In Praise of Deficit: Public Money for Sustainability and Social Justice

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Abstract.

This paper is based on my forthcoming book *Debt or Democracy: Public Money for Sustainability and Social Justice* (Pluto). It will make the case that deficit, expressed as surplus public expenditure is essential for socially just and sustainable provisioning. Conventional notions of public money as public expenditure based on taxation of privately created wealth will be critiqued. Public money will be defined as the creation of public currency free of debt, and therefore free of the necessity to grow. It will be argued that both sovereign deficit and debt are misleading concepts and stem from neoliberal 'handbag economics' that sees the public sector as a dependent household. Through exploring two circuits of money, public and commercial, it will be argued that growth driven capitalist economies are dependent on the public creation of public money. The seeming dominance of the commercial circuit reflects the 'Janus-faced' role of central banks that supports both debt and growth. The alternative to debt is a money system based on surplus expenditure (deficit) that can enable social and public exchange of use-value rather than exchange of commodity value for profit.

Introduction

The background to this paper reflects three crises: environment, inequality, money/finance. I want to argue that money/finance is key to the other two. Concerns about climate change and other ecological problems are side-lined by the demand that economic growth, that is, profitability in money terms, must be maintained at all costs, or that remedial action cannot be afforded, that is, there is not sufficient money. The post war move towards greater equality has also been reversed by financialisation and the concentration on financial assets and financial speculation, all represented as growth in money terms. This is not to deny the importance of other economic factors, but money itself has been largely neglected in economic debate. Instead, the politics of money should be seen as a key aspect of political economy. Environmental and social priorities are rejected by the claim that money is in short supply. However, there was no shortage of money when it came to the banking bailout.

Money cannot essentially be in short supply as it is an entirely social construct.There is as much or as little as those who create, control and determine the distribution of money choose there to be. In this context I do not distinguish between notes and coins and bank credit in the definition of money as both create the supply of public currency. I want to argue that the financial crisis must be seen as a crisis for money, or more precisely, a crisis of the privatisation of the supply of the public currency. What the crisis reveals is the key role of publicly created money in sustaining private finance. Yet, the ideology of what I describe as 'handbag economics', claims that the public sector has no right to the money that it, itself, creates. Publicly created money

must only be used to support the privatised creation of the public currency as debt. There is quantitative easing for the financial sector, but not the people. Worse, the people are punished through austerity for the deficits and public debts created by the crash. If sustainability and social justice are to be achieved, the privatisation of the public currency needs to be challenged. Public money must be a public resource that addresses democratically determined priorities (Mellor 2010).

The 2007-8 crisis was not just a crisis of banking and finance but a crisis of the supply of public currency. The major fear that triggered the vast creation of public currency by public authorities was that the ATM machines would dry up. Certainly banks and financial institutions were insolvent as well as illiquid, but for the public the most immediate sign would be that there would physically be no money. However, the monetary authorities did not get the printing presses going, there was no time. It would take months, if not years, to produce enough banknotes to 'back' bank deposits. Also there was no other representation of value such as gold, which in any case would be not sufficient, even if the link with gold had not long been abandoned (if it was ever effective anyway). States and central banks backed their banking systems with nothing but their authority. They said the money was there and people accepted it. States nationalised or bailed out banks, central banks made rock bottom loans they did not expect to get back, and attempted to 'quantitatively ease' the amount of money in circulation by buying up various forms of debt or investment. In all cases they used public money, that is money created and circulated by public monetary authorities.

The newly issued public money did not originate outside of those authorities, it was not 'made' elsewhere. Conventional economics has a contradictory attitude to this public money-creating capacity. While public expenditure is seen as dependent upon the 'wealth-creating' sector (states must not 'print money'), it is quite accepted that monetary authorities create money. This is even graced with the title of 'high powered money' or 'base money'. However this is not considered to be public money in the sense that the public has any right to it. It is created as public currency, in the public's name, but it is only to be circulated via the banking system. The one body that must not 'print money' is the public itself through its public (but not necessarily democratic) organ the state. The people and the state can only borrow money from the banking and financial sector which includes the central bank.

