

Limited Purpose Banking Laurence Kotlikoff Professor of Economics at Boston University Laurence

Kotlikoff How can economists fix the banking system?

What is the role of “opacity” in the financial system? How can Limited Purpose Banking keep us from having financial crises? A Limited Purpose Banking says that purpose of the banks is not to borrow money in the form of deposits or by selling bonds to the public, taking in money and promising to pay it back for sure, and then gambling with it, investing it in risky assets and maybe not being able to pay back the creditors, in which case the bank goes under, the highway system breaks up, breaks down, and the state of confidence in the economy’s future is damaged. It’s very simple how you can keep the banks from failing. And the way to do that is not let them borrow money to invest at risk. And the words ‘Limited Purpose Banking’ mean you want to limit the banks to their legitimate purpose. And their legitimate purpose is the intermediation, the connecting the borrower and the lender, the saver and the investor. That’s their job. Their job is not to gamble with these public goods. The idea of Limited Purpose Banking is to take this safe form of banking, which is equity financed mutual fund banking, and make the entire financial system based on that type of banking. Require that all financial corporations operate exclusively as mutual-fund holding companies, that do one thing only, which is to market individual mutual funds, that take in money by selling shares and buying assets. So, Limited Purpose Banking would eliminate the opacity, would require disclosure of all the securities the mutual funds are investing in – very fine, detailed, real time disclosure on the Internet of what your mutual fund is holding, and that’s very important. And also, all the money that comes in on the equity basis, and that’s very important. Now you have a banking system that can never fail and macroeconomy which is much more stable through time. I’m hoping that this proposal of limited purpose banking, which I’ve written about in the book called “Jimmy Stewart Is Dead” will eventually be adopted by different countries and that we will have a more stable macroeconomic economy through time.