

Notes on Bob Hockett, “Finance without Financiers”

Some general comments:

1. *Real Utopia Proposal discussion*: I think the key thing is to expand the material beginning on p.53. That is really where the real utopia discussion begins. The material that comes before is useful for setting this up, but really the critical objective is to specify alternatives.
2. As I interpret the main thrust of the argument, the proposal is about the state taking over more of the finance system and proactively being a player in the market. The vision is thus more statist than democratic. So the democraticness of the process hinges on the democratic accountability of these state-centered mechanisms. As we know one of the problems with the Fed is precisely its lack of democratic accountability. You don't need to address the issues of how to make the state overall more deeply democratic – that is a separate problem – but it would be good to indicate what aspects of each of these mechanisms would be most directly under processes of democratic accountability.

It would be worth saying something about the kinds of parameters of the actions of these institutions which would be most amenable to democratic participation. This seems easier for the public investment bank proposals, since the priorities for investment could be subjected to democratic deliberation. It would be good to say more about how the priorities for the nonmarket public goods/infrastructure projects would be set.

3. One of the issues I am interested in is how to shift the core of the economy from conventional privately owned capitalist firms to one dominated by worker cooperatives and hybrid firms like ESOPs with democratic participation. I wasn't sure exactly where financial institutions that might facilitate this would fit into your framework. This doesn't really constitute “infrastructure” in even a broad sense – except, perhaps, for things like coordination and training structures for cooperatives. Would these kinds of issues be part of the third agenda? It is rather different from the idea of more general diffusion of income-generating capital asset ownership.
4. The third proposal is the hardest to figure out. There seems to be two rationales in place – a general egalitarian rationale and the macro-economic demand stabilization problem because of labor displacement. Why can't the latter problem be solved through various Keynesian-type public spending mechanisms? And wouldn't Basic Income accomplish this more efficiently than SOPs? There is a whole other justification for capital diffusion and dilution, which is breaking the power of wealth-holders, but if the point is just income distribution effects of wealth inequality, than BIG would seem better.
5. The big data section in the middle should be drastically cut – it is really not needed. The point of the section is just to add credibility to the justification for the first part of the

new institutional design – Part A which is about macro-prudential prevention/stabilization. The data section should be 5-10 pages tops.

6. Currently there are too many places where the exposition has an insider flavor. I have noted some of these below, but generally we want this paper to be accessible to a broad educated readership.
7. There is no mention anywhere about the various kinds of new capital allocation mechanisms/processes/platforms that have emerged, ranging from things like Kickstarter to lending clubs. Do you feel these are too peripheral to matter?

More specific notes/comments on the analysis

Central thesis about source of finance:

p.10. Hence it is not only the case the loans make private deposits rather than the other way round, but is also the case that loans even make central bank reserves themselves rather than the other way round

p.12. It is that even what privately owned banks dispense is effectively an indefinitely extensible public resource – a resource on which they are licensed, moreover, to charge private rents. The banks are, in other words, best viewed as privileged outlets for something that is ultimately publicly produced and more or less freely extended to them – something the banks in turn dispense for a profit. In the U.S., that something is the monetized full faith and credit of the United States.

p.20. What all of these forms of banking – commercial banking and ‘shadow banking’ alike – jointly add up to is a financial economy in which financial capital is both superabundant and in effect publicly provided, with actual ‘intermediation’ between private suppliers of finance capital and sundry users thereof having very little to do with what actually happens. By effectively guaranteeing, when not directly supplying, the assets and liabilities of both banks and shadow banks, the federal government effectively converts these to liabilities of its own.

These liabilities the government in turn ‘monetizes’ by facilitating banks’ and shadow banks’ extending money loans that are the asset side counterparts to the mentioned federal liabilities. In effect, then, all of this investment that takes place through sunlight and shadow institutions amounts to a form of ‘shadow’ public investment. The returns on and allocation of the investment, however, are left mainly to private participants in the financial markets – to financiers. The returns, moreover, are in the nature of oligopoly rents. For the government limits, through licensure and other requirements, the number of ‘authorized dealers’ in the public credit.