Neoliberalism has made this clear by deeming central banks, with their authority to create money, as independent of any democratic institutions. States themselves are just another borrower. When states stepped into to rescue their banking sectors, they overran their expenditure plans dramatically, that is, they went into deficit. This required 'borrowing' under which excess state expenditure was securitised by the central bank and sold on to financial investors. The public sector was then pilloried for being in debt and forced into austerity. I want to argue that public deficit and debt is not a 'problem'. In fact, commercial monetary economies cannot function without a long run surplus of public expenditure (deficit) over tax extracted. They cannot exist without publicly created money, that is, money free of debt spent into circulation or public currency made available to exchange for bank loans. There is no truth in the claim that environmental or social justice solutions cannot be 'afforded'. There is no shortage of money. What does exist is a dominant 'handbag economics' that ignores the social and public history of money. It also does not acknowledge that bank

accounts are as much public currency as notes and coin. There is nothing private about bank-created money. In the last resort it is a public liability. Why, then, is it ideologically and in practice, captured as a private, rather than a public, resource?

In response to the crisis, monetary authorities offered an almost blanket guarantee of their public currency in whatever form it was held. Intangible promises were made to support intangible money. This raises the question of the nature of money itself (Ingham 2004). What kind of money was in crisis and what kind of money was rescuing it? The crisis is acknowledged as being a crisis of credit supply and toxic debt as banks threatened to fall down like a line of dominos. As Duncan argues, this failure of 'creditism', the growth of debt, was equivalent to the collapse in money supply in the 1930's (2012: 32). In the run up to 2007-8, banks were not just issuing credit, they were issuing the public currency. This challenges the conventional nostrum that there are two different kinds of money, 'real money' (notes and coin, central bank reserves) and 'credit money' (bank accounts).

What is Real Money?

Writing in an era when most people still used cash (notes and coin) Galbraith argued that central banks provided 'a reliable supply of wholly acceptable money when… people wished to turn their deposits in the commercial banks into the cash which, by the nature of deposit creation, was not there' (Galbraith 1975:40). Such 'backing' for bank-created money was essential because 'the monetary achievement of the nineteenth century was a fragile thing' with a number of crises (Galbraith 1975:42). What is that 'wholly acceptable money'? The illusion that it is gold has gone, fewer people use cash, so what exactly are central banks providing?

In conventional money theory High Powered Money (HPM) or Base Money refers to the money controlled by the monetary authority usually seen as the total of bank reserves and cash in circulation. HPM is contrasted with credit money, the money created only as bank 'sight' accounts. If an account holder asks for cash, the bank has to buy this from the central bank paying from its reserves. Keynes saw bank money as 'acknowledgements of debt' whereas only HPM, 'money proper', could finally settle that debt (1971:5-6). However, in practice, bank transfers between people are perfectly adequate in settlement of debt. Banks also settle debts between themselves at the level of the central bank, but they are not using a special form of money to do so.

Distinguishing 'money proper' from bank money implies that bank created money is a different form of money to state created money. This was more clearly the case when bank notes were private agreements between borrowers, creditors and the bank and the only backing for the notes was trust in the long term viability of the particular bank. However with the establishment of public currencies, the right of banks to issue their own bank notes was largely prohibited. Banks could only borrow and lend central bank notes or produce their own notes by agreement with the monetary authorities. Theoretically, the central bank could now control lending through control of the amount of notes issued. However, limiting the number of bank notes in circulation did not limit the bank's ability to create 'sight accounts' that exist only as bank records but are still designated in the public currency. Bank transfers could operate through paper or electronic records, increasingly so today. Given that

electronic records designated in the public currency are as trusted as cash, there is no effective distinction between ‘real money’ and ‘credit money’. Hence states and central banks had to offer their banks virtually unlimited support (Konings 2009, Montgomerie and Williams 2009). If bank credit wasn’t ‘real money’ why did states feel compelled to underwrite their banking systems which, in Keynes’ terms, will be riddled with private bank debt rather than ‘money proper’?

A lot of the confusion is caused by the myth of ‘hard money’. If high powered money is taken to be the equivalent of gold there must be something tangible in reserve. This illusion cannot hold today. The public currency can be created publicly and privately in electronic form. The difference therefore cannot be one of form. However, there is still one clear point of difference between the state and the banking system as a source of money supply. The state can create new money without debt, whereas the profit-based capitalist banking system cannot. Even conventional economics acknowledges the power of banks to privately create money through new loans in the theory of fractional reserve banking. The pretence was that the bulk of the loans were not ‘real money’. As all money is now fiat, without even the suggestion of an intrinsic base, that distinction falls.

