

# Introduction to the Special Issue\*

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## Abstract

This article introduces the articles and commentaries in the special issue titled “Democratizing Finance.” Here, the term “democratizing finance” focuses on reducing inequalities of income, wealth, and power.

## Keywords

finance, democratizing finance, Erik Olin Wright, real utopias

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\*This article is part of a special issue titled “Democratizing Finance” that includes an introduction, anchor articles by Robert C. Hockett and Fred Block, and commentaries by William H. Simon, Lenore Palladino, Mary Mellor, Michael A. McCarthy, and David M. Woodruff. The papers were originally presented at a workshop held in Madison, Wisconsin, in July 2018 organized by the late Erik Olin Wright as part of his Real Utopias Project.

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The articles in this special issue on democratizing finance originated in a workshop held in Madison, Wisconsin, in July 2018 that was organized by Erik Olin Wright, as part of his Real Utopias Project. The issue includes two anchor articles, by Robert C. Hockett and Fred Block, and five commentaries, by William H. Simon, Lenore Palladino, David M. Woodruff, Michael A. McCarthy, and Mary Mellor. Sadly, Erik died while these papers were being prepared for publication. Nevertheless, our plan is that, as with earlier Real Utopias volumes, these pieces and additional commentaries will be published as a book by Verso.

Before describing the articles in this issue, this introduction begins by explaining what is meant here by “democratizing finance” There are some important disagreements among the contributors over the strategies to be pursued to reach this goal, but there is considerable agreement on why a democratization of the financial industry is an urgent political priority.

The phrase “democratizing finance” has a number of possible meanings. For some, it means expanding access to formal credit institutions for poor and marginalized segments of the population whose access to credit has been limited to predatory borrowing from loan sharks or pawnshops. For others, it refers to the opening up of savings accounts and investment opportunities for those who had previously been “unbanked” or who lacked any savings to invest.

These meanings, however, are politically ambiguous. Extending credit or investment opportunities to the poor could be a project of egalitarian reform, a cover for new forms of exploitation, or a complicated combination that benefits some and hurts others. So, for example, the initial project in microlending carried out by the Grameen Bank in Bangladesh appeared to empower women in rural areas of that nation, but subsequent for-profit versions of microlending have sometimes proved predatory and have entrapped low-income borrowers in endless cycles of borrowing.<sup>1</sup> Similarly, access to bank accounts could facilitate saving for the poor but could also be yet another means to extract resources from them and deepen their poverty.

Our use of the term “democratizing finance” focuses instead on reducing inequalities of income, wealth, and power. We start with the recognition that the existing configuration of finance in most developed and developing countries works to reproduce the income and wealth inequality that has been ever-more extreme in recent decades. The financial system enhances the agency of the already wealthy and often blocks those in the bottom two-thirds of the income distribution from changing their situations or accomplishing their life goals.

The fact that those who are already wealthy have access to credit on extremely favorable terms empowers them to take actions that deepen inequality. The largest global corporations can easily raise the capital to buy up potential competitors, thus ensuring future profits that are distributed to top managers and investors who are disproportionately wealthy. Private equity firms routinely borrow money at favorable interest rates to buy up existing firms. They then slash costs by eliminating jobs and cutting back on employee benefits before eventually selling the business again at a considerable profit.

In contrast, the poor, working people, and even the middle classes often find themselves constrained by either the high cost of borrowing or the complete unavailability of credit. Farmers or small businesses might want to borrow to invest in their businesses, but they already experience difficulty servicing past debts. Employee cooperatives and nonprofit organizations routinely find it impossible to borrow to finance the start of a business or to build low-income housing. In the United States, the cost of borrowing to finance higher education drives some young people to give up on college and saddles others with a burden of cumulative borrowing that now exceeds \$1 trillion in loans.

At the same time, the financial system often works to redistribute income upward. Thomas Piketty's research shows that those in the top 1 percent of households have access to investment opportunities that produce substantially higher returns than the investments available to middle-income households.<sup>2</sup> Since they can also borrow at extremely favorable rates, they are able to increase their returns further through leverage. Meanwhile, as we saw with subprime mortgage loans to poor and minority households, lending on predatory terms can be extremely profitable for both mortgage brokers and investment bankers. Even the 18 percent interest rate that many working and middle-class people pay on their credit card debt enhances the profits of banks and their shareholders.

The existing financial system also reinforces the control of elites over key investment decisions that shape the future trajectory of economic activity. For example, the investment decisions of oil companies and automobile firms dictate continued dependence on the internal combustion engine despite global climate change. Moreover, even when governments at the local or federal level invest in infrastructure projects, their actions are often constrained by the need to satisfy the financial intermediaries that help them to raise money in the capital markets.

