STATE, NEOLIBERALISM AND FINANCIALIZATION

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Abstract: *As liberalism took roots during the 18-th and 19-th centuries, and as United States closed to such an overwhelming position which has made it a political actor with outmost importance at global level especially after the 1-st World War, there was another activity which accompanied this evolution, which is connected to financial activities and their speculative character; one important effect of these actions was the Great Depression in 1929-1939, which threw waves of shocks in America, and all over the world with unforeseen consequences. After the experiences brought upon by the Second World War, doubled by fresh memories of Great Depression, Keynesianism and its system torsed around Bretton Woods negotiations imagined a greater role for the state in relation with the market, especially the international financial market. As this gave birth to what can be seen as the Golden Age of capitalism, it is important to mark the role of state versus market during this period. But as the British Empire was closing to its end, London found a way to reinvent itself, as heir of the dying empire. In order to hold a central position in world affairs, it has looked at money, and the power they could provide: to save its system, London help inventing Eurodollar, circumventing the key-aspects of Bretton Woods and what it stood for. Slowly but surely, the market – especially the financial market – has gained more central position in face of state, and with it, the financialization of the economy. Between 1956 and 1980 there were identifiable clashes in state-market nexus, the most important being triggered by the oil shock in the 70's; but as world entered the 80's, it became clear that the market would gain the upper hand. The Reagen-Teacher understanding was the visible point of the picture regarding the shift of importance from state to market. The 90's will only bring new and fresh markets ready to embrace globalization, sustained by the revolution in communications, which was already in full development. And now we see a minimal state put in a marginal position by the forces of economic globalization and the philosophy of free-market, while the market is seen as a "know and fix everything"; its invisible hand can overcome any temporary disequilibrium. A recurrent question needs to be addressed: where is the state, with its main attributes, in order to protect the people from selfish market forces?*

Keywords: *financialization, market, neo-liberalism, state*

JEL Classification: *E12, G15, N20*

”*I fear that foreign bankers with their craftiness and tortuous tricks will entirely control the exuberant riches of America and use it to systematically corrupt civilization*”
Otto von Bismark

Background

Since ancient times, philosophers and practical people wanted to understand how the state-market nexus is working. A remarkable collection of such ideas can man find in Aristotle’s *Politica* (Aristotel, 2001). As he progressed with his study, the types of political regimes are presented with their characteristics; but all types of political regimes, in order to survive, must find a way so that the state-market nexus works as fine as possible. But not all regimes are good for the people, which (together) are the state. In order to exist, a state must have: territory, people, a legal order to provide expectable ways of behaviour from its citizens, and a special framework related to how and in which conditions it would use its monopoly related to force, both internally, and externally (Wendt, 1999: 198-214). One such regime Aristotle describes as oligarchy, which is characterized by few strong persons (families) which run the state’s affairs in their own interest. On one hand, in a democratic regime, the state wants to create the legal framework to prevent the appearance of monopolies, while on the other hand, the market with its forces press for such a concentration of economic power. The state is a legal order, and it has legal means, while society has its own laws which are based on power relations; this is the reason why – in case democratic regimes unite people which are not very aware, and are not very educated in relation with the importance of the state – money, with their own law which says that money attracts more money, would tend to flow to those who already have more, from those who have less. Such a movement of money and wealth in society from more to few will bring changes in the political regime; it could morph from democracy into aristocracy or oligarchy. The difference between these two is huge. Even there are few in both regimes which create the rule for governing society, aristocrats rule the society haunting benefits for all, while oligarchy run it for its own narrow interests.
In a few simple words, aristocracy has a nationalist trait, while oligarchy has a large international character. Oligarchs are more open to “run” during times of crises, in order to protect their wealth; attacks on different currencies, investment funds or

hedge funds movements, for example, are focused foremost on profit, and not on large social benefits. These activities – which are connected to pure speculative activities – are important traits of an oligarchic political regime.

