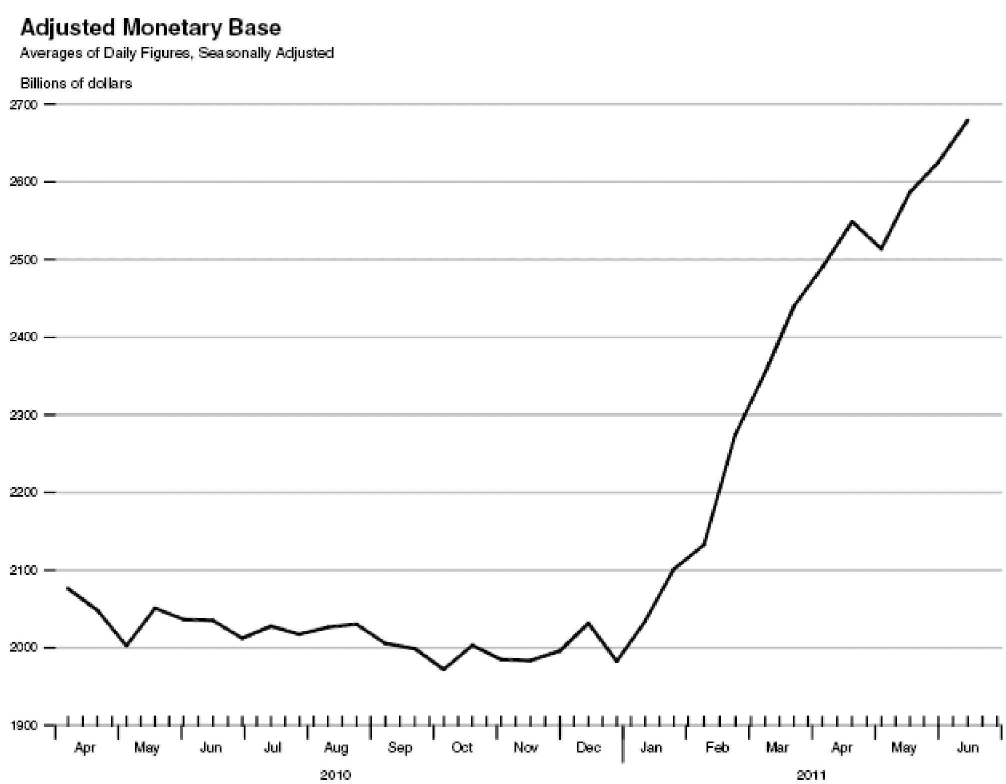
Mitchell's Musings 6-20-11: A Lesson Learned from Mr. 880

UCLA's Anderson Forecast for the U.S. and California was released last week and it was not a happy picture. Recovery is underway, but seems to have slowed – even stalled. Unemployment is coming down but the forecast for the U.S. in 2013 is still around 8%. The rate doesn't get down to levels seen prior to the Great Recession for five or more years.

The St. Louis Federal Reserve puts out a weekly chart book of monetary and financial indicators. Below is a chart from the latest edition which reminds us that the Federal Reserve is the most active element in macro policy today in trying to deal with the aftermath of the Great Recession. Whatever criticisms can be leveled at the Fed for its pre-crisis policy, Fed Chair Ben Bernanke has been doing what he could since the crisis unfolded to avert what might have been a total disaster. In essence, what our EPRN hopes to foster, i.e., learning from academic research, has been reflected in Fed policy. In the case of the Fed, it is the research literature on the Great Depression which suggests that Fed policy back then tended to be passive or perverse. So taking that lesson, Fed policy has been active.



Nonetheless, despite pushing the envelope on Fed policy, the central bank is constrained in what it has the authority to do. You may recall that in the early days of the financial crisis in 2008, the Fed could not on its own produce the so-called TARP (troubled asset relief program) due to legal restrictions. It had to go to Congress along with the Treasury for action to be taken.

In the abstract, a central bank would seem to be able to buy toxic ("troubled" was a euphemism) assets from distressed financial institutions simply by writing a check. But apparently that option was not permitted under the law. Indeed, in the abstract, a central bank could purchase anything, not just financial assets, by writing a check. In theory, a central bank could have done the bailouts or even run its own New Deal-type jobs program by writing checks. But, of course, there are legal and institutional constraints.

The usual explanation for such constraints is that central banks might excessively "print" money and cause inflation. However, I think there is something deeper than that fear, particularly in the American case, which feeds a need to constrain the Fed and to regard it with suspicion. It is hard for the average person to wrap his or her mind about the concept of creating money – which is what central banks do. Money is supposed to be "real." Folks and businesses compete for money. They cheat and steal and even murder for money. So how can it be just created?

