Public Banking and Post-Keynesian Economic Theory

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Abstract: In this article, we make an appeal for the incorporation of public banking into public discourse regarding the management of the U.S. economy. We argue that the history of post-Keynesian thinking shows a perennial interest in offering solutions to financial and economic problems that often involve the participation of the State. However, in more recent history, discussion has revolved around fiscal and monetary policy, with little consideration given to credit policy and the role of public banking. Basing our arguments on what we believe to be Keynes’s most important lessons for the current crisis, we establish several forms in which public banks can confront the economic morass that the Too Big to Fail banks have created.

Keywords: public banking; TBTF; post-Keynesianism

JEL Classification: E12; E52; E60

INTRODUCTION

Many post-Keynesians have traditionally argued against the use of countercyclical monetary policy (see Arestis and Sawyer 2003; Lavoie 2014; Rochon and Setterfield 2008; Wray 2007) and have argued instead for more fiscal policy to stimulate economic activity and create jobs in the private sector, while also providing an important voice of dissent in the context of the rise of austerity policies and neoliberalism in countries around the world. That being said, we believe there is nevertheless an important missing space—or black box—within post-Keynesian economics between fiscal and monetary policies, whose absence becomes more noteworthy in the current economic reality of the United States, as well as many other countries.

Keynes placed a great deal of emphasis on the role of banks in monetary productive systems. For instance, Keynes states that “banks hold the key position in the transition from a lower to a higher scale of activity” (Keynes 1937: 668). Elsewhere, he claims that “Credit is the pavement along which production travels and the bankers if they knew their duty, would provide the transport facilities to just the extent it is required in order that the productive powers of the community can be employed at full employment” (Keynes 1930, VI: 197). This stands in direct contrast to mainstream academics and policy makers who have in large part seen banks as mere financial intermediaries or have ignored or minimized the role of...
credit policy in recent years, particularly when offering solutions to confront the recent crisis.

Yet despite their discussion of endogenous money where banks play a central role in the creation of money, post-Keynesians have for the most part overlooked credit policy. As we hope to show, this lack of attention, while easily understood, nevertheless limits academic discourse regarding the benefits and pitfalls of monetary and fiscal spending. Moreover, we believe it deprives policy debate of the potentially transformative role of public banking in fulfilling Keynes’s goals of full employment, the euthanasia of the rentier, and generalized prosperity through the unlocking of the nonscarcity of credit and money.

As we argue in the following, the ceding of credit policy to private institutions has systematically stymied fiscal and monetary mechanisms for stimulating the economy, particularly in the moments of crisis in which much of the world is engulfed. Basing our argument on both existing post-Keynesian literature and historical experiences, we will make the case for public banking as a powerful policy option, both in good and bad economic times. Public banks are a policy tool that can be used with much more precision than fiscal and monetary policy, and their social and economic utility is therefore even more dependent on who wields them. Public banking is therefore not a panacea but an additional instrument—in the toolbox of any government. Perhaps more than anything, this article strives to shine light on a policy option that has been largely excluded from public debate and that must be taken into consideration if the control of credit is to be reclaimed from the control of Too Big to Fail (TBTF) banks.

Our case for public banking will revolve around several key arguments, which are reflected in the organization of the article. In the first section, we discuss the limited economic literature regarding public banking and argue that credit policy should be open to public debate on the same level as monetary and fiscal policy. In the second section, we briefly examine the ascent of TBTF banks and argue that in the absence of publicly debated credit policy, the largest U.S. banks have come to fill the role of policy makers in this realm and have strayed far from prudent economic stewardship. In the third section, we highlight several aspects of the fraud-riddled housing bubble, crisis, and bailout and argue that they have created two new realities: (1) TBTF banks now fill the criteria of state banks, and (2) the monetary creation used to bail them out has proven the nonscarcity of public funds. Within the context of this confluence of historical forces, the fourth section examines the potential operation of public banking within the current macroeconomic context of the United States. Here we argue that if public funds are not scarce and TBTF banks are now public in all but name, but do not serve the economy’s needs, why should credit policy exclude the option of employing public banks that can use nonscarce credit to benefit the productive economy?