Comments:

1) Let's imagine three systems:

system 1. The government prints money and gives it out as loans to people and businesses through government run banks.

system 2. The government prints money and gives it out as loans to private banks who then loan these funds to people and businesses

system 3. the current system.

Am I correct that the argument here is that these are essentially the same?

2) In addition to the kinds of credit-making/allocating institutions described in the paper, there are also a wide range of processes that look much more like a loanable fund being made available to borrowers (i.e. not generated by state based full-faith-and-credit). That is, even in a world with fiat money and central banks, there are still fully private transfers of funds. This seems obviously the case in inter-personal loans, but also things like lending circles, or perhaps some of the new e-loan platforms. Is this right? Or is there a more general sense in which all loans – even my lending \$5000 to my brother – are “backed” by the full faith and credit of the US government because of the background problem of inflation/deflation and the meaning of a loan with unstable currency?

3) I am having a little trouble really nailing down the distinction between two ways the state could figure in a finance system: a) creating the necessary conditions for the system to work effectively, and b) directly creating the funds that are distributed in the system. Providing insurance (eg FDIC) in one sense “creates” deposits, because they would not be forthcoming with the guaranteed safety, but this still seems different from directly depositing resources in a bank. Is the basic argument in the first part of the paper that there is less of a distinction here than might at first appear?

Regulation

p.20

Nearly all that the government does by way of regulating this activity, when it effectively regulates at all, is to modulate the total quantum. This it does via fiscal policy, monetary policy, and leverage regulation in the forms of minimal capital and collateral requirements. There is some credit allocation, true, (a) in the forms of direct investment and procurement, and (b) in the favored treatment offered certain forms of debt issued by favored issuers – for example, agricultural and ‘blue chip’ firms, along with some ‘small businesses’ looked out for by the Small Business Administration (SBA), more on which below. But there could – and should – be much more along these lines. Indeed it is odd that there isn't already, given (a) the public nature of the credit-resource, (b) the over-issuance of this public resource by private franchisee-issuers in recent decades, and (c) the relative sterility of those investments *made* with the over-issued resource.

Comment: You don't present any general discussion of the distinction between the state allocating resources via a finance system vs the state directly spending money on projects. It might be good to explicitly explain the rationale for deciding to allocate credit in order to get certain priorities accomplished versus directly allocating resources to those purposes. One version of this is *loans* versus *grants* when the funds are being directed at non-state agencies. Some discussion of this might help the general reader get a handle on the scope conditions for the proposals.

Magic of self-fulfilling prophecy

p.21 In effect, we find that the reasonable prospect alone, of some bona fide production's actually occurring through productive activity, can be monetized in advance. It can be monetized so as to finance and thereby enable productive activity itself in such a system. The system in other words is such that dreams themselves, at least when shared or indulged widely, can prove self-fulfilling.

But speculative manias, bank-runs, and asset 'fire-sales' as well, at least temporarily, are likewise in the nature of self-fulfilling prophecy.

comment: I like the poetic rumination here.

The Model

p.23. Next, as proportional income and wealth accordingly migrate toward the top of the distribution, beneficiaries of the skew do not consume in matching proportion to their increasing share of the national income. The average propensity to consume (APC) is diminishing in wealth. If we are discussing an 'open economy,' moreover, much the same occurs among nations running persistent current account surpluses with deficit nations, whose unbalanced trade relations themselves help to drive inequality within the deficit nations.

All of this means in turn that a growing share of income, from both home and abroad, must find 'investment' outlets, since a growing share goes unconsumed.

p.24. In order to earn returns on idle capital, then, wealthy rentiers turn increasingly toward lending arrangements, often one or more financial intermediaries removed, with those for whom real incomes have not grown like their own and who must accordingly borrow if they're to consume as large a portion of the national output as they have done in the past. Trade surplus nations act similarly by investing surpluses in trading partner currencies and consumer debt products that prop up trade partner currency values and borrowing capacities, enabling the same surplus nations to maintain export advantages.

The proportion of surplus devoted to debt-associated financial products accordingly grows as a percentage of aggregate investment both within the nation with a skewed distribution of wealth, and on the part of any nation with export advantages rooted in domestic labor exploitation, currency manipulation, or related practices. The financial sector of the economy

thus attracts more investment relative to the 'real' sectors of the economy, both within and across nations: the makings of 'financialization' fall into place as demand both for more borrowing and for more debt-associated investment vehicles picks up.

