Financialization and Neoliberalism

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1. Introduction

The neoliberal era is now more than a quarter-century old, dating from around 1980.[1] Among the unsettled issues concerning neoliberalism is its relation to the growing role of "finance" in the economy that has accompanied neoliberalism. This aim of this essay is to contribute to our understanding of this relation.

A common view is that the rise of neoliberalism is explained by the growing role and power of finance in the political economy of capitalism. According to Dumenil and Levy (2004, 1-2), "...neoliberalism is the expression of the desire of a class of capitalist owners and the institutions in which their power is concentrated, which we collectively call 'finance,' to restore ... the class's revenues and power..." Some analysts view the rise of what might be called "financial dominance" as the underlying development that explains not only the emergence of the neoliberal order but also the associated form of globalization in this era (Dumenil and Levy, 2005, 17).[2]

This essay presents a different view. The changing role of finance in the economy in recent decades can, in our view, best be captured, not by the idea of dominance by the financial sector, but by the concept of "financialization," which suggests an expanding role for finance in economic activity. It will be argued here that the immediate cause of the financialization process of recent decades is found in neoliberal restructuring, rather than financialization explaining the rise of neoliberalism. However, financialization also has deeper roots that are unrelated to neoliberalism. This interpretation of the relation between financialization and neoliberalism clarifies what would otherwise be puzzling differences between the form of financial dominance that arose in the late nineteenth/early twentieth centuries and the financialization of the current neoliberal period.

Section 2 explains what is meant by neoliberalism, making use of the social structure of accumulation theory of periodic changes in the institutional structure of capitalism. Section 3 explains what is meant by financialization. Section 4 considers the origins of financialization and of neoliberalism, as well as the relation between the two. Section 5 analyzes the differences between financial dominance in the late nineteenth and early twentieth centuries and the financialization of the neoliberal era, in light of our interpretation of the relation between financialization and neoliberalism. Section 6 offers concluding comments.

2. Neoliberalism and Social Structures of Accumulation

The particular institutional form of capitalism has changed periodically since capitalism emerged several centuries ago. Neoliberalism can be understood as the latest institutional form of capitalism. The social structure of accumulation theory offers an analysis of the periodic changes in the capitalist institutional structure (Kotz, McDonough, and Reich, 1994; McDonough, Reich, and Kotz, 2010). A social structure of accumulation (SSA) is interpreted here as a coherent, long-lasting capitalist institutional structure that promotes profit-making and forms a framework for capital accumulation.[3]

According to the SSA theory, each SSA functions effectively at promoting profit-making for several decades, but at some point it ceases to do so. This brings a period of crisis, which eventually gives rise to a new SSA. Each SSA exists at the level of global capitalism as well as within individual countries, although with some institutional variation across countries.

The construction of the post-World War II SSA was completed by the late 1940s and worked effectively through around 1973. That SSA was characterized by active state regulation of economic activity both within states and in the global system, well developed welfare states, significant capital-labor cooperation, and a co-respective form of competition among large corporations. The postwar SSA was a significant departure from the past, when the state had played a more limited role in the economy and individuals were left largely to fend for themselves. The postwar system is often referred to as "regulated capitalism" because of the historical break entailed by the great expansion in the role of the state in that period.

Around 1973 the postwar SSA entered a period of crisis, and in the late 1970s a new SSA began to take shape, initially in the USA and UK. It came to be called "neoliberalism," since its main features resemble the pre-Great Depression "free-market" version of capitalism. In most of the world, although not in the USA, the term "liberal" refers to the view that the state should stay out of the economy.

The neoliberal SSA was well established by the early 1980s (Kotz and McDonough, 2010). This SSA represented a sharp break from the previous one. Its main features are the removal of barriers to free movement of goods, services, and especially capital, throughout the global economy; a withdrawal by the state from the role of guiding and regulating economic activity; privatization of state enterprises and public services; the slashing of state social programs; a shift to regressive forms of taxation; a shift from cooperation between capital and labor to a drive by capital, with aid from the state, to fully dominate labor; and the replacement of co-respective behavior among large corporations by unrestrained competition. Neoliberalism has an associated ideology of worship of the so-called "free market" along with a denial of any positive role for the state apart from its coercive functions.