**KEYNES, PUBLIC BANKING, AND THE FALSE DICHOTOMY OF MONETARY AND FISCAL POLICY**

Public banking is in no way a new idea; such institutions have existed for centuries in Europe and have made fundamental contributions to economic development in regions as
diverse as Asia and Latin America during the last century. While English-speaking nations have a lesser public banking tradition, the United States does have some experience in this area, ranging from Benjamin Franklin’s proposal for a land bank, through the United States Postal Savings System (1911–1967), to the public credit institutions established in the New Deal, and all the way up to the only surviving U.S. public bank at the state level in North Dakota. Yet with some very noteworthy exceptions, public banking has been discussed very little in the United States. Indeed, its exclusion from public discourse is revealing in itself.

One important exception can be found in Seccareccia (1995: 48), who analyzes Keynes’s thinking on the subject:

How far would Keynes have been willing to go in socializing investment? When pressed by fellow economists in 1943, Keynes envisaged that in his proposed system as much as “two-thirds or three-quarters of total investment” would be directly influenced by public and semi-public bodies whose activities would be guided by the traditional “motive of private exchange” as well as by the “technically social” motives that have normally justified investment in social infrastructure. Keynes, however, fell short of suggesting a precise mechanism for implementing such a policy, even though this was essential if one was to achieve the long-term goal of full employment and of a more equitable distribution of income through the elimination of rentier income, as described in the last chapter of the General Theory.

With this description in mind, and referring to the National Investment Board, an idea supported by Keynes throughout the 1930s and 1940s, Secareccia continues: “The Board would behave much like a large publicly-run investment bank, which would engage in the longer-term financing of investment projects in order to provide a necessary ‘make-weight’ in the system” (Seccareccia 1995: 49). Much like Seccareccia expands upon Keynes’s ideas, we believe it is possible to expand upon them both in the spirit of the socialization of investment and extend Keynes’s theoretical conceptions of the monetary economy of production to include public banking. Yet this very exercise does indeed cut through the false dichotomy between fiscal stimulus and monetary stimulus that currently divides many academics and policy makers. Within academic debate, both the politically dominant New Keynesians and many within the post-Keynesian camp continue to omit credit policy in their focus on monetary or fiscal policy. Many New Keynesians claim that the credit channel is a by-product of the more traditional monetary transmission mechanism of monetary policy (see Rochon 1999, for a discussion), while many post-Keynesians likewise assume a fully functional banking system, and in their arguments for a greater role for fiscal policy, simply assume that the banking system would act as an efficient transmitter of fiscal policy, disregarding changes in the banking system that belie such optimism. For reasons we detail in the following, both positions are problematic. Rochon (2017) is one of the few post-Keynesians who have argued that banks can greatly stymie the impact of fiscal policy. According to Rochon, the effectiveness of fiscal policy depends on how cooperative the banking system is. This only exemplifies the need for a public banking option.

The New Keynesian approach had been correctly criticized for relying on the loanable funds theory, which when put in practice in the context of a liquidity trap leads to
situations in which central banks are pushing on a string (Lavoie 2014; Rochon 1999). The argument that private banks are simply concerned with their profits has become sharply relevant during the recent crisis. When bailout funds were first made available to banks, many bankers flatly stated that they would not lend out the new money but rather use it to reconstruct balance sheets (Bloomberg 2008; Business Insider 2008). Such an outcome was to be expected within the framework of endogenous money theory. Banks do not depend on reserves in order to lend (Lavoie 2014; Moore 1988; Rochon 1999), nor must they lend out government bailout funds. Private banks seek profits, and therefore the hope that the large Wall Street firms that received a lion’s share of the bailout would automatically begin business lending was always wishful thinking. The bailout was not directed at the economy at large and therefore was never designed to create a more favorable lending environment.

Yet not only have TBTF banks not used bailout funds to increase business lending, they also used the funds to pay off the same top executives that led their institutions to financial ruin. Once again, this is not a surprise. The current conditions of crisis were caused in large part by dominant Wall Street banks, which far from fulfilling their social utility of providing accessible credit for productive endeavors, relied on consumer fraud, speculative bubbles, and accounting fraud for their profits (Marshall 2009, 2013). Such actions led directly to the crisis, and unsurprisingly, trillions of dollars in essentially no-strings-attached bailout funds only served to encourage such activity (Marshall 2009).

