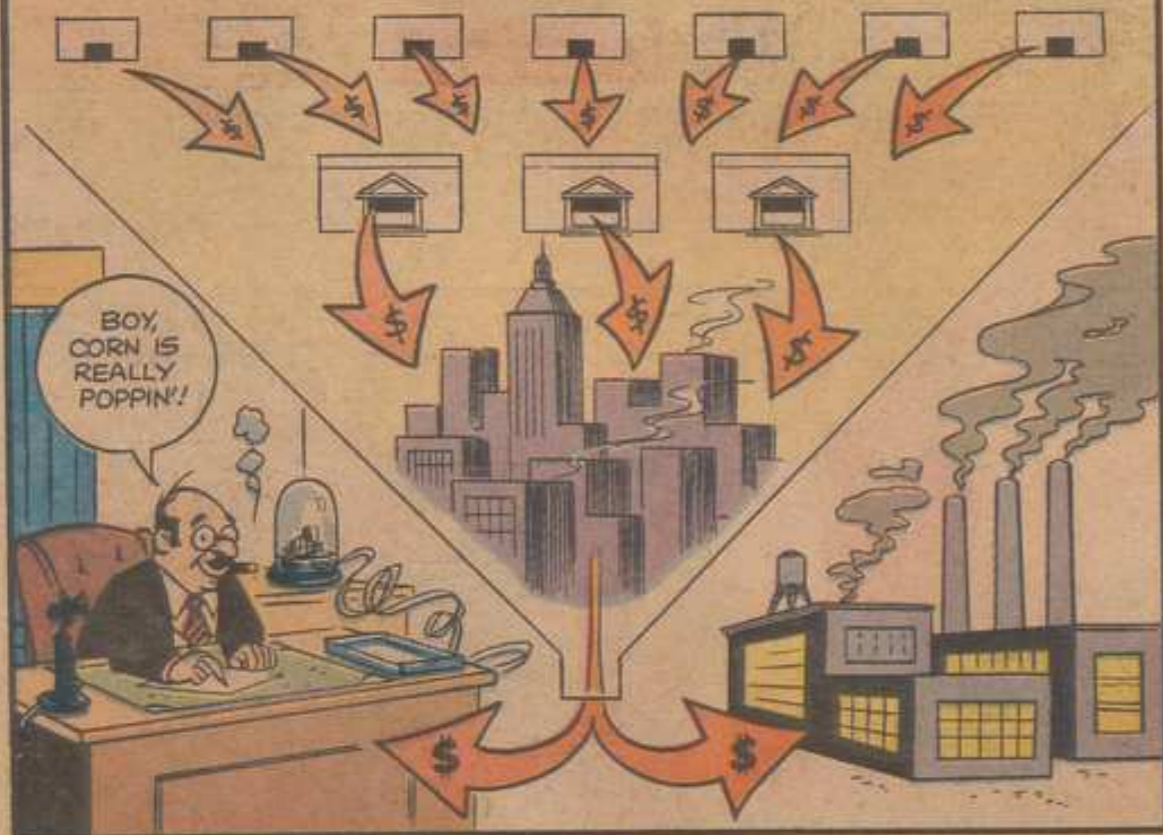


BUT AS THE GOVERNMENT PAID OFF ITS BONDS AFTER THE WAR, THE AMOUNT OF BONDS USED AS BACKING FOR CURRENCY SHRANK, AND THE MONEY SUPPLY DECLINED. THUS, THE CASH SUPPLY WAS "INELASTIC"-- INCAPABLE OF EXPANDING OR CONTRACTING WHEN NECESSARY.

