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Making Money Work: How to Rewrite the Rules of Our Financial System. By Matt Sekerke and Steve Hanke, Wiley, 2025

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Abstract. MMW starts with the unique role of commercial banks in creating money, and deplores the way this critical function has become a compliance exercise. A different concept of commercial banks' central role can change the way we understand competition in banking, while also energizing the role of investment banks, private equity and venture capital. A more efficient banking system will boost economic growth. The authors revisit Basel capital and liquidity rules, the Dodd-Frank Act, and management of universal banks. They introduce a new concept of "monetary neutrality." They then provide discussions of deposit insurance, of monetary consequences of real estate tax distortions, and of post-GFC QE and LSAP's. They offer a critique of "old monetarism," then show how Divisia metrics can aid monetary management.
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Book Review

Fiscal Sekerke and Hanke's book is likely to become a lamp light for understanding and potentially reforming the way banking and finance work in the US, and even in the world beyond. On the fly-leaf, and inside, but before we get to the title page, 20-odd academics, investors and public officials praise the book's findings and scope. Nearly all of them describe Sekerke and Hanke's work as "panoramic," "integrated," a "challenge" to mainstream macroeconomics, or as for those who want an "in-depth understanding" of the banking system, of economic growth, and so on. But for any except those most comfortable with related literature, the book is a difficult read: it is well-written, but long and often densely argued, and with intervals of mathematics.

We can reconstruct a fairly linear argument from MMW. The authors begin by explaining, or reminding us, that commercial banks create money when they make loans. They are not financial intermediaries (despite a body of theory that suggests otherwise) – in this, they are unlike investment banks, money market funds, insurance companies, and other kinds of nonbank financial institutions. Historically, bank money creation broke the constraint of gold or silver stocks on extending credit. Banks now break the otherwise

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binding constraint of matching investment (or even consumption) with prior savings. Commercial banks loans are immediately matched by new deposits – while money is extinguished as loans are amortized and repaid.

Bank money-creation and consequences

The money-creation process ought to contribute to efficient, hence aggregate supply boosting, deployment of resources. The authors write, "Credit creation to support new bankable projects is the jet fuel of the banking system (p.96)." The argument becomes clearer as they note, "a more productive banking sector accumulates information in multiple domains to make more investable projects bankable.... Elastic money creation by the banking system allows the economy to grow faster when the claims backing new money are well-derisked bets on productive investment projects... Our inquiry ... rests on the suspicion that forces restraining bank lending are also restraining the economy's ability to grow" (p.97). The authors later cite research evidence that "isolates the causal effect of bank credit on productivity and GDP growth (p.269)." They comment that "competition in banking" is mostly about overcoming information asymmetry between lender and borrower, enough to make previously "rationed" projects less uncertain in their market prospects, hence bankable. Competition should lead to new credit products. (pp.273-275)

Evidence for the authors' view that the financial system is "broken" highlights the failure of capital markets to supply capital to risky projects. The largest pools of savings are directed toward safe projects that could be financed by banks; risk-supporting equity capital is available only for small, asset-light initial investments, while larger projects struggle to get off the drawing board (p.98). A productive money-creation system, in contrast, should allow banks to "amplify" capital available from intermediated sources, which capital may then be subordinated to bank credit. The authors argue that commercial banking has become hidebound, unwilling or unable "to configure new bankable projects." Innovation in finance – the "necessary investments in information, contracting and secondary marketability to support lending at large scale" – are mostly not happening in banks, which stunts performance of both bank and intermediary finance (p.297). The policy object of MMW is to detail ways to recharge banking.

Sekerke and Hanke challenge a premise common in economics discussion, and especially in finance textbooks, that "markets clear." The premise implies that investable projects will be funded, whether by financial intermediaries or by money-creating banks, at interest rates that reflect some quasi-consensual understanding of risks (p.72f). The result of competition in capital markets and banking should be to bring markets closer to clearing. The authors' theme is that current capital markets, banking practice, regulation, and enterprise structure are not advancing this goal, and are leaving financial markets far away from clearing.