In the recent crisis, the logical fallacies of the New Keynesians have blossomed into devastating political policy. Banks have not acted as transmitters of monetary policy to the economy at large—again, as would be expected under a post-Keynesian framework—nor have trillions of dollars in virtually unconditional bailouts changed Wall Street’s business practices that led to the crisis in the first place, as would be expected from simple common sense. Indeed, we feel that once all factors are properly accounted for, each dollar of bailout money will be shown to create negative gains in output, meaning that the bailout will have created a significant negative multiplier, as suggested by Parguez (2011).

The lack of importance that post-Keynesians have assigned to public banking is most likely explained by two factors. The first can be attributed to the lack of Keynes’s explicit interest in public banking, which is in itself perhaps a symptom of the second factor: the lack of experience with public banks in English-speaking countries, from where the majority of post-Keynesian authors hail. Yet the current paucity of debate regarding the role of banks—of any stripe—in the effectiveness of fiscal policy is more surprising, particularly given the available literature on the subject. When analyzing the potentials of the fiscal multiplier, post-Keynesians over the years, from Kahn (1931) to Sawyer (2008), have singled out the participation of (private) banks as a key factor. Yet this recognition has not been taken to its logical conclusion in the realm of public policy advocacy by the economic profession in general. It would appear that for many academics and policy makers, monetary and fiscal policy should be considered in the public domain, but credit policy should not, even when it is the latter that in part determines the effectiveness of the former two (see Rochon and Setterfield 2008; Sawyer 2008, 2009).
Keynes (1937) insisted that banks “hold the key” to an economy’s production; exactly how the key is turned, however, has varied over time. In previous decades, when the dominant banking model was one of “originate to hold,” Parguez (1996) emphasized that banks essentially made two bets. The first bet is whether borrowers will be able to reimburse banks and extinguish their debt owed to them. The second bet is whether, given overall economic conditions, borrowers will maintain their solvency. Rochon (2006) called this micro-uncertainty and macro-uncertainty respectively.

However, such bets are a characteristic of a competitive and regulated market. Once fraud becomes tolerated by regulators, fraudulent behavior becomes “rational” and fraudulent profits a “sure thing” (Akerlof and Romer 1993: 5). In this environment micro-uncertainty no longer dominates risk management. As the neoliberal project became consolidated and Wall Street banks became more dominant in the U.S. banking sector and secured explicit government support (Dymski 2012), concerns regarding macro-uncertainty credit risk faded along with internal risk management.

A key pillar of the transition to the model of “originate and distribute” was the greater use of derivatives. The permission to lend money “off balance sheet” with no backing assets formed the legal basis upon which the shadow banking sector was erected (Marshall 2014; Shwarcz 1994). At the same time as the mainstream argued that derivatives would distribute risk, Greenspan was also extolling the virtues of financial innovation in the opening up of new markets (Greenspan 2002). Yet in reality, derivatives and structured products were often used to defraud. In the housing bubble, Wall Street banks made fraudulent profits on the front end by duping poorer clients in these newly opened markets, while on the back end, loans were grouped together, structured, and sold to “greater fools” (Financial Crisis Inquiry Commission 2011; Lewis 2010).

Indeed, under conditions of growing legal and financial immunity, the dominant banking model has distorted the basic logic of managing the micro- and macro-uncertainty that Rochon (2006) explores. At the retail end, the creditworthiness of clients became all but irrelevant, as commissions for packaging loans and selling them as securities were paid out at a quick and generous enough pace to eclipse any traditional logic of risk management. At the wholesale level, money markets became ever more important sources of liquidity, obliging banks to make increasingly important bets regarding counterparty risks. When these bets soured in moments of panic, banks such as Bear Stearns and Lehman Brothers were brought down in a matter of weeks.