Comments:

Giovanni Arrighi has a very different theory of the shift from accumulation in the real economy to accumulation through finance:

The key idea Hockett is proposing is that because of decreasing propensity to consume with wealth and income, increasing inequality generates an excess of idle capital – idle surplus: “a growing share of income, from both home and abroad, must find ‘investment’ outlets, since a growing share goes unconsumed.” And this in turn leads to “The proportion of surplus devoted to debt-associated financial products accordingly grows as a percentage of aggregate investment both within the nation with a skewed distribution of wealth.”

This is quite different from Arrighi’s view about the shift from what he calls material expansion to financial expansion: he sees this as a result of increasingly intense competition that builds up during stable periods of capitalist development under the guidance of some hegemonic power, which results in reducing the rates of return available in material production and which therefore prompts capitalists to try to escape from competition via financial expansion.

The debt increase part of the model: household debt, income time series

comment: I have some concerns about the time trends you indicate in the section beginning on p. 35. Household labor supply has increased enormously in this period – both because of women’s labor force participation and increased hours of work -- and that is often seen as one of the main drivers of increasing consumption in the face of stagnant wages. You acknowledge this, but you don’t indicate what percent of the maintenance of household incomes comes from debt vs these other sources. It is also the case that the within-career age-slope n earnings has increased, not decreased. This is the case whether the slope is estimated from synthetic cohorts -- the ratio between a median earner at age 55 to the median earner at age 30 25 years earlier –or longitudinally within an individual’s career.

Question re Financial asset markets and commodity markets

p.56 as with credit and money markets, so in the case of financial asset and commodity markets, recursive collective action problems are pervasive. *While prices rise in these markets on the strength of loose credit*, it is individually rational for private actors to purchase more with a view to logging the spread between current prices and later prices; but everyone’s acting thus rationally drives aggregate prices yet higher and more out of line with anything like ‘fundamental’ or long-term sustainable value.

Question: is it always the case that an asset bubble is driven by loose-credit, or is it simply that this is the form of a bubble that generates the catastrophic ramifications when the bubble bursts?

Institutional design issues

A. Government organized mutual fund of financial assets in order to affect the market: The OFAMO and OCOMO funds.

p.58. The initial capitalization should be sufficient to impart to the Fed sufficient market power to 'move' either particular submarkets within the full portfolio or the full portfolio as a whole. Anywhere between 5% and 10% would seem a plausible beginning.....

While it presently does this pursuant to its de facto macroprudential oversight role, it will now do so additionally pursuant to a macroprudential intervention role – i.e., a contingent buying and selling role.....If, for example, over a course of months or years such as those of the first five years of the present century, it emerges that some particular asset class such as residential mortgage backed securities ('RMBS') or tech stocks appears to be rising in market value at rates inexplicable by reference to anything like 'fundamental' value, FOMC will begin instructing the FRBNY trading desk to sell quantities of these securities each day, with a view to putting downward pressure on prices and thereby incrementally raising credit costs – e.g., mortgage credit costs – in the submarket in question. Symmetrically and by the same token, FOMC will instruct FRBNY to commence purchasing activity in respect of particular asset classes when it begins to emerge that such assets are artificially undervalued

Questions:

- This initial capitalization through stock purchases would itself affect the market, right? Is this just a transition problem?
- How is the initial capitalization funded? Is this like the Fed creating money, or would it be paid by taxes, or what?
- You argue on p.60 that the information conditions for judging specific asset classes prices relative to fundamentals is not more complex than what the Fed already does when it estimates "current 'natural potential' growth paths of the macroeconomy in light of demographic, industrial, expenditure, and other patterns that it must track economy-wide." (60) Is that really the case? I don't know anything about this, but it would seem that there will be lots of sector specific issues that would make things tougher for specific asset classes.

