I'm Ezra Klein, this is The Ezra Klein Show.
So a bit of housekeeping before we get started, we are going to do another AMA episode pretty soon. There's really a lot going on and we need your questions. We're only going to hold this open for a week or two to handle the volume we get, but please send them over to EzraKleidShow at nytimes.com with the subject line AMA. So for my sins, I've covered a number of financial crises now and certainly read about a lot more. And I think it's safe to say this, every financial crisis is different and every financial crisis is the same. It's always something that a lot of people thought was safe. Mortgage-back bonds or banks holding bucketfuls of long-term treasuries isn't safe. We were wrong. And when we're wrong and we need to reassess how safe our money is or whether
we can get money on the fly, we panic. We try to get all the money out at once. We try to sell off what we think isn't going to be worth anything. We have bank runs and runs on money markets. And then the system goes into crisis. But notice that there are two parts to that problem. And so you can think about it differently. One is a part about being wrong, about something being safe.
And so the implication of that might be we always need to know what is and isn't safe. Regulators have to be more on the ball. Banks need to hold more capital and report their financial condition in ever more detail. They need to imagine what would happen to their capital if there was more financial stress. And because we can't do that for every institution at the level of granularity we wish, we really need to figure it out for the ones that we decide are important. And we need to do it for them double hard. But you can also look at the other side of that equation, the panic.
You can say, well, we can't always know what's safe. Life is going to surprise us. It always does.
So what we need to do is make it so no one really needs to panic, even if something isn't safe.
We need to panic proof the parts of the financial system that can't be allowed to fail.
That's how we stopped financial crises for a long time after the Great Depression.
The crown jewel of that project, and there was a lot of regulation and supervision,
that's all important too. But the crown jewel of that project was FDIC insurance. You didn't have to run and get your money out of the bank, even if you thought the bank was in trouble,
because the government would back your money up, no matter what happened to the bank. We panic
proved the banking system, and for a long time we didn't really have bank runs. My guest today, Morgan Ricks, he thinks we need to do a lot more panic proofing. He's now a law professor at Vanderbilt
University, but he's worked on both Wall Street and in the Treasury Department during the financial crisis. And he wrote the book, The Money Problem, to talk about the 2008 financial crisis. But the theory of it, particularly this idea of money as something bigger and more complex, and we typically give it credit for, it ends up being a very powerful way to think both about what went wrong in Silicon Valley Bank, but also what went wrong with the Dodd-Frank regulations that, yeah, allowed Silicon Valley Bank to happen, that did not stop this from happening.
So I brought him on to walk us through it, as always on my email as a recline show at NYTimes.com.
Morgan Ricks, welcome to the show.
Great to be here.
So let's begin this conversation back in 2009. You're working in the Treasury Department,
you're watching the global financial markets meltdown, and there is this split that emerges,
at least for you, between a dominant concept being systemic risk, how risky an institution is,

and the question being around panic-proofing these short-term debt markets. Tell me a bit about that split. It was a bit of a split. I mean, there were a lot of problems in the financial sector, and no one could deny that. And I was helping the team that was crafting Dodd-Frank, I was helping that team out, and we all agreed that there were a lot of problems. But I really thought there was one sort of preeminent problem for financial stability policy. And I thought it always had been, which was the creation of what I'll call private monies, and we can talk about that more a little later. But demandable and very short-term debt of the financial sector, that it seemed to me was really the central problem for financial stability policy, and I still think that. And so the alternate view was that that was a problem more co-equal with a bunch of other problems, and they were all sort of grouped under this catch-all phrase of systemic risk. And my view was always that that concept really wasn't that coherent. It was sort of a placeholder for our ignorance or indecisiveness in the sense that systemic risk could be, in the eye of the beholder, it was whatever you wanted it to be. And so I thought we needed to dig a little deeper and be a lot more targeted and specific. Well, we've had in the law a definition of systemic risk or a systemically important institution, which I think functionally means an institution we've decided is too big to fail. And for a while, that was $50 billion in assets, then there was a lobbying effort during the Trump administration, which got almost every congressional Republican on board, no small number of congressional Democrats, and ultimately the agreement of the Trump people. And that moved the systemic risk or importance level up to $250 billion in assets. That's been something people focused on a lot because Silicon Valley Bank was part of that lobbying effort, and they would have been considered systemically important if they had not been successful in getting that change made. So why isn't that a good enough definition? You could say, look, we have this $50 billion, we should have kept it where it was, and everything would be fine today. Well, you know, there's a lot of other financial institutions that are not banks. So the systemic definition that you're referring to is part of Title I of Dodd-Frank and applied to banks and bank holding companies, and then other companies that were
designated by the Financial Stability Oversight Council as systemically important. But you know, your listeners should know currently there are zero non-bank financial companies that are so designated. And so we have a big financial sector with a lot of different kinds of companies, including hedge funds below $50 billion or below $100 billion, whose failure I think could be really catastrophic. And so picking sort of a single cutoff is perilous. I mean, we could say, look, Dodd-Frank got it right, $50 billion is obviously the right number, but you know, you could have a circumstance where a smaller money market mutual fund or a smaller hedge fund below that size, threshold would really cause big problems in the financial sector. I think it's sort of fundamentally misguided to say this is a size-based test for systemicness. So then there's another piece of that, which is to stay in that regulatory change. The idea was if you classify an institution as systemically important, then you expose it to this higher level of regulation, of oversight, you give it stress test to see if its assets are good in an adverse economic scenario.
And I think one of the dominant narratives, particularly among liberals about what happened to Silicon Valley Bank is that it got out of this higher level of regulation. And if it had just been kept in it, we'd be fine today. Do you think that's true? I think it might be true. I mean, we can't run the counterfactual scenario where the 2018, you're referring to the 2018 changes that rolled back a part of Dodd-Frank. Yes. That was in the Trump administration. The Republicans

