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Democratizing Investment*

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Abstract

Americans have trillions of dollars invested in public and private companies, yet stock ownership is highly unequal: the wealthiest 1 percent of households possess 40 percent of all wealth, and there is a large and persistent racial wealth gap. What if innovations in distributed technologies allowed for democratic facilitation of new opportunities for wealth and a rebalancing of power within the capital markets? This article proposes using innovative financial technologies to create a "Public Investment Platform"—a public option for participation in capital markets—and a "Public Investment Account" to universalize access to investment opportunities. Capital markets are currently governed by public policies that submerge the role of the public in structuring them and enable an inequitable accumulation of wealth. To democratize finance, new policies are required to democratize participation in investment.

Keywords

economic democracy, crowdfunding, fintech

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Americans have trillions of dollars invested in public and private companies, and the stock market continues its upward climb. Yet stock ownership is highly unequal: the wealthiest 1 percent of American households possess 40 percent of all wealth, and there is a large and persistent racial wealth gap.[1] Access to investment opportunities is a key driver of the increasing wealth disparity, along with housing, income, access to banking, and assets. The principal role of the government in capital markets is to ensure disclosure of corporate activity, and little public policy is focused on creating access to capital markets for those locked out. Part of the Real Utopias Project of creating a democratic financial system should be reimagining the role of the government in the private capital markets. This article proposes the creation of a "Public Investment Platform," using innovative financial technologies to create a public option for participation in the capital markets, and a "Public Investment Account" to universalize access to investment opportunities.

US financial history has shown the power of the government to structure financial markets; and, as Robert C. Hockett's work in this issue demonstrates, private financial entities are best understood as franchisees harnessing the public's permission to create credit and wealth. Capital markets are governed by public policies that submerge the role of the public in structuring them and enable an inequitable accumulation of wealth. To democratize finance, new policies are required to democratize participation in investment, and careful attention must be paid to "democratization" proposals that replicate existing hierarchies of wealth and power.

Today's capital markets require a minimum sum of available funds to invest, generally restrict the nonwealthy from investing in private companies, and provide little opportunity for small businesses to seek equity investment. The average American finds it all but impossible to buy a small equity stake in a local business, and virtually no market exists for them to do so. The nonwealthy cannot invest in the pizza shop downtown; they can invest only in large, public companies, usually by purchasing stock through a Wall Street–based fund aggregator. The wealthy, or "accredited," can invest privately, mainly in large companies or start-ups that have managed to gain access to venture capital. Although securities laws were put in place with the intention of protecting nonwealthy investors from the predation that befell them before the Great Depression, the result has been that the wealth assets of most Americans who hold equities at all are concentrated in large pools of institutional capital that invest in large businesses.

Thus America's businesses have unequal access to capital. Large publicly traded companies have the best access to bank loans and equity investment. Locally owned small businesses are crucial job creators and are key to regional prosperity and competition (although jobs at larger firms tend to pay higher wages and have better benefits). Crucial economic activities such as care provision, infrastructure, and clean energy are currently constrained by the financial sector; and small loans for small businesses are more difficult to access than large loans for large businesses.

The financial sector is rapidly changing. New financial technologies, the blockchain, and cryptocurrency are ushering in new possibilities along with new risks. New players outside the traditional regulated system are emerging, and new ways of doing business inside traditional financial entities are becoming mainstream. "Fintech" refers to either new uses of technology within regulated banking institutions or new types of financial companies, not regulated as banks, that engage in loans or other financial transactions with the public. "Cryptocurrency" refers to the invention of non-government-backed money, stored electronically, which uses a nonbank open and distributed ledger, known as a "blockchain." In other words, "money" is not issued by a government in the form of central bank notes, and records of transactions are no longer stored inside financial institutions.

These new technologies open up the potential for a radically different approach to financial participation by lowering the costs of transactions and transmission of information. Some have claimed that the rise of fintech will lead to the democratization of investment. Investment and lending today can be conducted from one's smartphone, and loans can be taken out over a peer-to-peer platform, although both are still intermediated by a large financial institution. The financial institutions in the mid-twenty-first century may be far more decentralized than today's megafirms, but a shift could happen without any deeper structural change; the concentrations of power could morph in form but not in function. The physical requirement of a location in which to make a transaction is gone, and there are new possibilities to scale. Technology has disrupted the regulatory supervision and oversight of single institutions and the system as a whole.[2] This disintermediation has profound implications for the provision of financial services in coming decades.

This article asks, What if new innovations in distributed technologies allowed instead for *public* facilitation of new opportunities for wealth appreciation and a rebalancing of power within the capital markets? I take up the charge from Wright: "What institutional designs for a more democratic and egalitarian finance system can be instituted in the present that plausibly prefigure a radically democratic economy beyond capitalism?"[3] In the twenty-first century, what kind of public institutional structure would allow all people truly to participate in wealth creation without exposing them to undue amounts of risk? As a corollary, what structure would allow for funding the types of businesses that too often lose out in today's Wall Street–driven economy: small businesses, businesses for social needs, and worker-owned businesses?

