Financialization, Class Interests, and Karl Polanyi's Protective Response

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Abstract: Many observers expected a stronger countermovement against neoliberalism following the Great Recession. This paper argues that such a protective response failed to materialize because the financialization process has aligned the preferences of labor and *rentier* classes. The result has been weaker support in democracies for expansionary monetary and fiscal policies during the early stages of recessions, which further lowers aggregate spending by increasing uncertainty. Thus, reversing the culture of financialization may be a necessary condition for preventing and responding to financial crises.

Keywords: Karl Polanyi, double movement, financialization, financial crises, macroeconomic policy

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A revived interest in Karl Polanyi's notion of the double movement emerged after the Great Recession began in December 2007. Polanyi ([1944] 2001, 140) describes this process as a persistent tension in democratic societies between groups attempting to establish self-regulating markets and others rebelling against the social dislocations resulting from them. Since capitalists require reliable supplies of land, labor, and money to produce efficiently, they commodify these resources. Fred Block (2008, 3) describes how this is accomplished: "Since the market acting alone cannot produce these things in correct and sustainable quantities, the state *must* manage the supply and demand for these critical inputs to the production process." However, people whose livelihoods are threatened by free markets may also seek relief through government intervention. According to Block, the phase of the double movement that dominates depends upon the relative opportunity, power, and capacity of opposing groups to influence politicians. Because financial

firms have strengthened these capabilities through the process of financialization, efforts to control them have been ineffective.

What is financialization? Gerald Epstein (2001,3) defines it as the "increasing importance of financial markets, financial institutions, and financial elites in the operations of the economy and its governing institutions, both at the national and international levels." Moreover, Özgür Orhangazi (2008) and David Harvey (2003) consider it to be an important aspect of neoliberalism. Regarding the recent crisis, Rana Foroohar (2017, 60) writes: "Suffice it to say that all the elements of financialization were in play in 2008." However, despite the culpability of Wall Street and the perceived unfairness of its bailout, the public's response in the U.S. was relatively muted. As explained below, this reaction may reflect the development of a financialization ethos, in which the policy preferences of workers and *rentiers* are aligned.

This relationship differs from the conflictual one assumed in most macroeconomic theories incorporating class differences, in which laborers prefer policies that increase wages and employment, which often come at the expense of *rentiers* who favor high, risk-adjusted returns. If ideologues convince people that government budget deficits and expansionary monetary policy depresses asset values or limit access to credit, workers may be more likely to support austerity measures early in recessions, but later change their minds if the downturn continues. Because this preference ambiguity increases uncertainty about macroeconomic policy, changing financialized cultures in democratic societies may be required for effective economic stabilization. The paper concludes by considering prospects for this type of reform.

Financialization, Class Interests, and Macroeconomic Analysis

Most studies of class conflict assume that capitalists support neoliberalism and that labor attempts to constrain it. For example, economic historians Barry Eichengreen and Peter Temin (2000) recount that because maintaining currency parity was the primary policy objective during the classical gold standard, current account deficits could only be reversed by reducing costs, which were mainly wages. Moreover, because this system's operation required participating countries to balance public budgets, permit automatic adjustments of the money stock, and to encourage capital mobility, Apostolos Fasianos, Diego Guevara, and Christos Pierros (2018) classify the gold standard era as a financialization period. Drawing from Polanyi, Eichengreen (1996) notes that increased unionization and labor voting rights led to higher wages and improved workplace conditions in the late nineteenth century despite resistance from industrialists. Ultimately, these interfered with labor market flexibility, contributing to the collapse of self-regulating markets.

