**The End of Banking**

By Jonathan McMillan

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Review by John Howell

McMillan’s approach to monetary reform represents an alternative to the National Emergency Employment Defense (NEED) Act.  McMillan criticizes the NEED Act approach for its failure to address threats of “shadow banking.” His criticism bears merit but can be addressed by restricting how banks use funds borrowed from the Revolving Fund of the NEED Act.  However, a more interesting solution may be to incorporate McMillan’s principal recommendation—namely, his proposed change in accounting rules—into an updated NEED Act proposal.  Incorporating McMillan’s proposed change in accounting rules with the NEED Act’s approach to how new money should be created might address the shortcomings of both approaches and stimulate thinking about how to advance monetary reform.

McMillan’s title is dramatic, but what he defines as banking is the creation of money out of credit, which he thinks must be ended. That is also precisely what the NEED Act does. McMillan argues that information technology (IT) has now made banking obsolete. Banking made sense for the industrial revolution, but IT changes all of that. Financial institutions, which could include the institutions we now call banks, will still be needed to mediate payment systems and peer to peer lending, but such institutions will not hold our money as deposits. He speaks of “custodians” converting people’s savings into investments, but these custodians will not own the money; they will only be intermediaries linking the customer directly to his/her investments (the borrowers). IT will make this process as seamless as banking is to us now. Payment systems can also be peer-to-peer, without a bank holding our money. An organization does not need to be a bank to mediate payments. The key change is that neither the custodians nor the payment system organizations will create money as banks do now.

McMillan proposes that a simple change in accounting rules, which will apply to all institutions, can bring about this change. The new rule is this: “The total value of financial assets of a company has to be less than or equal to the value of its equity.” This is what the NEED Act accomplishes with regard to banks, by making “deposits” off limits for lending, by restricting lending to what a bank has in equity. (The NEED Act effectively includes customer money held in time deposits, i.e., savings accounts, under “equity.”

McMillan adds another feature to his accounting rule: “The value of real assets of a company has to be greater than or equal to the value of the company’s liabilities in the worst financial state.” The purpose of this is to prevent insurance companies from creating money. His concern is that if insurance companies take out insurance on their liabilities, their equity would become protected from risk. The result would be that their equity shares would become traded as money. McMillan’s explanation for how his accounting rule would prevent this is a bit arcane, but probably correct.

McMillan criticizes the NEED Act approach, which he refers to in his book as the Positive Money approach, for failing to rein in the shadow banks. His new rule will apply to all institutions including shadow banks. McMillan argues that shadow banks create money as banks do. It is not clear to me that that is true (Mitchell, 2016). Shadow banks certainly do extend credit, but it seems to me that they depend on the banks for the preceding credit extension step, which creates new money. Shadow banks use money created by banks for further lending (leveraging). Shadow banks use borrowed money or equity money, all of which has come ultimately from banks. In this way debt outstrips the money supply. It may seem that shadow banks are doing the same thing as banks do in extending credit, but if Richard Werner (2014) is right only banks are actually creating money.

McMillan argues that the NEED Act approach fails to deal with what he calls the “boundary problem,” that is the boundary between banks and shadow banks. It is true that under the NEED Act banks can borrow from the Revolving Fund in the Treasury Department if they need liquidity beyond that provided by their equity plus customer time deposits. The Act makes this lending subject to approval by the Secretary of the Treasury but puts no restrictions upon it. This raises the question as to whether under the NEED Act banks could use that source of liquidity to lend to shadow banks, thus channeling what would be public money (from the Revolving Fund) into private speculation, thus perpetuating the current system.

The question is whether the constraint upon banks to fully accept the risks involved in their lending, as provided in the NEED Act, would be sufficient to prevent this. If not, one approach would be to specify restrictions on bank use of money from the revolving fund. A list of such restrictions, offered in a different context, was offered by Mosler (2011). These include forbidding banks to securitize loans, to buy or sell credit default swaps, to accept financial assets as collateral for loans, and to loan off-shore. Well-intended restrictions such as these always raise the possibility that banks would find ways around them. A better approach may be to use the accounting restriction proposed by McMillan, limiting bank financial assets to the extent of their equity, as discussed above. Such a restriction would virtually eliminate shadow banking, because shadow banking depends on borrowed money, rather than on equity, for lending. This does raise a question as to what effect would the elimination of shadow banking have on the economy.

McMillan does an excellent job of describing the current system and making a case for the elimination of money creation by banks. This leaves the question of how new money is to be created. Like other monetary reform proposals, including the NEED Act, McMillan puts money creation in the public sphere, namely in government. He proposes a Monetary Authority (MA) to manage this, which is similar to what is proposed in the NEED Act. What is different is that McMillan proposes that the MA use only two tools, one for injecting money into circulation and one for removing it. For injecting money into circulation, he proposes a citizens’ dividend, a direct deposit into the digital currency account of every person. For removing money from circulation, McMillan proposes a liquidity fee on held money. Details aren’t given on how the liquidity fund would work. Its purpose would be to enable the MA to withdraw money from circulation in case inflation threatens. It is not likely to be necessary if populations and economies continue to grow and the money supply only needs to be increased.

The NEED Act allows for a citizens’ dividend to be provided, but the authority to do that, as with all government spending, would be the province of Congress. The NEED Act also allows for other types of government spending to be done with newly created money, the kinds of things that are needed to respond to climate change, to the infrastructure needs, to health care and education. The NEED Act ends government borrowing; McMillan’s proposal does not, although it doesn’t exclude it if enacted separately.

McMillan’s proposal and the NEED Act are not far apart. They both end the private creation of money. The financial institutions called for by McMillan could be what are now banks. They just wouldn’t be doing “banking” according to McMillan’s definition. That would also be true with the NEED Act. In considering re-introduction of the NEED Act, perhaps a way should be found to incorporate McMillan’s accounting proposals into it, which would then make it unnecessary for the NEED Act to specify how banks could or could not use money borrowed from the Revolving Fund, and which would explicitly address the matter of potential money creation through shadow banking or the insurance industry,.

**Sources**

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