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REPLY

Politics in a theory of money: A reply to Dietsch et al.

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Dietsch, Tonkin, and Wong (2025) provide a generous reading of my recent book, *A Political Theory of Money* (Kapadia, 2023). They nicely describe it as a work of 'synthesis by modular recombination', but ironically they do not take that pithy description to heart. As such, they misread the endeavor as one that attempts 'a genuine compromise between commodity, state, and credit theories of money'. In doing so, however, they provide me an opportunity to restate some of the book's main arguments, which might have been lost due to poor presentation on my part.

My aim is not compromise but synthesis, just as they state: to take elements from each school of monetary thought and combine them into a new, sounder theory. There are other social theories in the mix as well: Mehrling's balance-sheet-based Money View and Unger's and Common's political ontology of institutions in particular.

Dietsch et al. rightly identify the key theoretical question: why are some monies better than others? What I came up with was an account of how money comes to be institutionally anchored in a real economy. There are two axes of variability here: first, *how* money is anchored in an economy – that is, via political or economic modes of 'mutualisation' – and second, the *scale* of the underlying economic catchment area. Variability in the space outlined by these two axes drives hierarchy both within domestic credit systems, namely between banks and central banks domestically, and between discrete national systems across the world.

This is the role that politics plays in this theory of money: to account for the variable performance of money by theoretically distinguishing political from economic mutualization. Different political settlements generate different monetary, fiscal, commercial, and financial institutions that can mobilize resources differentially. Existing theories can neither adequately account for why modern money has real economic value, nor why different monies have different values – i.e., why there is hierarchy in all monetary systems.

This logic is applied in the first instance to domestic monetary systems, where there is a hierarchy between national money issued through the state-central banking complex and bank monies issued by commercial banks. The national/bank money distinction is not necessarily a public versus private distinction, since commercial banks can, of course, be publicly owned, as they are in many countries. The distinction rests on the type and scale of mutualization. This logic can then be extended to comparisons between national monetary systems within the global currency hierarchy, to the IMF's Special Drawing Right, and so on.

Monetary systems are hierarchical – simultaneously centralized and distributed in nested layers of credit – because such an arrangement produces money best-equipped to meet the twin demands of capitalism and democracy. Capitalism requires liquidity to meet the ongoing needs of commerce and production in a manner that is granular: Hayek taught us why credit cannot be efficiently allocated centrally. But mere private, local monies operating independently would be dynamically unstable and entail debilitating transaction costs. Functional banks always mutualize with other banks operating in different branches of the division of labor to efficiently deliver liquidity to their own customers, thanks to the randomness of payments flow. Hence, banks *always* aggregate and mutualize of their own accord into banking systems (this is logically true, if not always chronologically so). But mere commercial aggregations lack the scale and stability of secure cash flow and the binding power of public law. States also aggregate value claims over a larger economic catchment area but by means of the stronger and broader-based form of public contracting (taxation-for-legitimacy) ensuring their banks (central banks) are best placed to provide the stability necessary within a credit system, as well as highly credible last-resort emergency liquidity.

Democracy requires a fisc that is flexible enough to respond to political demands from below without being tied to the Victorian discipline of a commodity anchor – hence, Polanyi's story about the demise of the gold standard with the rise of democracy. Discipline is still, of course, required in all credit systems, but the fiscal articulation of state and society – deeper the more democratic the state is – turns the national economy itself into a much more flexible reserve asset for money even while enabling the state to attend to democratic demands. The demand for a return to a commodity anchor for money, the appeal of commodity-like cryptographic tokens as money, and the drive for central bank 'independence' to adhere to an explicit inflation target can all be understood as calls to discipline the state's role in a credit system. The economic question of liquidity always dovetails into the political question of liquidity: for whom, when, how much, and at what price? The question of credit discipline, therefore, always has to be answered with reference to local political, normative, and credit-cycle concerns.

The marriage of national money and bank money occurs via the 'par constraint', whereby commercial banks are mandated by law to fix the price of their monetary liabilities against those of the central bank at 1 ('par'). This invisibilizes bank money and creates a fetish of 'fiat money'. The dynamics of this marriage can range from healthy to abusive depending on the local political settlement. Bank money is invisibilized behind the par constraint in normal times; we only see that there is a marriage at all in times of crisis.

Thus, 'modular recombination' is a feature of modern money itself. National money and bank money each emerge from distinct forms of mutualization at scale; their synthesis into modern money creates hierarchical credit systems generating money that is at once granular (Hayek's concern), stable (the Currency School's concern), and liquid, both in daily use and in an emergency (the Banking School's concern). Hierarchical systems can modulate between discipline imposed from higher levels and elasticity generated 'endogenously' at lower levels precisely because the hierarchy is *nested*: the upper level's (inside) credit is the lower's (outside) money. The system can therefore be managed, in Hawtrey's (1919: 16) phrase, 'on banking principles' and set toward any number of political or normative ends.

This system evolved over several rounds of crisis-bred trial and error to be replicated, in form, across the world. The points of variation come, once again, from the underlying political settlement that determines the scale and institutional character of the particular credit system under analysis; outlining a few such cases is the job of Part II of the book.