Similarly, Neoclassical, Marxian, and Post-Keynesian macroeconomic models that incorporate social conflict assume that workers and capitalists strive to attain their expected objectives. Mainstream economist Kristen Forbes (2013) describes a general equilibrium model that incorporates a real wage that must exceed a predetermined "social peace" level to avoid labor unrest. The key point is that dissatisfaction about pay leads to a backlash that disturbs macroeconomic equilibria. Post Keynesian models summarized by Eckhard Hein and Till van Treeck (2010), and related Marxian research, focus on how financialization affects the distribution of income between capital and labor. For example, Georgios Argitis and Stella Michopoulou (2011), construct a short run Keynesian/Kaleckian model in which income inequality lowers consumption spending. Because they assume the marginal propensity to save out of wage income is

zero, workers cannot accumulate wealth, which separates labor and *rentier* classes. Thus, although Argitis and Michopoulou show that an increase in *rentier* income lowers employment by reducing aggregate demand, they do not consider investment returns earned by workers that could offset spending declines.

Polanyi, however, describes a society in which members of all economic classes organize to restore social cohesion that has been disrupted by unfettered markets. He ([1944] 2001), 147) writes: "The legislative spearhead of the countermovement against a self-regulating market as it developed in the half century following 1860 turned out to be spontaneous, undirected by opinion, and actuated by a purely pragmatic spirit." Today, however, these efforts may be more deliberate since capitalists and workers may possess similar economic interests, which may develop during the economic liberalization phase of the double movement. Regarding businesspeople, Gareth Dale (2012) observes that they may support public spending that directly benefit working families because these programs provide them with a healthy and educated workforce. Relatedly, the next section explains how financialization links worker macroeconomic policy preferences with those of *rentiers*. The result is a protective response that is less visceral than Polanyi described, and one that is ".... not only uncertain in terms of its outcome, it is also uncertain in terms of its timing" (Bienefeld 2007, 14).

Financialization, the Double Movement, and Policy Uncertainty

In *The Great Transformation*, Polanyi emphasizes a conflict between the demand for legislation to shield people from the ravages of free markets and the deflationary policies to maintain currency values. Similar conditions have been experienced recently - especially in the Eurozone. For example, a European Commission (2018) poll in February 2015 revealed that 73.58

percent of Greek respondents preferred to remain in the European Union and to continue using the euro, while 24.23 percent were against. This was at a time when unemployment was an estimated 25 percent, and the results from a Metron Analysis survey revealed that 55 percent of the respondents wished to end austerity measures. This inconsistency in public sentiment helps explain why Syriza Party head Alexis Tsipras, who assumed power in January 2015, promised to adhere to EU rules governing public budget deficits and other restrictions, but to curtail deflationary policies. Americans also were divided during the depths of the crisis with poll results in 2010 revealing 51 percent favoring federal budget deficit reductions and 40% supporting additional fiscal stimulus measures (Galston, 2010). Joseph Stiglitz (2018) concludes that these and other countries were in a political "state of paralysis," which may explain the recent popularity of right-wing nationalist movements that promise prompt and decisive political action.

As noted earlier, financialization underlies these contradictory preferences held by the middle and lower classes. What determines labor support for austerity policies are two related factors: (1) the degree to which financialization is culturally embedded; and (2) relentless publicity and propaganda about the benefits of economic liberalism. Regarding the former, Polanyi describes what Barry Eichengreen and Peter Temin (2010) call the "gold standard mentalité." He writes ([1944] 2001), 25-26):

> Currency had become the pivot of national politics. Under a modern money economy nobody could fail to experience daily the shrinking or expanding of the financial yardstick; populations became currency-conscious; the effects of inflation on real income was discounted in advance by the masses; men and women everywhere appeared to regard stable money as the supreme need of human society. ...Belief in the gold standard was the faith of the age. ...Indeed, the essentiality of the gold standard to the functioning of the international economic system of the time was the one and only tenet common to men of all nations and classes, religious denominations, and social philosophies.

However, as Block and Margaret R. Somers (2014, 55) note, by the end of the nineteenth century, resistance to the gold standard emerged among all social classes in reaction to repeated cycles of economic instability, which eventually led to the adoption of activist monetary policies by central banks.