After the enriching debates in 2009 on whether to nationalize TBTF banks, the reality is that these banks are now closer to state entities than private ones in three ways. First, TBTF banks are no longer subject to the discipline of the market. As the bailout showed, these entities no longer have to be profitable to stay in business. It is worth noting here—both for its rich irony and this article’s topic—that during the decades leading up to the crisis, mainstream press and academics (White 2004) criticized the many extra-market advantages granted to Fannie Mae, a formerly public housing bank that later was mostly privatized but retained certain state guarantees, earning it and other similar institutions the title of
Government Sponsored Entities (GSEs). By the time of the housing bubble, the GSEs had been captured by Wall Street (Black 2010), which by then had been operating for decades under the TBTF precedent, which never included the GSEs.

Second, TBTF banks are also no longer subject to the discipline of the law. From the postcrisis massive falsification of mortgage documentation (Financial Crisis Inquiry Commission 2011: 407–408; Taibbi 2010) to the criminal manipulation of all major markets, to the international scandal of HSBC’s money laundering, the world’s largest banks are not only TBTF but are now also TBTP—Too Big To Prosecute.

With specific reference to the HSBC case, the expression TBTP was coined by Lanny Breuer and Eric Holder when they headed the U.S Department of Justice (Black 2012). In his excellent 1990 book, The House of Morgan, Ron Chernow dedicates a great amount of time to “the breakdown of the Gentlemen bankers’ code.” Today’s largest banks are now aptly described as criminal corporations. For instance, in May of 2015, the Department of Justice (DoJ) issued the following press release:

Five major banks—Citicorp, JPMorgan Chase & Co., Barclays PLC, The Royal Bank of Scotland plc. and UBS AG—have agreed to plead guilty to felony charges. Citicorp, JPMorgan Chase & Co., Barclays PLC, and The Royal Bank of Scotland plc. have agreed to plead guilty to conspiring to manipulate the price of U.S. dollars and euros exchanged in the foreign currency exchange (FX) spot market and the banks have agreed to pay criminal fines totalling more than $2.5 billion. A fifth bank, UBS AG, has agreed to plead guilty to manipulating the London Interbank Offered Rate (LIBOR) and other benchmark interest rates. (Department of Justice 2015)

The third element that allows us to categorize TBTF banks as essentially public institutions is the level and degree of communication between TBTF banks and public authorities. The well-documented (Ferguson and Johnson 2009; Galbraith 2008) revolving-door relationship between TBTF banks—particularly Goldman Sachs—and high public office in many countries is perhaps the clearest manifestation of the false separation between private and public spheres that forms part of J. K. Galbraith’s The Economics of Innocent Fraud (Galbraith 2004). Yet as innocent fraud is overtaken by “deadly fraud” (Mosler 2010), TBTF banks have now become a strange type of public monopoly, for while they are essentially exempt from antitrust regulation in the United States and Europe, and their political ties are reminiscent of those of a public bank, their formal exemption from obeying the law is a condition under which no recognized public monopoly could operate. This is perhaps the most ironic aspect of current TBTF banks.

While public banks are not subject to the discipline of the market, they are subject to the discipline of the voter. Indeed, the only existential risk that public banks confront is political risk. But when voters do not identify TBTF banks as public entities, and do not know that they have the power to change their management, or more simply to shut them down altogether by doing nothing more than applying the law and withdrawing extraordinary public support, TBTF banks enjoy the best of all worlds, being exempt from political, legal, and market discipline, all while benefiting from public largess.
Such a dramatic shift in the operating environment at the peak of the global financial power structure leads to fundamental changes in the economy. One is that U.S. and other Western economies are to ever lesser degrees monetary production economies, as the banks at the center of this mode of production no longer obey the market dynamics of capitalist accumulation. As institutions that need not be solvent to be profitable and that are immune to criminal liability, concepts frequently associated with private banking and its many problems become irrelevant. For example, the hypothesis that TBTF banks are caught up in the liquidity trap and are merely being overly cautious regarding the traditional bankers’ bets on the overall state of the economy and the individual positions of borrowers (Krugman 2011) can now be seen as disingenuous at best.

