PhD Dissertation: 'How to make money: Finance, distributive justice and monetary constitutions'

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A capitalist society has at least two features that a theory of justice should accommodate. First, it is a society that leaves exchange and production largely to private individuals and firms. Property rights demarcate a domain within which it is up to economic agents themselves to make decisions. The consequences of their choices are for them to bear and economic agents are generally not accountable to everyone who is affected by their decisions. As a consequence, a theory of justice that has no resources for dealing with issues of personal responsibility will be inadequate for theorising a capitalist society. In discussing the topic of justice, philosophers have paid ample attention to personal responsibility, but have only recently turned to a second feature which I believe is equally important.[1] In a capitalist society, individuals and firms coordinate their activities through contracts that involve obligations to pay money. To allow economic agents to meet their obligations to pay at a particular point in time, a capitalist economy has a financial system. This system, which involves both public and private institutions, has not been given due recognition by existing

[1] Some important topics discussed are financial instability (e.g., Anderson 2007; James 2012; Linarelli 2017), microcredit (e.g., Sorell & Cabrera 2015), monetary policy (e.g., Claveau, Dietsch, & Fontan 2016; Dietsch 2017), private debt (e.g., Baradaran 2014; Gourevitch 2012; Herzog 2017), public financial institutions (e.g., Douglas 2015; Vague & Hockett 2013), the right to credit (Hudon 2009), and sovereign debt (Barry 2011; Wollner forthcoming).

theories of distributive justice. The aim of my dissertation is to persuade the reader that this is a grave neglect. I argue for three main claims:

1. Money and finance are central to any account of distributive justice that is adequate for a capitalist society.

2. There are five objections to unregulated private money creation.

3. Existing monetary constitutions need fundamental reform.

I have summarized the structure of these claims in Figure 1.

Main Claims	Sub-claims	Supported by
Main claim 1: Money and finance are central to any account of distributive justice that is adequate for a capitalist society.	*Distributive* Claim: The distribution of money and finance is central.	§§2 and 3
	Institutional Claim: The authority over money and finance is central.	§§4-7
Main claim 2: There are five objections to unregulated private money creation.		§§3, 5 and 6
Main claim 3: Existing monetary constitutions need fundamental reform.		§§6 and 7

Figure 1 – The main claims of the dissertation

Main claim 1 holds that money and finance are central to any account of distributive justice that is adequate for a capitalist society. This is the central claim of the dissertation and has two sub-claims, which I refer to as the *distributive* and the *institutional* claim. The distributive claim concerns the importance of the distribution of money, while the institutional claim concerns the authority over money. I will now explain each these claims and how they are related in more detail.

1. The distributive claim

The dissertation starts with my argument for the distributive claim, which holds that the distribution of money crucial for any theory of justice that is adequate for a capitalist society. I argue for the distributive claim in §§2 and 3.

1.1 Money and justice

Despite the obvious importance of money in the coordination of exchange and production, political philosophers have often treated it as a mere proxy for what should be of final interest to normative theorizing. As I discuss in §2 'The metric of democratic capitalism', philosophers have focused on topics such as the distribution of welfare, economic resources, capabilities, social power and standing. This, I will argue, led them to ignore the crucial importance of money for the theory of distributive justice. The dissertation brings out two ways in which money has such a role.

First, a capitalist economy is a monetary economy. It is, as John Maynard Keynes puts it, 'an Economy in which Money plays a part of its own and affects motives and decisions and is, in short, one of the operative factors'.[2] In §2 I will develop my version of this claim by explaining that in a capitalist economy, money acts as an independent unit of account. Economic agents do not owe each other hours of labour or amounts of natural resources. Rather, they owe each other money and use the money to acquire the economic means they

[2] Keynes [1933] 1963, p. 7.

need. Failure to meet obligations to pay when these are due results in an insolvency procedure.

Second, because money itself coordinates exchange and production, it has a central role in political deliberation on topics as diverse as economic inequality and the impact of alternative policy measures. Catastrophic climate change will not only kill millions of people, scientists think, but will also cost $12 trillion in lost growth, or 10% of world GDP, by 2050.[3] As I argue in §2, there are good reasons to use money rather than alternative metrics in political deliberation, which in turn impacts the theory of distributive justice that is appropriate for a capitalist society.

1.2 Finance and justice

Philosophers have not only neglected money, they have also neglected financial contracts. As I argue in §3, due consideration of money also forces us to recognize the pivotal role of financial contracts in a capitalist economy. As I argue, a narrow focus on income and wealth ignores the crucial role of finance in realising a fair intertemporal distribution of money.[4] Only few life plans are entirely income-dependent in the sense that they involve spending only income earned at a given point in time. Some life plans are credit-dependent in the sense that they involve spending income before it is earned. Others are savings-dependent in the sense that they require saving money to spend later. To accommodate different intertemporal

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[3] UNDP 2016.