As such, my aim is not to satisfy any of the money theorists, as Dietsch et al. note, but rather to take some of their theoretical elements and set them on a firmer footing. For instance, the materialism of commodity theorists is sound; its application to the physical

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commodity backing is not. Even under a formal gold standard system, gold functioned as a *disciplining mechanism* in a credit system rather than as an ontology of money (again, as the reading following Hawtrey indicates). Rather than dead labor congealed in a fixed amount of commodity gold, we have the future, unborn labor of the citizen-worker substantially anchoring our money. The national economy moving forward in time is the material basis of money. Fiscal mutualization of citizen and corporate balance sheets into a state ('a financial theory of state') turns the national economy into the reserve asset of the central bank; this is an obvious entry point for the (variable) politics of fiscal capacity. Whether or not this notion satisfies the commodity theorist is beside the point. It does, however, serve as an argument for the materialist grounding of money under a broad variety of monetary systems, both gold and post-gold.

This materialism is critical in rescuing money from the nominalism of the neochartalists, who also go by the label of Modern Monetary Theory (MMT). Dietsch et al. risk condemning the neochartalists to further nominalism by conceding that the former acknowledge only a 'prudential' limit to issuing money (viz. inflation) even as they recognize no 'formal' limit. Prudence does not make for a theory of money, nor does it even begin to account for monetary variability. Prudence merely emerges from practical observation without really generating theory. Surely recognizing that 'real economic capacity puts constraints on government spending' is no more than common sense: it does very little indeed to establish MMT's materialist credentials and in no way substantiates 'a direct connection between money and the material dimensions of the economy' as Dietsch et al. claim.

This is because so-called 'fiat' issuance in the neochartalist account remains entirely *exogenous* to the economy itself. The neochartalists may, along with common sense, recognize the possibility of inflationary overissuance, but what is their account of the (variable) value of money? For MMT, money is valuable *only* because it extinguishes a taxation liability imposed by a politically-exogenous state: their account of money's value is entirely *internal* to the debt relationship between the sovereign and the taxed subject. This is quite inadequate to account for hierarchy and variability in money. And yes, what MMT views as chartal tokens (things, not IOUs) might be overissued and result in inflation, and this practical difficulty must be avoided. However, there is no *economic* predication to money's value in MMT, merely a paper-thin political predication, namely their black box of 'sovereignty'. There are no balance sheet relations, public or private, that anchor money as a claim on real economic activity, so there can be no materialism in its account.

My argument is not, as Dietsch et al. put it, that 'political mutualization of money is *constrained* by the productive capacity of the economy in question' (emphasis added); rather, it is that, for state banking, political mutualization *anchors* national money in real value through a fisc of varying capacity, just as economic mutualization anchors bank money in real value at lower scales and weaker mutualization (which also varies over time and space). This is primarily an argument of the source of money's value and the reason for credit's hierarchy, one that emerges out of a particular economic ontology, that is, the interlocked nature of all balance sheets including that of the state. Dietsch et al. mention this ontology in passing without observing that it is a fairly central point of distinction between this theory of money and others, especially MMT, even as I draw substantial inspiration from the Money View orientation. 'Constraint' is therefore far too extrinsic a reading of how I conceived of the connection between money and value.

'Constraint', however, points to the operational question of monetary policy rather than to a theoretical question of money's value and credit's hierarchy. These operational institutions are critical to money at another political level – not the macro-politics of the political settlement between state and society, but the micro-politics of the financial plumbing. A chapter on capital controls might well have been in order, as Dietsch et al. suggest; so too might one on central bank digital currencies, digital payments systems, and

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so on. These topics would all sit in the second part of the book that deals more with the micro-politics of money.

The aim of the book was not to exhaust the entire empirical domain of money's micro-politics (as if one could), but rather to identify the micro-politics of financial institutional design as another *political* source of money's variability alongside the macro-politics of the general political settlement. Part II offers a small sample of such micro-political accounts that linked up to macro-political dynamics in particular contexts, including the nature of the global reserve system.

The point of invoking politics, therefore, is not to exhaustively describe the myriad ways in which money can be political. It is to illustrate that politics at these two levels (along with economic scale) constitutes a space of variation within which actually existing monies can move. The book identifies various modes and scales of politics as a source of variation in monetary quality, thereby accounting for hierarchy in money.

Questions concerning the micro-politics of money must be answered contextually. Thus, Dietsch et al. ask what the adequate decision-making mechanisms for monetary institutions might be in the abstract. Offering answers would not constitute a political theory of money, but rather a contextual account adequate to the particular institutions at hand. Again, Dietsch et al. inquire as to the tension between democracy and independent central banks, but this can only be answered contextually as we did when outlining how the Fed was suspended between populism on the one hand (condemning it to gradualism) and capture on the other (disabling it from adequate regulation and counter-cyclical policies).

At a general level, as mentioned, the politics of credit systems comes down to the question of the discipline and/or elasticity of credit: for whom, how much, when, and at what price. Arguments around 'central bank independence' then have to be mapped to particular configurations of discipline and elasticity in particular contexts; normatively, they have to be set against what the particular political community at hand considers valuable.