Finally, the financial system works to reinforce the disproportionate political power of the wealthy, which can be mobilized to block egalitarian reforms. In the United States, giant Wall Street firms spend hundreds of millions of dollars on campaign contributions and armies of lobbyists on Capitol Hill. It is almost universally acknowledged, for example, that the "carried interest" provision in the US tax code is deeply unfair because it allows those who run hedge funds and private equity funds to pay only 15 percent or 20 percent tax on their earnings while their secretaries generally pay at a higher rate. Nevertheless, the political clout of the beneficiaries is so great that efforts to repeal that provision have been easily defeated.

In our approach, the democratization of finance involves several distinct dimensions. One is to narrow the class difference in access to credit at favorable interest rates, so that poor, working, and middle-class people have greater opportunities to borrow on a sustainable basis to realize their life plans. This access would operate at both the individual and the community level. People would find it easier to finance higher education or to start or expand a small business. It would also create more opportunities for employee-owned firms, theater companies, or community organizations seeking to upgrade the housing and amenities of a previously neglected urban neighborhood.

The second dimension is to weaken the dominance over the financial system of a relatively small number of giant private financial firms. This dimension follows

logically since those firms have prioritized lending at favorable terms to those who are already wealthy. Moreover, creating a much more competitive financial system in which public and nonprofit institutions control a significant share of financial flows would also weaken the political clout of those giant firms and, in turn, open up possibilities for more egalitarian legislation.

The third dimension is to increase democratic input into the critical investment decisions that shape the future of the economy. One aspect of this dimension is to democratize corporations themselves by giving employees greater voice in corporate decision making. This project, although complementary to what is being proposed here, will not be discussed further because of limitations of space.<sup>3</sup> Another aspect is to diminish the share of investment controlled by large corporations while expanding the share of investment organized by small and medium-size enterprises, employee cooperatives, nonprofits, and public entities. The idea with regard to the public entities is to make them more open to democratic input and less influenced by the priorities of privately dominated capital markets. Finally, more of the institutions that provide financing would be subject to democratic input, so that the allocation of credit would increasingly match democratically derived priorities.

This multiplicity of dimensions makes it obvious that the goal of democratizing finance is complex and cannot be accomplished with just one or two key reforms. Moreover, as Michael A. McCarthy makes clear in his contribution, even if the major financial institutions were taken over by the government, there is no guarantee that their financing decisions would match the preferences of a democratic polity, whatever the institutional arrangements for determining those preferences.

In other words, the democratization of finance follows the general logic that Erik Olin Wright lays out in his books *Envisioning Real Utopias* and *How to Be an Anti-capitalist in the 21st Century*.<sup>4</sup> He argues that a truly democratized economy is a distant horizon that we can bring nearer by experimentation with a variety of reforms that seek to erode the dominance of capitalist firms and expand the democratic character of the state. The process of erosion combines four distinct strategies—taming capitalism through regulations and public provision, resisting capitalism by creating trade unions and other forms of collective organization, dismantling capitalism by displacing for-profit firms, and escaping capitalism by creating alternative economic institutions. In Wright's vision, neither politics nor the state will wither away; disagreements and conflicts will continue. However, he envisions a process of social learning and institutional redesign by which populations become progressively more effective in governing themselves and in diminishing inequalities of income, wealth, and power.

The issue begins with an anchor essay by Robert C. Hockett, professor of law at Cornell University, titled "Finance without Financiers." His argument is that the provision of credit by banks and by the increasingly important "shadow banking" system is ultimately underwritten and validated by public entities including the central bank (in the United States, the Federal Reserve) and by the treasury departments of the central governments.

Hockett challenges the conventional view that banks are primarily financial intermediaries that connect lenders with borrowers.<sup>5</sup> Instead, he shows that the

credit system fits more closely the model of a franchiser and multiple franchisees. Government authorities are the franchisers; they are the ones with the capacity to create legally binding money and credit. Banks and various entities in the shadow banking system can be understood as franchisees that have been granted the authority to expand the supply of credit by the franchiser.

Hockett's argument effectively reverses the usual understanding of the power relations in the credit system. When banks are seen as financial intermediaries, it follows that government regulators must treat them with kid gloves to avoid a potentially disastrous drying up of the credit needed for the economy to function. In the franchise model, however, government actually has the power, and deference to bankers is unnecessary.