The argument proceeds as follows. I first outline current conditions in the financial sector and the limits on wealth accumulation for the majority of the population. I also consider the investor-protection components of our securities laws. In the next section, I propose two major areas of policy intervention: the Public Investment Platform and the Public Investment Account.

Current Conditions in the Financial Sector

Wealth Inequality in Capital Markets

Participation in capital markets is deeply unequal. The wealthy elite own the majority of shares, and the middle-class investing household has a small retirement or investment account. The two groups have different purposes for holding shares and different power vis-à-vis the companies they invest in. Small shareholders are primarily invested in big public corporations. They own shares indirectly, through an employer retirement account, a mutual fund, or pension fund, and tend to hold for the long term. Wealthy shareholders invest in both public and private companies, have much higher average holdings, and invest through funds that turn over their holdings much more quickly. This section discusses why there is such significant inequality in capital markets; it then turns to recent public policies meant to create mechanisms for broader participation in those markets but that have mainly reinforced existing inequities. In the third section, I will propose policies that would truly democratize investment.

The vast majority of Americans have no significant stake in corporate securities and have been locked out of one of the main drivers of wealth. Nearly 50 percent of American households own some stock, but only 14 percent own stock directly. Forty-six percent own stock indirectly, through a pension account (46.6 percent), mutual fund (9.8 percent), or trust fund (3.9 percent).[4] It is important to look at the dollar value of total wealth holdings: only 37 percent of households have total stock holdings over $5,000, meaning 13 percent have holdings between zero and $5,000. Only 25 percent have holdings worth as much as $25,000.[5]

New data from the Federal Reserve's Distributional Financial Accounts give a picture of the evolution of wealth inequality. These data combine household-level data from the Survey of Consumer Finances with the Federal Reserve's Financial Accounts of the United States to give the distribution of wealth assets and liabilities on a quarterly basis, starting in 1989, of four household wealth quartiles: the top 1 percent; the next 9 percent; the next 40 percent; and the bottom 50 percent. On the one hand, the data show that inequities in corporate equity and mutual funds have been consistent: in 1989, the top 1 percent held 39.1 percent of corporate equity, and the top 10 percent combined held 80.3 percent, while the bottom 50 percent held a mere 1.4 percent. The data also show that the distribution has grown steadily worse, even as Americans increasingly shifted to equity-based retirement savings plans and away from traditional pensions. By the fourth quarter of 2018, the top 10 percent held 86.5 percent of corporate equity (and the top 1 percent alone broke 50 percent), while the share held by the bottom 50 percent had fallen to .8 percent—a .6 percentage point decline.[6]

The racial wealth gap is significant in holdings of direct and indirect stock and grows even starker when we look at holdings over $10,000. Table 1 presents data on direct and indirect stockholdings of non-Hispanic white households, African American households, and Latino households. Holdings stayed nearly constant from 2001 to 2016: 57.5 percent of white households held stock in both 2001 and 2016, while the share of black households holding stock fell four percentage points to 29.7 percent in 2016 and the share of Latino households holding stock fell two percentage points to 26.3 percent. Perhaps more important is the percentage holding stocks with a value of $10,000: in 2016, there was a gap of twenty-eight percentage points between white and black households (42.9 percent to 15.2 percent), and a gap of thirty percentage points between white and Latino households (42.9 percent to 13.1 percent). For portfolios above $10,000, the gaps were roughly the same as existed in 2001 (when the white-black gap and the white-Latino gap were each twenty-eight percentage points).[7]

Table 1. Wealth Gap in Stock Ownership Rates, 1989–2016.

	Ownership Rates (Percentages)					
	1989	2001	2007	2010	2013	2016
Non-Hispanic whites						
Stocks, directly or indirectly owned	37.5	57.5	55.4	54.5	53.9	57.5
$5,000 or more	23.2	46.6	42.0	43.0	44.2	47.3
$10,000 or more	17.1	41.7	36.9	37.9	39.8	42.9
African Americans						
Stocks, directly or indirectly owned	10.1	34.2	28.3	27.6	27.5	29.7
$5,000 or more	4.2	21.5	16.7	16.2	16.2	19.7
$10,000 or more	3.2	16.1	14.2	12.5	12.1	15.2
Latinos						
Stocks, directly or indirectly owned	12.4	28.0	22.4	22.1	19.5	26.3
$5,000 or more	3.0	15.0	1.5	11.1	11.7	17.1
$10,000 or more	2.2	13.0	10.6	9.4	9.6	13.1

Note: Includes direct ownership of stock shares and indirect ownership via mutual funds, trusts, IRAs, 401(k) plans, and other retirement accounts.
***Source*:** Author's presentation of data from Federal Reserve Financial Accounts and Survey of Consumer Finances.