The neoliberal SSA has entailed a major restructuring of the global capitalist system as well as a transformation of domestic institutions in the USA, the UK, and many other countries. However, some capitalist countries have only moved marginally toward the neoliberal model, such as the Scandinavian countries and Japan.[4] The neoliberal institutional structure qualifies as a SSA, since it is a coherent, long-lasting capitalist institutional structure that has brought a rising rate of profit in the leading capitalist countries[5] and has formed a framework for capital accumulation.[6]

3. Financialization

A literature has arisen recently about the phenomenon of financialization. Definitions of this awkward term vary among authors. Perhaps the best, and most inclusive, definition is given by

Epstein (2005, 3): "...financialization means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of domestic and international economies." To clarify this definition, it may be helpful to explain what is meant by "finance." Finance has to do with the movement of purchasing power between actors in the economy, either in the form of extension of credit or the assumption of ownership rights over an asset that is expected to yield payments over time.[7] Since capitalism reached its corporate stage, securities became the representation of both ownership and creditor status. As securities became tradable, financial markets arose in which the status of owner or creditor could be bought and sold. In recent times increasingly complex types of securities have been created and traded, including "financial derivatives" whose value is tied to the value of other securities.

Thus, financial activity includes dealings in stocks and bonds, mortgages, financial derivatives, futures, foreign exchange, and many other types of assets, as well as making old-fashioned loans. Financial activity is traditionally distinguished from non-financial economic activity, where the latter refers to the production, storage, and distribution of goods and the production of those services classified as non-financial based on having a purpose not directly related to financial activity (such as haircuts or education).

The wording of the definition of financialization given above suggests a quantitative expansion of the role of finance in the economy, but it is not clear whether this means that the role of finance changes qualitatively. That is, does financialization imply a change in the relation between the financial and non-financial sectors of the economy? If such a change does accompany the "increasing role" of finance as stated in the preceding definition, what kind of change is it? Possible changes include the following: 1) finance becomes more powerful in relation to the nonfinancial sector; 2) the link between finance and the non-financial sector becomes either tighter or looser.

To address this question, we will examine the historical background of the emergence of financialization in the neoliberal era, drawing largely on the U.S. case. During the 1920s the financial sector in the U.S. was largely unregulated, and the later part of the decade saw widespread financial fraud and speculative excess. At the end of the 1920s the stock market collapsed, followed by the banking system a few years later. As the Great Depression wore on, the view became influential that the excesses of unregulated finance had been a major factor responsible for the severity of the Depression.

This view greatly influenced the new regulation of finance that became part of the postwar SSA. Financial institutions in developed capitalist countries were typically state owned or closely regulated by the state in the postwar SSA. In the U.S. there were state controls on interest rates, financial institutions were segmented by type of business permitted, entry into financial markets was closely regulated, and banks were protected against failure by the state. The tight regulations forced the financial sector to concentrate on promoting capital accumulation in the nonfinancial sector.

Starting in the 1970s activity in financial markets and the profits of financial institutions began to rise relative to non-financial economic activity and profits. Foreign exchange transactions in the world economy rose from about $15 billion per day in 1973 to $80 billion in 1980 and $1,260 billion in 1995. World trade in goods and services was 15 per cent of the value of foreign exchange transactions in 1973, but by 1995 it had fallen to less than 2 per cent of foreign exchange transactions, implying that the explosion in currency trading was primarily for financial transactions, not the purchase of internationally traded goods and services (Bhaduri, 1998, 152). In the USA the value of all financial assets rose from about 150 per cent of GDP during 1960-80 to over 300 per cent of GDP in 2003 (Orhangazi, 2008, p. xii). The pre-tax profits of financial corporations in the USA rose from an average of 13.9 per cent of all corporate profits in the 1960s to 19.4% in the 1970s, fell slightly to 17.2 percent in the 1980s, and then rose to 25.3 per cent in the 1990s and 36.8 per cent of all corporate profits during 2000-2006 (U.S. Bureau of Economic Analysis, 2008).[8]

Dumenil and Levy (2005, 38) found that in France the rate of profit of financial corporations was far below that of nonfinancial corporations in the early 1980s, but by the late 1990s the financial profit rate had far surpassed that for nonfinancials. Epstein and Jayadev (2005, 51-52) found that the share of national income received by financial institutions and holders of financial wealth was much higher in the 1990s than it had been in the 1970s in a majority of OECD countries studied.[9]

The change in the role of the financial sector in the neoliberal era has not just involved a quantitative expansion of its activities and profits. In this era financial institutions, particularly the giants among them, broke out of their role as servant of nonfinancial capital accumulation to pursue their own profits through financial activity. They increasingly did so through financial market-based activities, rather than just making loans to nonfinancial sector institutions. The creation and sale of new financial instruments largely replaced the long-term loan relationships with the nonfinancial sector that had predominated in the regulated capitalist SSA.