But always, for something which is unnatural – too big is not necessarily natural – time comes and the judgment is brought upon; market forces were pushing for profit maximization, while society at large must pay... Bailouts for example, are instruments which are used to protect exactly those powerful market actors which brought in the shock and crises, while states (people) are kept to pay those mismanagement activities pushed by the greed of the few. And the state, which market pressed to play a minimal role, is asked for intervention. With the financialization of economic activities promoted by economic globalization, these shocks are far greater, while their settlement time brings large social and even greater political consequences; in this context, the possibility of strong nationalist movements and even wars, with all negative consequences, especially for those who cannot "run" – ordinary citizen – cannot be overlooked.

That for, we must see the interest related to creation of the state by people, not only in order to protect them in face of any internal menace or external threat, but in order to protect them, in relation with market forces, too. There are a lot of historical evidences which bring to our attention the fact that a more powerful market creates disequilibrium, while a more powerful state can crush the individual. Free market and especially free financial flows can bring havoc during settlement time, while a powerful state – as it was in Eastern European countries during the communist period, or in North Korea nowadays – can crush all initiative which had it been much free, it could have brought larger benefits for society.

The equilibrium between market and state is hard to find and maintain, but not impossible. The good case practice in our case is Bretton Woods and what Keynesianism stood for; they are inseparable from the Golden Age of capitalism.

While Bretton Woods was a benchmark aiming at curtailing unchecked market forces, the re-emergence of liberal thinking is quite contemporary with it; the neoliberal revolution was born at Mont Pelerin, near Geneva in 1947 during a meeting attended, among others, by Hayek, Friedman, Robbins, Stiegler. The "meeting was *financed* by Switzerland's three largest banks, its two largest insurance companies, the Swiss central bank, the Bank of England and City of London interests" (Shaxson, 2018a: 37). Such a sponsorship cannot be unconnected to forces generating momentum for the re-emergence of global finance and the financialization of the economy. Furthermore, free market doctrine and its promotion through international institutions (such as World Trade Organization) has created the premises for free flying capital to easy relocate where it can faster and

easier extract profit, not necessarily where it could be involved in direct production of goods and services. As a consequence, the financial sector has become outsized related to productive economy; by 2006, for example, UK banking assets were five times British GDP, and if we count other financial activities/services and institutions, the ratio is ten times GDP (IMF: 2017).
The cost incurred upon society due to this doctrine promoting free market and "efficiency", which promoted capital concentration, cannot be overlooked. As Epstein (2005a) points, the *promotion* by governments of financial *liberalization* has been done despite its enormous and tangible costs. Even neo-liberalism and financialization are not synonymous trends, it can be noted that a change in ideas generates shifts in material world. As a consequence, the free market doctrine has promoted capital flying, capital concentration, and with it, the financialization of the economy.

Losing an empire doesn't mean it is impossible finding a new role

With the horrors of the Depression during 30's fresh in the memories of governments, they wanted to create the condition to have the power to create full employment. So, state was asked to come back in order to create conditions for regulations which generated New Deal (in the US), and the welfare state (in UK and various countries on the continental Europe); all were centred on greater role for national governments in controlling investment levels, in order to improve living standards (Bullough, 2022: 33). As the policies connected to such restrictions started to bear fruits, there were important restrictions regarding international flow for the capital, while the gold was central to the system: in 1956 one USD could buy 0,03 ounces of gold, by law, guaranteed by the Federal Reserve (Bullough, 2022: 50); that means, then one USD can buy 0.933 grams of gold.
Just for comparison, this year gold hovered around USD is 1850/ounce, and in March, after Moscow started its military actions in Ukraine, there was a spike of 55 times in the price related to 1956 level (At the moment of writing – late November 2022 – gold is valued at USD 1755/ounce). If in the post-war world gold and other currencies had a very restrictive framework to fluctuate, one pound sterling being valued at USD 2.8, the disappearance of Bretton Woods, and of states as key-players, and the re-emergence of market forces and private finance, would make a clear point, showing how speculative activities handle actions related to gold market, and how these actions influence the price of this commodity. Any emotion brought by a dramatic event means that speculative finance handling currencies,

gold, and other investment opportunities is focused principally on profit maximization/limiting looses, without much care about society (and state), at large. If you want to crack down on tax heavens, one must start with the banks, said Shaxson (2018a: 94-107). As much of the blame for the Great Depression had been laid on banks, and their “hot money” (e.g. speculative financial capital), that was deemed to generate inflate asset bubbles, bringing in the end crash in stock market, the governments after the WW2 decided to favour productive activities over financial ones; exporters gained the upper position over financial houses and their interests; put in another words, *productive capital took priority over speculative capital* (Bullough, 2022: 34). And as a consequence, capital flows were severely restricted; state was back, while market had to comply.

