Intermezzo

‘Economic Crisis and Critique: Undoing Financialisation’

Financialization: Taking Stock and Moving Forward

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Introduction

Financialization occupies centre-stage in contemporary discussions on political economy. It usually figures as part of the debate about the crisis of capitalism, notably in the wake of the 2008 financial meltdown. The literature on political economy presents changes in modern finance as a key facet of the transformation of capitalism in the developed capitalist economies. Coming up with a single definition of the term is difficult, but Geoffrey Ingham’s description conveys the general sense: financialization, he says, has to do with ‘the increasing dominance of financial practices and the fusion of business enterprise with “financial engineering”’ (Ingham 2008: 169).

This definition is by no means theoretically unbiased. ‘Financial practices’ are viewed as both *exogenous* and *antagonistic* to ‘business enterprise’ and as capable of contaminating, or indeed dominating, all other economic (and social) activities. This perspective has served as an analytical point of departure for a series of research projects highlighting features such as: changes in the nature of capitalist growth, shifts in firms’ investment decision-making and governance-models (i.e. to be geared to the maximization of shareholder value), and the boosting of financial profits through a range of income-expropriation mechanisms. Although analyses of the symptoms of financialization are many and varied, when it comes to identifying its roots (why the sudden rise in finance?), the focus is generally on one of two aspects: trends in capitalist profitability and/or

the dominant position of economic elites in the context of absentee ownership.

One problem with these interpretations is that they see modern finance, and related technological developments, as passive and adjustable. Finance is thus *ahistorical*, in the sense that its own history as a social domain is viewed as merely a reflection of external developments. And it is usually seen as a distortion of capitalism only because it passively fills the gaps resulting from external contradictions or organizational inadequacies.

This brief account seeks to challenge this perspective and offer an alternative approach to understanding financialization.

Underconsumptionist analytical narratives: Modern finance as a passive and adjustable factor

In the study of political economy, the majority of approaches to the social aspects of modern finance and its ramifications slot into one of two explanatory categories. In this section, a brief description will be given of these categories and of their shared analytical basis – namely, the perception of finance as a passive domain which is shaped and driven by causes external to itself.

The rise of finance as a response to trends in the profit rate

The first type of explanation views developments in finance as a by-product of trends in the profit rate. The latter is usually related to capitalism's inability to absorb final economic product. On this view, the rise of finance is an unstable (and therefore temporary) solution to capitalism's long-term problem of underconsumption. This explanation comes in two versions.

The first interprets financialization as a product of high capitalist profitability: if wages are relatively low compared with profits, and profits are mostly saved, the potential productive output cannot be absorbed unless there is an increase in final consumption. Capitalists are faced with a dearth of investment-outlets, resulting in a build-up of excess capital. From this perspective, finance appears as an unstable remedy to lack of demand, and one which, at the same time, favours capitalists as over-savers. Surplus capital can either be recycled to workers and other subordinate social classes in the form of debt or it can devolve into speculative activities. This is clearly an advantageous situation for the capitalist class as a whole, because it resolves the problem of surplus capital without jeopardizing capitalists' income-position. The only drawback is that financial recycling cannot be viewed as a permanent solution. This analysis appears in various forms in the accounts offered by, among others, Husson (2012), Resnick and Wolff (2010), and Mohun (2012).

The second version of the profit-rate explanation cites the same problem of underconsumption but proposes low profitability as its cause: output cannot be absorbed, and profits cannot be realized, because low wages (rather than, as above, high profits) keep demand low. Poor profitability results in stagnant and excess capital because capital can only be channelled into production at a declining rate. In the absence of other solutions that might boost demand, financial recycling can become a crucial form of intermediation, decongesting the build-up of surplus capital. The argument here is essentially the same as in the previous scenario: finance bubbles and credit bubbles offer capital the easiest means of tackling declining output-expansion and profitability without incurring major costs. On this view, financialization is the unstable result of underconsumption based on poor capital profitability. Some authors, whilst remaining true to the overall spirit of this argument, link low profitability not only to low wage incomes (demand) but also to high values of constant capital already invested (overcapacity). Demand thus always lags behind productive capacity. This is merely another facet of the same idea. Even as profit falls, there will continue to be investment; this will add to the overall 'amount' of capital and the productive capacity thereof, which will exceed demand. This line of argument emphasizes over-investment of capital relative to realized profitability. It identifies an additional channel via which downward pressure is exerted on the profit rate: the numerator (decrease in realized profit) is not the only thing that counts; so does the denominator (the increase in the amount of constant capital and the creation of overcapacity relative to poor demand). Many of the current approaches to financialization can be viewed as falling within the theoretical tradition outlined here, in which long-term crises in profitability are followed by a 'growing reliance on credit bubbles to sustain economic expansion' (Callinicos 2010: 50). Summarizing with Foster and Magdoff (2009: 18): 'financialization is merely a way of compensating for the underlying disease affecting capital accumulation itself.'[1]

