

Well and Truly Buried

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Can a nation that cedes control of its money supply to private interests ever be seen as truly democratic? When something like 95% of broad money creation in a modern economy is due to lending by the private commercial banking system, should we panic over the 5% or so that's created by the excess of federal spending over federal revenue? Was the relatively widespread prosperity and brisk economic growth that accompanied the Bretton Woods era in the latter half of the twentieth century a fluke, or did a temporary subservience of the finance sector to the productive sectors of the economy play a crucial role? *The Production of Money: How to Break the Power of Bankers*¹ (Verso, 2017), by Ann Pettifor², prompts these and other questions. Pettifor's style is friendly and accessible even to those who have not yet sipped the Kool-Aid of modern money theory (MMT). This is a book you can safely recommend to your liberal friends.

In sweeping away the carefully placed obfuscations of "Keynsian" economists in support of big finance, Pettifor resuscitates the work of the great master J. M. Keynes. She urges us to dust off his playbook of theory and practice for tools to restrain the freewheeling lords of finance and to restore the finance sector to its role as society's servant, not master. If we seek to euthanize our rentiers, we will certainly want to give a careful listen to Pettifor and maybe undertake our own excavations from Keynes's "revolutionary monetary theory, his understanding of

¹ <https://www.versobooks.com/books/2706-the-production-of-money>

² <https://www.annpettifor.com/>

bank money, of the banking system and of how the rate of interest is determined.” We will need beware the public authorities, the finance sector, and the mainstream economists by whose hands these teachings have been “well and truly buried.” (p. 140).

Money is a social construct.³ Money is not and never has truly been a commodity, although there’s a highly developed narrative⁴ that relies heavily on mendacious notions like the finitude of money.⁵ According to Pettifor, Keynes sought to generalize to interest rates:

Keynes understood the rate of interest as a social construct, set according to the balance of conflicting economic interests. Keynes did not use the language of class, but his theory meant that the class struggle was very much a reality. But his was changed from Marx’s account in this respect: **productive industry and labor shared interests, and these were opposed by finance** — what Keynes called “vested interest” or the rentier class. Low rates of interest or cheap money favoured industry and labor. Dear or costly money at high rates of interest favoured finance. The progressive “euthanasia of the rentier” was for Keynes the price society paid for securing full employment, decent public goods and services, and economic stability. Given that the rentier was hardly likely to engineer his or her own demise, then the **assertion of public authority over the financial system was essential.** Until Keynes, finance had been jealously guarded by private authority. Today such public authority of the kind advocated by Keynes is rejected by mainstream economists, and even by many progressive economists. . .(pp. 85-86. **Bold added.**)

In the postwar years of the Bretton Woods era, applications of Keynes’s theories permitted some meaningful assertion of democratic management of the financial

³ ../money/is-money-complicated.html

⁴ ../getting-money-right.html

⁵ ../money/is-money-finite.html

system. That was not to last:

[F]rom the 1960s onward, private wealth, led largely by private bankers, in collusion with elected politicians, began to wrest control of the monetary system away from the regulatory democracy of governments. Today **the global economy is governed by a small number of actors based in private global banks and other financial institutions.** They manage the system in their own vested interests to the detriment of wider society. In the absence of any real political challenge from society, private wealth owners have used the public infrastructure of money, and their power over private money production, to amass astounding amounts of wealth. (p. 38. **Bold** added.)

Despite the intrinsically social nature of money and interest rates, the exercise of democratic oversight on those who influence the money supply and interest rates has been diminishing steadily throughout the neoliberal era, culminating in the sacrifice of millions of homeowners⁶ to save the banks in the aftermath of the 2008 financial crisis.

The foundation for the power of the finance sector lies in its legal authority to create bank money by lending.⁷ Understanding this basis for the bulk of money creation is essential in recognizing where power lies, and in undertaking to redeploy power along more democratic lines. Pixels by the billions are lit up around the internet in the service of decrying government deficits and national debt. But in reality, only about five percent of circulating money is due to the excess of federal spending over federal revenue.