As money has no intrinsic value, what does it represent? Why do people accept and use it? In circulation it represents previous value (entitlement) or a promise to provide the value the money represents (obligation). The value itself is relative within a money system, two pounds is worth twice one pound. Money only has a ‘price’ when interacting with another currency: a pound is worth so many euros or dollars or when artificially linked to a fixed standard. Acceptance of money is a mixture of social trust and public authority. As the money passes from hand to hand there is the presumption that the next recipient will honour its agreed value. Lying behind that is the authority of the state. There is no basis for trust in the banking sector itself because its solvency is an illusion as the fractional reserve theory acknowledges. There is a nicety about talking about bank illiquidity rather than insolvency, but in a crisis they are indistinguishable. Banks have only a fraction of capital and reserves to back their balance sheets.

Given that money is entirely a social construct, how is it constructed? Who has the right to construct it? As Minsky said, anyone can create money, the trouble is getting it accepted. For Modern Monetary Theory (MMT) money is an IOU, a credit/debt (Wray 2012:262). If it is an asset to one person it is an obligation to someone else. At its loosest, holding money is a call on the labour, assets or resources of that money system. If that promise does not hold, then the money becomes worthless. The specificity of a public currency is that its acceptance is generally assured (although collapses are not unknown). There are many questions that may be asked about money in circulation, such as how it is distributed, how its relative value shifts and changes, but a central question is who has the right to create the public currency? The distinction between real money and credit money implies that only public monetary authorities can create real money (taken to be notes and coin), but as argued here, that distinction no longer holds. Both banks and states create the public currency as electronic records.

In fact, far from not being able to create the public currency, bank debt is increasingly seen as the only source of public currency (Jackson et al 2012, Ryan-

Collins et al 2011). What has happened is that supply of the public currency has been collapsed into the supply of credit on a commercial basis, thus making it susceptible to the latter's endemic tendency to crisis. Bank loans expand the amount of money in circulation and when credit dries up, so does the money supply.

The Commercial Circuit of Money

The commercial circuit of money has been explored by Money Circuit Theory (MCT). The Italian economist Augusto Graziani (1933-2014) saw bank finance as central to capital formation. MCT sees money as both the key to production and the goal of production for capitalism. Money is borrowed to pay the cost of production, this is then repaid following the process of exchange and consumption, and the circle turns again. Money circuit theory's 'endogenous' view of money gives total precedence to the commercial sector. It rejects the idea that the state can impose any top down 'exogenous' control of bank lending, for example through manipulation of central bank reserves.

For Rossi, money is 'a creature' of banks, rather than the state (2007:21). Money is created by banks when producers borrow money in order to launch the circuit of production: 'Money's value is based …on production and banking systems working together to associate a real object (that is, produced output) to a numerical counter (money)' (2007:20). Placing the banking system at the centre of its analysis of money's origin, money circuit theory sees bank lending as growing out of personal loans and promises of payment. Banks acted as a 'third partner' in commodity exchange. Based on their own credit-worthiness, bankers agreed to 'cash' a debtor's promise to a creditor for a fee and/or a discount pending later payment to the bank by the debtor. This meant the creditor had ready money from a creditworthy source in place of a personal debt, while the banker took the risk of non-payment.

Unlike conventional theory, money circuit theory does not see money as a neutral reflection of the circuit of production. It is an active force for capitalism, determined by conflict and structural power that makes possible 'both market exchange and the more extensive set of relationships known as capitalism' (Smithin 2009:59). It requires full 'elasticity of credit'. If debt creation ceases, it is disastrous for capitalism. While money circuit theory provides an important analysis of the commercial circuit of money, and reveals the importance of the private creation of money to the survival of capitalism, it does not address the possibility of a public circuit of money. Equally, neoliberal economics recognises only the commercial circuit of money but does not see the implications of banks creating new money. Banks are only seen as intermediaries between savers or investors and borrowers.

What then, are the implications of creating the public currency supply through debt created money? The first is that there is a drive to growth. If a profit is to be made and debts repaid with interest, there must at least be monetary expansion. This would also drive physical expansion in terms of use of resources etc. At the minimum there would be no basis for movement to curtail growth, much less de-growth (Latouche 2012, D'Alisa et al 2015). Second, public currency supply based on debt means that who borrows and for what purpose determines the direction of the economy. Third, it produces a 'handbag economics' where public expenditure is deemed to be dependent on the commercial creation and circuit of money. Fourth,

the money supply will always be threatened by the periodic crises that the credit circuit creates. To focus on the commercial circuit obscures the public circuit of money.