[1] See also Brenner (2002), Harvey (2010), McNally (2009), Lazzarato (2012).

The rise of absentee ownership

Another long-standing theoretical tradition associates the rise of finance with the predominance of a particular economic elite. Keynes described this elite as a class of *rentiers or* 'functionless investors'. To him, these individuals were akin to Ricardo's landowners, enjoying incomes founded on scarcity without making any real productive contribution. The term used by Veblen to characterize this same group was *absentee*

owners – the class that had managed to subordinate the regime of 'traffic in goods' to that of 'trading of capital' (Veblen 1958: 75). Taking the same analytical line, Minsky introduced the term *money manager capitalism* to describe a version of capitalism that is 'dominated by highly leveraged funds seeking maximum returns in an environment that systematically under-prices risk' (Wray 2013: 245). There is a fast-growing body of literature concerned to provide a systematic analysis of the current financialization of capitalism in terms of the hegemony of this rentier group. Seen from this perspective, modern financial developments are not necessarily linked to trends in profitability; rather, they are a consequence of social conflicts being resolved in ways that favour absentee owners.

This is an idea that is by no means foreign to the Marxist tradition. At the start of the twentieth century – even before Keynes and Veblen had made their arguments – Hilferding maintained that a form of capitalism was possible in which the industrial sector was subordinate to the financial sector:

> The power of the banks increases and they become founders and eventually rulers of industry, whose profits they seize for themselves as finance capital, just as formerly the old usurer seized, in the form of 'interest', the produce of the peasants and the ground rent of the lord of the manor.[2]

[2] Hilferding 1981: 226.

Although there is not the space here to give a proper account of Hilferding's point of view (which was greatly influenced by the historical conditions prevailing in Germany at that time), it is fair to say that his ideas have inspired a number of recent approaches. Fine, for instance, views neoliberalism as a capitalist regime that lays stress on 'financial-speculative activities as opposed to industrial investment as an increasingly important source of profit' (Fine 2010: 113). One form of capital (interest-bearing) predominates over all others (industrial etc.). In a similar spirit, Lapavitsas (2009) sees the financial expropriation of workers by capitalists and banks as an additional source of profit that has emerged in the sphere of circulation as a result of the poor level of real accumulation since the late 1970s.

The common ground: Was Harry Markowitz a prophet?

Changes in profit-rate trends may indeed affect developments in finance, but this process cannot be unidirectional or straightforward. Nor does it, of itself, explain the critical historical transformations that have taken place in finance. At the same time, the rise of financial engineering cannot be linked solely to a particular class, or segment of a class, far removed from 'real' capitalist production. What unites the different approaches described above is their view of the nature of finance as a passive element ever amenable to adjustment by extraneous forces.

Finance in its contemporary version encompasses much more than accumulated liabilities and increased indebtedness. It presupposes substantial levels of analytical research and financial innovation and it is shaped by major institutional developments, economic strategies, and state regulations within distinct capitalist societies; all these have their own unique histories, institutional paces, and temporalities. The range of unique historical patterns of finance that have emerged in different societies cannot be reduced either to a mere reflection of a general historical trend in the profit rate or to the dominance of rentiers among other economic groups or classes. Approaches that regard finance as so 'flexible' that it is able, neatly and instantaneously, to fill the gaps created by underconsumption and/or the rise of absentee ownership actually fail to grasp the true nature of finance in capitalism.

