Financial Democratization and the Transition to Socialism*
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This essay proposes a strategy for radical financial reform that could be implemented in the United States or other developed market economies.\(^1\) It builds on the argument elaborated by Robert Hockett in “Finance without Financiers” that credit creation is ultimately dependent on the power and resources of governments. As Hockett shows, this authority has usually been deployed to underwrite the profitability of banks and other for-profit financial institutions. The proposal here is that this governmental authority would be used to build over time a network of decentralized, nonprofit financial institutions that would significantly improve the allocation of credit with positive results for economic welfare. If these positive economic results actually occur, radical financial reform could provide the critical missing element to make a democratic and gradual transition to socialism politically feasible.\(^2\)

This agenda is possible now because financialization over the last four decades has focused credit creation into several narrow channels with the consequence that a number of increasingly vital economic activities have been left without adequate access to credit at reasonable interest rates. These credit-starved sectors include infrastructure, the financing of small and medium sized enterprises, multi-family housing for middle income and low income families, and social entrepreneurship by nonprofits. The idea of the reform proposal is that the federal government would provide enhanced subsidies that would make it possible for both existing and newly created nonprofit financial institutions to develop the expertise required to provide sustainable finance to these vitally important economic activities.

In fact, the federal government has a long history of creating new credit channels to finance previously neglected types of economic activity. This happened in 1916 with the Farm Loan Act and in 1932 with the passage of the Federal Home Loan Bank Act which became the basis for the New Deal’s dramatic expansion of home mortgage financing.\(^3\) More recent federal initiatives expanded the availability of credit for small businesses, student loans, community development, and alternative energy initiatives. In short, the proposal represents a deepening of earlier efforts rather than a completely new direction. Moreover, as a legacy of previous reform projects, the U.S. has a remarkably strong infrastructure already in place to provide support to nonprofit financial institutions.

The full version of this financial reform agenda also includes reforms to the global financial system that would work in synergy with the domestic reforms.\(^4\) I will not address these global

\(^1\) While the description of the context for reform relies on the U.S. case, the strategy could be applied in other developed market economies without major modifications.


\(^3\) These are discussed by Sarah Quinn, “‘The Miracles of Bookkeeping’: How Budget Politics Link Fiscal Policies and Financial Markets.” \textit{American Journal of Sociology}, forthcoming. See also Prasad (2012), pp. 199-200.

reforms at any length for reasons of space. But there are three key elements to the global reform agenda. First, there is a need to reduce the dollar’s global role and to create a global credit institution along the lines of Keynes’ proposal in the 1940’s for an International Clearing Union. Second, the amount of lending organized through nonprofit global development banks would be greatly increased. Finally, a global transaction tax and other measures would lower the flows of private global capital. Suffice it to say that over a ten or fifteen year period, these global reforms will also be politically feasible. The current international monetary and financial system is plagued with very serious problems as reflected in the Global Financial Crisis and the nearly decade-long period of slow and precarious economic recovery. Up until now, the major obstacle to global reform has been the stance of the U.S. government since there is broad interest around the world in revising what is widely seen as a dysfunctional global set of rules and institutions.

The argument of this essay will be developed in five parts. The first section is an introduction that places the reform proposal in the context of historic debates over the reform of existing financial institutions. The second section lays out three critical factors that have opened up the possibilities of a new financial reform politics. The third section lays out the standard dilemmas of socialist transition and shows how radical financial reform could make it possible for a socialist government to manage that transition successfully. The fourth section explains why it might be possible to mobilize majority support for radical financial reform even in the United States. The fifth section provides a brief sketch of what that radical financial reform would entail. The conclusion summarizes the overall argument.

1. Introduction.

Recent events in Greece have suggested the possibility of a surprising convergence between radical financial reform and socialist politics. Since 2010, Greece has been the most serious European victim of austerity policies that have produced high unemployment and economic misery. On January 25, 2015, Syriza—a left-wing party opposed to austerity—won the Greek parliamentary election and was able to form a government. What followed were months of painful negotiations with the Troika—the European Commission, the European Central Bank, and the International Monetary Fund—over the terms of a new loan that Greece needed if it was to stay in the Eurozone. The Syriza finance minister, Yanis Varoufakis, a leftist economist, became extremely unpopular with the Troika negotiators because of his insistence that Greece be released from years of painful austerity. His resignation was required before a new bailout that involved continuing austerity was finalized.

After leaving the government, Varoufakis revealed that his department had been working on a contingency plan if Greece could not come to terms with the Troika. The plan was a response to the threat that the European Central Bank would stop providing lines of credit to Greece’s banking system which would mean that Greek banks would have to close their doors and the resulting absence of credit would bring the entire economy to a standstill.

Varoufakis and his team planned to use the nation’s tax identification system to construct a parallel credit system that could function while the Greek banking system was out of commission. In the absence of checks, individuals and businesses would be able to pay their bills by having this newly created parallel banking system debit or credit their tax account by the amount required. Presumably, those with large debt positions would have to pay some interest, but many of those who were economically active would see their debits offset by inflows of
payments from others. Once this system was in place, ordinary economic activity could continue even without a banking system, and it might even be possible to reverse years of austerity in Greece if those running the parallel system made access to credit available at favorable interest rates. Some businesses that had been previously starved for credit could conceivably expand their operations. In short, this was a plan to use the government’s authority to create a public system of credit creation.

To be sure, this plan was never implemented and its mere existence was seized upon by other political parties in Greece to tell voters that the Syriza government was reckless and dangerous. Nevertheless, the incident is important because it represents a rare moment of convergence between two political and intellectual currents that have been deeply at odds for many decades. The first is the tradition of Marxian socialism that has historically adopted quite orthodox positions on questions of finance. Polanyi argues, for example, in *The Great Transformation* that after World War I, socialist intellectuals were virtually unanimous in advocating a return to the Gold Standard and even when socialist parties won national elections, they were usually quite reluctant to engage in deficit financing or other unorthodox policies.  

The second tradition is more heterogeneous; it includes thinkers of both the right and the left who imagined that redesigning the mechanisms through which credit is allocated in the economy could be a path to significant economic and political improvements. We can call this group radical financial reformers; representative figures include C.H. Douglas who inspired “social credit” parties in a number of English speaking countries and various left-wing proponents of local money systems based on labor time. In *The General Theory*, John Maynard Keynes pays tribute to Silvio Gesell, a German-born thinker who lived for a time in Argentina and proposed the concept of stamped money. Currency would lose its value unless it was stamped each month and the cost of the stamps would provide a powerful incentive against hoarding.

With a few notable exceptions, there has been little love lost between these two traditions. For one thing, fascists in the 1920’s and 1930 often made use of these alternative credit ideas to

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7 One of the most important current movements in favor of radical financial reform has been the effort to create a universal currency independent of government through Bitcoin or similar initiatives. This effort has been closely tied to a libertarian ideology. This is inherently a utopian project because viable currencies cannot exist without the backing of some kind of governmental entity. However, it is possible that the underlying technology of blockchains could be an element in a democratized financial system.