In a class I used to teach on international economics, when we got to international monetary systems and their relation to domestic monetary systems, we would take up central banking. I told a story – a true story – that occurred in the late 1930s and into the 1940s. I first read about this tale when I was in high school, although I don't recall the original source. A more recent search for references led me to a book that told it in comic book form, one frame of which is reproduced below.[1]

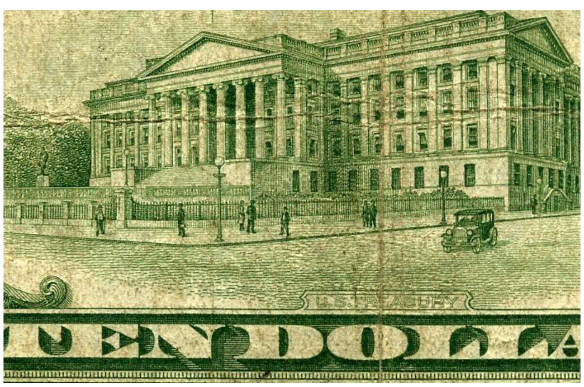
Here is the story: Mr. Emerich Juettner lived in New York City with his dog, eking out a very modest living. As hard times pressed in, he got the idea of counterfeiting one-dollar bills. His reproductions were so bad that the name of George Washington was misspelled. But he got away with it for years because no one looks at one-dollar bills. Despite all the impressive seals and numbers and signatures on the One, people take them and pass them on because they know that other people will take them and pass them on.

[1] George Hagenauer and Carol Sifakis, *The Big Book of Little Criminals* (New York: Paradox Press, 1996), pp. 86-88.

In effect, in modern monetary systems, money is a social convention.[2] You accept dollars because everyone else does. Everyone else does it for the same reason. What exactly is a "dollar," after all, but an abstract unit of account?[3]

Mr. Juettner continued for years just passing a few of his bills to have enough to eat. He might never have been caught except that his dwelling caught fire and some kids found his printing press plates in the ruins which were turned over to the police. The story had a happy enough ending. Juettner was given a few months in jail and Hollywood turned his tale into a movie, *Mister 880*, so named because the file kept by the Secret Service on the phony bills was numbered 880.[4] You can see the trailer for the film at http://www.youtube.com/watch?v=3Xk2oPkKuAI.

Sometimes the tale of Mr. 880 did not sufficiently convince students. Money *must* be something. They would argue that no one looked at Mr. 880's one-dollar bills because of their low value. Back in the day before the Treasury introduced its new series of bills with the enlarged presidential pictures off center and other changes that are supposed to make counterfeiting more difficult, I had another demonstration. When the old series was still in circulation, I would show the students the front of each bill ($1, $2, $5, $10, $20, $50, $100) and ask which one had a picture of an automobile on the reverse side. The students would be asked to vote by a show of hands – not call out – as I displayed each one. Most students abstained – they didn't know. Of those voting, the most common answers were the Two and the Hundred. (Because you don't see those denominations that often, the students assumed they must be the right answer.) Actually, the answer was the very common Ten:[5]



[2] If you have stumbled on this website and now feel an overwhelming urge to send me a tract on why we should return to the gold standard, or on monetary conspiracies, or why you don't have to pay income taxes because the money isn't real, please save yourself a stamp and refrain. You are just proving the point.

[3] If you Google the word "dollar," you will find it derives from the German for "valley," a specific valley in what is now the Czech Republic. (Try searching on" Joachimsthaler" if you have trouble finding the reference.)

[4] The Secret Service is in charge of dealing with counterfeiting. Sadly, the film is not available on DVD in the U.S. although apparently it is sold in Europe.

[5] Rather than update the car, the new ten-dollar bills eliminated it from the picture.

My final tale came from my undergraduate days at Columbia College. Prof. Peter Kenen taught the introductory economics course and included on the syllabus was a book of readings. One of these readings, which also involved a Ten, was a reproduction of a correspondence with the Secretary of the Treasury. Ten dollar bills back then (the 1960s) bore the statement that "The United States of America will pay to the bearer on demand Ten Dollars." Someone enclosed a Ten in an envelope and wrote his demand to the Secretary of the Treasury for ten dollars. He got back a polite letter with two Fives.[6]

Bottom line: I have seen criticism of the Fed of late, coming from left and right. The Fed is charged with not doing enough, or with doing too much, or not doing what it was doing the right way. There are complaints that the Fed isn't sufficiently "transparent," although I am never sure what that means exactly or how more transparency would improve policy. My sense is that at the base of the complaints – and at the base of the constraints on the Fed – is the simple fact that most people just cannot deal with the concept of an institution that creates money or the idea that money is only a (very useful) social convention.

[6] The new series of bills just say "ten dollars" but they don't promise ten dollars to the bearer on demand (presumably because the bearer already has ten dollars).