"The Janus Face of Financialization - How Discrete are 'Finance' and the 'Real' Economy?"

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Abstract:

Financialization has become a hybrid concept somewhat uneasily weaving together questions about the emergence and growth of (speculative) financial markets with observations of the transformations occurring in the wider economic system (and society) in response to this growing “ecological dominance” (Jessop) of finance. Despite a growing recognition that both aspects are linked in many ways, there is still a tendency to treat them as discrete, if interacting, phenomena. I suggest, instead, that such a conceptualization of their relationship as “accidentally (causally or externally), not systemically (internally) related” (Streeck) prevents us from coherently theorizing the financialization of contemporary capitalism and the ways in which the transformation of finance, and of the “real” economy, are constitutively linked. The exponential growth and increasingly speculative character of financial activity is typically depicted as the result of its “dis-embedding”, permitting a self-reinforcing cycle of increasing self-referentiality and autonomization of financial processes, Financialization of the wider economic system, in contrast, is seen to result from the growing power of finance to impose its interests on the “real” sector of the economy; the “finance-led accumulation regime” (Boyer) is thus the consequence of this imposition of financial imperatives on the wider economic system. Drawing on heterodox economic conceptions of modern capitalism as a system of mutually constitutive monetary flows and assets, I argue instead that we must understand transformations in the structure of finance and corporate practice as co-constitutive: the dis-embedding and growing self-referentiality of speculative finance would not have been possible without corresponding transformations in the monetary forms that corporate activity takes. Rather than understanding the “financialization” of the wider economy as the causal result of the dominance of speculative finance, we need to dissect the systematic relation of the co-evolution of those institutional forms in order to understand the role of finance in contemporary capitalism.
Introduction:
Since the global financial crisis hit first in 2008, scholars in fields such as Political Economy, Economic Sociology, and Economics have been digging up a plethora of different concepts with which to understand the structural context within which the crisis occurred, and in particular how the transformations of the global financial and economic system\(^1\) over the last decades has made the crisis possible in the first place. Empirically, this has unearthed the following observations which resurface throughout and across different theoretical and thematical accounts, and have come to form a common-sensical (least-common-denominator), if internally incoherent and under-conceptualized explanatory-historical narrative of the process of financialization, its key features and driving factors:

i) the growing importance of “speculative” activities within the financial sphere of the economy, and the (systemic) financial fragility it breeds;

ii) a growing volume of financial activity as compared to “real”, i.e. productive economic activity and trade (i and ii are usually together referred to as the “dis-embedding” of finance from the real economy);

iii) lastly, the negative influence of this increasingly “ecologically dominant” form of finance on the economic system, and the real economy, is pointed out (sound money policies associated with low growth, a starving of the real economy of credit, etc.).

It has become increasingly common to refer to this bundle (in various combinations and emphases) under the – infuriatingly vague – umbrella term of financialization\(^2\). Two main strands can be distinguished here: one conceives of financialization more in terms of micro-, agentic practices, rationalities, subjectivities and the like – suggesting at least implicitly that such financialized activity is somehow more virtual, self-referential, detached from “real” economic activity (hence dis-embedded) –, while the other looks at the structural transformation of economic systems at the level of macro-economic aggregate patterns. The boundaries between both strands are, of course, rather flexible across various research projects and fields.

While most scholars refrain from making explicit claims regarding how the various notions being juggled with are concretely related with regard to the evolutionary path of the economic systems in question, if one reads between the lines\(^3\) it becomes quite clear that there is a common (pre-analytical) narrative about how the various aspects bundled under the term financialization

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\(^1\) Mainly, but not limited to, the most „advanced“ Western capitalist economies.
\(^2\) financialization conceived of as a gradual transformation in advanced capitalist economies “in which the financial sector grew larger as a percentage of economic activity and expanded its influence over the rest of the political economy” (Deeg und O’Sullivan 2009, 731).
\(^3\) Spelling out, for instance, the pre-suppositions about causal connections not quite explicated in historical narratives and accounts, the implications of policy recommendations, or of calls to „re-embed“ finance, and the like.
hang together. This narrative, I would suggest, is modeled – not very surprisingly, given its prominence – after the Polanyian narrative of the dis-embedding of the self-regulating market\(^4\), the contradictions this generates, and the re-modeling of the economic system\(^5\). I will first shortly outline the narrative, and how it structures the understanding of the process of financialization as a transformation of the economic system having specific (structural) causes; I will then problematize the tendency to juxtapose various phenomena in quasi-causal terms and in terms of an evolutionary narrative as externally, rather than internally related. This tendency makes it very difficult to come to a coherent understanding of the driving forces of financialization, and the complex interdependencies between its empirical manifestations (and, crucially, the question of how this evolution can be steered, if at all). For this purpose, I will develop a more careful conceptualization of what I take to be the key elements of the financialization story, namely the notion of speculative financial activity and of the accumulation process.

**Dis-embedding, autonomization, virtuality – how to conceive of the transformation?**

Probably the most common way (at least, within the field of IPE) to make sense of the “re-emergence of global finance” (Helleiner 1994) has been the notion of “dis-embedding” originally used by Polanyi (Polanyi 2001; Polanyi 1977) to describe the autonomization of the economy as a separate field of social action. Unfortunately, it is somewhat difficult to know what precisely is implied when scholars use the concept of dis-embedding – the concept itself has undergone various transformations since it was re-discovered in the 1970s and 1980s by historical (Block und Somers 1984) and economic sociologists (Granovetter 1985). While Polanyi – at the microlevel – meant to describe the increasing autonomization of economic rationality and motives from other forms of social action, the so-called „New Economic Sociology“ has argued for the opposite, namely that economic action is never self-sufficient but always embedded in and dependent on other social factors (normative, social relations, networks, etc.) (Beckert 2006; Beckert 2007; Granovetter 1985; Barber 1995). What both have in common is a concern with the ways in which economic activity and practice relates to other social logics and rationalities, and the (systemic) consequences this has.

Contemporary IPE tends to wed those two dimensions together in a rather uncanny way in order to make sense of the rise of speculative activity in contemporary capitalism and its systemic implications. In a nutshell, speculation is seen as an autonomization of a specific rationality of economic activity, namely one which uses the language of prices typical of the economic system but in a way that is increasingly self-referential (i.e. devoid of reference to “real” economic or social processes, values, etc.) - a form of economic activity that is virtual in that it does not involve

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\(^4\) This should not be very surprising, as scholars particularly in IPE and related fields are imbued from their academic infancy with the Polanyian story.

\(^5\) In Polanyi’s original account, of course, it is society that is being re-modelled to fit the functional imperatives of the economy. In the current adaptation, it is the real economy that is adjusting to the imperatives of speculative markets or finance capital.
any “productive” activity. This rise of speculative activity is then related to developments at the macro-level – along the lines of Polanyi’s frustratingly vague original narrative in the „Great Transformation“ (Polanyi 2001). Inspired by Polanyi’s argument that the attempt to allow the “laws of the market” to govern the economy without interference from other social logics (the “utopia of the self-regulating market”) would be self-defeating, many scholars treat the dis-embedding of finance through speculation analogous to Polanyi’s argument (irrespective of the merits of his original argument). Observing that finance grew both in quantitative terms and qualitatively – in the extent of its permeation or dominance of the real, productive sector –, they conclude that the dis-embedding of finance leads to a dynamic similar to Polanyi’s: namely, that the rise of (speculative) finance would put a strain on the real economy, increasingly forcing the latter to succumb to the imperatives of smooth functioning of finance even at the danger of disrupting its own “fabric” and functioning. This process then would account for the increasing fragility and crisis riddenness of the economic system, together with the undermining of welfare provisions and labour conditions usually discussed under the label of “neoliberalism” (see, for instance, James Crotty 2005; Apeldoorn, Drahokoupil, und Horn 2009; Duménil 2004; Fougner 2006; Harvey 2007; Jones und Ward 2002; Kotz 2009; Patomaki 2009). The parallels to Polanyi’s original line of reasoning are obvious: “Instead of the economy being embedded in social relations, social relations are embedded in the economic system. The vital importance of the economic factor to the existence of society precludes any other result. For once the economic system is organized in separate institutions, based on specific motives and conferring a special status, society must be shaped in such a manner as to allow that system to function according to its own laws.” (Polanyi, The Great Transformation, cited in Jessop 2001, 215). The structural power of speculative finance subordinates the “real” economy – and this is somehow to be related to the fact that finance has become increasingly self-referential, autonomous, “organized in separate institutions [financial markets, global micro-structures], based on specific motives [speculative, virtual profit], and conferring a special status”. This autonomization narrative regarding financial markets is visible both in micro-studies such as the social studies of finance literature (Michel Callon 2007; Çalışkan und Callon 2009; Çalışkan und Callon 2010; Michel Callon 1998; M. Callon und Muniesa 2005; MacKenzie 2006; MacKenzie 2005; MacKenzie, Muniesa, und Siu 2007) which is concerned with how specific rationalities of finance emerge and are constituted – not least by the increasing use of methods of calculation derived from economics, a theme also reminiscent of Polanyi – and the focus on „global micro-structures“ of finance (Knorr Cetina und Bruegger 2002b; Knorr Cetina und Bruegger 2002a; Knorr Cetina und Preda 2001), and which is frequently cited in studies of macro-patterns or historical transformations as a somewhat self-evidently being related to the growing power of finance and its transformative impact on the wider
economic system. As plausible as the overall neo-Polanyian narrative appears at first blush, so vague are its specific arguments as to how what I have called above the micro and macro level are related. Polanyi uses a rather loose analogy between the dis-embedding of economic (financial) rationality and the notion of crisis as resulting from subjecting other realms of the social to the imperatives of such a dis-embedded economic realm to make his historical argument. However, he alternates between different notions of dis-embedding (Jessop 2001), moving at will between dis-embedding as a question of rationality or agency, incompatibility of institutional configurations, and structural contradictions at the systemic or macro-level of accumulation (borrowing loosely from Marxian arguments). How precisely these aspects are related theoretically just remains elusive – as it does with regard to the financialization narrative as well, arguably.