9 The Bavarian Soviet Republic in 1919 brought in Gesell to redesign the financial system, but the Republic lasted less than a month. A slightly more durable link between the two traditions occurred when the Swedish Social Democrats embraced the Meidner Plan that envisioned workers’ gaining ownership of the means of production through their pension savings. However, employer resistance ultimately defeated this initiative.
attack existing financial elites and to attract the support of disillusioned leftists. Ezra Pound, for example, was influenced by both Douglas and Gesell and their views helped to inform his idiosyncratic embrace of Mussolini. But the deeper issue is that Marxists have generally argued that the only way to transform the financial system is by ending the system of private property. They have viewed attempts to tinker with the organization of the financial or credit system as a diversion from the struggle to gain control over the means of production.

But the Syriza incident suggests that in the current period characterized by an accelerating process of financialization of economies around the world, there is now a possibility of a creative synthesis between these two traditions. This essay will go even further to suggest that radical financial reform might provide the means to overcome the formidable barriers to a democratic transition to socialism. In parallel with the concerns of the Syriza finance ministry, elected left governments from the 1930’s onward have had to contend with capital flight and capital strikes when they try to implement measures that threaten the interests of property holders. The result of these resistance efforts is generally a downturn in economic output that undermines political support for the leftist government. As Wright has argued the difficulty of getting through these periods of diminished output has repeatedly frustrated democratic socialist advances.10

But what if an elected left government were able to implement an incremental program of financial reforms that began to create a parallel financial system that existed alongside the existing financial structures? It might be possible that after these parallel financial institutions had grown over some years, the left government would be able to survive a direct conflict with propertied interests because the historic weapons of capital strike and capital flight would no longer be sufficient to cause a sharp economic downturn. In other words, if radical financial reform could weaken the structural power of capital to resist a broader program of socialist transition, it might be the key strategic tool that advocates of socialism have long sought. In this sense, the democratization of finance would be the paradigmatic real utopia because over a decade or two, it could transform the balance of power in the struggle to shape the social order.

2. What has Changed.

There are three basic reasons that a synthesis between socialist theory and financial reform is now feasible. The first is the dramatic shift in the role of large corporations in developed market economies. This shift is particularly visible in the United States where one scholar has written a book entitled, The Vanishing American Corporation.11 The basic idea is that the corporations that dominated the U.S. economy a generation ago employed hundreds of thousands of people in giant factories and huge headquarters buildings. But this is no longer the case. Large manufacturing firms such as General Motors have drastically reduced their global labor force through the adoption of new production technologies. Newly dominant corporations are exemplified by Facebook and Apple. Facebook employs fewer than 13,000 people and Apple has only about 66,000 employees in the U.S.12 To be sure, they accomplish this leaness in

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12The main exception to this general trend has been Wal-Mart with its 2.3 million global employees, but it seems clear that there is a slot for only one retailer of this size. Most other large retailers in the U.S. have been closing stores and reducing employment.
different ways. Facebook relies on hundreds of millions of users to produce content while Apple relies on subcontractors in Asia to produce most of its products. But the end result is the same; the share of total employment provided by large corporations has been falling precipitously for decades.

Moreover, the new technologies have also created expanded opportunities for small and medium-sized enterprises. Part of this is the decomposition of production processes as large firms increase their reliance on subcontractors and various forms of outsourcing. But another part is that declining capital costs put sophisticated technologies in the reach of small firms. Current possibilities range from people making a living by buying and selling things on E-Bay or renting out units on Airbnb to people developing new smart phone apps to highly specialized and tiny manufacturing firms that sell their products over the internet. At the same time, a cultural interest in healthy and organic food has also led to a proliferation of new restaurants and small businesses selling specialty foods and beverages.

These trends mean that most people are now either self-employed, work in the public sector and nonprofits, or in business firms with fewer than 500 employees. To be sure, many of those who are self-employed or work in small firms might still be directly dependent on large corporations, working for them as subcontractors or franchisees or hoping that their small firm might ultimately be bought out by a larger firm. Nevertheless, the result is still an economy that is substantially more open to bottom up initiatives than was true thirty or forty years ago.

Yet at the same time, the financial system has been moving in the opposite direction towards greater centralization in giant firms. This has been particularly acute in the banking sector where a handful of giant banks now control a wildly disproportionate share of all consumer deposits. This creates a large financing gap because these giant institutions have very little interest in the time-intensive work of providing loans to small and medium sized enterprises. The result is a large and growing disjuncture between expanding entrepreneurial opportunities and a financial system that is preoccupied with giant transactions in large money markets. This gap means that for the first time since the heroic days of agrarian populism in the late 19th century and early 20th century, the issue of financial reform to make low cost credit available to millions of people has the potential to motivate large scale social movement pressures.

So there is a political opportunity at the same time that the corporate community’s capacity to resist reform pressures has fallen. In earlier decades, when the biggest corporations were responsible for a large share of total employment, their political clout was much greater. Their threat to reduce investment and to shut down factories could almost instantly produce mass unemployment. Now, however, with their diminished payrolls, such threats are less compelling. These big firms have become much more reliant on political allies in Congress and the White House to protect them from reform initiatives that threaten their power. But this shift is a source of vulnerability because pro-business politicians can suffer big electoral defeats.

A second factor that facilitates this synthesis between socialism and radical financial reform is that at the current stage of economic development, investment in infrastructure has become an

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13 Block, “Democratizing Finance.”

14 Prasad, Land of Too Much.
increasingly large element of total investment. There are basically four reasons for this. The first is the accelerated processes of urbanization that have concentrated human populations in cities. In contrast to towns and rural areas, urban agglomerations require much more infrastructure per capita in order to manage flows of goods, people, energy, water, and sewage. Second, new technologies of transportation and communication tend not to displace earlier ones so there need to be simultaneous investments in multiple systems. In transportation, we now require infrastructure spending for water-borne transport, roads, railroads, air travel, and space travel. In communications, we have land lines, broadcasting, cable systems, mobile phones, the internet, and plans for a much more advanced system for transmitting vast amounts of digital data. Third, most infrastructure projects—both maintenance and new construction—are relatively labor intensive as compared to manufacturing and this drives up their relative cost. Finally, climate change is necessitating major new investments designed to protect populations from deadly storms and rising sea levels.

The growing magnitude of infrastructure investment creates a huge problem because most infrastructure spending has features of a public good. This means that private firms, acting alone, are usually unable or unwilling to make these investments. Governments end up building infrastructure themselves, contracting with private firms to do the actual building, working out regulatory formulae that guarantee profits to private firms that make needed infrastructure investments, or resorting to public-private partnerships that assure private interests a future income stream for helping to finance the infrastructure. The difficulty is that resistance to higher taxation across the developed market societies means that governments at all levels find it increasingly difficult to finance needed infrastructure spending no matter which of these strategies they choose.

A logical solution to this problem has emerged in countries such as Brazil and Germany that have state investment banks. Such banks are defined as off-budget entities, so their debt is not included on the government’s balance sheet, but they have a franchise to create credit. So these institutions are able to make very large investments in infrastructure projects with both other public sector partners and with private firms. Even in the United States with its deep hostility to violations of the separation between government and the market, President Obama pressed for the creation of a national infrastructure bank that would emulate what Germany and Brazil have done. While Congress has refused to cooperate, this is an indication that the issue of infrastructure spending has put on the political agenda a major reform of the financial system.

