Just Money Profiles
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Public Money: Digital Dollars? Fed Acccounts? Postal Banking?

Public Money: Digital Dollars? Fed

Accounts? Postal Banking?

Prompt for Discussion

Contributors: John Crawford, Morgan Ricks, Lev Menand, Aaron Klein, Robert Hockett, Abbye Atkinson, Leonidas Zelmanovitz, Bruno Meyerhof Salama, Sheila Bair, James McAndrews, Yesha Yadav, Sarah Bloom Raskin, Mehrsa Baradaran, Christopher Giancarlo, Saule T. Omarova, and Nakita Q. Cuttino.

The recently enacted CARES Act has exposed glaring problems in the U.S. system of money and payments. Delayed stimulus payments are costly for struggling families and for the economy as a whole. Unfortunately, the United States has one of the slowest payment systems in the developed world. On top of that, millions of Americans don’t have bank accounts. They must receive their stimulus dollars as physical checks, which are slow to arrive and often costly to convert into cash.

Growing awareness of these systemic defects has stimulated renewed interest in public sector solutions. When Democrats in the U.S. House of Representatives released their proposed stimulus legislation in March, they included a provision giving people the option to receive their stimulus as “Digital Dollars” through a new system of “FedAccounts” maintained at the Federal Reserve. While this provision didn’t make it into the ultimate legislation, Senator Sherrod Brown, ranking member on the Senate Banking Committee, later introduced separate legislation “to allow everyone to set up a digital dollar wallet, called a FedAccount.” Maxine Waters, chair of the House Financial Services Committee, did the same. And Representatives Rashida Tlaib and Pramila Jayapal included similar language in recently proposed legislation.

These proposals intersect with and complement proposals to implement postal banking as a way of serving un- and underbanked households. As these debates unfold in the United States, other central banks, including the Bank of China, are preparing to release their own central bank digital currencies (CBDCs) in the coming months.

In this roundtable, we invite participants to comment on these public-sector initiatives and what they mean for the future of money. Should the Federal Reserve issue a digital dollar, available to the general public? What problem would it solve or mitigate, and what new problems and risks would it create? Should central bank digital currencies take the form of “accounts” or should they try to emulate digital “tokens”? Can and should a FedAccount program be linked to or even merged with a postal banking initiative? Does maintaining the U.S. dollar’s status as the dominant global currency hinge on launching a digital dollar?

Contributions

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The Other Half of the FedAccounts Plan: What Happens on the Asset Side of the Fed’s Ledger?
Saule T. Omarova, Cornell Law School

October 16, 2020
Central Bank Digital Currency: the hidden agenda
Leonidas Zelmanovitz, Liberty Fund
Bruno Meyerhof Salama, UC Berkeley Law School

October 7, 2020

On Equity within Public-Sector Banking Initiatives

Abbye Atkinson, Berkeley Law

September 28, 2020

The Inclusive Value Ledger: A Public Platform for Digital Dollars, Digital Payments, and Digital Public Banking

Robert Hockett, Cornell Law School

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Designing Financial Services for People with Low and Uncertain Income

James McAndrews, TNB USA Inc., and the Wharton Financial Institutions Center

August 27, 2020

What to Do While Waiting for Fed Accounts

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How to Fix the Covid Stimulus Payment Problem: Accounts, Information, and Infrastructure

Aaron Klein, Brookings Institution

August 10, 2020

FedAccounts: Digital Dollars

Morgan Ricks, Vanderbilt University

John Crawford, University of California Hastings College of the Law

Lev Menand, Columbia Law School

M. Ricks, J. Crawford, L. Menand, FedAccounts: Digital Dollars

August 10, 2020

Morgan Ricks, Vanderbilt University
John Crawford, University of California Hastings College of the Law
Lev Menand, Columbia Law School

In 1989 the Board of Governors of the Federal Reserve System came out against the "basic banking" legislation that Congress was then considering, which would have required U.S. banks to offer no-frills transaction accounts at cost to all Americans.[1] While the Board "share[d] the belief that banking services should be widely available to all," it doubted that there was really a problem to begin with. Low-income households might just have difficulties managing bank accounts and might distrust banks and prefer dealing with alternative payment service providers, it noted. "The Board does not believe that enough of a problem has been demonstrated to justify sweeping legislation."[2]