The major divide in the securities markets is between public and private investment opportunities. Private investment opportunities are limited to accredited investors; publicly traded securities require heightened disclosure, and private investment is limited to those to protect investors who can take less risk of losing their investment.[8] The Securities and Exchange Commission defines accredited investors by net worth, which has much to do with inherited family wealth and very little to do with sophistication regarding judgments about investing. At the time the Securities Act of 1933 was enacted, Congress was rightfully concerned that investors had lost faith in the financial markets after the 1929 stock market crash. The motivating purpose of the securities laws was to bring confidence back into the market through full disclosure by issuer companies and by rules around who could invest. For public offerings, conducted on the exchanges, investors were protected by stringent registration and disclosure requirements. For private offerings, or those exempt from registration, investors would be protected by limiting who could invest and how the offerings would be conducted.[9]

The Securities Act of 1933 and the Securities Exchange Act of 1934 were among the New Deal reforms made in response to the speculation of the 1920s that led to the Great Depression. Passed after the Pecora Investigation of 1932–33, in which Congress brought the misdeeds of bankers into the public record, the acts created a new legal framework intended to minimize the risks to households that wanted to invest in America's growing corporations. That framework was laid out by Adolf Berle, a key adviser to FDR, in his 1932 book *Modern Corporations*. It sought to ensure against management's self-enrichment at shareholders' expense and settled on disclosure as the best way to balance management's entrepreneurial authority with the rights of shareholders.[10] As Julia Ott describes in *When Wall Street Met Main Street*, one strand of argument for broadening access to business equity was that "universal investment could bring corporations in line with democratic political traditions."[11] On the other hand, such broadening of access with guardrails served to soften more radical public claims on the country's wealth; as the discussion above shows, it has not resulted in a "shareholders' democracy" of wealth distribution.

The institutional structure of the asset management industry means that household investors do not make the same returns as elite investors.[12] Public pension funds—the retirement investments of public sector workers—have invested massively with hedge funds, which are able to charge large and obscure fees that can leave pensioners worse off than if they had never invested at all.[13] The ongoing policy question of whether financial advisers should have a fiduciary standard of care to their clients illustrates just how problematic the nature of financial advice can be, if brokers posing as investment advisers can steer clients toward products that earn the adviser extra compensation.[14] The wealthier the household, the more access to private investment opportunities and better investment advice, compounding wealth inequality over time.[15]

New Public Policies Attempt to Democratize Investment

In the last few years, policies have sought to ameliorate many of the problems described above by purporting to open up wealth accumulation potential to nonwealthy individuals through crowdfunding technology and changes to the rules around private placements (equity offerings by businesses limited to accredited investors, i.e., wealthy households). The practice of crowdfunding itself—raising funds, whether donations or equity, from large numbers of people who contribute small sums—is not new. Crowdfunding portals that allow individuals and businesses to solicit small amounts of funds from large numbers of people through a central platform have proliferated.

The Jumpstart Our Business Startups (JOBS) Act of 2012 was meant to open up investment to the general public through the regulation of crowdfunding portals,[16] which allow businesses to solicit investment from no accredited investors because the portal itself is supposed to serve as a check on speculative opportunities. The purpose of the crowdfunding platforms is to connect potential investors *as individuals* directly with businesses who are approved by the platform. That the nonwealthy can invest through the portal opens new opportunities, in theory, to invest in private firms. This represents a major change from the original Securities Act of 1933, which divided investment opportunities into publicly traded and private markets. The stated intent of the congressional drafters was to keep the general disclosure requirements that undergird the public capital markets while opening up investment on both sides of the divide—to businesses that could not afford the high cost of complying with the rules of the public markets and to investors whose wealth limited them to the fewer than 5,000 companies that are publicly traded.

The portal lowers or eliminates many of the transaction barriers that stood in the way of connecting small investors and small issuers. Nevertheless, participation in crowdfunding portals is limited to those who have funds to invest and the resources to find and participate in such portals. The effort of navigating among the multitude of portals that have emerged since the passage of the JOBS Act makes it unlikely that such portals will substantially increase the number of households that invest. Investor protection for those nonwealthy investors participating on the portals focused not on disclosure, which is the mainstay of the securities laws generally, but on limitations to an investor's financial exposure.

The purpose of the JOBS Act was to spur entrepreneurship and give start-ups a wider pool of potential capital to tap into. All investors, in theory, can now invest directly in any private business that sells its securities through a portal. The JOBS Act's crowdfunding provisions create potential risk for a prospective investor, however, because the new crowdfunding portals lack the due diligence experience of the large brokerage houses and certain disclosure requirements are relaxed for businesses. On the other hand, if crowdfunding portals are public rather than profit-making private sites, small investors could gain more of the wealth flowing from private companies. Small investors previously able to participate only in the public securities market now can participate in private offerings even if they do not meet the definition of an accredited investor. Whether that constitutes an expansion of investor democracy or an increase in the potential for predatory behavior is debated among investor advocates. It is unlikely that these recent innovations will make much of a dent in the wealth inequality statistics described. However, the idea of crowdfunding portals is useful: the portals facilitate direct connection between sources and uses of funds; and they may do so in a democratic manner with appropriate risk safeguards in place. The idea provides the motivation for one of the policies proposed in the third section, below, with an important difference: the portals should be run in the public interest.