As a matter of fact, London companies were those who first conquered India, Africa, North America, not the British state, the City of London being the interface between Britain and the rest of the world; and if under Bretton Woods, the City wasn’t allowed to finance trade and to attract business and money wherever it wanted, its role as world financial pivot was greatly reduced. Another player manifested its prowess: the USA, and its booming centre, New York. Business that once flowed through London – trade financing, bond deals, everything London saw as its birth right – were now conducted by “parvenus” on the Wall Street, while the City was almost absent from national conversation (Bullogh, 2018: 68-69).

Under Bretton Woods, the US aimed at pegging currencies to USD (and the gold), but not all foreign governments trusted Washington would honour the commitment related to using dollar as an impartial international currency; the example of US actions immediately following WW2 related to sequestrating communist Yugoslavia’s gold reserves were fresh, coupled with its refusal in helping communist Poland to recover after the war. Furthermore, as Suez Crisis took shape, London wanted to keep its influence in the area, commencing a military adventure along with Israel and France against Egypt, who had just nationalized the Canal; as their action were unfurling in 1956, a disapproving Washington, fearing Arab countries would orbit towards Moscow, froze Paris and London access to dollars, and doomed their action. The conclusion is simple and direct: the US wasn’t acting as a neutral arbiter.

During that period Britain jumped from a shock to another, and in 1957 they took a decision regarding interest rates’ rising, in order to restrict Pound sterling using, with the aim to protect it; City banks, being cut off from sterling, began to use dollars instead, which they got from the USSR, who decided to keep them there, in order to avoid any blackmail from Washington (as previous examples show).

This is the context in which the idea of Eurodollars took roots; lending USD by Moscow Narodny Bank (Soviet-owned bank, based in London) to another bank from London (the first one doing this was Midland Bank), could make available those dollars, without buying them! This was a big idea pushing London again towards the central place in the world of finance. Borrowing money didn't mean they were bought, which wasn't allowed under the limits related to capital movements imposed by Bretton Woods (Burn, 2006: 20-29). As London was losing its military empire, it was reinventing itself as a centre or global finance and world influence. As in the past, when British elites promoted overseas expansionism through trade and military actions, decisions were taken by Britain's financial elites to re-establish a regulatory order, largely independent of the British state (Moran, 1991: 16) bound under Bretton Woods requirements.

So, the market has taken the lead determining outcomes for itself, and for the state, too.

This action can be regarded as opening gambit in a new era of economy's financialization, where speculative capital (with its different forms but the same character) gained the upper hand in relation with productive/investment capital; market's free forces were unleashed again in full force, to the detriment of labour force and state' projects.

Tax heavens have only come to add complexity and power to this financial activities (Epstein, 2018) helping market represented especially by large banks and multinational corporations to upgrade their profits due to capital flights (Epstein, 2005b), while dodging income taxes (Zucman, 2017). As a matter of fact, along banks and large global corporation, organized crime (Gragert, 1997) was one of the most adaptable actors using these new opportunities brought by financialization (Galeotti, 2018).

Furthermore, in the context of liberalization brought by Eurodollars' using, more deepened by the race to attract hot money, large banks made a central focus in helping wealthy individuals dodging taxes in countries where they gained their money; in this way the neo-liberalism not only unleashed speculative capital to hunt low tax places with no or lax scrutiny (Shaxson, 2018b), but it has created a very lucrative business for large banks, too (Birkenfeld, 2020).

