BUILD A MODERN RECONSTRUCTION FINANCE CORPORATION

From increasing production of essential medical equipment and manufacturing vaccines to reviving industries devastated by the coronavirus, overcoming and recovering from the pandemic will require substantial efforts to restore and expand industrial capacity. Addressing the threat of climate change will require even more significant industrial shifts. To get there, we need a renewed public role for financing solutions to problems the market can't resolve on its own. We need a modern Reconstruction Finance Corporation.

The Reconstruction Finance Corporation (RFC) was a government institution that lent and invested tens of billions of dollars throughout the economy during the New Deal era—even creating whole industries from scratch (Bossie and Mason 2020).[2] The RFC invested in banks, public work projects, farms, the fishing industry, and many other sectors. It used loans as a primary tool but also purchased preferred stock in banks, giving it an ownership stake and voting rights in the companies. In some cases, the RFC used those voting rights, voluntary agreements with industries, and eligibility requirements for loans to shift business practices away from corporate extraction.

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The RFC solved two New Deal—era problems that plague our economy again today. First, it gave a single government entity the authority to engage in industrial policy, taking steps to shape the relative composition of and linkages between industries in the US economy. The RFC didn't just invest in companies; it solved complex industrial problems by understanding their interconnections. For example, at the outset of the Great Depression, farm households were in deep trouble. The major culprit was a disconnect between high costs of operation and low prices for their product on the market. To address costs, the RFC gave loans to promote rural electrification and the purchase of cost-saving appliances. To address low prices, the RFC offered marketing loans to farmers to keep their crops off the market and shift them into stockpiles.

Farmers relied on railroads for transportation of crops, but the railroads were insolvent due to mismanagement, underinvestment, and depressed demand in cities. In response, the RFC plowed money into the sector, with requirements that improved the railroad business overall. Further, the RFC made investments that boosted the economic health of urban areas, simultaneously improving residents' lives and increasing consumption in ways that benefited farmers. By replenishing the connective tissue between rural and urban economies, the administration was able to promote recovery.

Second, the RFC provided an alternative to private capital—a "public option" for capital, so to speak—offering an alternative that can meaningfully change the shape of industry today. Where private capital favors short-term returns and is relatively indifferent to broader social or economic utility of investments (Hockett and Omarova 2018), public capital can be used to invest in projects with

[2] The RFC set up many subsidiary corporations. Some survive today, such as the Export-Import Bank and the Commodity Credit Corporation. For simplicity, when we refer to "RFC" here, we refer to both the parent corporation and its offshoots.

longer-term or uncertain profitability outlooks, and it can focus on directing industry to meet larger public goals. Where private capital steers companies toward practices that benefit investors, like share buybacks in publicly traded companies or leveraged buyouts in private equity, taking public stakes in companies can steer them toward practices that strengthen productivity, minimize extraction, and support workers. In the 1930s, when banks needed government support but were skittish about lending, the RFC conditioned bank relief, pushing bankers toward lending that would rebuild the economy, while also engaging in lending directly to businesses.

A Modern Reconstruction Finance Corporation: Policy Basics

A new Reconstruction Finance Corporation would be constituted as a government corporation with the authority to make loans directly to businesses, buy and sell bonds, and purchase stakes in companies in order to steer them toward the country's industrial goals. Though a modern RFC's charter should be flexible, it should have a clear mission and a delineated scope, along with strong oversight. Unlike the original RFC (which operated at a time when private capital markets were largely wiped out by the Great Depression), the new RFC would emerge at a time of deep capital markets and significant global demand for safe US dollar-denominated assets. While the RFC 1.0 was *authorized* to raise money from bond sales, in practice, it was unable to do so in significant measure. The RFC 2.0 could finance itself primarily through bond sales and with money raised from institutional investors. This would allow it to operate "off budget," lessening its vulnerability to austerity measures that often arise in reaction to economic downturns and delay urgent investment.

As in the New Deal era, we need an agency that can help drive our economy's recovery, build economic strength, address looming societal and economic challenges, and improve our resilience to future economic shocks. A public mobilization of private capital would provide the government with a powerful tool for both rebuilding and reshaping American industries. The COVID-19 pandemic's effects were intensified by the country's inability to quickly shift industrial capacity to respond to urgent public needs; months after COVID-19 hit the US, shortages of PPE still plague us (Allen and Farivar 2020).

And the pandemic has hurt American industries in a variety of ways, from slowing or halting production in factories that present threats of transmission, like meatpacking and auto manufacturing, to decreasing demand for travel-related businesses and nonessential consumer goods and services. These changes in turn have knock-on effects on upstream and downstream industries—for example, losses for farmers and ranchers and plummeting oil demand.

But deep vulnerabilities predating COVID-19 have made our country far less prepared to weather crises like the current one. First, some industries, like medical face masks (Noguchi 2020) or active pharmaceutical ingredients (Lupkin 2020), are all but absent from our shores altogether, leaving the US at the mercy of shifts in the global supply chain. Second, American businesses have made decisions that promote their short-term interests over long-term health, like running up huge corporate debts that make companies susceptible to takeover by foreign and domestic actors (Vandevelde 2020).

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So far, Congress has focused on solutions that shore up big businesses while leaving these vulnerabilities intact, or even exacerbating them. The CARES Act funded Federal Reserve (the Fed) lending facilities to offer liquidity to financial institutions and support lending, as well as furnishing direct loans to businesses—including small and medium-sized businesses and municipalities. The Fed also committed to purchasing corporate debt, and the CARES Act included specific provisions bailing out airlines and supporting businesses critical to national security. These options ask little in return of the businesses that receive them: Though there are some minimal restrictions on stock buybacks, companies are generally free to partake in these programs while continuing their extractive corporate practices and without any requirement to invest in ways that strengthen the US economy.

Moreover, the Fed is reluctant to deal with nonbank entities (Warmbrodt and Guida 2020). More broadly, the choice to rely on the Fed means that our country's approach to investing in US businesses in a downturn is governed by the Fed's dual mandate—maximum employment and stable prices—rather than by a broader mandate to reshape the US economy or address looming challenges like pandemics, supply chain disruptions, or the climate crisis.

In the coming months, it seems more than likely that we will hear policymakers call for increased investment in American businesses. Investment is vital, but to meaningfully advance our economy, we must also ensure that these businesses meet public goals—in everything from the products they make to their treatment of workers. Through a modern version of the Reconstruction Finance Corporation, we can invest in American businesses, stabilize and grow the economy, and direct investment in ways that minimize extraction, and help our country meet pressing social and economic challenges.

One of the biggest opportunities for an RFC is addressing the climate crisis. Through an RFC, government can create industries at home where little to none existed and ensure impacts on one industry don't lead to undesired impacts. Both of these strengths would help with the transition to decarbonization. A new RFC could also create new state-owned corporations to directly engage in green production. Achieving an economy-wide climate transition will require a speedy, large-scale mobilization, and an RFC could provide the funding for projects that reduce carbon emissions while also providing capital to shape industries that are affected by climate change, or those that need to shift to accelerate the transition to decarbonization. The public accountability baked into an RFC could help ensure that these investments are made in ways that adhere to the goals of the Green New Deal, reducing corporate power, furthering racial justice, and decreasing wealth inequality.