The third factor that facilitates a new synthesis between socialism and radical financial reform is that we now have available a better understanding of how the credit system works than the perspectives used by earlier generations of left theorists. This new understanding is what Robert Hockett has outlined in his contribution to this volume. It is basically the franchise theory of credit creation. The argument is that in the modern era of central banks as lenders of last resort, the state basically grants a franchise to private actors to engage in the process of credit creation. Without the state’s ultimate agreement to protect these franchise holders from failure,

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they would not be able to engage in the process of creating credit out of thin air. But this process of credit creation is essential or otherwise economic activity would quickly decelerate in the absence of access to credit at reasonable rates.

The critical feature of the franchise model is that it makes clear where power actually lies. As franchisees, the private financial intermediaries that create credit are obviously dependent on the government. Without the franchise arrangement, the risky activity of credit creation would sooner or later lead them to fail. However, these institutions also have a very strong interest in hiding the reality of this dependence because government authorities must also regulate the financial sector and place limits on the riskiness of their portfolios. Since the banks and other financial institutions make greater profits by taking on higher levels of risk, they are constantly facing conflicts with regulators about the appropriate level of risk. Their main strategy for gaining leverage on the regulators is by insisting that the dependence runs in the opposite direction. They do this by arguing that banks and other financial institutions engage in the critical task of intermediation—connecting lenders and borrowers. They further claim that if they are unable to engage in the vital task of intermediation, economic activity would slow to a crawl and government revenues would fall precipitously. It follows that financial intermediaries must be granted maximal freedom to direct credit where it is needed. Excessive regulation of finance will “kill the goose that lays the golden eggs.” Of course, this argument gains force because of the widely believed idea that the fastest route to prosperity is to depend on the self-regulating dynamic of markets.

Since the franchise model cuts through this ideological haze, it opens up a whole set of alternative policy options. One is to replace the current framework of financial regulation with the public utility model. That model is based on the idea that in providing a private firm with the monopoly rights to provide electricity or natural gas to homes and businesses in a certain geographical area, it is appropriate for regulators to control the amount of profit that the firm can earn from that business. In exchange for giving a particular financial institution the franchise to create credit, the government should set a maximum amount of profit that the firm could earn. Such an approach would have the great advantage of discouraging financial institutions from taking on higher levels of risk since they would not be able to retain profits in excess of the government set ceiling.

The more radical option is for the government to expand the category of franchisees that are authorized to create credit to entities that are not organized to pursue profitability. This can happen in two ways. One is for the government to create in-house franchisees which would be public sector agencies that have the ability to create credit. The other is to encourage the creation of organizations, organized by local or state governments, or nonprofit institutions that would be credit creating franchisees. In both these scenarios, granting the franchise would have to be accompanied by regulatory measures since public or nonprofit entities would still have incentives to engage in irresponsible or unsustainable credit creation. But as we have argued,

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19 One incentive operates through executive compensation and portfolio growth. The larger the institution’s portfolio, the easier it is to justify higher pay for top executives. The second incentive is the
the United States has already implemented parts of this radical scenario. Moreover, the
unsuccessful Obama proposal to create a national infrastructure bank is essentially the idea of the
government creating another in-house franchisee.\textsuperscript{20} Hence, the changes that are proposed here
represent not something fundamentally new, but simply expanding the scale of what already
exists.

Another strength of the franchise model is that it makes clear how much agency governments
already exercise in shaping their nation’s financial system. Let us take by way of comparison
the apparel industry. In the case of apparel, government actions including trade policies, labor
policies, tax policies, and so on are likely to influence the way the industry has evolved, but very
often this influence occurs at the margin. The choices made by entrepreneurs and firms, within
the context of government policies, make a huge difference in determining how much production
occurs domestically, whether that production is oriented towards fashion and high end
consumers or to mass markets, and the mix of cutting edge technology and skilled or unskilled
labor that are used for production.

In finance, in contrast, government policies tend to exert a much stronger influence over the
evolution of the industry. There are some legacy institutions that have continued in some form
since the 19\textsuperscript{th} century, but the specific role that they play in the 2010’s generally has less to do
with their historic emphases than on recent government policies. In the U.S., for example, there
was a very long history of a highly diversified banking sector with thousands of small and
medium sized banks. But that changed in the 1980’s when the Reagan Administration decided
that insufficient industry concentration was hurting the competitiveness of U.S. banks in the
global economy.\textsuperscript{21} Government policies drove a huge wave of mergers and takeovers over a
quarter century that ended up with a handful of giant banks controlling more than 50\% of all
consumer deposits. In Germany, in contrast, a very different set of government policies worked
to preserve a tripartite structure in which the terrain was divided among private banks,
landesbanks (state banks), and cooperative banks.\textsuperscript{22}

The point is that even theorists who draw on a Marxian framework for understanding the
dynamics of capitalism have to acknowledge what we can call the relative autonomy of the
financial superstructure.\textsuperscript{23} The logic of extracting surplus value at the point of production does
not dictate a particular form or structure for a society’s financial system. There is great diversity
in the structure of financial institutions in different developed market societies with some relying
heavily on public sector financial entities and others demonstrating considerable regulatory
effectiveness in keeping destabilizing speculative finance in check. In short, state policies have
been and continue to be critical in determining what a nation’s financial industry looks like. All
of this suggests that reform initiatives in this sphere could be successful.

\textsuperscript{20} Michael Likosky, \textit{Obama’s Bank: Financing a Durable New Deal}. New York: Cambridge University


\textsuperscript{23} Significant differences were analyzed in John Zysman, \textit{Governments, Markets, and Growth: Financial
3. The Problem of Socialist Transition.

The recent experience of Greece’s Syriza government exemplifies the problem faced by leftist parties that have promised their supporters a definitive break with “capitalism” defined as the rationality of a market economy based on the pursuit of profit. Such governments generally have faced a combination of domestic and foreign opposition that fundamentally weakens the domestic economy with the usual result that the leftist government retreats from its transformational agenda. Chile in 1973 represents the exception where the elected government persisted in its project, but mounting domestic turmoil provided the excuse for a U.S.-backed military faction to cease power. One way or the other, every time an electoral path to socialism has been attempted, it has ended in defeat.

Wright has theorized this problem in terms of the “transition trough” that an elected socialist government is likely to face. While the new administration is elected with a promise to raise living standards for a majority of the population, domestic and foreign resistance generally leads to an economic downturn that inevitably erodes the government’s support because the promised increases in output and more equitable distribution are not occurring. So the critical issue is whether there are means by which both the depth and the duration of the transition trough can be minimized. If the trough is shallower and briefer, the chances are greater that the government can consolidate its domestic support and move forward with its transitional program. But assessing this issue requires a more careful view of why and how the transition trough emerges in the first place.

The trough is generally created through the confluence of domestic and global pressures. At home, resistance to the government’s proposals means that businesses and wealthy individuals are likely to forego new investments and large firms might begin layoffs in anticipation of weakening demand. At the same time, both foreign and domestic groups are likely to start shifting liquid capital out of the country in anticipation of a fall in the value of the national currency. The government’s ability to offset this capital flight with increased foreign borrowing is likely to be limited because of the hostility of international banks and global organizations. The result is invariably a currency crisis where the government has to take action to prevent a dramatic fall in the value of the nation’s currency. While the government might impose controls to slow the flight of capital, it usually has to raise domestic interest rates in an effort to slow the outflows. But the tighter monetary policy generally has the effect of further slowing domestic economic activity so that the transition trough becomes even deeper.

