Democratizing Finance*

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Politics & Society published online 19 December 2013
DOI: 10.1177/0032329213512976

Politics & Society
XX(X) 1–26

DOI: 10.1177/0032329213512976
pas.sagepub.com

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Abstract
While financial institutions have not figured prominently in utopian thinking, the democratization of finance is central to any vision of bringing contemporary economies under democratic control. This paper is an initial effort to conceptualize a series of feasible reforms that could incrementally weaken the power of incumbent financial institutions while helping to facilitate economic development that is more egalitarian and sustainable. While the focus is on the US economy, the specific ideas have relevance in other national contexts. The core of the reform idea is to mobilize a combination of governmental supports and grassroots entrepreneurialism to create an expanding network of nonprofit financial institutions that would redirect household savings to finance clean energy, growth of small and medium-sized enterprises, and infrastructure.

Keywords
Real Utopia, finance, democracy, political economy, banking

*This article is part of a special section of the March 2014 issue, which follows the June 2013 special issue of *Politics & Society* called "Real Utopias." The papers were originally presented at the 2012 Annual Meeting of the American Sociological Association held in Denver, Colorado. The theme of the conference was "Real Utopias: Emancipatory Projects, Institutional Designs, Possible Futures." Please see the Introduction in the June 2013 issue for further information.

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Introduction

Financial institutions have generally been left out of utopian proposals or positive visions of a postcapitalist future. Through the end of the nineteenth century, most economists viewed banks as unproductive institutions,[1] so it is not surprising that radicals envisioned a future without a financial infrastructure. Many Marxists anticipated the elimination of the entire cash nexus of trading money for goods, so it followed logically that there would be no need for credit-providing institutions of any sort.

But over the last century, everyday life in the developed societies has been transformed by a process of financialization. Consumption of goods, services, housing, and education now critically depend on access to credit. The consolidation of retirement as a predictable life course event involves nearly everybody in a financialized process of establishing—either through private saving or public programs or a combination of the two—claims on resources for years when they will not receive income from work.

Yet over the last thirty years, as this process of financialization has accelerated, it has facilitated the accumulation of vast power and profits in a small financial elite centered in a handful of giant global banks and allied institutions.[2] Moreover, the irresponsible actions of bankers sent the world economy into a deep crisis in 2008, and yet the same bankers have had enough political clout to limit reforms that could make another financial meltdown less likely. In short, the concentration of financial power has become a threat both to future economic growth and to the viability of democracy itself.

Finance has also become a critical element in global stratification and a key mechanism that reinforces the existing distribution of income and power. In fact, one can think of differential access to credit as the principle axis of stratification in the current global economy. Literally everyone could be placed on a single scale that combines the amount they could borrow and the favorability of the terms. At the top would be the owners of the largest hedge funds, who can borrow tens of billions to finance leveraged positions at low interest rates and with fairly lenient conditions, while at the bottom are the poor of the planet, whose only possibility of borrowing would be small amounts at confiscatory rates.

At the same time, debt and continuing access to finance operates as a powerful disciplinary mechanism. This has been most obvious during the Euro crisis, as nations on the periphery of Europe have been forced to accept painful austerity in order to receive additional credits from the International Monetary Fund (IMF) and the European Community. But the same drama plays out on the level of individuals and families, as we saw with widespread evictions during the mortgage crisis.[3]

Hence, there is an urgent need for ideas about how finance could be reorganized to disempower the existing financial elite while simultaneously making it possible for those without wealth to realize their life plans and experience increased economic security at all stages of the life course. Building on Erik Wright's idea of Real Utopias,[4] this article is intended to provide an initial outline for democratizing the financial system of the United States.

But precisely because finance is global and also reaches into every corner of social life, analyzing the democratization of finance within the limitations of a single article inevitably entails making some hard choices. The scope of this article will be limited in the following ways. First, this article will only briefly touch on the urgently needed reforms to the global financial system that would complement the domestic reforms described here. Second, the paper will not address reforms to corporate governance and corporate finances that are a necessary part of any effort to renew the US economy.[5] Third, the discussion of alternative financial institutions will focus on the problems of consumer finance, small business lending, innovation, and infrastructure.

The argument of the article is developed in four parts. The first will address the feasibility of this particular reform approach, explaining why and how the power of the financial elite could potentially be challenged. The second will lay out the principles that would govern a reformed financial system. The third would elaborate what this revised financial system would look like. The final section is a conclusion.

Power and Feasibility

The power exerted by financial institutions has been geographically concentrated in a handful of global financial centers that are home to the preeminent markets and financial institutions. First among these is New York City's Wall Street, which handles each day trillions of dollars of transactions. The ultimate indicator of the power concentrated in the financial sector is what happened on Wall Street in 2008.

Many of the key Wall Street institutions—commercial banks, investment banks, insurance companies, and hedge funds—participated enthusiastically in the spectacular growth of a globalized market for Collateralized Mortgage Obligations (CMOs) that were packages of subprime mortgage loans that promised a high yield and had been given Triple A ratings by the leading credit rating agencies. However, the underlying loans had often been made on predatory terms, to people with uneven credit histories whose ability to keep up on their mortgage obligations was problematic.[6]

When the long upward movement of residential housing prices in the United States came to an abrupt halt in 2006, foreclosing on delinquent borrowers ceased to be an effective strategy because reclaiming homes and reselling them only served to accelerate the decline in housing values. As defaults on the subprime loans rose far beyond predicted levels, the value of the accumulated stock of CMOs also fell precipitously. Financial institutions around the world found that they were holding vast quantities of bonds that were worth only a small fraction of their face value. Even worse, as fear spread, these bonds could not be sold at any price.

In September 2008, financial institutions began to fall like dominoes. Some were insolvent because with the collapse of the CMOs, the value of the assets on their books was no longer sufficient to cover their liabilities. But after the collapse of Lehman Brothers, insolvency became a general problem because financial institutions were so tightly interconnected. Firms had reduced their reserves to the lowest possible levels and had maximized their short-term lending to each other. In that moment, those short-term loans—no matter how "safe" they might have been historically—faced a high risk of not being repaid, since even the Bank of America and Goldman Sachs might go down.

In this context, the Bush Administration and the Federal Reserve Bank launched a large-scale rescue of Wall Street. Congress passed a $700 billion bill to rescue Wall Street firms, and this was supplemented by an unprecedented level of lending by the Federal Reserve to financial institutions both in the United States and abroad. At its peak, Federal Reserve lending exceeded $3 trillion. These efforts ultimately succeeded in pulling financial institutions back from the brink, although many major institutions faced significant reorganization.