Another type of securities offering with democratic features is the direct public offering (DPO), which allows local investors to invest directly in a business without going through a public securities exchange or a cumbersome registration process. DPOs are made possible by the "intrastate offering exemption," Section (3)(a)(11) of the Securities Act, and require investors to be residents of the state where the business is incorporated and where it conducts at least 80 percent of its operations. The exemption balances the tensions described above: opening up capital-raising to the nonwealthy carries the risk of predatory and unscrupulous behavior. Businesses must meet regulatory requirements for a DPO dictated at the state level and must fall within a federal exemption from registering with the SEC. Although some small inroads have been made to popularize the idea, DPOs remain few and far between.

Investing remains a wholly private act, whether through a DPO or a crowdfunding platform, notwithstanding light regulation by the state. It is unlikely that these mechanisms will bring the 50 percent of American households not currently in the stock market into investment participation. It is more likely that some investors will diversify their holdings through DPOs or crowdfunding and that start-up businesses will rely slightly less on the concentrated capital typically sought from venture capital or angel capital funds. To democratize finance effectively, government must facilitate entrance for all Americans to the capital markets.

An important caveat: the argument is emphatically not simply that all households should be able to invest in private companies that do not meet stringent disclosure requirements. Although such an approach is currently under discussion at the Securities and Exchange Commission, a loosening of admission to private offerings could increase the potential for fraud and the risk to household investors, precisely because there would be no intermediary to screen the offerings. The goal of this article is to shift away from the notion that democratization of investment must be driven by the private sector.

One final question concerns the impact of "futurist fintech" on the evolution of the capital markets and whether these proposals will make sense if financial markets change dramatically.[17] Advocates of the blockchain and cryptocurrency argue that the rise of decentralized ledgers will destroy the central power of financial institutions. Although it would change the nature of transaction costs and intermediation, there is no reason to think that the blockchain in itself—or even broader decentralization of financial transactions—would substantially increase wealth equality or asset building for the majority of householders. Substantial amelioration of the consistent wealth inequality pervasive in the American financial system requires new public policies.

Access to Equity, Not Access to Credit

The underlying claim of this proposal is that including more people in the financial markets is in the public interest. Before proceeding to discuss the proposal itself, it is necessary to ask whether that claim is true. The financialization of households has meant an increase in household interaction with the financial markets. Families in the United States purchase equity or take out loans for the financial needs across the life cycle, including retirement, home purchases, and education.[18] The rise in debt load and market-based risk has been catastrophic for millions of families, shown in sharp relief by home and retirement losses during the financial crisis and by the ongoing student debt crisis.

I nevertheless contend that *public* expansion of access to democratic investment opportunities, where the benefits accrue to both small businesses and nonwealthy households, is in the public interest. This claim is not mutually exclusive with policies that increase public provision of basic social goods, such retirement or higher education. First, and most important, the proposal here contemplates *public provision of funds for investment*, which places no debt burden on any household and can make strides toward ameliorating historic racial and gender wealth gaps. Put simply, even if all the funds are lost, the household would be in no worse a place than it is today. Second, the proposal would *add a public option in the financial markets*, to reduce the ability of private financial institutions to extract wealth from the majority of American households. Finally, the proposal would *strengthen opportunities for investment for small businesses*, the types of businesses owned by the nonwealthy and currently suffering from a lack of access to capital.[19]

Increasing concentration of wealth is a global hallmark of the economy in the twenty-first century. As Thomas Piketty points out, wealth has always been concentrated, and the current distribution in the United States and Europe can be viewed as a return to historical levels of wealth inequality after an aberrant period that resulted from the shocks of two world wars.[20] Multiple public policies must be pursued to begin to counter the inequality in the United States, ranging from wealth taxes and higher marginal tax rates on upper incomes to public investments such as the Green New Deal, a jobs guarantee, and public provision of social goods such as health care and education. There are also a range of options to address the problem of the "unbanked," including postal banking and other mechanisms to widen access to credit and banking services to low-income households.[21] Increasing the wealth assets of the nonwealthy must be coupled with policies that reduce the wealth holdings that are passed along and grow for generations. Although detailed discussion of a global wealth tax and higher top marginal tax rates are beyond the scope of this article, the reforms proposed here are not likely to dent the structures of inequality unless there is a deconcentration of wealth at the top.

This article focuses on access to wealth assets as a central problem for democratizing finance, without assuming that widening access to credit (or liabilities) would necessarily have positive impacts on inequality. As the economist Darrick Hamilton says, "Wealth begets wealth":[22] wealth is a transmitter of both the possibility and the freedom to make one's own choices across generations. Unless all goods and services are publicly provided, skewed access to wealth will continue to lock in race and income divides. Wealth *assets* provide security and income that is not dependent on labor. Liabilities, on the other hand, can either create new economic potential or trap an individual in a cycle of unaffordable debt repayment, as the student debt crisis makes clear. In the United States, closing the racial wealth gap is not a matter of increasing income potential or even of reducing liabilities. Put simply, the wealth-asset gap for households of color and low-wealth white households is so large that other workarounds will not solve the core distributional challenge. That is why using public tools to grant wealth assets is required—along with other tools that tax the wealth of the upper echelons of households.