4. The Relation between Financialization and Neoliberalism

It is widely recognized that a radical shift took place from state-regulated capitalism to neoliberal capitalism around 1980. It is also well known, at least by specialists, that during the neoliberal era a process of financialization has taken place in capitalism. However, determining the origins of these two developments, and the relation between them, is not a simple matter.

One view is that financialization arose independently of neoliberalism. There are several variants of this position. Paul Sweezy (1994) argues that the tendency toward stagnation, which in his theory is inherent in the monopoly stage of capitalism, led to a shift in investment from the real sector, which had declining investment opportunities due to developing stagnation, to the financial sector starting in the 1970s. There followed an explosion of financial activity that we have come to know as financialization. John Bellamy Foster (2007) took Sweezy's analysis one step further, arguing that the financialization resulting from the stagnation tendency of monopoly capitalism led in turn to neoliberalism: "What we have come to call 'neoliberalism' can be seen as the ideological counterpart of monopoly-finance capitalism … (p. 9)."

In his sweeping analysis of the history and pre-history of capitalism, Giovanni Arrighi (1994) argues that a series of cycles referred to as "long centuries" (or regimes of accumulation) have characterized modern Western economic history. First was the long 15th-16th century dominated by Genoa, and last (so far) is the "long twentieth century" dominated by the US. Each regime of accumulation eventually enters a crisis phase, as overaccumulation and increasing competition result in declining profitability in trade and production. The crisis phase is marked by a shift of investment from trade and production, due to its declining profitability, into finance (Arrighi, 1994, 214-15). In this view, contemporary financialization is a reflection of the crisis in the US-dominated long twentieth century, analogous to the period of finance capital in the late 19th and early 20th centuries that reflected the crisis of Britain's long 19th century. However, Arrighi does not specifically link neoliberalism to contemporary financialization.[10]

As was noted above, Dumenil and Levy (2004) hold that growing power on the part of financial capital, associated with financialization, led to neoliberal restructuring as a means to benefit financial capital. However, this view suffers from serious problems. If neoliberalism represents the victory of financial capital, or of some broader category of "finance," then two questions arise: 1) over whom was this victory won? 2) how was finance able to achieve such dominance? Let us consider the first question first. If an identifiable financial capitalist interest was able to bring about neoliberal transformation by defeating an identifiable nonfinancial capitalist interest, there should be evidence of a battle between the two. Nonfinancial capital, presumably embodied in the giant nonfinancial corporations that now straddle the globe, would surely have put up a good fight, if neoliberal restructuring had not been in their interest. Yet no one has found evidence of such a fight.

Neoliberalism first took root in the USA and UK at the end of the 1970s. In the USA the shift toward neoliberalism appeared to have unified support from the capitalist class, apart from a few mavericks. A major part of big capital had earlier supported the regulated capitalist SSA, in alliance with organized labor (Kotz, 2002). It was the desertion of that alliance by big capital in the 1970s which made it possible for neoliberal restructuring to proceed so quickly, since labor was too weak to stop the shift to neoliberalism on its own. In the UK, when Prime Minister Thatcher began neoliberal restructuring in 1979, there was some division within the capitalist class over it, but it did not pit financial against nonfinancial capital -- initial opposition arose from old-line, aristocratic sections of finance and industry reacting to Thatcher's emphasis on upward mobility (Harvey, 2005, 31).

Some advocates of the view that financial dominance explains neoliberal transformation define "finance" so broadly that this claim becomes consistent with the absence of any visible struggle between financial and nonfinancial segments of capital. Dumenil and Levy (2005, 21-22) define finance as "...both institutions (the financial system: commercial and investment banks, pension funds, insurance...) and individuals, [that is,] capitalists -- or a fraction of capitalists since some capitalists are more 'financial' than others" (wording in brackets added). The capitalists specified to be excluded from "finance" include the "small shareholder or the owner of a small firm" who "does not actually belong to finance" and also corporate managers ("finance can be used to refer to capitalist owners as opposed to management"). Thus, it appears that finance includes not only financial institutions but also all large-scale owners of capital, excluding only small business, small shareholders, and managers. That is, finance turns out to more or less coincide with big capital, perhaps with small financial institutions thrown in.

If big capital as a whole supported neoliberalism, then it is not surprising that there was no visible battle within the capitalist class over its installation. Small business has always predominantly supported a liberal regime -- in the USA it was the main opposition to the New Deal and the institutions of postwar regulated capitalism. Furthermore, high-level corporate managers have gotten fabulously rich in the neoliberal era, as management pay has skyrocketed in countries that underwent neoliberal restructuring, which suggests no opposition should be found to neoliberalism from that quarter.

