

Forbes

Printing Money, Literally

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(Author's note: This post is about the literal printing and issue of money. The next will cover money printing figuratively.)

The holiday season is upon us and one thing is for sure: the public is demanding more folding money—cash—for shopping, although debit cards no doubt have cut into that ritual significantly. The public gets more cash by “cashing checks” or withdrawing cash from their accounts at banks and other financial institutions. They pay for their additional cash—coin and currency—by drawing down their checking and savings account balances.

The Public Determines the Amount of Money Printed

There are seasonal patterns to the public's demand for cash, the strongest being this time of year when retail shopping peaks. In January, the process will reverse as the public reduces its cash holdings in favor of deposits. Cash will flow back into the banks as the public exchanges it for deposits. It is important to note that the demand for cash—the coined and printed portion of our money supply—is entirely determined by public preferences. If the public wants more printed or coined money, it buys it with deposits. If the public wants less cash, it sells it for deposits.

The Role of Banks and Federal Reserve Banks

As the public increases its cash holdings, inventories of cash at banks are drawn down. Banks then order more cash from their local Federal Reserve Banks, which have their own inventories of pre-circulated and newly-printed cash stored in large vaults. Banks pay for their additional coin and currency by drawing down their reserve deposits at the Fed. Just as the public's holdings of money don't change when cash is substituted for bank deposits, or vice versa, the banks' reserves don't change initially either since both cash in their vaults and deposits at the Fed count as reserves for regulatory and liquidity purposes.

In this process, the decision of what form money will be held is made entirely by the public. The commercial banks and the Federal Reserve Banks play a passive role, responding to the public's preferences.

After the holidays, cash will flow back into the banking system in exchange for customer deposits and will, in turn, flow from the banks into the Federal Reserve Banks in exchange for bank reserve deposits. The Reserve Banks will run the newly deposited cash through highly sophisticated automated machines that count it, detect counterfeits, and destroy bank notes deemed unfit for re-circulation. The unfit notes are destroyed and the notes deemed fit for re-circulation are added back into Reserve Bank inventories to be paid out to banks in filling future orders.

When Reserve Bank inventories of fit cash run down to certain levels because of the destruction of unfit notes, the Reserve banks order new notes from the Bureau of Engraving and Printing, a division of the Treasury Department. The average cost of printing new notes is far below the face value of the notes. They won't be "worth" their face value until they are "issued" by the Federal Reserve Banks in filling new orders from commercial banks.

The Impact of Printing Money

Let me emphasize that while the Bureau of Engraving and Printing prints money (banknotes)—\$1, \$5, \$10, \$20, \$50, and \$100 notes—these notes get into circulation without adding to the total money supply. Why? Because printed money is being exchanged for deposit money that already exists. Literally speaking, printing money has no net effect on the size of the money supply, and thus, by implication, on total spending, inflation, or the foreign exchange value of the dollar. More money in total—printed money plus deposit money—may do those things, but there is no logical reason that printed money alone would. (I have ignored coinage, which essentially is created and functions the same as paper money.)

Counterfeiting and Printing Issues

In recent years, counterfeiting has become a more serious problem, especially abroad. The Bureau of Engraving and Printing, under the direction of the Treasury Department and with the cooperation of the Federal Reserve, has taken technical measures—holograms, watermarks, etc.—to make counterfeiting more difficult. This is why the Bureau has changed the design of the various notes from time to time in recent years. I recall a "photo-op" a few years ago when, as president of the Dallas Fed, I spent the first note—I paid for it—of a new design in the

Eleventh District. I don't recall which denomination the note was, but I do recall spending it on breakfast at "Bubba's" in downtown Dallas.

The Bureau has to undertake increasingly sophisticated printing methods to stay ahead of the counterfeiters who also have access to sophisticated engraving and printing technology. Recently the Bureau discovered a technical flaw, or flaws, in the production of a newly designed \$100 note. Much publicity ensued, much of it fair and balanced, and much of it not.

Serial Fed bashers insisted on blaming the technical printing mistake on the Fed, which doesn't print money, and, perhaps more disingenuously, many insisted on assigning a dollar value to the snafu based on the face or issued value of the \$100 notes rather than their dramatically lower unissued value stored at the Bureau. When Fed Chairman Ben Bernanke belatedly pointed out recently that the Fed doesn't print money, he was taken to task by many for not being a good sport and taking the rap. Come on, give the guy a break. Don't you think he makes enough mistakes of his own, making it unnecessary to attribute to him the mistakes of others?