Equity-financed banking and a run-free financial system

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Principle

- Name, diagnose, and limit the problem before you start fixing

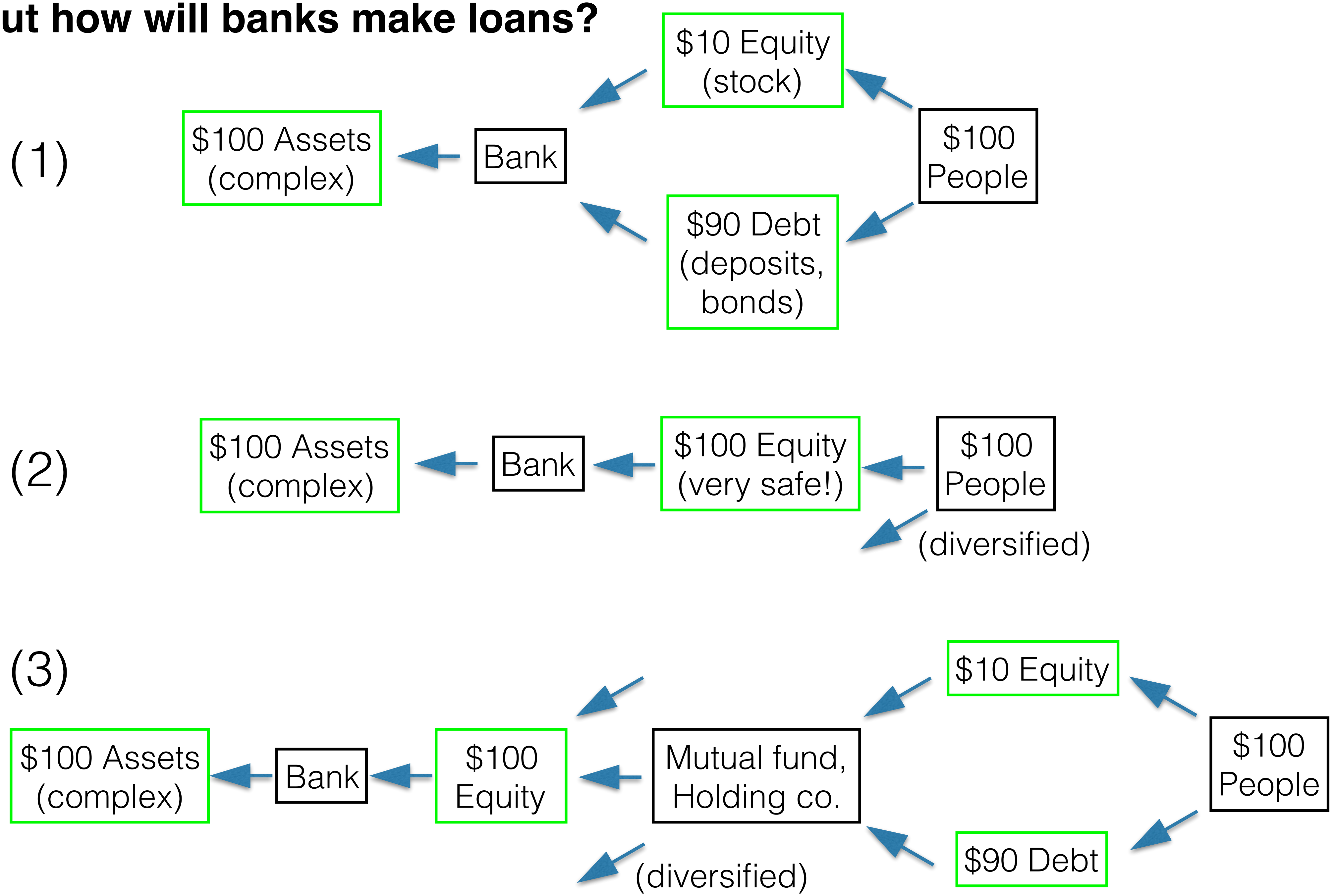
Premises

- Goal: End financial crises. Period.
- Not: End to big to fail per se.
- Financial crisis = systemic run.
- Not: Dominoes. Outsized losses. Dark ATMs. Holes in ground.
- Stock crashes = good. (Or at least not our problem.)

Vision before regulation

- Central problem: run-prone liabilities
- Answer: no more large-scale funding by run-prone liabilities!
- “Banks” finance their risky asset holdings with equity, (+long-term debt).
- Fixed-value “deposits”-> reserves, treasuries.

But how will banks make loans?



