The future of money

The financial crisis has shattered the neoliberal illusion that a globalised banking and monetary system can operate independently of traditional state support and regulation. But the reforms that have so far been proposed, as bankers rush to return to the pre-crisis bonus culture, do not go nearly far enough, argues Mary Mellor. If the people have to prop up the system when it fails, why should they not also have control over the supply of money in the first place?

At the height of the financial crisis, the total public financial exposure in rescuing the world's financial systems was around $15 trillion - a quarter of world GDP. Most of this was not used, but the existence of public backing prevented a worldwide collapse of financial institutions. This vital role of the public sector has in practice been ignored, as the surviving banks return to the bonus culture, benefiting from reduced competition and further state support through, for example, quantitative easing (increased money supply).

Not all states could support their bloated financial sectors. Iceland collapsed with financial commitments up to ten times its GDP. Britain, with a financial sector worth around five times GDP, could have faced similar problems. Globally the financial sector eclipses world GDP by at least ten times.

Finance is not private

Why do governments feel obliged to spend untold billions rescuing the banks and financial sector when other businesses are often left to fail? The answer is that the financial sector is not a private sector at all. It embraces a public function, the issue and circulation of money - something that has been appropriated by private capital.

The contemporary banking and financial system has hijacked this public activity for its own benefit. However, when the financial system goes into crisis, the need to retain this public function means that it becomes a liability on the public, as represented by the state or equivalent monetary authority. As John McFall, chair of the UK Treasury select committee, wrote (Guardian, 9 January 2009), 'After the extraordinary self-induced implosion of the financial system, the future of the market system now rests in the hands of governments. The politicians are the only show in town.' The financial crisis and the public response have revealed both the instability of the global financial system and the importance of a public monetary authority of last resort.

The latter half of the 20th century saw a rapid growth in the financial sector as people became enmeshed in debts (particularly consumer debts and mortgages), as collective and public financial security was abandoned in favour of personal investments (particularly pensions), and because there was benefit to be had from inflated financial assets (particularly housing). Even institutional investors were tempted by the promise of higher profits in the most speculative areas, such as hedge funds.

With such a large proportion of the population entangled in the financial system, a demand for public rescue became more likely. A collapse in the financial system is much more threatening to social order than failures in the productive sector. If one factory fails it does not automatically close the rest (they may even benefit from less competition). But if a bank fails the panic threatens to become systemic as people lose confidence in the banking system. This alone was a major reason why states had to step in.

The need for state intervention has exposed the contradictions of financialised capitalism and its reliance on 'Wall Street socialism'. A pivotal point was the rescue of the US investment bank Bear Stearns. The US monetary authorities were not only bailing out the retail banks, but finance capital as well. When the US Treasury later tried to isolate the investment sector by letting Lehman's fail, there were nearly fatal consequences for the banking sector. The financial sector was so interconnected that a crisis of default in the US subprime sector could bring down a relatively small bank in the UK via the functioning of the global money market and the drying up of credit.

Public foundations of the financial system

The financial system is concerned with the issue and circulation of money. Within capitalism the aim is to direct money to the most profitable use.

Money is a strange phenomenon, real and yet not real. In essence it is a promise. Holding money is a claim on any resources, goods or services that are denominated in money terms. However, for these claims to be realised, the sellers of resources, goods or services must trust in the continued value of that money.

Historically, money has been made of a commodity that can itself be resold, such as gold, but today it mostly consists of base metal, paper, or merely electronic record. People trust it because convention and experience tells them it will be honoured. It is also backed by a public monetary authority as legal tender that has a stated value.

This is critical to public responsibility for money. All monetary activities designated in pounds are collectable from the British banking system (or its international agents). Underlying the whole banking system is the Bank of England. Despite it having been made independent in policy terms, the Bank's authority rests on the financial viability of the nation in terms of its productivity (GDP) and its ability to collectively assemble money through taxes.

As has been shown in Iceland, the people, through the state, are forced to take on financial liabilities created by the private sector. If a company produces a car that ceases to function, the owner does not go to the state asking for a new one. With money, however, this is exactly what the holder of that money will do. People invested in Icesave, the Icelandic online bank, because it offered higher interest. Despite the fact that the bank was linked to a small country of only 300,000 people, investors did not see it as a risky investment.

When the parent bank failed, depositors turned en masse to the British government and demanded payment in full. In order to secure the safety of its own banks, the UK lent Iceland the money to repay deposits - a huge debt on the Icelandic people against which they are now protesting.