The indicator of Wall Street's power is the startling lack of conditionality of this rescue effort. When financial institutions offer rescues to governments or businesses, they invariably impose tough conditions that can involve the replacement of top managers and massive belt tightening. But even though it was clear that Wall Street firms had been directly responsible through imprudent actions for producing a disaster with global consequences, they were rescued with almost no conditionality. Most firms retained the same top managers, and criminal prosecutions of firms or individuals for actions that produced the crisis have been rare. Only those with an extraordinary degree of power can act very badly and suffer relatively few consequences for their actions.

But what is the source of this extraordinary power exerted by the financial sector? This is a question that has not received sufficient attention. Although we have significant works that track the growing importance of finance in the contemporary world economy, relatively little attention has been given to the question of financial power.

The classic analyses of finance capitalism produced around the time of World War I by Hilferding and Lenin are no longer relevant.[7] They were describing the fusion of industrial capital with financial capital typified by J. P. Morgan, who combined ownership of key industries with banking institutions that mobilized vast sums to create an ever-expanding business empire. With Morgan, it is not difficult to understand the power he wielded; his industrial empire generated a steady flow of profits, and the control over banks allowed him to greatly multiply this influence, so government officials ignored his entreaties at their peril.

But this fusion is rare today. In the United States, neither the giant commercial banks nor the historic investment banks own significant shares of nonfinancial firms.[8] Although they provide important services to major corporations, this is usually not their most profitable line of business. And the rest of the world has been moving in the same direction. Major German and Japanese banks historically had large stakes in nonfinancial firms, but they have been reducing their holdings for many years.[9] Hence, the current power of finance relies on something other than control over a steady stream of profits from nonfinancial businesses.

A second possibility is that the power of giant financial institutions rests on the same economies of scale and scope that allow a small number of giant corporations to dominate global markets for autos, computers, or smartphones.[10] In this argument, Citibank and Bank of America have become so huge because they can profitably provide customers with services at price points that competitors cannot meet.

There are, however, multiple reasons to disbelieve this line of argument. First, there are academic studies that show that banking institutions can realize all the available economies of scale and scope at a much smaller size than these mega-banks have achieved.[11] Second, it became clear during the crisis that top managers at the mega-banks were simply not able to monitor and effectively oversee the extraordinary range of speculative bets that were being made in different markets by different traders within their organizations. Third, the rise of boutique financial firms—including hedge funds and private equity, which manage billions of dollars with staffs of twenty or thirty people—suggest that the new technologies have, in fact, significantly diminished whatever economies of scale might have existed earlier.

Finally, considerable evidence exists that the consolidation in the US banking industry was a direct result of federal government policies driven by fears that US-based banks were at a competitive disadvantage internationally relative to giant banks in Germany and Japan.[12] Historically, widely held public suspicion toward finance in general and Wall Street in particular had given the United States a highly variegated banking infrastructure with barriers to interstate banking and a diverse population of savings and loans and small community banks. However, from the Reagan Administration onward, the government pushed for consolidation and centralization in the banking industry with the idea that giant banks would be more efficient and more globally competitive.

During the Reagan Administration, one of the top banking regulators, the comptroller of the currency, testified before Congress that a certain number of large banks were deemed to be "too big to fail" (TBTF) because their collapse would have systemic implications. This designation, however, gave the named banks an enormous advantage relative to their competitors; they could take on more risk and raise capital more easily because they were assured government bailouts. The result was a vast wave of consolidation in which the twenty-one listed banks were consolidated into five giant banks that owned 40 percent of consumer deposits by 2008.[13] The comparable figure in 1984 was 9 percent.[14]

This history suggests an alternative explanation for the power of giant financial institutions. With considerable support from the federal government,[15] financial institutions have been able to construct a system in which the overwhelming bulk of private savings are directed into a small number of channels that they control and from which they extract considerable transaction fees. It is as though the interstate highway system in the United States had been privatized and financial firms were allowed to set up tollbooths every few miles. People still have an option that is equivalent to driving on back roads to avoid the tollbooths, but there are considerable risks and costs that come with such avoidance strategies.

So why has the US government collaborated with large financial institutions in this way? This system of tollbooths was not structurally necessary; on the contrary, this centralization of finance represented a break with earlier US history.[16] But for more than three decades, government policy makers in the United States have favored increased concentration in the banking sector, and large financial institutions have also exerted growing influence in the political system through their role in campaign finance and in maintaining armies of Washington lobbyists. In addition, there has been a process of regulatory capture in which the Federal Reserve, in particular, has come to see its major role as supporting and protecting the largest financial institutions.[17]

The system of financial tollbooths can be discerned when one looks at the actual financial assets held by households. Most household financial saving in the United States—both resources directly controlled by the individuals and those invested on their behalf by pension funds and life insurance companies—are held in a quite narrow range of assets: deposits in banks, corporate equities, and bonds issued either by big corporations or federal, state, and local governments.[18] Most households acquire stocks and bonds through mutual fund shares that are purchased directly or through pensions, insurance, or employer-provided saving plans. But within each of these asset classes, there is also a very high degree of concentration. A very large proportion of bank deposits are now controlled by giant banks. The vast bulk of corporate bonds and equities owned by households are those of the 1,000 largest private corporations. Furthermore, the mutual fund industry is also very concentrated, with two giants controlling almost a quarter of all mutual fund investments.

These high levels of concentration make it easy for the financial industry to extract higher tolls or higher transaction fees for their services.[19] But there are two even more critical consequences of this concentration. The first has to do with the role of the stock market in the US economy. In most other countries, industrial growth in the first half of the twentieth century was financed by bank lending, but in the United States this was accomplished by firms issuing stock.[20] In recent decades, however, the corporate sector has in the aggregate been a net purchaser of stock; it has actually transferred income from the corporate sector to the household sector, rather than the other way around.

This has happened, in part, because the investment banking houses that underwrite new stock issues in the United States have been careful—except during the height of the Internet boom of the 1990s—to limit the quantity of new firms that are able to issue shares on the major stock markets.[21] Despite all of the hype about initial public offerings providing financing to emerging corporations, the magnitude of these transactions has not been large enough to offset the disappearance of shares as they are eliminated through mergers and acquisitions or private equity deals.