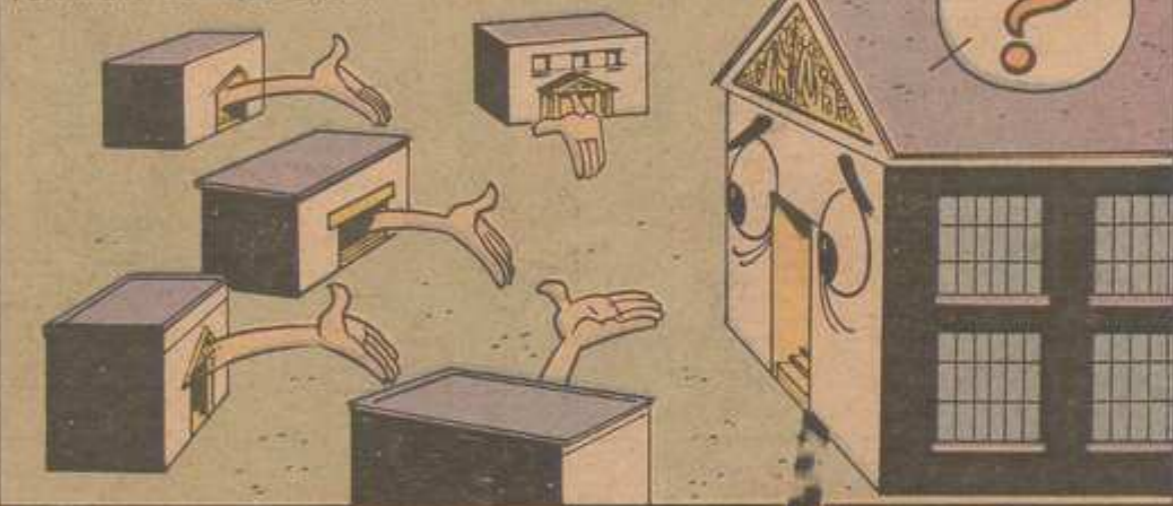
THIS INELASTICITY LED TO "MONEY PANICS" THAT PERIODICALLY WRACKED THE NATION UNTIL 1913, WHEN THE BANKING SYSTEM WAS RESTRUCTURED.

MONEY, BANKS AND THE FEDERAL RESERVE

AT THE TURN OF THE CENTURY, MOST BANKS KEPT LITTLE CASH ON HAND. SMALL COUNTRY BANKS DEPOSITED CASH RESERVES AT LARGER BANKS, WHICH THEN DEPOSITED THEM AT BIG CITY BANKS, WHICH LENT THEM TO BUSINESSES AND BROKERS.



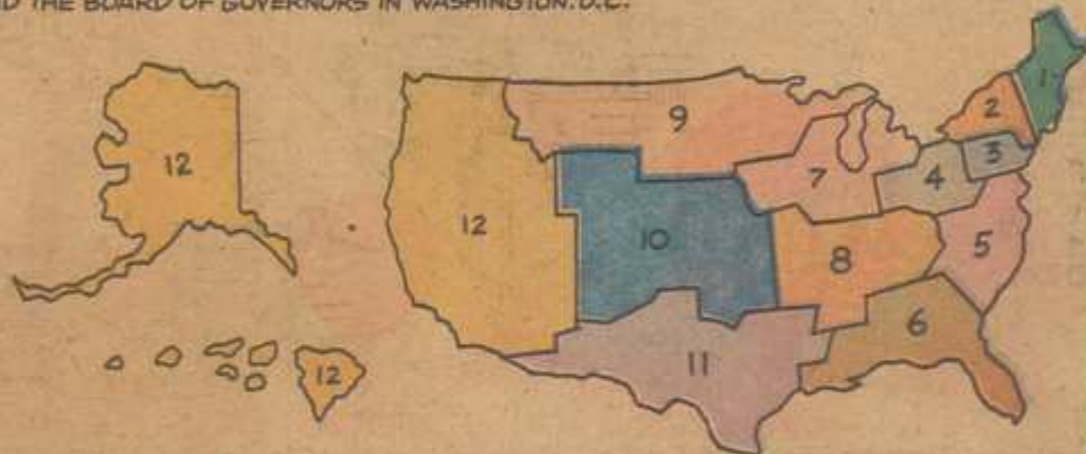
THIS "PYRAMIDING" OF RESERVES HURT BANKS AND THE PUBLIC. A WIDESPREAD, SUDDEN DEMAND FOR CASH, BECAUSE OF SAY, A BUMPER CROP, CAUSED SMALL COUNTRY BANKS TO ASK FOR THEIR RESERVES BACK.