B. Infrastructure

p.61. that infrastructure can and should be understood much more broadly than simply comprising roads, bridges, water treatment facilities, and the like. Infrastructure is actually all swathes of the material and cultural environments that we share and on the basis of which we live and produce. Some portions of these swathes are best managed, maintained, and

improved over time, yet this is unlikely to happen absent coherent and concentrated collective action – the form of action that only a collective agent can properly perform.

comment: I want to be sure I know what the boundary conditions are for infrastructure. This conception is stills about *investment* rather than funding *activity or programs*, right? That is: take the national parks. The “infrastructure” of the national parks would include buildings, solar plants, trails, perhaps training facilities for rangers. But the actual ranger guided hikes and visitor centers programs would not themselves be “infrastructure.” A concert hall is infrastructure, but the concert is not. So, is the idea here for a “public investment authority” that is restricted to non-program investment, and the actual programs, if they are to be funded, would have to come through ordinary public budgets? The idea then is to create more efficient ways for various governmental agencies to borrow money for those kinds of projects, but not to run programs.

A question is whether there is good reason to draw this line of demarcation? Is this just because of the idea that an investment has large upfront costs but last for a long time?

p.70. It is likely no accident that FHA, Fannie and Freddie operated effectively and well until made to compete with Wall Street investment banks for securitized mortgage loan market share in the early 2000s, and that the Stafford Loan Program and Sallie Mae did likewise in the securitized student loan market until private lenders were allowed onto Stafford’s turf and Sallie was privatized at the end of 2005. *If the public must ultimately provide itself with its own public goods via its own public instrumentalities, there seems no reason to honor private wishes to earn profits in the process that are in excess of what is required to attract such private capital as is desired to supplement available public capital.* [italics added]

Comment: This is really a key issue: the reasons for blocking competition between public and private forms of credit allocation are that public lenders are “rooted in values other than profit-maximization and cost-externalization fundamentally alters the incentive equation in a manner that settles for reasonable rather than maximal or merely speculative returns on investment, in return for appreciable increments of safety, soundness, and stability....” This is a crucial point: how to block the siren call of competition with the private sector as a way of improving finance.

A question about the idea of “tapping” into “sources of capital”.

In the opening sections of the paper, when speaking of debt/credit and criticizing the *loanable funds* model, the point was made that basically all credit was actually government issued. On p.72 you are talking about something different when you speak about “tapping capital” – here the issue is *investable funds* not *loanable funds*. Is the only connection between these two when people borrow in order to invest – that is, the amount of the investible funds which they have at their disposal comes from their capacity to borrow – which ultimately means the government giving them (indirectly) loans? Is the shift then that is proposed on p.72 from an infrastructure credit bank to an infrastructure equity investment bank?

C. Redressing deep inequality

p. 78 If these trends continue, and there is no reason at this point to think they will not, then we are faced with a long term challenge of immense proportions. In effect, there will be no obvious way to maintain aggregate demand sufficient to underwrite full employment other than (a) continued and steadily increased reliance on ultimately destabilizing consumer and mortgage hyper-credit as modeled above in Part II, or (b) massive confiscation and redistribution of a sort that appears to be politically difficult, to put the point mildly.

Comment: Why wouldn't something like UBI solve the problem also – giving everyone unconditionally enough buying power to buy the stuff made by the robots? I don't think that this would require confiscatory taxation.

I generally found the plan for SOPs much less clear and persuasive than the other parts of the argument.

minor editorial issues

p.23 and elsewhere: the use of the word “per” should be changed -- this is not conventional lay useage. Example:

p.32. The data are about income concentration, but the graph title refers to high wealth and the text on the previous page referred to periods of “wealth accumulation”.

p59 (as an example): there are places where the discussion is too much of an insider's discussion for our purposes. For example: “First, the Fed has already begun incrementally extending more garden variety OMO, at least in the mortgage finance space. That is precisely what both QE3 and the FRBNY's Maiden Lane Funds are and were, respectively”. Everything really needs to be transparent to an ordinary left-intellectual, fairly well informed about political economy issues, but without insider familiarity with Acronyms or special arrangements. The discussion on p.73 is another example – non-experts will be completely lost here.

Additional Comments from reading April 28 revised draft.