The Public Circuit of Money

One of the earliest proponents of a public conception of money was the German, Georg Knapp (1842-1926). Far from a market-oriented and privatised view of money, Knapp saw the state as central to the existence of money. In his major work *The State Theory of Money* (1905/1924) Knapp argues that money is not an economic phenomenon linked to the market; it is very much a public phenomenon: 'money is a creature of law' (1924:1). For this reason, he sees the study of the monetary system as a branch of political science and 'the attempt to deduce it without the idea of a State ..(is)..absurd' (1924:viii). It is states that establish the status of money forms such as coins, public currency notes or abstract notions such as the pound sterling. Keynes echoed Knapp's view: ''that money is peculiarly a creation of the state' (1971:4) and claims it has been so for four thousand years.

While for conventional economics the first function of money is as a medium of commodity exchange, Knapp stresses money as a more general means of payment. Although money is used in market exchange, there are many situations in which payment does not relate to the market, such as fees, fines or taxes. In fact, Knapp sees public administrative payments as a better grounding for the status of money than general acceptance in trade: 'the money of the state is not what is of compulsory general acceptance, but what is accepted at the public pay office' (1924:vii). Knapp acknowledges that commodities of material value (such as precious metal) have been used in exchange, but he does not consider this to be money. In fact, money only comes into play when the actual form of payment has no intrinsic value: 'money comes into being when the material is no longer the means of payment' (1924:25). He goes on to argue that even where money is made of precious materials, 'the soul of the currency is not in the material of the pieces, but in the legal ordinances that regulate their use' (1924:2). He notes that the first question a trader will ask in a new country is, what is the nature of the currency?

At the time that Knapp was writing, paper money was well established and he wanted to defend the view that 'the much-derided inconvertible paper money is still money' (1924:38). Knapp sees all forms of money as a chartal or token (chartal comes from the Latin for token). Paper or other non-material money is not inferior to metal money, as both are part of an administrative monetary system: 'Coins are stamped discs made of metal' while 'warrants are stamped discs of paper' (1924:56). Knapp's state theory of money has a very different view of the origin and nature of money from conventional economics. Money is created by the state as a convenience for society 'the State….creates it' (1924:39). Knapp sees it as particularly beneficial to the taxpayer that the state creates the money that it later accepts in payment of tax as it 'frees us from our debts to the state, for the state, when emitting it, acknowledges that, in receiving, it will accept this means of payment' (1924:52).

What Knapp is describing is a public circuit of money. Money is created and circulated through state expenditure and retrieved as tax. A public sector circuit

reflects the long history of sovereign creation of money. Early coinage was created free of debt and spent, mainly on war or aggrandisement. The money was then left to circulate or demanded back as tax. When modern bank lending emerged, rulers combined public money creation and taxation with borrowing from the commercial money sector and the sources of public funding became intertwined.

The public circuit is obscured because public expenditure is an ebb and flow of money. States do not wait to collect taxes before engaging in expenditure. It is only when outgoings and tax income are brought together in the accounts that the balance between them can be seen. The sequence of taxation and expenditure is therefore circular: taxes are spent and expenditure is taxed. Rather than seeing the circuit starting with tax to fund expenditure, expenditure can be seen as providing money to pay taxes. The 'chicken and egg' nature of the public circuit creates confusion over the role of the central bank (or equivalent public authority such as the Treasury). The central bank/Treasury can be seen as lending money for public expenditure pending the receipt of taxes, or it can be seen as creating money for public expenditure that will be redeemed through taxation. If the public monetary authority behaves like a commercial bank, it will see this money as a loan to the state. Future taxation is then a fiscal matter of retrieving the money to repay the loan (with interest). If the monetary authority sees itself as a public agency, the public currency could be created debt free, and spent, pending possible future taxation.

Depending on how the public money circuit is interpreted, the incoming tax can be seen as being drawn from activities in the private sector (based on commercial wealth-creation) or it can be seen as the state's own expenditure being returned. Given that in modern economies there is both public and commercial creation of public currency, both are true. Both circuits can be seen as creating value by providing goods and services. While the commercial sector extracts its value as price on the market, the value of the public sector is judged by the quality of its provisioning.