In order to get to the problem of why this narrative is problematic – if not misleading – for understanding the dynamics of financialization and speculation and their interrelation, it is crucial to shortly discuss what empirical phenomena are usually discussed in these regards.

The empirics of financialization – transformations of practice, finance-led accumulation
At the most general level, one can distinguish structuralist accounts of the macro-economic dynamics and consequences of financialization from those which are concerned with the level of economic practices and agency and their transformations.

On the structuralist side, the starting point for Marxian and / or heterodox economic analyses of financialization is usually the paradoxical observation that not only the volume, but also the profitability of financial activities have greatly increased since the 1980s, while overall economic development has been quite sluggish (James Crotty 2005). There has been a rather spectacular inflation of financial assets' values in that period (Toporowski 1999; Toporowski 2009), with finance yielding more and more of the total profits accruing in the economic system (Özgür Orhangazi 2008; O. Orhangazi 2008). From a heterodox / Marxian perspective, this is usually interpreted along the lines of the notion of „fictive“ or „fictitious“ accumulation (Harvey 2006; Harvey 2007; Harvey 2010; Arrighi 1994; Arrighi und Silver 1999), with financial profits compensating for a lack of profit in the productive sectors at the expense of financial inflation.

6 Of course, there is, as usual, a semblance of sophistication: debates are being fought over the transmission mechanisms of the structural power (Gill und Law 1989) of finance (capital), and whether it should be attributed to structures, agents, or ideas (for instance Blyth 2002; Blyth 2003a; Blyth 2002; Blyth 2003b; Best 2004; P. A. Hall 1993; P. Hall 1989), while the underlying vision remains relatively naïve: when it comes to the broader question of why finance finds itself in such a position of power, there is some gesturing towards „accumulation crises“, changes in „economic ideas“, and the like, without much detailed exposition of how those are related to one another, and in particular to the autonomization of finance.

7 The crisis of which is usually explained by some variety of the over-accumulation argument; of course, over-accumulation is tendentially made worse by financialization, which drains investment and, through austerity, undermines consumption and hence aggregate demand (underconsumption).
It is precisely this problematique that Marxist notions of accumulation and accumulation crises aim to get at; in a type of functionalist argument, the rise of finance is considered to have stabilized accumulation by restoring profitability. This notion of the restoration of profitability ties in quite nicely with arguments stressing how – with financialization – rentier income has indeed increased (both in relative and in absolute terms). Marxist arguments about accumulation put great emphasis on how the stability of accumulation depends on sufficient overall profitability, and discuss various mechanisms that might undermine accumulation through the channel of profitability; one can distinguish three main types or mechanisms (Wright 1975): i) a line of argument stressing the problem of finding sufficient new “outlets” for profitable investment (the problem of valorization of existing capital in new M-C-M’ cycles discussed by Harvey in connection to neoliberalism, see Harvey 2006; Harvey 2007), ii) crisis of underconsumption (i.e. lack of aggregated demand) (a point discussed most prominently by heterodox macro-economists; for a good overview, see James Crotty 2005), and iii) “profit squeezes” (Magdoff und Sweezy 1987) stressing the relative balance of power between capital and labour and the dependency of profitability on the disciplining of labour.

As suggested above, the notion that financialization has stabilized accumulation – and thus been functional to it – usually rests on the, more or less explicit, argument that profitability has been rising across the world economy since the crises of the 1970s. However, in order to understand how – and which – structural transformations can be considered to have been functional in this sense, and what role finance has played in this, it is crucial to evaluate where and how (corporate) profits are generated (Krippner 2005, 175; van Treeck 2009, 908) in the economic system; rather than simply point to the size of “rentier income”, we need to understand how financialization has transformed accumulation in order to overcome impediments to the stability of its cycle. If one looks more closely at the generation of profits on the macro-economic, systemic plane, accumulation has not so much picked up in terms of physical production capacities or material output, but profits are made seemingly at the expense of physical investment (in production capacities), and sinking non-financial sources of profit are compensated by a hike in financial operations, and an even larger hike in the profitability of financial transactions and investments (van Treeck 2009, 908). This phenomenon has led several scholars to argue – following the narrative of financial capital becoming relatively more dominant and powerful – that financialization has led to a diversion of funds or capital from productive investment to financial speculation and investment (van Treeck 2009, 911). There is a wide-spread interpretation that the financial sector is effectively “crowding out” the real economy by diverting scarce capital into more profitable financial investments, thus permitting only relatively more profitable financial investments (or requiring rationalizations and productivity increases in the less profitable
ones) (J. Crotty 2009). This fact – that overall growth and profitability would be increasing, while the growth of the production sectors of the economy is much slower, and even negative in relative terms – has been interpreted as a sign that financial profits are largely “virtual” in nature (van Treeck 2009, 911). This line of argument has a long tradition in Marxist accounts, where “fictitious accumulation” of a largely speculative nature is seen as indeed propping up profitability, and thus stabilizing accumulation – at least for a certain period of time (see for instance Arrighi 1994; Arrighi und Silver 1999; Harvey 2010; Harvey 2006). From this perspective, finance provides a new “outlet” for accumulation, even though a largely fictitious one; this virtual nature of financial accumulation, however, has at the same time detrimental effects on “real” accumulation, with the following “dis-embedding” and growing structural power of finance putting increasing strains on economy and society. Financialization, then, paradoxically has restored profitability while impeding (physical) accumulation (Özgür Orhangazi 2008, 46) – entailing a whole new set of problems for the economic system. The crowding out of the real economy not only undermines material accumulation, but can also be construed as exacerbating the underconsumption crisis, as lower profitability in the real economy puts additional pressure on labour remuneration, and lowers aggregate demand through sluggish investment; however, at the same time, this “disciplining” of labour can be seen to be necessary for accumulation, as it helps to offset the “profit squeeze” discussed above (James Crotty 2005, 95ff.). In this way, financialization obtains a certain self-reinforcing quality – it helps to stabilize8 (finance, virtual) accumulation, while at the same time structurally affecting the economy in ways that push them further towards financialization. Indeed, this kind of self-reinforcing quality seems to be intuitively very compatible with notions such as “dis-embedding” (a self-propelled process of virtual finance re-configuring the economy in line with its functional requisites) of the growing “structural power” of financial capital.

Preliminarily, one could summarize the effects of financialization on the generation of profits within the economy in the following way (Özgür Orhangazi 2008, 3):

i. size and profitability of the financial sector have increased (in relative and absolute terms)9,

ii. (national) income from financial as opposed to non-financial activities has increased,

iii. total debt has increased exponentially;

8 All the more as these processes can be interpreted to be functional to (financial) capital in some regards: from a regulationist perspective, Crotty (James Crotty 2005) has argued that neoliberalization and financialization have been reinforced by the negative effects on growth, employment, and investment they themselves have helped condition by a confluence of macro-economic factors essentially brought about by the growing dominance of finance: slow growth, high real interest rates, high debt restraining investment and consumption, restrictive fiscal policies. From a similar perspective focusing on the dominance of financial capital, Panitch and Gindin (Panitch und Gindin 2005; Gindin 2012) have stressed how financialization has helped restore profitability by enhancing the mobility of capital, and its capacity to move out of unprofitable investments.

9 The share of national income that goes to financial corporations has steadily increased – from around 12 to 14 % between WWII and the 1980s to about 20 % in the early 2000s. Similarly, the profitability (both absolute and relative to non-financial profits) of the financial sector has increased massively (Özgür Orhangazi 2008, 11ff.) see- also Dumenil and Levy).
iv. the relationship between the real and financial sectors of the economy have evolved significantly, with non-financial corporations engaging more in financial transactions and deriving a significant share of their cash flow and profits from them, and with financial interests having a far larger control over their corporate strategies: “financialisation... as a process of inflating capital markets or more strictly financial inflation... alters the financial structure of capitalist firms, which in turn affects the nature and the dynamics of capitalism” (Toporowski 2009, 145).

