Discussion of
Mobile Collateral versus Immobile Collateral
by Gary Gorton and Tyler Muir

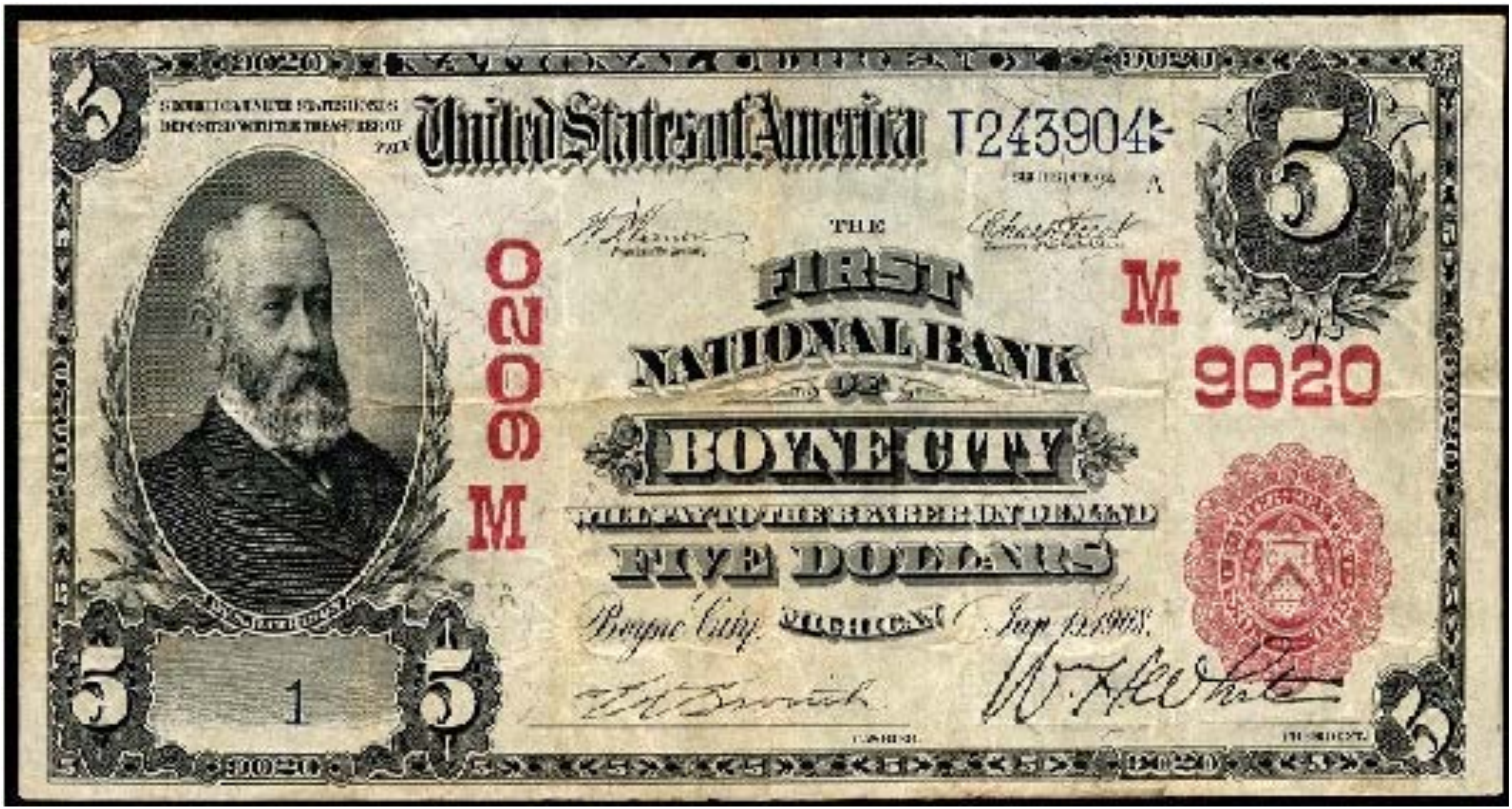
Andrei Kirilenko
MIT Sloan School of Management