How does this mentalité develop? Eppo Maertens (2008) claims that Polanyi failed to address this issue because he believed that free markets and democracy were incompatible, and that the double movement was part of a unique historical episode rather than a general theory of human agency. Maertens develops the latter framework by linking individual behavior to the social and political forces that shape the formation of market cultures. Specifically, he describes a society in which community resistance to self-interested actions limits the extent to which people pursue personal gain. To obtain approval, individuals must convince others about the benefits of the "invisible hand" through messages that extol personal freedom. For example, Rojhat B. Avsar (2008) considers why "neoliberal autonomy" appeals to many Americans. Often associated with Friedrich Hayek and Milton Friedman, this philosophy requires individuals to accept the responsibility for meeting their needs through market transactions rather than public programs. During the 1970s and 1980s, businesspeople, politicians, lobbyists, and think tanks saturated the media with this neoliberal message, converting many to political conservatism (Blyth 2002). Avsar reminds us, however, that acceptance of this ideal was not universal, as in the case of former President George W. Bush's "Ownership Society" proposal, which sought to replace Social Security with private retirement accounts. If successful, this reform could have divided the support of working-class voters between finance-centered policies to conserve their wealth and public pensions guaranteeing retirement security. Voters rejected this vision; in fact, poll results during

the 2006 mid-term election suggest that it contributed to the loss of a Republican majority in Congress. Whether because of the dramatic institutional changes required, or political inertia, many preferred the status quo.

Less dramatic policy changes, however, accelerated financialization. Besides the allure of the neoliberal ideal, Greta R. Krippner (2011) cites deregulation beginning in the 1970s as a key factor, since it enabled the finance industry to replace the state as the principal conduit of loanable funds in the U.S. This transition helped develop what Neil Fligstein and Adam Goldstein (2015) call a financialization culture, which is a society that increasingly views lives in financial terms, and whose members manipulate financial assets to accomplish their goals. The result is what Dan Herman (2012) calls a "democratization of finance," in the U.S. in which members of all socioeconomic classes have an interest in the health of financial markets and institutions. Echoing Christopher Brown (2008), Fligstein and Goldstein show that because of increased economic inequality, lower class citizens borrow to meet basic needs, and as John P. Watkins (2017) concludes, ensuring this credit supply necessitated the rescue of the financial sector during the subprime mortgage crisis. Middle class families, on the other hand, borrow and invest to acquire "positional" goods like housing and education, while those at the top engage in financial transactions to preserve their privileged status. The result is increased borrowing and risk-taking by households, which combined with similar behaviors by financial and nonfinancial businesses, increase financial fragility and the likelihood of an economic crisis.

Also important is how this culture helps propagate economic downturns after the onset of a financial crisis through political influence on macroeconomic policy in democracies. In a financialized society, workers join *rentiers* to favor policies consistent with what Amartya Sen 1998)

terms “financial conservatism,” which stress monetary stability and balanced public budgets. However, Sen (1998, 733) quotes and then elaborates upon Ralph Waldo Emerson to describe how these preferences may change during recessions: “Men are conservative after dinner,” to which Sen adds, “It is much harder to pursue conservatism when the belly is empty.” These comments suggest that workers are more likely to support “sound money” policies in the early stages of an economic slump, but reject them once “hunger” sets in. This transition, however, increases uncertainty about macroeconomic policy, further depressing the economy. Empirical results by J. Peter Ferderer and David A. Zalewski (2009) show that the diminishing credibility of a country’s commitment to the gold exchange standard in the 1930s sparked capital flight, which elevated interest-rate uncertainty and reduced output. Similarly, Pavel Smietanka, Nicholas Bloom, and Paul Mizen (2018) conclude that uncertainty about economic recovery in the U.K. following the 2008 financial collapse lowered investment and increased cash holdings by British firms, reinforcing effects from the post-crisis austerity policies that restrained the economy.

These findings suggest that addressing the culture of financialization may be necessary for implementing stabilization policies during economic downturns. Hyman P. Minsky (1986) provides several “big government” strategies to accomplish this indirectly – namely, running federal budget deficits large enough to offset declines in business fixed investment and establishing the federal government as an employer of last resort. Both of these would reduce the amount of debt households incur to meet basic needs. Minsky also proposes regulatory reforms to prevent financial fragility and crises. Besides these, I recommend reestablishing the federal government’s role as an allocator of credit and as a manager of household financial risks. However,

implementing these programs in a financialized society may be a difficult task; thus, prospects for reform will be considered in the next section.

