Debt or Democracy

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## Public Money for Sustainability and Social Justice

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# *Introduction*

> A system that is based ... on the ability of profit-seeking institutions to create money as a by-product of often grotesquely irresponsible lending is irretrievably unstable ... ordinary tax payers are being forced to suffer in order to save a banking system that has brought them only excess and ruin. This is intolerable: indeed a form of debt slavery ... No industry should have the capacity to inflict economic costs that may even surpass those of a world war.
>
> Martin Wolf, Deputy Editor and Chief Economics Commentator, *Financial Times*, London (2014: 350)

Following election defeat in 2010 the outgoing British Labour Chief Secretary to the Treasury left what was meant to be a humorous note for his successor: 'I'm afraid there is no money – with kind regards and good luck.' This note was subsequently portrayed by the victorious Conservative-Liberal Democrat government as a confession of financial profligacy that justified the imposition of austerity to 'balance the books'. At the same time, the Bank of England was making potentially unlimited new publicly created money available to the banking sector. Why were private financial institutions being supported by public money while public institutions were being starved of funds or privatised? How could one arm of the state have run out of money when another arm appeared to have unlimited amounts? This is the question I want to address in this book. Why was there public money for the banks but none for the people?

'Where is the money to come from?' 'Who is going to pay?' are some of the most politically debilitating questions. Proposals seeking to achieve environmental sustainability, social justice or other progressive policies are rejected by the implication that money is in short supply. Public expenditure is presented as zero sum. Somebody has to pay. Any public expenditure must therefore be at the expense of the individualised 'taxpayer' or private 'wealth creators', who are

assumed to be reluctant to part with their money. Public expenditure then becomes politically problematic. However, public expenditure need not be zero sum; public money is not in short supply. The outpourings of new money to meet the financial crisis did not have a 'bottom line'. As the head of the European Central Bank declared, he would 'do what it takes'. Why did the banking sector trigger such largesse when the poor and vulnerable and the planet did not? While the people were subject to austerity, the financial sector quickly got the bonus culture rolling again.

### *Public Money for Private Rescue*

Following the 2007–8 financial crisis, governments and public monetary authorities around the world pumped huge amounts of money into their banking sectors. Banks were supported or nationalised, toxic debts purchased, bank deposits guaranteed and cheap money made available. Governments ended up spending much more than they could raise in taxes to bail out their banking sector through loans, investment capital, or outright nationalisation. Central banks released high levels of 'liquidity', that is, they made new money available to support failing banks. By 2009, US government and central bank action had totalled $10.5 trillion (Wolf 2014: 361), and Wray calculates that by 2012 the US federal reserve could have allocated as much as $29 trillion in loans and various other forms of support to the US banking sector (2012: 89). This is nearly twice US GDP. Britain and Ireland had to offer similar levels of support to steady their banking and financial sectors. Ireland in particular publicly guaranteed all bank deposits. Felix Martin suggests that the crisis overall may end up costing more than three times global GDP (2014: 303).

Making such huge sums available didn't mean that they were spent or lost. By being made available they prevented the threatened collapse. However, the proportion that was spent and the subsequent economic downturn caused severe problems for governments. The extra expenditure was compounded by a collapse in tax revenue so that public deficits increased dramatically. In the US the annual deficit went from under 3 per cent of GDP to around 13 per cent between

2007 and 2009 (Wolf 2014: 30). As a consequence, overall state debt rose; in the case of the UK from just over 40 per cent of GDP in 2007 to over 80 per cent by 2014. Rather than being grateful for such extensive public rescue, mainstream economic opinion turned on governments, accusing them of profligate expenditure and burdening future taxpayers with unpayable debt. Austerity was imposed as states sought to eliminate deficits and cut public debt, with the heaviest impact on the poorest and most vulnerable, particularly in Britain.

While political attention was largely directed to increases in government expenditure, less attention was paid to the much more substantial sums of money made available by the central banks. Unlike government expenditure, the ability of central banks to spend such large sums of money was not challenged. Although it was being 'spent' with an uncertain expectation of being returned, the central banks were not seen as borrowing the money they dispensed and therefore it did not contribute to totals of state debt. This is because central banks have the privilege of being able to create money. More than that, they are expected to create money. They are seen as the source of public currency for the whole banking system. Why, then, are they not a source of public currency for the people? This question is central to the choice between debt and democracy.