⁶ <http://wallstreetonparade.com/2012/08/how-treasury-secretary-geithner-foamed-the-runways-with-childrens-shattered-lives/>

⁷ [../money/do-banks-lend-deposits.html](http://money/do-banks-lend-deposits.html)

As the then-governor of the Bank of England Mervyn King once explained, **it is the private commercial banking system that “prints” 95 percent of broad money** (money in any form including bank or other deposits as well as notes and coins) while the central bank issues only about 5 percent or less. In a lightly regulated system, it is private commercial banks that hold the power to dispense or withhold finance from those active in the economy. (p. 3. **Bold** added.)

The creation of money via bank lending requires the participation of a borrower who is willing to undertake the burden of repayment with interest and to risk whatever collateral the lender will require. Although Pettifor considers this “in a sense democratic” (p. 106) that seems quite a stretch to this reader in that qualifications for borrowing do not seem to correlate very strongly with those for citizenship. Nonetheless, there is valuable insight in recognizing the importance of demand in money creation. In times of exuberance, tolerance for risk will be high, and borrowers will be lining up for loans. Money creation explodes and inflationary pressures rise as more money chases limited assets and services. When asset prices rise accordingly, bigger loans are authorized against more valuable collateral, creating a self-reinforcing cycle that, unchecked, inflates a speculative bubble.

Conversely, as greed gives over to fear, risk tolerance plummets and borrowers flee so bank money creation too plunges, further contributing to deflationary pressures. As fear intensifies and demand falls, investments are cancelled or postponed and employees are discharged. As asset prices fall, loans go bad when the underlying collateral is devalued, reinforcing the deflationary tendency. These feedback mechanisms in enthusiasm and revulsion for lending are at the heart of perhaps the most useful theory of the business cycle, the financial instability

⁸ <https://www.perrymehrling.com/2015/09/minskys-financial-instability-hypothesis-and-modern-economics/>

hypothesis⁸ due to Hyman Minsky.⁹ Where once bank failures and fraud prosecutions put a consequence to reckless lending, today lenders can be confident of the backing of the central bank no matter how irresponsibly they deploy capital.

So what is to be done? Pettifor offers a handful of policy suggestions, possibly suitable for inclusion in our post-capitalist bag of tricks:

[I]f societies are able to mobilise political will to hold the finance sector accountable, what policies should be adopted to subordinate finance? . . . **[M]oney production must be managed and regulated in both the commercial and shadow banking sectors and in both the domestic and international spheres.** . . . [P]rivately created finance for productive activity should be encouraged, and priced at low rates. By contrast, money production for speculation should be greatly discouraged by the authorities and priced at very high rates of interest. . . . Governments could use [macroprudential tools] to **monitor and manage credit growth**, for example by monitoring and measuring private bank credit growth relative to a nation's GDP. Another way of managing loan production is by setting **standards for loan-to-value ratios.** . . . **Debt-to-income ratios and "leverage caps"** are standardised tools that central banks can require private bankers to apply. . . .(pp. 134ff. **Bold** added.)

Who could disagree that we need to manage and regulate money production in both domestic and international spheres, while discouraging speculation and encouraging productive investment? But the specifics above seem underpowered. Regulators can be captured. Speculation can sneak around. What we need to do is cut out the rentier bezzle. And here Keynes offers some useful guidance:

. . . Keynes's theory of liquidity preference explains that **interest rates**, and therefore economic output and employment, **can be determined and shaped by central banks managing the supply of and demand for government assets** (i.e. government

⁹ <http://www.levyinstitute.org/pubs/wp74.pdf>

bonds/treasuries or gilts). Interest rates are not determined, as many neoclassical economists argue, by the demand for savings. . . . Vital to the control of the rate of interest, argued Keynes, is the provision of a full range of safe government assets that meet those different and varied time preferences. . . . By creating, offering and managing a range of government assets to meet the demands of investors for liquidity over different time periods, the government can both exercise great control over its own financing costs, and also determine the rate of interest over those time periods in ways that reduce the financing costs of the private sector. (pp. 138-139. **Bold** added.)

Liquidity preference is an attractive policy hook. We could provide it as part of a public sector post-office bank service. The sovereign could offer savings instruments with variable terms and set an interest-rate term structure on that basis. Future payout programs could be purchased free of counterparty default risk. Safe annuities could be provided in combination with publicly maintained actuarial tables. Pension funds could prefund commitments with low volatility, free of default risk, and free of rent collection by investment agents. Predacious financial institutions would no longer be able to monopolize the market for private savings, leaving customers hanging or demanding public bailouts due to irresponsible investing behavior.