The historical narrative thus starts with the accumulation crisis in the 1970s to suggest that finance, having been functional in stabilizing accumulation\(^1\), has in the longer run proven to be dysfunctional by undermining the real economy and transforming it in its mould, thus imparting upon it its own internal contradictions and fragilities. The increasing financialization of the real economy has made it increasingly self-referential in its operations and thus “virtual” in the value it generates as the speculative financial sphere. Obliquely, then, the problem lies in the increasing dominance of self-referential and virtual, speculative forms of economic activity.

And indeed, if one looks more closely at the question of how and where profitability has been regenerated, rather than the simple dichotomy of financial corporations simply benefiting (increasing profitability) at the expense of the production sector and thus non-financial corporations (NFCs) – the parasite narrative, if one wants –, there seems to be some evidence along those lines. The increased profitability of NFCs (non-financial corporations) is to a large part due to the fact that they have increasingly been engaged in financial activities themselves; as Krippner shows, the ratio of portfolio income relative to corporate cash flow in total (i.e. the relative share of financial profits) has been climbing rapidly over the 1970s and 1980s (Krippner 2005, 184ff.) for NFCs. Portfolio income has thus been closing the gaps in profitability for NFCs left by a decrease in profitability of manufacturing. In other words, not only have financial profits saved accumulation by restoring overall profitability in the economy, they have effectively ‘subsidized’ the non-financial sector, with companies generating cash-flow effectively with financial operations rather than manufacturing and sale. These facts suggest that financialization has not simply changed the balance of power between finance and production sector, but has transformed accumulation and the nature of profitability in more fundamental ways.

Indeed, the relationship between financial sector and real-economy corporations cannot be adequately grasped in terms of these external relations suggested by the macro-economic, sectoral view on financialization. Indeed, while NFCs derive more and more of their income stream and profits from financial income – such as interest on financial investments, and dividend

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\(^{10}\) Even though there is still debate about how best to describe the ways in which it did so. By providing new outlets for investments, by subduing labour, by opening up more space for the market, or by producing fictitious value and profit, for instance.
payments out of holding various kinds of shares and other papers – they have, as the flip-side of the coin, been paying out more and more in interest and dividends to financial markets from their income (Özgür Orhangazi 2008; O. Orhangazi 2008). For a fascinating case study demonstrating this effect with regard to the US car industry, see (Froud u. a. 2002). In this case, profits arise from financial operations relatively directly related to the core activities of the companies (leasing and purchasing finance). However, more interestingly, many major (multinational) corporations – especially in the US – have themselves become engaged in financial investment and speculative operations; in addition, profits are also bolstered through portfolio effects, and the active management of financial investments (Özgür Orhangazi 2008; O. Orhangazi 2008). And while Krippner focuses mainly on the US economy, financialization is not an artifact of cross-national accounting effects, and seems to move parallel for international profit ratios (Krippner 2005, 193–198). This macro-economic pattern of financial flows is, of course, intimately linked to the forging of an ever-closer link between corporate governance and financial markets – which Minsky has described as “money-manager capitalism” (H. Minsky 2008; Wray 2009; Williams 2001; Zorn u. a. 2005; Whalen 2001; Useem 1993; Useem 1996; Van Lear und Sisk 2010): “Financialisation is usually defined... as an increase in the remuneration of shareholders, and an increase in their influence in firm decision making... This change is held to occur at the expense of workers, consumers or even the management of the firm” (Toporowski 2009, 145).

These changes in ownership structure, in corporate governance and effective control have been thematized from the perspective of the corporation, following up on Fligstein’s early work (Fligstein 1990; Fligstein 2001, Kap. 6–9), and have been taken to have led to financial considerations becoming increasingly dominant for corporate decisions. As Lazonick and O’Sullivan have shown, the predominance of financial orientations in the management of large-scale corporations has led them to switch their focus from sustained innovative investment to maximizing (short-term) profitability and liquidity (Lazonick und O’Sullivan 1996; Lazonick und O’Sullivan 2001; Lazonick und O’Sullivan 2002), thus giving credence to arguments emphasizing how financialization undermines the long-run dynamism and sustainability of the productive sector.

This strand of argument, of course, ties in intuitively well with the emphasis on the dysfunctional aspects of financialization at a macro-economic level, “lining” the canvas of structural patterns with some details regarding the agency producing them. And yet, this approach focusing on the relative strength of competing “interest” in corporate control in understanding the structural changes entailed by financialization falls short in the respect that it does not consistently integrate the changes occurring in the dimensions of corporate control, the

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11 As Krippner also demonstrates, these effects are not simply statistical, accounting artifacts of corporate reorganization such as outsourcing or subsidiarization (Krippner 2005, 188–193).
origins of profits, and macro-economic patterns and dynamics systematically. In this regard, the notion of “coupon-pool” capitalism (Froud u. a. 2002; Froud, Leaver, und Williams 2007; Erturk u. a. 2007) provides useful insights; its basic suggestion is that there is a general tendency for accumulation (real-economy corporations, financial institutions, and institutional investors representing the middle-classes) to focus economic activity – also *within* the productive sphere – on the buying and selling of (financial) assets. This suggests that finance can no longer be considered as a sort of functional counterpart of the real economy, but that there is a sort of fusing of what originally was considered as “financial activities” and the rest of the economy.

Indeed, arguably it is this fusing of financial activities with other economic sectors that has been pivotal for enabling the “stabilization” of accumulation in many respects. On the one hand, productive economic practices have increasingly been financialized - crucial Aspects include: the financialization of corporate discourse (Davis und Stout 1992; Davis und Thompson 1994), the drift from stakeholder to shareholder orientation (Useem 1993; Useem 1996; Lazonick und O'Sullivan 2001; Williams 2001), and the role of financial experts' discourse shaping corporate governance practices (Zorn u. a. 2005) -, while macro-economic, systemic patterns of accumulation driven by finance have also helped to stabilize the profitability of the productive sector through a form of “privatized Keynesianism” (Crouch 2009) or “finance-led accumulation (Boyer 2000), in which the inflation of asset prices has allowed for higher aggregate demand to stabilize corporate profits flows. Critically, this sort of finance-led accumulation has led to a sort of “virtuous” cycle in which rising asset prices raise aggregate demand and financial profits, thus further bolstering asset prices (built on the projection of income streams and profitability) (Toporowski 1999; Toporowski 2009; Boyer 2000).

This restoration of profitability and stabilization of the accumulation process, however, bears a strong resemblance to the sort of “fictitious” accumulation suggested by early Marxist accounts – although it is clearly distinct from the ideal-typical, pure form of generation of profits through purely speculative financial activity. To discuss only a few measures, the volume of credit market debt grew from around 150 % of GDP between the 1960s and 1980s to 300 % by 2003, with the total volume of financial assets growing from less than 500 to over 900 % of GDP (Ozgür Orhangazi 2008, xii). Similarly, there has been a persistent and spectacular inflation of the values of both (purely) financial and materially grounded assets (the bubbles in the housing market being only the most ‘popular’) across the same period (Toporowski 1999).

This two sides of the financialization coin should lead one to wonder how they are connected – *externally* (in the sense of both causally driving and influencing one another), or maybe *internally* (in the sense of being constitutively intertwined)? In order to clarify this point, it is necessary to disentangle much more carefully than is usually done the mechanisms linking those two realms.
The fallacies of the Polanyian narrative about financialization:

While both the respective research programmes on transformations in the institutional structures of capitalist economies\(^\text{12}\) and on the changes in macro-economic patterns of accumulation have assembled considerable empirical observations (macro-economic data, institutional details, etc.), they have largely failed to explicate consistently and in-depth how these are related internally; in other words, the two dimensions are juxtaposed with little explication of how they hang together. The virtuality and self-referentiality of speculative finance – and the transformation of the real economy in this vein – are related to the macro-economic patterns (crisis, sluggish growth, fragility, etc.) simply by virtue of the metaphor of its speculative, hence virtual, hence problematic, nature. The notion that virtual accumulation and “blind”, speculative activity without regard to other rationalities or consequences should cause problems seems self-evident so as to not require elaboration. But, if one looks more carefully, it is hard to say where speculation begins and more “down-to-earth” activity ends. How does the mere fact that some activity is more speculative (self-referential?) cause those problems? And: is there any common denominator to “speculative” activity except that it is what is seen to be problematic in the first place? Is a corporation optimizing its balance sheet to economize on funding “speculating”? Where do we draw the line? At what point is financial activity dis-embedded from “real” economic activity, and how does this dis-embedding cause any of the dynamics discussed above? Therefore, in this section, I will dissect the notion of “speculation”, what is meant by its self-referentiality, and how this is related to macro-economic patterns.