However, if "finance" is defined so broadly that it includes all of big capital, the claim that neoliberalism represents the victory and interests of finance has no explanatory value. Big capital has been part of every ruling coalition since capitalism reached its monopoly stage. Most of big capital supported, even if reluctantly, the interventionist, welfare state, strong trade union SSA following World War II. By defining "finance" so broadly that the absence of any big battle within capital is understandable, we are left without an answer to the question of why big capital deserted regulated capitalism in favor of neoliberal restructuring in the late 1970s.

If finance is defined more narrowly to refer to an identifiable financial capitalist segment of capital, then the second question raised above must also be answered: how did financial capital achieve a dominant position? According to this view, presumably nonfinancial capital was dominant in the postwar SSA. In the USA, banks and other financial institutions complained throughout that period about the restrictions on their activities. It was not until after neoliberal ideas became dominant toward the end of the 1970s, including the new belief that regulation was harmful and free markets were always best, that the financial sector was deregulated by the US Congress starting with the passage of two new laws in 1980 and 1982.[11] Financial deregulation set the financial sector free, allowing the process of financialization to develop. It appears that the beginning of neoliberal restructuring set the stage for financialization.

Figure 1 shows the pre-tax profits of financial corporations in the US as a percentage of total corporate pretax profits. Not until 1989, about seven years after financial deregulation, did financial profits begin to rise well above the 20 per cent share of total corporate profits that had first been reached in 1970. After 1989 financial profits as a share of total profits displayed a marked upward trend, although with large fluctuations around that trend. Thus, in the U.S. the period of rapid growth of financial profits relative to total profits came significantly after the neoliberal restructuring of the financial sector. This is consistent with our view that neoliberal restructuring led to financialization, rather than the alternative view that growing power of the financial sector led to neoliberal restructuring.

However, financialization is not simply a consequence of neoliberalism. One can identify a strong tendency toward financialization within core processes of capitalism, once it has reached the stage of corporate capitalism. The rise of the corporate form of organization in the nineteenth century turned capitalist property from personal property into corporate property. Ownership of capital was transformed from direct ownership of enterprises to ownership of financial securities, which represents indirect ownership of enterprises.

This offered an opportunity for capitalists to escape the chief problem they always face as individuals -- the fearsome risks built into capitalism from the introduction of new technologies and new products. Any fortune that is stuck in the form of an actual productive enterprise is always in danger of eroding due to competition from new products and new processes. Hence, capital always is looking for ways to escape such risks. There are various ways to gain some protection against such threats, including the pursuit of monopoly power or protection by the state. However, shifting ownership of capital from real capital to financial capital is the best way to insulate against the inherent risks of the capitalist marketplace. This is likely the reason why the Rockefellers' huge fortune, born in oil, was soon shifted to finance and real estate. Chase Manhattan Bank, the Rockefeller bank, was not tied to any particular company or industry.

However, even banking faces some risks, particularly if banking involves medium-term loans to various productive enterprises. Holding, and dealing in, marketable securities promises still more safety. The ideal is to hold wealth whose form can be changed instantaneously when any threat appears. In that way, capital remains safe, with only workers bearing the risks of new products and new processes.[12] This explains the existence of an underlying tendency toward an "increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of domestic and international economies," the definition of financialization cited above.

The tendency toward financialization can be held in check by institutional arrangements, which ultimately reflect the relative power of various classes and groups at the time the institutions are formed. After World War II financialization was largely held in check by the institutions of the postwar regulated capitalist SSA. However, the financialization tendency exerted pressure against the various regulations that hindered it during the postwar SSA. Toward the end of that period, financial institutions found various ways to partially get around the regulations. Once neoliberal ideas began to gain strength during the 1970s, the pressure that was rapidly building to tear down the regulation of the financial sector in particular joined with neoliberal arguments against regulation in general to provide the justification for rapidly granting bankers their freedom.

If the dominance of finance does not explain the rise of neoliberalism, what does? The context for the rise of the neoliberal SSA was the crisis of the postwar SSA. During the 1970s that SSA was no longer working effectively at promoting profit-making. The world economy became very chaotic in that decade, with large fluctuations in prices of key raw materials, inflation rates, and currency exchange rates. As was noted above (in endnote 5), the rate of profit fell in the leading capitalist countries during that decade. The Keynesian techniques for management of the economy, which had seemed so effective in the 1960s, could not deal with a combination of high unemployment, stubbornly high inflation, and chaos in international currency markets. In that context, a search for a new institutional structure for capitalism began.

