The Open University

The History of Money

Money and saving the banks

Narrator:

The History of money in 10 minutes. Number 8, money and saving the banks

To understand how governments tried to prevent global financial meltdown after 2008, economists distinguished between two kinds of money: money created by banks inside the banking system, and money created by governments outside the banking system. When a bank creates money by making a new loan the bank acquires a new private asset - the loan - with an equivalent private liability to the borrower to pay it. This is money created inside the banking system. Governments can create money by selling new bonds.

These bonds go into circulation as new private assets but there is no equivalent private liability to pay them. Instead, this outside money is added to the public debt. Although it's normally a very small percentage of total money in the economy that was used to buy up the banks' bad private debts and write them off. The private sector retained its wealth with new assets inside the system supported by government, with public debt from outside the system.