DEPARTMENT OF THE TREASURY
WASHINGTON

March 10, 1993

Mr. Gregory K. Soderberg
2410 4th Drive, SW
Austin, MN 55912

Dear Mr. Soderberg:

This is in response to your letter of March 1 in which you asked a number of questions about money.

I believe that the following information responds to your questions:

The Board of Governors of the Federal Reserve System has the responsibility for determining United States monetary policy. With the assistance of the twelve Federal Reserve Banks, the Board manages the Nation's money supply. Since our economy has grown between 1913 when the Federal Reserve System was founded and the present, this ordinarily means that the Board determines the rate of increase in the money supply.

When the economy grows there are more economic transactions, and more money is needed to pay for them. If the Board were to decrease the money supply during a period of economic growth, it could stop the growth. Of course, if the Board increases the money supply too rapidly, it can cause inflation.

If the money supply is to be increased, money must be created. The Federal Reserve Board (or "the Fed" as it is often called) has several ways of allowing money to be created, but the actual creation of money always involves the extension of credit by private commercial banks.

Modern banking is often explained by analogy with the practices of goldsmiths in early seventeenth century England. These goldsmiths held their customers' gold in safekeeping and issued notes to the customers instead, promising to deliver the gold on demand. The goldsmiths discovered that the customers would not all want the gold back at the same time, so it was safe to loan the gold to someone else in the meantime. When the goldsmith loaned the gold out, he had created money. Obviously, the amount of gold had not increased, but the note promising to pay gold circulated as money and so did the gold it was based on -- before the goldsmith intervened only the gold circulated as money. It was an easy step to making the loan in the form of a note promising to pay gold, and keeping the gold safely in vaults at all times. Then only the notes circulated as money. Nothing limited the number of notes the goldsmith could issue except the fact that he did have to pay gold if anyone presented them to him. If he issued too many people would not believe that he

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CRS Report for Congress

Money and Near-Monies: A Primer

Money is created when loans are issued and debts incurred; money is extinguished when loans are repaid. A loan from a bank creates a deposit which the borrower may draw upon for the payment of obligations; the payee is the new holder of the new money. Some existing money in circulation must be acquired by the borrower to repay the capital of the loan; when that is returned to the bank it is withdrawn from circulation.

CRS-29

John B. Henderson
Senior Specialist in Price Economics

June 7, 1983

CRS

would be able to pay, and would refuse to accept them. To avoid this problem, prudent goldsmiths -- and, later, prudent bankers -- always kept a certain amount of gold on hand as a reserve.

Modern banks operate in a similar way, with several important differences. One is that they are required by law to keep reserves equal to a percentage of their deposits. The Fed has the power to change this "reserve requirement" but, generally, the ratio of deposits to reserves is kept at about six to one. This means that the private, commercial banks cannot create all the money they might like to create. They are limited by the amount of reserves which they possess. Another difference is that the reserves now consist of cash (coins and paper money) and of deposits with the twelve Federal Reserve Banks, instead of gold. (The twelve Federal Reserve Banks are called "bankers' banks," because the member banks, the United States Government, and foreign governments keep deposits there.)

In both the goldsmiths' practice and in modern banking, new money is created by offering loans to customers. A private commercial bank which has just received extra reserves from the Fed (by borrowing reserves for example) can make roughly six dollars in loans for every one dollar in reserves it obtains from the Fed. How does it get six dollars from one dollar? It simply makes book entries for its loan customers saying "you have a deposit of six dollars with us." Why does this work - how can the bank pay out money to all the borrowers? The answer is that in practice the borrowers don't all withdraw their money at the same time, any more than the goldsmiths' customers did in the seventeenth century, especially since the Federal Deposit Insurance Corporation insures that the customers can leave their money in the bank without worrying about losing it. (Actually, the borrowers might take their deposits to other banks, but the result -- the creation of money -- is exactly the same if one then looks at all banks taken together rather than at the bank which made the initial loan.)