Harvey (2005) argues that neoliberalism was a response by ruling elites and classes to the threats and chaos they saw in the 1970s. He argues that neoliberalism was a project "to re-establish the conditions for capital accumulation and to restore the power of economic elites" (Harvey, 2005, 19). While neoliberalism was not effective in restoring the rapid accumulation of the regulated capitalist era, Harvey points out that it did restore the power and wealth of the elite, observing that the greatest beneficiaries in the U.S. have been financiers, CEO's of large corporations, and owners of some new sectors such as computers, the internet, and mass media.

This analysis, which identifies the capitalist class as a whole as the promoter of neoliberalism, is consistent with the absence of a sharp battle between financial and nonfinancial capital over its introduction. However, observing that neoliberalism benefitted most of capital does not provide a full explanation for its emergence. It was in many respects surprising that a new version of the old liberal ideology and institutions returned at the end of the 1970s. There were good reasons why the liberal type of institutional structure was abandoned after World War II in favor of a regulated capitalist SSA, which produced the fastest economic growth in capitalist history. It is not obvious that in the 1970s neoliberal restructuring was the only way, or the best way, to restore capitalist power. Some maverick capitalists in the U.S., such as investment banker Felix Rohatyn, during the 1970s advocated a new regulated capitalist institutional structure that would overcome the problems with the previous one. We need an explanation for why Rohatyn's position gained little traction.

One factor that led toward a new liberal SSA was undoubtedly a tendency to look to an imagined perfect past, before big government and strong trade unions hemmed in the actions of capital. The old-time religion of free markets -- free of government regulation and the need to bargain with trade unions -- was bound to exert some appeal for big capital. Strong trade unions raise wages and exercise some control over working conditions. A regulatory state taxes business and limits its freedom of action in the market. With profits falling, the desire to cut wages, gain control over working conditions, cut taxes on capital, and get out from under government regulations made the old liberal ideology appealing to capital. It is much more effective to cite the neoliberal liturgy that the regulatory state, high taxes on business and the rich, and strong trade unions undermine economic efficiency, discourage investment, and hinder economic progress, than to just demand the right to pay lower wages, impose harsher working conditions, produce unsafe products, and shift the tax burden to those least able to shoulder it.

However, the appeal of an idealized past is not the only factor that was pressing toward neoliberalism. There were several factors in the concrete historical conditions of the 1970s that help to account for the rise of a neoliberal SSA at the end of the 1970s.[13] First, during 1948-73 capitalism had become increasingly globally integrated (Kotz, 2002). What began as relatively insulated national markets in the leading capitalist countries grew increasingly competitive, as firms from the US, Europe, and Japan invaded one another's markets. As a result, by the early 1970s long-established relations of co-respective behavior toward rivals broke down in markets, such as those for autos, steel, and electrical machinery, that had been dominated by a few giant corporations in each country. As monopoly power eroded, big capital could no longer afford to consider the long-run advantages of state regulations and trade unions, which had stabilized key relations of the system. Instead, fearing for their survival over the short-run in the new, more competitive environment, big business turned its attention to reducing its costs and increasing its control by any means possible. This provided a reason for big business to desert its previous coalition with labor, which had created and maintained the postwar SSA, and to join with small business which had always opposed regulated capitalism. Increasing global economic integration had placed big business in the position of small business, which would encourage big business to adopt the outlook long held by small business.

Second, the Great Depression had been a major factor in convincing big capital to support a regulated capitalist SSA after World War II. Its severity threatened the survival of capitalism itself. Fearing a return of the depression after World War II, it seemed that big government, along with concessions to the working class, was the only guarantee of the survival of the capitalist system. By the 1970s the Great Depression had receded into the past. Over time it came to be seen as a peculiar historical accident, one not likely to ever be repeated. A major reason for big business to support state regulation and a capital-labor compromise was no longer compelling.

Third, the threat posed by the alternative state socialist system in the late 1940s had passed. In the late 1940s the "socialist bloc" in Europe seemed very strong and was soon joined by China. Communist and Socialist parties had emerged with large popular followings in many leading capitalist countries. This created large incentives to compromise with labor in that period, to stave off the threat of revolution. By the late 1970s, the threat of socialist revolution had become remote in the West, as the Communist ruled states seemed to stagnate and lose their earlier revolutionary fervor, while leftist parties in the capitalist countries had accepted a reformist role. Such institutions as a welfare states and strong trade unions now seemed unnecessary as components of any new SSA.