This combination is powerful because the domestic and foreign opponents are able to continue the pressure month after month. It makes sense for firms to withhold investment and make do with lower profits for a year or longer in order to defeat the leftist threat and guarantee larger profits in the future. At the same time, the outflows of capital are likely to continue, so

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25 The strategy of simply letting the value of the currency fall means that imports, including purchases of capital goods become significantly more expensive, and this will also reduce living standards and deepen the transition trough.
the government has little respite from the ongoing currency crisis. The possibility of a reform-driven domestic economic expansion gets pushed off into the future as the transition trough becomes longer and deeper.

However, the kinds of financial reforms proposed here have the capacity to reduce the severity and duration of the transition trough. The central mechanism is the expansion of the not-for-profit portion of the financial system and the shrinking of the for-profit segment. The nonprofit financial institutions could be expected to maintain and expand their lending so as to blunt any kind of investment slowdown by large firms and for-profit financial institutions. Given the growing importance of infrastructure spending and the fact that employment by large corporations has already dropped precipitously, there is a distinct possibility that expanded lending by the more democratic financial institutions would maintain employment levels at pre-transition levels.

But even if there was little or no domestic investment slowdown, the pressures of capital flight would continue. But it is here that the growing size of the nonprofit financial institutions would become relevant. Not only would they be reluctant to participate in the capital flight, they would also have the ability to increase their borrowing abroad to offset the pressures on the national currency. So, for example, a public infrastructure bank and large nonprofit investment banks, for example, with an established track record of operating effectively would retain their capacity to borrow on global capital markets. They might in this transition period have to pay a somewhat higher rate of interest, but their increased borrowing could give the government some respite from pressures on the currency.

Moreover, if the level of domestic economic activity did not fall substantially during the transition, the government would have more legitimacy in denouncing the flight of capital as a deliberate effort at economic sabotage. As long as the economy was doing reasonably well, the claim that investors were shifting capital abroad to protect themselves from economic disaster would be less credible. This would create a political context in which the government could legitimately impose more effective capital controls to slow the outflows. The combination of those controls and increased international borrowing by large nonprofit banks might be sufficient to avoid a currency crisis.

With this additional breathing room, the left government might be able to sustain its reform agenda long enough that the electorate would begin to experience real gains. If a reform-driven economic expansion were to begin, then some of the domestic and foreign opponents might decide that a boycott strategy no longer made sense. As some private firms and international lenders began to relent, the government would have growing room to maneuver and its economic successes would grant it greater economic legitimacy. Once past the transition trough, there would still be the possibility of reversals, but some of the critical reforms could become firmly institutionalized.

This is the core claim for why radical financial reform represents a real utopia. It could make it possible for an elected leftist government to make the transition trough shallow and short enough that the government could survive and win the next election. But this still leaves open the question of how the left government would organize the stages of its reform projects and shape the rhetoric it uses for both its base and its opponents.
The Strategy of Transition

The strategy proposed here includes two distinct stages that are likely to play out over a ten to twenty year period. In the first stage, the left pushes through a program of radical financial reform that is designed to dramatically expand the scope and reach of the nonprofit financial sector. However, those reforms will inevitably take some years to mature as some newly created institutions take root and grow and as some already existing institutions expand their operations. The maturity of the parallel financial institutions is absolutely essential for the ability of a left government to eventually withstand the transition through. In other words, the left wants to postpone a direct confrontation with domestic and foreign opponents until the nonprofit financial sector has reached critical mass. So how could this play out strategically and rhetorically?

The critical rhetorical element is that the left political movement needs to embrace the Polanyian definition of socialism as the subordination of markets to democratic politics. This formulation indicates that there is no single moment of transition from a profit-oriented economy to a socialist economy; it is rather an evolutionary process through which there is an ever greater and deeper extension of democracy into economic decision making. This formulation also highlights that the movement is firmly committed to protecting democratic institutions and democratic norms including competitive elections fought against parties with very different political commitments. Within this framework, the movement can be quite open with its opponents and its supporters that it is committed to a gradual and deep socialist transition that will preserve democratic institutions and practices.

The movement then explains that one of the most important planks in its socialist agenda is the democratization of the financial system. The arguments are made that the existing financial system, despite being underwritten and guaranteed by the government, serves oligarchic interests and fails to work for the vast majority of the population. The promise is made that while there will be some tightening of the regulations of private financial firms, those firms will continue to operate only now they will face direct competition from a network of nonprofit financial institutions. Since the theorists of the market always stress the value of competition, what could be wrong with subjecting entrenched financial firms with some healthy disruption by new market entrants?

Once the movement raises the banner of radical financial reform, the idea is to create a broad movement that includes small and medium sized businesses who can be persuaded of the advantages of radical financial reform with the argument that in a democratic society, finance should also be organized democratically. After some years, the movement would win an election and it would then be able to implement its financial reform agenda. There would, of course, be opposition from the existing financial institutions, but they would not be expected to escalate their opposition to a full scale confrontation. Since the movement had gained broad public support for its proposals, the financial interests would risk even harsher regulations if they escalated the confrontation and still ended up losing.

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The victorious movement would also pursue other reforms that are familiar in the repertoire of social democracy. This would include enhanced programs to transfer resources to people in the bottom half of the income distribution, the strengthening of labor rights, measures to combat racial and gender inequality, improved environmental regulations, a push to increase democratic participation in governance, and modest increases in taxation on corporations and the rich. The movement would, however, avoid pursuing reforms that directly challenged the power of big business such as very large tax increases or reforms to require corporate boards to be restructured to include stakeholders such as employees and customers. The movement would stress its commitment to incremental improvements that made the economy work for all citizens.

The idea in this phase would be to avoid provoking a major confrontation with business and owner interests both domestically and internationally. If the scenario of capital flight and capital strike began to unfold, the movement would retreat while working to hold on to the financial reforms that it had implemented. It would, in effect, for the next period of ten to twenty years bide its time while the reforms were producing an incremental restructuring of the financial system. Even in the likely event that the movement was voted out of office during this period, the new decentralized system of financial institutions would continue to grow since they were meeting real needs of a variety of constituencies.

When the movement felt that the time was right, it would campaign for office with a promise to make deeper reforms that would challenge the power of the rich and large corporate entities. This is when issues of restructuring corporate governance or a major escalation of redistribution through the tax system would be on the agenda. In short, the movement would provoke a confrontation in the hope that the transition trough would be short and shallow. Having weathered this storm, the movement would then be able to create an economy that truly worked for all citizens.


This is the strategic vision for a successful transition, but two critical questions remain. First, could radical financial reform gain majoritarian political support even in a nation as historically pro-market as the United States? Second, what would be the actual content of the financial reform agenda? These issues will be addressed in this section and the next.

