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Abstract

Finance is traditionally studied by lawyers as well as by economists on the basis of the premise that a market economy has, at its core, a single natural and necessary institutional form, expressed, for example, in the basic rules and doctrines of contract and property. The literature about "varieties of capitalism" has proved insufficient to challenge this assumption. A corollary of this premise is the view that, barring particular market defects, a market economy can be counted on to channel the savings of society to its most efficient possible uses. The first task of regulation is supposedly to redress such localized flaws in competitive resource allocation.

This brief text outlines the rudiments of another way of thinking about finance. It does by advancing a series of connected propositions. Under prevailing institutions, finance has become evermore decoupled from the real economy. The production system remains largely self-financed on the basis of the retained and reinvested earnings of private firms. Financial intermediation is substantially self-directed, oriented to asset trading and position taking by highly leveraged financial institutions, supported by accommodating monetary and regulatory policies.

It need not be this way. A series of innovations in our present institutions and practices can greatly enhance the usefulness of finance and mitigate its dangers. Regulation, as conventionally understood and practiced, is not enough. Regulation, better oriented, can represent a first step toward institutional reorganization.

The reorganization of finance should in turn be judged by the standard of its service to broader aims. The most important proximate aim is to increase the likelihood that finance will serve the productive agenda of society rather than serving only itself. One ulterior purpose is to enhance the contribution of finance to socially inclusive economic growth: the most widely professed political-economic objective in the world today. Another is to organize finance in ways that favor active rather than passive globalization: the engagement of a national economy with the world economy without abandonment of its capacity to implement a distinctive strategy of national development and to establish the institutional arrangements that the strategy may require. Such arrangements are likely to contradict the institutional formulas preferred by the interests and ideas prevailing in the great powers of the day.

A crucial test of every program of reform is success in establishing the institutional vehicles that the program needs. This imperative gives reason to re-invent comparative law as a handmaiden of institutional innovation. Institutional details matter. They exist only as law.

RETHINKING FINANCE THROUGH LAW: A Theoretical Perspective

The most important constraint on the understanding of finance and financial crisis, as well as on the role of legal analysis in addressing them, is intellectual: the unrecognized limitations of the ideas that shape the debate. In a series of writings, some already published, others in progress, I have proposed another view. In this note I single out some of the elements of this alternative approach and suggest its usefulness by bringing it to bear, in summary fashion, on a number of particular contexts.

Guiding Ideas

The underlying conception is presented here in summary fashion in the form of seven theses. The first three describe an approach to the understanding and organization of finance and financial regulation within national economies. The second two conjectures describe the counterpart to this approach in the area of global finance (variability, asymmetry, and the reorientation of global governance and global law.) The last two theses connect the emergent view of finance and financial development to the program of socially inclusive growth, globalization, and the method of legal thought.

A major assumption of the view composed by these theses is a conception of the institutional variability of the relation between savings and production. I explore this theme in greater detail in accompanying work. For purposes of this discussion, consider in highly abbreviated form the content of the underlying conception.

1. The main theoretical argument: contrary to what has been generally assumed by neoclassical and Keynesian economists, the channeling of savings to productive investment is not automatic, is not automatically provided by the market; its failure can't be understood as a consequence of short-term, market imperfections.

In fact, there are different sets of market-oriented financial institutions; differing in the extent to which they contribute to – or work against – the task outlined here. The earlier discussion of the post-war experience of US financial policy and reform provides a series of examples of this.

2. The universally shared advantages of high local savings under circumstances of contemporary globalization are as political as they are economic and as applicable to first world countries as they are and have been to the third (such, at least, is one of the more important lessons of the financial crisis in the past two years.) The ability to maintain a high level of savings - both public and private - and at the same time effect a tighter link between savings and productive investment increases the room for maneuver among national governments and political economies within the global economy, and creates the possibility for active rather than passive integration in the global trading and financial regime.

3. This fact has been partly obscured for the US due to the special circumstances of the US possessing the world's reserve currency. However, this may now be changing in light of two circumstances:

1. The degree of structural imbalances has reached a point where it is now recognized as unsustainable. (see the discussion in R/R as well as in many other places)
2. There is an increasing belief that USD will no longer be the reserve currency forever; that different monetary arrangements will evolve, including either (a) a basket of reserve currencies; or (b) quasi money drawing rights.