For TBTF banks, risk management is now reputation management, as the only significant risk to the viability of such institutions is that the public at large recognizes them as public banks, disapproves of their actions, and makes the issue an electoral one. As TBTF banks are now very close in reality to public banks but serve no social or market good—and indeed do great social and economic harm—many would ask why not establish true public banks that are designed exclusively to promote socially and economically useful banking?


In early 2012, the Financial Times’s Martin Wolf stated that we were confronting a “bonfire of the verities,” as the crisis turned many long held truths on their heads. Wolf includes in his bonfire the beliefs that “the financial system would be self-stabilizing, that managers of banks would prove competent, that financial innovation would improve risk management, that low and stable inflation would guarantee economic stability” (Wolf 2012).

We can now confidently add to the bonfire the long-held concept that the scarce supply of money is supply driven from the top down—from the central bank downward through the passive commercial banks and on to businesses and households—and that savings can be turned into loans but not the other way around. At the heart of the Keynesian revolution was the fact that economies were not theoretically bound by scarce resources, as money is not scarce and credit can be created ex nihilo. Post-Keynesian tradition has insisted upon the fact that the money supply is demand driven and that commercial banks are the key transmission mechanisms between fiscal and monetary policy above and businesses and households below. Private banks are also active agents in the creation of ex nihilo credit. Yet many decades of convincing arguments were not as influential to public thinking as the realities of the crisis that created this “bonfire of the verities.”

Perhaps no single mainstream document better serves to discredit the long-held beliefs of how the banking system works than a 2014 Bank of England (BoE) Quarterly Bulletin authored by McLeay, Radia, and Ryland (2014):

In the modern economy, most money takes the form of bank deposits. But how those bank deposits are created is often misunderstood. The principal way in which they are created is
through commercial banks making loans: whenever a bank makes a loan, it creates a deposit in the borrower’s bank account, thereby creating new money.

[. . .]

While the money multiplier theory can be a useful way of introducing money and banking in economic textbooks, it is not an accurate description of how money is created in reality. Rather than controlling the quantity of reserves, central banks today typically implement monetary policy by setting the price of reserves—that is, interest rates.

[. . .]

So, in reality, the theory of the money multiplier operates in the reverse way to that normally described.

The situation in which banks can exist aloof from market discipline only by means of non-scarce bailout funds, while austerity is imposed under the banner of the scarcity of money, is a cruel and telling irony of the crisis’s resolution. The logic has boiled down to a painfully clear political choice: Money is scarce for some but not others. When used to bail out financial firms, public expenditures are limitless. Yet when it comes to fiscal expenditures such as health care, education, and pensions, money again becomes scarce. What we have described as “the best of all worlds” for the TBTF/TBTP banks becomes the “worst of all worlds” for the public interest: fears of inflation or “running out of money” resulting from sharply increased federal budgets have clearly not materialized, but even as these long-held verities are left burning for all to see, the reality of nonscarce money cannot be employed for the public good.

In addition to Wolfe’s now defunct verities, we could also add that bank managers would not be criminal or fraudulent. The fact that noncriminal individuals are denied a return on their tax dollar while criminal enterprises receive full public funding rounds out this section of ironies. As we now argue, the mere existence of a dominant public bank could go surprisingly far in taming the TBTF banks and attending to the needs of the productive economy. First, however, we turn to recent international history to highlight a few key lessons from public banking that demonstrate the many roles that it can fulfill as a policy tool.

OPERATIONAL CHARACTERISTICS OF PUBLIC BANKING

Public banks have several institutional characteristics that clearly distinguish them from private banks. First, they do not operate for profit: Interest gained on repaid loans can be recycled into higher rates paid on deposits or more ideally into lower rates paid on loans when financial calm prevails. When not, soured productive loans can be absorbed and incorporated into the state budget.

Second, public banks are not founded on the principle of speculateing with public money. Public banks, however mismanaged they may be, do not have internal divisions dedicated to
speculative activity and therefore cannot be active actors in episodes of speculative mania that have led to countless banking crises. When private banks abdicate their social function of extending credit to productive activities in favor of pursuing the personal gain of bankers, they have over the centuries led speculative manias that have ruined entire economies (Kindleberger 1989; Galbraith 1990). However, when public banks operate under similarly damaging incentives, managers need not involve the investing public in their schemes.