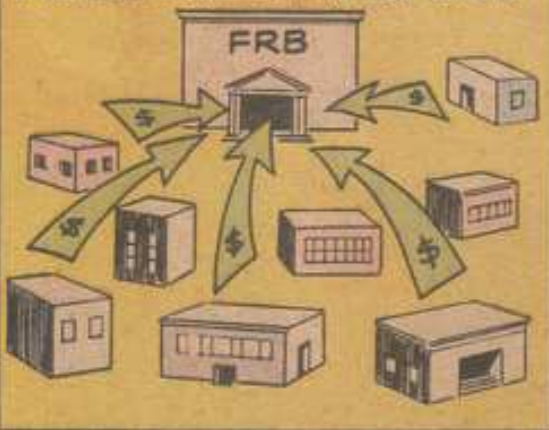
TO PROVIDE THOSE RESERVES, BIG CITY BANKS LEFT THEMSELVES WITH LITTLE CASH TO MEET THE DEMANDS OF THEIR OWN CUSTOMERS. EVENTUALLY THEY RAN SO LOW ON CASH A PANIC STARTED.



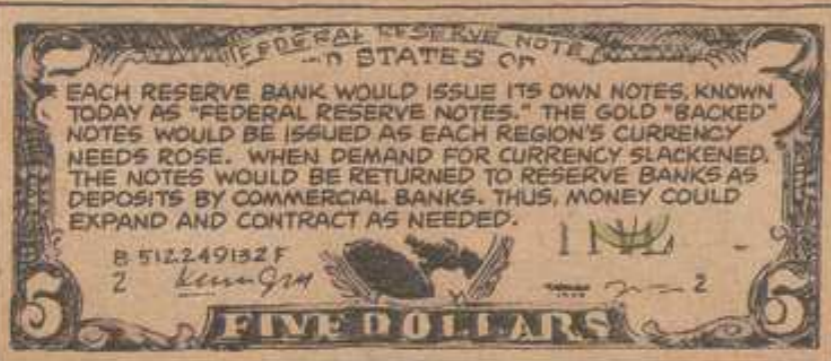
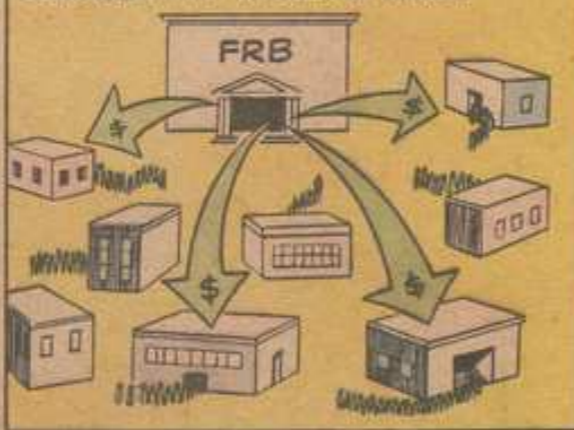
A VERY SEVERE PANIC IN 1907 SPARKED A REFORM MOVEMENT THAT ENDED IN 1913 WHEN CONGRESS ESTABLISHED THE FEDERAL RESERVE SYSTEM-- 12 REGIONAL RESERVE BANKS AND THE BOARD OF GOVERNORS IN WASHINGTON, D.C.



FEDERAL RESERVE BANKS WOULD HOLD THE RESERVES OF ALL NATIONALLY CHARTERED BANKS, WHICH HAD TO JOIN, AND ANY STATE-CHARTERED BANKS THAT WANTED TO JOIN.



RESERVE BANKS WOULD LEND MEMBER BANKS FUNDS TO MEET SUDDEN AND UNEXPECTED CUSTOMER WITHDRAWALS, AVOIDING THE CASH SHORTAGES THAT TRIGGERED PANICS.



MONEY IN THE 20TH CENTURY
BECAUSE THE AMOUNT OF COIN AND PAPER MONEY WAS TIED TO GOLD, INDUSTRIAL NATIONS OFTEN HAD EITHER BOOM OR BUST ECONOMIES.

A RISE IN GOLD HOLDINGS, EITHER FROM NEW DISCOVERIES OR PAYMENTS FROM INTERNATIONAL TRADE, INCREASED A NATION'S MONEY SUPPLY. IF MONEY ROSE FASTER THAN OUTPUT, PRICES SOARED.