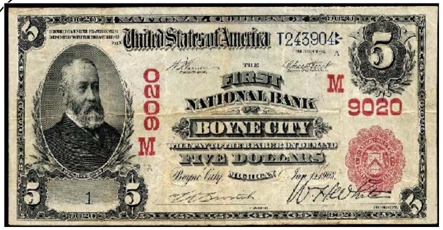
Main points of the paper

- "In the thirty years prior to the 2007-2008 financial crisis, the global financial system evolved away from a system of immobile collateral into a system of mobile collateral."
- "Since the financial crisis of 2007-2008, regulatory initiatives have been aimed at making collateral once again immobile."
- "There is a cost to making this collateral immobile because it ties up safe debt."
- Instead of providing the benefit of making the system safer, "other forms of bank debt increase when safe collateral becomes immobile, possibly making the system riskier."

Argument: BIS LCR Era is "structurally similar" to the U.S. National Banking Era

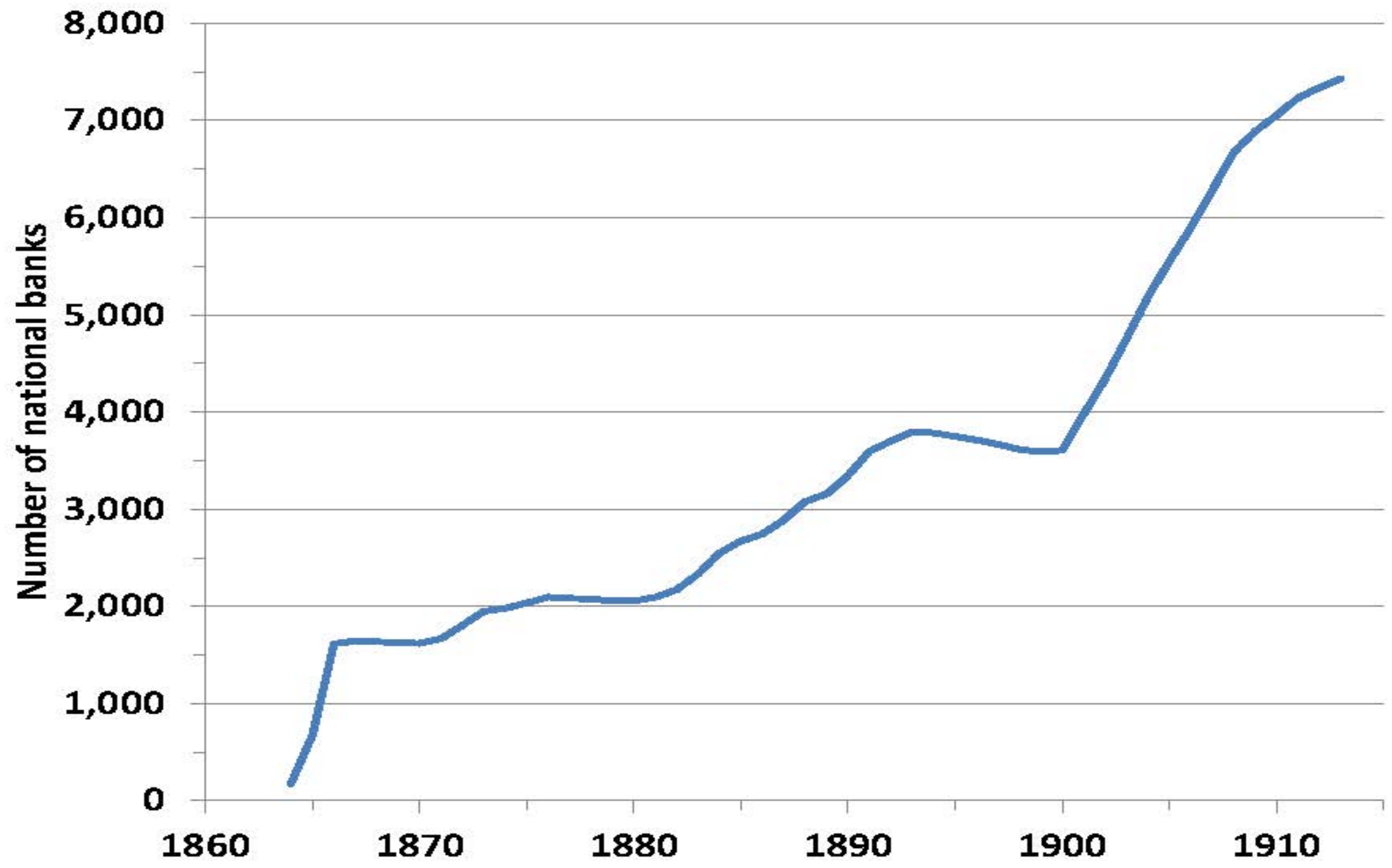
The National Banking Era





The Rise of National Banks

National Banks in Operation, 1864-1913