At the same time, the dollar value of shares outstanding in major corporations has been dwindling because of the widespread use of share repurchases. Rather than returning profits to shareholders in the form of dividends, firms have increasingly repurchased shares. This has been a powerful mechanism to transfer income to top corporate managers because of the rising importance of stock options in executive compensation.[22] For thirty years, a growing portion of executive compensation has been through stock options in order to more closely align the interests of executives with the interests of shareholders.[23] But by engaging in strategic share repurchases, managers can drive the stock price higher, even in periods when the firm's performance is otherwise unexceptional. This arrangement benefits top corporate managers along with major financial intermediaries because it puts share prices on a rising trajectory that, in turn, reinforces the attractiveness of this form of investment.

One important symptom of this shift has been the accumulation of vast cash reserves by major corporations. The veteran reporter David Cay Johnston estimated from IRS sources that by 2009, US nonfinancial corporations were holding $5.1 trillion in liquid assets in the United States and abroad.[24] And while business investment levels in the United States have rebounded since the Great Recession, record profit levels means that this huge horde of cash has continued to grow.

But this highlights the second problem generated by the concentration of savings in a small number of assets. While the current system channels funds into the stock market to firms that are accumulating vast amounts of cash, there are critical types of domestic investments that are not currently being financed at sufficient levels:

1. Clean energy and conservation retrofits for both residential and nonresidential buildings have been proven to pay for themselves in a relatively short period of time. These include replacing older fixtures and appliances, installing insulation and reflective roofs, and accelerating the introduction of new energy-saving building technologies. These are expenditures that produce higher annual returns at lower risk than most other types of investments.[25] But to date, our financial system has been reluctant to extend credit for these projects to homeowners, businesses, or public entities.
2. Many small high-tech firms are pursuing the commercialization of new technologies. Many of them perish as they cross the "valley of death"—the period between a laboratory breakthrough and having a commercial product.[26] Even if they survive in the short term, the incentives are very strong to sell the firm to a larger corporation rather than remaining independent. But often after takeovers the new owners might abandon the innovative technology for a variety of reasons.
3. There is a more general problem of financing for the larger universe of small and medium sized businesses that are not high-tech innovators.[27] These firms loom ever larger in the US economy, as the largest corporations have reduced domestic employment and become reliant on these smaller firms to produce many of their key inputs. Data from the Federal Reserve show that even as nonfinancial, noncorporate businesses were significantly expanding their levels of investment during the 2000s, they were able to rely on outside capital to finance only a small share of their investments.[28]
4. Many infrastructure projects—including rebuilding of decaying bridges, sewer systems, and water treatment plants—have been deferred because of the difficulty that local and state governments face in raising the needed capital.[29] In fact, in 2009, the American Society of Civil Engineers estimated the total cost of rebuilding the national infrastructure to be $2.2 trillion, with the nation falling further behind each year. This does not even count the costs of shifting an energy system dependent on burning carbon-based fuels to renewable energy sources or improving mass transit and inter-city transportation to reduce the wasteful dependence on the automobile.
5. 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.[30] But the consequence of this instability of household income is to produce extremely low scores on measures of creditworthiness.[31] This lack of access to credit on reasonable terms makes it far harder for households to engage in any of the kind of "bootstrap" operations that have historically been routes to upward mobility.[32] For example, small-scale entrepreneurialism, such as fixing up decaying housing, becomes impossible without some source of credit.

Aggregated together, these five areas of systematic underinvestment represent an enormous problem for the US economy, both in the short term and the long term. In the short term, levels of new productive investment are being unnecessarily reduced which, in turn, means slower growth of economic output and slower growth of employment. Over the longer term, the failure to invest in small innovative firms and in critical types of infrastructure will likely place additional barriers to future economic growth.

At the same time, these problems of misallocation also suggest the possibility of creating a broad political coalition to carry out a major structural reform of the nation's financial system. This coalition could bring together organized labor, environmentalists, minority communities, small business, and proponents of local economic development. The coalition's agenda would have two dimensions. The first would be to shrink the major financial institutions and prevent them from engaging in the kind of dangerous speculative activities that produced the 2008 meltdown. The second would be to create new financial channels so that private savings could be directed to overcome the shortage of financing in those five distinct but overlapping areas.

The strategy would have two separate but interrelated prongs.[33] The first would be to wage battles in Washington, DC, to dismantle the set of legal and political arrangements that privilege the incumbent financial entities while simultaneously working to create the regulatory space for the building of an alternative financial infrastructure that would direct resources toward those investments that have been neglected. The second prong would operate at the local level. It would involve mobilizing entrepreneurial initiatives to establish or revitalize local community financial institutions and ultimately persuade people to move their savings out of big banks and brokerage firms and into nonprofit financial intermediaries that would begin investing in local communities.

This is a long-term strategy designed to produce significant change over a twenty-year period. Since the strategy is evolutionary and long term, it does not require winning a big victory over Wall Street at the very outset. The United States has a long history of government supporting local economic development initiatives,[34] and the initial reform proposals would very much fit that mold. Wall Street might well oppose these measures, but they are unlikely to fight as ferociously as when their immediate profits are threatened.

Moreover, as locally based financial institutions proliferate and enjoy success in jumpstarting local economic development, the reform efforts would gain greater momentum. With this increasing strength, the reform movement would be able to fight for more ambitious reforms, and eventually Wall Street would be forced to limit its political investments as more and more people shifted their funds into the new financial channels.[35] In short, a series of reform struggles unfolding at different political levels could ultimately dismantle the power that finance currently exercises in the economy.

This would, in turn open the path for the construction of a different kind of economy that would enhance the power of local communities, put greater emphasis on equality and social inclusion, and prioritize significant movement toward environmental sustainability. In short, democratizing finance fits the framework of a real utopia because it could simultaneously weaken the power of entrenched elites while moving society toward an economy that is subordinated to democratic political initiatives.

There is no question that before the 2008 Global Financial Crisis, such a proposal would have been completely utopian. But the existing financial system—both in the United States and globally—failed spectacularly in recent years; it fueled a disastrous bubble in mortgage financing, and when the bubble burst, the collapse of financial institutions brought the world to the brink of a global depression. Although a 1930s-style crisis was avoided, recovery since 2009 has been slow and unemployment levels around the world remain at elevated levels. The need for radical reform of both the United States and the global financial order is obvious, but there are few existing visions of a reorganization that would be both radical and realistic.

The Principles for Organizing a New Financial System

At the core of Karl Polanyi's critique of the self-regulating market is his argument that land, labor, and money are fictitious commodities because they were not initially produced to be sold on the market.[36] Labor is the work effort of human beings and land is subdivided nature; neither nature nor human beings were created to be sold on the market. It follows for Polanyi that the conventional accounts of how a market system works are based on a falsehood because everyone has to pretend that these fictitious commodities behave in the same way as standard commodities.

