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A **Straight Dope Classic** from Cecil's storehouse of human knowledge

## How much money is there? With the U.S. borrowing so much, why aren't we broke?

23-Aug-1991

Dear Cecil:

How much U.S. currency (cold cash) is in circulation around the world? Who decides how much to print? With the government continually borrowing money, shouldn't lenders be broke by now? Where do they get the money to keep lending out, especially when they know that none of it will ever be paid back? --F. Lucre, Dallas

Cecil replies:

Cheezit, Phil, you're asking me to boil two semesters of freshman econ down to 600 words. Fortunately, this is not that hard. The following pretty much covers what the well-informed citizen needs to know:



*Coins and paper currency are economic petty cash.* At the end of 1990 the total amount of currency in circulation was \$246 billion. The total amount of money, by the strictest definition (what economists call M1), was \$825 billion. M1 money is whatever you can spend right now--currency plus checking deposits. A more inclusive estimate of the money supply (M2--includes savings accounts) was \$3.3 trillion.

While currency is still the most popular method of payment, it accounts for only 1 percent of the value of all transactions. (The big money travels via "wire transfer" between banks--0.1% of the transactions, but 80% of the dollars.) People sometimes say inflation occurs when the government "prints too much money." Nonsense. The amount of money actually printed is

inconsequential.

*Nobody is in charge of deciding how much currency to issue.* The Treasury Department prints it, but the amount actually distributed to the public is purely a function of consumer demand. If people want more greenbacks, they draw down their checking accounts and get them. The government prints as much as people want.

*The government doesn't create money, private banks do.* Banks create money by making loans. Suppose I put \$100 in my checking account. The bank bets I won't draw it out for a while and lends \$85 of my \$100 to legendary cartoonist Slug Signorino. Slug blows the \$85 on Captain Morgan and lottery tickets at McGinty's. Now McGinty's has \$85 in folding green and I've got \$100 in checking that theoretically I can draw out at any time. Behold, the local money supply has bloomed from \$100 to \$185.

It doesn't stop there. If McGinty's puts the \$85 in its checking account, its bank will lend out most of it, increasing the money supply even more. That's how the banks find the cash to lend to Uncle Sam. They lend it out, the government spends it, the recipients put the money in the bank, and the banks lend out that. The total amount of money that banks can create is regulated by the Federal Reserve. Too much money (not too much currency) = inflation.

*The whole financial system is a house of cards.* Probably during that last example you were thinking, jeez, what if Uncle Cecil drew out his \$100, as he was legally entitled to do? It wouldn't be there! Righto. If everybody decided to take what they had coming out of their accounts and bury it in the garden, the financial system would collapse, civilization would end, and we'd all go back to being hunter-gatherers. The modern world is made possible by the trust and sheeplike predictability of millions of depositors. (Deposit insurance makes it less of a crapshoot than it once was.)

*The Federal Reserve System is not part of the government and is answerable to no one.* (I know you didn't ask, but lots of other people have.) By "government" I mean the executive branch. The President does appoint the Fed's governing board but the members serve for long terms and can do as they please, free of political interference (in theory). The Fed is a quasi-public agency created by Congress and as a practical matter does not lightly defy the President.

*The government will never pay back the money it owes and nobody expects it to.* The government borrows money by selling bonds. Each bond is a portable money machine, generating interest for its owner on a dependable schedule. Nobody wants these bonds to go away. In fact, in a time of worldwide financial instability, they are in great demand. To pay off old bonds the government simply issues new ones. The main concern is that the government not issue so many bonds that the interest payments get out of hand.

Strange business, eh? Strange as nuclear physics in its way, about as widely understood, and offering much the same attraction: the chance to yank the wires holding together the world.

--CECIL ADAMS

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