1. **The Hayekian mechanism argument.** I very much like the formulation for how to think about the articulation of public authority and private for-profit agents:

The franchisees, for their part, aid the franchisor in discharging these functions by in effect 'betting' on various alternative directions that what is always ultimately public investment might take. In so doing they play a Hayekian information-gathering and -aggregating function from which the franchisor benefits in determining where best to deploy capital.

This, I believe, is the best way to understand why it is that I allow nominally private banks and shadow banks both to dispense and to profit by dispensing what is at bottom a public resource. The dispensary role is a Hayekian role, and the profits earned therefrom are compensation for playing it. (27-28)

There are two issues that this raises for me:

(1). If this is the sole rationale for a private role, then I don't see why public-private partnerships are needed for public infrastructure investment. Why not just have public authority with public credit/money creation as the funding mechanism. If one hits a money supply constraint – i.e. more money should not be created – then what is the advantage of private partners over using taxation as a way of mobilizing part of the surplus for direct investment? The Hayekian function of private equity partners in public goods funding seems considerably weaker than in funding business ventures. Is the issue here that the bond issuers for these public goods include lots of local entities like school boards or cities and these local entities have very different likelihoods of defaulting on their bonds – and thus the bonds have different risks – and thus you need private investors to signal the risk-profiles of the bond-issuers? What I don't see here is why for-profit agents are better situated to make that kind of risk assessment than is the public authority involved in the public infrastructure bank. Also, in your exposition of the need for private investor partners you suggest that it is important "to use investor preferences as signals concerning the likely future success of alternative prospective investments." But I don't see how in public goods investing this is relevant – how can investor preferences bear on the success criteria for public goods? It bears on the repayment of loan by the bond-issuer – a city, say – but not on the success of the public good that is funded by the bond itself.

(2). There is an argument in the deliberative democracy literature that democratic processes, if sufficiently robust and deliberative, can also serve information conditions for setting priorities and allocating resources, especially where the optimal allocations depend on the correspondence to values rather than a criteria that can be operationalized as private bets. Allocating credit across business proposals where the businesses are meant to generate profits might be well served by Hayekian mechanisms, but allocating investment across public goods or quasi-public goods like arts projects would not be served by this kind of mechanism.

2. Another comment on the problem of mobilizing private capital for public purposes. In the discussion of the public goods infrastructure investments, you also argue that inducing private capital owners to participate is desirable because it can direct private capital away from inflation-inducing speculative investments and get them to invest in long-term projects. To do this they need various sweeteners. I see why this might be politically needed. But why not just tax the capital when it is invested in these undesirable ways -- and then deploy the state-appropriated surplus towards infrastructure. Again, there may be political obstacles, but wouldn't that be better. There seems to me to be a tension here between the theme of creating money for purposes allocating credit to worthy projects on the one hand, and the need to direct existing capital towards particular projects. For the latter there is the choice between taxing the capital and reallocating it to public purposes versus inducing private capital to do so. Where there are significant Hayekian problems, then the latter might be needed, but otherwise I don't see why.

3. OFAMO & OCOMO funds. Is it plausible that the state could purchase a sufficient number of shares or futures contracts to enable it to influence the market without the very purchase of these shares dramatically affecting the prices in the market at the time of their purchase?

4. Contingent public governance. This is a very radical proposal, and it is hard to see how this could really work – the government stepping in and taking over the management of financial institutions that are not immanently insolvent but just engaging in what is perceived as excessive risk-taking. I would think that the information conditions needed to know when to intervene in a particular internal governance process of particular firms would be pretty difficult. The proposal for “a ‘golden share’ mechanism allowing for contingent public governance – a sort of ‘manager of last resort’ function – constitutes a fitting and critical tool for my franchisor to have at its disposal.”

5. CDA proposal. There is an alternative way of getting citizens to have a greater capital-ownership that is along the lines of the original Meidner plan in Sweden: Have corporations pay their profits taxes not in cash but in newly issued shares. These shares go into a wage-earners fund. The property-rights to the dividends generated by those shares could be: (1) on a per capita basis – the more egalitarian solution, or (2) on a basis proportionate to wages – which would mirror the typical ESOP pattern. There could be various provisions which either allow or disallow different forms of transferring these property rights, depending upon how much one wants to make these function like real privately owned wealth or simply as a basis for an income stream in addition to wages.