Mobile Collateral versus Immobile Collateral

Gary Gorton, Yale and NBER
Tyler Muir, Yale
Components of Privately-Produced Safe Debt as a Fraction of Total Privately-Produced Safe Debt (U.S.)

- Deposits
- Money-like debt
- MBS/ABS Debt
- Corporate Bonds and Loans
- Other Liabilities

Shadow Banking
Traditional Banking
U.S. Primary Dealers' Repo Fails: US Treasuries Receive minus Deliver

$ Millions

Policy Evaluation

• How can we understand the possible effects of the LCR?

• We tried this system before: the U.S. National Banking Era.

• Private bank notes had to be backed by Treasuries.
Riskless Arbitrage?

- It was profitable to buy Treasuries, deposit them, and issue bank notes.

\[ r \approx \frac{(0.04)(1.10)-(0.017)(0.9)}{1.10-0.9} \approx 14.4\% \]

- Bond price=$1.10 with yield of 4%
- 0.017 is issuance cost
- 0.9 is the fraction of the bond that can be issued as notes
Profit Rate from Note Issuance, % per annum
But . . .

• “Profit” due to a convenience yield to Treasuries and bank capital was costly.

• Treasuries scarce.

• Meanwhile the shadow banking system grew: the ratio of bank notes to demand deposits fell, from just over 100 percent in the early part of 1865 to 14 percent by 1909.
Demand Deposits not Understood

• Bray Hammond (1957), in his Pulitzer Prize-winning book *Banks and Politics in America*, wrote: “. . . the importance of deposits was not realized by most American economists . . . till after 1900” (p. 80).

• Russell C. Leffingwell, the Assistant Secretary of the Treasury wrote as late as 1919: “All of these people who believe in the quantity theory of money . . . choose to call bank deposits money, but bank deposits are not money.”