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# The Crisis of Financialised Capitalism:
## Highlighting the Urgent Need for Public Banks

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Superficial explanations of the financial crisis of 2007-2009 abound. For example, some analysts have attributed it to weak regulation, others to speculative excesses. But we regard it as a crisis of the capitalist system itself—of 'financialised capitalism'.

A thorough-going systematic failure of private banking, concentrated in advanced capitalist countries such as the US and the UK, precipitated the recent global crisis. Hence, nothing less than a fundamental, structural reform of the financial sector is needed. This Development Viewpoint argues for re-instituting Public Banks as a central component of such a reform.

**Trends of Financialisation**

What have been the underlying trends of the financialisation of capitalism? Three are worth highlighting.

First, large corporations have become less reliant on banks since they have been able to finance investment either out of their own retained earnings or by securing financing on the open market. They now possess independent capacity to engage in financial operations for their own profit.

Second, banks have therefore had to transform themselves, extracting more surplus out of individual households and engaging in open financial markets themselves in order to earn hefty fees and commissions. Earning interest from lending has become a less important aspect of their operations as they have added profit-maximising investment banking to their traditional function of commercial banking.

It is evident that some of the usurious and predatory features of the traditional moneylender have resurfaced as a central function of modern finance. The result has been huge profits for the financial sector, primarily from investment banking. A startling example is that in 2002 finance accounted for 45% of all US profits.

At the heart of contemporary investment banking is securitisation. This involves handling claims on some underlying debt (such as housing debt), earning fees as a share of the future payments on that debt but passing the risk onto the buyer of the claims.

The third trend underlying financialisation is that workers have had to turn to banks for more lending because their real wages have stagnated or fallen for decades in advanced capitalist economies. This trend has been exacerbated by the retreat of the public sector from the provision of such services as education, health, pensions and housing. As a result, workers have had to take on more debt in order to finance the private provision of these services.

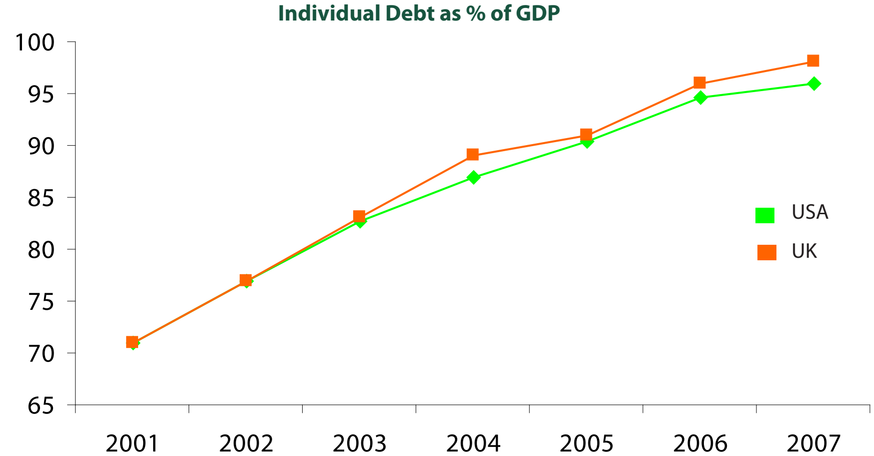
The Figure shows the dramatic rise in individual debt as a percentage of GDP in both the US and UK. Starting at a little over 70% in 2001, this ratio rose rapidly in both countries, approaching 100% by 2007, before the financial crisis struck.

Such a rise was, in a sense, inevitable. When the profits of investment banking reached massive proportions, there must have been a similarly huge accumulation of debt somewhere else in the economy. At that time, neither the private sector nor the public sector was shouldering such a heavy burden of debt. Thus, it was left to the household sector to perform the function of rapidly accumulating debt, primarily on housing.

The financialisation of capitalism has not occurred as a natural, organic outgrowth of economic trends. It has been actively aided and encouraged by public policies: financial deregulation and the retreat by the state from the provision of many vital services have supported the rapid fattening of financial-sector profits.