[4] Authors who conceive of a just distribution of money narrowly in terms of income and wealth include Anderson 2007; Arneson 2002; Cohen 2011, p. 172; Dietsch 2017; Dworkin 2000, p. 76; Frankfurt 1987; Nagel 1978, p. 106; Satz 2010, p. 63; Scheffler 2003, p. 23; van Parijs 1995, pp. 30-47; Walzer 1987, pp. 95-128.

spending patterns, a just distribution of money must complement income with adequate options for saving money and taking out credit. Once these options have been taken into account, consideration of wealth becomes superfluous.

Although my argument is aligned with recent work on distributive justice and financial inclusion, I emphasize the pervasiveness of distributive conflicts: Who gets to spend money at any given point in time has systemic consequences that directly impact the economic opportunities available to others. I contrast my account with that of recent philosophers who have argued that there is a right to an invariant minimum level of financial provisions. I argue against the idea of a right to credit by highlighting the distributive conflicts that result from the different intertemporal spending requirements of life plans.[5] To show why the distribution of money matters, I conclude by arguing that private provision of financial intermediation fails to realise a just distribution of money because it systematically privileges the already well-off. Drawing on the economics of asymmetric information, I explain that private credit provision makes it easier for individuals with more wealth to borrow. Those with more wealth will also be more likely to receive credit and pay lower interest rates for projects of equal quality. Drawing on recent work on the dynamics of income and wealth, I explain how the effective rate of return on wealth increases with wealth levels. My account of the just distribution of money shows that these forms of financial exclusion are unfair in their own right and not just because they increase inequalities of income and wealth.

The arguments of §§2 and 3 together serve to establish the crucial role for the distribution of money in a capitalist society. I then turn to institutional sub-claim, which concerns the institutions that govern money.

[5] Brownlee & Stemplowska 2015 and Meyer (forthcoming).

2. The institutional claim

Theories of distributive justice have not only neglected money and finance. There likewise remains a sizable gap in the understanding of the financial institutions of existing capitalist economies. The institutional sub-claim holds that the authority over money is crucial for theories of distributive justice. Crucial economic institutions such as the banking system, capital markets and the central bank have only recently captured the attention of political philosophers. Due recognition of money and finance as topics of distributive justice should lead us to think in new ways about the role of these institutions.

2.1 The monetary constitution

The dissertation spends considerable time in explaining the main features of the existing financial system and the way it distributes access to finance. Most chapters make descriptive claims as part of a larger normative argument. In §4, in contrast, I put focus exclusively on description in discussing what I refer to as the monetary constitution. The monetary constitution is the set of legal and non-legal rules that govern the authority over money. Monetary constitutions, I argue, merit detailed attention from political philosophers because their design has pervasive consequences for the ability of capitalist societies to realise just outcomes.

The central bank is often described as the 'monetary authority', but in the existing financial system, the provision of money actually takes place through a hierarchical order of money creation. Money issued by the central bank stands at the top of the hierarchy. Below it, private financial institutions issue different forms of credit money. In this sense, the monetary constitution is a hybrid of both public and private authority over money.

Monetary authority has a formal and an effective component. The formal sense of monetary authority concerns whether it is within the law for a given institution to issue money. Effective monetary authority concerns the ability to issue assets that economic agents use as means of payment. Counterfeiters have the effective ability, but not the formal right. During a period of hyperinflation, the central bank retains its formal rights, but its effective ability is very limited. The monetary constitution distributes the formal monetary authority and thereby serves to allocate effective monetary authority. The chapter describes this structure in more detail.

§4 shows that monetary authority is itself diffuse and difficult to situate. Even if economic textbooks still describe the volume of money as set by the central bank, my dissertation will start from the otherwise widely accepted view that this account of false. In fact, structures of monetary authority are strikingly invariant across different capitalist societies. Money creation is largely in the hands of private financial institutions, banks, which are regulated and supervised by a publicly-owned central bank. As a form of private authority, issuing money is a decision that banks make based on their own private motives.

Although both the central bank and private banks have monetary authority, their authority is ordered in a hierarchy. Central banks issue money that serves as the means of final settlement. It does not, save in exceptional circumstances, provide credit to the economy directly. Instead, money creation for the real economy is a private prerogative of commercial banks, which seek profit within the confines set by regulation and monetary policy. The central bank thus leaves the authority over credit money to banks, which decide on the provision of credit, at what interest rates and under what conditions. Public authority is limited to the operations of the central bank and to the decisions of governments in how to regulate their banking sector. Together, private banks and central banks constitute the heart of the financial system.

