

On banking: a reply to Positive Money

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I've [been in debate](#) with [Positive Money](#) and its supporters on the issue of banking. I admit this was not intentional in that I was not seeking to provoke such an exchange at this time, but to give PM their due, they never miss a chance.

My concerns with PM's proposals on bank reform are fundamentally three fold. First, PM are aware, as I am and I hope all people interested in this subject one day will be, that with the exception of notes and coins all money is created by lending. PM take exception to banks partaking in this process, arguing with some good reason that to permit such a critical economic function to be undertaken almost entirely in the private sector and without effective regulation makes no sense from the point of view of regulating the economy or for reason of the enormous economic influence and gain that it provides to banking. PM's response to this, although they deny it, is to abolish banks.

This suggestion on my part that PM are seeking to abolish banks appears to be the first point of contention. They say the banks will continue in existence but will, instead of creating the money that they lend, act as the intermediaries that most people think that they are present, and will lend to customers funds that they have in turn borrowed from, or been allocated by, what PM calls the Money Creation Committee. This body would be part of the Bank of England, and I will return to it and its functions below.

I cannot accept the argument that if you remove the key identifying quality that defines a bank, which is its ability to create and so lend money, that it remains a bank. It does instead become a deposits and loan institution, which is something quite different, whilst its lending function is no longer about the creation and destruction of money but is, instead, more akin to being an outsourced credit committee of the Bank of England. I am aware that some PM supporters have suggested that I'm being pedantic for making this point. I disagree, unsurprisingly. If we are looking at fundamental economic reform then we should discuss fundamentals, and not semantics. The fact that under the PM proposal some institutions would retain the word bank in their title does not mean that they continue to be banks: their role will be entirely redefined. I cannot see how anyone from PM can argue otherwise.

My second concern is similarly fundamental. The following quote is from Modernising Money by PM (I have a copy: I was sent it by PM):

The decision over how much new money to create/remove from circulation would be given to an independent body, to be known as the Money Creation Committee (MCC).

PM [argues that](#):

The first (and most common) of these would be to grant the money to the government (by increasing the balance of the Central Government Account), which would then spend this money into circulation, as discussed in the next section. This process increases the amount of money in circulation without increasing the level of debt in the economy and can therefore be thought of as 'debt-free' money creation.

The second method would be for the central bank to create new money via the MCC and lend it to banks, which would then lend this money to businesses and the productive economy (but not for mortgages or financial speculation). This increases the quantity of money in circulation but simultaneously increases the level of debt, and so does not constitute debt-free money creation. This option provides a tool to ensure that businesses and the real economy do not suffer from a lack of access to credit.

I admit that I have very real problems with these ideas. I am, of course, well aware that governments can create money. The whole logic of green quantitative easing is based upon that fact. But, and it is worth stressing the point, that process does, invariably, require the use of debt. Admittedly, as I argue in the case of green quantitative easing, by keeping both sides of the debt under government control the net effect is net money creation without addition to public debt, but debt has to be used to create money.

What is more, creating money for the government but then not using it, is not, in effect money creation: that is creating the capacity to spend but such capacity has no impact until spending occurs. This essential point is missed in this account of creation of money for the use of central government, as is the matching, and essential, point that tax paid cancels this money. If it is the process of spending government created money into the economy that provides the substance of this money creation process, then the corollary of tax paid must, of course, negate it. I do not recall this issue being addressed in PM's work.

The second part of this explanation provides my third concern which covers a number of areas. The first of these is that money will, of course, be needed for mortgages and financial speculation. The second is that, as Ann Pettifor has argued, there is no way that a central committee can anticipate the needs of finance system for money in the following month. There will, inevitably, be credit rationing as a result for productive activities. PM's responses on this issue, including the argument that not all credit is money, are simply not credible: it is not reasonable to argue the businesses should wait to make settlement of commercial obligations because of a shortage of cash created during the course of a month by the MCC, which is what they imply. Like it a

lot that will inevitably constrain economic activity.

Last in this group of concerns is this, which PM [said in a response to Ann Pettifor that](#):

*The Money Creation Committee will have **no control over how the newly created money is used**.* Whilst the way the money is used will determine to some degree its effect on inflation, giving the MCC any influence over how the money is spent would introduce a conflict of interest, whereby its members might find that their judgement is swayed by their opinion on the merit of various spending programmes. In order to prevent this conflict of interest from arising, and to ensure that the MCC does not become politicised, the decision over how much money is created and what that money is used for must be taken by separate bodies.

There is something deeply, and even profoundly, troubling about this paragraph. First it implies that PM think that there is a stock of money which, somehow, exists beyond electronic debt. That is simply not true, notes and coins apart, and I presume that they are not proposing a return to their use for significant commercial transactions.

Then there is a suggestion that money creators should not be influenced by those demanding money. That is seriously worrying at two levels. First, this effectively says that this MCC will determine the level of government spending without any reference to the need that it might meet. That is monetary policy gone mad, and profoundly undemocratic and surely not what PM mean, in which case they need to make revision.

And it is also deeply troubling that the real economic consequences of money creation as indicated by the merit of various spending programme should have no influence upon the decision as to whether to create that money or not. In my opinion the exact reverse should be true, including in the private sector where the precise problem is that money has not been used for appropriate purposes.

I could expand all these arguments, of course. But what they suggest are real issues of concern and not petty sniping (in which I have no interest at all). I want banking and monetary reform. I want that to be used as the basis for a better economy. But I am deeply worried about making money creation so much a priority that government and economic activity is subjugated to it, and despite what PM says that seems inevitable to me.

Sp government has to be in control of its demand for money and the central bank has to meet that need.

And money creation has to be undertaken for directed purpose in the rest of the economy.

And banks have to be permitted to play a role in that process - subject to regulation, limitations on activity when appropriate and proper taxation. If that does not happen

then we have a totally centralised and undemocratic economy which cannot be the aim.

So let me assure PM: I want the understanding and reform you do but please address the real concerns that many who have sympathy have with what you're saying. We're spending our time on this to make the process work. We're worried you're not delivering a workable or democratic or accountable solution, and that's worrying.