But this dishonesty is particularly acute when it comes to the supply of money and credit. On the one side, most defenders of "free-market" arrangements acknowledge the need for a governmental institution—the central bank—whose role is to influence the supply of money and credit to avoid both inflation and deflation. Moreover, they also recognize that the central bank must play the role of lender of last resort because financial intermediaries are vulnerable to runs even when their assets well exceed their liabilities.[37]

And yet, most of these same people go on to argue that the market for credit is basically a self-regulating system that will achieve optimal results when managers of financial intermediaries are allowed to respond to the signals of the competitive marketplace. They also argue that for the same reasons financial regulators should not be heavy handed but should grant these institutions considerable latitude. Moreover, they also insist that governments—at all levels—must avoid deficit financing, except under very special circumstances. They insist on balanced budgets because government spending is not subject to the same kind of market discipline that pushes private actors to economize on the use of resources.

The Role of Government

All of these claims are deeply problematic. In the real world of actually existing market societies, government and financial intermediaries have long been deeply intertwined and interdependent. And, in fact, the developed societies did not reach their current level of development by pursuing a *laissez-faire* approach to the financial sector. In fact, in the United States, some of the central parts of the current credit market emerged only when government stepped in and offered various kinds of incentives or guarantees to private borrowers. For example, the rise of the thirty-year residential mortgage in the United States was closely tied to mortgage guarantees offered by the US Department of Veterans Affairs (VA) and the Federal Housing Administration (FHA). Similarly, the Small Business Administration (SBA) has underwritten a significant share of business lending to small firms through its loan guarantees. Moreover, government guarantees have also figured prominently in the rapid growth of educational loans to students.[38]

Other developed market societies have also used combinations of guarantee schemes, tax incentives, and public sector banks to assure that capital flowed in particular directions. In Germany, for example, what were historically state-owned *Landesbanks* played a critical role in providing credit to the German *Mittelstand*—the medium-sized firms that continue to be central to Germany's manufacturing economy.[39]

But the other side of the story is the considerable evidence that profit-oriented financial intermediaries are dangerous. There is ample empirical support for Hyman Minsky's financial instability hypothesis.[40] When financial intermediaries are not effectively restrained by regulators, they will take on higher levels of risk in order to realize higher profits. As indicated by repeated instances where banks help fuel asset price bubbles by increasing the allocation of credit, there is no justification for attributing a higher level of rationality to profit-oriented financial institutions. If it were not for periodic bailouts organized by governments, such entities might well have disappeared completely.

All of this suggests that government can and should play a central role in structuring the financial system to achieve sustainable long-term economic growth. And in contrast to the current system, which centralizes power in mega-firms and directs capital in just a handful of channels, an ideal system would be more decentralized and create more diverse channels for capital investment.

It also follows that direct government spending has an extremely important role to play in allocating capital to productive uses. Some types of spending, including support for scientific research, public education, and a variety of forms of infrastructure are pure public goods where government is the only appropriate funder. But there are also many mixed cases where private parties gain income streams but the streams might not be sufficiently large or sufficiently predictable to justify the initial investment. It is here that government can and should subsidize the investment through interest rate subsidies or loan guarantees or tax benefits.

Moreover, these necessary forms of government spending either to produce public goods or to help subsidize their production are inevitably rising as a percentage of GDP. Outlays for education, health care, and scientific research are all subject to Baumol's cost disease because of the difficulty of realizing ongoing productivity gains.[41] Moreover, developed societies have need for an ever-growing supply of infrastructure, and a significant share of these projects—bridges, tunnels, airports, water treatment plants—are not amenable to mass-production techniques.

This means that arbitrary limits on government spending, such as requirements that outlays must balance with income in a given year or the Maastricht Treaty rule that total government debt must not exceed 60 percent of GDP, are economically irrational. Greater outlays by government are often needed as a critical catalyst for economic growth, and there is no persuasive justification for denying government entities the opportunity to use debt to finance productive investments.[42]

These arguments suggest two important principles for democratizing the financial system:

1. *There should not be arbitrary restrictions—such as balanced budgets or the Maastricht rule limiting government debt to 60 percent 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.*
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.*

The Problem of Creditworthiness

Financial markets are organized around gatekeepers whose job is to decide who is worthy of credit at what interest rate and under what conditions. While much is made in the literature about the distinction between national financial systems that center on bank lending and those that center on stock markets, the reality is that gatekeepers necessarily play an indispensable role in both systems.[43] In bank-centered systems, lending officers at banks evaluate potential borrowers and establish the lending terms. In the US system, investment bankers underwrite stock and bond issues by businesses, state and local governments, and other entities. While impersonal markets determine the day-to-day value of the securities that have been issued, the investment banks play the role of gatekeepers. They are the ones who decide which entities are worthy of having their paper sold in a particular market and they shape the specific terms under which it is to be sold.

There is no way to avoid this gatekeeping function in the organization of capital markets. For the foreseeable future, there will be less available capital than potential projects that are asking for finance. Somebody has to make decisions about which projects are worthy and which are not and what are the relative levels of risk of different undertakings. And it is simply a fantasy to imagine that the gatekeeping can be done effectively by some version of voting on the Internet or by judgments on an impersonal market. Effective gatekeepers are in a position to extract detailed disclosures from those raising capital that market participants are not eager to reveal more broadly. Without these disclosures, impersonal markets have no protection against fraudulent operations.

But if a financial system needs gatekeepers, everything hangs on the decision rules that those gatekeepers employ to evaluate creditworthiness. In the past, gatekeeping positions in the United States were filled largely with upper-class individuals who had gone to the right schools and knew all the right people.[44] It was simply common sense for these gatekeepers to define creditworthiness in class terms; the closer an individual came to the manners and styles of upper-class men, the more creditworthy they were seen to be. If they were female, from a minority group, or working class in origin, then they were obviously less creditworthy.

Potential entrepreneurs from disfavored groups were then forced to find other ways to borrow the capital they needed. Certain ethnic groups developed parallel financial institutions or used informal mechanisms, such as rotating credit associations, to finance business efforts. In the worst case, they might resort to desperate exchanges with predatory lenders whose terms would significantly reduce the probability of business success.

But the central point is that creditworthiness has been defined in ways that incorporated existing social hierarchies of class, gender, and race. The merits of a particular borrower's project were much less important than who they were. During the course of the twentieth century, these definitions of creditworthiness came under sharp attack.