As always, changes such as these may evolve in different directions and have different effects. For the US, the question becomes what to do now that the status of the USD is no longer taken for granted and has become an item on the world agenda rather than a fact on which the country may continue to rely.

4. One corollary to the above: the universal interest in securing the conditions of economic sovereignty and experimentation, both in the choice of development strategies and in the formulation of projects of institutional reform.[1]

This point may be given more general formulation. The comparative experience of development in the post-war period suggests that the most successful developing countries experimented with alternative forms of financial openness and integration. They did not blindly follow the institutional recipe of the day. Japan, Germany and the East Asian tigers – to name the most obvious examples – relied on capital controls, dual currency regimes, and other "heterodox" policies and arrangements in an effort to mobilize domestic savings for long-term productive investment. These same countries combined these "pro-growth" policies and institutional preferences with other policies and arrangements designed to curb speculation, stabilize capital inflows, and dampen volatility in currency and derivative markets.

These experiments and initiatives cannot be understood in terms of a simple contrast between market and bureaucratic ordering. They may be seen, instead, as efforts to promote a deeper reconciliation between economic and financial

[1] The theme of the importance of broadening the policy space for economic and institutional experimentalism has been emphasized in the work of Rodrik, Wade, Sabel and Unger, among others. Relevant comparative and historical experiences are treated at greater length below. They include: US, German and British experiences during the 1930s; post-war experiences in advanced and developing countries, including: the East Asian tigers (mobilizing savings for long-term, domestic investment according to the principle or doctrine of "financial restraint"); the institution of the development bank in Latin America and in East Asia; and institutional experiments in the organization of domestic financial markets and in their relation to global markets, especially in successful developing countries in the past thirty years. Further elaboration on the range of experiences, together with illustrative legal and institutional detail may be found in Charts 1 and 2 at the end of this piece.

experimentalism at home and active rather than passive participation in global markets.

5. The thesis of alternative globalizations

The financial crisis of the past three years has highlighted differences in the ways countries participate in global markets, not just in terms of quantitative measures (for example, levels of de jure or de facto openness or closure, or flows of trade and investment in relation to domestic GDP) but in qualitative terms as well. Much of the research has focused on a relatively narrow set of policies and arrangements – for example, whether and under what circumstances to use capital controls, or to permit foreign portfolio capital to move freely in an out of national economies. But the choice transcends questions of narrow, technical detail and is of great consequence for politics as well as finance.

The same idea applies to the institutional organization of global finance. Just as countries differ in the arrangements adopted to organize finance and development within the national economy, so global regimes differ in the nature and extent to which they support rather than subvert our collective interest in the universal deepening of financial markets in richer and poorer countries, for the sake of development in particular countries and stability in global markets.

At the most general level, we can identify three different sets of conditions required to promote the project of economic and financial development in richer and poorer countries. An initial set of conditions involves expanding the "policy space" enjoyed by all successfully developing countries in the post-war period. A second set of conditions involves the mobilization of domestic savings made available to long-term productive investment. Still a third set of conditions is cultural: the broadening of access to education and economic opportunity to citizens in every country of the world.

In the closing decades of the 20th century, orthodox financial openness and integration was often viewed as synonymous with the project of economic growth and globalization. But the financial crises of the past 30 years, including the financial crisis of the past two years, have shaken the belief in this assumption. We now recognize that there is little empirical support for the thesis. Instead, heterodox policies and arrangements in the area of global governance and financial integration – for example, policies and arrangements associated with the original Bretton Woods regime - are increasingly viewed as more favorable to the project of financial deepening and development in richer and poorer countries.

The thesis of alternative globalizations applies the same critical and constructive method to the institutional organization of global financial markets as it does to the institutional organization of the domestic financial system. Just as there is no "single best practice form" of market-oriented financial organization, so there is no "single best practice form" of an open international financial system.

6. Socially inclusive growth, globalization and reorganization of the global financial regime

The contemporary debate has emphasized the importance of coordination to preventing instability in global finance; this approach is too narrow, and leads to the wrong approach. The emphasis should be on universal financial deepening in the service of broadening economic opportunity in the world as a whole.

