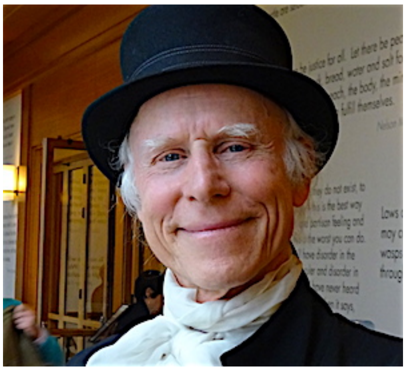
Money Myths, Legal Realities

By Kerry Pechter *Thu, Jan 3, 2019*

At a conference at Harvard Law School called "Money as a Democratic Medium," law professors debated the origins, purposes, and rightful ownership of money in the modern era. (Photo: Bil Lewis portraying President James Madison, at the conference.)



Aside from knowing that money doesn't grow on trees, do we really understand where it comes from? Banks supposedly create money out of thin air just by lending. The Federal Reserve magically found trillions of dollars to resolve the financial crisis. But how? And for whose benefit?

That second question—for whose benefit do the banks and the Fed create money—was front and center at the Harvard Law School a few weeks ago. During a two-day conference called, "Money as a Democratic Medium," a parade of academics presented the case that money over recent decades has been co-opted, even hijacked.

"We've allowed money creation to be privatized," said Morgan Ricks, a professor at Vanderbilt School of Law, who spoke at the conference.

If you're of a libertarian, gold-loving, neoliberal bent, you'd probably say that industrious people create money and politicians confiscate it through taxation. If so, you'd have been lonely at this conference. Many of the historians and economists there believed that bankers, abetted by lawyers, have stolen the public's purse.

Law, in fact, is essential to the story. One law professor showed that US law has been explicitly written to prevent blacks from accumulating wealth. A Columbia law professor explained how lawyers invent new kinds of collateral and play regulatory arbitrage. A Connecticut banker described his ongoing legal battle to deposit client money in an interest-bearing account at the Fed.

An all-but-invisible presence at the conference was Modern Monetary Theory, or MMT. MMT is a type of **chartalism**, a branch of macroeconomics that describes today's money as circulating government debt, given legitimacy by a government, and financed by taxes. Christine Desan, Ph.D., who organized "Money as a Democratic Medium," spoke at an MMT conference in late September. The mere fact that Harvard hosted this conference may signal a breakthrough in recognition for MMT, which most mainstream economists consider fringy.

Money and the law: Inseparable

Held in Wasserstein Hall on the law school campus, the free conference featured more than 50 presenters and was attended by hundreds of academics and Harvard students. Several of the presenters offered evidence that, historically and up to the present day, US banks and courts have created byzantine rules that privilege certain parties—often the ones who write the rules—and disadvantage others.

One of the first speakers was Katharina Pistor, a professor at Columbia Law School and the author of the forthcoming ***The Code of Capital*** (Princeton, 2019). If you like the current banking system, Pistor had good news: The status quo is protected by a deep moat of securities laws, bankruptcy laws, and contract laws. Globalization makes it harder than ever for national governments to stop securities lawyers from creating exotic new negotiable assets, like a **CDO-squared**.

"In times of globalization the idea that we could control money top down is problematic," said Pistor, who seemed appalled by the situation. "Lawyers have pushed the limits on creating new types of assets. It's hard to regain control over these processes. It's hard to dislodge control at the national or even the global level. Only the US and the UK acting together could roll back some of the excesses."

Mehrsa Baradaran

In a presentation that drew a standing ovation, Mehrsa Baradaran, a banking law specialist at the University of Georgia and author of ***The Color of Money: Black Banks and the Racial Wealth Gap*** (Belknap, 2017), made a richly-documented case for the idea that African-Americans have been systematically marginalized from the larger economy, with restricted access to banks, credit and homeownership, a traditional path toward capital accumulation.

After the Civil War, the government created the Freedman's Bank. But the bank failed in the Panic of 1873, taking with it $75 million in savings from 80,000 depositors and leaving many American blacks with an ingrained mistrust of financial institutions, Baradaran said. Injustices continued into the modern era. In its early versions, Social Security didn't cover domestic workers, many of whom were black women. After World War II, blacks were barred from buying homes in Levittown, the archetypical suburbia that was financed with federally insured loans.

Another speaker was James McAndrews, a former Federal Reserve researcher and a faculty member at University of Chicago's Booth School of Business. McAndrews is also CEO of The Narrow Bank, or TNB USA, which was founded in Connecticut in 2016 to perform one function. TNB would accept large deposits from institutions and transfer the money to an account at the Fed.

McAndrews wanted to cash in on the Fed's policy, introduced after the 2008 crisis, of paying member banks 1.95% on their excess reserves. Those banks are not passing those earnings through to depositors, however. McAndrews saw an opportunity to get an account for TNB at the Fed, and pass through 1.90% of that 1.95% to his depositors, taking a five basis-point service fee ($500 per $1 million).

But the Federal Reserve Bank of New York denied TNB USA a Master Account. So last September, McAndrews sued the Fed. The Fed won't say why it won't give TNB an account. But, as TNB says in its **lawsuit**, "If successful, TNB would place competitive pressure—primarily on large banks—to raise depository interest rates for all depositors."

What about wampum?

Desan, the organizer of the conference, is a law professor who, after setting out to write a legal history, ended up writing a history of English money because, as she told an audience in New York in late September, the English legal system and English money grew up together. A nation's money, she found, is a legal construct—a creature of the law, a contract.

But what about wampum, cowry shell money and especially gold, which many consider the only true money? Didn't primitive people create so-called "commodity money" to ease the frictions of barter? Didn't "goldsmith bankers" invent paper money by circulating gold receipts? Isn't money a private matter?

Those are well-preserved fictions, Desan explains in ***Making Money: Coin, Currency and the Coming of Capitalism*** (Oxford, 2014). The immense abstract quantities of national currencies that now exist did not evolve from the exchange of gold coins between private traders, she says. According to her book (and a growing shelf of financial histories with a similar theme), money in the modern sense appeared when kings and parliaments, to mobilize unprecedented sums for war or infrastructure, began spending IOUs whose value depended on the future redemption of those same IOUs as taxes.

"Making money, a phenomenon almost impossible to explain if we limit our field of vision to individuated exchange, becomes easily comprehensible once we enlarge that lens to include the collective activity that links individuals and communities," Desan writes. "Money is a way to mark and mobilize material value that can start at the center, work selectively and with limited information, and yet enlist the contributions of a broad group." If you read this book, you're bound to look at money in an entirely new way.