If finance can be reduced to (and is contemporaneous with) either the trends in the profit rate or the dominance of rentiers, absentee owners, and/or money managers in social conflicts, then Harry Markowitz (the father of modern portfolio-theory) and other important figures in the development of modern financial theory must be recognized as true prophets. They would, after all, have managed systematically to convey a message concerning the nature of financial markets years, or even decades, before there was any practical need for such an analysis. Developments such as subprime lending, asset-backed securities (ABS) (including collateralized debt obligations (CDOs) of various types and other forms of securitization), global capital-flows in the context of diversified portfolios, contemporary banking intermediation according to the 'originate and distribute' model, option pricing methods, and private insurance markets would be unthinkable without the theoretical and institutional groundwork done in the 1950s – that is, in the glorious era of 'welfare capitalism', long before the demise of the Bretton Woods regime.

Whatever the approach to financialization, it cannot ignore the fact that the theoretical and empirical foundations of practices that were to emerge fully in the 1980s were actually laid down, little by little, decades before. If modern finance is merely the byproduct of profit-rate trends and/or of the resolution of social conflict to the advantage of absentee owners, then we have indeed to believe that Harry Markowitz was able to address problems that would only arise in a distant future.

The point of this paper has been to suggest that the roots of financialization should be radically reconsidered. This is not to say that serious existing research on the symptoms of

financialization should be discarded, or that the study of trends in profit rates or of the conflicts between social groups is not important. My point, rather, is that the two most widely accepted approaches to financialization are unable to explain its rise because finance is already endogenous to (that is, it influences and is influenced by) economic trends in profitability and related class struggles.

New directions in the study of finance

Critical discussion needs to focus on the specificity of finance in the organization of contemporary capitalist societies. Such an analytical enterprise calls for a reorientation in the way political economy has been used to address questions concerning finance.

My own suggestion in this regard derives from Marx's argumentation in *Capital*.[3] I propose a synthesis of two critical concepts in social theory: *fetishism* and *governmentality*. The first plays an important role in Marx's thinking (and is richly developed in Althusser – see, for example Althusser 2014). The second is an analytical loan from Foucault – though it should be noted that my interpretation of Foucault it is quite different from the one which Deleuze proposes (2012) and which has significantly influenced subsequent discussions.

[3] For a detailed version of the argument, see Sotiropoulos et al. (2013).

Every form of debt, capital essentially appears as asset/liability, suggests a reification process. What is important is not the confrontation between the creditor and the debtor but the very fact that liabilities themselves bear a price. Calculation of the latter may be erratic and incomplete but always relies upon a particular representation of the capitalist economy on the basis of risk. Risk is not neutral and it does not simply transmit an informational content. Risk conveys an interpretation, which is in line with what Althusser called *ideological mispresentation*: it is combined with the norm of behaviour it calls forth.

However, the idea of ideological mispresentation cannot offer a complete explanation, because finance encompasses different social power-relations. So risk misrepresents capitalist reality in a way that is *detached from* and *commensurate across* different social relations. This type of articulation suggests a Foucauldian condition of governmentality: a regulation superimposed upon social power-relations with a view to organizing their workings and reproduction. Modern financial derivatives are of critical importance in allowing finance to exist as a governmental technology of power.

This type of reasoning invites a different analytical agenda. The rise of finance is not a threat to capital, nor does it indicate a weakness in the latter (its inability to secure proper accumulation patterns). Finance sets forth a particular technology of power (along with a particular mode of funding economic activities), which is completely in line with the nature of capitalist exploitation. Financial derivatives are integral parts of this process to the extent that they unify into a single interpretation partial economic activities and ideological representations of reality. However, while finance is not extraneous to capitalist power, it does not coincide with it either. In other words, finance does not soak up capitalist relations and is not contemporaneous with their dynamics. The social geography of the latter does not fully overlap with the configuration of modern finance (despite its extending pattern).[4]

[4] But more importantly, the social whole is a structured and complex totality which cannot rely solely on this function of finance for its reproduction. For instance the central role of the capitalist state and the ideologies attached to it play a crucial role in the organization of the class domination of capital.

The above analysis places financial innovation in a different context. The latter is not a passive reflection of underconsumption, as usually argued. What really matters in contemporary finance is not so much the level of indebtedness but the multiplicity of relations that support it, in other words the social content of financial innovation. Thus the key analytical task when it comes to finance is that of explaining the complex linkage between financial innovation and the workings of capitalist social relations.

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