Again, it is important to recognize that the U.S. has a long history of democratizing financial reforms, driven by the Federal government, in response to weaknesses in the credit system. Quinn describes two important examples. In 1916, the Federal Farm Loan Act relied heavily on the creation of cooperative lending institutions to provide farmers with access to credit. In 1932, the Federal Home Loan Bank Act created the infrastructure for the development of Savings & Loans to provide mortgage credits to homeowners.27 In this sense, it is the last thirty year period that has been exceptional. During this recent period, a relentless process of financial consolidation has concentrated much of the capacity for credit creation in the hands of a small number of private mega-institutions. This process of consolidation was driven by government officials who believed that decentralization in the U.S. financial system had put the U.S. at a

27 Quinn, “The Miracles of Bookkeeping.”
disadvantage in global financial competition. So, for example, when ill-conceived changes in the regulations governing the Savings and Loan industry led to a major government bailout in the early 1990’s, this was seen as another opportunity to encourage consolidation and the result was a sharp fall in the number of locally-based financial entities.

But this process of consolidation has had the effect of tilting credit creation in the U.S. economy into very narrow channels. Giant banks with loan portfolios worth hundreds of billions of dollars are acutely attuned to the costs and risks of retail lending operations such as small business loans that tend to be labor intensive. They much prefer larger scale transactions such as lending hundreds of millions to real estate developers or providing huge credit lines to hedge funds that use leverage to increase the return on their investment strategies. They do continue to provide credit to households in the form of mortgage lending and credit card debt. However, in the former case, they have reduced costs by outsourcing the writing of the mortgages to others and in the latter case computer algorithms and high interest rates on unpaid balances make this a lucrative activity.

But this orientation by large banks means that there is much important economic activity that suffers a chronic shortage of credit at reasonable rates. The problem is particularly acute in the U.S. because bank lending to small and medium sized enterprises has never been a central activity of the banking industry. This is in contrast to countries in Europe, especially Germany, where there is a long tradition of family owned businesses relying on long term credit arrangements with nearby banking institutions. The U.S. model for financing the growth of firms has centered on stock market financing, but this option is realistically available to only a few thousand of the largest firms. The Small Business Administration was initially created to address this problem; it established a set of loan guarantees designed to facilitate bank lending to small firms. But all evidence suggests that credit demands by small and medium sized firms far exceeds what is available through the SBA. The reality is that aspiring entrepreneurs are encouraged to use credit card debt to finance their firms, but this is an expensive and dangerous path.28

We can identify five distinct but somewhat overlapping categories of economic activity in the U.S. that are chronically constrained by the absence of credit at reasonable rates.

1. **Infrastructure spending.**

Estimates are that the U.S. has an infrastructure deficit of something on the order of $4.6 trillion over the next decade.29 Governments at the federal, state, and local level have been experiencing fiscal stress for a generation and are reluctant to take on the increased debt burden required to

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29 The estimate is from the 2017 report card from the American Society of Civil Engineers. http://www.infrastructurereportcard.org/
finance vitally needed infrastructure maintenance and improvement. There have been limited experiments with public private partnerships to address infrastructure needs, such as privately financed toll roads, but the results have not been particularly promising.

2. **Clean energy and energy-saving retrofits.**

There is now ample evidence that a variety of outlays by households and firms to reduce energy consumption or to install solar panels or wind turbines will produce a high return on investment. For example, replacing incandescent bulbs with LED bulbs can pay for itself in a year and insulating walls and attics in single family homes can often recoup the expenditures in two to four years. In some states with prices at current levels, solar panels will pay for themselves in four or five years. Making these types of investments could have a huge impact in reducing greenhouse gases, but many of these investments are not being made because households and firms lack sufficient cash reserves, and most existing financial intermediaries have shown little interest in these forms of lending.

There are various initiatives underway to overcome this financing hurdle. Some solar firms have been able to raise money in the capital markets, so that the firm, rather than the homeowner, finances and owns the solar installation. A number of states have been developing alternative financing mechanisms that would make it easier for homeowners to find lending for energy retrofits. But none of these efforts have yet reached any significant scale and they are unlikely to do so without support from the federal level.

3. **Lending for small and medium sized businesses and nonprofit groups.**

Repeated surveys show that many small and medium sized businesses feel themselves to be credit constrained relative to opportunities to expand their activities. Again, the major barrier is the rate of interest that they have to pay for credit. If one has to borrow on a credit card at an annual interest rate of 18%, there will be very few expansion opportunities that are likely to produce returns that would cover that kind of debt burden. However, if the rate of interest were closer to 4%, for example, there would be a far greater menu of opportunities.

One of the key issues in this kind of lending is the question of collateral. Financial intermediaries are generally far more interested in lending when the loan is backed by assets that can be forfeited in the event of a default. The consequence is that lending in this sector tends to be tilted in favor of those engaged in real estate development. Firms in other sectors of the economy face much higher hurdles in gaining access to credit.

This also means that the problem of credit is particularly vexing for high tech startups that are seeking to produce new products or new processes. While those firms that have grown from startups to major corporations are widely celebrated as central to the vitality of the U.S. economy, the reality is that many of these startups fail to cross what is called “the valley of death”. This is the interval between proving the concept for a new product and having a

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31 See footnote 28.
commercial prototype. For many high tech firms, this period of time can be as long as five to ten years. While a variety of federal programs, such as the Small Business Innovation Research Program, help firms through the early years of this process, survival becomes more difficult with every passing year.

4. Nonpredatory lending

The deepening economic inequality in the United States has meant that many households in the bottom half of the income distribution are effectively excluded from any kind of nonpredatory access to credit. As Jacob Hacker has shown, household income for many is highly unstable, with dramatic ups and downs being common as a result of spells of unemployment, health crises, or marital instability, which are not offset by government transfer payments. But the consequence of this instability of household income is to produce extremely low scores on measures of creditworthiness.

This lack of access to credit on reasonable terms makes it far harder for millions of households to engage in “bootstrap” operations that have historically been routes to upward mobility. For example, small scale entrepreneurial efforts, such as fixing up decaying housing, becomes impossible without some source of cheap credit. Similarly, it is difficult to finance the acquisition of new skills by adults without some borrowing.

5. Nonprofit low rental housing development.

There is an acute lack of affordable and decent rental housing in many cities in the U.S. The focus of developers has been on building high end apartment towers that can produce high economic returns, so those who are not rich have to compete for the older housing much of which is located in less desirable neighborhoods. But the population pressure on this existing housing stock has driven rents to unprecedentedly high levels. Many households are forced to pay more than half of their income in rent for apartments that are small or poorly maintained and younger people have returned to the parental home in increasing numbers. If capital at reasonable rates were available, many more nonprofits could enter this field and either build new units or upgrade existing structures.

It seems obvious that the failure to finance these five categories at higher rates is costing the U.S. economy a tremendous amount in loss of economic vitality, diminished quality of life, weaker job growth, and lower rates of innovation. But the irony is that the failure to provide adequate credit for these economic activities is occurring at the same time that giant U.S. corporations are sitting on huge cash hordes because they cannot identify investment projects that promise a sufficiently high rate of return to meet the profitability goals set by Wall Street

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35 The problem is particularly acute on the East and West coasts, but Desmond shows that even in older Midwestern cities, the lack of affordable housing creates extremes of deprivation for the poor. Matthew Desmond, Evicted. New York: Penguin, 2016.
investors. U.S. firms alone were estimated in late 2015 to hold cash reserves of $1.4 trillion. What is happening instead is that many of these large firms are returning cash to their shareholders through stock repurchases that have the additional benefit of buoying the stock price and improving the compensation of top executives. But the obvious consequence is that overall levels of new investment in the economy are being artificially depressed because low cost credit is not available to the entities that are most likely to use it.