The above factors can explain the emergence of a neoliberal SSA at the end of the 1970s, in the context of the crisis of the previous SSA. The neoliberal SSA was reinforced at the end of the 1980s, when the state socialist systems in Europe disappeared and China became increasingly integrated with world capitalism. In the 1990s the stability of the neoliberal SSA was demonstrated when the coming to power of the Labor Party in the UK and the Democratic Party in the U.S., the twin birthplaces of neoliberalism, led to further reinforcement of the neoliberal SSA in those countries, rather than the turn away from it which had been suggested during the election campaigns.

Thus, in our view neoliberalism does not represent the interest only of financial capital. It represented the changed interests of a relatively unified capitalist class under the particular historical conditions prevailing during the period of the crisis of the preceding state-regulated SSA in the 1970s. Financialization, a long-term tendency in capitalism, was held in check by the postwar SSA, and was released only after neoliberal restructuring that began in the late 1970s. Once established, the neoliberal SSA presented a favorable environment for financialization.

5. Finance Capital versus Financialization

The late nineteenth/early twentieth centuries saw the rise to power of financial capitalists in some leading capitalist countries, particularly the USA and Germany. This development led Rudolf Hilferding to propose the concept of finance capital (Hilferding, 1981). As the financialization of capitalism has proceeded in recent decades, it may be tempting to see this as a new version of the finance capital of that earlier period.[14] Yet the historical record shows that they are two quite different social phenomena. The analysis of the relation between neoliberalism and financialization presented here sheds light on the differences between finance capital and financialization. We will discuss the U.S. case for this purpose.

In the late nineteenth century, the New York bankers, led by J.P. Morgan and Company, gradually extended their control over a growing share of US industry, starting in the 1880s in railroads. In the 1890s banker control was extended to manufacturing and communication and after 1900 to electric power and light. By the middle of the first decade of the twentieth century, the New York banks controlled a major share of large nonfinancial corporations in the US (Kotz, 1978, 24-39). The banks had representatives on the boards of the major corporations and often named the CEO. The bankers' aim, particularly that of Morgan, was the elimination of "excessive competition" and the establishment of "order."

In pursuit of such objectives, the banks sought to expel two types of capitalists from control of large corporations. First, where possible they squeezed out the highly competitive entrepreneurs who had started many of the new large companies. The most famous example was Morgan's expulsion of the unreformable price-cutter Andrew Carnegie from the steel industry upon the formation of Morgan-controlled U.S. Steel Corporation in 1901 (Josephson, 1962). Morgan viewed such entrepreneurs as preventing orderly progress in industry by persistently engaging in destructive forms of competition.

Second, Morgan sought to drive out financial speculators such as Jay Gould, who would buy up a controlling interest in corporations, loot their assets through various clever schemes, then sell out before the damage became known (Josephson, 1962). Morgan and the other bankers viewed the financial speculators as equally dangerous to industrial progress as the overly competitive entrepreneurs.

What developed was a merger of financial and industrial capital, with the banks serving as coordinating centers for newly formed financial groups -- a relationship that Hilferding called "finance capital." One of the major financial groups emerged from the Standard Oil fortune, centered initially around National City Bank and later around Chase Manhattan Bank (Kotz, 1978, 35-39). An important point about the finance capital of that period was that, while it had a monopolistic character that involved caution concerning investment in new industries, it was directed toward developing the real sector of the economy through maintaining close relationships between financial institutions and nonfinancial corporations. It is important to note the difference in the role of financial speculators such as Jay Gould, who engaged in pure theft, from that of Morgan and the other major bankers of that era, despite the association of both with the term "finance."

By the 1920s the power of the New York bankers declined somewhat, as new financial centers emerged in the Midwest and Pacific Coast and some large companies arose outside the bankers' control (such as the Ford Motor Company). The later part of the 1920s, a decade marked by Laissez Faire policies in the U.S., saw a resurgence of financial speculators, such as the Van Sweringen brothers of Cleveland and Samuel Insull of Chicago (Kotz, 1978, 46, 48). The new speculators engaged in "financial innovation," creating holding companies in the railroad and power utility sectors and investment trusts (speculative forerunners of mutual funds). As a wave of speculative fever took hold in the late 1920s, even some of the old-line banks were drawn into financing speculative activities. Alongside the old system of finance capital, based on close financial-industrial relations aimed at industrial progress, was emerging a new system involving separation of finance from nonfinancial activity, in which financial operators sought purely financial profits independent of the progress of nonfinancial companies. Thus, it appears that a first round of financialization was taking hold in the second half of the 1920s in the U.S.

