Study Questions—Dunbar

Dunbar describes the operations of the check clearing system in the U.S. at the end of the 19^{th} century, i.e. before the establishment of the Fed.

1) On p. 44-45 Dunbar argues that legal reserve requirements have little effect on the banking system's ability to expand and contract bank deposits. Contrast his views with the standard intermediate macro account of the "money multiplier".

2) In lecture I have described bank lending as a "swap of IOUs", in which the borrower promises to pay the bank and the bank promises to pay the borrower, with the difference that the bank's promise is a demand deposit so money is "created" in the process. Dunbar (p. 46) describes the process of repayment of debt as a "mutual release". Explain how such repayment "destroys" money in the process.

3) Dunbar recognizes in principle that withdrawal of money can cause problems for banking system, whether it is withdrawal into hand-to-hand circulation or withdrawal to make foreign payments. Explain why this is so.

4) Dunbar argues that in practice such withdrawal of money does not cause problems, "is not of great importance" (p. 45). This appears to be in conflict with Young's account of the propensity for regular financial crises under the National Banking System. What accounts for their different interpretation of the very same economic history?

5) In the example on p. 53, Dunbar shows a hypothetical clearing. Suppose that Bank No. 3, which owes the clearinghouse 6,770, in fact has only 3770 in clearinghouse certificates and so cannot meet its obligations. What are the alternatives available to No. 3 to avoid failure?