One by-product of the second or alternative approach to globalization is the prevention of instability at a deeper level, by preventing the world economy from collapsing in a deeper way. The first approach may also lead to greater stability, but in a much more superficial way. The alternative defended here proposes institutional minimalism in the service of deeper globalization, meaning more contact, collaboration, and connection without the imposition of a single set of financial arrangements.

This proposal stands in stark contrast to ongoing efforts to find a "single best practice approach" in the area of financial reform and regulation. Although chastened by the recent crisis, the belief in a single "best practice approach" continues to inform many of the most influential proposals today for the reform of the global economy. The argument of this piece rejects that idea. Instead, I advocate a return to the spirit (but not the arrangements) of the original Bretton Woods regime: institutional minimalism in the service of deeper globalization; universal financial deepening within each national political economy, for the sake of greater freedom of maneuver to experiment with alternative strategies of development and projects of reform, in richer and poorer countries.

7. Socially-inclusive growth, globalization and the revision of legal thought

My analysis of the financial crisis differs from the standard view chiefly in the crucial role I attribute to the distinctive institutional framework generated by what I have called the hollowing out of the New Deal Regime. This analysis relies on and implies a distinctive conception of law and legal analysis. I thus conclude the essay with a series of remarks on the nature and significance of this conception and its relation to the traditional approach to comparative law and legal thought.

Conventional comparative law has often degenerated into a purely descriptive exercise comparing alternative doctrinal systems: for example, civil law and common law traditions, and their histories.

Many non-lawyers have accepted this doctrinal analysis (e.g. LLSV) and claim to find great practical significance in it.

But the use of functional analysis in the late 20th century comparative law (e.g. Arthur von Mehren, John Dawson) has undermined the significance of this conventional comparative approach. It has done so by showing that the same

doctrinal system can be used to achieve contrasting results and that the same results can be achieved by contrasting doctrinal systems. The outcome is to leave comparative law without a mission.
But comparative law does have a mission. The mission has two parts:

The first part is to analyze the nature and range of different models of social organization in different areas of social life. Thus, one topic would be the arrangements governing the relation between finance and the real economy.

The second part is to expand the range of available models, in the service of our interests and ideals.

This essay should be read, among other things, as a practical example of this work in legal analysis. It shows, in the particular domain of finance, how we can begin to supply the conceptual component of the task of reorganizing the market economy and of redirecting the project of globalization.

Theme and variations: A schematic comparative-historical contextualization of the theoretical argument

The best way both to develop and to support the way of thinking outlined in the first part of this essay is to suggest how it can inform a comparative-historical understanding of the transformation of finance in a number of contexts since the great world economic crisis of the 1930s

I do so here schematically through three series of remarks: about the United States, the United Kingdom, and Germany in the 1930s; about East Asia in the post-War period; and about some of the major emerging economies (China, India, Brazil) today. In other writings, I have explored the theoretical and programmatic significance of these comparisons in greater detail.[2]

Once developed through its historical contextualization, the theoretical argument can more readily serve a programmatic as well as an explanatory purpose and help

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[2] I have explored the transformation of finance in the post-war period in a number of different settings. For a discussion of the transformation of the rules and arrangements governing sovereign debt in two different historical circumstances, see Lothian, The Criticism of the Third World Debt and the Revision of Legal Doctrine (1995 b). For a comparison of the Latin American and East Asian experience with financial orthodoxy and financial heterodoxy, see Lothian, The Democratized Market Economy in Latin America (and elsewhere): An Exercise in Institutional Thinking within Law and Political Economy (1995 a). Recent writings develop a comparative and historical understanding of the transformation of finance in advanced and developing countries in the closing decades of the 20th century. See, for example, Lothian, The Past and Future of American Finance: American Experimentalism without American Exceptionalism (2010 a); Lothian, After the Crisis: Institutional Innovation and the Alternative Futures of American Finance (2010 b); and Lothian and Unger, Crisis, Slump, Superstition and Recovery: Thinking and Acting beyond Vulgar Keynesianism (2011).

inspire a response to the problems revealed by the recent crisis and subsequent slump.