And London's new imperial financial feature has helped transforming the world economy, but the City has wreaked havoc globally, and at home, too; vast financial sector salaries have emptied manufacturing industries of their best-educated people, while its interests have come to dominate the society. Between 1979 and 2011 employment in UK manufacturing sectors fell from 6 to 2.5 million, its output stagnated, while financial services output trebled (Shaxson, 2011: 277). Over this

fact, in the decade before 2007 financial fallout, only 3% of banks' net cumulative lending in the UK was directed to manufacturing, while ¾ went to home mortgages or commercial real estate (Shaxson, 2011: 277). Under the City's new imperial framework, "money floods into London, then is repackaged and is recycled out again, often via offshore satellites, to build glittering skyscrapers in Dubai, giant condominiums in Sao Paolo and games of financial bait and switch in New York" (Shaxson, 2011: 278).
But negative consequences are visible too: Britain and the US, the leaders of modern global finance have one of the most unequal societies in the developed world: in Britain 0.3% population owns 2/3 of the land; while just after the crisis City bonuses were Pounds sterling 14 bn in 2010-2011, 40% higher than the average for 2000-2007 period, the boom years leading up to the financial crisis (Bonus Payments flat in 2010-2011, Office for National Statistics, 2011).

Financialization of the economy

As shown in last phrases above, in the beginning of 70's there was a huge change in the world related to finance and its role in world economy; Bretton Woods' downfall doubled by oil shock put pressure on financial market and financial streams and international credit. As breaks on transferring currencies at international level were eliminated, and as banks and other large entities connected to financial speculation (insurance companies, pension funds, hedge funds, shell companies, private equity companies, and trust companies) have taken deeper roots in the world economy, their proclivity to speculation and risky business has constantly risen.
Coupled with this trend, there was another aspect, with huge implication in the long run: competition among states to attract hot money has gained political momentum. Countries started to accommodate more and more to the desires of those who manipulated money. Synthetically, there was less control by the state upon the financial market, and financial flows; so that the market has gained the dominant position in relation with the state and society. As political discourse, especially in countries with powerful banking and financial sectors, have channelled debates underscoring the importance of lower taxes, doubled by lax laws and regimes related to money transfer and the identification of the source of money crying for a more "friendly atmosphere" fearing the relocation of finance towards other more friendly places, a race to the bottom has started. Deregulation has become the main trend.
As states' governments started to accommodate the requirements of financial interests, welfare state was put to the margin, negatively influencing public expenses

related to different infrastructure and social actions. In the mean time, tax heavens registered upsurge, without citizens of these state filling the whole benefits of this trend. For example, the tiny Cayman Islands enjoys the 5-th position in world finance; Cayman Islands' shadow banking sector, open to various sources of money, held assets worth USD 5.8 trillion, the equivalent of 170000% GDP of Cayman state, or twice as big as UK's GDP (Shaxson, 2018a: 153).

It is important to note that special financial interests in the City of London – not the UK – have played a crucial role in the creation of this deregulated financial market, supporting in the same time the financialization of economy, deregulation, speculative actions, tax heavens role in channelling hot money springing from clean or more opaque sources, all which generated social inequalities and weakening the states, all over the world.

Neo-liberalism became the mainstream *philosophy* to be embraced by universities, political leadership, private actors, and especially large multinationals and banks. Of course, in theory this philosophy sounds good, but when it comes to real world, due to traits common to almost all humans – such as greed – neo-liberalism creates huge opportunities for one who can, to the detriment of one who cannot. Deregulation took the reins of economic activity from the hands of the state, handling it down into the hands of the market. In mathematical models a free market, through its mechanisms based on competition, should generate benefits for customers; but in real life money has another law: it tends to concentrate, creating premises for monopolistic actions, through mergers or acquisitions. This is the *ideological layer* of financialization.

It is important to note that as Cold War was closing to its end, technological revolution in global transports and especially in communications overlapped this ideological trend. Furthermore, it was the same period when the study of international *regimes* (in different fields) gained momentum, and World Trade Organization became the main forum where negotiations have created the framework for trade in services, including financial services. Large law and accountancy companies have played important role in this trend; all these can be regarded as *instruments* of economy's financialization.

As mentioned before, London changed its imperial coat with a more sophisticated one, embedded in its trading traits; 7 from the 14 territories, the last fragments of the British Empire, are tax heavens (Anguilla, Bermuda, the British Virgin Islands, the Cayman Islands, Gibraltar, Montserrat, the Turks and Caicos). These can be regarded as *vehicles* for the economy's financialization. As a matter of fact, cash intensive businesses as gambling activities are connected to London via Gibraltar

(Cassidy, 2020), Gibraltar being more than that, a favoured destination for dodgy money from countries belonging to former Soviet Union (Shaxson, 2018b: 99).