But even granting that there was a problem, the Fed said, the proposed solution was wrongheaded. "[A]s a general matter, we question whether it is wise for the government to mandate the services that financial institutions must provide."[3] A mandate to serve low-income households with basic banking services might "stifle innovation and experimentation," it warned. "The Board believes that voluntary efforts by financial institutions will continue to be successful in meeting many of the concerns that have been expressed without the burden and cost that rules and regulations inevitably impose."[4]

Thirty years later, those voluntary efforts have not borne much fruit. Today, 6.5 percent of U.S. households are unbanked, meaning that no individual in the household has a bank account.[5] Another 18.7 percent of U.S. households are underbanked, meaning that, despite having a bank account, they rely to some degree on expensive nonbank services—such as nonbank money orders, check cashing, and payday loans—for payments and other financial needs.[6] These un- and underbanked households are primarily low-income and disproportionately minority.

In contrast to the United States, bank account penetration in other advanced economies like Canada, France, Germany, Japan, and the United Kingdom exceeds ninety-nine percent. At least some of those other jurisdictions achieve universal service through just the sort of mandate that the Fed opposed back in 1989.[7]

If universal service mandates are off the table, another possibility is direct public provisioning: a public option for bank accounts. The United States already has a big public bank, the Federal Reserve, and it already offers bank accounts (with trillions of dollars in total balances) and processes payments between them. These accounts consist of digital dollars—they are dollar balances maintained as ledger entries on the Fed's electronic books. The Fed's digital dollar accounts are highly attractive, offering instant payments, higher interest than ordinary bank accounts, and full government backing no matter how large the balance, with no need for deposit insurance. These accounts, however, are restricted to an exclusive clientele, consisting of banks, certain other large financial institutions, and certain governmental entities. Privileged access to these accounts creates a striking asymmetry at the core of our monetary framework: government-issued physical currency is an open-access resource, available to all, but government-issued digital currency (in the form of central bank accounts) is not.

This asymmetry is a policy choice—one that appears increasingly anomalous in the modern digital world. Other policy choices are available. In particular, Congress could direct the Fed to make its digital dollar accounts—call them FedAccounts—available to anyone who wants one. Digital dollars would be an open-access resource, available to all, just like the physical dollars that the Fed issues. Why should the central bank make its physical dollars available to the general public but restrict its digital dollars to banks?

FedAccounts might offer all the functionality of ordinary bank transaction accounts—debit cards, ATM access, direct deposit, online bill payments, online and mobile phone access, and so forth—but without any fees or minimum-balance requirements. Moreover, the Fed could partner with the U.S. Postal Service to serve as a ubiquitous physical branch network to service these accounts. Thus, FedAccounts could be merged with postal banking proposals[8] to create a robust public system for money and payments. The U.S. money-and-payments system would, in effect, become fully public infrastructure akin to roads, sidewalks, public libraries and the judicial system.

Opening up access to FedAccounts would have an astonishing range of benefits, which we describe in detail in a paper outlining the proposal. It would foster financial inclusion, bringing millions of households into the mainstream system of money and payments and lessening their reliance on expensive and subpar alternatives. It would reduce the likelihood of future financial crises by “crowding out” unstable deposit substitutes, which are a major source of financial instability. It would make the U.S. payment system faster and more efficient, because all payments between the accounts would clear in real time. It would improve the transmission of monetary policy, because the Fed’s interest-rate adjustments would be transmitted directly to a wide swath of the public rather than just to banks. The Fed could also conduct direct “helicopter drops” of money into FedAccounts for emergency stimulus if necessary.[9] And it would reduce payment system tolls, because the Fed would not charge interchange fees to merchants accepting its debit cards.

Over the past few years, central bankers around the world have become increasingly worried that privately controlled digital currencies, like Facebook’s Libra, will relegate them to the sidelines of monetary affairs. To avoid this fate, central banks have been studying, and in some cases actively pursuing, issuing digital currencies of their own: so-called central bank digital currency (CBDC).