The authors point to another benefit to shifting financial innovation back to money-creating banks. They note that the US has for decades received capital inflow through what Professor Bernanke, and others, call the world's "savings glut" (starting with China's). This situation could change drastically for demographic reasons – aging in the rich world -- or should US assets come to be thought less desirable – based on a mix of less-credible US commercial and political environments. Or perhaps the rest of the world, again starting

with China, will save less and consume more. With less saving from abroad to draw upon, US banks' capacity to create money in ways that boost overall production, to escape the antecedent-savings constraint, would become even more important.

Sekerke and Hanke point repeatedly to bank regulation as creating both compliance and bank-culture constraints on a more productivity-enhancing role for banks. From the Bretton Woods, post-WW2 era, regulation was dominated by lawyers and accountants focused on definitions and "compliance," rather than on the economics of banking or insightful risk-return modeling (p.180). Following waves of defaults on loans from US banks in Latin America during the 1970s, G10 countries directed a BIS Committee to develop cross-country capital rules. The Basel I Accord (1988) encouraged banks to hold government and agency securities, claims on other OECD banks, and mortgages by establishing low risk weights on them. In contrast, the Accord placed high risk weights on corporate credit, commercial real estate and asset-based lending. As the Basel I Accord was implemented after 1992, the weight of US bank balance sheets shifted from loans to securities; within loans, the share shifted away from the nonfinancial business sector in favor of residential mortgages (pp.183-184).

Basel II (1996) encouraged VaR approaches (allowing banks to build their own internal models) for both trading and credit risks; this phase was undermined, probably unfairly, by arrival of the Great Financial Crisis (GFC) in 2007-2008 (The authors are sympathetic to the view that the Fed was wrong, both practically and legally, to deny lending to Lehman Brothers in September 2008. Further, the downward spiral after the Lehman failure was driven by "an exaggerated crisis of market risk" -- not by the credit risk usually associated with bank failures. pp.185, 199n). Basel III, adopted post-GFC, continues the Basel I pattern of moving banking business away from nonfinancial business lending, and makes yet more balance sheet room for securitization, derivatives and trading-book assets. Basel III also imposes stiffer liquidity and reserve requirements, another concession to the post-GFC sense of alarm; this is of course a de facto tax on business lending (p.193). MMW elsewhere argues that banks do not fail from illiquidity – only from insolvency (p.208). Liquidity should therefore be provided through central bank discounting, at cost, as a matter of course. But the post-GFC Dodd-Frank Act unfortunately contains provisions that restrict crisis discounting.

When we look at bank lending as a vital economic function, one strengthened by competition for information and for developing new products, rather than as a fragile, quasi-utility, then bank management can move from worst case outcomes to pricing. MMW gathers portfolio modeling themes for improving risk-return adjusted bank profitability. In concept, similar models can be used for both regulatory structures and internal bank management.

The Gramm, Leach, Bliley Act (1999) completed the transformation of US bank holding companies into universal banks, which meant that trading and banking books would exist and be managed under the same roof. During the 1990s, universal banks were thought to be like mutual funds, so that diversification could be achieved by holding a mixed portfolio of banking and capital market businesses. Sekerke and Hanke comment that the state of theory was "indeed this thin" (p.277). A consequence of putting trading and banking books together in one enterprise has been that low-risk projects that

should be bank-financed are "cannibalized" by the capital market side of the business. Doing so wastes risk-absorbing potential of the latter, and hinders market clearing.

Capital market businesses also use banking business equity capital as a backstop for riskier or less-understood -- hence harder to price -- activities. (Eg, lending to capital market platforms within universal banks uses transfer rather than market-based pricing. pp.115-116). The authors note that universal banks "make more money" from issuing and trading bonds than from making loans, which leads them to under-invest in the banking side of the business (p 268). They cite evidence that mixing trading and fee-based business with bank lending tends to amplify enterprise risk, not disperse it. And, "higher ratios of non-interest income to assets are associated with increased systemic risk, tail risk, and interconnectedness." (p.279).