While there is thus disagreement about the specific causal relationships of various phenomena leading to financialization, there is hardly any disagreement or discussion of the question of how speculative finance relates to fragility and crisis. Here, the dis-embedding, Polanyian narrative reigns supreme. Speculation, or speculative finance, is seen to lead to a form of profits or accumulation that is “fragile”, either not backed by real values (fictive accumulation) or increasingly risky (due to financial innovation). Whatever the macro-economic correlates of fragility (some authors emphasize more the detrimental effects upon real-sector accumulation, others more the inherent instability of speculation-fueled bubbles), there is agreement that financial, speculative activities are problematic because they are becoming divorced from “real” economic transactions and operations. However, what is never quite explicated is how – constitutively, causally – speculative financial activity is related to dis-embedding at a meso and macro-level, and to the macro-economic dynamics that we can observe. Speculation may lead to fragility, but does it have to? Speculation may coincide with the dis-embedding of the financial

\(^{12}\) I have discussed here mainly the issue of corporate control and strategy, for brevity. A more complete account would also have to discuss institutional changes with regard to the functioning of financial markets, monetary policy, the international monetary system, etc.
sector, but (how) is it causal for it? Or, put more generally, can we explicate more systematically what contextual configurations make speculative activity a problem at the meso- and macro-level?

What is “speculation”, really?
A fundamental problem in the treatment of speculative finance with regard to systemic structures is that it is frustratingly unclear what is meant by “speculation”. Speculation is casually defined in terms of whether activity is “directly” related to activity in the productive sector (functional definition), or in terms of the behavior of traders and financial corporations (agency-based definition), or in terms of its relative fragility (ex-post success), or – last but not least – in terms of whether it leads to asset price bubbles or not (economic fundamentals definition). In a beautiful example of empiricist circularity, the effects of speculative finance are taken as evidence of its dis-embedding by some, while others use the notion of dis-embedding to explain its consequences – wedding together the different dimensions by and large at will and at whim.

I will press the point that the loose analogy of speculation as i) being oriented not toward productive endeavours but price differentials and assets, ii) leading to unsustainable and fragile asset price bubbles, and iii) thus imparting the stability of its bubbles on the – otherwise stable – rest of the economy is misleading and obfuscates the constitutive relations between (speculative) finance and the real sector of the economy – unless we clarify how these hang together in more detail. Instead, I will attempt to clarify, in the remainder of the paper, the relationship between what one could call the structural effects of financialization on the accumulation cycle and the ways in which financial activity has become more self-referential or dis-embedded. My conclusions are that, while there are many connections between those two dimensions, we need to be significantly more careful in conceptualizing them, and their internal, constitutive relations, if we want to avoid misleading and simplifying historical narratives about the “dis-embedding” of finance. In order to develop a more consistent account, it is useful to first outline a conceptual account of the basic macro-economic structure of modern capitalist economies.

Financialization and accumulation - redux:
In this section, I will delve deeper into the question of how one should best conceive of financialization in structural, macro-economic terms to get the most analytical leverage over the theoretical and conceptual problems raised above. A good starting point is Toporowski’s definition – based on a careful reading of heterodox economic theories of the accumulation process – of financialization as “… a process of inflating capital markets or more strictly financial

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13 That is, to disentangle questions about dis-embedding, „ecological dominance“, and (systemic) fragility.
inflation... [which] alters the financial structure of capitalist firms, which in turn affects the nature and the dynamics of capitalism” (Toporowski 2009, 145). The crucial point is that, despite the (seeming) temporal and causal ordering of this definition, it is most useful to understand these elements not as “accidentally, externally” (even if causally and sequentially) related, but as internally related14. The question then becomes how financial inflation is based on specific changes in the structure of accumulation which are reflected (to use some old-fashioned, but in this context illuminating Marxian-Regulationist terminology) in the institutional forms of the financial and corporate system. As I will argue, the macro-systemic dynamics and changes in rationalities are co-constitutive, with changes in rationalities and practice being simply the reflection of changed patterns of fragility and profitability at the macro-level, rather than being externally and causally related.

In order to understand why, it is helpful to understand capitalist economies along the lines of Minsky (H. P. Minsky 2008; H. Minsky 1984; H. Minsky 2008) and other heterodox economists as constituted by patterns of cash flows, and economic units as constituted by their balance sheet relations. Helpful here is in particular Graziani’s notion15 of monetary production economies to describe the interrelation of the real side of the economy and the financial system (Graziani 2003). Graziani conceives of the capitalist production process as being made possible by credit-money creation (loans) ex nihilo16 through which (capital) investment (and wage payments) are financed, with money being extinguished from the financial system’s balance sheets when the original loan is repaid and thus retired17. Other heterodox scholars have thus pointed out the vehicular nature of endogenous money generation in capitalist production as outlined by monetary circuit theory (Parguez 2001; Parguez und Seccareccia 2000; Rossi 1997)18. The classical case of an “embedded” system – i.e. on that is subservient to the production process in Graziani’s sense – would then be one in which the banking or financial system is limited in its function to providing credit to finance investment, which is extinguished when the loan is repaid (ushering into a new cycle, ad infinitum). In other words, the monetary circuit is “opened” with investment finance being

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14 That is to say, to conceptualize them – not to make causal claims – against a functionalist conception of capitalist accumulation as a set of internally related structures that form an interdependent (if, in principle, open, i.e. Capable of evolution) system.
15 Drawing, of course, on Keynes.
16 i.e. Loans are not made by first „collecting“ savings or deposits. Loans created credit-money ex-nihilo: banks „sell their own debt“ (Baeccker), they issue claims against themselves which circulate as money and which are „backed“ by the promise of repayment in the future. In this sense, „loans make deposits“ or „loans make savings“, and not the other way round. Hicks as a good exposition.
17 Not when it is rolled over, i.e. Renewed or repaid by taking up another loan.
18 From this perspective – and for this analytical objective – ... it may be more useful... to look upon capitalist finance as a clearing system that cancels claims and debts and carries forward the differences – so that ‘money’ payments’ come in only as a special case without any particularly fundamental importance” (Schumpeter 1954, p. 717; quoted from Ganssmann 2011, 134). In other words, when „money is introduced into the economy through the productive activities of the firms, as these activities generate income“ (Lavoie 1984, 774), a loan and a corresponding liability are created on the balance sheet of the banking/financial system, and this liability is extinguished – and the monetary circuit closed – when the original loan is repaid.
generated by credit-money creation, and closed when such a loan is eventually repaid.

Within such a monetary circuit, the basic structural parameter for understanding the stability and dynamics of the system is the rate of profit(ability) (cf., for instance, Pasinetti 2000; B. J. Moore 1989); this, of course, says nothing else but that the system, to remain stable, must generate surplus in monetary terms¹⁹ (for an excellent numerical exposition of this necessity, see Smithin 2011) ²⁰. Since – as is by now recognized explicitly even by mainstream, orthodox economists²¹ - money is created endogenously through credit-creation of the banking / financial sector to finance capital investment, this means that additional money (in accounting, bookkeeping terms!) must be created over time²² for profit in monetary terms to be possible systemically – i.e. (debt-financed) investment drives profits. As Kalecki – as well as many others, including Keynes – have pointed out, this requires that (at least) one sector of the economy must go into / be in debt, as credit-money is created in the lending operations of the banking system. The financial system, then, is best understood as a system of temporally overlapping operations of lending and indebtedness, giving rise to monetary stocks and flows, with money balances created in lending and and extinguished when loans are repaid.

Such a system is fundamentally open in the sense that there is always more than one way to stabilize accumulation by generating the monetary precondition for systemic profitability²³. Of course, different configurations of institutional forms entail different conditions of stability. Instead of prematurely jumping right away – is is the custom in IPE literature – into arguments about the relative degree of stability of different regimes of accumulation, it is worthwhile to dwell a little longer on the question of what financialization might mean in terms of what

¹⁹ With this statement, nothing has been said about the question of whether this surplus in monetary terms is backed up by real, material accumulation. At the level of the stability of accumulation, this is, in the first instance, irrelevant. We thus avoid the “disjuncture paradigm” (Anastasia Nesvetailova 2007a, 45ff.) - A tendency to see the financial system as increasingly de-coupled from the real, productive sector of the economy; becoming increasingly speculative, inflated, and acting as a drain (of funding) on the productive sector of the economy -which makes such disjuncture the theoretical cornerstone of its crisis theory of capitalism, nicely summarized by Knafo: “This structural model has entertained a specific understanding of the contradictions of finance which emphasises the imbalances in its relation to production. For those who ascribe to it, finance is dependent on production for it is profits in the real economy which support its growth (e.g. dividends or interest rates). Financial expansion thus relies ultimately on a corresponding development of production... The basic idea generally put forth, in one way or another, is that these investments are unfounded because they cannot be validated by production. For this reason, speculation is generally presented as an inflated superstructure which is bound to collapse under its own weight because it neglects the foundations upon which it rests (production).” Instead, it is more useful to re-introduce (long-run) stability conditions later, once the contours of the basal model have been clarified.

²⁰ “perhaps the single most important question to ask in attempting to understand the method of enterprise is how it is possible for M′ to be greater than M... in the aggregate and on the average across all enterprises, and therefore for profits to exist. There is really only one answer... which is simply that during the circuit both money and credit creation must have taken place” (Smithin 2011, 73)

²¹ Most of the time (see Woodford 2009; for a criticism of the neglect of this insight’s implication for macro-economic modelling, see Goodhart 2009; for a good exposition of the theoretical debates about money endogeneity, see B. Moore 1988; B. J. Moore 1989).