IF GOLD HOLDINGS DIDN'T EXPAND AS RAPIDLY AS OUTPUT, PRICES FELL AND WORKERS WERE LAID OFF.

DURING THE DEPRESSION OF THE 1930s, MOST NATIONS ABANDONED THE RIGID USE OF GOLD MONEY AND GOLD-BACKED CURRENCY, HELPING LAUNCH THE MODERN ERA OF "FIAT MONEY."

TODAY, MOST COIN AND CURRENCY IS "FIAT" MONEY--MONEY BY VIRTUE OF GOVERNMENT DECLARATION AND PUBLIC ACCEPTANCE. FIAT MONEY ISN'T VALUABLE IN ITSELF AND DOESN'T REPRESENT A CLAIM ON GOLD OR SILVER.

FIAT MONEY IS ACCEPTABLE BECAUSE PEOPLE KNOW MONEY'S TRUE VALUE IS ITS PURCHASING POWER--ITS ABILITY TO BUY GOODS AND SERVICES--NOT ITS METALLIC VALUE.

THEY KNOW THAT WHEN PRICES ARE LOW, MONEY'S VALUE IS HIGH.

5¢ GUMDROPS

THERE GOES MY STANDARD OF LIVING!

8¢ GUMDROPS

WHEN PRICES RISE (INFLATION), MONEY'S VALUE DECLINES.

PRICES RISE WHEN A NATION HAS TOO MUCH MONEY, AND PEOPLE AND BUSINESSES SPENDING THE EXCESS MONEY BUY UP AVAILABLE GOODS AND SERVICES.

OUTTA MY WAY!

PRICE

GOODS AND SERVICES

AS SUPPLIES SHRINK, PRICES BEGIN RISING. BUT WITH MORE AND MORE MONEY, PEOPLE CAN PAY HIGHER PRICES, AND THE MACHINERY OF INFLATION HAS STARTED.

OUTTA SIGHT!

PRICE

THE STORY OF MONEY IS PUNCTUATED BY EPISODES OF INFLATION THAT DESTROYED MONEY'S VALUE. GERMANY SAW THE WORST INFLATION OF ANY MODERN INDUSTRIAL COUNTRY ONLY FIFTY YEARS AGO, WHEN THE VALUE OF ITS PAPER MONEY FELL SO LOW THAT CURRENCY WAS A CHEAPER FUEL THAN FIREWOOD.



MEN AND MONEY

ALTHOUGH ECONOMISTS KNEW FOR CENTURIES THAT CHANGES IN THE AMOUNT OF MONEY AND HOW QUICKLY IT WAS SPENT AFFECTED BUSINESS, THEY DIDN'T DISCOVER HOW THE RELATIONSHIP WORKED UNTIL THIS CENTURY.



IN 1911, AMERICAN MATHEMATICIAN AND ECONOMIST, IRVING FISHER, MATHEMATICALLY PROVED THAT DOUBLING A NATION'S MONEY SUPPLY WOULD DOUBLE PRICES. HE BELIEVED ECONOMIC "BOOMS" AND "BUSTS" WERE MALADIES CAUSED BY TOO MUCH OR TOO LITTLE MONEY. FISHER'S COMBINED USE OF STATISTICS, MATHEMATICS AND ECONOMICS HELPED START A NEW APPROACH TO ECONOMICS KNOWN AS "ECONOMETRICS."

IN THE 1950s, ANOTHER AMERICAN ECONOMIST, MILTON FRIEDMAN, SUBSTANTIATED FISHER'S THEORIES AND CONCLUDED THAT CHANGES IN THE AMOUNT OF MONEY ARE A MAJOR INFLUENCE ON OUR ECONOMY'S DIRECTION AND THE PACE OF PRODUCTION, EMPLOYMENT AND SPENDING. A STABLE ECONOMY, HE SAID, REQUIRES MONEY SUPPLY TO INCREASE STEADILY IN PROPORTION TO OUR ABILITY TO PRODUCE.