As do the Basel capital and liquidity rules, the Gramm, Leach, Bliley Act thus leans against use of bank lending to support new bankable projects. The authors propose various regulatory fixes that might offset the governance pitfalls of universal banking – eg, requiring executives to write long-term out-of-the-money put options as a way to force them to act in their enterprises' long-term interests (p 281). But their preference for the US would be to return to the Glass-Steagall days of separate investment and commercial banking.

Money Neutrality

Sekerke and Hanke introduce an apparently new concept of "monetary neutrality." The term has been used in the past to describe the situation where the targeted, or "exogenous," interest rate is the same as the (unobservable) "neutral rate." Alternatively, it has meant the aggregate supply of money matches its aggregate demand. MMW instead defines money neutrality more broadly, to mean that M(s) matches M(d) across sectors (p.266). By inference, "credit should be deployed over a broad spectrum of activities based on their ability to generate surpluses (p.21)." ("Surplus" here means approximately profits -- including those now foregone by a non-neutral monetary framework.) It matters in which sectors liquidity is introduced. Liquidity is not automatically redistributed in a surplus-enhancing manner.

A parallel concept of fiscal neutrality implies that government taxing, spending and borrowing should avoid distorting economic decisions by private sector actors. Monetary interventions can favor one economic sector over others, and they often do. Eg, banking regulations often favor extension of credit to housing and consumer goods. Government outlays for medical services and higher education have a monetary impact, increasing demand and prices in those sectors. Large-Scale Asset Purchases (LSAP's) since the GFC, often of mortgage agency securities, have had large sectoral monetary, demand and price effects. The authors' goal is to make us aware of the sectoral non-neutrality of money – which reinforces the case for re-imagining the money-creation function at the heart of banking.

One monetary non-neutrality in particular should be eliminated. Bank lending against real estate collateral has been the basis for much money creation. Real estate has value for the labor and capital invested into it – and also for rent. Neoclassical theory, and most tax systems, have been slow to recognize that land, unlike capital, is a distinct factor of production. Rent is the yield on land over and above the value of complementary inputs to production. Invested capital gets depreciation as a tax-shield over time;

economic rationale for the shield is to encourage upgrade and re-investment. But land, as part of a real estate investment package, can also be depreciated for tax purposes, even though land itself ("space") does not depreciate. Thus the value of real estate includes the capitalized value of its land rent. Further, no tax is paid on land appreciation until its time of sale, which encourages long-term holding – even absent any improvements.

All of this makes land easy ("lazy") for banks to lend against; it thereby takes up balance sheet that should better be deployed for more innovative credit. Lending against land also sets up conditions for financial crises – many or most of which are triggered by collapses in the value of land itself (p 294). An annual tax on the value of land (ie, a Georgist tax), excluding value of any improvements, would be economically efficient -- "monetarily neutral" – hence would make real estate a more productive vehicle for bank lending and money creation. It would prevent the value of land rent from being privately appropriated. And bank balance sheets would be decoupled from fluctuations in land values (pp.291ff).

Sekerke and Hanke draw attention to a couple of very large non-neutral monetary impacts of US economic policy in recent decades. One is the massive role of government-sponsored enterprises (GSE's) in mortgage finance, compounded by regulations that favored bank holdings of agency securities over actual mortgages. They comment that GSE's played a large role in making mortgages available during the 1960s and 1970s, but are no longer needed for that purpose (p.321).

A second is the eight-fold swelling of the Federal Reserve's balance sheet from mid-2008 to the peak of the COVID crisis. The authors somewhat understate the role of the Fed's October 2008 decision to pay interest on reserves (IoR) in this development – which predictably swelled bank excess reserve deposits over the next few years by 200-fold (Table 10-1). The Fed's QE policy, combined with IoR policy, beyond expanding the government's footprint in capital markets, has contributed to capsizing the interbank reserve market. It also leaves the central bank with nearly inevitable portfolio losses running in the hundreds of $billions. The authors propose mechanisms for reducing the role of GSE's in mortgage markets, and for shrinking the Fed's own balance sheet – both of which would shift monetary policy in the direction of neutrality.