supported it. A lot of Democrats supported it too and changed this threshold from 50 to 250 billion. Silicon Valley Bank supported the change, lobbied for it, and it got them out of a lot of regulation and supervision. And it may well be the case that in the absence of that change, the supervisors of Silicon Valley Bank would have been more on top of things, would have been stress
testing the institution. But you know, it may not have been. One thing that's interesting about Silicon Valley Bank is that its big issue was interest rate risk and treasury securities.
Now, treasury securities, I mean, traditionally we think, I mean, if banks are going to hold something safe, that's sort of like the safest thing they can hold aside from reserve balances of the Fed itself. And we have a whole history in this country since really the 1860s of encouraging banks to buy more treasury securities precisely because they're safe. And so it's not completely obvious to me that in a stress testing scenario, if they weren't really looking very closely at interest rate risk, and the stress tests have not always looked at interest rate risk, that the supervisors would have necessarily seen it and caused them to shorten the duration of their portfolio or enter into interest rate hedges. I mean, the answer is maybe yes, maybe no.
One thing I think that gets at, which is interesting, is that one of the implications of basing things on systemic risk and oversight regulation, is it not only do you have to get right who is systemically risky, which say what you will, we have definitely gotten wrong. I mean, we said Silicon Valley Bank was no longer systemically important than when they failed, we decided they actually were and guaranteed everything that was happening over there.
But we also then have to be right about what kinds of risks are being posed to the system, that if what you're doing is trying to peer into a bank or financial institutions' innards and say, listen, are they healthy, then it's not just that they need to be healthy, but you need to be right about what might occur next. And to your point about the Federal Reserve Stress Test in 2022, they did not have the right forecast of interest rate risks. So it's very possible Silicon Valley Bank would have passed the test because the regulators would have been wrong in their forecast, just as Silicon Valley Bank was clearly wrong in its forecast.
So on the one hand, one of the good things I feel like about the Dodd-Frank rules is there's a fair amount of regulatory discretion, which maybe you want in a complicated industry. But on the other hand, fair amount of regulatory discretion means the regulators have to get it right and they have to get it right again and again and again. And if you have a correlated failure in terms of what the financial sector sees and what the regulators are paying the most attention to, then you could have a really big mess on your hands. I think that's really well put. It puts a lot of pressure on supervisors and regulators to really get everything right. And I think what we've learned through history is that's a really tall order. If you would ask people in 2016 or 2017 of Silicon Valley Bank, a bank that was loading up in Treasury securities was something we should be really concerned about, that has kind of a boring business model for the most part. I mean, its clients are exciting. Its depositors have exciting businesses, but Silicon Valley Bank was sort of a boring bank. And I think what a lot of people were focused on in the aftermath of the financial crisis of 2008 and 2009 was really large, complex financial institutions, as it's called in the industry, with lots of derivatives that are doing securities dealing that are prime brokers for hedge funds. And Silicon Valley Bank was none of those things. And I think it's quite natural for people to be looking at those kind of risks and not the kind of risks that Silicon Valley Bank posed. And so it does. It puts a lot of pressure on regulators and supervisors to be

very attuned to all types of risks, even some that we haven't really seen materializing quite some time. And that's a tall order. So this is where your book makes a pretty profound move in its theory of financial regulation. So the dominant theory, I think, has been to regulate in general institutions. Say, we've chosen these are the important ones, now we're going to cordon them off, we're going to look very closely at them, we're going to keep an intense eye on them, we're going to know a lot about their assets and their liabilities and so on. And you're saying that's a bit of a mugs game. And what we should instead do is panic proof the markets were worried about collapsing or the kinds of private monies to use a term that I think is going to become important here, that were worried about having default. So tell me about this idea of instead of focusing on institutions and their stability, panic proofing entire markets.

Yeah. So I mean, one way of thinking about this is, look, I make the argument in the book that really America's system of money and banking is broken. And sitting here today, we've had four emergency interventions in the past 15 years to prop up a system that was unraveling. That's the 2008 intervention, the Silicon Valley Bank intervention that just happened, the COVID intervention, which is in many ways bigger than all the rest of them. And then there was another intervention that is somewhat forgotten in 2019 where the Fed had to lend $300 billion to Wall Street securities firms to prevent markets from unraveling at that point. And so unless we do something fundamental, this is just going to keep happening. And so the argument in the book is that what needs to be dealt with is private money. And people maybe when you use that term will sort of think about Bitcoin. But that's not what I mean. I mean dollar-denominated stuff. You know, we're all thinking a lot right now about uninsured deposits. It was sort of Econ 101, that deposits are a form of money. We use deposit accounts as money. And banks are in the business of, you know, they have more deposit liabilities than they do actual currency on the asset side of their balance sheet. So they're really in a very real sense in the business of augmenting the money supply. The Federal Reserve and other central banks understand this. They include bank deposits in their measures of the money supply. And so when I say private money, I mean defaultable
money, money that is susceptible to default. So an uninsured bank account would be that kind of thing. You know, a dollar bill is a type of money that is not defaultable, right? It can decline in value, but there's no meaningful economic sense in which the Fed can default on it, right? That's the nature of fiat money. So the argument again in the book is that uninsured deposits and a lot of other types of private monies in the financial sector, issued by all sorts of institutions, are really prone to unraveling. And those unraveling events have a sort of self-fulfilling quality. And when that happens, that crushes the economy. And so these instruments are really the primary source of danger that the financial system poses to the economy.

And so that's maybe a little more long-winded answer to your question, but that leads you.

No, I actually want to go very slowly here. Because as you know, when we first spoke, it took me some time to grok what you were saying, but I think once it is understood, it's actually quite profound. So let me try to get at another wrinkle of it this way.

The word money is what I think you are pointing to as being confusing here. That when you say money,

I think, well, there's a thing, money, right? I have some of it in my wallet. I have some of it in theory in my bank account. And you're saying there's not really money. There's a spectrum of qualities one might call money-ness. So tell me about money-ness.

