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Conservative Economist Wants To Basically Ban Banking

By Mark Gongloff

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In these days of political strife, of Cruz v. Warren, Bush v. Clinton, Sterling v. Humanity, it is nice to know that at least one thing can still bring us together to hold hands and eat casserole: Hating banks.

In fact, one of the most radical anti-bank schemes you're ever going to see comes from a conservative economist, John Cochrane of the University of Chicago Booth School of Business, who is also affiliated with the Hoover Institution and the Cato Institute, two conservative think tanks. In a recent paper, "Toward a run-free financial system," Cochrane proposes a dramatic change in the way banks do business, forcing them to back every single thing they do, every loan they make, every bond they sell, with either some kind of stock or relatively safe Treasury debt.

Such a plan would certainly end banking as we know it, and might end our need to worry about a huge bank collapsing and setting all of our money on fire. It will probably not become reality any time soon: It is a variation of an idea, known as "The Chicago Plan," that has kicked around since the Great Depression and has enjoyed flashes of interest almost every year since the Great Recession, without leading to anything.

The Chicago Plan would stop banks from essentially "creating money" by making loans or taking other risks without a pile of government-issued cash to back it up. Banks now must have a tiny bit of capital, stuff like stock or cash, to back up their risk-taking. The Chicago Plan, and Cochrane's, would make them back up *everything*, 100 percent. This would stop "runs" on banks, when everybody scrambles to dump bank debt all at once, as happened to Lehman Brothers in the most recent crisis. If all bank debt was backed with cash or stock, then creditors would have no reason to worry.

Cochrane floated his own idea last year, in the form of a Wall Street Journal op-ed piece, shortly after some other economists had lobbed their own versions, leading people to briefly take the idea seriously again. It is suddenly a lukewarm topic again these days.

You will not be shocked to learn that banks do not love it. More surprising is the idea's bipartisan support, which has made strange bedfellows all over the place. The sort-of-liberal Martin Wolf of the Financial Times recently called for an end to banks' ability to create money, echoing The Chicago Plan and Cochrane. And liberal economist Paul Krugman, typically a bête noire of bankers, has suggested all of these ideas might be *too radical*.

"Cochrane's proposal calls for a remarkable amount of government intervention in finance; it makes liberal proposals for a transactions tax look like minor nuisances," Krugman wrote. Once again, that's Paul Krugman, of The New York Times.

One ultimate, admirable goal of all of these plans is to prevent future financial crises like the one triggered by the Lehman run. Almost everybody (some bankers excepted) agrees that banks need more capital. The news that Bank of America and its regulators failed for years to notice that the bank was screwing up its capital accounting speaks to the importance of building better buffers to protect us against these sprawling, complex monstrosities.

But The Chicago Plan and its cousins have some serious flaws. For one thing, ending traditional banking might only cause the "shadow banking" system -- hedge funds, brokerage firms, finance companies and other creatures less regulated than banks -- to get bigger and more powerful and more crash-inducing. We'd have all kinds of fun stuff to bail out in the next crisis. Making the U.S. government the sole provider of cash for the economy, as these plans would basically do, could mean putting the levers of growth in the hands of our politicians, who frequently can't get their act together long enough simply to raise the debt ceiling and pay old bills. Conservatives are still having conniptions about the government "taking over" health care; imagine how they'll feel about taking over the entire banking system.

Maybe more importantly, as other critics have pointed out, some of these plans could dramatically squeeze the availability of credit, dealing a death blow to the economy. This is of course the standard bank objection to any sort of regulation or curb on their ability to make money. But in the case of The Chicago Plan and its ilk, the banks might actually be right.