²² This does not mean, as monetarists have suggested, that there must be a stable, secular increase in some monetary base or quantity. Credit-money creation, depending on regulatory and institutional context, can take various forms, so that some fluctuation is possible. (Tille und Flandreau Seminar, Paper zu Kreditwachstum).

²³ Examples of functionally stabilizing monetary processes would be rising indebtedness of states, or household debts as captured recently under the catchy term of „privatized Keynesianism“ (Crouch 2009).
heterodox economists have aptly called the flux and reflux (creation and extinguishing) of credit-money, and hence the closure of the monetary circuit. On this basis, it becomes possible to understand both what financialization means in terms of institutional forms, and how and why it generates systemic fragility, breeds speculative activity - or, in more general terms, in what sense finance becomes dis-embedded and ecologically dominant. On this basis, it also becomes possible to understand in what sense financialization – following Toporowski, focusing here on financial inflation – is a sort of dis-embedding.

A dis-embedded finance can thus be seen to exist as soon as a higher level of reflexivity is introduced into the system, namely the purchase and selling of capital assets (instead of investment in capital goods). Financial assets (bonds / equity) are of course, in a sense, created with every loan (which can, in principle be traded on markets). However, if loans are used to finance production in real goods, the circuit remains (largely) vehicular: as Kalecki pointed out, systemic profit (in accounting terms) is equivalent to the (additional) investment of capitalist or the corporate sector. In systemic terms, then, it is also equivalent to saving (monetary surplus).

Problems in the stability of the monetary circuit emerge, then, when what Keynes called “hoarding”\(^\text{24}\) occurs – i.e., when credit-money is not used to finance the purchase of newly produced capital goods (generating profits), but is used to purchase existing financial assets: For this by necessity undermines the closure of the circuit and, ceteris paribus, the possibility of monetary profits within the system! Hoarding, as Keynes pointed out long ago, means the – systemically self-defeating, as Marx pointed out even longer ago – attempt to use credit-money created by the production-financing loans of the banking section to purchase financial assets (i.e. claims to the future revenue streams arising from the property rights associated with these assets). However, through this purchase, no new assets are created nor any new monetary value is created in system-wide accounting terms: instead, what happens is that a liability (within the banking system) is bought with monetary value that was put into circulation with the creation of this liability).

Hoarding, then, necessarily has at least two effects: it means the build-up of credit(-money) within the system, as loans are no longer retired but shifted around portfolios; as Minsky described it, this means that the relation of liquidity to credit becomes smaller and hence the system more fragile\(^\text{25, 26}\). It also means, however, that at the same time, systemic profitability is undermined (ceteris paribus): essentially, because every attempt to hoard (independent of which

\(^{24}\) Keynes introduced the distinction between saving and hoarding to point out the fact that saving is a systemic accounting identity that is given by basic, double-entry bookkeeping accounting rules (ex-post saving – loans make deposits); hoarding, as opposed to this, designates the activities of agents trying to „save“ more than this, thus undermining the closure of the monetary circuit. Of course, mainstream economics has totally muddled this distinction and failed to grasp its theoretical motivation.

\(^{25}\) For an exposition of this dynamic, see Minsky, Hicks arguments on final means of payment.

\(^{26}\) This is not even taking account of the dynamic moment that this phenomenon of hoarding can give rise to, namely Minsky’s cycle of appreciating asset values and ever higher indebtedness.
sector of the economy) means that there is a shortfall of expenses for the produce of the economic system over the monetary value created in the process of producing them. This, of course, also further increases the fragility of the system.

The point of this discussion of dis-embedding in deliberately structural terms was to demonstrate that the basic problem is not the allegedly “speculative” nature (motivation, intent) of certain forms of activities as such, but rather that their very condition of possibility already is responsible to an important degree for the consequences that are casually attached to the speculation and bubbles emerging from it. From a systemic perspective, what generates fragility is not the nature and prevalence of some sort of activities (speculative, e.g. speculation on price changes, and resulting bubbles), but the question of whether credit-money is used to purchase current output or existing claims to future income.

Higher levels of reflexivity, bubbles, and the problem of speculation:

Why, then, this widespread concern with the autonomization and increasing self-referentiality of “speculative” financial activity? To appreciate this point, it is useful to dissect the ways in which the self-referentiality argument is constructed. Starting from the basic insights on the nature of the monetary circuit and the accumulation process, we can now ask how we should understand “dis-embedding” in this context – more precisely, whether dis-embedding is really something about the nature of the activity of speculation, or – as I want to suggest – the transformations usually attributed to the growing “importance” of speculative activity is an emergent phenomenon that is best understood as resulting from transformation of the monetary circuit. While this does not, strictly speaking, falsify the intuition that dis-embedding is somehow related to financialization and its negative implications, it does do much to clarify the muddle surrounding different conceptualizations, causal processes, and their relations that have arisen in these discussions.

The typical, if unfortunate, tendency in recent discussion is to take Minsky’s discussion of the dynamics of asset-price bubbles (financial inflation) and the different types of finance (hedge, speculative, Ponzi) out of the context of this structural understanding of capitalist economies and tie the speculative character to the ways in which economic activity relates to its wider environment, and to the intentions and rationality “behind” its practice. Not only does this move

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27 It should be noted here that Minsky’s dynamic, which is more frequently discussed recently – even though usually in a decidedly undercomplex way –, collapses both analytical dimensions into a dynamic, interactive model. I distinguish them here to be able to better disentangle dis-embedding from ecological dominance. Dynamic here in the sense not simply of temporalized approaches as they have also been developed by mainstream economists. Dynamic here refers to Minsky’s adoption of Keynes’ very peculiar methodology of constructing macro-economic accounts not by starting from the notion of a general equilibrium, but by proceeding in Marshallian fashion by dynamically interrelating different markets with separate equilibriums (mutually „irritating” one another, to use another systems-theoretical term), and conceiving of causal relations in terms of accounting identities and the way their simultaneous identities unfold over accounting periods (Hicks 1985).
not do justice to Minsky's subtle and multi-faceted arguments, but it also moves us dangerously close to the mainstream economics notion that we could solve the problem if only irresponsible, reckless, etc. speculation were reined in. What is more, reducing Minsky' arguments to questions of speculation obscures how, systemically, financialization makes it difficult for the system to observe financial inflation; asset price bubbles, then, are not the (causal) result of speculation so much as speculation (in the sense of speculating on asset price differentials) leading to bubbles because of the way in which the system is structured by observation and operations of a higher level of reflexivity which do not allow the system to “see” the dis-embedding effects along the structural parameters outlined in the previous section.

Some authors arguing from the perspective of autopoietic systems theory have attempted to articulate more clearly the question of what could be meant by a dis-embedding of financial practices: namely, in their view, a higher degree of self-referentiality and reflexivity of the constitutive operations of the economic system. This position is articulated quite clearly by Willke (Willke 2006), and it is well worth reviewing his arguments in a bit more detail. Willke makes much of the tried and tested distinction between what he calls a use of money as a medium of communication that is i) used to form prices of real commodities, and ii) money reflexively applied to itself. This definition simply refers to the fact that, in one case (i), money is used to price and purchase goods „of the primary economy [which] derive their value.. from their usefulness for the direct appetites of consumers“, and in the other (ii), in which „the prices of the secondary economy... build on their usefulness for the deferred appetites of investors, particularly their risks/opportunities calculations of assets in specific future circumstances“ (Willke 2006, 38).

Willke builds on an earlier distinction developed by Baecker (Baecker 1988), between product, financial, and futures markets, and uses it to rethink the question of what is specific about speculative economic activity. This will allow us to get away from the unhelpful tendency to call speculation whatever turns out in retrospect to have been for some reason unsustainable. Baecker, in this context, usefully applies Luhmann’s notion of the degrees of reflexivity of social systems’ operations to the case of economic practice (Baecker 1988; Baecker 1991). This permits him to distinguish between first-order economic operations (payments) – which means purchasing commodities at a given price – from higher order operations. A second-order operation is one that forms expectations on prices, e.g. futures and options, where one purchases the right to purchase at a certain price. What is being priced here, then, is the uncertainty about the development of

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28 Of course, it is somewhat problematic to couch my contribution in terms of better or more significant causality. As Luhmann has pointed out, causality, from a systems-theoretical perspective, does not exist so much in sequential chains, but is better understood as existing in functional net(work)s (Willke). This simply means that it is possible to describe causality in many different ways, depending on what social forms and mechanisms of complexity reductions one chooses to problematize in scholarly second-order observation. In this regard, I aim to clarify IPE discussion by disentangling the various functional relationships implied and presupposed in competing causal accounts, in order to be able to provide a higher-order semantic that can systematically grasp their interrelations, point of overlap, contradictions, etc.
future prices.