The FedAccount system *is* a CBDC—it is a digital dollar—and it would be far superior to the CBDC approaches that dominate current discussions. Most existing proposals portray CBDC as a sort of disembodied physical currency—a digital “token” that retains physical currency’s properties of anonymity and direct peer-to-peer transfer.[10] These proposals typically envision a closed system of digital “wallets” that is segregated from the existing system of money and payments and that is based on distributed ledger technology, like the blockchain technology that undergirds Bitcoin and (prospectively) Libra.[11] We question these design features. We do not think that the Federal Reserve and other central banks should be eager to facilitate anonymous transfers, which can be used for terrorist financing, money laundering, tax evasion, and other illicit activities. Nor is it apparent to us why central banks should wish to create a segregated, closed system that is walled off from the mainstream payment system. When it comes to money and payments, integration and interoperability are demonstrably better than fragmentation and balkanization. On top of that, distributed ledger technology, however ingenious its conception, remains extremely slow and inefficient compared to centralized ledger systems. For central banks, these cryptocurrency design features are a needless distraction.[12] The FedAccount system would be seamlessly interoperable with the existing system of money and payments and would rely on low-cost, reliable systems and technologies that the Federal Reserve has used successfully for decades.

The Federal Reserve should keep it simple. CBDC does not require new technologies, it merely requires expanding access to a desirable, proven product that the Federal Reserve already offers: bank accounts at the central bank. Physical currency is already an open-access resource; digital dollars should be as well.

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[1] Martha R. Seger, Member, Board of Governors of the Federal Reserve System, Statement before the Subcommittee on Consumer and Regulatory Affairs of the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, June 7, 1989, 75 Fed. Reserve Bulletin 550 (1989).

[2] *Id.* at 555.

[3] *Id.*

[4] *Id.* at 557.

[5] *See* 2017 FDIC National Survey of Unbanked and Underbanked Households 1 (“Approximately 8.4 million U.S. households, made up of 14.1 million adults and 6.4 million children, were unbanked in 2017.”).

[6] *See id.* (“Approximately 24.2 million U.S. households, composed of 48.9 million adults and 15.4 million children, were underbanked in 2017.”).

[7] For example, Canadian banks are required to open accounts for applicants unless an enumerated exception applies (generally relating to fraud prevention). See Access to Basic Banking Services Regulations (SOR/2003-184), § 3 (issued

pursuant to §§ 448.1(3), 458.1(2), and 459.4 of the Bank Act (2001)).

[8] *See, e.g.,* Mehrsa Baradaran, *Postal Banking's Public Benefits*, American Affairs (Fall 2018); Mehrsa Baradaran, *It's Time for Postal Banking*, 127 Harv. L. Rev. F. 165 (2014).

[9] *See, e.g.,* Julia Coronado & Simon Potter, *Securing Macroeconomic and Monetary Stability with a Federal Reserve-backed Digital Currency*, PIIE Policy Brief 20-4 (2020).

[10] *See Central Bank Digital Currencies*, Bank for Int'l Settlements Committee on Payments and Market Infrastructures and Markets Committee, March 2018, at 6.

[11] *See, e.g.,* Tommaso Mancini-Griffoli et al., *Casting Light on Central Bank Digital Currency,* IMF Staff Discussion Note, Nov. 2018, at 29 (describing a CBDC design involving "preloading tokens onto a wallet"); Benoit Cœuré, *The Future of Central Bank Money*, speech at the International Center for Monetary and Banking Studies, Geneva, May 14, 2018 ("[C]entral banks today could make use of new technologies that would enable the introduction of what is widely referred to as a 'token-based' currency—one based on a distributed ledger technology (DLT) or comparable cryptographic technology.").

[12] *Cf.* Aleksander Berentsen & Fabian Schär, *The Case for Central Bank Electronic Money and the Non-case for Central Bank Cryptocurrencies,* 100 FRBSL Rev. 97 (2018).

Lacewell v. OCC

Author: Lev Menand & Morgan Ricks

When it comes to U.S. monetary policy, the Federal Reserve looms large. But a lesser-known agency also plays an important role: The Office of the Comptroller of the Currency ("OCC"). Congress created the OCC in 1863 – fifty years before it set up the Fed.[1] Congress charged the OCC with chartering, regulating, and supervising a system of "national banks." Today there are 1,200 of these privately-owned federal instrumentalities. They issue and maintain $15 trillion of deposit balances, and these balances – not the paper notes issued by the Fed – make up the vast majority of the U.S. money supply.