General introductory observations

1. Institutional innovation about law and finance, as well as about other topics in the 20th century, was much more limited that it might have been, if (a) the dominant ideas had been more hospitable to the imagination of alternatives and (b) democracies had been organized so as better to facilitate the repeated practice of institutional experimentation (raising the temperature and hastening the pace of politics)

2. However, even within these limits, institutional experimentation and divergence – including about the relation of finance to the real economy - went much further than dominant economics, legal and historical understandings are able to countenance.

3. The restricted variations of the past inform the institutional imagination. They serve as points of departure for the greater possible variations of the future.

US/UK/Germany during the 1930s

In all of the major north Atlantic industrial economies, significant institutional experimentation took place in the 1930s under pressure of the worldwide crisis and slump. Some features of this experimentalism:

a. Use of the power of the state to mobilize people and resources in the absence of adequate "effective" private demand. An example: "labor fronts" in both the democratic US and authoritarian Germany. It was a way of anticipating, in peacetime conditions, some features of the war economy.

b. There was broad experimentation with different variants of what, in today's vocabulary, we would describe as "public-private" partnerships. In the US, the most important examples were the GSEs. Some of the public-private connections foreshadowed the bolder experiments of the subsequent war economy. Others prefigured, in the relation between private and public, the organization of production on the basis of a dense and decentralized nexus of contractual relationships among firms/agents each of which was responsible for particular inputs. That is a way of organizing production that is becoming increasingly important in the early 21st century. However, it was alien to the way of organizing production under the aegis of large corporations and stable, unified labor forces that became common in the 20th century.

The conventional arrangements for the organization and protection of labor (such as the American collective bargaining system) presuppose a way of organizing labor that may prove retrospectively to be a brief interlude between two long periods in which work was once organized, and will again be organized, on the basis of decentralized contractual networks. The implications - legal, economic and social – extend beyond labor to finance. A major and unfamiliar problem arises if finance becomes more centralized in vast financial institutions as production becomes decentralized and its direction vested in multiple corporate entities headquartered in different jurisdictions around the world. The result is to increase the risk that finance will become the master rather than servant of the real economy.

c. Both sets of institutional experiments, however, remained relatively truncated or quarantined. In the US, for example, the experiments in the mortgage markets were not generalized to the economy as a whole.

East Asian political economy in the post-war period

Institutional experimentalism undertaken not out of appreciation for an experimentalist practice but rather, as if, the objective were to reconcile the greatest possible national military and economic power with the least possible trauma to the circumstances of the preexisting structure of powerful interests and established customs. What is remarkable is how much institutional innovation – including innovation in the organization of finance – this minimalist principle came to require.

a. One tendency was to use foreign capital while preventing it from gaining the power to set the direction of the national economy. The method was to privilege loan/risk capital over capital that could control the "commanding heights" of the production system.

b. A second tendency was to create national institutions that could both raise the level of national savings and channel long-term saving to long-term productive investment. Accomplished, among other ways, through public or quasi-public financial institutions such as the postal banks. The principle was that national autonomy to formulate a development strategy requires a broad base of national saving as well as arrangements capable of ensuring the predominance of financial deepening over financial hypertrophy (in the categories of my argument here.)

   In the predominant economic theory, both neoclassical and Keynesian, saving is represented as more the consequence than the cause of growth. This theoretical thesis fails to recognize the importance of a broad-base of national saving, the both public and private, in ensuring at the outset of a development process the margin to defy and to diverge: to "do things my way" rather than according to the interests and prejudices of global capital markets. The East Asian economies operated on the principle, which experience has subsequently vindicated that foreign capital is both more useful and less dangerous the less it is needed.

c. A third dimension of institutional innovation had to do with strategic coordination between governments and firms. The institutional conditions of a market economy are always set outside the markets – in politics and law. However, it is another matter when the state and its long arms collaborate with firms to craft a trade and industrial policy. That is what happened in these East Asian economies. The state helped create comparative advantage by tending to the supply of missing, physical, financial, technological and human inputs and by counterbalancing or compensating the risks of those who pioneered new sectors. It is a gross simplification to characterize the practice as "picking winners."

   The narrower the range of firms (accordingly, big businesses) with which the state allied (e.g. Korea), the greater double risk of favoritism and ("crony capitalism") and dogmatism. The broader range of firms brought into the network of public-private collaboration (e.g. Taiwan), the more the strategic coordination between governments and firms took on the aspect of an effort to democratize the market economy: to turn it into a machine for the experimental development of new comparative advantage.