Instead of reaping profits through market mechanisms, corrupt public banks, which can only exist for long periods of time under likewise corrupt regimes, need only steal the money directly from their own banks. This basic difference between how public and private banks deviate from their public utility to pursue private gains accounts for the fact that neither Barth, Caprio, and Levine (2000), nor LaPorta, Lopez de Silanes, and Shleifer (2002) have found causal links between public banks and systemic banking crises, despite their clearly stated opposition to public banking.

The fact that public banks are removed from the discipline of the market leads to a further advantage: their ability to act as a strongly anticyclical actor. In moments of calm or expansion, shareholder pressure will often lead private banks to chase new opportunities for profit, as if a bank lags behind, a more profitable competitor can always buy it out. Such “herd” behavior can lead to speculative bubbles and increase their volume and duration. By the nature of their nonmarket ownership, public banks do not face such market pressures in times of financial expansion: They cannot be bought by another competitor, nor do they have shareholders steering them toward the herd out of a fear from missing out on profits. In moments of financial distress, the fact that public banks can operate at a loss without going out of business means that depositors and other bank creditors are less likely to panic when storm clouds roll over the economy. Indeed, if a crisis deepens and private banks go under, public banks can act as an anchor and can diversify public policy options when bailing out a financial system.

A key bargaining chip of TBTF banks has been the argument that their demise would mean the demise of the entire economy. If a large national public bank were available to quickly absorb a TBTF bank’s retail operations, such a threat would lose much of its bite. Perhaps more relevant to the current U.S. context is the possibility that public banks could act as local institutions to guide productive credit as a branch of fiscal policy. The current institutional structure of the U.S. economy does not have this luxury. The most promising avenues of “frictionless” fiscal expansion, including greater government pensions and unemployment benefits, as well as lower taxes, may indeed raise aggregate demand, but the channeling of such spending into investment and employment has become increasingly problematic.

If families and businesses use fiscal stimulus to pay off bank loans, then fiscal policy offers similar results to monetary stimulus—an increase in bank profits but little increase in aggregate demand. Indeed, even if consumers opt to pursue entrenched consumption patterns, the goals of full capacity utilization and employment will still remain elusive, as the principal beneficiaries will be the highly concentrated global corporations that have most prospered under the growing financialization of the productive sector and that systemically siphon
money away from production and into finance. In other words, using current channels for fiscal stimuli is akin to filling a leaky bucket with water.

As mentioned, public banking can be seen as branch of fiscal policy. However, unlike conventional fiscal policy, which necessarily operates through a top-down approach, public banks do not need to be national, nor does the federal government need to grant each bank the capital necessary to operate. In many parts of the world, public banks have operated successfully not only at the national level but also at that of the town, city, municipality, and state. Facing dire straits in the United States, public sector workers could easily capitalize a bank and extend loans as their local public bank sees fit. This possibility offers a stark contrast with the current situation in which many U.S. states, cities, and municipalities find themselves chronically starved of capital—often recurring to private banks at higher rates of interest than could be offered by public banks.

Long-term investments that bring social utility but not necessarily high returns have often been taken on by public banks. Basic public services and infrastructure projects have long been favorites, and indeed, such projects are of utmost importance in maintaining national economic development. Public private partnerships and outright privatization of entities that once provided public services have been key to the dynamic of privatization of gains and the socialization of losses that have led to growingly unequal societies in the global north and the growing underdevelopment of the U.S. economy (Vidal and Marshall 2014). Yet some social losses are never even reaped for private gains; in the absence of financial alternatives, sectors of the economy can simply be left to wither on the vine. After many public banks in Latin America were shuttered under the economic justification of “unfair competition,” private banks celebrated their lack of competition by no longer lending to sectors of the economy previously attended to by public banks.

While financial rent cannot be efficiently extracted from many impoverished sectors of Latin American economies, this is not the case in the more developed United States. Once-public banks Sallie Mae and Fannie Mae, which were important actors in the economic development of the United States, have through ownership changes fallen in the thrall of Wall Street (Black 2011). The provisioning of finance for purchasing homes or higher education thereafter became a medium through which financial rent could be extracted from those pursuing what most consider to be noble causes. On a national level, public banks at the service of society at large could certainly be reestablished to fund such endeavors without extracting financial rent.

