Finance without Financiers

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A common view of banks, as well as other financial institutions and markets, is that they function primarily as ‘intermediaries,’ facilitating and managing flows of scarce ‘loanable funds’ from parties who have accumulated them to parties who have need of them and are willing to pay for their use. Indeed this is surely the dominant view of finance and the financier – it is overtly stated in text after text, and lurks just beneath the surface each time we hear phrases like ‘skittish capital,’ ‘bond market discipline,’ and the like.

The intermediated scarce capital understanding of finance bears at least two salient properties. The first is that it lends a veneer of ‘hard-nosed,’ ‘realist’ respectability to many needlessly costly policy prescriptions where matters of public finance and the regulation of private finance are concerned. These are prescriptions to which even self-described ‘liberals’ and ‘progressives’ implicitly commit themselves when they treat capital as scarce or financial institutions and markets as if they were principally ‘intermediaries.’ The second salient feature of the intermediated scarce capital view of finance is that it is false. Financial institutions and markets do intermediate, but that is not what they are mainly about. Nor, relatedly, is capital nowadays relevantly ‘scarce.’

The dominant intermediated scarce capital orthodoxy is, in short, a myth – a myth whose widespread acceptance is convenient for certain sectional interests in contemporary ‘financialized’ societies, but a myth nonetheless. This paper is an attempt at an overdue update and reorientation of thinking about finance, its uses, and its regulation in light of the mythical character of present day financial orthodoxy. In my rendering, finance is at most secondarily private and intermediated. The critical portion is publically provided and must be in large measure publicly directed. Private finance is for its part an outgrowth of public finance, and should be forthrightly employed as a tool of the same. Private ‘intermediaries’ in turn are primarily purveying a public resource – the full faith and credit of the sovereign public – sometimes adding value in so doing, other times not. In effect, the financial system is a franchise arrangement, with the public effectively (if not always cognizantly) functioning as franchisor, public credit functioning as franchised resource, and private ‘intermediaries’ acting as franchisees in the resource-dispersary task.
This characterization of our financial system is readily verified through a complex but nevertheless tractable tracing exercise – an exercise that the paper carries out. I first show how traditional banks in effect purvey a public resource supplied by the central bank – in America, the monetized full faith and credit of the United States – earning privatized seigniorage for their ‘gatekeeping’ role in so doing. I next show how the capital markets, which might be thought more closely to conform to the intermediated scarce capital myth, do not actually underwrite a counter-narrative to the franchise view at all. For, first, they rely crucially upon massive issuances of sovereign debt – in America, the securitized full faith and credit of the United States – in order to function; and, second, they now function primarily as a medium for the operations of erstwhile ‘shadow’ banks, which I show now fully to replicate, under Dodd-Frank, traditional banks in their public full faith and credit dispensary functions.

After thus schematizing the financial system as we presently find it, I turn to the ‘anarchic’ fringe of crowdfunding, P2P lending, and cryptocurrencies. Far from anything novel or special, I show, these forms of fringe finance are merely the present day’s new ‘shadow’ forms, which will not attain to significance without ultimately tapping into the public credit pipeline as their recent shadow bank forebears did, thereby effectively joining the public-private finance franchise as other financial institutions and their money-forms have done.

I close by drawing a few normative implications from the ‘franchise’ view of finance that the paper elaborates. The key to ensuring a healthy financial system that fuels healthy – that is to say ‘real,’ inclusive, and continuous – economic development is first to understand the true roles and comparative advantages of the public and private therein, then to act in manners that capitalize on these roles and advantages for the good of us all.