

Some general comments on Fred Block Paper

Some of the comments below are also discussed in the more detailed comments which follow, but these are the main issues:

1. The Polanyi framework. I liked the exposition of the Polanyi perspective and find it intriguing that Polanyi endorses the kind of hybrid/ecosystem view of economic structures that I endorse as the basis for real utopian strategies. My reservation about the framework is that it mostly directs attention towards the irrationality and self-destructiveness (in the sense of unsustainability) of weakly subordinated markets. The diagnosis of the problem is dominated by issues of inefficiencies and market failures. None of that especially suggests that what is needed is *democratic* subordination of the market, nor that the economy so organized should pursue egalitarian. The self-regulating market is condemned, but this does not discredit a techno-bureaucratic state subordinating the market in the interests of elites. Polanyi himself may have been in favor of democracy – as suggested by the quote you give on p.5, when he speaks of “...the tendency inherent in an industrial civilization to transcend the self-regulating market by consciously subordinating it to a *democratic* society” – but I don’t see where a commitment to a democratic-egalitarian ideal comes out of the argument that money is a “fictitious commodity.” (Mostly you refer to subordination to society rather than subordination to democratic society, eg. “...so one might think of socialism not as a fundamentally different form of society but as a variable linked to the extent to which the market has been subordinated to society.” So, is the core idea subordination to *democratic* society or to “society”? And again: What is the basis, in Polanyi, for the belief that democracy is the preferred way to subordinate the market?

2. Corporate governance reforms. While I am all in favor of the full gambit of democratic initiatives over corporate governance – co-determination, stakeholder boards, works councils, etc. – it isn’t clear why this is an organic part of a democratizing *finance* agenda. It is part of the broad democratizing *the economy* agenda, and it would also be relevant to mention how moves in the direction of more democratic finance might facilitate democratic corporate governance, and perhaps the reverse as well (more democratic governance would make it easier to democratize finance); but I found it confusing to include this as an element *within* democratic finance. I do like the idea of specifying the specific place of democratizing finance in the broader agenda of economic democracy, and I don’t object to the hypothesis that this is somehow the anchor for the broader project, as suggested in your statement on p.32. “the democratization of finance could become a unifying political program that could advance the long-term goal of subordinating the market to democratic politics.” But this is not the same as collapsing democratic governance of production into democratizing finance.

3. Dynamics of the system. I did not find the arguments that trajectory of the system outlined in the discussion of institutional alternatives would dynamically undermine the power of capitalist resistance very persuasive. At its core there seemed to be a claim that the new forms of nonprofit finance and the accompanying forms of corporate governance – the B+ corporations – would be able to out-compete ordinary capitalist firms and capitalist finance on the market. This was not convincing to me – or at least, I didn’t see how the mechanisms you postulated would actually work.

4. The proposals. The proposals as laid out – both the ten principles in Part III and the four Alternative Financial Institutions in Part IV – did not, for me, create a coherent picture of an alternative system. This reads more like a laundry list of ideas, most of which would be desirable one way or another, but not a sketch of a real utopian alternative. Indeed, most (but not all) of the discussion seemed to point to how to rectify problems of irrationality and inefficiency – market failures – that would make capitalist markets work better. There was a lot of talk about family firms, lack of credit for innovative entrepreneurs wanting to start businesses, the “valley of death”, information failures, and so on. All of this is relevant for a reform agenda for financial institutions, of course, and for an improved capitalism, but this does not bring into relief the emancipatory agenda for an alternative finance system. You invoke more emancipatory ideas from time to time, but these do not constitute the core of the analysis as I read the paper.

5. Three forms of finance institutions: Capitalist (for-profit institutions), State, and Nonprofits (including community, solidarity associations, and private nonprofits, etc.). In your exposition you discuss, basically, three forms of the institutions that could function like banks (and other kinds of financial intermediaries): ordinary for-profit capitalist institutions; state institutions; and a variety of institutions that are nonprofit, which could include private nonprofits, community institutions, cooperatives, social/solidarity economy institutions, etc. (Let’s just call these generically social nonprofit institutions). But you do not really give an argument about the contexts in which one or another is to be preferred. You state on p.33. “But the other side of the story is the considerable evidence that profit-oriented financial intermediaries are dangerous.” This raises the question: why not eliminate the profit-oriented financial intermediaries completely? Why not have all banks – i.e. all credit creating agencies – be public or social economy institutions? For me, the logical implication of Polanyi is that all land should be in land-trusts with leases for private purposes; labor should never be a commodity in any way and its reproduction should be guaranteed through public goods; and all credit-creating institutions should be public (which includes both state and social economy forms). Why not advocate this stronger position? The transition problem is then how to get rid of private for-profit banks. This may be impossible in the short run, so then the problem is how to contain them in a way that enables these social/public credit institutions to thrive. But there would be a clearer, more forthright model of finance as a public utility as the real utopian alternative.