Yeah. So I think you're like most people when they think about money as a concept, you know, you're thinking about the green pieces of paper that we hand around. But bank deposits are also money. We use them to make payments. When I pay my mortgage, I'm not handing over a brief case of
dollar bills. I'm writing a check or actually doing an automatic transfer out of my bank account, but it's the same idea. It's being done through a deposit account. And so the deposit account really is money. Banks create deposit money in the course of making investments, making loans and buying bonds. And so the banking system is out there augmenting the money supply. And again, this is a well-understood thing within economics. There's also some other things. And this is where we get into the money-ness concept that are quite similar, but not quite as money-like as a bank account. And so if you think about another type of instrument most listeners may be familiar with would be a money market mutual fund. And they issue you shares. And you can't actually use those shares directly to make a payment. I mean, some money market funds offer payment services, but they do that because they connect up with the bank. And so the shares of money market funds, we all understand are money-like. They're kind of money substitutes, but they're not really transactable in the same way, say a dollar bill or a bank account is. So they're money, but they're a little less money-like. And then if you step back and look more broadly across the financial sector, there are several markets that have this sort of money-ness quality to them. And what they are is they're always really at bottom the same thing. It's very, very short-term or demandable debt denominated in dollars. And so that includes things like the repo markets, which people may have heard of or remember from 2008 that melted down, something else called the euro-dollar markets, which we might get into later if we want to dig deeper. But all sorts of markets. I hope not. That would turn out to actually be really important. I mean, the Federal Reserve put in place swap lines just yesterday, which has done on a number of occasions in the past, precisely in order to back the dollar-denominated deposit liabilities of non-US financial institutions. And so that's what those swap lines are really about. They sound really mysterious, but that's what they are. But let me zoom out on this, because even for me, I've covered financial crises. I've covered financial regulation. I've learned more about repo markets than I ever really wanted to know. The thing that is consistent here is that you have these money-like debts, which I don't think people think of a deposit this way. If you put money into the bank, you think, oh, my money is sitting there in the bank. I think the operative metaphor in your mind is actually a kind of storage. But no, what it turns out you have is a claim for the bank to give you back money. And they're actually not holding all of your dollars all at once, which people know if they think about it, but I don't think is the way we naturally intuit it. But then when you go up a couple of levels to the financial system itself, because they can't fund themselves by keeping $250,000 or less in a federally insured deposit bank, they are constantly funding themselves on short-term debt. So the way money works in the financial system, I think we assume Goldman Sachs has a lot of money, but what they really have is a lot of these claims on money. Is that the right way to think about it? Yeah, or they're issuing a lot of claims on themselves, just denominated in dollars. I mean, the way to think about a broker-dealer like Goldman Sachs is that it's funding itself with things that look like deposits from the standpoint of its counterparty. Its counterparty thinks of this as just a cash parking contract. It's called a repo, but that's part of its cash balance. The suppliers of repo financing call that cash. They refer to it as cash for accounting purposes

that's classifiable as a cash equivalent. And even central banks sometimes recognize repo claims as sort of a part of what they call the broad money supply. So there's all this financing in the financial sector where large institutions especially are relying on really overnight or demandable debt. And that from the standpoint of the counterparty that's financing them is functionally equivalent to cash. And they're using it as part of their cash balance. They're calling it a cash or cash equivalent instrument. And so now to bring these two things together, the reason this matters is, as you said a few minutes ago, the thing we typically call money, right, the dollars in my pocket, they don't default. They can lose value, but they don't default. There's not a world where all of a sudden the Federal Reserve is not going to use them as money. But these other things we're talking about, a deposit in a bank that is uninsured. So Roblox was keeping $150 million around in Silicon Valley Bank. So that is an uninsured deposit. That can default if the Silicon Valley Bank falls apart. The repo market can default. There are all these things that people are relying on as money that are short-term or demandable debt, as you put it, that can default. And the big point you're making in the book is that that is what financial crises are made out of. A default in a short-term debt market that people were relying on as functionally money, even though it wasn't actually money backed by the state. Yeah, that's exactly right. So a default or a fear of default, right? I mean, we didn't actually end up with a default in the case of SVB, but nonetheless, we ended up with a banking panic that the Fed had to step in and the Treasury Department and the FDIC and take extraordinary measures to make sure it didn't spread. And this is an idea, you know, there are economists who have been writing about this for a long time, Gary Gorton at Yale being probably the most prominent among them, who've written about this set of issues. And so I'm not the only one who to sort of conceptualize financial crises in this way. But it is the case that when you look across the sweep of U.S. history, the severe acute financial crises we've had that are associated with severe acute macroeconomic disasters, right? Deep recessions have all involved runs on private money. These things just seem to crush the economy in a way that other sorts of financial disruption don't crush the economy as much. I mean, the tech bubble bursting, right? There was a huge
amount of lost wealth. And we did have a recession. It was a fairly mild recession, though. Even the SNL debacle of the 80s, where deposit insurance had to be bailed out by Congress, we never had a panic in the system. And again, we had like sort of a really mild recession in the early 90s. But the really bad ones, the Great Depression, the panic of 1907 and the recession associated with that. And of course, the Great Recession that started in late, very late 2007 and 2008, all involved this run behavior. And I think there's a causal relationship there, right? I mean, this is something we can talk about also, just because there's correlation doesn't mean there is causation.
But I think there are good reasons to think that actually panics themselves really do crush the economy. Well, let's talk a bit about that. Because you do, I think, a nice job in the book of outlining these two sides of a debate, which is we often have an economic crisis of some sort that starts somewhere in what we might or might not call the real economy. But so for the financial crisis a couple of years ago, there was a problem in the housing markets. For the tech bubble burst in 2000, it turned out we had invested way too much in tech companies that didn't have an actual profit rationale. You can go back to the Great Depression, right? There are real things happening in the economy. And so one view of what happens is that the financial panic, the bank run, the