The advantage of creating money by extending loans is that the new money goes to people that the bank believes will be able to pay it back. In general, this means that the money will go to people who are engaged in productive economic activity. Ideally, the new money will serve to channel real resources into productive use and, ideally, the new money will be created by banks only when there is loan demand in the first place, that is, only when more economic activity is taking place and more money is needed to finance it. You may want to know whether the bank is the one getting the benefit of the new money, since the bank owns the new money while the customer has merely borrowed the money. The bank does indeed get the benefit of the new money. However, if the bank loses reserves for any reason (say, by paying back to the Federal Reserve Banks the reserves which it has borrowed) then it must call in its loans and stop making new ones until it

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 10, 1996

Mr. J. Drew Foster
c/o 41 Manners Road
Ringoes, New Jersey

Dear Mr. Foster:

I have received your letter of April 28, 1996, in which you ask a question related to your earlier correspondence with this office. Once again, I hope that I will be able to address your concerns.

It is important to remember that the value of all assets in the economy vastly exceeds the value of the money supply. The value of the money supply, however, exceeds the value of the economic transactions that are occurring at any given time. These economic transactions include the purchase of goods and services, as well as the repayment of loans and the payment of interest. Thus, the money that one borrower uses to pay interest on a loan has been created somewhere else in the economy by another loan.

I hope that this explanation is responsive to your concerns.

Sincerely yours,

John M. Yetter

John M. Yetter
Attorney-Advisor

DEPARTMENT OF THE TREASURY
WASHINGTON

June 4, 1993

Mr. G. K. Soderberg
2410 4th Drive, SW
Austin, MN 55912-2866

Dear Mr. Soderberg:

This is in response to your letter to me of May 30, 1993. In your letter, you raised several questions concerning the money of the United States.

United States notes are not being issued by the United States Government. I believe that, if and when the United States Government decides to issue United States notes, it will notify the public as to how they can be obtained.

The answer to your second question ("If all money is created as a loan or principal, where does the money come from to pay interest on the borrowed money?") is that such money comes from the same source that all other money comes from.

The statement "debts in the U.S. are normally measured in dollars" does not mean that if there were no debt there would be no dollars.

I hope that this information is useful to you.

Sincerely,

Russell L. Munk

Russell L. Munk
Assistant General Counsel
(International Affairs)

DEPARTMENT OF THE TREASURY

BUREAU OF ENGRAVING AND PRINTING

WASHINGTON, D.C. 20228

March 27, 1987

Mr. Byron C. Dale
Secretary, Treasurer
Commercial Trust of South Dakota
Post Office Box 53
Mobridge, South Dakota 57601

Dear Mr. Dale:

Your personal check #020 for $412 00 is herewith returned.

The Bureau of Engraving and Printing is not authorized to print or issue United States paper currency for direct delivery to the public. Currency notes are placed into circulation by your local financial organizations and can only be obtained from that source.

We can be of no further assistance to you in this matter.

Sincerely,

Linda W. Coleman

Linda W. Coleman
External Affairs Staff

Enclosure:

STATE OF MINNESOTA
OFFICE OF THE STATE AUDITOR

SUITE 400
525 PARK STREET
SAINT PAUL 55103

MARK B. DAYTON
STATE AUDITOR

(612) 296-2551

October 10, 1994

Mr. Gregory K. Soderberg
2410 Fourth Drive S.W.
Austin, Minnesota 55912

Dear Mr. Soderberg:

Thank you for taking the time to contact me with your inquiry about the property tax status of the Federal Reserve Bank in downtown Minneapolis. I asked the Research and Information Division of our office to respond to your request.

According to the Hennepin County Property Taxation Department, the Federal Reserve Bank, located at 250 Marquette Avenue, paid the following property taxes between 1991 and 1994:

Year	Property Taxes Paid
1994	$675,660
1993	$746,705
1992	$846,173
1991	$962,906

The Federal Reserve System is an independent agency, it is not part of the federal government. For these reasons, the Federal Reserve System's property is subject to property taxation in Minnesota.

If you would like more information, I would urge you to contact Mr. Patrick O'Connor, the Hennepin County Treasurer, at 8603 Government Center, 300 South Sixth Street, Minneapolis, Minnesota 55487-0063. Mr. O'Connor's telephone number is (612) 348-4084.

Again, Mr. Soderberg, thank you for taking the time to contact me. I trust you will find this information helpful.

With best regards.

Sincerely,

Mark B. Dayton
State Auditor

MBD:svm