   The result was then to create both a space and a need for what I have called financial deepening.

Brazil, India and China in the context of the crisis today

There is the temptation to imagine that we do not need to look for an alternative approach to the management of finance and to its relation to the real economy. The relative success of the BRIC economies, especially of China, India, and Brazil, in response to the crisis of 2007-2009 would, according to this view, show the way forward better than any abstract doctrine could hope to do. I here argue that the experience of the BRIC economies, although it provides lessons of great value, supplies no such alternative model deserving of imitation.

These three great continental developing countries differ in many respects. No one would confuse the planning and controls in China for the economic policies, arrangements and political systems in Brazil or India. Nonetheless, from the perspective of this essay, these three emergent giants share a series of financial policies and arrangements that depart from the dominant model of financial orthodoxy and integration. In varying manner and degree, these features have contributed to the development of long-term domestic savings made available for long-term productive investment, (relatively) free from the global liquidity cycles and crises so dominant in recent years.

Consider two different sets of arrangements: (1) public/private partnerships in the area of domestic finance; and (2) policies and arrangements associated with selective integration of the national economy into global financial markets.

Public/Private Partnerships

A major factor explaining the relative success of these emerging economies is the use of governmentally controlled banks to ensure the continuation of credit flows. It is a great advantage to count such banks among the instruments of public policy. However, it is not as great an advantage as genuine financial deepening would be a tightening of the links between finance and production, enhanced by a broadening of access to credit, especially credit for producers, by enterprises in all sectors and of every scale. Better to decentralize and democratize the whole of finance than to use banks controlled by the state to make up for the deficiencies of an unreconstructed banking system.

There is no reason in principle why the governmentally controlled banks could not be used to help fund small and medium-size businesses, start-ups included, and to mimic the work of private venture capital. In this way, they would work – and in fact they have sometimes worked – as a front line in the deepening and the democratization of finance. However, in a very divided and unequal society, as the large developing countries generally are, the distribution of subsidized credit has more often favored a relatively small number of big enterprises, with sweetheart relations to the state. In Brazil, for instance, the major part of these resources has been used to benefit a small group of big private business, under the pretext of helping to turn them into "world champions." In China it has served largely to maintain the funding for governmentally owned enterprises.

Dualism in the credit market – two different markets for credit, organized by different rules and with unequal prices for money – has been characteristic of these economies. Such dualism has repeatedly created the means with which to favor a few and to disfavor many. Sometimes the dualism takes the form (as it does no in Brazil or China) of a contrast between an administered market in subsidized credit and a relatively freer market in non-subsidized credit. AT other times it takes the form (as it has in economies marked by financial repression) of credit rationing: someone in the government gets to decide who has access to scarce credit. One or another, the expansion of credit under the conditions of credit dualism, although motivated by the effort to prevent a slump, magnifies the impact of the preexisting inequalities.

Selective Integration with Global Markets

A second factor is relative autarky: the degree to which a national economy is independent of the world economy. Despite the vast changes of recent decades that have brought the large emerging economies into the global economy, they remain relatively autarchic. It is obviously true of Brazil; foreign trade is still only % of

GDP. However, it is more surprisingly true even of China, a driving force in the world economy today; its foreign trade still amounts to % of its GDP, by comparison with % for Japan.

A paced and limited integration into the world economy, subordinated to the requirements of a national development strategy, is better than an unconditional integration. By an unconditional integration I mean one that accepts the present allocation of comparative advantage among national economies as the basis for place in the world economy, and then goes on to subordinate national strategy to the constraints imposed by this global niche.

However, the best is a movement that enhances integration but seeks to shape it in the service of a project designed to create new comparative advantages. The most effective way to create them is not dogmatically to choose sectors that are supposedly bearers of the future (as if the future did not have to make its own choices). It is to empower experimentalism: by establishing arrangements that broaden economic and educational opportunity, by giving small and medium-size business access to forms of credit, technology, marketing, and knowledge normally reserved to big businesses, by propagating successful local practice, and, above all, by creating the means and the conditions for pluralism and experimentation in the institutional forms of the market economy – that is to say, in the ways of organizing production and exchange.