Exactly two years ago, the OCC announced that it would begin granting new "special purpose" national bank charters to financial technology ("fintech") companies that do not issue or maintain deposit balances. These new national banks would be exempt from federal regulations governing depository institutions, while still benefitting from the federal status national banks enjoy. Thus, they would be entitled to ignore many state business regulations as well as large portions of the federal securities laws (from which banks are explicitly exempt).

In September 2018, the Superintendent of the New York State Department of Financial Services ("DFS") challenged the OCC's proposed charter in federal court.[2] It argued that a nondepository national bank was an oxymoron. In October 2019, the Honorable Victor Marrero agreed, entering judgment in favor of New York and enjoining the OCC from issuing its proposed charter. In December, the OCC appealed. The substantive question presented in the appeal is whether the OCC has the authority under the National Bank Act ("NBA") to charter nondepository national banks.

This week, thirty-three banking law scholars[3] filed a brief in support of the DFS.[4] The brief – available below – argues that the OCC has no such authority. It explains that the OCC's position is based on a fallacy: that "banking" is just another word for "lending." As the amici put it:

> *Banking involves lending, but mere lending does not constitute banking. When a bank makes a loan, it posts a credit in the amount of the loan to the borrower's deposit account. It need not have any cash on hand. By contrast, before a nonbank lender can lend, it must procure cash or its equivalent. Thus, while nonbank lenders "deal" in money, "banks do not merely deal in[,] but are actually a source of, money." United States v. Philadelphia Nat'l Bank, 374 U.S. 321, 326 (1963) . . . [I]t is for this reason that banks are subject to strict federal oversight.*

A ruling in favor of the OCC would conflate banks' *permissible* activities with their *essential* activities. While, under prevailing doctrine, national banks are permitted to engage in a wide range of financial commerce, the OCC does not have the power to charter entities that do not augment the money supply. The OCC's contrary position contravenes not just the text and purpose of the NBA, but also the Federal Deposit Insurance Act, the Bank Holding Company Act, and the Federal Reserve Act, the last of which it would undermine by giving nondepository companies that play no role in monetary policy the ability to participate in selecting six of the nine members of the Boards of the regional Federal Reserve Banks. The consequences of a judgment in favor of the OCC would also extend far beyond money and banking – opening up the possibility of general business incorporation at the federal level for much of the financial sector and perhaps large portions of the nonfinancial sector.

For those who are interested in the case, we have included links below to other public documents, including an amicus brief filed by Wharton Professor David Zaring in support of the OCC's position and several amicus briefs filed in support of DFS.

Documents Related to Spotlight:

District Court Opinion

Brief of 33 Banking Law Scholars

Brief of the OCC

Brief of the DFS

Brief of David Zaring

Brief of ICBA

Brief of Consumer Groups

Brief of State Credit Regulators

Brief of State Conference of Banking Supervisors

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[1] And twenty-five years before it created the Interstate Commerce Commission, what is often erroneously considered to be the country's first regulatory agency.

[2] DFS is the oldest banking agency – and oldest independent regulatory agency in the country – predating the OCC by twelve years. *See* Lev Menand, *Why Supervise Banks? The Forgotten Past and Uncertain Future of a Distinctive Form of Governance*, 71 Vand. L. Rev. __ (forthcoming).

[3] Hilary J. Allen, Dan Awrey, Mehrsa Baradaran, Lawrence G. Baxter, Prentiss Cox, John Crawford, Nakita Cuttino, Christine Desan, Adam Feibelman, Gina-Gail S. Fletcher, Anna Gelpern, Erik F. Gerding, Jeffrey N. Gordon, Robert Hockett, Kristin N. Johnson, Jeremy Kress, Adam J. Levitin, Da Lin, Jamie

McAndrews, Patricia A. McCoy, Lev Menand, Saule Omarova, Christopher K. Odinet, Nadav Orian Peer, Christopher L. Peterson, Katharina Pistor, Sarah Bloom Raskin, Morgan Ricks, Heidi Mandanis Schooner, Graham Steele, Joseph Sommer, Jennifer Taub & Arthur Wilmarth.