market crash, whatever, is a symptom of this actual problem. And until you fix the actual problem, you can't fix the economy. And then the other view is that really the damage comes from the bank run, from the financial panic, irrespective of what's going on in the actual economy. And you have a nice little lineage of that latter view, going back to Milton Friedman and Anna Schwartz, among others, that I'd like you to talk through, because I think it's an interesting argument. So I think you laid that out really well. I mean, there's sort of a natural human tendency to look at the panic in the private money markets and say, yes, but why did the panic happen, right? And to trace that back to some earlier cause, and there always is some earlier cause. I mean, in this case, in SVB's case, it was an increase in interest rates that decreased the value of their bond portfolio. And there's a natural, I think, human tendency to want to trace back the causal chain to the beginning, right? Go back to the big bang as close to it as you can to find the true fundamental cause. But I think that's actually a misguided way to approach policy. But there are sort of two sides of this debate and have been for a long time sort of two sides of this debate about whether we should care about the panic's proper, right? The panic itself, or whether we should be concerned about, say, boom and busts and asset markets that tend to precede the panics. You mentioned Milton Friedman and Anna Schwartz. They wrote sort of the definitive monetary history of the United States, which they published in the 1960s. And they took the money view, the panic view that I also adopt. I disagree with about Milton Friedman on many things. But this is one thing I think he got right, which is that the Great Depression was mostly a monetary phenomenon in the sense that the reason that we ended up with unemployment above 20% is that we had a massive monetary contraction in the banking sector. And Ben Bernanke's work has sort of expanded on that and looked at the effects of the panic on the asset side of banks' balance sheets. But the panic is really the central part of the story there and not the stock market crash of 1929, which did in some ways precipitate the panic. But Milton Friedman said, it doesn't really matter what precipitated it. What matters is the panic itself. We could talk more about the Great Depression. There are other contributing causes to that. The international gold standard played a partial role there as well. But I think most experts agree that the banking panic was a major driver of that recession.

So your theory and your book are written in the context of the 2008-2009 financial crisis. One of the reasons I wanted to talk to you here is that I'm always interested when a theory that is built for one moment ends up being explanatory in another. And I think that's been true with the collapse of Silicon Valley Bank and then the runs on a couple other banks. So tell me how you understand from this perspective what happened at Silicon Valley Bank and the damage it did or at least threatened to do to the economy. Yeah. So what happened is that depositors panicked. And there was a run on its deposits. And we could say there's a good reason for that run. I mean, they had lost a lot of money on their asset portfolio. Interestingly, that loss was known to the marketplace long before the depositors actually ran. I mean, SVB's fourth quarter earnings were released on January 19th of this year. And it showed the loss on their treasure securities that ended up being a big part of what spooked the depositors. But there was a run. And the bank didn't have enough cash to cover it. Now, if it was going to be contained just in that bank, then it's really no problem. You force the uninsured depositors to take a haircut, and everyone goes on with life. But the long experience with runs in these markets and what the Fed understands and what the FDIC also understands in the Treasury Department is that these things are contagious. There's a self-fulfilling quality to runs on money-like

instruments. In fact, the most recent Nobel Prize in economics went in part to Doug Diamond and Philip Divig, who are famous for having sort of modeled this formally, the self-fulfilling qualities of bank runs. And so they have this contagious quality. And when you see runs at one bank, you start to see runs at others. And then it swaps the system. And the result is, if not stemmed by the central bank or the federal government in some capacity, then you end up with the economy going into absolute free fall. That's the reason we care about this is because of the implications for the real economy. And again, I think this question about looking for the specific cause at Silicon Valley Bank, which in this case was rising interest rates that reduce the value of its bond portfolio, is to miss the forest for the trees. We're looking at a very specific cause, but the more general issue is the runability of money claims themselves, private money itself. And so my view is we really need to shore up the private money markets. And then we could worry a lot less about the particular types of events that could result in a run in the first place. One reason I find Silicon Valley Bank an interesting way to think about this theory and this question of money is when we're talking about financial markets like repo markets, one, people very little familiarity with that. And two, we don't treat that stuff like money at all. And so trying to mentally or conceptually reclassify it to say nothing of reclassify it under policy as something the federal government backs up is very unintuitive. But at Silicon Valley Bank, what you have is interesting because you have a cutoff in the same kind of asset beneath the level it's treated by the federal government as functionally sovereign, right? We will ensure and you deposit up until $250,000. And then in theory, although not obviously now in practice, above that we will not. So below $250,000, this is money and you are entitled to it. And if anything happens, a state steps in to make sure you get it. And above that, you're on your own. Now, we didn't do that, which I think shows that we don't really believe that we don't want money that people keep in a bank if it's $300,000 to actually be fake above the $250,000. And they're not fake, but defaultable. But that to me is the place where you start to see, I think, what you're talking about here, which is that you can have just through law the exact same kind of asset and part of it is public money and part of it is private money. And then there's a question of whether or not we really believe in that cutoff we've created. Yeah, well, we don't believe in it for the largest banks. I mean, I don't think anyone would tell you with a straight face that it would be conceivable for an uninsured deposit at JPMorgan, Bank of America, or Citi, or Wells Fargo, would ever be allowed to default in the event of the distress of one of those institutions. We would be courting economic disaster if we allowed that to happen. And so those are implicitly guaranteed, and we just have to confront the fact that that's true. We have a lot of small banks in this country where it's not uncommon when they go and solve it for uninsured depositors to take losses, because the FDIC is just convinced that it's not going to spread from there. And then there's sort of this mid range of banks. I would have thought SVB was on the smaller side in the sense that I would have thought that regulators and the FDIC would allow them to default on their uninsured deposits, but they didn't. And so there's this sort of gray zone in the middle when it comes to the size of the institutions. Stepping back for just one second, I mean, one thing you suggested is that the repo markets and these other institutional money markets might just be backed by the Fed. I think they are probably implicitly backed by the Fed. It keeps stepping in to protect those as well, just as it does for uninsured deposits in the SVB case. But this strikes me as a really, really bad way to approach how to deal with these issues, to be able to have institutions that are able to essentially create monies and have it

