Banking: Intermediation or Money Creation

Prompt for Discussion

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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
Christine Desan, Harvard Law School

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

February 19, 2020
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

January 08, 2020

Endorsing the Money-creation View

Marc Lavoie, University of Ottawa