If the creation of public currency is not through the commercial sector, money does not have to be issued as debt. Unlike the banks, publicly created public currency doesn't have to be commodified. It can be spent or allocated as a public resource without the need to be returned (with profit). However it is not wise to create unlimited amounts of money. The public money circuit is therefore completed not by repayment of debt, but payment of taxes or fees. Tax in this case is not a fiscal instrument as in the commercial money circuit (raising taxes from individuals, households and companies for the public sector to spend) but a monetary instrument, to retrieve money from circulation that could otherwise be inflationary.

This creates a very different position for the taxpayer. Instead of 'hardworking families' paying out their 'hard-earned money' in taxes, they can be seen as returning money that has done its work in creating public benefit (paying doctors, building bridges, environmental work, care for the elderly).The main difference between the commercial and public circuits of money is that publicly created money *may* be issued as debt, but bank created money can *only* be issued as debt. While the former can be used for social purposes on a sustainable basis, the latter must demand growth and profitability. The former can spend more money than it seeks in

return (surplus expenditure), the latter always wants to receive more money than it creates.

Rethinking Deficit

Recognising the public circuit of money puts deficit spending in a new light. Running a deficit does not need to put the public sector into the red. A deficit means that the public sector is spending more money than it is asking back in tax. How this is perceived depends on whether the source of money is seen as emerging from the public or commercial circuit of money. The role of the central bank is critical here. If the extra public expenditure is seen as being 'borrowed' from the central bank it will be sold on to the financial sector and added to the national debt. Seeing the central bank as exercising the sovereign prerogative to create money, would allow the additional money to circulate debt free. If the 'deficit' is not taxed, it can filter into the private sector and be a net gain to the economy as a whole. Quite the opposite occurs when there is the demand for the public sector to balance the books, or, worse, go into surplus. If the public sector takes more in tax and payments than it spends, it is extracting money from the economy. As Duncan argues 'however much government spending is cut by, the economy simply contracts by that amount' (2012:24).

Far from being a problem, there *needs* to be a public deficit. Creation by public authorities of money that is not reclaimed is necessary, otherwise the privatised money supply will go into crisis, as a purely debt-based money supply is not sustainable. Rather than demanding an end to budget deficits, they should be seen as a key element of macroeconomic policy in creating financial stability (Arestis and Sawyer 2010). As Wray argues, 'if government emits more in its payments than it redeems in taxes, currency is accumulated by the non-government sector as financial wealth' (2011:7)… 'affordability is never the issue, rather the real debate should be over the proper role of government, how it should use the monetary system to achieve public purpose' (2011:17).

Suggesting that the state should openly reclaim its money-creation power, will almost inevitably be met by the assertion that the issue of debt free public currency risks inflation. This ignores the monetary role of taxation; as Galbraith has pointed out, fiscal policy can be used to manage excess demand as well as managing falling demand (1975:306-7). If more money is issued than can be absorbed by the level of goods and services in the economy, taxation can be used to retrieve that money. Critics of states 'printing money' tend to ignore the inflationary pressures of the floods of bank issued debt that have led to a series of asset-price booms. Good and bad management of money can occur in both state-based and bank-based money creation.

Securitising public expenditure as debt, while not fiscally necessary, does have monetary and financial uses. Its monetary role is similar to that of taxation, to withdraw money from the economy. Its financial role is as an investment. In times of crisis, public debt, far from being a problem, is an essential asset for the financial sector. Following the recent crisis, investors were willing to embrace negative real interest rates for the safe haven of sovereign debt. Even bailout countries such as Portugal were able to return to the commercial markets at a reasonable rate of

interest relatively quickly. Pension funds and other financial institutions rely heavily on public debt. However, selling public deficits as debt is socially unjust, as repayment of that debt falls on the public while the investments are mainly a source of benefit to the already wealthy who can directly or indirectly ‘buy’ the debt. A fairer way is to remove money through progressive taxation, particularly of capital, as Piketty suggests (2014). The choice between additional taxation or increasing national debt is highly ideological and goes to the heart of modern public finance.

In the run up to the crisis there was no sense of the public sector as a legitimate creator of money or of a public money circuit. Only the commercial circuit of money figured in the dominant ‘handbag economics’.