Laws were passed that required that creditworthiness be measured in ways that were independent of these ascribed social characteristics. But not surprisingly, these seemingly objective criteria to evaluate creditworthiness still reproduce and recreate older inequalities.

This was particularly clear in the subprime mortgage crisis. A seemingly objective scheme was used to measure creditworthiness and people whose scores fell below a certain point were put into the subprime category, where they were only eligible for mortgages with higher interest rates and more demanding conditions. Although this scheme was allegedly colorblind, minority households were disproportionately placed into the subprime category because on average they have substantially fewer assets than comparable white households.[45]

A second problem with established ideas of creditworthiness is that they are excessively individualistic; they rest on the erroneous assumption that each individual entrepreneur either does or does not have the capacity to succeed. But the reality is that economic development is a collective project; whether one is talking about community revitalization or regional economic growth, the process depends on interdependent decisions by multiple actors. Gatekeepers who understand this interdependence can tilt the playing field toward more successful outcomes.

In short, a system of democratized finance would involve the continuing effort to improve the criteria used by gatekeepers to evaluate the creditworthiness of different parties attempting to raise capital. Such a system would need to incorporate four additional principles:

3. *Evaluation of creditworthiness of individuals and organizations should be based on 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.*
4. *Evaluations of creditworthiness should no longer privilege profit-making firms. Sufficient data now shows that alternative types of organizations, including employee-owned firms, can survive and flourish.*[46] *It follows that there need to be new types of financial instruments to provide credit to these nontraditional firms.*
5. *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.*
6. *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,*[47] *and it is the design principle of venture capital firms that operate on the expectation that most of the firms they support will fail.*[48]

Organizing Financial Intermediaries

The problem with gatekeeping is that it is 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 almost always 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, he or she will be denied credit or as with subprime mortgage lending, be required to pay a substantially higher interest rate than other borrowers.

This kind of automation is a particular problem with small-business lending. 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 toward real estate development and away from other endeavors.[49]

The best way to overcome this dynamic is to introduce significant competition from financial intermediaries who are not seeking to generate profits. These could take the form of credit unions, community banks, nonprofit loan funds, or banks that are owned by government entities; but the key is that their mission is defined as facilitating economic development in a particular geographical area. With this mission, they have a reason to employ loan officers who develop the 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.

Moreover, when strong competition exists from nonprofit banks, there can be a shift in the strategies used by profit-oriented banks. When most financial intermediaries are ignoring the needs of small business, there is no real cost to following this trend. But if your nonprofit competitors are helping small firms develop into effective firms, you are likely never to regain them as clients because they will probably remain loyal to the bank that gave them critical support at the beginning. In short, competition can force for-profit banks to invest again in skilled loan officers.

A second important reason to develop a significant nonprofit financial sector is to reduce the Minskyan danger that financial intermediaries will follow the path of pursuing higher risks by accumulating ever-riskier investments. Here again, competition from more sober institutions might also operate as a restraint on profit-oriented firms since investors would have an alternative place to deposit their savings. To be sure, cooperative or nonprofit status does not automatically solve this problem; unscrupulous managers can still pursue risky strategies while also bidding up their compensation rates. A strong regulatory apparatus is still needed to make sure that these institutions do not take excessive risks.

Finally, there should also be relatively low barriers to entry to create new nonprofit financial institutions as a way to counteract the tendency of existing institutions to become insular and unresponsive to newcomers or different constituencies. Even without an orientation to profit, there is still a need for ongoing competition among these institutions for consumer deposits and for loan applications.

This argument suggests two additional principles of a democratic credit system:

7. *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.

8. *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.*

Alternative Financial Institutions

The strategy of financial reform proposed here has three main components. The first and most critical is to create a much larger sector of nonprofit retail financial intermediaries. These would be the base of a democratized financial system. The second piece would be to create a set of nonprofit institutions that would compete directly with investment banks to underwrite securities. The final piece is the creation of a new fixed-price stock market that would provide capital for high-technology startup firms.

New Retail Financial Intermediaries

There are numerous models for nonprofit financial institutions that collect deposits from a geographical area and then relend 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.[50] 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.[51] Mendell and her coauthor describe the complex web of locally based financial institutions that have supported the development of the social economy in Quebec starting around 1996.[52]

The main emphasis here is on credit unions because they already have a significant presence within the US financial marketplace.[53] 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 United States, much of the regulatory and support structure for credit unions to play an expanded role already exists. The US 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 United States 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.

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 give customers 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:

1. A federal matching funds program to help 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.

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 more careful design because these loans are riskier and the dangers of abuse and fraud are substantially greater. The goal would be something similar to a guarantee program that exists in Germany where the risks are distributed across different institutions.[54] One might imagine, for example, 25 percent of the risk being covered by the Federal

Home Loan Bank Board, 25 percent by the Federal Reserve System, 25 percent by the Treasury, and the final part being carried by the originating institutions. Since these guarantees are designed to support probabilistic lending 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.

The idea here is to diminish the role of the stock-market financing in the US economy by increasing the share of bank lending to finance long-term business investment. The reason for emulating the financing pattern that has long been followed by Germany is that there is an affinity between high rates of innovation and greater reliance on small and medium-sized enterprises that are frequently family owned. With this shift, those in charge of small and medium-sized enterprises would have a viable alternative to having their firms listed on public exchanges and they would be effectively insulated from the short-term time horizon problem that plagues publicly traded corporations. There would also be enhanced opportunities for employee-owned firms to flourish because they would no longer face discrimination when attempting to borrow.

It will, of course, take time for these emergent financial institutions to learn the specific skills required to be effective as financers of small and medium-sized firms. The clean energy guarantees and the broader guarantee program would help to facilitate this transition. But over time, the guarantee programs should be focused on recently created firms because lending becomes progressively less risky as small and medium-sized enterprises become more established. And during economic downturns, when these firms experience temporary difficulties, the decentralized financial institutions would be able to maintain lending by increasing their own borrowing from the Federal Reserve or the Federal Home Loan Bank system.

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 United States and these institutions control about 10 percent 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 percent of deposits in the credit unions and only 10 percent left for commercial banks.

Nonprofit Investment Banks

However, shifting deposits from commercial banks to credit unions does not address the flow of resources from households to purchase securities. As we have seen, those flows empower brokerage firms and giant mutual funds, and support the deeply flawed governance of giant corporations. The next step is to create 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.

These new institutions could be created as entities jointly owned by large public pension 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. 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 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 further expand 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.[55]

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 percent or 4 percent per year would be attractive, especially when people understood that these investments were contributing to sustainable economic growth.

