Opinion: How banks can help end financial crises

By Robert Leeson

The cause of financial crises – and thus the central malfunction of capitalism – is the discretion allocated to banks to stop lending. If such destabilizing discretion were exercised by a foreign dictator, and if the economic flow were related to oil or shipping lanes, it would be regarded as a national security issue to be followed by an ultimatum and war.

To eliminate financial crises we need an injunction of biblical proportions: Banks who do not lend, neither shall they take deposits.

Banking should be a simple flow: channeling the current savings of one person into current borrowing by some else. This spending flow can be blocked at three points: Individuals can hoard savings under the mattress, and banks can hoard deposits or use them to buy secondhand assets (i.e., existing government bonds).

The first blockage was largely removed by Federal Deposit Insurance.

The other two can be engineered away by a simple change in bank charters: Deposits should be accepted only if they will be transformed into loans for capital expenditures (to build offices, factories, equipment and machinery). Deposits should be swept into a bank’s account at the Federal Reserve and held until the bank has a capital expenditure loan to make (or depositor withdrawals to meet).

If banks do not wish to reacquire their traditional – but now neglected – role of assessing and bearing the risks associated with making loans, the excess deposits should fund newly issued government bonds and infrastructure projects.

All parties would benefit.

First, governments: There wouldn’t be credit-crunch recessions to jeopardize re-election chances.

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