Source: Annual Report of the Comptroller of the Currency (1914, Table 6) and Weber (2015)

National Banks Were Given An Advantage

- National banks had to pay 1 percent (0.5 percent from 1900) tax on their national bank notes in circulation.
- State banks had to pay a 10 percent tax on their notes in circulation.
- National banks can take the full value of their capital, invest it in government bonds, deposit bonds with the Comptroller of the Currency, get 90 percent (100 percent after 1900) of that value in national bank notes and loan the notes out.
- State banks can only loan out the notes that they issued backed by their capital.

To Make the Payment System Cheaper and the Banking System Safer and Deeper

★ National bank are accepted as legal tender in states other than those in which they are issued.

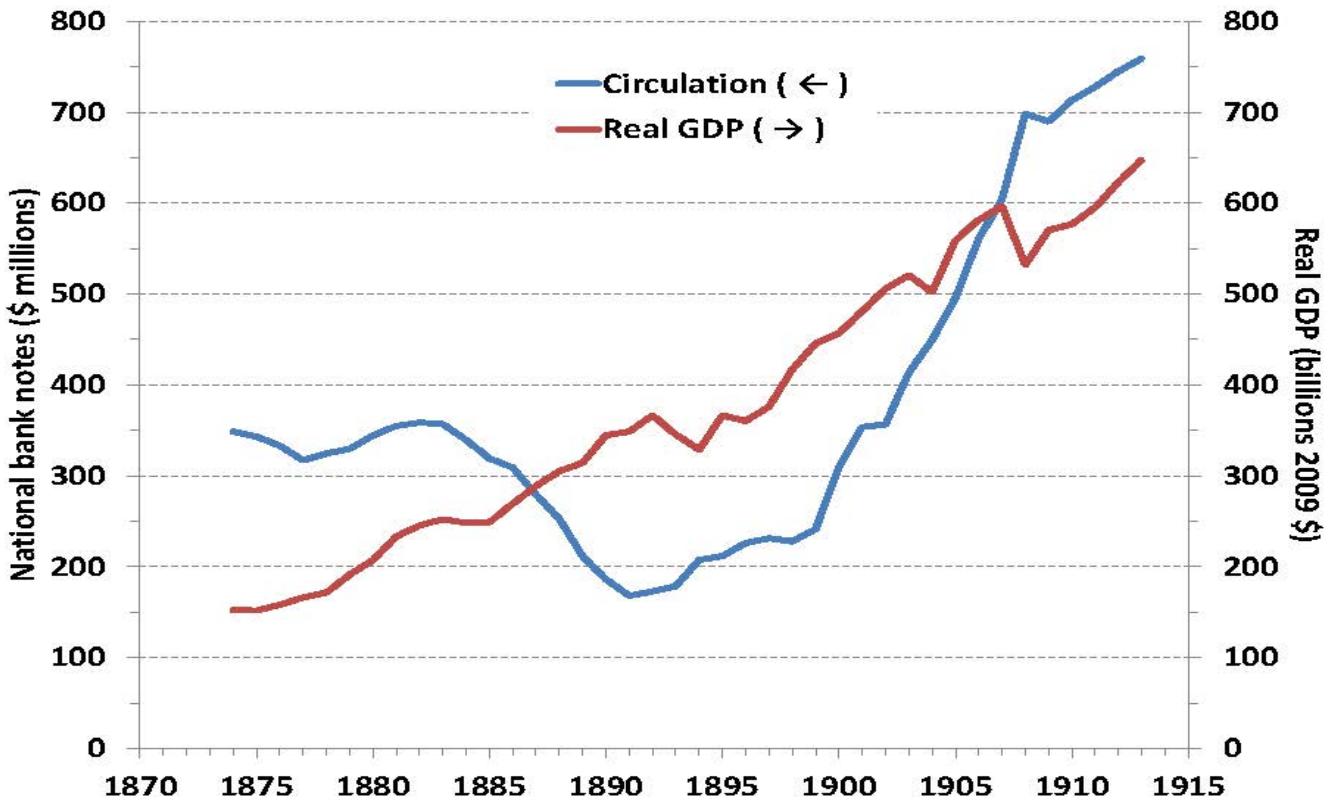
★ National bank notes are designed to be more difficult to counterfeit.