A Nonprofit Innovation Stock Market

A final measure is needed, however, 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 probabilistic 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 others. 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 to this problem would be to create a new nonprofit stock exchange where high-technology startup firms would be rigorously screened and have the opportunity to raise up to some limit—perhaps $10 million—by selling shares that would initially sell for a dollar a piece.[56] 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.[57]

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 provided they were successful in product development.

Conclusion

For reasons of space, the focus of this analysis has been on financial reforms within the United States. But the reality is that the unique position of the United States in the global economy has played a critical role in empowering Wall Street firms. With the dollar being the world's major reserve currency and the United States running chronic balance of payments deficits, hundreds of billions of dollars of foreign capital flow into the United States each year, with Wall Street firms handling a large share of these transactions.[58]

It follows that weakening the dominant financial firms requires international reforms as well as the domestic initiatives that have been described here. The needed global reforms can be very briefly summarized here:[59]

1. It is irrational and undesirable for the world's remaining superpower to be importing capital from the rest of the world. The United States should be moving its current accounts back to balance by significantly reducing its imports, especially petroleum; increasing exports; and substantially cutting back on its global geopolitical commitments, particularly the vast empire of foreign military bases. Moreover, there is an urgent need to reform the existing tax system that incentivizes US firms to invest abroad and to book profits in foreign tax havens.
2. There should be an international financial transactions tax to dampen speculative international capital flows.
3. The dollar's role as the dominant international currency should be phased out, ideally by moving toward the kind of international financial mechanism that J. M. Keynes proposed in the 1940s. He argued for an International Clearing Union that would automatically provide credits to nations in a deficit situation.[60]
4. There needs to be significant expansion in the scale of global development banks that would relend funds for productive uses across the developing world.

> This would provide a productive outlet for global savings that now often move into speculative and destabilizing investments. But this expansion should occur simultaneously with major efforts to expand the democratic accountability of these lending institutions.

These global reforms would help reinforce the democratization of finance within the United States through a number of different channels. First, taxation on financial transactions would increase incentives for more productive forms of lending. Second, the phasing out of the dollar's reserve currency role would weaken the dominant Wall Street firms by reducing their access to capital inflows from abroad. Third, the expansion of the role of development banks could internationalize the model of nonprofit and sustainable lending.

Nevertheless, some readers might argue at this point that while all of these changes might be desirable, they hardly add up to a utopia. After all, even if all of these reforms were accomplished, there would still be great inequalities of income and wealth, employers will still have a structural advantage over people needing work to put food on the table, and profitability would still dominate in large sections of the economy.

But a real utopia is not intended to make all problems go away in a single instant; that only happens in schemes that cannot possibly be realized. What makes something a real utopia is that the changes are actually feasible and they potentially could shift the balance of forces in favor of further reforms and improvements. The proposals advanced here for democratizing finance accomplish this end by significantly expanding the scope of democratic politics and weakening the resistance of existing elites.

Let us think of the scenario in which a reformist government comes to power determined to redistribute income in favor of households at the bottom while also strengthening the rights that employees have at the workplace. The classic scenario is that large employers and financiers would express their displeasure by engaging in an investment strike and by shifting capital abroad. The strategy would be to subject the population to enough economic pain that the government would be forced to retreat.

When we replay that scenario with these proposed reforms in place, things play out very differently. The decentralized and nonprofit financial institutions might see little danger in the reforms. On the contrary, some small and medium-sized enterprises might imagine that income redistribution would boost consumer demand for their products. And as long as the government could get the central bank to keep interest rates low, the volume of new investment might stay relatively high.

At the same time, access to resources through an international clearing arrangement and the use of capital controls could limit the damage from any capital flight that occurs. This would give the government time to prove to everyone that the redistributive and employee empowering reforms were not actually bad for business. In other words, the consequences of reforms would be determined by actual experimentation and not by the ideological claims made by those opposing redistributive measures.

In sum, these changes would reinvigorate the social democratic project of creating a society in which citizens could use democratic politics to make key decisions about how the economy would operate.[61] While there is no way to legislate an end to scarcity, democratic politics can play a major role in deciding who will bear the costs of particular scarcities and how various critical tradeoffs—for example, between investment and current consumption—will be managed. For this to happen requires the kinds of reforms described here to overcome the despotic power of those who control key financial resources.

Acknowledgments

This paper was initially prepared for the Real Utopia program organized by Erik Wright for the American Sociological Association Meetings, August 2012. Without his encouragement and helpful comments this article would never have been completed. I am also grateful to Miriam Joffe-Block, Matthew R. Keller, and Lucas Kirkpatrick for conversations that generated some of the ideas that are included here. John Kincaid and Tim Gutierrez provided important research assistance. Valuable comments were provided by the *Politics & Society* editorial board, participants in the Power and Inequality Seminar at the University of California, Davis, as well as Karl Beitel, Leonardo Burlamaqui, Jan Kregel, Greta Krippner, and Claus Thomasberger. However, they are all absolved of any responsibility for the final product.

Declaration of Conflicting Interests

The author declared no potential conflicts of interest with respect to the research, authorship, and/or publication of this article.

Funding

The author gratefully acknowledges support from the Ford Foundation for this research through grant #1110-1158-0.

Notes

1. Brett Christophers, *Banking Across Boundaries* (Chichester, West Sussex: Wiley-Blackwell, 2013).
2. Greta Krippner, *Capitalizing on Crisis* (Cambridge, MA: Harvard University Press, 2011).
3. Finance also plays a critical role in reproducing the power of employers in relation to their employees. One of the reasons that capital hires labor rather than the other way around is that worker-owned firms have generally found it difficult to find the financing they need. See Joan Scott, *Glassworkers of Carmaux* (Cambridge, MA: Harvard University Press, 1974).
4. Erik Wright, *Envisioning Real Utopias* (London: Verso, 2010). See, also, the special issue of *Politics & Society* on this topic, June 2013.
5. There is a growing literature that addresses these questions. See Gerald F. Davis, *Managed by the Markets* (Oxford: Oxford University Press, 2009); William Lazonick, *Sustainable Prosperity in the New Economy* (Kalamazoo, MI: Upjohn, 2009). My own ideas about corporate reform are suggested in "Corporation with a Conscience?" *New Labor Forum* 15 (Summer 2006): 75-83.
6. For standard accounts, see Simon Johnson and James Kwak, *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown* (New York: Pantheon, 2010); Joseph Stiglitz, *Freefall* (New York: Norton, 2010).