Handbag Economics and the ‘Public as Household’ Analogy

‘Handbag economics’ sees the public sector as analogous to a household, dependent upon external sources of income. Like a dependent housewife, the public sector is limited to only spending what is in her handbag/purse, that is, what can be raised by taxation. In the absence of any alternative source of money, the public household is seen as solely dependent on the private ‘wealth-creating’ sector. The supply of money to the public sector must therefore originate with the taxpayer or the money markets (public borrowing).

Under handbag economics the public-household is in a much more constrained position than actual households. Whereas actual households are encouraged to borrow extensively provided they can afford the repayment, any borrowing by the public-household is condemned by handbag economics. The ideal would be for states to be in surplus, but at minimum they should ‘balance the books’, ‘pay their way’, ‘live within their means’. The case is made that as all debt and interest payments are a burden on the taxpayer, now or in the future, the public sector must be limited as to how much can be borrowed (overall debt) or how far current expenditure can exceed income (deficit). Preferably states should have no borrowing at all and certainly no deficit.

In the late twentieth century the public as household analogy became the commonsense of the age. It found resonance with the public and lay behind a major attack on the state, and particularly welfare systems. Privatisation of public assets and private investment in public assets and services were seen as the route to prosperity. This, even though outsourcing ‘efficiencies’ were achieved by cutting pay and services (Funnell et al 2009) or had disastrous consequences as in security for the 2012 Olympics.

Monitoring effectiveness was difficult as firms could hide behind claims of commercial confidentiality. Margaret Hodge MP chair of the UK Parliament Public Accounts Committee is reported as saying what is happening is ‘the development of quasi-monopoly private providers…we don’t really understand the size of their empires…It’s a new phenomenon’: ‘What is becoming really clear to me… is that (private sector providers) – they’re good at winning contracts, but too often, they’re bad at running services’ (Guardian 30.07.13). As well as privatising public services, there also seems to be a growing ‘publicisation’ of commercial companies which

depend on public contracts for their survival. This is particularly true of the care industry.

Pressure on public services through lack of adequate public funds creates public frustration at limited or poor service. A democratic deficit emerges as people see elected bodies as 'doing nothing for us' and being 'as bad as each other'. Similarly, the employed are turned against the unemployed and other welfare recipients. Everything is presented as a zero-sum game: your benefit is my tax. Money is assumed to be a limited resource that can only legitimately be used by the 'wealth-creators' even when they are bonus-driven, speculative, derivative traders. Public expenditure is undermined by the claim that the tax-payer is being robbed by wasteful governments. The rich demand lower taxes to support their 'entrepreneurship' or threaten to take their money elsewhere. Tax avoidance is rife and very few governments dare raise taxes. However the dominance of the commercial circuit provides very little benefit to the public.

Rather than contributing to the provision of goods and services through productive investment, the rich extract resources and hoard their money. This is what Keynes feared and led to his demand that governments seek to maintain full employment when capitalist investment failed. As the rich do not carry out the basic money circulation function of employing labour to produce, there is little money outside of the financial sector. This has resulted in huge inequalities between millionaire earnings and bonus-enhanced salaries in the financial gambling arena, and zero hours contracts with unemployment or underemployment elsewhere. As Piketty has argued, the concentration of wealth and growing inequality is stifling the growth of capitalism itself (2014). As Andrew Sayer argues, the public can no longer afford the rich (2014). Financialised capitalism is profiting without producing, and one of its major sources of profit is debt (Lapavitsas 2013).

So how did the commercial circuit capture creation of the public currency and thereby its stranglehold on public expenditure? In this, the evolution of central banks played a major role.

The Central Bank: the Pivot between the Circuits

The public and private money circuits are brought together in the central bank. This is a Janus-faced organisation, which can be a public or private institution, with both a public and private role. As a public body, the central bank has the traditional power of the ruling authority to create the public currency free of debt. That is, the traditional power of seigniorage, the ability to create and spend money. The classical example is Alexander the Great who is reputed to have needed half a ton of silver a day to pay his troops. However rulers were not limited to precious metal money and used many mundane forms of money such as wooden tally sticks (Desan 2014). As modern banking emerged, the power of the monarch was curtailed, particularly as warfare became more costly and taxation was less effective. Money slipped from their control and instead of being money creators, rulers became debtors to powerful commercial forces using mainly mundane forms of money, predominantly paper.