## *Debt or Democracy*

It is not contentious that public monetary authorities have exclusive control over the issue and circulation of national currencies. It is one of the most closely guarded national privileges, particularly for bank notes and coin (cash). As I will show, this right to create the public currency descends from the autocratic powers of rulers. The question is, why has it come to rest with central banks, rather than with states more generally? More importantly, how has this power been made available to the banking sector and not the people?

The problem with issuing new publicly created money through the banking sector is that it is only accessible as loans. As a result, the public currency supply has been privatised as debt. New public money only emerges when governments, businesses and individuals take on more debt. The main response to the crisis was therefore to pump

more money into the banks hoping to get the great lending machine going again. Unfortunately, the main borrowers were in the financial sector itself, driving asset inflation, mortgages and speculation.

A money supply based on debt must end in crisis if debts can no longer be sustained. Banks had to be rescued not just because they were too big to fail; they were also too central to the creation and supply of the public currency. Even investment banks that were not supposed to directly interact with the public money supply had to be rescued, because they were so tied in to the banks' debt machine. This lesson was learnt when Lehman Brothers, the fourth-largest investment bank in the US, was allowed to fail. It had no automatic public guarantee as it was not a high street bank that took customer deposits with the obligation to refund them. It took only investor's money which was supposed to be subject to risk. However, the supply of national (and international) currencies had become so entangled with financial investment, borrowing and speculation, that Lehman's collapse threatened to take the whole commercially based money supply system down with it. Without large-scale, prompt, public action an unstoppable run on the largely insolvent banks could have been triggered.

The supply of new public money does not need to be circulated only as debt. When central banks create new money they do not borrow it from anyone: it is debt free at the point of creation. In fact, this is how I define public money. It is money that does not have any other origin – it is created by fiat, that is, on public authority alone. This meaning of public money must be distinguished from public funds perceived as money extracted by governments from the wider economy through taxation. Public money in this book refers to *new* money created by public monetary authorities. The crucial question is how does this money only become available through debt? That is a political question. There is no 'natural' way for public money to enter the economy. Whether it is spent, lent or allocated is a political choice. But it is one that people are not aware can be made. Why is there no democratic framework for the creation and circulation of that most public of institutions, the public currency? Worse, the public sector is seen as just another borrower. There is no public right to public money.

What the 2007–8 crisis shows is that if there is to be meaningful democracy in modern societies, there needs to be public debate about the balance between private control of, and public responsibility for, the monetary system. The size of the bailout by central banks and governments shows how dependent the banking and financial sector is upon publicly created money and public expenditure in a crisis. However, it is the public that then ends up in debt.

### *Public Debts and Deficits*

While central bank support for the banking sector met with very little public comment or criticism, the position was very different for governments. When the budgetary impact stemming from the crisis drove them into deficit, there was an adverse political reaction. This is because they were deemed to be borrowing the money they spent, even when they were drawing on newly created money from the central bank. The public origin of this money was obscured by the claim that it is a debt that the public must repay. Given the debt relationship is between two arms of the state, who are the public in debt to? Are they not in debt to themselves?

This confusion occurs because central banks hover between the state and the banking sector. They are bankers to both. As I explore in Chapter 5, central banks are Janus-faced, combining the sovereign power of money creation and the commercial face of lending. I will argue that this confusion of roles has been central to the privatisation of the public money supply. The dilemma of government 'borrowing' publicly created money is resolved by the central bank selling the government debt to the wider banking and financial sector. In effect this means that the public are indebted to the very sector they are rescuing.

I will argue that the notion of public debt is largely an illusion reflecting the way that public money systems have been privatised in capitalist economies and the particular way central banks have developed. Deficits do not increase public debt if they are financed by new money. I will make the case that new money is continually being created by public authorities as they spend and by commercial banks as they make loans. While money created by banks always

becomes a debt to the bank for the borrower, money created by public monetary authorities is not owed to anyone or by anyone. Declaring this public money to be a debt reflects the ideological economics of capitalism and the privatisation of the public money supply as a commercial commodity.