[4] Brief of Thirty-Three Banking Law Scholars as Amici Curiae in Support of Appellee in *Lacewell v. OCC*, No. 19 Civ. 4271 (2d Cir. July 29, 2020).

Banking: Intermediation or Money Creation

Banking: Intermediation or Money Creation

Prompt for Discussion

Contributors: Morgan Ricks, Marc Lavoie, Robert Hockett, Saule Omarova, Michael Kumhof, Zoltan Jakab, Paul Tucker, David Freund, Charles Kahn, Daniel Tarullo, Stephen Marglin, Howell Jackson and Christine Desan, Sannoy Das

Commercial banks are, indisputably, at the center of credit allocation in virtually all modern economies. Astonishingly, however, it remains controversial exactly how banks expand the money supply.

According to one view, banks operate as intermediaries who move money from savers to borrowers. The basic idea is that banks extend the monetary base by lending out of accumulated funds in a reiterative way. In round 1: a bank takes a deposit, sets aside a reserve, lends on the money; round 2 – the money lands in another bank, that bank sets aside a reserve, lends on the money; round 3 – the process repeats. Money’s operation is effectively multiplied in the economy because banks transmit funds constantly from (passive) savers to (active) borrowers, thus distributing money across those hands. The system works because savers, who are content to leave their funds alone, are unlikely to demand more than the (respective) reserve amounts back from any round. Banks balance their flow of funds over time as borrowers repay their loans.

According to another view, commercial banking activity amounts to “money creation” rather than the pooling and transmission of existing funds. Banks fund the loans they make by issuing deposits (or promises-to-pay in the official unit of account) that are treated by the wider community as money, not only as credit. They have, in effect, immediate purchasing power. The constraint on banks’ lending capacity is not the sum of previously accumulated funds, but the banks’ ability to clear obligations owed to other banks against obligations demanded from other banks. That activity depends on national payments systems coordinated and stabilized by central banks.

We open this roundtable to proponents of each approach to banking. We invite them to argue their case, to respond to one another, and to elaborate the implications that their view has on matters including the definition of money, the role of private capital accumulation, the relationship of commercial banks to central banks, and the behavior of the money supply.

Contributions

August 3, 2020
Roundtable Wrap-up
Sannoy Das, Harvard Law School

March 12, 2020
The Power of Paradigms in Histories of Economic Development
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March 5, 2020
Thinking about whether and why money matters is more important than debates about "views" on banking intermediation
Sir Paul Tucker, Harvard Kennedy School

February 27, 2020
What Do Banks Do?
Stephen A. Marglin, Harvard University

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Focusing on Risk
Daniel K. Tarullo, Harvard Law School

February 13, 2020
Towards a Mixed View
Howell E. Jackson, Harvard Law School

February 5, 2020
What Do Banks Intermediate?
Robert Hockett, Cornell Law School
Saule Omarova, Cornell Law School

January 29, 2020

Banks Are Not Intermediaries of Loanable Funds

Michael Kumhof, Bank of England

Zoltan Jakab, International Monetary Fund

January 23, 2020

What’s at Stake in Debates over Bank Money Creation Mechanics?

Morgan Ricks, Vanderbilt Law School

January 15, 2020

Are Banks Special? A Fintech Perspective

Charles M. Kahn, University of Illinois

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Endorsing the Money-creation View

Marc Lavoie, University of Ottawa

M. Ricks, What’s at Stake in Debates over Bank Money Creation Mechanics?

January 23, 2020

Morgan Ricks, Vanderbilt Law School

"[T]he familiar controversy as to how and by whom bank-deposits are 'created' is a somewhat unreal one." So wrote John Maynard Keynes near the start of his 1930 *Treatise on Money.*[i] Keynes asked whether deposit balances can be created "actively" by banks or only passively by depositors "on their own initiative." He thought it was obvious that banks can create deposit balances actively, albeit only within practical limits. Keynes acknowledged that active deposit creation—i.e., crediting deposit accounts in the process of lending or investing—tends to "diminish the reserves" of the bank as newly created balances are "paid away to the customers of other banks." He continued:

> *Practical bankers . . . have drawn from this the conclusion that for the banking system as a whole the initiative lies with the depositors, and that the banks can lend no more than their depositors have previously entrusted to them. But economists cannot accept this as being the common-sense which it pretends to be. I will, therefore, endeavor to make obvious a matter which need not, surely, be obscure.*

Keynes went on to explain that, while a bank will experience a clearing drain when it creates deposits actively, by the same token the bank "finds itself strengthened whenever the other banks are actively creating deposits"—that is, it will receive clearing inflows. He concluded that banks can safely create deposits on their own initiative "*provided that they move forward in step*":

> *Every movement forward by an individual bank weakens it, but*

> *every such movement by one of its neighbor banks strengthens it; so that if all move forward together, no one is weakened on balance. . . . Each Bank Chairman sitting in his parlour may regard himself as the passive instrument of outside forces over which he has no control; yet the "outside forces" may be nothing but himself and his fellow-chairmen, and certainly not his depositors.*

Kenyes was not alone in conceiving of bank money creation in this way. Irving Fisher wrote in 1913 that "A bank depositor . . . has not ordinarily 'deposited money.'"[ii] And Joseph Schumpeter wrote in 1954 that "It is much more realistic to say that banks … create deposits in their act of lending, than to say that they lend the deposits that have been entrusted to them."[iii]

Others have seen these issues somewhat differently. In a classic 1963 article, James Tobin criticized as "superficial and irrelevant" the notion that "a bank can make a loan by 'writing up' its deposit liabilities." After all, he wrote, the new deposit balance stays with the bank only for "a fleeting moment" because "the borrower pays out the money, and there is of course no guarantee that any of it stays in the lending bank." Though a Keynesian himself, Tobin evidently didn't see eye-to-eye with Keynes on this issue. The same goes for Paul Krugman, who wrote in 2012 that "any individual bank does, in fact, have to lend out the money it receives in deposits. Bank loan officers can't just issue checks out of thin air; like employees of any financial intermediary, they must buy assets with funds they have on hand."

This debate presents itself as a somewhat clinical, descriptivedebate over banks' operational mechanics. But it has always been clear that more was at stake. Tobin in particular was primarily concerned with issues beyond the narrow question of bank money-creation mechanics. He sought to make a bigger, more conceptual point: that “[t]he distinction between commercial banks and other financial intermediaries has been too sharply drawn.” Tobin was promoting what he called a “new view” that would “blur the sharp traditional distinctions between money and other assets and between commercial banks and other financial intermediaries.” His paper’s title—*Commercial Banks as Creators of “Money”* (note the scare quotes around money)—says it all. Paul Krugman was coming from a similar place in writing a few years ago that “what banks do” is “not mostly about money creation!”

So what’s going on here is not so much a factual, empirically resolvable dispute over bank operating mechanics as a deeper clash between two paradigms. On one side there is an “intermediation paradigm” which sees banks as being primarily in the business of “taking funds” from depositors and then lending them out. The intermediation paradigm, which is where Tobin and Krugman are obviously coming from, tends to downplay the distinctions between banks and other financial institutions. (“‘Banking’ has become virtually synonymous with financial intermediation,”[iv] writes Richard Posner, in a typical example from this vein. “I … use the words ‘bank’ and ‘banking’ broadly, to encompass all financial intermediaries.”[v]) It also tends to downplay the significance of the monetary function of bank liabilities. Anat Admati and Martin Hellwig go so far as to say that the notion that banks “produce (or create) money … rests on an abuse of the word ‘money.’”

The intermediation paradigm is grounded, perhaps unconsciously, in concepts from modern finance, which posits that a firm’s financing structure is irrelevant to its value, provided that certain conditions are met. Tobin himself came to academic fame in part by applying new financial concepts from portfolio theory to the analysis of money demand.[vi] And when Krugman wrote that banking is “not mostly about money creation” he referred to the seminal bank-run model of Diamond and Dybvig, which is a corporate-finance model in which there is something called banking but nothing called money. Krugman has criticized the money paradigm as “banking mysticism,” opining that banks are really just “a clever but somewhat dangerous form of financial intermediary.”