★ Deposits made in national bank notes can be transferred among banks.

★ National bank notes are a "new technology" that (among other things) helps facilitate a cheap, safe, nationwide payment system (via third party intermediaries - national banks).

And the Issuance of Notes Did Not Explode

National Bank Notes in Circulation and Real GDP, 1874-1913



Source: Annual Report of the Comptroller of the Currency (1914, Table 22), Williamson (2014) and Weber (2015)

The National Bank Note Issuance Puzzle

- ★ The authors argue, "our results indicate that the profits to note issuance fluctuate with the convenience yield on Treasuries, and our evidence is consistent with the idea that profits are related to the cost of bank capital."
- ★ There is a large literature on this, but perhaps there is another thought: the cost of government insurance of its guarantee on the national notes.
- ★ National banks notes were insured by the U.S. Treasury.

"[T]he United States guarantees the final payment of the notes"
(Annual Report of the Comptroller of the Currency, 1874, XI)

The National Bank Note Insurance and Its Cost

- ★ To protect itself, the U.S. Treasury was entitled to sell bonds it held as collateral to guarantee the issued notes.

- ★ The U.S Treasury had first lien on the assets of a failed national bank.

- ★ If the bonds and assets were not enough, the U.S. Treasury can use the capital of the national bank shareholders' to pay off holders of the national bank notes.

- ★ And, national banks were subject to federal supervision and reporting requirements, so problems can be detected early and dealt with quickly.

The BIS Liquidity Coverage Ratio

The BIS Liquidity Coverage Ratio

- The authors argue that the National Banking system and the LCR system "enforce a correspondence between two types of debt instruments, each with a convenience yield".

- "The input for making one kind of money, bank notes or money market instruments, is required to be Treasuries".

- "Such a system is fragile because by forcing two kinds of money together it is likely that there will be a shortage of one kind of money, leading to its private production elsewhere, which creates fragility in the system."

Speaking about the BIS LCR and the U.S. National Banking Era

- ★ Another thought comes to mind…
- ★ While the LCR might be intended as a way to strengthen global third party intermediaries using sovereign bonds issued in "national" currencies,
- ★ "New technologies" are being developed to (again) facilitate a cheap, safe, global payment system that does NOT rely on third party intermediaries – global banks.
- ★ Crypto-currencies – all the way down to individual (peer) liabilities.

Will "the Private Production" be of National Currency or Private (Crypto) Currencies?

- ★ Bitcoin: peer-to-peer payment system and crypto-currency.
- ★ Or some alternative: Litecoin, Peercoin, Namecoin, Dogecoin, Primecoin, Mastercoin…?

- ★ It will need a different kind of supervisory regime and reporting requirements. More like commodity markets.
- ★ We had little experience with such regulatory regime 100 years ago. We do now.