It follows then that there is a three pronged argument in favor of a far reaching project of domestic financial reform. First, vital and necessary economic activities are being deprived of credit and the resulting underinvestment is bad for the economy and bad for the population. Second, this shortfall is wildly irrational because the economy is far from using the available resources of labor and productive assets. Directing credit to currently underfinanced but productive activities is a win-win. Third, creating new circuits of capital that redirect credit towards underfinanced activities is the best way to avoid financial bubbles that are likely be followed by another crash.

5. The Structure of the Reforms.

The reform project is to create a complete set of new or revitalized nonprofit financial institutions that would have the ability to provide the credit required to fund these systematically underfunded activities. The government would extend its financial franchise to permit the scaling up over a ten year period of these alternative financial institutions. Moreover, as these institutions matured, they would provide attractive savings and investment instruments for people who wanted an alternative to giant banks and mutual funds. As this parallel system expanded, it would finance high levels of productive activity and it would change capital flows to reduce the size and power of entrenched financial institutions.

But there is one important issue that needs to be addressed first. One of the great ironies of conservative rhetoric is the idea that governments should live within their means and only authorize expenditures that are equal to revenues in any given year. But this, of course, is contrary to how both businesses and households operate. Private economic actors distinguish between current expenditures and capital expenditures, and they routinely borrow to finance home purchases or the building of new productive capacity on the theory that such outlays produce a flow of services over a long life span that will exceed the annual payments required to pay off the debt. But governments, of course, also make capital expenditures such as building new airports or roads or sewage treatment plants. It follows logically that governments should also maintain separate accounts for current and capital expenditures and that it is appropriate for them to borrow to finance some share of these capital outlays.

But over the last thirty years of fiscal crisis and heightened anxieties about government borrowing, there has been a strong tendency to rely on “off-budget” mechanisms to finance some of these urgently needed capital outlays. In some states, for example, governments have made deals with private firms to build new highways with the promise that the firm will be able to collect all of the tolls for fifty or hundred years. In Chicago, for reasons that are unclear, the

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city turned over the collection of revenue from parking meters to a private firm. Such measures have been justified with the rhetoric of privatization, but they make neither economic nor political sense.

In short, there are certain vital government outlays that should be financed entirely out of current revenues or through direct government borrowing. Off budget mechanisms, such as a public infrastructure bank or loan guarantee arrangements or credit creation by nonprofit entities are appropriate for other categories of outlays where risks are greater, returns are uncertain, or the mix between public and private benefits are more complicated. But, of course, establishing these decision rules as to which expenditures should be financed through which type of mechanism should be determined through a process of democratic deliberation.

With this proviso, we can establish three design principles for the process of radical financial reform. The first is that the newly created institutions should be structured as nonprofits. This is critical for two reasons. First, profit maximizing is the fundamental source of financial instability identified by Hyman Minsky. Financial institutions that seek to maximize profits face the constant temptation to increase the riskiness of their loan portfolios because higher risk equals higher returns. For Minsky, the only way to hold this temptation in check is through regulation, but both the power and zeal of regulatory institutions tends to fluctuate with changes in the political balance of power and fading memories of the last financial disaster. Nonprofit institutions are not immune to this temptation; there are examples of nonprofits that have been overly aggressive and bid up the salaries of their executives. But the combination of a nonprofit orientation, some mechanisms of democratic accountability for these entities, and strong regulatory institutions will reduce significantly the danger of Minskyan instability.

The second reason they should be nonprofits is that lending is basically a labor intensive activity. Face-to-face work is usually needed to extract from borrowers the disclosures that are necessary to evaluate their creditworthiness. And it is here that profit-making financial intermediaries run into problems. Hiring loan officers is expensive and the number of transactions that each loan officer can handle in a given day or week is limited. When banks compare the profits to be generated by these loan officers with the profits generated by portfolio managers who buy and sell various securities, the portfolio managers invariably win.

For-profit banks have addressed this problem through automation. They have eliminated the high staffing costs of various forms of lending by using computer programs to score and evaluate loan applications. But these techniques tend to redefine creditworthiness as resemblance to a statistical norm. If the applicant looks similar to people who have paid off loans in the past, then he or she will receive credit on reasonable terms. If not, they will be denied credit or as with subprime mortgage lending, be required to pay a substantially higher interest rate than with other borrowers. Since failure rates of small business loans are high, the computerized algorithms tend to limit credit to firms that have already proven themselves or to firms that have collateral in the form of real property. This tends to bias credit availability towards real estate development and away from other endeavors.

But nonprofit institutions with a mission defined as facilitating economic development in a particular geographical area will have the motivation to employ loan officers who develop the

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37 Minsky, Stabilizing.
skill set needed to provide credit to individuals and firms who fall outside the parameters of the standard lending algorithms. Such institutions are far more likely to employ criteria of creditworthiness that emphasize the particular history of an individual or firm. With appropriate support from government, they would also be in a position to engage in synergistic lending by extending credit to multiple firms in the same area.

The second design principle is decentralization which will vary from extensive to moderate depending on which niche these institutions are seeking to fill. In the case of lending to households and small business and funding clean energy, for example, the idea would be similar to the 1916 and 1932 legislative initiatives—to encourage the creation of many new financial institutions at the local level that would rely on local knowledge to distinguish between promising and risky loans. In the case of infrastructure spending or support for high technology startups, the idea would be to divide the work across five or ten institutions with some degree of regional specialization. The goal is to avoid recreating the centralization and giant size of the dominant Wall Street institutions. Maintaining decentralization is also a way to assure that none of these institutions grow too large and there continues to be some element of competition where those seeking funding have multiple options to choose from.

The final design principle is specialization; each of these financial institutions would focus on one or two niches in the market; they would not attempt to become financial generalists. The reason is that it takes specialized knowledge for financial intermediaries to become proficient in distinguishing between prospective borrowers with a reasonable chance of success and those that are likely to fail. Moreover, the criteria for distinguishing between meritorious and deficient proposals are quite different for energy retrofits, small business loans, or infrastructure projects.

One can see this logic at work in the field of venture capital where a handful of relatively small firms have been extraordinarily successful in providing critical financing to firms that ended up being spectacularly successful. The venture capital partners have been deeply rooted in Silicon Valley for decades, so they have developed a strong intuitive sense of what is likely to work and what is not. Moreover, the transaction is not an arm’s length one; the venture capital partners play an ongoing role in giving the firms they support advice, network connections, and other types of help. Even with all of this, success is probabilistic. Venture capitalists make their money from the 5 or 10% of supported firms that end up experiencing rapid growth and successful stock market offerings.