Conclusion

Dale (2012) refers to the economic regime that followed the Great Recession as "zombie-capitalism" in which free-market ideology has been widely discredited, but its enabling institutions continue to thrive. Are Dale's observations pertinent today? Although Costas Lapavitsas and Ivan Mendieta—Muñoz (2018) claim that financialization in the U.S. peaked before the recent crisis, there is evidence that the process continues.

Regarding neoliberal dogma, President Trump has diverted attention from how his policies disadvantage labor with populist messages about how free trade and immigration increase economic insecurity. Despite condemning Wall Street and Washington elites during his campaign, Republican leaders have enacted tax cuts and deregulatory programs that benefit this class, while doing little to aid workers. For example, a series of executive orders, appointments to the National Labor Relations Board, and Supreme Court rulings have weakened labor unions, contributing to a decline in real wage growth from 1.4 percent between 2015-16 to 0.4 percent from 2017-18, forcing families to borrow to meet their needs. The Federal Reserve Bank of New York (2018) reported that U.S. household borrowing increased $454 billion from one year ago, reaching a record level of $13.29 trillion in the second quarter of 2018. Moreover, the FDIC (2017) found that only 6.5 percent of U.S. households lacked bank accounts in 2017, the lowest number since the survey began in 2009. These data support Zalewski and Charles J. Whalen's (2010) conclusion that financialization and income inequality are positively correlated.

Other political initiatives, including the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018, have benefitted financial firms, increasing the likelihood of another meltdown. These include eviscerating the Consumer Financial Protection Bureau, increasing mortgage risks by both lowering minimum mortgage down payments and risk-retention standards for loan originators, and weakening key provisions in the 2010 Dodd-Frank Act such as bank capital requirements and derivatives regulation. The nonfinancial business sector has also contributed to financial fragility. The real value of corporate debt outstanding worldwide increased from $25 trillion in 2007 to $66 trillion in 2017. Of this amount, the proportion of junk bonds has nearly quadrupled to $1.7 trillion, representing a large share of the $1.6 – 2.1 trillion in bonds that are expected to mature between 2018 and 2022 (Lund, et. al. 2018). Overall, these data suggest that financialization continues and they provide evidence for Minsky's (1986) observation that periods of economic stability often lead to financial instability.

To prevent future crises or to ensure expansionary policy responses if they occur, electing the "right" officials may be insufficient. Robert Kuttner (2018, 283) describes how financiers captured the Democratic Party beginning with the Clinton administration, leading him to conclude: "Globalization under the auspices of private finance has steadily undermined the democratic constraints on capitalism. In a downward spiral, the popular revulsion against predatory capitalism has strengthened populist ultranationalism and further weakened liberal democracy." This suggests that adopting proposals like those described in the last section require changes in the culture of financialization, which should begin at the grassroots level. Unfortunately, this may require a new crisis similar to the Great Depression, during which the gold standard collapsed. Evidence from the relatively milder Great Recession suggests diminished

risk-taking (Kozlowski, Veldcamp, and Venkateswaran 2018), and a 2017 Gallup Poll showed that 54 percent of Americans invested in stocks from 2009-2017 compared with 62 percent from 2001-2008 (Jones, 2017), but excessive borrowing and the power advantage of the finance industry persist.

However, the "yellow vests" protests in late 2018 against French President Emmanuel Macron's labor market and tax policies suggest that a Polanyi-style countermovement is possible. Adam Nossiter's (2018, A1) description of this insurgency, which was fueled by stagnant living standards and economic uncertainty, echoes Polanyi: "With little organization and relying mostly on social media, they have moved spontaneously from France's poor rural regions over the last month to the Seine, where they have now become impossible to ignore." What will result from these efforts, and whether they spread geographically, remains to be seen.

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