General issues for the finance discussion

I. **Possible division of labor of two papers**.

In response to the failures of the current system of finance, both papers indicate two different kinds of proposed changes:

1. **Better Regulations.** Improve regulations of existing institutions that help to avoid self-destructive instability. These mostly have the character of making the system work better as a sensible capitalist system driven by private capitalist financial agents/organizations.

2. **New institutions or policies to significantly change the weight in the system of existing institutions.** This involves creating new kinds of credit institutions or providing new forms of subsidies to strengthen some kinds of existing institutions (eg. matching funds from the state to enhance solidarity funds). The result is increasing the role of noncapitalist organizations in the financial ecosystem. The purpose here is not simply to stabilize the system and reduce destructive volatility; the purpose is to realize different objectives from a capitalism-centered finance system. These noncapitalist organizations can be then divided into various types:

   2.1 **State agencies:** state banks, municipal banks, state-run funds of various sorts, etc.

   2.2 **Private nonprofit organizations**: private foundations, nonprofit corporations, and other institutions which have specific kinds of charters that give them a nonprofit mission but which are not deeply embedded in communities.

   2.3 **Social/community organizations:** cooperative banks, community banks, more democratic-egalitarian forms of organization.

   2.4 **Nonstate, Network structures**: I'm not sure how to treat these novel organizational forms – kickstarter-type, open crowdfunding finance, and the like.

Both Fred and Bob's papers suggest new regulations to contain destructive volatility. They set-up the need for this in somewhat different ways, but at its core the Polanyian critique of the self-regulating market for fictitious commodities and the recursive collective-action failure critique of credit markets are complementary. And both Bob and Fred see the need for new State organizations of various sorts. However, even though this is not very explicitly developed, I think the Polanyian/sociological view would tend to place socially-embedded institutions at the core of an alternative whereas the game-theory collective action failure view would tend to emphasize state institutions. If this is correct, then this might suggest complementary discussions: In the introduction to the two papers I could lay out the issue of different types of agencies needed to populate a financial ecosystem and the problem of giving them weight. One paper could focus on the state-centered agents, the other on the society-centered agents.

This also touches on another issue which is not very systematically discussed in either paper: the problem of the vigorousness of democratic participation and accountability. Both papers

assume a broadly democratic state, so that the regulations in question and the rules of the agencies that are developed would be democratically formulated. But neither really probes the specific democratic processes. My sense is that deeper democratic participation is more closely bound up with the Polanyian intuitions than with the Game Theory collective action perspective. Bob Hockett's arguments are quite consistent with a techno-bureaucratic view of how rules and decisions are made, with experts at the core. Fred's Polanyian approach suggests democratic processes are more central to the institutional design. The role of stakeholder boards, for examples, implies more deeply democratic forms.

So, one way we can go with this is to have a contrast between a Sociological-Polanyian analysis of the economy and finance and a game theory collective action analysis. Both reject the self-regulating market. Both see the need for new institutions and new regulations. Both provide a space for private for-profit agents/organizations. But they suggest a somewhat different direction for the elaboration of new institutions: one pushes towards community based, stakeholder, participatory institutions in which democratic values are seen as critical to their proper functioning; the other pushes towards more techno-bureaucratic regulatory and organizational forms centered on the state.

II. More specific issues

1. **Role of Savings.** Given the strength of Hockett's claims about credit being entirely generated by state action, I am unclear about the role of savings in the finance system. Savings are clearly important in the direct purchase of stocks and other investments, but they seem to play no necessary role in credit creation. Their role in deposits is mostly a way of giving specific forms of control over regulatory agencies over banks, but not central to credit formation.

2. **Irrationality/instability versus Realization of emancipatory values**. There is a general issue in both papers about the nature of the problem to be solved by a restructured finance system. The main thrust of the discussion concerns irrational self-destructive, destabilizing dynamics, with the 2008 crisis as the exemplary instance. There is some attention paid to egalitarian and democratic goals from time to time, but not a lot. Both papers provide a rationale for values other than individual wealth holders profit maximizing guiding the priorities of a finance system; especially this is clear in the Hockett paper since credit is entirely created by a the public entities, which gives the public a justification for deciding on purposes. But still, there is not that much focus on these alternative purposes and how this implies specific mixes of new institutions. An example would be different kinds of matching-fund processes for different kinds of financial institutions depending upon their purpose – community banks in poor neighborhoods are treated differently from banks that serve the rich.

3. The problem of capitalization of banks in order to make loans

The problem of capitalization & securitization:

In several places Fred makes proposals that bear on increasing the capitalization of nonprofit financial institutions. This kind of issue figures in the matching funds argument and then in the securitization of loans 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 more loans? Once again this brings into play the loanable-funds view vs the created-credit view of bank loans in the first place. If the public policy objectives of allocating credit is served by these nonprofit firms, why is the optimal form 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 it solve?

4. **General design issue**: **Matching funds mechanisms.** Allocation of taxes to social entities engaged in various types of finance, perhaps on matching fun basis. Examples:

- solidarity funds which match pension contributions for use in direct equity investment, venture capital, SME equity investment with social charters, etc.
- community-based lending circles – matching funds to increase the capital available
- other community banks, cooperative banks, etc.: the idea is to increase the loanable funds here

5. **Typology of funds & agents.** Let's make the distinction between *dispersible* funds – which include *loanable* funds, *grantable* funds, and spendable funds – and *creatable* funds (i.e. credit). Dispersible funds are allocations of the social surplus; the second is not. Only the state can reliably do the second of these – this is Hockett's view of credit as a state-created form of finance. What banks do is allocate state-created credit, rather than disperse private generated savings as loans.