In short, venture capital is a knowledge industry that works because partners accumulate a deep understanding of the challenges that firms in their market sector will face. In the same way, loan officers or cooperating entities in this network of nonprofit financial intermediaries will develop parallel forms of expertise that will allow them to become more effective over time in deciding which loans to approve and which to deny. Moreover, as their knowledge develops, they will also be able to provide useful advice to loan applicants that can help improve their level of success in using the funds productively. But such expertise is far more likely to develop in the context of specialization where loan officers are dealing repeatedly with infrastructure projects or lending for the retail sector, so that they are able to learn from past experiences.

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Alternative Financial Institutions

The proposal here involves four distinct elements that are designed to work together to produce a highly effective parallel credit system. In each case, legislation will be needed to create or expand existing institutions and ongoing government efforts, including new regulatory measures, will be needed to make sure these efforts are successful and do not produce perverse consequences.

I. An expanded sector of nonprofit retail financial institutions.

There are numerous models for nonprofit financial institutions that collect deposits from a geographical area and then re lend the funds for mortgages and to finance local business activity. Schneiberg describes how mutual banks were created in the pre-New Deal period as part of an infrastructure of local bottom-up institutions that played an important economic role particularly in the upper Midwest. Deeg describes the important role that public and cooperative banks have played in financing economic activity in Germany, especially investments by small and medium-sized enterprises, over recent decades. Mendell and her co-authors describe the complex web of locally-based financial institutions that have supported the development of the social economy in Quebec starting around 1996.

The main emphasis here is on credit unions because they already have a significant presence within the U.S. financial marketplace. Credit unions are nonprofit financial institutions organized as cooperatives with each member having one vote and the opportunity to elect the organization’s leadership. As a consequence of the historic popular distrust of Wall Street in the U.S., much of the regulatory and support structure for credit unions to play an expanded role already exists. The U.S. government has a dedicated system of deposit insurance and regulation for credit unions and credit unions are eligible to be part of the Federal Home Loan Bank system that provides small banks with credit lines to help them through temporary liquidity crises. Furthermore, credit unions have accumulated a strong track record of functioning well even in economic downturns.

However, it also must be recognized that on the whole, credit unions in the U.S. have not been particularly dynamic or innovative in recent decades. Part of the issue is that existing legislation tightly restricts small business lending by credit unions. But even credit unions that were originally created through social movement energies tend to become routinized and limited in their focus as they age. Finally, until the process of computerization had progressed quite far, credit unions simply could not compete with commercial banks in the range of services they provided.


40 Deeg, Finance Capitalism Unveiled.

Now, however, even very small institutions of this type—organized in networks—are able to provide clients with a broad range of financial services. For example, credit unions can provide access to a network of automatic teller machines and the ability to wire funds to other destinations. And these small institutions need not hire all of the staff required to do the appropriate due diligence for small business lending. This could be done on a contract basis with small, nonprofit consultancies that develop expertise in particular business domains and work with a range of different financial intermediaries.

Hence, with only two steps, it might be possible to set off a wave of entrepreneurial effort that would create new nonprofit financial intermediaries and reinvigorate those that already exist:

Step 1. A federal matching funds program would be set up to capitalize or recapitalize new or existing nonprofit financial intermediaries.

Given the enormous costs that the society has paid for its dysfunctional financial system, an outlay of $50 billion over five years would be a small price to pay to create a vigorous locally oriented financial system. The idea is that local investors would raise $10 million to capitalize a new credit union or nonprofit bank and the government would provide an additional $10 million—perhaps in the form of a low interest, thirty year loan. Or similarly, a sleepy bank or credit union would be recapitalized with an additional $20 million that would be matched by $20 million from the federal government. The idea is that the matching funds would simultaneously signal the government’s strong support for these new institutions and create strong incentives for grassroots efforts to build this new sector.

Step 2. A new system of loan guarantees to support lending by these institutions.

Along with the capital infusion, the federal government could also immediately provide loan guarantees for these institutions to lend to households, businesses, and government agencies for conservation or clean energy projects. The value of these investments has been well documented. Again, the urgency of a green transition would justify the relatively small budgetary commitment that would be involved since these loans for energy-saving should have a very small failure rate. But this would be an efficient means to underwrite a dramatic initial expansion in the loan portfolios of these institutions.

On a less rapid timetable, there is also the need to build a system of loan guarantees to support long term lending to small and medium sized businesses. This requires careful design because these loans are riskier and the dangers of abuse and fraud are substantially greater. The goal would be to create something similar to a guarantee program that exists in Germany where the risks are distributed across different institutions. One might imagine, for example, 25% of the risk being covered by the Federal Home Loan Bank Board, 25% by the Federal Reserve System, 25% by the Treasury, and the final part being carried by the originating institutions. Since these guarantees are designed to support somewhat risky loans at the local level, it is assumed that there will be periodic losses from businesses that fail, but these losses would be spread across strong institutions whose revenues would be increased by the stronger growth resulting from more vigorous lending to small and medium sized firms.

One complexity here is that many small local credit unions or community banks are unlikely to be able to develop the expertise in-house to engage in this kind of business lending. However, nonprofit consultancies can and should emerge that develop this kind of expertise and they could work with a network of credit unions to identify worthy projects that would be eligible for the
government loan guarantees. To protect against fraud, it would also make sense to license these nonprofit consultancies and subject them to some ongoing regulatory scrutiny.

This strategy requires that millions of citizens be willing to change the way they invest their savings. At present, roughly 92 million people belong to credit unions in the U.S. and these institutions control about 10% of consumer deposits—about $600 billion. With such a strong base at the start, it is plausible that people would be willing to move much more of their savings from big commercial banks to credit unions once they saw a broad effort to revitalize the credit union sector. The goal at the end of a twenty year transition period would be to reverse the current ratio with 90% of deposits in the credit unions and only 10% left for commercial banks.

II. Nonprofit Investment Banks

These new institutions could be created as nonprofit entities jointly owned by large public pensions funds or by other nonprofit financial intermediaries. They would compete directly with existing investment banks that underwrite bonds. This would give local governments an alternative to dealing with existing Wall Street firms when they decide to issue new municipal bonds. This alternative is important because the relationship between municipalities and Wall Street has been marked by both predation and corruption. These institutions would also be able to finance large-scale infrastructure projects. But in evaluating these infrastructure projects, these nonprofit investment bankers could add an additional creditworthiness criterion. They would also consider whether the planning of the project involved sufficient democratic input and engagement from citizens in poorer and more marginal communities.

Finally, these new institutions would also be able to securitize loans written by nonprofit financial intermediaries. For example, loans to individuals and businesses to finance solar power or to build multi-family housing could be consolidated into bonds that would be sold to investors. Through this instrument, the credit unions would have an infusion of new capital to expand further their lending activity. To be sure, this securitization process would have to be carefully regulated to prevent any participants from playing the “pass the trash” game that was so central to the subprime mortgage disaster. But with all of the key participants operating on a nonprofit basis, the incentives for large-scale fraud would be diminished.

The issuance of these bonds would provide individual investors, pension funds and other institutions a safe and socially productive outlet for their savings. The intuition here is that most people are not looking for outsized returns on their personal saving; they want primarily security and predictability. Bonds that reliably paid 3% or 4% per year would be attractive, especially when people understood that these investments were contributing to sustainable economic growth that was improving their own communities.