What marks out Baecker’s distinction is that it suggests – even if Baecker himself fails to take this step – to understand speculation in financial assets in terms of a higher degree of reflexivity of the system as a whole. In order to understand what changes with a higher degree of reflexivity or self-referentiality of finance, it is useful to discuss Baecker’s conceptualization of different types of markets in a bit more detail (Baecker 1988; Baecker 1991). He distinguishes between product, financial and futures markets in the following way: product markets are markets in which commodities are being sold against monetary value; financial markets are distinguished by the fact that “Operationen auf Finanzmärkten sind... Zahlungen, die die Reproduktion von Zahlungen durch Zahlungen antezipieren. Das heißt, sie nehmen diese Reproduktion zwar vorweg, aber sie ersetzen sie nicht. Sie sind das Medium einer provisorischen und prognostischen Wiederherstellung von Zahlungsfähigkeit. Die Zahlungen auf Finanzmarkten sind folglich zugleich Leistungen, die als solche ihre eigenen Preise haben: Zinsen.”

Baecker does point to an important point when he argues that financial markets anticipate, but do not replace what John Hicks would have called final payments (cf. Hicks 1989) (i.e. payments in an ultimate means of payment, when commodities are exchanged against cash) – at least not among all types of actors. It is right that purchases of financial assets do not extinguish debt (credit-money) relations in the same way that the purchase of a commodity does. However, by failing to integrate this insight into a vision of the systemic, emergent properties of the monetary circuit, he ultimately cannot come to a notion of speculation that goes beyond one that focuses on virtual gains through the formation of bubbles, either.

Baecker sees this speculative feature enhanced in what he calls “futures’ markets”: these do not even require that any of the payments being priced and hedged actually need to take place. Instead, what they do is to develop „Kombinatoriken“ of possible access to commodities and payments; this essentially makes possible temporal price arbitrage. Futures, then, are a combination of mechanisms for finding prices by gauging present and future supply and demand and price relations: “Ihre Funktion besteht ausschließlich in der Generierung, Verteilung und Bewältigung von Informationen und Risiken.” (Baecker 1988, 299): “Es ware daher verfehlt, die Zukunftsmärkte alternativ entweder als Risikoabwalzungsinstrumente oder als

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29 Reflexion through observation only enters at the level of the programmes, i.e. The profitability orientation of the corporation.

30 “operations in financial markets are... payments which anticipate the regaining of liquidity. That is, they anticipate this regaining, but they do not replace it. They are the medium of a provisional and prognostic restoration of liquidity. The payments in financial markets have, accordingly, their own price: interest”

31 The problem is that, from the agentic (rationalities) perspective of Baecker’s, financial asset purchase is no different from the purchase of capital goods: both are purchased now with a view towards the future income they generate. Baecker can describe the difference between consumption and capitalist accumulation, but not say us much about the difference between a financialized and non-financialized capitalist (monetary production) economy.

32 „Their function consists exclusively in the generation, and distribution of, and coping with information and risk“

Again, based on this discussion, it is quite unclear why a type of economic activity that aims at price arbitrage to generate sustainable prices (and thus potentially improve allocative efficiency) would by itself be a problem? Evidently, Baecker’s argumentation about an increasing degree of reflexivity between those markets somehow is connected to the point that they are somehow less “final” (from actual payments to anticipation of payments to no payments at all). But, does this mean anything with regard to financialization? Can we explain financialization (entirely) on the basis of this higher degree of reflexivity of economic observations? What is the missing link between “virtuality” and “self-referentiality” and systemic fragility and instability?

For my purposes, it is not futures in and of themselves that are interesting (futures on commodities such as raw materials may be speculative, and lead to bubbles), but the logic of futures applied to financial assets. Financial assets are observed and priced as streams of future revenues in capital markets (on the basis of various technologies of observation and calculation). However, in a circular movement, this way of finding prices for them also feeds back into the portfolio structures of corporations (financial and productive), that is in their financing conditions, and becomes the basis for further investment / saving / hoarding decisions.

The problem is not that speculation the quantitative increase or qualitative intensification of speculation, or the asset bubbles that emerge in certain markets (even though this also is a problem, but not from the perspective of the problem discussed here, i.e. financialization), but that the entire macro-structure of the economic system becomes subject to the form of beauty contest that Keynes describes and which Minsky has elaborated by showing how not only is it rational for investors to swim the tide of financial inflation, but how the circularity of profits and capital actually generates “monetäre Strukturzusammenhänge” that make the monetary circuit as a whole akin to speculation. Along the lines of Minsky’s influential re-interpretation of Keynes, when Keynes quipped that "speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done....", he did not mean that speculation became quantitatively more important, more intense and externally dominant vis-à-vis the real economy, but he referred

33 “Accordingly, it would be misguided to consider the futures’ markets as either forms of coping with risk or generating and distributing informations. These alternatives are indistinguishable empirically. Both moments are integral elements of every decision in a futures’ market. Both risks and information relate to the development of prices, more precisely: the trying out of pricing decision. The issue is to find out, which prices will stabilize.”
to the transformations of the monetary circuit brought about by a dominance of financial asset purchases and generalized financial inflation over new capital investment!

What this enables us to see is that it is not speculation as such (its quantity, intensity) that can be blamed for financialization (at least not in the Mynskian, systemic sense\textsuperscript{34}). Rather, the problem is that, at the level of the system / monetary circuit, expectations of future earning capacities are recursively linked to the valuation of financial assets which, in turn, shape systemic conditions of profitability, generating the very observational data with which the expectations about future earning capacities are being gauged\textsuperscript{35}. It is precisely this mechanism which – despite the plethora of half-baked and partial interpretations and borrowing – Keynes and Minsky had in mind. With these prolegomena, we can now approach the initial problem – namely, the question of how and in what ways financialization means that speculative rationalities and activities have taken hold and pervaded the economic system, and how this speculative transformation is linked to macro-economic, structural transformations.

The financialization of the monetary circuit – dis-embedding and the lack of closure

With this intellectual munition, one can carefully dissect two moments that are usually collapsed in discussions of speculation – or, more precisely, that are collapsed into the unquestioned category of the \textit{virtuality} of financial prices and values\textsuperscript{36}. In systems-theoretical terms, one might say that operations are becoming more self-referential, more sensitive to dynamics internal to finance than to external reference points (Baecker 1991, 42), with speculation. And it is, without any doubt, true, as Stäheli, for instance, argues (Stäheli 2007, 46ff.) that the game of money („Geldspiel“) of speculation is somehow differentiated from „real“ economic activity by recurring upon the scarcity (and hence, value and price) of money itself, and not upon the circulation of „real“ commodities. Within this logic, the points of reference for

\textsuperscript{34} Despite what is frequently and annoyingly alleged in various contributions, Minsky did not have in mind bubbles in specific asset classes (even though he did illustrate some of his arguments in this way), but system-wide processes of financial inflation.

\textsuperscript{35} Rather, Minsky is interested in the fact that the value of capital is constituted by the relationship between the cost for payments to acquire it, and the revenues it can yield. In a Minsky bubble or financial inflation, agents do not become more optimistic because they follow a beauty contest type of dynamic, but because their assets appreciate in value due to the higher cash flows generated by credit-money financed investment. As their balance sheet position is improved, their net value increases, both allowing them to acquire more and cheaper finance and giving the impression that there is profit opportunities to be exploited. In this way, a self-reinforcing cycle is set in motion. The crucial point is that this is invisible from within the system due to the fact that individual operations (purchase of assets / borrowing-lending / investment / valuation of assets) are all oriented to one another so that the overall process or (artificial) asset inflation cannot be observed by the system. As Minsky pointed out, „the ultimately liquid assets of the economy consist of those assets whose nominal value is independent of the functioning of the economy“ (Minsky 1982: 9 – cited from Nesvetailova 2006 ?); this liquidity is undermined, so Nesvetailova summarizes Minsky, as financial institutions are driven by optimism and increasing profits to overinvest and design financial innovations to be able to keep investing despite vanishing liquidity. Long-term assets are purchased with short-term credit (Nesvetailova 2006).

\textsuperscript{36} At the macro-level, this is reflected in the alleged virtuality of financial profits (producing fragility and realization problems), while, at the micro-level, virtuality is seen to flow from the self-referentiality of speculation, divorced from „real“ transactions (even though, of course, the same sort of bubbles is entirely possible when real transactions are taking place).
speculation are not the prices of „real“ commodities, but immaterial prices of money or (future) transactions (Stäheli 2007, 51ff.). However, how does this transform the monetary circuit as a whole, rather than remaining (even though more, and bigger) “bubbles on the stream of (solid) enterprise”?

One may well wonder whether this definition in terms of types of actors and activities will really do, given in particular the systems-theoretical emphasis on emergent effects. And indeed, as the discussion of speculation above demonstrates, the distinction between the two types of economic activity rapidly collapses when one considers that, at the very least, the production of (real) commodities – arguably the driving force of economic dynamics in capitalist, monetary economic systems – similarly is based on arbitrage of risk and opportunities.

Following Minsky and other heterodox economists, one can indeed see any type of capitalist economic unit as a bundle of assets that is concerned with (not necessarily maximizing profitability), but with struggling with a “survival constraint” (Minsky) which requires the protection of liquidity in a world in which payments and cash flows do not temporally match. In this sense, every capitalist economic unit has to weight risks and opportunities, making Willke’s distinction obsolete. The “primary” production economy of is, therefore, just as self-referential and operationally closed as Willke’s “secondary” economy; if anything, Willke seems to have produced a reformulation of Marx’ distinction between the commodity, productive, and money capital circuits.