As Graeber points out, the early years of modern banks saw a shift in state funding. When rulers needed more money and could not raise more tax, they reverted to

borrowing, often demanding ‘forced’ loans. For Graeber, there is a fine line between a ruler demanding taxation and requiring a loan from wealthy citizens when needing additional resources (2011:338-9). However, there is a critical difference. Taxation implies a sovereign right to command resources, borrowing creates an obligation to the lender. While today there would seem to be little difference between rule by an autocratic monarch or a cartel of bankers, there is an important influence on the modern conception of public debt and the functioning of the two circuits of money.

Large scale state borrowing reflects a major shift from feudal power to capitalist power. Before sovereigns became reliant on commercial debt, rulers obtained the goods and services they needed by direct appropriation of goods and services or by money-based taxation. When the sovereign began incurring debts rather than raising taxes, this could be seen in two ways. One way would be to see it as an advance of taxation. Desan sees tally sticks as providing this function from at least the thirteenth century in Britain (2014:174) Tallies were issued by rulers as receipts for goods and services provided and could be submitted when taxes were due as proof of pre-payment. Tallies are records of payment or debt on a stick which is then split lengthways with each party holding a matching half. The cheque book is a modern descendant.

The second pattern of lending to sovereigns is entirely the opposite. Rather than a prepayment pending future taxation, the money is seen as a loan that will be repaid out of future taxation. Rather than the money form being created by the sovereign and then returned through the (autocratic) public circuit as taxation, the money form is created by the private lender, given to the state to spend and then paid back to the lender out of future taxes. This makes little difference when the lenders are also the major tax-payers. They are merely deferring their own taxes. When the taxpayers and wealth-owners are separate groups the distinction between taxation and borrowing becomes critical. Today, the wealthy are the lenders but the whole public is the debtor/taxpayer.

Until 1694 British royal debts were personal loans to the sovereign. They became the national debt when subject to parliamentary guarantees as demanded by the commercial investors who created the Bank of England. The history of central banks shows that the creation of national debt is closely aligned with the privatisation of the creation of the money supply to fund that debt. In 1694 the newly established Bank of England did not fund the King with gold or goods and services. The commercial founders funded him with new paper promises and cancellation of old crown debts. In the process, taxation of the rich became replaced with borrowing from the rich. The National Debt was born. Over time, the private paper promises became the public currency and central banks developed their two faces. They are issuing public money which is free of debt at the point of creation, reflecting the sovereign right to create money, but it is then circulated as debt via the commercial money circuit. The public sector has lost its sovereign capacity to create money, it is just another borrower.

Felix Martin describes the historical link between the ruler and the commercial sector as the Great Monetary Settlement. The sovereign gave public authority to private money and the bankers put their commercial credit at the service of the ruler: ‘the crown provided liquidity support to the Bank, while the Bank provided credit support

to the sovereign' (2014:239). However, he argues that following the recent crisis states are providing both liquidity and credit to their banking sectors, while 'the tax-payer gets nothing'.

If the central bank is seen in a purely commercial context, its job is to be the bank of bankers. It holds the reserves of those banks and clears payments between them. When banks run out of reserves and can no longer get credit from other banks, the central bank is the lender of last resort. As seen during the crisis, it must make as much currency available as the bloated banking system requires. The crisis showed that no matter how irresponsible the banking and financial sector, in the last resort it falls back on the capacity of public monetary authorities to create public money. This vital role of public money has become obscured because the capitalist class has expropriated the sovereign right to create money and thus denied it to the people.

Under handbag economics the central bank uses the sovereign right to create money to rescue the banking sector, but turns its commercial face towards the public sector. Rather than creating new money free of debt to fund the public sector, it deems the money as being borrowed. This Janus-faced nature of the central bank reflects its role as banker to the banks and banker to the state. Traditionally rulers monopolised the creation of the public currency to their personal benefit. If this was carried through into modern democracies, the central bank would create public currency for public use, for public benefit. Instead, it treats the public sector as if it were an individual borrower. Like a commercial bank, it will circulate new money only as a loan. This denies the capacity of public creation of money without debt. As a result, modern states have accumulated extensive national debts. Even when the Bank of England bought back a large portion of the outstanding public debt in its £375 billion quantitative easing programme, this debt was not cancelled. The public sector still owed it to the public central bank.