backstopped by the state without paying anything for that, creates all sorts of other problems and side effects that we shouldn't be happy about. In the Financial Times, Martin Wolf has a line where
he writes, banking stands revealed as a part of the state masquerading as part of the private sector. How do you think about that? That's the whole design of our banking laws. From the start of federal banking laws in the US, generally applicable federal banking laws, which really started in a Lincoln administration during the Civil War during a monetary crisis. What the federal government did was it chartered banks, federally chartered banks. Corporate chartering in the US is almost always by the states, but this is the one area. The federal government charters banks in order to issue the money supply. In fact, back then, they were issuing what were called bank notes, which were tangible dollar bill type things, but they were issued by banks. The federal government, the Lincoln administration, wanted to make sure all that stuff was really stable, all the notes were printed and had to be collateralized by treasuries. The way this was spoken about at the time is that they were delegating their sovereign power of creating money to these
entities that were created by the state for that purpose, that banks exercised delegated power. It was an outsourcing. It was very self-consciously an outsourcing arrangement. The National Bank Act of 1864 is still the core of our federal banking laws. It's the bedrock of all of our federal banking laws. We sort of lost sight of it. I think that's a big part of the problem, but that's just a way of saying that Martin Wolf is recapturing here the traditional understanding of what banks are and what their relationship is to the state.
So the federal government steps in at Silicon Valley Bank. They ensure deposits up to really any amount. They extend lending and other stabilization facilities to other banks, but you still begin to see a fair amount of contagion. It goes overseas to banks that are in a pretty different situation like Credit Suisse, which is now getting sold off to UBS.
Why are we seeing, despite the extension of the insurance here, so much fear and contagion?
Yeah, that's a great question. To think back to 2008, and I think this is something that Hank Paulson said, is that when problems erupt in these markets, you want to bring a bazooka and if you bring a bazooka, you might not have to use it is the idea. And so we could argue about whether the Fed and the FDIC here brought a bazooka. I mean, the real bazooka would have been if they could have announced a temporary guarantee of all deposits in the financial system. They did that in 2008. That's exactly what they did, and they guaranteed money funds and sort of tried to back every segment of the private money markets. This time around, they didn't bring maybe quite as big a bazooka, in part because they couldn't. They couldn't do a transaction guarantee of all deposits of all banks in the system without a joint resolution of Congress. That's a change to the law that happened in 2010. So they were a bit more constrained in what they could do. And it may be that if they had done something bigger, and we could argue about
what that might be, but that if they were able to or had done something bigger, that we would not have seen any contagion at all. It's hard to predict how these things are going to play out. Even after Lehman went bankrupt, the day after when bankrupt, leading economists, some of them were sort of cheering and saying, look, Lehman Brothers wasn't big enough to cause big enough issues in our economy. And I think in retrospect, that prediction sort of turned out to be wrong. So you just don't know how things are going to play out. And if your bazooka isn't

quite big enough, you can still see problems spread. And I think that's what we saw here.
So one of the historical arguments you make is that, and other people have made as well,
is that the inspiration we should look back to is a creation of deposit insurance, which
when it is created, when it covers far more of the money in the system, ends up creating a fairly
long period of banking quiet after I think what is fairly said to be a very loud period of banking
crisis before it. So tell me a bit about that history. What happens after deposit insurance?
And what do we learn from that now? I think this is a really crucial thing to understand
is that we've had this private money problem a lot in US history, but we fixed it before. We
fixed it successfully. So in the 19th and the first third of the 20th century, we were seeing
panics essentially like every decade on average. And they were really crushing the economy,
especially the Great Depression, which is partially, as I mentioned earlier, a consequence
of a widespread bank run. But we fixed it. We fixed it over time. And yes, deposit insurance was
the last piece of the puzzle that came in at 1933. But it was part of a larger and coherent
framework that came actually in three key pieces of legislation. First was the National Bank Act,
which I referred to earlier in the Lincoln administration. Second was the Federal Reserve
Act of 1913. And then the third one was the Banking Act of 1933, which did a couple of things. The
most important was deposit insurance, as well as the Glass-Steagall prohibition, which people
may recall was separating commercial and investment banking. And so once we did that,
the 1933 Act was sort of the last piece of the puzzle. And we had a really coherent system
at that point for dealing with a private money problem, which was for there to be a lot less
private money. So we essentially confined all private sector money creation to this set of banks,
and we backed it, for the most part, through deposit insurance. And this worked for 75 years.
We didn't have another banking panic, and we didn't have another recession on the scale of
the Great Depression or even the Great Recession. So what happened is that we let this legal system
erode, we degraded it and let it essentially collapse. And that started in earnest in the 1980s.
So I think the question is whether we can fix it again. But the broad takeaway, Ezra, is that,
yeah, you know, a key aspect of the way we solved the problem was we said, we're just not going to
have private money anymore. We're going to have public backing through the deposit insurance
system
of the money created by the banking sector. And we're not going to have money created outside
the banking sector. And that really worked. I think when something is part of our system,
I was thinking about this with public libraries, which I find it basically impossible to imagine
we would create today. But I think when something is part of the system, we can ignore mentally
what
a big cognitive or ideological jump it was for people to get there when it happened. And deposit
insurance always feels like this to me, that to go from a world where banking was quite profoundly
a private matter, I mean, there was some public regulation, but the idea that the government
is responsible for if you put your money somewhere that wasn't safe. It's not that nothing like that
had ever happened, but to do it so broadly. I think that was a very big jump. And there were
people who thought that was crazy, and it would create all kinds of moral hazard. And, you know,
it's very important for people to assess the risks they take and for banks to be exposed to the risks
they take, right? If you, you know, ensure all their deposits. And of course, they can do stupid
things. Can you just talk for a minute about that part of it, that sort of move from understanding
this money as private to public? Yeah, you know, I think about this kind of issue a lot because