7. V. I. Lenin, *Imperialism* (New York: International Publishers, 1939 [1917]); Rudolf Hilferding, *Finance Capitalism*, tr. by Morris Watnick and Sam Gordon (London: Routledge and Kegan Paul, 1963 [1910]). Available at: https://www.marxists.org/archive/hilferding/1910/finkap/index.htm.
8. Under the Glass-Steagall regime established in the 1930s, there was a strict separation in the United States between commercial banking, based on taking deposits, and investment banking, which focused on underwriting securities. However, the distinction eroded beginning in the 1980s as US government policy favored consolidation in the banking sector and was formally ended with the Gramm-Leach-Biley Act passed in 1999. During the 2008 crisis, the historic investment banks either went bankrupt (Lehman Brothers), were bought by commercial banks (Merrill Lynch), or were reorganized as bank holding companies to receive government bailouts (Goldman Sachs, Morgan Stanley). Sandra Suarez and Robin Kolodny, "Paving the Road to 'Too Big to Fail': Business Interests and the Politics of Financial Deregulation in the United States," *Politics & Society* 39, no. 1 (2011): 74-102.
9. On Germany, see Richard Deeg, *Finance Capitalism Unveiled* (Ann Arbor: University of Michigan Press, 1999). On both Germany and Japan, see Sigurt Vitols, "From Banks to Markets: The Political Economy of Liberalization of the German and Japanese Financial Systems," and Steven K. Vogel, "The Re-Organization of Organized Capitalism: How the German and Japanese Models are Shaping Their Own Transformation" in K. Yamamura and W. Streeck, eds., *The End of Diversity? Prospects for German and Japanese Capitalism* (Ithaca: Cornell University Press, 2003).
10. The centrality of economies of scale and scope in the rise of large corporations is detailed by Alfred D. Chandler, Jr., *Scale and Scope: The Dynamics of Industrial Capitalism* (Cambridge, MA: Harvard University Press, 1990).
11. The measurement of economies of scale in banking remains a hugely controversial topic, but the studies used to justify consolidation in banking focused on banks with assets of between $10 and $25 billion. However, the three mega-banks now have over $2 trillion in assets and it is possible that they suffer series diseconomies of scale. See Robert DeYoung, "Scale Economies Are a Distraction" Federal Reserve Bank of Minneapolis, *The Region* (September 2010): 14-16.
12. Christophers, *Banking Across Boundaries.*
13. This argument is developed in Gary Dymski, "Genie out of the Bottle: The Evolution of Too-Big-to-Fail Policy and Banking Strategy in the U.S." Unpublished paper, UC Riverside, 2011.
14. Luigi Zingales, "Capitalism After the Crisis," *National Affairs*, no. 1 (2009). Accessed at: http://www.nationalaffairs.com/publications/detail/capitalism-after-the-crisis.
15. For example, laws and government regulators privilege certain asset categories such as credit instruments with AAA ratings while other asset categories are defined as risky and speculative.
16. The strongest argument for structural necessity has been advanced by Giovanni Arrighi and Beverly Silver, *Chaos and Governance in the Modern World System* (Minneapolis: University of Minnesota Press, 1999). Their argument is that declining global hegemons have always turned to financialization as a way to preserve their global position. But they do not explain the mechanisms through which the interests of finance prevail over other economic interests or whether there are any contingencies influencing these processes.
17. Significant responsibility for this regulatory capture lies with Alan Greenspan, who brought his extreme libertarian ideology to the task of chairing the Federal Reserve Board.

On Greenspan's close ties to the great theorist of libertarianism, Ayn Rand, see Jennifer Burns, *Goddess of the Market* (New York: Oxford University Press, 2011).

18. Many households do not have any financial savings at all; many working-class and middle-class people are lucky if they have some equity in a home. However, among the wealthiest households, the composition of assets is different, with much more wealth held in businesses or in complicated trusts. Data are available in the Federal Reserve, *Flow of Funds Accounts of the United States*, release Z1, Table F100 available at: http://www.federalreserve.gov/releases/z1/Current/z1r-3.pdf. Additional data are available in the Survey of Consumer Finance administered by the Federal Reserve every third year. Available at: http://www.federalreserve.gov/econresdata/scf/scfindex.htm.
19. The documented collusion among big-money center banks to manipulate the London Interbank Loan Rate (LIBOR) suggests how easy it is for these institutions to cooperate against their customers. Jan Kregel, "The LIBOR Scandal" *Policy Note* no. 9 (2012), Levy Institute of Bard College.
20. Alexander Gerschenkron, *Economic Backwardness in Historical Perspective* (Cambridge, MA: Harvard University Press, 1962); John Zysman, *Governments, Markets, and Growth* (Ithaca: Cornell University Press, 1983).
21. Jay R. Ritter, "Initial Public Offerings: Tables Updated Through 2011." Department of Finance, University of Florida, 2012. Available at: http://bear.warrington.ufl.edu/ritter/ipodata.htm.
22. This argument has been developed by Lazonick, *Sustainable Prosperity* and "The Explosion of Executive Pay and the Erosion of American Prosperity," *Enterprises et Histoire* 57, no. 4 (2010): 141-64.
23. Michael Useem, *Executive Defense* (Cambridge, MA: Harvard University Press, 1993).
24. David Cay Johnston, "Idle Corporate Cash Piles Up," (16 July 2012). Available at: http://blogs.reuters.com/david-cay-johnston/2012/07/16/idle-corporate-cash-piles-up/.
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26. Philip E. Auerswald and Lewis M. Branscomb, "Valleys of Death and Darwinian Seas: Financing the Invention to Innovation Transition in the United States," *Journal of Technology Transfer* 28, no. 3-4 (2003): 227-239; Fred Block and Matthew R. Keller, eds., *State of Innovation* (Boulder, CO: Paradigm Publishers, 2011).
27. Nathalia Rogers, Ronald E. Roel, Edward T. Gullason, and Susanne Bleiberg Seperson, "Small Businesses in a Struggling Economy: Socio-Economic Issues and Measures to Improve the Small Business Climate," Dowling College, 2012. Available at: http://www.dowling.edu/aci/SBA_Report_Final_March2012.pdf.
28. Federal Reserve, *Flow of Funds Accounts*, Table F103.
29. On the politics of funding infrastructure, see L. Owen Kirkpatrick and Michael Peter Smith, "The Infrastructural Limits of Growth," *International Journal of Urban and Regional Research* 35, no. 3 (2011): 477-503.
30. Jacob Hacker, *The Great Risk Shift* (New York: Oxford, 2005).
31. For a recent study of the role of the financial system in marginalizing the urban poor, see Michael Barr, *No Slack: The Financial Lives of Low Income Americans* (Washington, DC: Brookings, 2012).
32. In the aggregate, US student educational borrowing has arguably risen too rapidly in recent years with the total debt now exceeding $1 trillion and an increasing share of borrowers