The broader significance of these variations

This schematic comparative-historical discussion supports a number of propositions that develop and refine the theoretical view outlined at the beginning of the piece.

First, the worldwide experience of the last eighty years discredits the view that there is a narrowing funnel of workable institutional arrangements for the organization of finance and of its relation to the real economy. The twin imperatives of protecting national development from cycles of liquidity in the world economy and of using national finance to help spur the creation of new comparative advantages (as opposed to simply relying on established comparative advantages) has fueled successive waves of innovations in the institutional setting and set-up of finance. The modesty of many of these innovations is counterbalanced by their number: as limited as many of them may seem to be, they represent potential points of departure for more far-reaching variations.

Second, many of the most successful innovations have had the twofold effect of making national governments and economies less dependent on the interests and whims of international finance, and thus enhanced national economic sovereignty, and of tightening linkages between finance and the real economy (financial deepening rather than financial hypertrophy).

Third, in the production of this double effect a particular set of institutional devices has played a central but ambiguous role: the creation of public or para-statal financial entities, such as the American GSEs or the Brazilian and Chinese development banks. On the one hand, they have represented a way to work against the current of national or global cycles and crises. On the other hand, they have sometimes seemed to exempt national governments and politics from the harder work of deepening finance by democratizing it to a greater extent (less, for example, in Taiwan than in South Korea, or in Germany than in the United States). Small business – the source of most of the product and of the vast majority of the jobs – has been shortchanged in relation to big business. The important programmatic and theoretical implication is that the reversal of this bias requires more than a reallocation of governmental resources or a reorientation of legal incentives and burdens; it requires bolder experimentation in the institutional forms of finance and, more generally, of the market economy than has yet taken place.

Fourth, in each case – and especially in relation to the third set of comparative experiences - the failure to carry forward the project of democratic experimentalism would exact a terrible price: limiting the stock of available ideas and arrangements for deepening democracy an development everywhere else.

The problem of the missing language for exploring actual and potential legal and institutional variation and reform

We lack a legal-institutional vocabulary as well as a theoretical view, with which to address the issues I explore here and in a developing body of work. The purpose of this note has been to suggest some elements of both the missing vocabulary and the needed view.

The dominant ideas, including the legal ideas, about finance inhibit our ability to identify in the rich store of micro-institutional experiments that already exist in the world, material for the construction of alternative strategies of national development, each with its corresponding set of institutional arrangements. To change this intellectual situation, we need to combine an institutionally informed political economy with a revised practice of comparative law. We would need to practice comparative law as the study, the criticism, and the enlargement – especially through analogical recombination – of the extremely limited range of institutional set-ups now available in the world for the shaping of different areas of social life.

There is also a second source of our difficulties: the ideological and political distance separating experimentalism in developing countries and experimentalism in the developed world. In each case, an effort to apply the narrow categories and spirit of an increasingly moribund (neo-liberal) doctrine would confuse and distort the historical experiences of reform, both failures and successes.

This schematic historical and comparative analysis suggests that finance can be organized, and related to the real economy, in many more ways than the present debate, provoked in response to the crisis, can countenance.
The analysis also suggests the reality of constraint in the evolution of institutional diversity. Although the range of institutional variation is much greater than anything that the stymied and blinkered discussion of regulatory reform in the North Atlantic world is able to envisage, it is much narrower than what an informed institutional imagination might take to be attractive and feasible. Path dependency carries enormous weight: in every instance, people develop institutional variations with the materials at hand, which means the ideas and arrangements produced by previous changes.

In weighing the second lesson against the first, it is vital to distinguish between two sources of constraint on further institutional variation. One source is influence of established interests – for example, the interest of financial rentiers as against producers. Another source is the influence of the theoretical orthodoxies – or illusions – of the age. A common mistake is to attribute the constraint entirely to the first source, disregarding the significance of the second.

Once we criticize and revise the terms of understanding of law and finance, we discover the constraints to be less formidable because less determinate, than they appeared to be. That is a major ambition of this piece.