In terms of the three forms – state, capitalist, social nonprofit – I would like clarification of the following issues:

(1). You generally seem to prefer social nonprofits to public agencies. Why? Is this because of concerns about rent-seeking or corruption or bureaucratic rigidity in state agencies – state banks for example? Are there information conditions that can better be served by civil society based groups/associations setting up nonprofit financial institutions than by the state directly organizing state-run banks? The issue of stakeholder boards and democratic input/accountability can be connected to both solutions. What is the basis for what seems

to be a preference for non-state forms of nonprofit financial intermediaries? Is there anything in Polanyi that points in this direction?

(2) Is there a positive role for the for-profit financial sector, or is this simply an accommodation to power realities?

6. The capitalization problem. Bob Hockett argues against the loanable funds view of credit and instead says that all credit (in banks anyway) is simply created out of nothing. “Capital reserves” are just a device for regulating banks – by insisting that they have something to lose if they go bankrupt (or something like that) -- but these reserves are not actually important for real credit creation. This suggests that one could have a banking system with no capitalization requirements: they could just be regulated franchises of the state that issue loans. There would then be no need for a derivative market in order to get more capital to lend out, since banks don’t actually “lend out” already existing capital. Securitization would not be a necessary condition for increases in loans. Is this incorrect? Is there really any good purpose served by a derivative market in loans – doesn’t this inherently reinforce speculative practices, since that is the only reason one would invest in such instruments?

Comments/Notes on Part III design principles

In Part III most of the proposals are pretty minimalist – either reaffirming traditional elements of many finance systems or modest modifications to improve market functioning. This should be made explicit so as not to confuse this with more real utopian formulations.

Most of the principles seem concerned with correcting inefficiencies in credit allocation. The one democratizing element concerns corporate governance, which is not directly (in my opinion) at element of the finance problem. Some of the principles touch on egalitarian issues – like probabilistic/lottery allocations – but still this is defended mostly in terms of improving on market failures.

Principle #1: *“There should not be arbitrary restrictions—such as balanced budgets or the Maastricht rule limiting government debt to 60% of GDP—to limit government borrowing for productive purposes. Those forms of investment that produce pure public goods such as funding for scientific research, certain types of infrastructure, and public education should be carried out by government.”*

The second statement is a design principle: the state should make certain kinds of investments, but I don’t see the connection between this and the idea of no arbitrary quantitative restrictions on such spending.

The first statement seems odd. Of course there shouldn’t be *arbitrary* limits/restrictions. But this does not mean that there shouldn’t be *nonarbitrary* restrictions. Surely there are some quantitative constraints that should be imposed on public goods provision.

Principle #2. Government has an active role to play in allocating credit to finance productive economic activity, and it should use a full range of policy tools including interest rate subsidies, loan guarantee programs, and tax incentives to assure that capital flows in the most productive directions.

Doesn't this simply re-affirm a basic element of all finance systems in most capitalist democracies? It is true that this has been downplayed by neoliberalism, but this seems pretty standard stuff, and it is only recently that it has been called into question.

Principle #3. It is important to create a mechanism that would increase the role of employees in corporate governance.

I agree with this, but this is basically a principle of a democratic economy more generally rather than democratizing finance as such.

Principle #4. The financial system should provide small and medium sized enterprises with a source of credit that allows them to remain independent and not pursue the route of public shareholding.

This seems fine, but is a pretty minimalist transformation. Isn't this just making capitalism a more genuinely competitive system – removing a market failure for credit to SMEs? The German model is good in many respects, but this is pretty distant from real utopia aspirations.