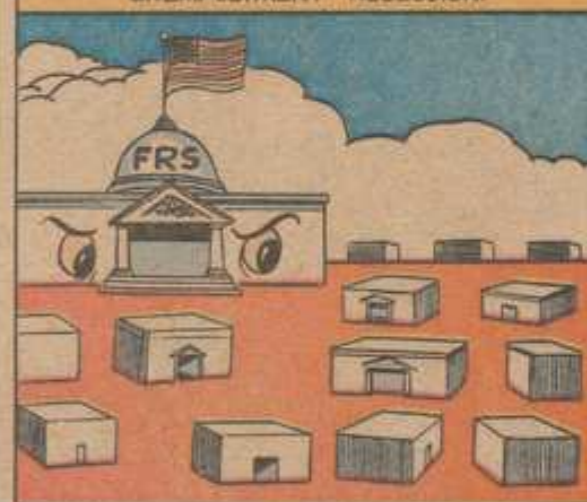
FRIEDMAN'S VIEWS, KNOWN AS "MONETARISM," HAVE VASTLY INFLUENCED HOW WE THINK ABOUT MONEY, AND THE WAY THE FEDERAL RESERVE CONTROLS OUR MONEY.



MOST COUNTRIES HAVE CENTRAL BANKS THAT TRY TO BALANCE THE MONEY AVAILABLE FOR SPENDING WITH THE ECONOMY'S ABILITY TO PRODUCE BY CONTROLLING COMMERCIAL BANK LENDING--THE ACTIVITY THAT CREATES NEW MONEY.



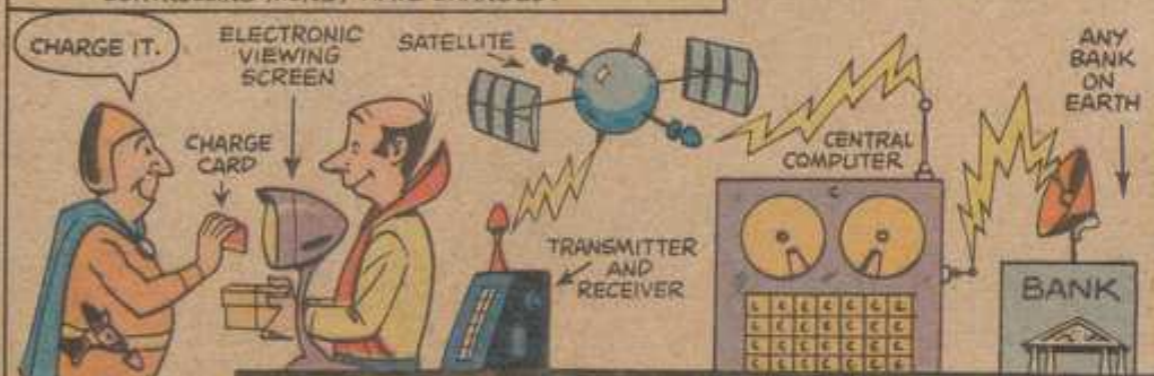
THE FEDERAL RESERVE SYSTEM IS RESPONSIBLE FOR MAKING SURE BANKS DON'T CREATE SO MUCH MONEY THAT WE GET INFLATION, NOR SO LITTLE WE SUFFER FROM FALLING PRODUCTION AND RISING UNEMPLOYMENT--"RECESSION."



THAT JOB ISN'T EASY. INDEED, NO CENTRAL BANK HAS BEEN ENTIRELY SUCCESSFUL IN MAINTAINING THE PROPER BALANCE BETWEEN TOO MUCH AND TOO LITTLE MONEY.



MONEY'S FORM, AS WELL AS OUR UNDERSTANDING OF ITS VALUE, HAS CHANGED OVER THE CENTURIES. WITH THIS NEW UNDERSTANDING, OUR ATTITUDES ABOUT CONTROLLING MONEY HAVE CHANGED.



IN THE FUTURE, MONEY'S FORM MAY CHANGE DRAMATICALLY, TOO. WE ARE ALREADY USING SOME FORMS OF "ELECTRONIC" MONEY WHICH MAY, PERHAPS, DOMINATE THE NEXT PHASE OF THE STORY OF MONEY. BUT THE PRINCIPLES THAT WE'VE LEARNED HERE WILL REMAIN THE SAME.

FEDERAL RESERVE BANK OF NEW YORK

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