The economic collapse that began in the autumn of 1929 came to be blamed, not just on the financial speculators, but on the entire unregulated financial system. The eventual involvement of many old-line banks in financing speculative activities toward the end of the 1920s left them vulnerable to attack. This led to the postwar system of close regulation of the financial sector, forcing it once more to focus on serving real accumulation.[15]

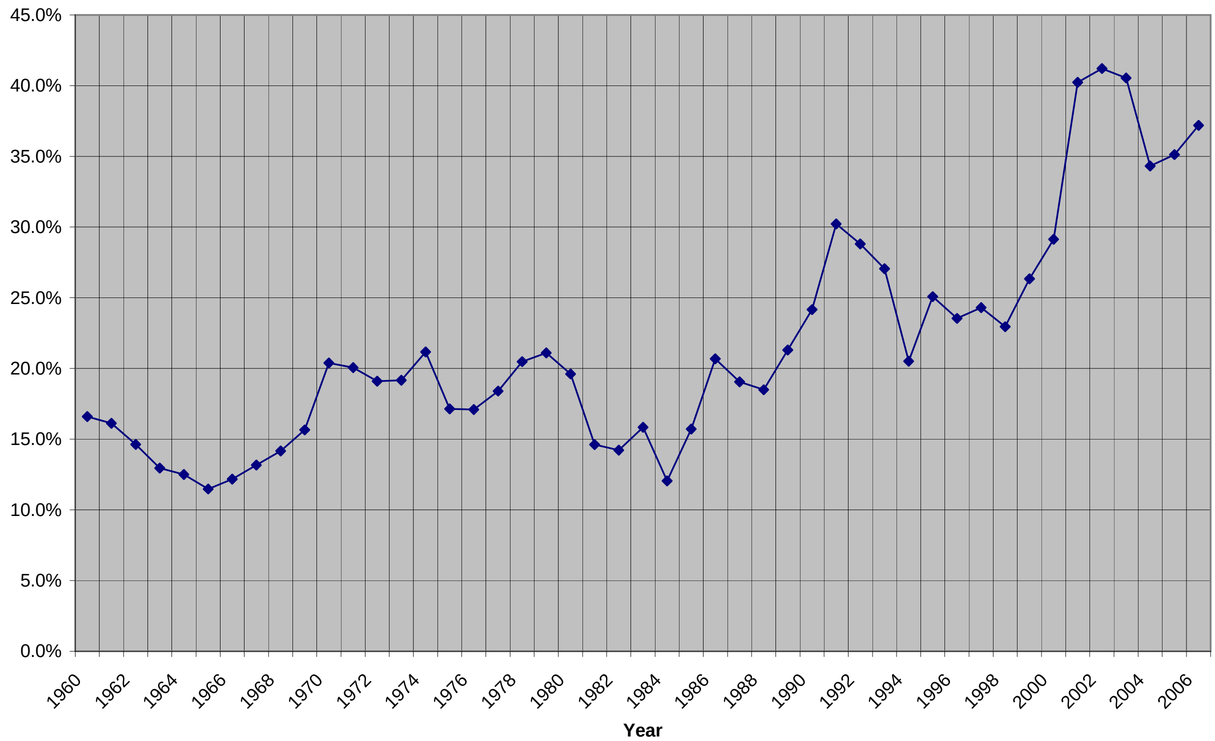
After the regulation of the financial sector was lifted beginning in 1980-82, the development that had been so prominent in the 1920s resumed, as the financialization tendency discussed above became free to operate again. The financial sector gradually shifted from loan-based financing of the nonfinancial sector to market-based and speculative activities. The financial sector became, not dominant over the nonfinancial sector as it had been in J.P. Morgan's day, but independent of it.[16] A growing share of corporate profits shifted to financial corporations, and many of the new fortunes gained were in speculative financial institutions such as hedge funds. The Enron scandal and the subprime mortgage debacle showed that the spirit of Jay Gould had reappeared in new forms.

6. Concluding Comments

This paper argues that a neoliberal SSA arose at the end of the 1970s for reasons not directly related to the process of financialization. It argues that the key causes, given the crisis of the previous SSA, were the increasing global economic integration of capitalism, the dimming memory of the Great Depression of the 1930s, the receding threat to capitalism from the rival state socialist system and from Socialist and Communist Parties, and a decade later the disappearance of the state socialist system. According to this view, financialization is an ever-present tendency in corporate capitalism and, once neoliberalism released the constraints against it, it developed rapidly in the favorable neoliberal institutional context. However, financialization has not involved a new dominance of the financial sector, but rather a growing separation of finance from nonfinancial activity.