Financial assets are far more unequally distributed than nonfinancial assets. In the fourth quarter of 2018, the top 10 percent owned 42.4 percent of nonfinancial assets but 72.2 percent of financial assets. The bottom 50 percent of the population owned 15.8 percent of nonfinancial assets (including 13.8 percent of all real estate and 25.3 percent of consumer durables) and only 2.1 percent of financial assets. The starkly unequal distribution of corporate equity and mutual funds—50.9 percent, 35.9 percent, 12.4 percent, and 0.8 percent by wealth quartiles (top 1 percent, next 9 percent, next 40 percent, and bottom 50 percent, respectively)—shows that addressing this asset category specifically, without requiring households to take on new liabilities, is part of closing the overall wealth gap. Because the nonwealthy cannot access privately held corporate equity, and because most equity of publicly traded companies must be purchased by the nonwealthy out of their labor income, there is no mechanism to reduce inequality in such assets without public intervention.

The risk remains that such assets will not perform well or that their prices will fall. The proposal also contemplates issuing equity shares in the types of small businesses that have not historically been subject to capital market disclosures, and it is impossible to say what kinds of returns such investments may have. Business cycles and macroeconomic risk make the future performance of small and medium-size enterprises unpredictable; however, small businesses are not prone to the shareholder primacy approach to corporate governance that can drive speculation in stock prices at the expense of long-term business investment.[23] In addition, one purpose of the proposal is to provide small businesses with alternatives to high-interest loans from big banks and fintech lenders that often take the form of personal debt.[24] After describing the proposals in more detail, below, I will return to the risks of democratizing investment through investment in small businesses.

Policy Proposals

In this section I describe the two policy proposals that can facilitate democratic access to capital markets. The first is that the government should establish a "Public Investment Platform," organized in the public interest, that serves as a crowdfunding platform for small companies offering debt or equity securities and includes an index fund of publicly traded securities at little or no cost to the public. Access can serve as a "public option" for wealth creation. The platform would have two functions: to compete directly with private financial platforms and to connect individuals directly to lending or investment opportunities, both individual opportunities and the creation of new indexes. A public option would create true competition for the financial intermediaries that extract wealth. A public platform goes beyond the idea of a new public financial institution and aligns instead with the direction in which the financial sector is going: decentralized interactions among individuals and entities. A public investment platform will ensure that the old power dynamics do not follow us into the new financial structure. The second proposal is to create a "Public Investment Account," in which Americans[25] are provided a small sum of capital, weighted according to family wealth to address historical inequities, to use as a wealth-building fund.[26] These proposals are not mutually exclusive with proposals for nonprofit banks,[27] public or postal banking,[28] or other methods for engaging the public in the financial market.

Public Policy Has Historically Shaped Finance

Public policy is required to set the stage for truly democratic participation in finance. The government should recognize the financial sector—both banking and the capital markets—as constituting a "social infrastructure"' that requires public intervention to achieve goals of equity and positive social outcomes. The public utility model of governmental regulation, developed by twentieth-century Progressive Era thinkers and undergoing a revival today, is a useful model for understanding the government's role in finance. It posits that sectors of the economy exhibit characteristics of a social infrastructure when "a good [is] of such sufficient social value to be a necessity."[29] Balancing accountability and oversight with efficiency of production, the government should treat the sector to a higher level of regulation to counter the likelihood of a serious aggregation of private power. Essential public goods should not be understood according to the mainstream theory of their nonexcludable and nonrival nature. Rather, a public good should be understood to the degree that users may be vulnerable to exploitation when the good is both highly utilized and necessary downstream, throughout the rest of the economy. Put another way, there are goods and services to which only some members of the public have access, but basic social inequality and disparity are not thereby magnified. There are other public goods to which access must be broadly shared or there will be strong negative social outcomes. The latter types of goods should receive special governmental intervention. A public option is simply the state's stepping in to provide the good or service directly in order to widen access to it while promoting a higher degree of competition in a marketplace.

Is the financial sector—and in particular, investment activity as distinct from banking—a public utility? Finance is "a critical service upon which the entire economy depends."[30] The results of private control can be seen in the inequitable access to wealth described above. Depository institutions, money creation, and credit creation are rightfully understood as public utilities. I argue here that investment markets should also be considered a public utility, and subject to government interventions, described below, to ensure that this form of social infrastructure benefits the public. The issuance of stock, bonds, and other financial instruments is critical to the development of downstream business. The ability to invest in, and benefit from, such assets is magnifying wealth inequality today, and the wealth requirements for accessing private investment opportunities in the first place only replicate the problems. Hockett demonstrates why finance is best understood as a public function. Block agrees: "Credit creation is ultimately dependent on the power and resources of governments."[31] That power has been deployed to support the profitability of financial institutions.

