Joseph Stiglitz needs to learn what banks do and don't ...

Published: January 12, 2026, 11:31 pm

Prof Steve Keen of Kingston University drew my attention to an article by Nobel Laureate Prof Jospeh Stiglitz in which he writes about the current malaise in the world economy.

Much of what Stiglitz writes in that commentary is sound, appropriate and to be agreed with. Unfortunately, this but is staggeringly wrong:

While our banks are back to a reasonable state of health, they have demonstrated that they are not fit to fulfill their purpose. They excel in exploitation and market manipulation; but they have failed in their essential function of intermediation. Between long-term savers (for example, sovereign wealth funds and those saving for retirement) and long-term investment in infrastructure stands our short-sighted and dysfunctional financial sector.

Former US Federal Reserve Board Chairman Ben Bernanke once said that the world is suffering from a "savings glut." That might have been the case had the best use of the world's savings been investing in shoddy homes in the Nevada desert. But in the real world, there is a shortage of funds; even projects with high social returns often can't get financing.

The only cure for the world's malaise is an increase in aggregate demand. Far-reaching redistribution of income would help, as would deep reform of our financial system — not just to prevent it from imposing harm on the rest of us, but also to get banks and other financial institutions to do what they are supposed to do: match long-term savings to long-term investment needs.

As the Bank of England conceded in April 2014, the idea that banks act as intermediaries between savers and investors is just wrong. The fact that economics textbooks and economists still say they do does not, they argue, make that true: it just means that the textbooks and economists in question are wrong, they say. Which makes it all the more surprising and even shocking that here is one of the world's leading economists making what should now be seen as an elementary error.

The reality is that banks technically do not need any deposits to make a loan: all money is created out of thin air through the process of money creation that occurs in the lending process. And money is cancelled by the repayment process. In that case banks do not allocate savers money to investment when they make loans: they create new money to provide to investors, and they have not been willing to do that.

The relationship between deposits and investment is much more remote and complex in that case. Effectively deposit taking is a service utterly distinct from lending although historically undertaken by the same institutions. What the deposit taking does provide is capital to underpin risk at very low cost. That is because money deposited in banks ceases to be the property of the depositor: it becomes the property of the bank. What the depositor is left with is a loan to a bank that may, or may not be repaid (hence the bank deposit protection schemes that would not, otherwise, be needed). So the cash deposited then becomes the bank's risk capital in the event that they make poor lending decisions (as was seen in the case of Northern Rock). But that capital is a buffer to the bank, and not a source of funds for lending.

It is vital that these distinctions are understood now because if not serious policy errors and blame result, and we cannot afford to do that again.