Another area of the economy identified by many as lacking stable and accessible credit and that could benefit from public banking is the small and medium enterprise (SME) sector (Stiglitz 2011; Hurley 2012). As a segment of the economy that provides the vast majority of employment and innovation but has been classified as difficult to fund by many, the SME sector is an ideal recipient for public banking, as the economic and social benefits of a diversified and vibrant economy are indeed high, but the financial return on such lending less so. The SME sector is also particularly interesting in the international context. For example, Argentine public banks were key in resolving the country’s banking crisis of 2001–2002, serving the aforementioned roles of anchoring the financial system in moments of great
turbulence and also in igniting a historical period of sustained growth, in large part through targeting SMEs for public banks’ credit policies (Marshall 2013b).

As stated, public banking does not need to function at the national level. Nor do public banks need to target any of the specific economic sectors mentioned for economic benefits to be reaped. We insist that public banks are merely a public policy option that currently does not exist in the United States. How this tool can be used should be left to society’s discretion, voiced through a democratic process. We see public banking in the same light as Abba Lerner’s functional finance. Any society can use these policy tools without fear of inflation, crowding out of private investment, a country running out of money, or any other boogeyman that the justifiers of private financial rent may offer up. Poorly operated, public banking is obviously of little social benefit, but if we do not even consider the possibility of their use, we are severely limiting public discourse, and this limitation is nothing more than a reflection of the overwhelming desire of TBTF banks to maintain their monopoly over the supply and distribution of money.

CONFRONTING THE TBTF PROBLEM: REFORM OR DIVERSIFY

Perhaps the most important role that public banking can play in the current U.S. context is that of confronting the core actors behind the creation and prolongation of the current crisis—TBTF banks. Public banking at a national level could at least partially attend to three current problems intimately tied to the existence of TBTF banks: excessive market concentration, lack of a decent return on bank deposits, and accessible credit to the productive economy. We address this last aspect first.1

As recent events have shown, attempts to create greater financial regulation show little to no signs of possible success. Regulatory requirements as proposed by the Dodd-Frank legislation and the Basel III agreements had all been postponed and/or eviscerated, largely as a result of bank lobbying (Prasch 2011; Vestergaard and Wade 2012), well before the Trump administration’s promise of repealing Dodd-Frank. The precedent of granting TBTF banks immunity to criminal prosecution is even more troublesome. There is now a very distinct possibility that the U.S. financial system may be saddled with unregulated TBTF banks for the foreseeable future.

If this is the case, a large national public bank could serve as an anchor to the financial system. In this scenario, TBTF banks would not be eliminated; they would simply have a strong counterpart in a large public bank whose conservative and straightforward practices would in part compensate for TBTF strategies and actions. Once again, this idea is not new. Uruguay’s large national public bank effectively served as an anchor before and during that country’s 2002 banking crisis (Marshall 2013b). Perhaps an even more relevant historical comparison can be found in Simon Schama’s account of early seventeenth-century Dutch finance:

... in the realm of money, the wardens of civic peace had to chart a careful course between the “safe” and “unsafe” zones of the economy. Without security, there could be no sustained
prosperity, but without risk, there could be no growth. . . . The safest place in all of Amsterdam was its Wisselbank, founded in 1609. . . . Its success in persuading both merchants both at home and abroad . . . depended crucially on its identification as a public rather than a private institution. . . . Its very existence testified to a determination to neutralize the worst evils associated with the unconfined world of money: usury, default, counterfeit and other kinds of fraud. Its working model was probity, not profit. (Schama 1997: 344–346)

If such a counterpart to TBTF activity were to exist, the capacity for TBTF banks to effectively hold public policy hostage would be greatly limited. Their most risky behavior would probably not be reduced under such a scenario, but the nation’s business could certainly go on much more smoothly if a TBTF were allowed to go under with the presence of a large public bank than without one. Such types of public banks can be used either as an orphanage or as a hospital for retail branches of failed banks, keeping them in public custody and in fully functioning order while deciding their ultimate fate. This is not idle speculation but the experience of Argentina’s largest national public bank during the depths of its crisis in 2002 (Marshall 2013a).