The consequence over time would be a dramatic transformation in the structure of most people’s retirement portfolios. Instead of the current mix which is heavily weighted towards equities, the bulk of retirement savings would be made up of various types of publicly issued and safe bonds. As the public gradually retreated from corporate stocks, there would be a decline in share values and proponents of significant reforms in corporate governance would gain significant leverage. In order to make their shares more attractive, big firms would now be forced to compete in a process of “definancialization”. This would include bans on share repurchases, significant reductions in executive compensation, improvements in corporate
governance that included recognizing other stakeholders, and an abandonment of the short-term time horizons associated with maximizing shareholder value.

III. A Public Investment Bank

Given the centrality of infrastructure spending, there is also the need for a national investment bank that would be able to create credit to fund needed infrastructure projects. On the principle of decentralization, this should be organized through five or six regional units that operated with a high degree of autonomy while also being able to share knowledge about the complexity of particular types of infrastructure projects. This bank would be able to raise capital by selling bonds to the public through one or another of the public investment banks.

But the principle of competition would also operate in that a city, a state, or some kind of regional entity would have several different options for funding a particular infrastructure project. It might go to one of the public investment banks to sell bonds or it might arrange to finance the project through the closest office of the public investment bank. The competition would reinforce the need for all of these entities to develop staff expertise and it would maintain pressure on them to make the loans available at the lowest possible interest rates.

However, the public infrastructure bank also requires arrangements to assure democratic accountability. Both the headquarters and the regional offices would have management boards that would include representatives of various constituencies such as business, labor, community groups, and elected officials. Congressional oversight would also be required to assure that the institutions were consistently serving the public and that large scale infrastructure projects were being done in a way that was consistent with both environmental impact and social impact studies. Since some large-scale infrastructure projects can reshape entire geographic regions, procedures must be developed to assure broad public involvement in these decisions.

IV. A Nonprofit Innovation Stock Market

A final measure is needed to assure a higher level of investment in innovative small firms working at the technological frontier. Such firms have chronically been starved for capital, and they have been heavily dependent upon various government programs for their survival. Moreover, since the path to long-term survival is so difficult, many of these entrepreneurs see little choice but to sell their firms to large corporate buyers with the consequence of less diversity and competition in the economy.

Since the chances that any one of these firms will survive and be profitable are relatively low, there is a need for a strategy that allows investors to hold stakes in many of these firms with the idea that success by a small minority of firms would compensate for losses on all of the other. This is the principal that venture capital firms use, but venture capital is extremely labor intensive and so it is very difficult to scale it up to provide resources for a much larger number of firms.

The solution would be for the government to work with the nonprofit investment banks to create a new stock exchange where high technology startup firms would be rigorously screened and have the opportunity to sell shares up to some limit such as $10 million. The shares would not compromise the existing ownership structure of the firm, but they would entitle shareholders
to a portion of the profits that the firm might eventually earn. Specialized mutual funds would then put together diversified portfolios that would take positions in hundreds or possibly thousands of these firms. Individual and institutional investors would then be able to have a stake in future innovation by purchasing shares in these mutual funds.

Some successful firms might decide to graduate from this stock market to the major stock markets, assuring a large return to those holding their shares. But other firms, including those organized as cooperatives or B corporations might opt to remain listed and continue using the market periodically as a way to raise capital for expansion. Here again, the idea is that a relatively small institutional change could have broad consequences in significantly expanding the diversity within the business environment. Most importantly, high tech startup firms, regardless of their form of business organization, would face improved prospects for long term survival.

Economic Synergy

This set of financial reforms is designed to accomplish several distinct goals. They would contribute significantly to a more dynamic and more environmentally sustainable economy by generating a higher rate of productive investment in infrastructure, multi-family housing, clean energy, conservation, and small businesses. This would result in new job creation and expand the flow of services that people really need. This set of reforms is also intended to weaken the dominant position of existing financial institutions including both giant banks and huge investment management companies such as Black Rock and Vanguard. This weakening would happen through an incremental shift of consumer savings from for-profit to nonprofit entities. Currently, something close to 90% of consumer bank deposits are with large commercial banks, but with the reinvigoration of credit unions and nonprofit banks, we could expect a large scale shift of these deposits towards more locally based institutions as consumers recognize the benefits of reinvesting in their communities. At the same time, savers would have attractive alternatives to putting their retirement funds in mutual funds and common stocks. They would be able to shift to a variety of bonds issued by nonprofit investment banks or the public investment bank and they could acquire mutual funds invested in the innovation stock market.

The combination of the new institutions and the changed consumer behavior would help move the U.S. away from the stock market centered model of business development. Small and medium sized firms would have a much richer set of financing options than aspiring to become publicly traded firms. By relying on loans from nonprofit institutions or the innovation stock market, such firms would be able to raise significant amounts of capital without the risk of takeovers that occurs with stock market funding. This would make it far easier for new firms to compete directly against incumbent firms. Such a diversified funding environment is far more appropriate in the era of the vanishing corporation than continuing a system of financing that was linked to an earlier historical period in which large firms accounted for a very high percentage of economic activity.

Finally, this process of reorganization would weaken the political clout of large financial institutions. With less control over consumer deposits and retirement savings, giant institutions

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42 B Corporation or Beneficial Corporations are incorporated under state statutes that allow them to prioritize interests beyond profitability. See Jane Collins, *The Politics of Value*, ch. 3.
would have to contract and make do with reduced flows of profits. This, in turn, would reduce the resources they have to invest in campaign contributions and right-wing policy institutions. This would make it harder for them to push back against regulators and harder for them to stop the advance of their nonprofit competitors.

**Conclusion**

For most of the last century, political movements committed to radical financial reform and those favoring a socialist transformation have been at odds and have often worked at cross purposes. Today, however, it is possible to see a creative synthesis of these two traditions in which radical financial reform become the critical measure that makes it possible for a government committed to a democratization of the economy to survive. The argument is that both the duration and the depth of the transition trough could be minimized if a successful process of radical financial reform had previously been implemented and given the time to mature.

This paper has focused almost entirely on a reform process within a particular nation. However, the vision elaborated here also has an important global dimension. The idea is that at the same time that leftist political parties within nations were fighting to implement radical financial reform domestically, they would also exert pressure for reforms of the global financial and economic order. In that arena as well, there is a significant opening for reform because those arrangements have become increasingly dysfunctional. The point is that winning even partial reforms at the global level, such as a global financial transaction tax, would work in synergy with domestic efforts. Such a tax, for example, would mean that those who were shifting capital abroad to destabilize a leftist government would have to pay a substantial upfront fee for the transaction. Moreover, as the global reform process proceeded further, these further steps would create a more favorable environment for these domestic transitions.

But the critical step in this real utopia is the rejection of the conventional account of the role of financial institutions in market economies. As long as people believe that such institutions are intermediaries who play the critical role of connecting savers with investors, it is very difficult to challenge their institutionalized power. But when it is understood that they are franchisees who have been granted a privilege by the government to create credit, it becomes possible to challenge that privilege and demand that the privilege be extended to other institutions that are not preoccupied with the maximization of profits. Such a reform is essential to democratize finance and ultimately to democratize the entire economy.

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