How could Iceland's banks have financial commitments several times larger than its economy? Partly this was because the banks took in deposits from around the world, but mainly it was because banks can themselves create money. They do this by issuing bank credit - loans.

Capitalism has been built on bank credit. Traders and companies have borrowed bank money to set up their businesses. Recently most credit issue has been related to consumption or financial investments such as housing. The illusion is that banks act as intermediaries between savers and borrowers, but that is not so. Banks take in deposits, some paying interest. They also issue loans and charge interest. There is no direct relationship between savers and borrowers.

All deposits are returnable, regardless of what loans are still outstanding. Banks can also lend much more than they have in deposits, traditionally up to ten times more and even more in recent years. This is how financial sectors can explode in total value, eclipsing the productive economy and inflating financial assets.

Recently bank lending has contributed to the vast use of 'leverage' to enable the investments of the rich to go even further. Hedge funds, private equity investments and the investment arms of banks use borrowed money to inflate their speculative gambles. Some of these may even be gambles against the banks themselves or the national currency. As more money is issued it floods into the financial system and becomes part of the waves of money looking for a profitable home. As it is impossible to separate the interests of bank depositors or pension holders from financial speculators, in a crisis the whole system must be secured.

In such a crisis, the public underpinning of the money and banking system becomes clear. As all bank-created credit is designated in the national currency, this becomes a liability on the state. The logic would be that such a public liability should also be seen as a public resource. If the people are to be made ultimately responsible for whatever money is issued in their name, should they not have a say about how this money is used?

Far from having democratically controlled access to the process of credit issue, the public, as represented by the state, has itself to borrow from the capitalist owners and controllers of the nation's money supply or tax money for public expenditure as it circulates. Today more than 95 per cent of money issue is through bank credit. Historically states controlled much higher levels of money issue as coinage. As expenditure on social or public needs are seen as secondary to privatised economic forces, the private sector determines how much public expenditure can, or cannot, be 'afforded'.

Privatised control of money issue creates the impression that it is the private market that is creating wealth. Certainly it is making money, quite literally, largely through issuing it to itself as leverage to swell speculative trading. Private ownership and control of money issue has created huge differences of wealth. The mass of the people can only hope for a trickle down of economic activity through the consumption of the champagne-swigging traders and increasing numbers of billionaires. On the illusion that the manipulators of money have actually generated the wealth they gamble with, those playing the money markets demand a huge percentage of the product. The levels of pay and bonuses have become so obscenely bloated that they have become an economic 'gated community' set apart from ordinary mortals by their wealth. In fact they have stolen what should be a public resource and harnessed it for private benefit.

The contradictions of privatised finance

Financialised capitalism rests on its capacity to create credit to lend to itself to inflate its speculative profits and financial assets. But financial asset inflation is always a pyramid scheme, whose value will collapse as soon as there are no new investors.

Traditionally states had a concentration of financial power through their ability to issue money as currency and tax it back. Capitalism has similar power through its control of financial resources. It creates money and calls it back with interest. This puts a growth dynamic into the economy. More money must come back than has been issued; this in turn demands that more money be created.

The neoliberal rationale for private control of money issue is that the market is more 'efficient'. This is despite the endemic tendency to crisis in financialised capitalism. People have been encouraged to trust their future security in terms of pensions and savings to the financial markets, which in itself creates the conditions for a boom.

While hedge speculators can make money on rising or falling assets, for most people money can only be made on inflating financial assets such as housing or equities. This requires constant creation of credit to fuel the new buyers, a phenomenon that was clearly seen in the mortgage market. When the market has peaked and no one is willing to take on more credit, or the borrowers can no longer pay, the value of the financial assets must fall. Even in the case of hedge speculators, winners will be balanced by losers.

Why were the banks so desperate to lend money recklessly to homebuyers and to develop such complex financial packages? The answer lies in the demand for increased profits to raise dividends and share prices. The bonus strategy of payment in shares also drove this. In such a situation banks engaged in the most profitable aspect of banking, which was also the most risky. It is not without irony that financialised capitalism fell because of its exploitation of the very poor. As capitalism runs out of a market for its goods, services or investments, all that is left is the poor. In the case of financialised capital this was the subprime householder. However, the subprime borrowers did not cause financialised capitalism to fail; the cause was its own contradictions.