As discussed in Chapter 2, the history of money, and contemporary examples of social money systems, reveal a very different concept of money than that employed by conventional economics. Far from the public sector being dependent on the so-called wealth-creating sector, I will argue that the private sector is parasitical on the public capacity to create and guarantee the public currency. Central banks, with their ambivalent status between the commercial banking sector and the state, are in reality a symbol of the failure of commercial banking to create sustainable monetary structures. In fact, it is not only when it is in crisis that the banking and financial sector is dependent on public money. It also relies on the social and public nature of money in its daily workings. Socially trusted and publicly authorised money is essential if profits are to be realised in commercial exchange and capital is to be accumulated. The critical question is who owns and controls the supply of that money? The privatisation of money in capitalist economies means the private sector has developed a stranglehold on the public sector through the actual and ideological control of public funding. This I describe as 'handbag economics'.

### *Handbag Economics*

Public services, public welfare and public infrastructure are all under attack from the ideology of 'handbag economics'. A handbag (purse) is here seen as symbolic of the public, as a 'housewife' dependent on an allowance from the capitalist 'head of household'. Handbag economics constantly reiterates a 'public as household' analogy that is rarely contradicted by mainstream opponents. All public activity is portrayed as a drain on the 'wealth creators', taken to mean the private economic sector, or the 'taxpayer', taken to be a purely private individual. All public funding is assumed to have been extracted by taxing the private sector. That this is a false view is clearly demonstrated by the huge

outpourings of new public money from central banks in the face of the 2007–8 crisis.

However, given the dominance of handbag economic ideology, the rescue money has been represented as either public debt, money that the state has 'borrowed' from the sector it is rescuing, or as just a technical creation of public money by central banks to deal with the specifics of the banking crisis. As a result, while money is poured into the banking sector, the public is subjected to austerity and the assets and institutions of the public sector are stripped bare (Hudson 2013). Nevertheless, despite the attack on public funding, the public capacity to create and spend money has not ceased to exist. Instead, it has been suppressed through the 'independence' of the central banks from democratic governance, and derided as 'printing money' – unless it is to rescue the banks.

One of the triumphs of handbag economics is its main bag-carrier TINA: There Is No Alternative. While I will argue that there are many alternatives, TINA correctly represented the situation at the time of the banking and financial crisis. There was no effective challenge to handbag economics – there was, quite literally, no alternative. The left had an analysis of productive capitalism, even of finance capitalism, but it had no analysis that could respond to a crisis of money itself. One of the weakest areas of opposition was the lack of an alternative conception of the role of money and banking. Although there had been many voices analysing and critiquing the money and banking system over the previous hundred or so years, not least Keynes, progressive movements and parties had not picked this up. Questions about the supply of public currency, its creation and circulation, have been largely ignored by both right and left. Both see it as secondary to 'real' economic forces, that is, the capitalist market. For the left, the whole discussion is an irrelevance to the wider critique of capitalism. This is unfortunate, as the history of money fits well with the Marxian framework, as I will show. However, in mitigation, the monetary critiques come from a wide range of political perspectives: from radical calls for the democratisation of the money supply to right-wing demands for an equivalent to the gold standard.

The case for a politics of money is that far from spreading wealth, the privatisation of the money supply and the financialisation of

society have led to a dramatic increase in inequality and the growth of fabulously wealthy financial elites. As governments lost control of their money systems and became trapped by them, the public lost faith in political democracy. Enormous financial wealth flowed around the world, paralysing government capacity to use tax as a means of redistribution. Instead of contributing to the welfare of society, the financial rich were profiting through investment in state debt: 'by replacing tax revenue with debt, governments contributed further to inequality, in that they offered secure investment opportunities to those whose money they would or could no longer confiscate and had to borrow instead' (Streeck 2014: 43). As Streeck points out, as state debt rose, democratic participation fell. The sense that there was no alternative led to disillusionment that political participation would have any effect. Worse, the public were responsible for a monetary system they could not control; they faced austerity to support the integrity of the monetary and fiscal regime. But if the people as a whole are held responsible for the money issued in their name, the public currency, they should have a democratic right to determine how that money is used.