Durable wealth creation in the hands of individuals, made possible by the distributed technologies of the twenty-first century, has the potential to reduce the power of the financial sector structurally. Crucial to the creation of a more democratic financial system is recognizing the structural inequities in our current distribution of wealth and designing solutions into the new financial system. Wealth creates a financial safety net and opportunity through intergenerational transfers of wealth that fund further asset accumulation. Investment funds also allow new businesses to grow and thrive. Wealth is important across the life cycle, to fund education, down payments on a home, and a secure retirement. The government can rebalance opportunities to wealth by directly provisioning capital, based on family net worth, and by creating a public intermediary that truly democratizes access to investment opportunity.

Government plays a central role in the economy: facilitating public and social goods, creating the rules, and allocating credit to finance productive economic activity. The state has often created a public option in a particular financial market. Such public policy has contributed to wealth creation and also to the unequal distribution of wealth. For example, the Corporation for Enterprise Development found that more than half of public funds meant to subsidize asset building go to the wealthiest 5 percent of taxpaying households. The bottom 20 percent of taxpayers receive almost no funds, because the policies are intended to promote asset building that requires some initial set of assets: homeownership, retirement savings, and access to higher education.[32] On the other hand, the government creates access to wealth through intervention in the credit markets by offering incentives and guarantees. There is no similar program to intervene directly in access to the capital markets, that is, not for some other asset-appreciation purpose.

Public options in finance are well grounded in our history, as the government has created new products and procedures when pursuing a social goal. Housing finance is a useful example. Before the Great Depression, housing finance was a private activity, with high risks and barriers to obtaining any kind of mortgage. Once the government engaged directly in the mortgage market as a participant, the presence of the new government-sponsored entities set new terms for the "American mortgage," with its fixed rate and full amortization.[33] The government does not directly provide mortgages but rather an upstream public option that takes advantage of the public ability to assume risk. Similarly, the government can create a platform for investment that does not directly replace the national securities exchanges but instead increases competition for household investment funds and both regulates and encourages small businesses' securities offerings.

The Public Investment Platform

Fintech allows the direct connection of individual issuers of equity securities and investors (or in theory of any two counterparties in a financial transaction). The proposal for a Public Investment Platform is to introduce a *public* intermediary that can compete with the intermediaries of the twenty-first century and provide a public option for the investment participation of those currently locked out of the capital markets—both households and small businesses. It would introduce more competition into the financial space and reduce the concentrated power of investment firms. Private crowdfunding platforms have been touted as democratizing entities, but they are, at the scale of their development today, unlikely to reach the size necessary to provide a counterweight. A truly public platform, using the government's unique ability to absorb risk and conduct economic transactions at economies of scale, should be established.

Public platforms would realize the vision of peer-to-peer platforms by creating the capacity and rules for true engagement on both sides of a transaction without a speculative intermediating entity. Some issuers and investors may still pay a transaction fee, to limit unproductive engagement and compensate the government for the required due diligence. But the incentives will be completely different if the government is at the center of the platform, rather than a private actor. The establishment of the platform and the index fund (discussed below) would perform a powerful regulatory function by setting a floor for the rate of return that the private sector would match.[34] Just as the US government created the American mortgage, the Public Investment Platform will create the new standard for index funds that the private asset management industry will emulate, lowering costs and setting a higher bar for clarity of the fee structure and the rate of return.[35]

An important feature of the platforms would be screening: they should establish appropriate levels of disclosure and reporting requirements, answering the need for confidence in due diligence while not placing impossibly high barriers to entry on small businesses.[36] The goal of public platforms is not to replace private exchanges or mutual funds that aggregate wealth but to serve as a public option for small investors who currently can invest only in the large public companies. Crowdfunding, in theory, gives small local businesses a way to connect with small local investors, but to date the platforms have focused on start-ups and are too dispersed for a household investor to find or use as their main source of building wealth. A public crowdfunding portal[37] should relieve small investors of worries about the platform's accuracy or the fees that it charges.

Households would be able to participate on the platform using their Public Investment Account (discussed below), up to a certain percentage of their net wealth. The platform could offer several types of securities. The first would be an index fund of all publicly traded securities. Households would thus have the option to participate in the public capital markets without paying steep fees to mutual funds or other fund aggregators. Since companies whose securities trade on the national stock exchanges are already subject to extensive disclosure requirements under the Securities Act of 1933 and the Securities Exchange Act of 1934, additional screening by the platform is not necessary. The Platform Index Fund would not engage in active trading strategies but would be limited to holding a balanced portfolio of all equities publicly traded on US national exchanges. The function of the fund is to create more competition in the market for index funds and to allow the half of American households who currently hold no stock to enter the securities markets. Economies of scale and the fact that no active trading strategy is required should keep costs for the Platform Index Fund extremely low, as management is largely administrative.