More good advice from Keynes when he tells us to shut down mobile capital:

Keynes understood that. . . **countries should actually close their borders to footloose, mobile international capital.** To do so, he advocated capital control: the taxing of cross-border capital flows. . . . [T]he financial transaction tax or Tobin tax is a form of “capital” control, a tax on and “sand in the wheels” of capital flows. . . . Keynes advocated controls over the mobility of capital, because “the whole management of the domestic economy depends on being free to have the appropriate rate of interest without reference to the rates prevailing elsewhere in the world.” (pp. 146-147. **Bold** added.)

Keynes aimed at a larger reform than he achieved: a global currency, the bancor, and an associated central bank for settlements between national central banks. Pettifor agrees that a global central bank would be helpful, but I have my doubts. Centralization tends to drift into tyranny. We've already seen the USG weaponize the reserve currency. The ECB hasn't been a great force for good either. Why should a sovereign nation willingly let any supranational institution hold it in thrall? Moreover, who can imagine the Fed handing over sovereignty?

Instead, we could use bilateral agreements between central banks to swap currency in support of trade. Replacing intricate agreements that immunize global corporations, central banks would just agree to swap funds. Now that would be a trade deal! The respective central banks could then auction the foreign currency to putative traders. Or just offer it at "list price", the notional rate at which the swap took place. Limiting transaction size might help discourage speculation. Could we close a rent flow for private currency traders thereby?

Quibbles over policy details aside, there's lots to like about this book. Pettifor has assembled a valuable bibliography of useful economic documents from recent times, including even a mea culpa from the IMF! (pp. 144-145) She directs our attention to what looks like a fascinating historical and technical treatment by Geoff Tily¹⁰ of Keynes's betrayal.¹¹ The mission of reinstating Keynes by careful study of his actual writings seems worthy enough for me to sign on. She alerts us to agnotology¹² in action: "By obfuscating the nature of their business, bankers have established a new kind of despotism." (p. 152)

¹⁰ <https://www.tuc.org.uk/person/geoff-tily>

¹¹ <https://www.palgrave.com/us/book/9781403996282>

¹² [../agnotology.html](https://www.agnotology.com)

Pettifor writes plainly and clearly, eschewing jargon. Educated laypersons should be comfortable with her prose. “Regulation” and “management” as light-touch course adjustments will not frighten liberals as yet unready to lay capitalism to rest, even if radicals may wish for a bit more ambition in policy proposals. She fails a little in succumbing to sovereign-as-household malarkey¹³ when she alludes to “tax revenues to finance government deficits” (p. 127) and urging governments to “spend and borrow” (p. 142). Central banker Beardsley Ruml knew better as early as 1946,¹⁴ at the dawn of the brief Bretton-Woods-era lapse of financial suzerainty:

The necessity for a government to tax in order to maintain both its independence and its solvency is true for state and local governments, but it is not true for a national government. . . Final freedom from the domestic money market exists for every sovereign national state where there exists an institution which functions in the manner of a modern central bank, and whose currency is not convertible into gold or into some other commodity.

Most importantly, Pettifor shines some long overdue illumination towards the well-shrouded origins of money in our society. The undemocratic sovereign-like power of bankers,¹⁵ vested in the ability to create money, is poorly understood by the populace and widely ignored by media and academia. That power almost entirely subtends our potential democratic sovereignty. Without ever agreeing to it or even knowing it’s happening, we’ve ceded the power of directing society’s investments to rentiers and speculators. The notion that private bankers create 95 percent of society’s money with little or no democratic oversight should be conventional wisdom and should guide our policies accordingly. We must bring

¹³ [../money/must-govt-tax-to-spend.html](http://money/must-govt-tax-to-spend.html)

¹⁴ http://www.constitution.org/tax/us-ic/cmt/ruml_obsolete.htm

¹⁵ [../money/unelected-sovereigns.html](http://money/unelected-sovereigns.html)

monetary sovereignty under democratic control.¹⁶ Knowing where it's gone — and who took it — is a good start. Exhuming the genuine teachings of Keynes will help.

¹⁶ ../money/democratic-sovereignty.html