Perhaps, Dietsch et al. misrecognized my aim here, which, again, is to identify 'politics' at two levels as a source of variation in money and thereby to undergird an account of hierarchy in money, not to provide a generalization or taxonomy of all the ways in which money can be political. Their expectation perhaps comes from a consideration of 'political theory' from the standpoint of political science; my own view, for what it is worth, is that such generalizations are of little lasting theoretical value and that more contextual accounts fare better. The book aims to provide a general conceptual vocabulary to make varied contexts legible and comparable: all monetary systems are hierarchical, but each is hierarchical in its own way.

A Political Theory of Money is emphatically not a normative political theory applied to monetary policy. It is a work of *social* theory (hence its interlocutors), not 'political theory' in the standard sense of the term. The book deploys 'politics' from the standpoint of a theory of money to ask: what conceptual work can 'politics' do to improve our understanding of money? The answer is: (a) to identify politics as a particular type of balance sheet mutualization at scale; (b) to see all institutions including banking institutions as summations of political struggles or temporarily 'frozen politics'; and (c) to combine this understanding of politics with the balance sheet view of the entire economy to produce an account of how nested hierarchies of institutions turn credit into money of varying qualities.

Finally, Dietsch et al. inquire as to the policy consequences of the book. While this is not a work of policy prescriptions, such prescriptions do emerge directly from the analysis; I mention a few here by way of conclusion.

In systems where money is nationalized but commercial banking remains in the hands of the private sector (i.e., most of the rich world), the theory works as a reminder of the subordinate positions of commercial banks vis-à-vis the central bank. The source of this subordination, to be clear, is different from the MMT view that banks can issue money only because they have been granted a 'finance franchise' by the state (Hockett and Omorova, 2017). For me, the power of the state over money emerges from stronger, *political* mutualization at greater scale than banks. Domestically, the state's bank is the best 'on banking principles', i.e., on commercial terms and not merely thanks to brute 'sovereignty'. This power comes to be encoded in laws of bank licensing and regulation, but the law is not itself the ultimate source of this power: J.P. Morgan's 'money' is superior to that of many nation states'. Some states have better money than some banks because politics in their domains are institutionalized in a manner and scale that gives them better credit than banks.

The source of monetary power is critical to remember, because it sets a limit of what can be achieved in the public-minded regulation and/or management of banks. Power in monetary hierarchies is operationalized through the modulation of credit by greater creditworthiness of the upstream balance sheet. However, lower order balance sheets do have some commercially obtained creditworthiness, however inferior to their own state's; they also have some informational advantages given by operating closer to the ground. At certain points in the credit cycle, these balance sheets can issue money-like liabilities that might find broad acceptance. A simple banning of such activity in the name of sovereign privilege might well work, but it would require substantial state capacity and might end up choking off much economic growth, thereby reducing the very fiscal ground on which the state operates. For optimal results, such control mechanisms ought to be combined with managing the hierarchy on banking principles.

Commercial and investment banks must therefore be reminded of their subordinate status by appropriate credit discipline, using both price and non-price means available to all central banks. Regulate banks properly and nationalize them if necessary; the distinction between regulation and nationalization is ultimately operational, since in either case the system will be both centralized and distributed. The sad irony of the political economy of banking in the rich world is that the functionally subordinate units are the politically dominant ones.

That law is not the source of monetary power becomes abundantly clear in the case of the global reserve system, where no law has handed the US a license to mint world money. Where global money and credit functions come to be mapped directly onto sovereign spaces, discipline has to take a directly geopolitical form. We also live in a unique historical moment of extreme global currency monopoly, which generates an unusually steep global currency hierarchy. To fix dollar dominance, therefore, other states have to generate sufficient political mutualization at scale, allow the world (or some substantial part of it) to use their money seamlessly, and be willing to be the lender of last resort in a crisis. Such a state would have to have a domestic political settlement that can accommodate these global functions. The IMF is neither a bank nor a state; as such, it lacks political mutualization at any real scale and cannot provide world money at any meaningful scale.

Finally, the chapter on bitcoin outlines why cryptocurrencies continue to fail as money. Cryptocurrencies are digital tokens issued according to algorithmic protocols. They are designed to be finite and inflexible, i.e., 'credit'-like features are totally absent by design. Yet, ironically, such inflexibility creates one of the most intractable central planning problems ever: how much money does the economy need at any given moment? The only way cryptocurrencies could meet the demands of money is by becoming the base of an actual credit system, but this would already be inferior to the system we have that is based on a much more flexible reserve asset, namely the national economy itself. Stablecoins are just unregulated money market mutual funds obfuscated by a new cryptographic form.

Our credit systems might well be captured by special interests, but rescuing them does not mean abandoning them for new-fangled pseudo-solutions. What our credit systems

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need is both discipline and elasticity in the service of productive democracy. This means that banking technocrats at the central bank and in commercial banks have to be made accountable to the public, either by means of regulation or nationalization. The means of doing so are familiar to us: there are several key pieces of public infrastructure that can only be managed by publicly accountable experts. The point is to recognize that money and banking are such public infrastructure.

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