The real question one should ask is in terms of the monetary circuit: in what ways are more speculative forms – in the sense developed by Baecker, as a higher degree of reflexivity – been inserted into the patterns of cash flows and asset structures constituting the monetary circuit in ways that we can speak of a “dis-embedding”? I would like to suggest that dis-embedding should not be taken to be related to the dominance or growth of speculative activity in the financial sphere, but it is best understood as a transformation of the monetary circuit along the lines of Minsky and Keynes, in order to maximize analytical leverage over how the different epiphenomena discussed above are internally related.

How could one lift the – plausible and fruitful, I would argue – idea that dis-embedding has to do with a higher level of reflexivity and self-referentiality to a higher level (of emergence), and link it to the concept of the monetary circuit? I would argue that Pahl’s (Pahl 2008a; Pahl 2008b) argument to look for the „Emergenz monetärer Strukturzusammenhänge“ is the

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37 No to mention that, with the increasing commonality of consumer-credit and a consumption-driven culture, similar activities can be observed with private households, so that it seems questionable what the actual use of a distinction in terms of the alleged more “primary“ orientation on goods use value can be. While this might be interesting at the micro-level and the psychology of consumers, it seems not a very promising avenue to understand systemic dynamics of financialization and autonomization of finance.

38 And in which interest payments on deferred payments impose a minimum profitability.

39 The „emergence of monetary structural configurations“
right way to go here. In Pahl's terms, this means that the system's dynamic and evolution is a result of "des Zusammmenhangs ihrer rekursiv aufeinander verweisenden monetären Formen (etwa Preis, Geldfunktionen, Kapital, Profit, Zins etc.)" (Pahl 2008, 10).

Keynes, and Minsky building on him, expressly argued that capitalism was prone to a dynamic in which the possibility of purchasing financial assets instead of investing in real capital goods would undermine systemic profitability, compensated by generalized asset inflation and triggering a recomposition of all economic units balance sheet- and economic strategies. This would transform the monetary circuit of accumulation cycles in ways that would make it more virtual or dis-embedded by generating a systemic dynamic that would come to rely on the cross-referential interplay of various structural monetary forms rather than corresponding to the closed, vehicular monetary circuit as depicted above. In this sense, it makes sense to speak of operative closure that is increasingly self-referential, even though not in the simple sense of self-referentiality or reflexivity that Baecker and Willke use to develop their typologies of speculative vs. non-speculative (or degrees of speculativeness): "The principle of operative closure radicalizes autonomy and recursiveness and thus increases the systems' interdependencies, because with elementary circularity, self-referentiality, and self-reproduction the systems become inner-directed not only in the self-organization of their own structure but also in the recreation of their specific elements and operational procedures. Working basically self-referentially, a system will be impressed by events in its environment only very selectively and according to its own selective criteria" (Willke 2006, 41).

The problem does not, however, lie in the category of "investment" as such, as Willke would suggest - "investments imply a recursive and reflexive use of money, decoupling the financial system from its linkage with the real economy... investments always refer to future events, including expectations about the future flow of capital, implying expectations about the risks involved in an investment" (Willke 2006, 53) -, but much rather, I would argue, in the fact that the emergent effects in the monetary circuit that result from what Keynes called "hoarding" (investment in financial assets) trigger recompositions in economic units "rationality" (the way they generate profitability, thus deal with the "survival constraint" of renewing their liquidity and

40 "In dieser Arbeit wird die These vertreten, dass die Entwicklungsdynamik der modernen Ökonomie - und dies schließt die oben genannten evolutionären Prozesse auf den heutigen internationalen Finanzmärkten ein - sich weder durch einen Bezug auf Handlungsrationalität noch auf dem Wege einer allgemeinen Theorie materieller Reproduktion entschlüsseln lässt, sondern nur qua Analyse des Zusammmenhangs ihrer rekursiv aufeinander verweisenden monetären Formen (etwa Preis, Geldfunktionen, Kapital, Profit, Zins etc.)" "In this work I defend the thesis that the evolutionary dynamic of the modern economic system – and this includes the evolutionary dynamics in today’s financial markets – cannot be deciphered with reference to the rationality of agents, nor by way of a general theory of material reproduction, but only through an analysis of the interdependence of the economic system's recursively related monetary forms (i.e. price, functions of money, capital, profit, interest, etc.)." (Pahl 2008b, 10).

41 "In this work I defend the thesis that the evolutionary dynamic of the modern economic system – and this includes the evolutionary dynamics in today's financial markets – cannot be deciphered with reference to the rationality of agents, nor by way of a general theory of material reproduction, but only through an analysis of the interdependence of the economic system's recursively related monetary forms (i.e. price, functions of money, capital, profit, interest, etc.)."
solvency) that put the monetary circuit, and thus the accumulation process, on a path of higher self-referentiality that pushes the entire system to greater and greater levels of fragility, as Minsky has worked out in great detail. While it is not possible to go into all the desirable (and possibly necessary) detail here, a short sketch of the dynamics Minsky had in mine is nonetheless helpful.

**Minsky's basic model of financial inflation dynamics:**

According to Minsky, the „fundamental theme of the GT [of Keynes] is that the asset-valuation process is a proximate determinant of investment“ (H. P. Minsky 2008, 9). Accordingly, Minsky develops a way of looking at the interplay between interest rates, asset prices, and investment decisions that can account for the symptoms of financialization as discussed above. The foundations for financialization, in this scheme, are then the result of what Minsky calls the „basic speculative decision“ oesf economic units in capitalism, namely the question of „how much, of the anticipated cash flow from normal operations, a firm, household, or financial institution pledges for the payment of interest and principal on liabilities“ (H. P. Minsky 2008, 84). Economic units, then, put out liabilities to raise the cash they require to acquire cash-flow generating assets – every asset thus has a counterpart in a liability. Every economic unit is making, with every investment, a speculative decision in that it assumes that the asset acquire by issuing the liability will generate a cash flow that is larger than the cash payment commitments of the liability. Evidently, this is happening under conditions of uncertainty (in the Keynesian, non-calculable, sense); i.e. Economic units require some form of complexity-reduction in order to be able to form (stable, rational) expectations as to the viability of their speculative decisions.

The crucial point here is that, as Baecker has pointed out (Baecker 1988; Baecker 1991) (Callon et al as well – but not with regard to systemic factors), economic rationality requires the ability of economic units to apply a calculus (of profit) in order to make economically rational decisions. But how can this be achieved under conditions of uncertainty, when probabilities of success not only depend on factors not under the control of the firm (development of the industry, etc.), but also on the endogenously created performance of the economic system as a whole (profitability depending on investment – Kalecki)? It requires a calculus that is oriented on certain parameters that can represent for the economic unit its relevant environment (in Baecker's words, by generating a system within the system that, for operational purposes, can represent the larger context).

How is this done? It is done by an intriguing interplay of the categories of (market) capitalization, investments (and their capitalized value), and interest rate (on acquiring cash for investment). A rational calculus would thus lead a corporation to keep investing until the
prospective cash flows of the investment become equal to the market rate of interest. However, it would be held back in such investment by the survival constraint (see above) – i.e. by the relation of cash in- to cash outflows, and the relation of payment commitments to capitalization.

The crucial point now is that – as Kalecki has demonstrated for the system as a whole – investment generates profits, and hence at the margins, every investment will generate cash flows that offset the payment commitments accepted to finance the investment. In putting money into investment (financial or real), however, every economic unit will also contribute to raising the value of assets (either by generating cash flow for units producing investment goods, or demand on the financial asset market) and asset markets in general, thus leading to a positive feedback loop in which investment leads to more cash flows, higher capitalization, and thus improved liquidity (if observed as the ratio of payment commitments to cash flow and near monies) – which will lead a rational unit to invest even further, since investment pays, the liquidity position is seemingly not affected, reinforcing the positive feedback loop even further (H. P. Minsky 2008, 110f.): „... the improvement of realized profits partially frustrates the planned debt-financing of investments of firms and simultaneously reinforces the willingness of firms and bankers to debt-finance further increases in investment. In addition, as debt charges are lower than anticipated, the share earnings are greater. Equity prices will respond favourably to such increases in the flow of internal funds.“ (H. P. Minsky 2008, 112). This means that, in Minsky’s words, the „popular estimations“ of lenders‘ and borrowers‘ risk shape the pace of investment (ibid.) - but these estimations are themselves formed by observing the consequences of this investment.