In recent years, radical theories around money have developed a depth of analysis better fitting the reality of modern money and finance that is pushing at the door of a failed neoclassical economics and neoliberal philosophy. Drawing on historical and contemporary monetary analysis, I will put forward a radical perspective on money that challenges capitalism and conventional economics. It will open up the possibility of creating an economic democracy that is based on green and egalitarian principles.

For this, an understanding of money is necessary.

### *Understanding Money*

Money is something of which nearly everyone has immediate knowledge. Most people would not leave the house without money, and children often receive pocket money at an early age. Not having money creates a severe social, economic and political disadvantage. However, identifying what money actually is and what it does, is more difficult. Its form may be represented by coins, notes, plastic cards,

bank or mobile phone data or a range of other forms from stones to wooden sticks. In terms of functions, economic textbooks generally list money as acting as a medium of exchange or payment, as a way of measuring relative values and as a store of value over time. There is considerable debate about what these mean in practice and which are the most important. However, the basic concerns here are not just what money is or does, but how its form and supply are controlled. In conventional economic thinking this question is rarely asked. Money is assumed to appear in the economy as commercial necessity demands: that economic activity somehow creates money. This presupposition leads to the assumption that having money is evidence of having created some form of economic value. The rich deserve their wealth because they must have done something to have earned it.

This benign view of the rich would be very different if they were known to be, directly or indirectly, able to simply create that money. In reality, rather than competing for a fixed stock of money where the winner was assumed to have been the most effective, efficient or productive, the wealthy have merely expanded the money supply with themselves as beneficiaries. It is not without note that the vast expansion of the financial sector and its culture of huge bonuses were accompanied by a dramatic increase in money supply. Total bank balances were exceeding GDP many times over, most notably in Iceland and Ireland. Even several years after the crisis the state-rescued Royal Bank of Scotland (RBS) had a balance sheet equivalent to UK GDP.

### *Money is Social and Public*

My focus in this book is public money, that is, the creation and circulation of the public currency by public authorities. Currency is often taken to just mean cash, notes and coin, but I will take it to include all forms of money that people readily accept in payment: credit or debit cards and transfers between bank accounts using various forms of technology. In modern economies there is a contradictory approach to how money is created and circulated. While it is accepted that public monetary authorities create and control the public currency, money is also seen as being 'made' in commercial

activities. Under handbag economics the commercial role of money is seen as the most important. While not disputing the centrality of money to commerce, I want to rescue the social and public nature of money.

Although money has a long social and public history, conventional economics tends to see it as a natural adjunct to the market. This is justified by the assumption that the origin of money was linked to both precious metal and commerce. As I will show in Chapter 4, the history of money reveals that it did not emerge from trade or gold; it is much older and broader than both. Historically it has been created and used in social and political contexts as much as in commercial ones. Early histories indicate that traditional societies had forms of money for social purposes such as injury payments, dowries or tribute. Military societies such as Rome used money for imperial conquest. Theocracies used money systems to build and fund temples and priesthoods. There are also many contemporary examples of people creating new forms of money such as local or internet currencies. Rather than emerging 'naturally', money systems are built on social custom or public authority; they are social and political constructs. Even today, the public currency in all its forms relies on social and public trust. People trust that bits of metal, paper, plastic and bank records will be honoured by others when presented.

While social money depends on traditional customary use, or newly adopted social agreement, as in the case of contemporary local money schemes, modern forms of money are mainly represented by public currencies supported by public authority. Public authority here embraces monetary institutions such as central banks and state treasuries but also the wider public itself who honour the publicly designated currency (that is, the authorised currency in all its forms) by supplying the labour, goods, services and resources it represents.

Public reaction to bank failure shows that depositors themselves see the money system as a state, and therefore a public, responsibility. When in 2007 the British bank Northern Rock found itself the dead canary in the coalmine heralding the future crash, the bank's chief executive unsuccessfully tried to stop the bank run, as did the Governor of the Bank of England. Only when the Chancellor of the Exchequer, Alistair Darling, put the full authority of the state behind