The United States as a developing country

The preceding theoretical and comparative-historical arguments establish a basis on which to think once again about the future of finance in American democracy and in the American economy. I have discussed, and will discuss, this future more extensively in other pieces. Here I want only to suggest a bridge from this analysis to an American argument. The starting point is a rebuff to American exceptionalism: the problems and prospects of American finance amount to American variations on global themes. The most important variation lies in a paradox: a country that organized the most decentralized –and in a real sense – democratic system of finance that had ever existed in the world has become the leading example of the perversion of finance: the triumph of financial hypertrophy over financial deepening.

Conclusion: Financial innovation and the legal imagination

Finance, supposedly the strong suit of institutional orthodoxy, invites a radical change of theoretical and programmatic approach. It is impossible to understand finance without attention to the detailed institutional forms of its internal organization, of its relation to the real economy, and of its broader setting in economic and political life. It is impossible to fix it without changing, in piecemeal but cumulative fashion, many of these forms. The detailed institutional arrangements exist as law and legal doctrine. There is no better area in which to appreciate the need for a practice of legal analysis that recognizes hidden institutional variations and creates new institutional possibility, informing the public conversation about our alternative futures.

In legal thought, including legal thought about finance, all else is superstition.

Chart 1
The institutional context of finance: comparative variations and their consequences

	Internal organization of national finance	Finance and the real economy	Finance in its international setting	Consequences: Internal institutional dynamic
US today	Short-term portfolio flows intermediated through the shadow banking system	Decoupling of finance from the real economy; government intervenes to stabilize and support the existing fin system	Dependent on massive inflows of foreign portfolio capital	Credit boom – asset bubble; debt deflation on systemic basis
US in the 1930s and in the early post-war period	Ample domestic savings intermediated through regulated banks, GSES and newly created institutional investors	Household savings channeled to government and non-financial enterprises	Relatively high domestic savings, institutional impediments to speculative trading by leveraged intermediaries	Virtuous cycle of domestic savings, investment, growth; active engagement in global markets
Mexico and Argentina in the 1980s and 1990s	Foreign portfolio inflows intermediated through domestic banking system	Decoupling of finance from the real economy; increased internal and external liquidity fuels asset inflation and debt-fueled consumption	Dependent on massive inflows of foreign portfolio capital, increasingly USD-based	Credit boom – asset bubble; debt deflation on systemic basis
BRIC countries today	Foreign and domestic funding intermediated via strategically coordinated banking system; capital controls and surplus reserves	State-owned banks and development agencies channel funding to firms and sectors deemed “strategically” important	Relative autarky: high level of domestic savings fuels domestic spending and investment; capital controls limit exposure to global shocks	Virtuous cycle of domestic savings, investment and growth; active participation in global markets
A better alternative	Rejection of credit dualism; decentralization of domestic banking system to broaden access and opportunity; institutional diversification and experimentation	Use of public-private partnerships to deepen domestic markets and to accelerate innovation in the forms and uses of finance	Active participation in global markets: restrictive treatment of short-term portfolio capital; accommodating treatments of investment in production	Finance subservient to the creation of new forms of production and new forms of finance

Chart 2

Different pathways to change: alternatives in the institutional response to financial crisis and to the reshaping of finance

	Approach to the basic framework of finance	Crisis management and response	Finance in its broader setting: regulation versus reorganization
US today	Acceptance of the existing framework, supplemented by enhanced regulatory vigilance	Government intervenes to bail-out the largest banks and stabilize financial markets	Regulation as an alternative to reorganization
US in the 1930s and early post-war period	Re-organization of the basic framework, reinforced and extended through federal insurance, liquidity facilities and multiple GSEs	Government responds to the economic and financial crisis by restructuring existing markets and creating new markets	Regulation as the first step toward reorganization of finance and its relation to the real economy
Mexico and Argentina in the 1980s and 1990s	Reshaping of domestic market by foreign capital and financial intermediaries	Diminished room for maneuver in the context of free flowing capital, and increasing use of USD-denominated assets	Deregulation as an alternative to the domestic reshaping of finance
BRIC countries today	Heterodox arrangements reduce hypertrophy in a context of limited financial deepening	Government control of credit and currency markets permits stabilization and support of domestic market in the context of a global crisis	Regulation as an alternative reorganization
A better alternative	Use of heterodox arrangements to promote financial deepening and socially-inclusive growth	Crisis as an opportunity to strengthen, stabilize and deepen domestic finance	Regulation as the first step toward reorganization of finance and its relation to the real economy

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