I just think there's a lot of status quo bias in certainly in my field. And this applies to maybe every field I don't really know, but I can only really, really speak for mine. And I often wonder whether people who often seem so hesitant to do anything of any real size, as opposed to just incremental tinkering around the margins, would have voted if they had been in Congress for deposit insurance, right? Would have voted for the National Bank Act. I mean, these big moments, or the Federal Reserve Act, right? These big moments of discontinuous change, right? We're really doing something big. We're going to take a new and different path. And so, you know, deposit insurance, you know, when it was passed was very controversial. Actually, FDR himself was pretty ambivalent and somewhat pretty negative on it. And it was part of a bigger legislative package. But the idea had been around for some time. I mean, William Jennings Bryan had been championing, had championed deposit insurance in the very early 20th century. So it's something that had been sort of floating around in the air and ended up getting into the legislation. You know, I think the key thing to think about is that, you know, we were at a moment of utter despair as a nation at that point and economic catastrophe on a scale that had never been seen before or since in this country. And so that created the political landscape for really doing things that were discontinuous and that were big changes where we were taking a big jump. And I sometimes wonder, you know, look, I helped work on Dodd-Frank. I'm a big fan of big parts of Dodd-Frank. But I think in some ways we miss the mark. And I sometimes wonder whether we'll get another good chance to do something really fundamental without a crisis that again plunges us into a deep recession. And, you know, honestly, I'm as worried about democracy if that happens as I am about the economy. So I think it usually takes a really big crisis to get really big change. So you wrote a Washington Post op-ed with Lev Menand, arguing that we should do explicitly what now we appear to have done implicitly, which is to say that the current $250,000 cap, it's window dressing, you called it, and the government should formalize unlimited deposit insurance. So first, tell me what the best arguments you hear against that proposal are, given that we did step in to do this rescue. Why do people say we shouldn't do that for everybody as a matter of policy? And then tell me where you think they fall short and why you advocate it. Yeah. So the big argument against that is moral hazard, which has always been the argument against having deposit insurance in the first place by its opponents, but also against extending it. And so what's moral hazard? You know, this is a concept from sort of economic and finance concept. The idea is that if someone else is bearing at least part of the downside, then you have an incentive to take more risks as you get more of the upside. And so deposit insurance has this quality, right? It's the deposit insurer that's taking the downside if the bank loses a lot of money on its asset portfolio. But then it's the shareholders of the bank that are the winners. If the bank makes a lot of risky high interest rate loans and they pay off, right? That's great for the equity holders. And so if there's an asymmetry here in who's bearing the upside and who's bearing the downside, then that's what we call moral hazard. And it's a theory of incentives of bankers is what it is. And I think there's some problems with this theory when we think about getting rid of the deposit insurance cap, which said is that it presupposes that depositors are really monitoring the bank in sort of real time. And that they're going to run away from the bank when they see it taking more risks that might get into trouble. And that is what supposedly is going to discipline, be what's called market discipline on the bankers, not to take more risks. Because if depositors aren't monitoring the bank, then the executives, the bankers still have the incentive to take big risks because it's still externalizing the costs

of failure. It's just on the depositors, but not the FDIC. But from the standpoint of the banker, that really makes no difference. So the idea that deposit insurance induces moral hazard depends critically as a theoretical matter on the idea that depositors are sort of monitoring in real time. And we know there's lots of reasons in both theory and evidence that we see in the world that depositors, even big depositors, really just don't do that. So on the theoretical side, there's a whole body of literature. Gary Gorton at Yale, again, is a big contributor here and begged Holmstrom at MIT. There's a whole body of theory that explains why money market creditors like this or depositors, holders of what's supposed to be safe claims, really don't do credit analysis. And they shouldn't be expected to. They're what's called informationally insensitive. And so there's a body of theory here that suggests that's true. And there's also just a lot of evidence that we know in a lot of parts of the money market, where money market claimants just don't do credit analysis in real time. I think the counter argument to this is, well, didn't the SVB creditors, didn't those depositors pay attention and actually disappoint the bank? But this goes back to a point I alluded to earlier, is they only ran after SVB, if you'll recall, they had a failed equity offering on Wednesday evening, because they had just taken a big loss and announced that they had taken a big loss on a portion of their portfolio that they sold. And the equity markets, the stock markets, which are monitoring in real time and doing excruciatingly detailed analysis on bank balance sheets realize that this had big applications for their balance sheet and their earnings power. And it's only then that the depositors, when they saw, I think it was about a 40% drop in the stock from closing on Wednesday to opening on Thursday, that the depositors actually started paying attention. And somebody goes back and looks at the earnings release and says, oh my gosh, they have a lot of losses on their health and maturity portfolio. And then they all start in their chat groups or text groups panicking and running away from the bank. But it's not the case that the depositors had been monitoring the bank in real time. I would wager that zero of those depositors when the earnings release of SVB had come out back on January 19th had actually even looked or even probably known it was released, right? They weren't concerned about that. They weren't doing the monitoring. And if I'm right about that, then the whole theory that deposit insurance is creating moral hazard starts to look less compelling.

Well, let me offer another version of that theory. So I think you're completely right. The idea that you have a mid-sized auto parts company is sitting around assessing bank risk is ridiculous. But the system we seem to have at the moment is that if a bank like this fails, a federal government is going to step in and it's going to be the lender of last resort or it's going to be the insurer of last resort. And in fact, people are not going to lose their money. But you really don't want to end up in the situation, oh, you bank executive, because you're going to go down in history as a total failure. You're going to lose your job. You're going to be front page news for a while. Your entire bank is going to collapse. Your legacy is going to be gone. So there is a moral hazard problem here by going up to unlimited deposits insurance. And the moral hazard problem

is that right now banks are in theory at least fairly well incentivized to not become Silicon Valley Bank. You really don't want to be Silicon Valley Bank. You really don't want the reputation that Greg Becker, the, I guess, former now CEO has of the guy who let your bank or the woman who let your bank completely collapse on your watch. And that this is actually totally fine system that, you know, having this kind of slightly ambiguous situation where the government will step in if it gets bad enough. But because you don't really know what bad enough means,