On the other side there is a “money paradigm” which tends to see banks not as takers of funds that are then lent out but rather as *issuers* of “funds.” Needless to say, taking and issuing are opposites. The money paradigm sees banks as an integral part of the overall monetary framework, a status that justifies a unique relationship with the state. Within the bank regulatory literature, the clash between the intermediation paradigm and the money paradigm shows up in disputes over the “specialness” (or lack thereof) of banks.[vii]

Here is my modest contribution to this perennial debate: Just as the dispute over banks’ operational mechanics isn’t really an empirical issue, the clash between the intermediation and money paradigms isn’t really a conceptual issue. It’s primarily a normative one. What I mean is that the specialness of banks—or of bank-issued money-claims—*is a policy choice.*

To see this, just consider a different institutional set-up from what we have today. Consider the nineteenth century, when banks’ liabilities consisted mostly of physical notes (redeemable for specie, i.e. gold or silver coin) rather than deposit balances. It would be odd to describe such banks as being in the business of “taking funds” that are then lent out. Surely holders of bank notes did not typically think of themselves as having delivered “funds” to the bank in any meaningful sense. They seldom deposited specie and accepted bank notes in return; rather, they accepted bank notes as loans or (more likely) in commerce. Bank notes were obviously issued by banks quite “actively” (to use Keynes’s word) in the process of lending or investing. And these claims circulated as money in a quite literal and conspicuous way. The intermediation paradigm just isn’t a good conceptual fit here. And the banking system’s shift from bank note liabilities to deposit liabilities arguably did not involve any relevant change in economic substance.[viii]

Or consider a fiat-money-issuing central bank like the Federal Reserve. Does it “take funds” that are then invested? Obviously not. Like other modern central banks, the Fed buys financial assets in exchange for newly created money in the form of reserve balances which are convertible by their holders (banks) into physical currency. The Fed obviously doesn’t need to “get” the “funds” first. Reserve balances are created at a keystroke in exchange for financial assets. “Funds” or “money” or “cash” never appears on the asset side of the Fed’s balance sheet. Its liabilities are funds. The intermediation paradigm doesn’t work here either, but the money paradigm obviously does, and this would still be true even if everyone held their bank account at the Fed.[ix]

So the institutional setup dictates the paradigm fit. And the institutional setup isn’t a fact of nature; it presents choices. I agree with Keynes that there’s something “unreal” about debates over bank money-creation mechanics. Everyone agrees that banks lend in the first instance by writing up their liabilities, and everyone agrees that there are practical limits to this due to clearing drains. But approach it now from a policy angle. Should we allow free entry into this business model—the practice of issuing large quantities of short-term or demandable IOUs, continuously rolled over, to fund portfolios of financial assets? Historically, Anglo-American law has recognized this as a sensitive activity and has sought to legally confine this distinctive funding model to one or more specially chartered banks, which have then been required to inhabit a special institutional environment, operating essentially as franchisees of the state.[x] This system was understood to be a way of outsourcing money augmentation, an activity that was thought to raise sensitive issues of instability, monetary control, and rent capture. And this always has required entry restriction: specifying the funding model that is permissible for banks but off-limits for everyone else.

In recent decades, entry restriction has fallen into disrepair in U.S. law. True, legally you still need a bank charter to maintain deposit liabilities. But Congress has not provided a functional definition of “deposit” for this purpose and nonbanks issue all sorts of functional substitutes for deposits on an enormous scale. This is the core of the so-called “shadow banking” problem. Experts define shadow banking in different ways, but pretty much everyone agrees that heavy reliance on short-term debt is a big part of it. And this problem arose in conjunction with the paradigm shift that Tobin helped spearhead. In an influential 1976 article, *The Soundness of Financial Intermediaries,* Robert Clark expressed deep skepticism that banks’ monetary function had much if anything to do with their regulation. The article’s title leaves no doubt as to which paradigm it adopts. Regulators followed suit. In 1980 the primary federal bank regulator, the Office of the Comptroller of the Currency (O.C.C.), relaxed its longstanding policy of granting new charters based on public convenience and necessity, a franchising approach.[xi] It concluded instead that “[t]he marketplace normally is the best regulator of economic activity; and competition allows the marketplace to function.”[xii] In 1987, as part of a general deregulatory trend, the O.C.C. declared that it was moving beyond the “textbook sense” of banking—i.e. the money paradigm—and toward a “modern concept of banking as funds intermediation.”[xiii]