Principle #5. Evaluation of creditworthiness of individuals and organizations should be based on an historical analysis that takes into account the obstacles that the individual or firm overcame to get to this point. Using this kind of historical analysis will operate against the credit system simply reinforcing the existing distribution of income and wealth.

This, again, is just correcting a market failure – basically information failures. And how is this connected to a Polanyian perspective? This applies to non-fictitious commodities also – eating at lunch counters, traveling in buses should be nondiscriminatory.

Principle #6. Evaluations of creditworthiness should no longer privilege profit-making firms. There is now sufficient data to show that alternative types of organizations, including employee-owned firms, can survive and flourish. It follows that there need to be new types of financial instruments to provide credit to these nontraditional firms.

Again: isn't this just a correction of an information-failure problem? This doesn't really seem to have anything to do with Polanyi. All sorts of markets have information asymmetries which need correction, whether or not the market involves fictitious commodities.

Principle #7. The provision of credit should be done on a highly decentralized basis so that financial intermediaries can recognize the positive synergies that come from multiple investments in the same locality. Even if the food at a restaurant in a decaying downtown neighborhood is excellent, the business is much more likely to prosper if other storefronts on the same block are also being upgraded by entrepreneurs with access to credit.

This does seem to involve a planning function within credit allocation and is therefore not just an information-failure correction. Localism and decentralization do seem like relevant principles.

Principle #8. There is a need for some portion of credit allocation to be done on a probabilistic basis to support firms that face high risks but have the potential for high rewards. This has been a critical mechanism in successful industrial districts where people move back and forth between being entrepreneurs and being employees, and it is the design principle of venture capital firms that operate on the expectation that most of the firms that they support will fail.

I don't see anything Polanyian about this. You are basically proposing a lottery for credit allocation. Maybe that is a good idea if the ability to predict is so bad. This is the way admission to medical schools is done in the Netherlands. This could be viewed as an egalitarian proposition, but there is nothing obviously democratic about it.

Principle #9. Government should facilitate the growth of nonprofit financial intermediaries because these institutions are less likely to engage in risky speculation and they are more likely to hire and retain the skilled loan officers needed to facilitate local economic development. This also means having mechanisms that encourage the creation of new institutions to respond to changing needs.

The two rationales here are very different: lower risk + different kind of local development. This idea needs more elaboration.

Principle #10. Government also needs to establish loan guarantee programs that help these nonprofit financial intermediaries engage in certain riskier forms of lending that promise high returns for local communities.

This seems fine if there are good reasons to believe that in fact the best projects for local sustainable balanced development are also higher risk. I don't quite see the argument here.

Comments on Part IV. Alternative Institutions

Alternative institutions are discussed under four rubrics

1. *New Retail Financial Intermediaries*
2. *Npnprofit investment banks*
3. *Corporate Reform*
4. *Global Level Reforms*

Again, the alternative institutions here seem mainly directed at the efficiency, market failure problem – time horizons need stretching; growth-promoting projects of SMEs need funding; better risk sharing mechanisms are needed for SME to thrive, etc. Mostly these will all facilitate a better functioning capitalism rather than a shift towards a socially empowered economic alternative to capitalism.

Here are some scattered comments on some of the details:

(1) *New Retail Financial Intermediaries*

The key idea here is to create an ecosystem of finance that has more “nonprofit financial intermediaries”.

In terms of specific institutional design proposals, two main things are mentioned:

1. “federal matching funds program to help capitalize or recapitalize new or existing nonprofit financial intermediaries. (47)

questions: (1) Given Hockett’s arguments about credit creation, why precisely is capitalization important here? Is this because of the reserve requirements problem? But Hockett says that this really has nothing to do with actual credit creation, in which case why would increased capitalization of a “nonprofit credit franchise” be important. (2) If the purpose of capitalization is to have dispersible funds under the discretion of nonprofit agents – to be used either for loans under the loanable funds idea or as direct investments – than why should matching funds only be a transitional idea. Why not have permanent matching funds for appropriately regulated nonprofit organizations – perhaps like the Quebec social/solidarity funds institutions?