What we have then is a process in which the homogenous nature of investment in capital goods or financial assets (both are the result of expectations of future income) trigger emergent effects which set in motion a dynamic that sees a transformation in economic units strategy which remain oriented on the same sort of parameters, but endogenously generate emergent effects that make their activities more speculative without (by necessity) changing the nature of activities. It is not (speculative) asset inflation as such – this can also occur with real investment (the origin of business cycles) – that is the problem; It is the systemic substitutability of investment in new capital goods vs. Purchase of existing capital assets that generates emergent implications for systemic profitability that triggers transformations in asset-structures and hence the coupon-pool capitalism Froud et al. describe, with corporations optimizing their asset

42 Point at which there is no arbitrage possible between the cost of finance and the profits to be made out of investment.
43 „we live in an economy in which borrowing and lending, as well as changes in equity interests, determine investment... A financial innovation which increases the funds available to finance asset holdings and current activity will have two effects that tend to increase investment. The first is that the market price of existing assets will rise. This raises the demand price for outputs that serve as assets (investments). The second is that by lowering the cost of financing for production, financial innovations lower the supply price of investment output“ (H. Minsky 1984, xvi)
structures rather than investing in capital goods.

**A short sketch of financialization in terms of the monetary circuit:**

On the basis of this „Minsky-dynamic“, we can then appreciate how precisely”speculation is not the result of the growing importance of a specific type of economic activity that is speculative per se, but results from a recombination of the institutional forms (and the cash flow patterns characteristic of them) related within and constitutive of the monetary circuit. As Toporowski (Toporowski 1999; Toporowski 2009) has succinctly described, an „era of finance“ or the financialization can be, at the most basic level, be understood as generating a net inflow of money into capital markets, raising prices there and attracting further funds (from the monetary circuit) (Toporowski 1999, 1).

The crucial transformation that takes place when the system becomes „financialized“ has been elaborated very succinctly by Toporowski:

„When expenditures create incomes in the economy, the resulting financial flows do not entail any future liabilities or financial obligations: when a commodity is exchanged and paid for, all liabilities are extinguished in the course of the transaction. However, when the flow of funds is intermediated through credit or capital market institutions, future liabilities are created. As these liabilities accumulate, economic agents and institutions alter their behaviour in and reactions to particular market situations or conjunctures. As we have argued, financial parameters, such as interest rates, exchange rates and stock prices, acquire a different significance as financial markets are inflated.“ (Toporowski 1999, 11f.)

Thus, the key problem with financialization is that it leads to a failure of the circuit to close, and means that, in Schumpeter’s words, the differences between claims and liabilities are being carried forward through time, with the resulting (less liquid) asset structures also affecting the situated strategies of economic units. In particular, the „simple“ strategy of capital accumulation commensurate with a periodically closing monetary circuit is undermined:

„...capital markets modify the process of capital accumulation in two ways. First of all capital markets make the return on capital a liability that firms owe to rentiers in the capital market. That return is therefore no longer, as it was in the early years of capitalism, the firm’s own internal financial accumulation (i.e., the saving of the excess of revenues over costs), which precedes actual capital accumulation through fixed capital investment. It is now returned or owed to the financial markets. Second, capital market inflation also inflates the liabilities of non-financial firms to capital markets. As prior claims on the financial resources of the firm, these liabilities then get in the way of accumulation through fixed capital investment. “ (Toporowski 1999, 13)

To relate this back to the discussion in Marxian terms above, financialization generates – or better, reinforces – the penetration of the system of monetary cash flows by the „average rate of interest“ on capital, as well as the (social-)factual nature of capital as a homogenous totality. Second, by making portfolios less liquid, it undermines the ability and willingness of economic
units to finance additional investment. In more detail, the development in the corporate (real) sector of the economy looks like this:

„Capital market inflation results in the over-capitalization of companies. Since the non-government assets traded in securities markets are the liabilities of companies, the effect of this inflation is to reduce fixed capital investment. It is safer for over-capitalized companies to hold non-productive liquid assets against long-term liabilities than tie up funds in plant and machinery, the return on which is subject to the vagaries of the business cycle. The stock of other companies is an obvious liquid asset to hold, and trading in titles of owner-ship to companies leads to takeover (merger and acquisition) booms. Occasional outflows of funds cause capital markets to ‘crash’ or cease functioning. In this sense they become unstable and dependent on continuing inflation.“ (Toporowski 1999, 14)

While, empirically, most companies prefer in principle – as this reduces the risk of insolvency by sticking to what Minsky has called hedge finance, i.e. a situation in which all payment obligations can be service out of incoming cash flows – to finance investment from internal finance, such financialization leads to an over-capitalization of companies, by transforming the incentive structure of corporations regarding alternative means of finance:

„in a process of capital market inflation, where there is over a longer period a positive excess net cash inflow into the financial markets, first notional prices and then actual prices are driven up until effective prices reach a level that elicits the issue of sufficient new stock to take up the positive net inflow, or until the positive inflow ceases. An excess net inflow circulates in the capital market raising prices in this way until it is fully inter- mediated, i.e., when it is taken out of the market. Unlike a portfolio ‘switch’ in which the increased demand for a stock (or stocks) is cancelled out by the additional supply of other stock, an excess net inflow gets passed around the market successively, appearing as additional demand for more and more stocks. The successive increments in demand for stocks multiplies the initial excess inflow into the markets.“ (Toporowski 1999, 34)

In other words, a capital market inflation creates the raw material to fuel its own fire, by triggering an ever-larger issue of financial assets which can then mop up savings and divert them from investment into the seemingly risk-free investment in interest-bearing assets.

Bearing in mind the above discussions of Minsky’s theorization of the dynamics of financialization, it is then possible to bring together what one might call the macro or systemic transformations of the monetary circuit, and the transformations in the mode of observation within the system.

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44 Precisely Keynes argument – before misinterpreted by the neo-classical synthesis and virtually every orthodox economist who came after – on the role of uncertainty and liquidity preference (or, more precisely, its precautionary and speculative as oppose to its transactions component) (cf. H. P. Minsky 2008, 71ff.).

45 Which, much like Minsky has argued, expands financial fragility into corporate balance sheets, not only the financial markets.

46 This works because the cash released from every purchase can – much like in a merry-go-round – continuously reinvested, raising prices of one asset class and releasing further cash in the process, etc. etc.

47 “Why should companies wish to issue more stocks than they need to refinance their investments? They may wish to replace bank debt with cheaper stock issues. But if the excess net inflow is sufficiently great to inflate the capital markets, then there is an additional incentive to issue stock to finance mergers, takeovers, deglomerations and various other kinds of corporate restructurings. These enable companies in effect to become corporate rentiers making a profit on the sale and purchase of companies as capital market inflation raises the value of assets which can be sold in that market.” (Toporowski 1999, 37)
Conclusion – The internal relation between speculation as a practice and financialization as a structural effect:
The purpose of this paper has been to (begin to) dissect the increasingly common narrative the describes the profound transformations of the most advanced capitalist economies over the last decades – their financialization – in terms of the notion of a dis-embedding of financial, speculative economic activity and its consequences for the broader economic system. This narrative, while being productively suggestive in many ways, fails to relate the various aspects of financialization discussed above in a consistent fashion.

However, loose analogies stressing how the „dominance“ of finances triggers changes in the productive sector, how the growth of „speculation“ breeds instability and undercuts the „real“ economy, will not do. It neither makes sense to blame the systemic transformations of the accumulation process on an allegedly more „dis-embedded“ practice or orientation among economic actors as the reverse – to see the rise in such activity as some sort of functional compensation to macro-level problems (of accumulation).

In somewhat outdated language, both sides are moments of the same dialectic: a transformed accumulation process is necessarily constitutively reflected in the situated rationalities of economic agents, as it consists, in the end, only in the emergent effects of their respective balance sheet configurations. It is not that there is such a thing as „speculative“ forms of practice that are somehow inherently more instable than „real“ economic activities, but certain configurations of practices engender dynamic processes that make the same practices that gave rise to them more fragile (and this is not the same as speculative activity becoming more frequent or intense).

Dis-embedding, then, is best understood as a transformation of the monetary circuit that undercuts its purely vehicular nature; but this transformation is best understood not as resulting from a specific type of (dis-embedded, self-referential) form of activity (speculative finance) gradually growing like a cancer and shifting the nature of the host (the real economy), producing all kinds of negative side effects. Instead, we must understand the (dialectical) interplay between social forms and the emergent effects that their interrelations produce.

In more systems-theoretical terminology one could say that the „dis-embedding“ of the monetary circuit (its increasing self-referentiality) does not suffice to explain side effects such as fragility or transformations of some economic forms (e.g. corporations), nor can it be explained (or adequately described) with reference to the characteristics of its constitutent elements. If it is, however, the relations in which social forms stand and the emergent effects arising from these forms of relationality that produce financialization, gesturing towards the role of „speculative practices“ and growing self-referentiality will not do as a guide to how these dynamics emerge.

It is not the nature of „investment“ (Willke), or the nature of some markets (futures,
financial) as such that account for the dis-embedding of economic operations – it is the emergent
effects at the level of monetary stocks and flows that certain configurations and orientations of
those practices, and their feedback into institutional morphogenesis and adaptation, that do the
(explanatory) trick. This is, arguably, a point well worth keeping in mind among all the talk of the
„rise of finance“, the „structural dominance of finance“, or the fragility bred by „speculation“, if we
are to understand how those elements interact to produce the sort of evolutionary trajectory
(and its consequences) we observe.
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