MMW has a useful perspective on deposit insurance. Bank lending creates deposit money which should trade "at par" with other money, the unit of account (p.208). Deposit insurance protects the money-creation function, it is the logical extension of the guarantee of the convertibility of bank balances (p.48). Bank funding through money creation should therefore be treated differently from funding for non-banks or non-financial firms (p.280). Unsuccessful banks exit through the bankruptcy process, but without total insolvency; prudential regulation, including deposit insurance, exists to achieve such decoupling (p.272). This argument in favor of deposit insurance also reinforces the authors' case for breaking up universal banks. As the latter engage in non-lending activities that increase enterprise riskiness, it seems inappropriate to back-up such activities, even in part, with commercial banks' privileged and regulated activity of money-creation lending. But Sekerke and Hanke come down on the side of insuring deposits, even for universal banks, and laud progress in that direction in the European Union (p.209).

Replacing "old monetarism"

In a useful detour from MMW's arguments on the workings of banking and finance, the authors seek to upgrade "old monetarism," by rehabilitating the Quantity Theory of Money in Divisia garb. Divisia employs the concept of the "user cost" of money, meaning the interest foregone by holding it. That allows us to fine-tune metrics so that immediately usable money (cash, deposits) is weighted differently from interest-bearing savings or money market accounts. When interest rates are zero-bound, the user cost of holding greater liquidity shrinks; Divisia numbers are then not very different from raw broad M-supply numbers. As interest rates rise, as during portions of 2024 and 2025, trends in Divisia and in raw M-supply will diverge. Consequently, Divisia measures of M will generally reduce variability of V (money velocity) in the equation of exchange, MV = PY; it will similarly reduce the variability of k in the Cambridge equation, M(d) = kPY. And, while MMW focuses on bank money creation, Divisia (like other M-supply indicators) also measures new deposits created through central bank OMO's.

Sekerke and Hanke's work is important for its micro-analysis of banking and finance, and its proposed rewriting of their rules. In the book's final chapter, they suggest new operating principles for monetary policy based on their micro-analysis. Beginning somewhat after the GFC, bank capital grew fairly steadily, and predictably, in the US under the oversight of Dodd-Frank's Comprehensive Capital Analysis and Review (CCAR) mandated stress testing process. The US banking sector's net interest margin, they note, has been fairly steady since 1955, despite great variation in interest rate levels. Bank interest margins then accumulate as capital, where it can either finance new money creation or be distributed to shareholders. So it becomes possible to anticipate that the process could stabilize the rate of bank-created money growth by regulating bank capital distribution to shareholders (dividends, buybacks, etc.), which the Federal Reserve might oversee. The authors describe this mechanism as a "potential policy tool" (p.308): it builds on their underlying argument that bank money creation should be at the heart of monetary policy.

The authors cite that distribution mechanism somewhat too enthusiastically in their concluding chapter, "Rewriting the Rules," which many readers may consult first in order to take in MMW's policy recommendations. The cautionary word "potential" may be lost. The gist of their case is that more efficient banking and finance, in addition to boosting economy-wide productivity, will contribute to macro-economic stabilization. That logic is suggestive; but it is easily detached from the linear argument at the book's core.

The authors finish by turning their attention back to equity capital markets, which supply the economy's capacity for risk-taking. They question why the very rich favor safe investments when their wealth could underwrite transformative risk-taking, and they take Silicon Valley to task for funding such a limited subset of new ventures. Sekerke and Hanke see the overproduction of safe assets by capital markets as a deficiency at the core of finance. Similarly, they argue that the migration of equity investments from public to private markets is destroying positive informational externalities that would permit more projects to be funded. Their arguments about the important and distinct roles of banking and capital markets, which underpin the book in its entirety, deserve much attention.