The whole panoply of sovereign debts and deficits needs to be challenged. Equally it needs to be recognised that the commercial circuit is not private at all. It requires regular top ups from the public circuit. It is parasitic on the public capacity to create money free of debt. For this reason, all creation of new money whether by central banks or high street banks should be a public question, because it has implications for the public as a whole. Ultimately what 'backs' the money is the willingness of the public to accept it in circulation. It is a combination of social trust and public authority. The privatised supply of money through bank debt, relies on the public's confidence in monetary governance. And this confidence does not rest with the central bank. The people know that in the end it is the state as government that matters. In 2007 when Northern Rock faced the first bank run in Britain since 1866 neither its Chief Executive nor the Governor of the Bank of England could get the queues to disperse. It was only when the Chancellor of the Exchequer, Alastair Darling, put the authority of the government behind the bank that the deposit-holders went home. The independence of the central bank is an illusion. When it comes to public confidence in the public currency it is the whole state that matters. And at the heart of this is the public circuit of money, the financial relationship between the government and the people.

The evolution of modern monetary systems is incomplete. The power to create money has shifted from sovereigns to the commercial sector, from the ruling class to

the merchant class, what is needed is to transfer this power to the public. The central bank must return the sovereign prerogative of money creation free of debt to the people, for the benefit of the people, as a public resource. To make the transition to people power, it is necessary to rescue the concept of public money from feudal seigniorage, that is the autocratic right to create and use money, to the seigniorage of the people. This would mean economies would prioritise provisioning through the creation, circulation and taxation of public money with the commercial circuit playing a secondary role. That is, money must be democratised.

Democratisation of Money

Commentators from the left and right have largely ignored the democratic potential of money. Instead they focus on the 'real economy' which is generally taken to be the capitalist productive sector. Money is seen as an epiphenomenon. What money circuit theory points out is the importance of the credit circuit in stimulating the productive process. Obtaining credit gives the borrower access to goods and resources that they have not yet 'earned'. If this is true of the commercial money circuit it is equally true of the public money circuit. The creation and circulation of public money give people access collectively to goods and services. In Marxist terms it stimulates use value rather than exchange value or more correctly it stimulates monetary exchange for use rather than monetary exchange for profit.

As argued earlier, money does not represent a value in itself, it is a representation of entitlement (access to goods, services or resources) matched by an obligation on others to accept it in payment. This is true for both the public and commercial circuits of money. In the same way that the commercial money circuit enables a commercial economy, the public money circuit can enable a public economy. There is no need to invent the public circuit – it already exists. Public money free of debt demonstrably exists, as when the central bank creates money it owes it to no-one. Any decision to then issue this money as a loan is purely ideological. There is also a public money circuit of expenditure and taxation where the need for surplus public expenditure is demonstrated by the fact that most states run deficits. Conventional economics also recognises the anomalies of currency monetary theories with the epicycle–like notions of fractional reserve banking and real versus credit money. To democratise money it is necessary to expose the illogical and ideological nature of conventional thought. The public sector is not monetarily dependent on the private sector, it is the private sector that is dependent upon public money.

Money is not a political irrelevance. It is also not commercial in essence. Money can be the servant, not the enemy of radical democracy. Historically its origins lie in social convention and public authority as well as commercial credit. Democratised money provides the potential to organise complex, large scale economies on a collective basis without undue bureaucracy or top down planning. In my forthcoming book I discuss in detail how democratised provisioning through the use of publicly created money could be achieved (Mellor in press). As Felix Martin argues: ' money is the ultimate technology for the decentralised organisation of society…only democratic politics provides the sensitivity to current conditions and the legitimacy …that is necessary for money to work sustainably'(2014:272).

Deficit is therefore not a deficit – it is surplus expenditure. In the absence of handbag economics, more money can be circulated than will be reclaimed. This money would be free of debt or obligation and therefore be free to circulate. Most importantly for capitalist economies, it could provide unencumbered money to pay debts and enable the extraction of profit. Rather than privatised money being 'made' in the market and then (grudgingly) extracted as tax to fund the public sector, a public economy would work the other way around. Public money would be created free of debt and used to enable democratically determined public services and policies. A monetary decision would be made as to how much should remain in circulation and suitable taxes then imposed (on environmental and social principles). The private sector would then earn the remaining money in circulation by providing goods and services on a commercial basis. The commercial provision of money as debt would cease to create new public currency and would revert to what orthodoxy says banks do – act as a conduit between savers and borrowers.

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