The second type of security offered would be those of small issuers—companies without the resources or need to conduct public offerings, that might turn to a crowd-funding platform. The platform should offer small-business workshops and training, similar to the Small Business Administration's, to introduce small businesses to the benefits and costs of securities offerings. At the same time, the platform would regulate securities issuance by small companies, conducting due diligence to ensure that bad actors and companies inappropriate for offerings are kept out of the system. Not all small companies should offer securities, and not all those who want to conduct offerings are appropriate risks for household investors. The role of the platform staff would be to increase demand through awareness and training and at the same time limit supply by conducting due diligence before companies are allowed onto the platform.

The third type of security will be in a new Small Issuer Index Fund. The Public Investment Platform should create a diversified mechanism for small investors to purchase equity from any small businesses accredited to sell equity on the platform. Investors should be able to purchase equity directly for an individual business if they choose to invest in their local community or in a particular sector (as described above), but those will necessarily be risky investments: any single business has a higher risk of low performance than a diversified bundle of equity. An index fund for all small businesses on the platform lets investors focus their capital on small and medium enterprises while remaining diversified. The platform needs to devote resources toward the creation of the index fund, but given that there is already a screening process in place for small issuers to offer equity on the platform, the standard for inclusion in the index fund is straightforward. It is crucial for both index funds to be established to create the option for Public Investment Account funds to flow to small businesses without placing undue risk on those who choose not to invest solely in publicly traded companies.

The Public Investment Platform should be open to all households, which should be able to use a small portion of their wealth to invest.[38] But it will not on its own enable access to households that do not have any wealth to invest. To democratize access to private wealth appreciation, the platform must be paired with a Public Investment Account.

The Public Investment Account

The government should provide every American with a local investment account, to be used on the Public Investment Platform when he or she reaches the age of eighteen. The starting sum should depend on family net wealth; it should be very small for individuals with significant family wealth and increase exponentially moving down the wealth ladder. This proposal is inspired by Darrick Hamilton and William Darity's proposal for "Baby Bonds" to address the racial wealth gap.[39] Most wealth is transferred through intergenerational and interfamily transfers, and since African Americans have been kept from wealth accumulation by de jure and de facto racist economic conditions, race-blind "universal" wealth-creation policies simply replicate historical conditions. Policies that simply "incentivize" savings are based on incorrect assumptions. African Americans do save at the same level as white Americans, once income is taken into account.[40] Targeted universalist policies—like Baby Bonds that are allocated at birth, can be used at age eighteen for asset building, and vary in amount according to family net wealth—take steps to close the racial wealth gap. This article will follow their mandate and propose a policy of targeted universalistic Public Investment Accounts intended to address the racial wealth gap in the same manner.

First, a disclaimer. It is critical that such investment accounts not replace public funds that are allocated for societal needs. In other words, the aim here is definitively not to privatize Social Security. Nor is the aim to displace the Baby Bonds account, which is a sum of money to be used for other asset-building activities. This additional set of funds should be made available to adults on the basis of family net worth. The Public Investment Account builds on the Baby Bonds proposal but differs in two important ways. Like the Baby Bonds, the sum of capital granted to an individual should be based on his or her access to family wealth, to address the denial of economic justice to people of color over generations, starting with chattel slavery, and to redress the stratospheric gains in wealth by a small minority of the population in recent decades.

The Public Investment Account should be available for use only on the Public Investment Platform. There should be no way to withdraw the starting grant until the age of retirement.[41] However, yearly dividends would be paid, increasing the wealth earnings of low-income families, which would be able to use the earnings freely. Individuals can choose whether simply to invest in the Index Fund, receiving yearly dividends and asset appreciation over time, or to invest in the small businesses conducting offerings on the platforms, or to mix the two. Individuals will need basic financial and investment education to make effective decisions. But the importance of the initial grant is recognized in the fact that the key to building wealth is not motivating savings, which is the basis for proposals like KidSave.

A critical consideration is the level and method of initial funding for each account. There have been numerous proposals for public grants of money to households, with a wide range of dollar figures. Determining the right starting sum for different tranches of households by wealth would be one of the first major operational design issues. There are multiple ways to fund such a proposal that would in themselves be useful for the productive economy. One mechanism is more equitable taxation of labor and capital and financial taxation.[42] Adequate capital and financial taxation could raise hundreds of billions of dollars annually. Another approach draws from modern monetary theory, which claims that sources of funding should not be a limit for social needs. Developing a funding mechanism should be the subject of future research.

Limits of the Public Investment Platform and Public Investment Account

Both the Public Investment Platform and Public Investment Account raise important challenges, as well as a range of implementation questions that are part of the rule-making process of any significant policy reform. Here, I focus on the top-level challenges, leaving the multiple implementation questions for further discussion, although there is no fine line between the two. The first challenge is that the focus is on investment in small businesses through a platform, when small business is a relatively untried form of equity investment. The policy mitigates the unknowns by also offering a publicly run index fund, comprising traditional corporate equities (which index and how it should be constructed are details that should be dealt with in a rule-making process). Since one of the goals of the policy is to increase small-business access to investment funds, the risk of closure or lackluster returns is unavoidable. One of the constant risks of investment is that the business fails and the equity becomes worthless. A related risk is reliance on the crowdfunding platforms themselves to ensure that the businesses offering equity have a reasonable chance of being successful: in other words, that it is not only failing businesses that make use of the platform.