As Kregel (2010) argues, there may be no way to return to Glass-Steagall with the continued presence of TBTF banks, particularly as their functions as investment banks garner ever greater proportions of their profitability. While we don’t see any economic reason why banks cannot be effectively regulated again, the point that we wish to emphasize is that there are other possible solutions to the TBTF problem. Indeed, in terms of the retail operations, the establishment of a large public bank could effectively create a Glass-Steagall-type bifurcated market, in which the traditional activities of the commercial bank (deposits and productive loans) would be the sole ward of the public bank, while TBTF banks would pursue the traditional activities of the investment bank. This bifurcation would almost naturally arise from the very existence of a large national public bank. As a not-for-profit institution, a public bank can systematically undercut the prices of private banks on loans, precisely eliminating their greatest profit center: false scarcity. In the current context of increasing banking concentration, scarcer and dearer loans, and persistent fraud, reputable public banking would at once lure customers away from TBTF banks and force these banks to lower their own costs charged to customers. The same would hold true on deposits. Instead of TBTF banks reaping the huge profits of socially harmful private banking, these could be returned to customers in terms of higher rates paid on deposits. On the retail side of banking, therefore, the mere presence of a reasonably well-run public bank should lead to clear benefits to customers in terms of cost, stability, and accessibility of lending, as well as providing a real return on deposits, which has not been the case at the retail level of U.S. banking in recent years.

If a large public bank were constructed on the notion of “probity, not profit,” TBTF banks could see their very survival compromised, and many would probably retreat to what would be generally considered as investment banking activity. In this sense, and perhaps most importantly, public banking is one of the surest ways to euthanize the most destructive of our current rentiers, the TBTF banks. If TBTF bankers are granted permanent immunity for their crimes, perhaps the most effective way of reversing the Gresham Law dynamic in which unethical behavior drives out ethical behavior in financial spheres (Black 2005)—and again,
well documented by Chernow (1990)—is for ethically guided public banks to displace them in the market. This would require no real euthanasia and certainly no violence or coercion. It would not even require the simple application of the law or the nationalization of TBTF banks but only the introduction of new players in the market.

CONCLUSIONS

Throughout this article, we have argued that too little attention has been focused on the public banking option. However, this is not to say that no attention at all has been given. Ellen Brown and the Public Banking Institute have been active and vocal proponents of public banking for the United States. While we believe for the most part that post-Keynesians have overlooked credit policy, many leading authors of post-Keynesian leanings have repeatedly and explicitly supported the idea of public banking in the United States under differing frameworks, including James Galbraith, Randall Wray, and Mario Seccareccia (Bougrine and Seccareccia 2013). In Latin America, work on public banking has been active, with CEFEDAR in Argentina representing public banks for years until its recent closing by the Macri regime, while other research centers have given considerable thought and time to the issue. At the level of national governments, under the Obama administration the United States used its export bank to guarantee financing for Ford and other companies; the United Kingdom has a green bank and North Dakota a public bank. In England, Vincent Cable was a strong supporter of public banks for SME, while in the United States Obama tepidly proposed an infrastructure bank.

Such political proposals are indeed welcome, but they are often offered as compliments to the current TBTF-dominated financial system. Our proposal is to use public banks to hack away at the root of the problem that TBTF banks have created and perpetuated. Once again, public banking is not a panacea. Yet with adequate public participation and political leadership, public banks can offer relief for extremely strained local finances. They can offer an alternative to the abusive and illegal practices of TBTF banks and even usher in their retreat. They can complement fiscal policy in extending stable and accessible credit for productive enterprises. Most of all, they can serve as an important policy tool if a resurgence in Keynesian economics is ever to take hold in which money is once again at the service of the people, and full capacity utilization, full employment, and general prosperity are again the guiding lights of public policy.

NOTE

1. One could also provide data on the evolution of the ratio of loans to the private sector over total bank assets.

REFERENCES


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