Every stage of capitalism has its contradictions, which eventually bring a systemic crisis. The contemporary neoliberal, financialized form of capitalism has its particular contradictions (Kotz, 2008). Some of these contradictions are located in the financialization process. While we argued that financialization involves the separation of finance from productive activity, such a separation cannot be complete. Ultimately financial profits are related to nonfinancial activity, and financial activity can have a large impact on the nonfinancial sector. For a time the expanding financial sector indirectly promoted capital accumulation in the system as a whole, by facilitating a rapid expansion of household borrowing, which made economic growth possible in the face of the wage stagnation produced by neoliberalism. However, the increasingly speculative character of the booming financial sector made it increasingly vulnerable. At this time the financial sector in the U.S. has entered a period of crisis, which has spilled into the global financial system. At the same time, the possibilities for continued real economic growth within the neoliberal model appear uncertain. While history does not exactly repeat itself, the possibility exists for a combined financial and economic crisis within the neoliberal institutional structure. If this scenario does emerge, we may be entering a new period of institutional restructuring, whose end point cannot be foretold in advance.

Figure 1. Profits of Financial Corporations as a Percentage of Profits of All Corporations in the U.S.



Note: Profits are before tax and with inventory valuation and capital consumption adjustments.

Source: U.S. Bureau of Economic Analysis, 2008.

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Notes

[1] See section 2 below for an explanation of the term "neoliberalism."

[2] Foster (2007, 9-10) also views neoliberalism as an outgrowth of the expanding role of finance. His interpretation is considered below.

3. This concept of an SSA differs somewhat from the dominant interpretation in the early SSA literature, which focused on the role of an SSA in promoting economic growth that is rapid by some historical standard. The traditional understanding of an SSA is criticized, and the SSA conception presented here is explained and justified, in Wolfson and Kotz (2010).

4. The most thorough neoliberal restructuring has taken place in the formerly Communist Party ruled states of East/Central Europe and Central Asia. Neoliberal restructuring was imposed in much of Latin America and Africa, with the IMF and World Bank playing a key role. A number of developing countries in East Asia and South Asia, including China, have adopted hybrid institutional forms incorporating elements of both a state directed development model and neoliberalism.

5. The rate of profit in the USA, and for a combination of the UK, France, and Germany, declined from the mid 1960s through the end of the 1970s, at which time it began a long-term rise (Dumenil and Levy, 2004, 24, figure 3.1).

6. Many studies have shown that the rate of economic growth has been significantly slower in the neoliberal era than it had been in the era of regulated capitalism, for the world economy and for the leading capitalist economies. Indeed, growth in most of the leading capitalist countries has been no faster in the neoliberal era than it had been in the crisis phase of the regulated capitalist era (Kotz and McDonough, 2010).

[7] Finance also refers to the shifting of wealth from one form to another, as in the exchange of one nation's currency for that of another.

8. From 2001-03 the profits of financial corporations were over 40 per cent of total corporate profits.

9. The large increases were found in Australia, Belgium, Finland, Korea, the Netherlands, the UK, and the US. In Germany the increase was smaller, and in Japan the share declined slightly.

[10] A problem common to the analyses of Sweezy, Foster, and Arrighi is that, as Orhangazi (2007, 46-53) points out, it is not obvious why opportunities for profitable investment in the financial sector should be available when such opportunities have become limited in the real sector.

11. The two laws were the Depository Institutions Deregulation and Monetary Control Act of 1980 and the Garn-St. Germain Act of 1982, which gradually deregulated interest rates and loosened the restrictions that had segmented the financial sector.

[12] Holding wealth in the form of marketable securities is safer in normal times. However, during a financial crisis some types of securities suddenly, and unexpectedly, become very risky,

although no form of private sector wealth is immune to a potential fall in asset valuations under such conditions.

13. The analysis of the rise of neoliberalism presented here draws on Kotz (2002).

[14] While Arrighi (1994) views both periods as episodes of financial expansion that attend the crisis of a regime of accumulation, although he does not explicitly suggest that the relation between financial and real sectors was identical in the two periods.

15. One study found that the major banks experienced a resurgence as centers of ownership and control over large non-financial corporations in the quarter-century following World War II (Kotz, 1978, ch. 4). However, the control position of banks did not reach the level of the era of J.P. Morgan.

[16] Sweezy (1994) and Foster (2007) make a similar observation about the difference between contemporary financialization and the era of finance capital. However, they do not analyze why the two cases are qualitatively different.