Important criticisms of the Public Investment Accounts include that the funds might be better spent and that placing limits on withdrawal from the accounts undermines the autonomy of nonwealthy households to make their own decisions about their wealth assets. Further, technical assistance or access to computer technology would be required to ensure that all households have the tools necessary to use their accounts. Another concern is whether thresholds should be constructed such that additional resources are granted to families that have lower net worth. But how many tiers to set up and how exactly to structure those thresholds remain crucial considerations.

Conclusions

If the public creates the ability of private financial entities to earn profits, the public can create new mechanisms to allow all citizens to partake in such profits.[43] America has a vigorous market for debt and equity securities, but highly unequal access contributes to generational racial and class stratification. The Public Investment Platform, by creating a public option for people's participation in financial markets, rebalances the power of large financial institutions to capture the gains from investment and lending activity. The creation of a Public Investment Account structurally rebalances wealth access distorted by historic wrongs. As we reduce our collective dependence on Wall Street institutions over time, the political process's increasing independence from the financial system's power will create the potential for other deep reforms in our political economy.

The proposals here are not meant to develop all operational considerations exhaustively but to motivate consideration of structural reforms that would break the cycle of intergenerational wealth transfer and its attendant political consequences. The financial system of the mid-twenty-first and twenty-second centuries will evolve to a more disintermediated network. But unless action is taken, the power dynamics within the new framework will follow the power dynamics in today's financial system. The true democratization of finance requires public intervention.

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Notes

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3. Erik Olin Wright, "Introduction to the Real Utopias Project on Democratizing Finance," in Fred Block and Robert Hockett, "Democratizing Finance," introductory essays for the Real Utopias Project conference on democratizing finance, 2017 (unpublished conference document), 1.
4. Since some households own stock directly and indirectly, the two proportions add up to more than 50 percent. Wolff, "Household Wealth Trends."
5. Ibid.
6. Federal Reserve, "Distributional Financial Accounts" (updated June 19, 2019), https://www.federalreserve.gov/releases/efa/efa-distributional-financial-accounts.htm.

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8. "Accredited" means that either their net worth exceeds $1 million or their income exceeds $200,000, with an expectation that such income will continue.
9. The definition of "accredited investor" has evolved over the decades. The Supreme Court decision in *Securities and Exchange Commission v. Ralston Purina*, 346 US 119 (1953), described private offerings as limited to those who had "no practical need for [the bill's] application." A private offering was defined as "an offering to those who are shown to be able to fend for themselves." Since this broad standard proved unworkable as private offerings expanded, the SEC in 1974 enacted Rule 146 (the "private offering exemption" from registration) under the Securities Act, Section 4 (2), to create an objective standard for private offering investors. The issuer had to believe that the offeree was "sophisticated," as determined by wealth or knowledge. The issuer also had to have a reasonable belief that the purchaser had assessed the offer and could bear the financial risk of the offer, and the offeree had to receive adequate disclosure about the company.
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16. Another available exemption improved under the JOBS Act is under Regulation A, which permits companies to raise no more than $5 million in a twelve-month period but has no wealth litmus test on the type of investors allowed in. The third exemption is under Regulation D, which establishes two separate rules, Rules 504 and 506. Under Rule 504, issuers can offer securities to an unlimited number of accredited investors and a small number of unaccredited investors. Although these new offerings create opportunities for new companies to invest, they do not change the structural dynamics of access to investment for the nonwealthy.
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24. Lenore Palladino, "Small Business Fintech: The Need for Comprehensive Regulation," *Fordham Journal of Corporate & Financial Law* 24, no. 1 (2018).
25. I use the term "Americans" rather than "citizens" deliberately; some mechanism should allow undocumented Americans who have worked in the country for some period access to the system.
26. This fund should in no way supplant adequate funding for retirement or Social Security.
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33. Adam Levitin and Susan M. Wachter, "The Public Option in Housing Finance," Georgetown Law and Economics Research Paper no. 1966550 (2013).
34. Rahman, "New Utilities."
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36. Platforms can look to the SBA loan program's due diligence or the due diligence required by CDFIs, e.g., as a starting point to evaluating the risks posed by any given small business.
37. The experience of, e.g., the rollout of the Affordable Care Act website shows that it is not obvious that government can actually build an effective platform, but the operational constraints should be considered separately from the theoretical constraints.
38. How much wealth a household should be able to risk would be a critical design question in the establishment of the platform.
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41. One design question is whether individuals should receive whatever sum their account holds at retirement or whether that sum should be adjusted to a longer-term average, so as not to advantage account holders unfairly who happen to retire when the stock market is high or disadvantage those who retire when the stock market is low.
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