- Eliminating financial crises with 100% equity financed banking does not require any new money, any less credit or any additional risk taking

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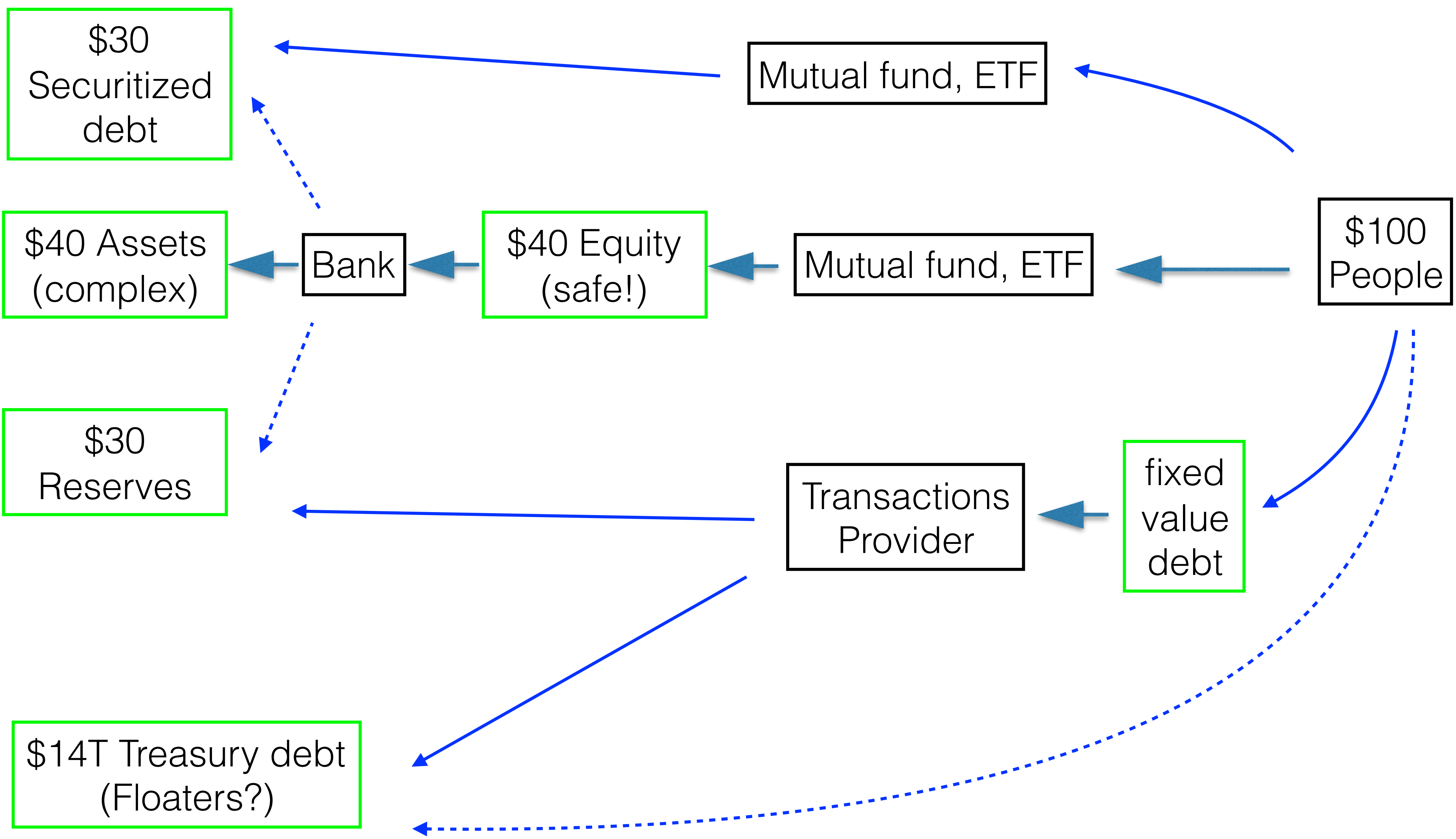
A more realistic structure



Getting there

Remove disincentives/bad regs first!

- Tax distortion
- Debt guarantees
- Regulations that encourage holding debt
- Capital gains tax
- Short term debt is poison in the well!
- ***Regulatory safe harbor***

Finally, a bit of stick:

- Not ratios, risk weights, etc.
- Pigouvian tax on debt, say 5 cents/ dollar
- Higher for high debt / market value of equity

Before you complain

- Costs and dysfunction of the current system.
- Current regulation lost in the woods.
- High hurdle for whining!