Both state and private entities can disperse funds which are acquired out of the social surplus. That is, the state can tax income and then disperse that through loans, grants to private entities, and directly funded projects (direct state spending); and private entities can disperse savings in these three ways as well. And then, of course, there is a social model of the allocating entities – not for profit entities allocating funds. So we basically have the following Matrix:

		Agent of allocation		
		Private: for profit	***State***	***Social entities***
Type of fund to be allocated	***Dispersible Funds: Loans***	Savings based loans	Tax financed loans	Lending circles
	Dispersible Funds: Gants	Corporate Social Resp. grants	Tax financed grants	Foundation donation based grants
	Dispersible Funds: Projects	Direct private investment	Ordinary state spending	Social economy investment
	Creatable Funds	Bank Allocation of state-created credit	Credit creation	Credit unions, cooperative banks

This is obviously crude and incomplete. But my general question is whether there is a preferred mix of types here.

6. **One way of approaching the design problem: Alternative organizational entities for the finance system & alternative types of financing:**

Agents of finance: Capitalist; the State; Social entities of various sorts

Use of finance: loans of fixed funds, loans of credit-created funds, grants, direct investment in real activities, speculative investment, etc.

The critical real utopia problem is to (a) think about what ecosystem would in a generic system be optimal for the goals of a more democratic egalitarian society, (b) what institutional innovations move us in this direction.

7. **Precise role of for-profit credit institutions vs public agencies vs private/social nonprofits.** What precisely should be the role of for-profit private credit issuing institutions vs public/social entities? Is there an argument that in the ideal system for-profit banks would disappear entirely or be extremely limited, and thus the design principles for changes in the current rules should move in that direction by creating bridging institutions, transitional forms, hybrids, etc. that expand the space for nonprofit banking. Or are there some problems for which a for-profit bank is the optimal solution?

Bob proposes a very interesting way of thinking about the articulation of the role of the state and the role of for-profit private agents (see Hockett pp. 27-28 attached below): The state provides the resources, sets broad priorities and oversees the process; profit-seeking private actors perform the "Hayekian role" of discovering the best projects worthy of financing. This is interesting, but if this is the foundation of the principle of articulation, then I am not sure why private for-profit investors should have any role in public goods and infrastructure development, organized through the proposed "Public Investment Authority (PIA)…which will function as a sort of "Public-Private Equity Fund" in both maintaining and transforming critical infrastructure broadly conceived." (Hockett: 59-60). The Hayekian role here is much more ambiguous where all of the projects are public goods. I see that that there is a risk assessment problem because the bond-issuers will include cities, school districts, etc. But I don't see why private investors are better placed to make that kind of risk assessment over some superordinate public authority that runs the PIA. If the credit-creation argument is correct, there is also no need to mobilize anyone's savings for building infrastructure – you can just create the credit. So why have a partnership model for this?

8. **P2P financial systems**. Neither paper deal at all with the emergent forms of finance – grants, investment, credit – that get organized through p2p platforms of various sorts. There is a lot of heterogeneity in the crowdfunding world, and some of it is closer to conventional institutions than others. But some offer quite novel forms of enabling finance to flow to projects.

9. **Hockett vs arrighi accounts of trajectory and destabilization:** marginal propensity to consumer dynamics with increasing inequality vs intensified competition with material expansion

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Summary statement by Hockett on the articulation of public authority and private decisions in the credit creation and allocation system (pp.27-28, April 28 draft):

> Before proceeding I should emphasize two things I am *not* saying here. First, I am not saying that there is no role for private actors as creditors or investors in a properly functioning finance franchise. The whole point of speaking in terms of franchises is to emphasize that there are two modes, not one mode, of action involved in the arrangement – that of the franchisor and that of the franchisee. My claim is simply that there must indeed be both, not just one. In my view, private actors in the finance franchise serve primarily, though not uniquely, an informational role in the allocation of finance capital. Their willingness or unwillingness to put their own funds at risk in connection with particular projects serves as a datum – not the sole datum, but an important one – in determining where best to allocate capital. Franchisees should not, on the other hand, be mistaken for necessary sources of capital supply – that is the intermediated loanable funds myth, which yields nothing but mischief.
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> Second and complementarily, I am not saying that the franchisor – or 'the government,' 'the public sector,' the central bank, or what have you – is the sole entity capable of determining where best to allocate financial capital. That would be to contradict what I just said of the value of franchisees in the allocation process. Rather, I am saying that the franchisor as collective agent has one cluster of crucial capacities in making allocation decisions that the franchisees haven't. That is the advantage offered by an indefinitely extended time horizon, along with a capacity both to maintain, and to commit credibly to maintain, certain macro conditions on which even disaggregated private actors' capacities to make rational longer term investment decisions depend. And this owes precisely to what I said earlier about financial markets' proneness to recursive collective action challenges.
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> In short, then, in my picture the franchisor maintains certain macro-conditions including the supply of finance capital, credibly commits to keep doing so, and acts in accordance with these commitments. It also makes and executes allocation decisions that either are (a) entailed by the aforementioned commitments, or (b) important for the polity as a whole but incapable of being executed by disaggregated individual actors. The **franchisees, for their part, aid the franchisor in discharging these functions by in effect 'betting' on various alternative directions that what is always ultimately public investment might take. In so doing they play a Hayekian information-gathering and -aggregating function from which the franchisor benefits in determining where best to deploy capital.**
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> This, I believe, is the best way to understand why it is that **I allow nominally private banks and shadow banks both to dispense and to profit by dispensing what is at bottom a public resource. The dispensary role is a Hayekian role, and the profits earned therefrom are compensation for playing it.**