your incentivized to not let it get bad enough is a bit of the best of both worlds because otherwise you're going to have too much of banks playing fast and loose with what ends up being taxpayer or somehow public money. Well, look, I mean, that's the situation. The largest banks are in any way because everyone knows that those are implicitly guaranteed. But look, you know, the way FDIC resolution usually works is the FDIC doesn't wait for a run to happen. They're monitoring the banks and so are the other supervisors. We've talked about the fact that that's not imperfect. But in most situations where banks are taken into resolution, it's before a run has ever materialized. If FDIC has just decided, look, this bank is insolvent on a balance sheet basis, their assets are worth less than their liabilities. And so that executive of that bank when the FDIC puts it into resolution has already gone down in infamy. It may be that the FDIC has covered a portion of the deposits and a portion of the losses has been borne by uninsured depositors. But failure can happen with the depositors still being honored by the federal government. Of course, that's what happened at SVB ultimately. And you don't need to have a run in order for that to happen. Maybe the FDIC doesn't hop in quite as quickly as you would want them to in a lot of cases. And I think that's true. That was definitely true in the 1980s, although we short up the law in 1991 to try to get them to do it better. But you don't need a run to have the FDIC wipe out the equity, wipe out the junior creditors, replace the management team and sell the bank off to someone else or put it in resolution. And that's a much less disruptive way than waiting for the run to happen. Because these runs on banks, it's a guillotine, right? And it's herd behavior, and the guillotine falls, but it so happens the guillotine is connected up to a nuclear bomb, and the nuclear bomb detonates whenever the guillotine comes down. And so the cost of this type of market discipline, this vaunted market discipline that we love, and that I love when it comes to equity markets, when it comes to longer term capital markets, bond markets. But when we talk about money markets, demandable and overnight debt, it is it's such a damaging form of discipline that we really should be willing to go to some length to avoid it. And I'll make just one more small point here, which is, you know, this is what equity capital requirements are also in significant measure about. When you have an FDIC insured institution, yes, it has insured deposits, but it has to maintain equity capital that's subordinated to all those deposits. So the first loss falls on the shareholder. The shareholder is going to go to zero. In the event the entity is taken into resolution. And that in itself, the existence of a significant layer of equity capital is the way that we think about usually dealing with moral hazard incentives. So one thing I hear you saying there is that the centrality of moral hazard to this conversation can slightly obscure what we're should be more worried about potentially, which is simply hazard. And if you take your argument, which to this extent, at least I do, that panics are a huge hazard to the entire economy, they seem to destroy semi healthy banks or even very healthy banks, if they get bad enough, they create all kinds of knock on financial problems, that the real hazard is not moral, it is systemic or it's financial, and that panic proofing important classes of private money or money like things is a thing that gets your hazard down and the morals are a little bit less important. Look, I think it's a mistake to turn these things into a morality play. And just to be clear, I mean, when I talk about getting rid of the deposit insurance cap, first of all, you have to charge banks and we do charge banks for deposit insurance, we're not charging enough. And if we were to scrap the cap, we should do it in conjunction with rationalizing and increasing the assessments. So the public should be compensated. But on the moral side, I'm talking about prospectively. So Silicon Valley Bank, I mean, I really have

pretty mixed feelings about that situation. I mean, what really calls me and always has is sort of changing the rules of the game in the middle, particularly to protect privileged segments of our society. And we're talking about startups, venture capital companies, Silicon Valley, you know, a center of wealth almost without parallel and the history of this country. And so there's a sense of unfairness that we change the rules of the game to bail out a class of citizens who we maybe shouldn't be all that concerned about in the grand scheme of things. And I agree with that. And my own feeling when I first heard that the bailout had happened was sort of a feeling of disgust. But when we talk about system design, that's not a moral issue about who's blameworthy and who deserves what, in my view, I think we should be trying to create a sound money, a sound monetary system, where money is as much a sovereign product as we
can make it. And that's what deposit insurance does. And that ultimately, we're down to the benefit of the entire public. And we shouldn't let the issues with SVB color our views about how to do policy going forward. So then there's this broader set of ideas about how to make more private money,
public money, how to create a system is a little bit more stable. And to stay on the banking side, as opposed to the sort of financial debt side, you have a proposal for Fed accounts. Tell me a bit about that. Well, this is a proposal with Levin and who you mentioned earlier, who I also wrote this op-ed about deposit insurance with and another scholar, John Crawford at UC Hastings. And so we wrote this a few years ago. And so the idea here was, look, there actually is one class of institutions, one segment of our society that actually has the ability to hold bank accounts at whatever size they want to that are absolutely fully sovereign and non-defaultable, no matter how large the balance is. And that class of institutions is banks themselves, because banks can hold their bank accounts and they do hold their bank accounts at the Federal Reserve. Those are not defaultable, no matter how large the balance. I mean, JP Morgan, believe it or not, has half a trillion dollars in its account. I mean, half a trillion dollars in its account at the Fed. And it's not doing credit analysis on the Fed and thinking about whether the Fed will default because the Fed can't default. There's no scenario in which the Fed defaults on its monetary liabilities. Those are as good as dollar bills from the standpoint of non-defaultability. And so all the banks in the country are able to maintain these accounts at the Fed. They're great. They're non-defaultable, no matter how large the balance. They pay very high interest. They offer instant payments. And so the question that the article asks is, well, what's the basis for that special privilege? Why should we restrict this to the banking system? Why shouldn't we let any business, large or small, any individual that wants to bank with the Fed to just have their bank account at the Fed? I mean, the Fed really is a bank. It's actually a set of 12 regional banks, but it's a banking system and it maintains bank accounts for customers. And it has an asset portfolio consisting mostly of Treasury and agency securities. And so why shouldn't I be able to have an account there if I want to? I'm legally not allowed to do that right now, but maybe it would solve some problems, including banking the unbanked and underbanked in this country. We have a pretty
large category of people who don't have bank accounts. And so this is sort of conceiving of the monetary framework. And bank accounts is more of a public good. We could speed up payments.
We can improve the transmission of monetary policy. We could reduce the amount of all these