2.2 Reform of the financial system

After describing the hybrid monetary constitution in §4, I turn to the second and third main claims of the dissertation in §§5-7. In §5 ‘Financial instability’ and §6 ‘Incremental abolition’, I articulate a range of objections to private money creation and explain how these objections relate to longstanding topics in the theory of distributive justice. The question of what reform is required, a topic that is itself very much contested, again raises new challenges, which I turn to in §6 and also address in §7 ‘The ethics of delegating monetary authority’. Together, these chapters show that there are five objections to unregulated private money creation (Main Claim 2) and that existing monetary constitutions need fundamental reform (Main Claim 3). These claims also serve to provide further support for the distributive claim by showing the crucial questions of distributive justice that arise in the distribution of authority over money.

Starting with §5 ‘Financial instability’, I turn to the normative evaluation of the hybrid monetary constitution. A banking crisis, a regular occurrence in societies with a hybrid monetary constitution, can disrupt individual lives in dramatic ways. I describe the dynamics by which financial crises unfold. I criticize Friedrich Hayek and Elizabeth Anderson, who argue for implausibly condoning financial instability as a consequence of their almost unconstrained reliance on personal responsibility for financial market efficiency.[6] I argue that their focus on legal consent and on income and wealth ignores crucial institutional conditions of life planning in a capitalist society. I then put forward an account of why financial instability is objectionable from the perspective of distributive justice focusing on two types of distributive consequences.

[6] Anderson 2007; Hayek 1976; 1982.

First, financial instability interferes with the ability of political institutions to realise a fair distribution of income, options for credit and options for saving. Second, financial instability compromises the epistemic positions from which individuals make their life plans. Although individuals are responsible for using the information that is available in making their life plans, just institutions should secure fair epistemic positions for each individual.

While the first objection is formulated by restating ideas that I have outlined in §§2 and 3, the second objection makes an independent contribution to my aim of theorising justice in a capitalist society. In thinking about the role of assumptions in life planning, I address a long-standing gap in theories that rely on resources, primary goods or other objective metrics in comparing distributive shares. Such theories focus on the means that are available to individuals in making their life plans rather than the extent to which life plans can be pursued successfully. These metrics thereby omits any consideration of the epistemic conditions of life planning. For Rawls, for example, 'there is no prior and independent idea of what we may legitimately expect, or of what we are entitled to, that the basic structure is designed to fulfil.'[7] As I explain in §5, this fails to consider distributive issues concerning the quality of expectations that individuals form in the context of the rules that govern the basic structure.[8]

In §§6 and 7 I turn to the question of how political institutions should respond to financial instability and other objections to the existing financial system. In §6 'Incremental abolition' I outline five objections to unregulated private money creation. Drawing on §3, I focus on the unfair distribution of money that results from capitalist coordination. Drawing on §5, I

[7] Rawls 2001, p. 72.

[8] Buchanan 1974; Brown 2011; 2012 put forward an account of legitimate expectations that focuses on expectations raised by government policies. Expectations in capitalist economies are often not of this sort.

discuss financial instability. I also raise objections to private authority over money that invoke macroeconomic instability, ecological unsustainability, and political inequality. These arguments show that leaving money to private authority can hinder a society in meeting the demands of distributive justice that apply to it.

I then turn to the difficult question of how to reform private money creation. To establish that reform is desirable, there should also be an alternative that does better. I review proposals for abolition of the hybrid monetary constitution known as Full Reserve Banking. I argue that although at least some of these proposals promise to address the objection to hybridity, it is not clear that they will, nor is it clear that better regulation of a hybrid system cannot achieve the same goals. I discuss what uncertainty of this kind means for the theory of political representation and argue for the importance of experimentation. On this basis, I propose a programme of incremental abolition. By gradually reducing the role of private authority over the provision of credit and deposits, political institutions will generate the evidence that is needed to reform the existing financial system.

Finally, in §7 'The ethics of delegating monetary authority' I explore the constitutional structures that govern public money creation through a discussion of central bank independence. My main claim is that today's independent central banks are insufficiently democratic and need to be reformed. This claim has a long tradition, but the argument I advance is novel. In contrast to those who reject central bank independence entirely, I argue that it should in principle be permissible for governments to delegate political choices to unelected experts. From a democratic perspective, what matters is whether the government has an adequate justification of its decision to delegate. Although central bank independence limits the government's control over monetary policy, it can also improve the quality of monetary policy and thereby help the government in pursuing its larger economic policies. I outline a moral framework for balancing these competing considerations. Focusing on the case of the European Central Bank, I then argue for democratic reform of existing institutions.

These arguments together should convince the reader of the crucial role of both the distribution of money and the authority over money in any account of distributive justice.

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