Profit-driven banks must always be tempted towards speculation, no matter how many firewalls are put up between deposits and investments. For this reason the calls for narrow banking or smaller banks will not work. As long as the companies running the banks are driven by capitalist values they must be driven by the drive for profit, and therefore risk. This would not be so important if the activities of the privatised banking sector were not a liability on the public. But the financial system is interconnected and the only way to save some parts is to save the whole. The speculative sector can only be separated if the deposit-based sector is not part of the capitalist system and if its credit creation capacity is brought under democratic control.

The private control of banking and finance is fundamentally flawed in that its neoliberal claim to financial freedom is in contradiction to the social foundation of money systems. The crisis has also undermined the claim that through global financialisation a substantial portion of national populations can sustain their economic future through appreciating financial assets. Far from 'rolling back' the state, the implosion of deregulated finance has directly contradicted the neoliberal case that the market and its money system is a self-regulating process that would be distorted by state intervention.

Under the illusion that money was a neutral representation of the wealth of the market, financial institutions operated far and wide. Financial traders speculated on currencies and borrowed from low-interest countries to invest in higher-interest ones. Claiming that their industry was global they played off countries against each other, demanding favourable tax status or lodging themselves in tax havens. In doing so they undermined the conditions of their own existence, the public authority of money.

A major problem for countries such as Greece or Argentina is that they have considerable problems in raising tax with substantial informal economies and high levels of tax avoidance. Finance may have escaped regulation but it has also separated itself from the legitimisation of money through public authority. This led the sector to expand to such an extent that the amounts of money at risk threatened the solvency of countries that had residual responsibility for their activities.

The need for radical change

Proposed solutions to the financial crisis tend to involve more regulation and the break up or separation of banking activities, but these merely scratch the surface. The financial sector is not only too big; it embodies massive contradictions. In particular, the social role of finance makes it impossible for monetary authorities to let the system fail. This creates moral hazard on an epic scale, 'Wall Street socialism' with massive benefits for the financial elite and costs and liability for the many.

Given that the public nature of money makes the financial system a public liability, there is no case for its private ownership and control. As bank credit issue is the main engine of money creation in modern societies, how that money is issued and circulated is a crucial question. The allocation of that credit determines economic priorities.

Under capitalism the only priority is private profit. On this basis global speculative ventures are supported while local, particularly social, businesses are marginalised.

The allocation of credit is only part of the problem, however. The main question must be why the private banking system should have control of the monetary system at all. Historically this was developed through the link between trading money, promissory notes and bills of exchange, which were exchanged for bank credit notes designated in the national currency (legal tender). More recently the system has shifted to 'sight accounts', money records rather than cash in hand. The question that needs to be asked is: why is the private issue of notes and coin (counterfeiting) punished by law while the private creation of sight accounts is seen as a natural function of banking?

Capitalist control of the financial system has played a major trick on the public. Given that bank credit is created out of fresh air, like fresh air it should be a public resource, not a private horn of plenty. Decisions about the allocation of that credit should be made democratically. Private profit should not be the only criterion for money issue.

Nor should all money be issued as debt with the interest charged accruing to the issuing financial institution. Debt-based money builds in a growth dynamic that prevents the emergence of a more socially and ecologically sustainable economic system. Instead money could be issued without debt as grants or interest-free loans. The only reason this is not done is that capitalism has ideologically captured economic reasoning. The right of banks to issue money for profit is not challenged.

If people demand to issue money themselves or demand that social and ecological priorities come first they will be told that 'this cannot be afforded'. The pretence is that the market puts some kind of brake on money creation and allocates it most efficiently. The recent crisis shows that neither of these claims is true. Any money creation by the public is decried as inflationary, while massive inflation of the capitalist financial system was given the euphemism 'capital growth'. The public were to be grateful for the few crumbs of taxes that were reluctantly extracted from the financial sector.

In fact, there is no reason why money should be issued through the private banking system. It may be that with money under democratic control the public would vote to give financial resources back to the private sector, but it is more likely that social expenditure would be prioritised. The private sector would then have to re-orient its activities to serving public needs. This could form the basis of an economy in which growth would occur in response to social need, rather than the demand for ever expanding profits. Money circulation would return to the production of goods and services and not the never never land of perpetual financial growth. The idea that the whole of society could secure itself on constantly inflating financial assets is a total illusion.

The financial crisis has revealed the financial system's enormous power and lack of democratic control. Money and finance, nationally and internationally, must be socially and politically re-embedded to enable socially just and ecologically sustainable economies to emerge. Rather than asking 'can the financial crisis be the basis of radical change?' the crisis must be the basis of radical change if we are not to continue on the capitalist financial merry-go-round until we all fall off.

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