2. loan guarantees for conservation:

comment: This is a very narrow proposal, without much argument. Why a loan guarantee rather than a direct subsidy? Why not a scheme like the one proposed by Joel Rogers to provide grants for energy retrofitting which are paid back via a tax on the savings – so that the property owners only get says 50% of the savings, the rest goes into the conservation grant/subsidy fund. (eg if utilities were \$100/month before retrofit and \$80 after the retrofit, the property owner pays \$90/month, with \$10 going to the retrofitting fund and \$80 to the utility.

The rationale that is provided for these ideas is: “The idea here is to diminish the role of the stock market financing in the U.S. economy by increasing the share of bank lending to finance long term business investment.” (48) This seems like pretty minimalist ideal – make the US system more like the German with SME businesses playing a more robust role. Is this basically what is argued here? I agree that the stockmarket as organized has lots of negative effects, but German finance seems just like a VoC (Varieties of Capitalism) issue rather than really a real utopian model.

One other question here about why ordinary people will embrace these alternatives:

“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 transition period would be to reverse the current ratio with 90% of deposits in the credit unions and only 10% left for commercial banks.”

Are there any incentives for people to change, or is the issue here entirely based on values of citizens: “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.” Would their returns be as high as in the for-profit sector?

(2) Nonprofit Investment Banks

“...new nonprofit investment banking firms that would be able to underwrite securities to finance government agencies, infrastructure investments, and to support lending by the expanded credit union sector.”

Transition Logic:

p50. “These new institutions could be created as 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.”

Comment: The basic mechanism here is *competition between nonprofits and for-profit banks*. Much more needs to be said about the conditions under which nonprofits can out-compete for-profit banks. Also: what is the rationale for these banks being nonprofit social sector banks rather than public banks? Is there an implicit argument here about information conditions or accountability?

nonprofits vs public investment banks: What is the argument for nonprofit social entities functioning as the investment banks rather than public banks?

The securitizing argument:

“...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 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.”⁵⁰

Question: Why is creating a market in packaged securities really useful for enabling loans? Once again this brings into play the loanable-funds view vs the created-credit view. If the public policy objectives of allocating/creating credit is served by these nonprofit firms, why is the optimal way of doing this capitalization-via-securitization rather than state-backed credit expansion? If the nonprofit bank is a franchisee of the state – as in Bob’s analysis – then there would be no need for securitization for this purpose. What problem does securitization really solve, not in the current system, but in a real utopian alternative?

(3) Corporate reform

The call for a stakeholder version of B-Corp’s may be a good one, but this does not really seem like a financial system reform. In any case, I also do not understand the argument for why the B+ form would have clear competitive advantage over other more conventional firms. Here is your argument:

Stakeholder structure: “However, the success of this initiative requires a further step—that B corporations be managed with a stakeholder board in which employees choose 40% of the board members, 40% are chosen by the shareholders, and the remaining 20% are chosen by other constituencies. (We can call these resulting firms “B+ Corporations to signify the additional requirement of stakeholder boards.)”⁵²

Advantage: “One of the most important advantages of this stakeholder structure is that it makes it easier for founding entrepreneurs to keep the company independent if that is their preference. With conventionally structured firms, as soon as an outsider has purchased the majority of the outstanding shares, they control the firm. But with a stakeholder board, even if one bought up all the shares, one would control only 40% of the seats on the corporate board.”

Consequence – expansion: “If we assume that the statutes were reformed in this way, then the voluntary choice by some firms to incorporate as B+ corporations could set in motion a cascade over the following years. As a group, we would expect that B+ corporations would be better managed and return a higher share of profits to the shareholders than conventional corporations where top managers will keep trying to maintain excessive levels of compensation.”

Comment: This general argument – that B+ corporations will be “better managed” *from the point of view of investors mainly concerned with rates-of-returns-on-investments* -- just does not seem plausible to me. The task of balancing conflicting interests in a stakeholder board of directors is complex and costly. I don’t see any general reason to

assume that from the point of view of stock appreciation or dividends this will also be maximizing the interests of shareholders. Indeed, this is one of the objections to shareholder elected boards: they maximize the interests of one group but not all stakeholders, so surely there is a trade-off here. The firm might be “better managed” in some normative sense but the returns on investors to shareowners could still be lower because the firm has to appease these other actors in ways that taps into profits. The dynamic story here is not persuasive.

General Conclusion:

A key argument is that these reforms would set in motion a dynamic that would be significantly corrosive of private capitalist wealth holders’ power. This is not very persuasive to me.