falling behind in their payments. The fear of excessive debt is particularly likely to discourage students from lower-income households. Two of the obvious solutions are returning to earlier levels of public support for higher education and significant reductions in the interest rates on a type of borrowing with considerable positive spillovers.
33. There is actually a third prong, which will be mentioned briefly in the conclusion—the fight for global economic reforms that would reinforce domestic reforms.
34. For some of the more recent history, see William H. Simon. *The Community Economic Development Movement* (Durham: Duke University Press, 2001).
35. The argument developed here rests on the idea that the power of finance is not an automatic consequence of the capitalist mode of production or a system of production for profit. I have begun to sketch such an argument in "Capitalism without Class Power," *Politics & Society* 20, no. 3 (1992): 277-303 and "Deconstructing Capitalism as a System," *Rethinking Marxism* 12, no. 3 (2000); 83-98.
36. Karl Polanyi, *The Great Transformation* (Boston: Beacon, 2001 [1944]).
37. The internal contradictions in the Federal Reserve System are discussed in William Greider, *Secrets of the Temple* (New York: Simon & Schuster, 1985).
38. For a survey that conveys the magnitude of the governmental role, see Sarah Quinn, "The Hidden Credit State: A Sociology of Federal Credit Programs in the United States," Unpublished paper, Department of Sociology, University of Washington.
39. Deeg, *Finance Capital Unveiled*.
40. Hyman Minsky, *Stabilizing an Unstable Economy* (New Haven: Yale University Press, 1986).
41. William Baumol, *The Cost Disease* (New Haven: Yale University Press, 2012). Baumol's point is that a string quartet will continue to require four members, so the cost of the concert ticket will inevitably rise relative to the costs of goods produced with less and less labor input.
42. Separating government budgets between current accounts and capital accounts, as private firms do, would help to assure that outside of economic slowdowns, government borrowing would be limited to financing those expenditures that produce a continuing flow of future revenues.
43. Zysman, *Governments, Markets, and Growth.*
44. See Connie Bruck's description of investment banking before the arrival of Michael Milken in *The Predator's Ball* (New York: Penguin, 1988).
45. Jesus Hernandez, "Redlining Revisited: Mortgage Lending Patterns in Sacramento 1930-2004," International *Journal of Urban and Regional Research* 33, no. 2 (2009): 291-313; Akos Rona-Tas and Stefanie Hiss, "The Role of Ratings in the Subprime Mortgage Crisis," in M. Lounsbury and P. M. Hirsch, eds., *Markets on Trial* (Bingley, UK: Emerald Group, 2010), 113-54.
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47. Michael Piore and Charles F. Sabel, *The Second Industrial Divide* (New York: Basic Books, 1984).

48. Paul Alan Gompers and Josh Lerner, *The Venture Capital Cycle*, 2nd edition (Cambridge, MA: MIT Press, 2004).
49. A useful source of data is Office of Advocacy, Small Business Administration, *Small Business Lending in the United States 2012*, available at: http://www.sba.gov/sites/default/files/files/sbl_12study.pdf. The data show a negative correlation between bank size and small-business lending as a percent of total assets. In 2012, banks with assets exceeding $10 billion held 77.7 percent of total bank assets, but only 48.2 percent of small business loans (10).
50. Marc Schneiberg, "Toward an Organizationally Diverse American Capitalism?" *Seattle University Law Review* 34 (2011): 1409-34.
51. Deeg, *Finance Capital Unveiled.*
52. Marguerite Mendell, "The Three Pillars of the Social Economy: The Quebec Experience (1996-2007)" in A. Amin, ed., *The Social Economy* (London: Zed Books, 2009); Gilles L. Bourgue, Margie Mendell, and Ralph Rouzier, "Solidarity Finance: History of an Emerging Practice," In M. J. Bouchard, ed., *Innovation and the Social Economy: The Quebec Experience* (Toronto: University of Toronto Press, 2013), 180-205.
53. However, activists in a number of communities are organizing on a parallel track—the creation of municipal banks that would operate on a model similar to the state bank in North Dakota. Local government would use the municipal bank for its own deposits and transactions and the bank could relend in cooperation with local banking institutions to accelerate economic development. See, for example, Aaron Sankin, "A Municipal Bank for San Francisco? City Explores Revolutionary New Model," *Huffington Post* (4 November 2011). Available at: http://www.huffingtonpost.com/2011/11/03/municipal-bank-san-francisco_n_1074600.html.
54. Axel Schmidt and Guy Selbherr, "Tasks, Organization and Economic Benefits of German Guarantee Banks," *The Journal for SME Development* 11 (2009): 45-86.
55. These institutions would also be able to develop new instruments such as the long-term loans developed in Quebec to finance nontraditional firms.
56. The costs of initially creating the market could be financed with a combination of federal dollars and matching funds from public pension funds and other large institutional investors who have an interest in long-term economic growth. The ongoing costs of maintaining a staff that would monitor new entrants and existing firms for compliance with the rules could be covered by a small tax on share purchases.
57. B Corporations, or Beneficial Corporations, have been created by legislators in a number of US states. Such firms are allowed to prioritize other goals such as environmental sustainability or good working conditions over and above profitability. See Dana Brakman Reiser, " Benefit Corporations—A Sustainable Form of Organization?" *Wake Forest Law Review* 46 (2011): 591-625.
58. Herman Schwartz, *Subprime Nation* (Ithaca: Cornell University Press, 2009); Barry Eichengreen, *Exorbitant Privilege* (New York: Oxford University Press, 2011).
59. See Fred Block, "Breaking with Market Fundamentalism: Toward Domestic and Global Reform," in J. Shefner and P. Fernandez-Kelly, eds., *Globalization and Beyond.* (University Park, PA: Penn State University Press, 2011), 210-27.
60. For an effort to bring Keynes' ideas up to date, see John Eatwell and Lance Taylor, *Global Finance at Risk* (New York: New Press, 2000).
61. Sheri Berman, *The Primacy of Politics* (New York: Cambridge University Press, 2006); Fred Block, "Reinventing Social Democracy in the 21st Century," *Journal of Australian Political Economy* 67 (2011): 5-21.

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