And when financialisation has run into trouble, the central bank has

**Individual Debt as % of GDP**




Sources: US Federal Reserve Flow of Funds and UK Office of National Statistics.

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been ready to intervene to prop up the monetary system. This occurred in the early 2000s, for example, when the central bank in the US quickly expanded the money supply and lowered interest rates after the stock market bubble burst.

**Replacing Private Banks**

How can these destabilising and inequitable financial trends be reversed? Piecemeal reforms will not be adequate. We advocate, instead, more radical measures. The most critical is the replacement of private banks by public banks.

One of the first priorities of public banks would be to divest themselves of the speculative and crisis-prone functions of investment banking. As is now evident, the mix of commercial and investment financing has proved to be catastrophic. Once ridden of investment banking, public banks could concentrate on restoring basic credit and monetary services.

One of the chief benefits would be the revival of credit and monetary services for workers and households in general. In contrast to past practices, such services could now be provided both safely and without extortionate charges. However, the provision of such services would have to be complemented by broader public policies designed to help raise real wages and restore the public provision of essential services.

One of the advantages of public banks is that they could take over the bulk of credit provision for small and medium-sized enterprises. A steady supply of credit to such firms could be essential in maintaining aggregate output and sustaining broad-based employment generation.

But public banks could also perform a more pro-active function in overhauling the structure of contemporary capitalist economies, laying the basis for a more radical social transformation. In other words, such banks could play a key developmental role in directing aggregate investment towards new and socially desirable productive activities.

For example, infrastructure investment is in urgent need of renewal in both the US and the UK. There is also a strong popular demand for investing in clean energy production as well as in greater energy efficiency in homes, automobiles and mass transport. The provision of credit by public banks could ensure that social criteria drive the decision-making process governing such investment.

**Achieving Radical Reforms**

In playing such a decisive role in restructuring the economy and undertaking long-term strategic investment, public banks would doubtless come into conflict with large corporate interests and private financial markets. This conflict would inevitably raise issues of how to regulate finance and contain the influence of Big Capital. One of the likely outcomes of persevering with the objective of strengthening public banks would be the need to exercise some control over interest rates and institute effective regulation of private financial operations.

In general, the renewal and rejuvenation of public banks could mark a major turning point in overhauling finance, reversing financialisation and shifting the economy in a radically progressive direction that could serve popular interests.

Public banks would not be free, of course, of problems, including the risk of corruption due to political influence. So, if public banks are to be successful, their internal organisation and management would need to be radically reformed from what currently prevails. The financial sector is now epitomised by unbridled profit maximisation, private greed and a stunning lack of any democratic accountability.

Public banks would have to operate in a fundamentally different fashion. Merely nationalising private banks and replacing failed private managers with state functionaries would not be sufficient, for instance. Public banks would have to be held to higher standards of transparency and accountability and be able to respond to demanding norms of public service.

Most fundamentally, they would have to be structured in order to respond effectively to a broad range of democratic demands. This should imply that the boards of public banks have full and effective representation of popular interests.

Finally, the defenders of the financial sector would no doubt argue that public banks are likely to lack the technical capacity to carry out modern banking functions. But the financial sector has already spawned a vast army of hundreds of thousands of financial specialists. Hence, there is no real shortage of technical expertise, a good proportion of which is now unemployed, which could now be recruited by public banks to serve public interests.

The case for public banks is a strong one. The alternative—protecting a bloated, inept and crisis-prone financial sector—is not viable. The global crisis has exposed the systematic and irremediable failures of financialised capitalism. More troubling is that political will now appears to be severely lacking to carry out the thorough-going reforms of finance that would be necessary to contain its mindless pursuit of short-term private profits at the inevitable expense of the achievement of broader social objectives.

Reference:
Lapavitsas, Costas (2009). 'Systemic Failure of Private Banking: A Case for Public Banks'. Discussion Paper No. 13, Research on Money and Finance, August.

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