The view Tobin had espoused in his 1967 article—his “new view” that sought to “blur the sharp traditional distinctions … between commercial banks and other financial intermediaries”—won the day. Conceptual blurring has led to actual, institutional blurring. The banking system no longer has a monopoly on money augmentation—this line has not been policed at all—but nonbank money-augmentation firms turn out to raise all the same policy problems that banks have always raised. Money creation has seeped out of the banking system proper, on a vast scale. In response, our financial regulatory apparatus has expanded enormously. So has the reach of public support facilities for the financial sector. As we speak, the Federal Reserve is supplying below-market funding to Wall Street dealer firms and hedge funds that rely heavily on overnight repo funding (a deposit substitute). This is the inevitable result of failing to police the traditional, structural institutional boundary that confined money augmentation to banks.

This, to me, is what is really at stake in debates over bank money-creation mechanics. It’s not really about the mechanics themselves; it’s about policy choices. We’re living with the consequences of a policy choice made circa 1980, one that was the product of an intellectual revolution. It will take another intellectual revolution to undo the damage.

[i] John Maynard Keynes, *A Treatise on Money* (New York: Harcourt, Brace, 1930), 1:23–30.

[ii] Irving Fisher, *The Purchasing Power of Money* 37–39 (rev. ed. 1913).

[iii] Joseph A. Schumpeter, *History of Economic Analysis* 1114 (1954).

[iv] Richard A. Posner, *A Failure of Capitalism: The Crisis of ’08 and the Descent into Depression* 46 (2009).

[v] *Id*. at xvi

[vi] *See* James Tobin, *Liquidity Preference as Behavior Towards Risk*, 25 Rev. Econ. Stud. 65 (1958).

[vii] *See* E. Gerald Corrigan, *Are Banks Special?,* Annual Report: Federal Reserve Bank of Minneapolis (Jan. 1982), https://www.minneapolisfed.org/article/2000/are-banks-special; Richard C. Aspinwall, *On the “Specialness” of Banking*, 7 Issues in Bank Reg. 16 (1983).

[viii] Ludwig von Mises, *The Theory of Money and Credit* 53 (H. E. Batson trans., Yale Univ. Press 1953) (1912) (“[B]anknotes, say, and cash deposits differ only in mere externals, important perhaps from the business and legal points of view,

but quite insignificant from the point of view of economics.”); A. Mitchell Innes, *What is Money?*, 30 Banking L. J. 377, 407 (1913) (“A bank note differs in no essential way from an entry in the deposit register of a bank.”); Schumpeter, *supra*, at 1115 (“[T]he obvious truth [is] that deposits and banknotes are fundamentally the same thing.”).

[ix] *See* Morgan Ricks, John Crawford, and Lev Menand, *A Public Option for Bank Accounts (or Central Banking for All),* https://ssrn.com/abstract=3192162*.*

[x] The franchising metaphor comes from Robert Hockett & Saule Omarova, *The Finance Franchise*, 102 Cornell L. Rev. 1143 (2017), https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=2660&context=facpub.

[xi] *See infra* text accompanying notes 177–84.

[xii] Clarification and Revision of Charter Policy, 45 Fed. Reg. 68603, 68604 (Oct. 15, 1980).

[xiii] Office of the Comptroller of the Currency No Objection Letter 87-5 (July 20, 1987).

Ricks, Morgan

Ricks, Morgan (profile)

- Regulation of Financial Institutions (Spring 2020) Syllabus
- The Legal Structure of the Market (Fall 2019) Syllabus

MDM 2018 Plenary Session: The Public Option and The Narrow Bank (TNB)

Recent work identifies money as a utility or infrastructural service, suggesting the government's obligation to provide access and to equalize compensation paid to those holding deposits. Innovative proposals for redesign argue that the central bank should provide transactional services directly to individuals or, alternatively, to large depositors.
Presentation and Comment

Morgan Ricks – Vanderbilt University Law School
Commentator: Jeremy Stein, Harvard University (formerly Governor, U.S. Federal Reserve)
James McAndrews – TNB Chairman and Chief Executive Officer
Commentator: Morgan Ricks