My article, "Financial Democratization and the Transition to Socialism," builds on Hockett's foundation. It argues that the government can use its franchising power to underwrite nonprofit financial entities that would be more likely to direct credit flows in directions that serve the needs of the public rather than the profits of financial firms. In fact, as Sarah Quinn shows, there is a long history in the United States of these publicly directed credit flows.<sup>6</sup>

I argue that a strategy of expanding existing nonprofit financial firms and creating new ones could eventually diminish the power and resources of the dominant private financial institutions. Moreover, a major shift in public saving from profit to nonprofit financial institutions could facilitate a transition to socialism, defined as significantly greater democratic control over the economy.

The article by William H. Simon, emeritus professor of law at Columbia University, focuses on the institutional arrangements for democratizing the economy. Simon identifies four distinct mechanisms for increasing democracy and shows that each has specific strengths and weaknesses. Whichever institutional mechanisms are used, he argues, standards need to be developed to assure transparency and assess the performance of those more democratic financial institutions. He insists that a process of peer review in which managers evaluate one another's performance and adopt best practices is an essential element in assuring accountability.

The other four contributions suggest other possible approaches to the problem of democratizing finance. Lenore Palladino, of the School of Public Policy and Department of Economics at the University of Massachusetts Amherst, proposes two additional innovations. The first is a public investment portal that would give savers the opportunity to acquire safe financial assets with lower transaction costs than those offered by private banks and brokerage firms. The second is a government-created public investment account that would help reduce the deep inequalities across households in the ownership of financial assets.

David M. Woodruff, of the London School of Economics and Political Science, argues that eliminating the independence of central banks must be a central aspect of any project of financial democratization. Market liberals have fought aggressively over recent decades to institutionalize central banks' independence from elected political officials. Woodruff argues that this independence has had perverse consequences and would likely block any significant moves to democratize the financial sector. In

his view, any progress toward democratizing finance requires that central banks be accountable to elected political leaders.

Michael A. McCarthy, professor of sociology at Marquette University, evaluates my proposal as well as Hockett's in relation to a number of different strategies for democratizing finance, including the creation of sovereign wealth funds; establishing inclusive ownership funds, as suggested by the British Labour Party; and nationalizing banks. He argues that bank nationalization is the strategy most likely to overcome the entrenched power of private financial institutions. But he also argues that for any of these strategies to be effective, new institutions of democratic engagement are required.

Mary Mellor, emeritus professor at Northumbria University, proposes that democratizing finance requires the democratization of money itself. She challenges conventional accounts of how money is created and explains how the model of participatory budgeting could be used in a truly democratic society to democratize both the creation and the allocation of financial resources.

As with earlier contributions to the Real Utopias Project, the articles assembled here are intended as a set of provocations rather than a blueprint. Discussions of democratizing finance have not been a significant part of left discourse either in the academy or in the political arena. But recent decades have demonstrated that finance can be an enormously destructive force as well as a powerful instrument of social reform. Our hope is that these articles help provoke further debate and discussion about the ways that the democratization of finance can be integrated into current political discourse.

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### Notes

1. Antara Haldar and Joseph E. Stiglitz, "Group Lending, Joint Liability, and Social Capital: Insights from the Indian Microfinance Crisis," *Politics & Society* 44, no. 4 (2016): 459–97.
2. Thomas Piketty, *Capital in the Twenty-First Century*, trans. Arthur Goldhammer (Cambridge, MA: Harvard University Press, 2014).
3. A future Real Utopias workshop is planned to address this topic. See Isabelle Ferreras, *Firms as Political Entities*, trans. Miranda Richmond Mouillot (New York: Cambridge University Press, 2017).
4. Erik Olin Wright, *Envisioning Real Utopias* (New York: Verso, 2010); *How to Be an Anti-capitalist in the 21st Century* (New York: Verso, 2019).
5. Hockett is certainly not alone in making this argument. It is widely embraced by post-Keynesians and proponents of modern monetary theory. See L. Randall Wray, *Modern Monetary Theory* (New York: Palgrave Macmillan, 2012). Woodruff (this issue) shows

that at times even central bankers come close to acknowledging this reality. However, Hockett's detailed analysis in this issue of the public's role in facilitating credit creation in the capital markets and in shadow banking is a distinct contribution to the literature.

6. Sarah Quinn, *American Bonds: How Credit Markets Shaped a Nation* (Princeton, NJ: Princeton University Press, 2019).

### **Author Biography**

**Fred Block** (flblock@ucdavis.edu) is a critical intellectual who has written widely on issues of politics and political economy. He is a research professor of sociology at the University of California, Davis. He also serves as president of the Center for Engaged Scholarship. His latest book, *Capitalism: The Future of an Illusion*, explains how US politics got caught in a loop that alternates between center-left Democrats and increasingly extreme right Republicans.