private monies that are out there because more of them would just hold accounts at the Fed until we'd reduce our instability problems. And so when you start to think about it, there's this whole host of policy problems that can be ameliorated by the Fed account proposal. And so that was, yeah, that was a paper we wrote a few years ago. And do you see that as something that would be significant for financial crises or just a good public service that the government could provide and a way of directly bringing what is a public service money into actual public alignment?
Yeah, I think it's both of those things, right? I mean, so it should make crises a lot less likely to the extent you have migration, particularly of large accounts to the Fed. Well, then they're not holding defaultable private money anymore. And they're not there. You're never going to have the occasion to have a bank run if large balances are there. So part of it is crisis prevention, but part of it is, as you say, it's sort of like thinking of the Fed. Think of the Fed more like we think of the post office, where it's a big nationwide system that supplies a public good, the post office, which is something that's had an incredibly important role in the history and development of this country. And we could reconceptualize the Fed as something more akin to the post office that offers a really key sort of network or platform service to the whole population. And that seems to get at the underlying philosophical, political shift you're trying to push people to make, which is to, as I understand it, and tell me if this is wrong, to think of this whole class of heavily money-like obligations, objects, whatever you want to call them, as sort of public infrastructure. I mean, if we've learned anything from the past 15, 20 years, it's that whenever anything in this class of debts or monies begins to default, we do step in and we do treat it as public. And maybe a simple way to put it is we've simply not been willing to face up to the implications of that. If we're going to, this is going to be public whenever it is in trouble, but we're then not going to admit it's public whenever it's not in trouble. And so you do then get into this socializing of the losses, privatizing of the gains problem.
If we're not willing to let these things fall, then perhaps we actually need to say more of them should be something that the public has actual control over.
Yeah. I mean, look, it's control over the money supply. And I think right now we're in a situation where the Fed, the Fed doesn't control the money supply anymore. It's private money that controls the Fed. Private money says jump, and the Fed says how high. That's true in all these crises. And we're seeing tomorrow the Fed has a meeting to decide whether to raise rates. And inflation is still significantly higher than they want it to be. We've had some inflation prints that are a bit worrying lately. But all indications are that the Fed is not going to raise rates as high as it otherwise would have to deal with the inflation problem because it's worried about more SVBs, right? It's raised rates and caused problems for a few banks. Who knows what other banks are sort of teetering that it's not aware of and that if a 50 basis point raise in rates would cause other banks to fail, then the Fed doesn't want to do that. And so we have a situation where private money has started to exert control over what the Fed does and the size of the Fed's balance sheet. And there's all sorts of other problems I think that come. You spoke of privatizing gains and socializing losses. I mean, I think that's exactly right. And there's all sorts of other side effects of what amounts to the privatization of money creation without any public control, but with a public backstop. And it doesn't take a whole lot of reflection to imagine that a lot of significant trends in our economy in recent decades might be connected up with this from rising, ever rising asset prices and stock markets and bond markets and real estate and all sorts of other areas which boosts inequality. If you think about the growth of finance itself,

I mean, if the Fed and the federal government is writing a put option behind the financial system, you should expect it to grow. A backstop should cause the growth of finance and more financialization of the economy. And so I think it's actually bigger than just crises. We have to think about all the side effects of what amounts to privatizing public infrastructure.
Let me key into one question of the Fed accounts there that has always been interesting to me because you mentioned a minute ago, rising asset prices, rising inequality. One frustration of the Fed, not in the exact moment we're in, but in the post financial crisis moment, was it understood us as having then a pretty profound demand problem? And it wanted to get money out into the real economy. It wanted to get money into people's hands in a way they would spend it. But what the Fed can do is shift interest rates and give or backstop money for banks and other, it turns out through quantitative easing, other kinds of financial asset markets. And you'd hear the old Ben Bernanke thing that in this kind of situation, you want to drop money from a helicopter, but they couldn't seem to do that. And so you had this very frustrating situation where they're pumping money into markets that first and foremost benefited people who held a lot of assets. It was great if you were a venture capitalist or you used a lot of debt financing or whatever else. And by the time it reached somebody who didn't hold any assets, it was quite attenuated. I mean, it was a pretty small stimulus for them. And in a world where you had Fed accounts, in theory at least, it seems a Fed could just say, great, but he's counted 100 bucks in it now that it didn't have before. It is often seemed to me that given the level of economic intervention we have from the Fed, the fact that the nature of their interventions is so focused on the financialized side of the economy, and so distant from normal people is an asymmetry that we may not want to have forever.
Yeah, I mean, that look the Fed by its very nature acts through financial markets. And as a consequence,
you know, they're quite limited in how they can boost economic activity and support demand. And quantitative easing, which you referred to, was buying a bunch of financial assets, which boosts asset prices, lowers risk-free rates, which reprices assets across the economy, reprices them upward. So it's an asset price boosting intervention. And that's not to say it shouldn't be done. I mean, it also helped support employment, which is really what the Fed wanted. I mean, they don't want to boost assets in and of itself. That's not their aim. They're trying to boost employment and juice demand, but they just have a limited set of tools with which to do that. Now, on the Fed account side, you know, could the Fed, if we had Fed accounts, just credit money to accounts? And the answer to that is, well, boy, that would actually require a real legislative change. I mean, right now, to get money into JP Morgan's account, what the Fed does is buys assets from the, if it wants to put more reserves in the banking system, in other words, credit bank accounts of banks, it's going to go out and buy treasury and agency securities, which is going to sort of mechanically lead to larger balances within the banking system. So the Fed currently doesn't increase the amount of money by just simply crediting the accounts of the banks. And that would be more akin to fiscal policy, but I think Fed accounts would at least open the door to a more efficient way of doing that kind of stimulus.
I think it's a good place to end. Also, final question. What are three books you'd recommend to the audience? Three books. So I'm writing something right now on a different topic, which is the structure of our stock markets. I have a book on platforms that I'm writing. And so something I've taken an interest in is stock exchanges and how they've changed. And so the

first book would be Michael Lewis's Flash Boys, which is just an incredible, I mean, typically of Michael Lewis, an incredible story about change in our markets and the efforts of some people to try to make the markets work better. So that's the first one. Second, John Gertner's The Idea Factory, which is about Bell Labs. And what I always find fascinating about Bell Labs is it was arguably the most important engine of innovation in the 20th century. And it was a part of the regulated monopoly telephone system. So there's sort of a tension there that I find very interesting. And it's just a great book. And the third would would be Levin Ann's Fed Unbound, which is a historical treatment of a lot of the private money issues that we've been talking about and the Fed's role on how the Fed has really been transformed in the past couple of decades. Morgan Rix, thank you very much. Thank you. This episode of the Ezra Klein Show was produced by Roland Hew, Quistin Lin, Emma Bagau, Annie Galvin, and Jeff Geld. Fact-checking by Michelle Harris and Kate Sinclair. Mixing by Jeff Geld, original music by Isaac Jones. Audience strategies by Shannon Busta and the executive producer of New York Times, depending on audio, is Andy Rose Strosser. Special thanks to Carol Saburo and Christina Samuelski.