But tax heavens' heart beat on every continent: in Asia, Hong Kong is China's financial bridge to the world; Singapore homes elites' money from Australia and South-East Asia; in Europe the "competition" is among old Switzerland and newcomers as Ireland, Luxemburg, the Netherlands; The United States boasts tax heavens such as Delaware, Nevada, and Wyoming. Pacific area has its butlers, too: Vanuatu, or Cook Islands, while Indian Ocean boasts with Seychelles and Mauritius; they are all created to serve well the interests of those how can to the detriment of those who cannot.

The *source* of money is another clue to understand how financialization works; as rich countries have constantly lowered their corporate tax rates since 70's corporate investment had stagnated, and tax avoidance has risen very much. This available capital can be a source of economy's financialization, while most large pension and equity funds touch the offshore tax heaven system one way or the other. But there is another shadow money pile, looking for clean investment vehicles; here tax heavens are the province of Mafiosi or drug runners (Glenny, 2009), tax-cheating celebrities, European aristocrats (Birkenfeld, 2020), major private-sector financial institution, and even politicians (who can use tax heavens to hide kickbacks). Burgis' book is more than illuminating in this respect (Burgis, 2015). If we look to Switzerland, just here in 2017 there were (at least) EUR 2100 billion belonging to people who parked their money on Swiss territory (Zucman, 2017); almost all this stuff is hot money, looking for investment opportunities which, due to high rate of financialization it promotes, it is the main determinant of financial instability, asset bubbles, increased economic and political instability, and even of "Dutch disease", especially in smaller economies or where diversification is missing.

In fewer words, world economy, due to high degree of financialization, has become to act as it were a huge casino, the world of finance offering the players different choice of games: foreign exchange market, commodity market, bonds, government securities and shares market; some players are large – banks especially – other are small operators; there are tipsters, too, selling advice, and system's peddlers to the gullible... The *croupiers* in this global financial casino are the largest banks and brokers: they "play for the house", while in the long run making the best living (Strange, 1997). These are the *beneficiaries* of economy's financialization.

Of course, if we have winners, we also must have some *losers*: financialization brings havoc to lucrative industries, relocating them towards more attractive places regarding taxes or environment requirements for example. States lose, too: as financial economy warms up, state's control upon economic activity and society's destiny weakens, hurting the most important ingredient of a sustainable democratic society: middle class. In this evolution of state's dissolution powers related to market forces, all main attributes of the state are affected: agriculture (large food industries and intermediaries are winning), transport (large infrastructure projects, which bear important military component are handled by private companies, possible with higher costs and lower quality), energy, education, medical services and social security activities...

As economic power concentrates in the hands of a few and social inequalities are rising, the transformation of democratic traits in a society is retreating, leaving space to a perverse form of democracy, where people can vote to no avail, while society and state's runners are few. We can imagine dealing in this case with a masked democracy, while the real mask bearer is an oligarchic regime.

Conclusions

As this paper shows, there have been important shifts in world economy during last century and in this time span the financial capital and lucrative capital changed their role. But as free-market gained large influence, especially after 1986, pushing globalization and benefiting from this process, some economic traits were manifesting too: different economic crises hurting more or less different parts of the world. As privatization has become the main trait and discourse especially during 90's, state has retreated, while market has come to the forefront. But when shock broke in 2007, it was state who was asked to save the market; bailouts became the main discourse. Even if the state hadn't been the actor who brought the crisis, but the market (especially the financial market with its "great inventions"), it has been asked to rescue exactly the greedy and speculative market actors.

It can be said that the world, as we see it, with capitalism flourishing cannot be separated by tax-heavens; they are inseparable. So in order to create the premises for a more equilibrated world with happier people, the state should *re*-gain its attributes in relation with market and society, to have instruments to tax market actors' profits and redistribute them in a way that will sustain the main ingredient of a healthy democratic regime: its middle class. Other way, democracy can be on retreat in face of oligarchy, and in the long run, in face of more dangerous ideologies, which could polarize society, with possible negative consequences related to internal and external security of states.

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