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Darlene N. Moorman
Cleveland State University

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Unwilling Gamblers and Loaded Dice: Considering Recession and Crisis as a Natural Effect of Financial Capitalism

Cover Page Footnote

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Around a third of Americans, according to Pew Research Center (Hartig, 2019), view capitalism negatively. All things considered (such as capitalism being as 'American' as Uncle Sam, guns, and Fourth-of-July fireworks), this is a meaningful and attention-deserving reflection of how people have recognized how their interests are subordinated to those of businesses and the market. Americans, as well as people all over the world, have been given plenty of reasons to resent and question their economic system as it is. One reason, for instance, can be listed as the Great Recession, during which many people felt the impacts of massive unemployment and home foreclosures.

The 2007-2008 financial crisis, which correspondingly led to the Great Recession, was an important moment that sparked a conversation on the failings of capitalism and of government in mediating the markets. The economic turmoil of 2007+, largely involved the housing bubble and subprime mortgage crisis in the United States. Some of the underlying contributors to this crisis and recession include securitization, risky and predatory lending, lack of oversight, and flawed corporate governance (Financial Crisis Inquiry Commission [FCIC], 2011). Under these detrimental practices and conditions, housing financing mutated into, as Minsky called it, a "huge global casino" (2008, p. xxiv), meaning it was tangled with extraordinarily risky financial practices.

Criticizing the Neoclassical View

For neoclassical policymakers and scholars, the ideal economic model is one in which individuals acting in self-interest and with rationality interact in an equilibrium-producing manner. Given this logic, the market is largely self-regulating and the 'invisible hand' should be left alone to rule. In this line of thought, a financial crisis is an abnormality or exception to the rule. The assumptions made, in this regard, are highly unrealistic for the real international political economy.

It is cases such as the 2007+ recession that clearly delegitimize and invalidate the neoclassical synthesis, that in application means having a tunnel vision leading to precarious policy implications and misleading theoretical interpretations. Indeed, a common response concerning the Great Depression (held by Secretary of State Cordell Hull and economist Hans Arndt, for example) was in part blaming protectionism for economic turmoil. However, as indicated by Strange (1998), protectionist sentiment arose as a consequence of public frustration because of economic turmoil that was already in motion; in other words, protectionist policies were "a symptom of economic pain, not a cause of it" (p. 87). Similarly, during the Great Recession, blind-sided "pro-marketeers" such as economist Jeffery Sachs and journalist David Lascelles also preferred to blame the state rather than the nature of the market (Strange, 1998, p. 11).

In contrast, exploring systematic explanations, which to be clear does not equate to having a deterministic approach (i.e., arguing the "inevitability" of something), can offer invaluable insights into why a financial crisis and recession happens. Fundamentally, for this paper, this means analyzing the internal conditions of financial capitalism conducive to crisis and recession as well as how that has changed over time.

Financial Instability and Institutional Change

Financial instability is observable through *prima facie* evidence of historical experience but also makes sense theoretically. In establishing such, the literature of Blyth concerning institutional change is helpful in illuminating how a neoliberal shift (which encompassed large-scale deregulation and liberalization) came about. In this resulting neoliberal environment, pivotal transformations materialized in a specific brand of financial capitalism, which Minsky tied to inherent instability and crisis-proneness of the economic system.

Counter Double Movement

Polyani described, as outlined by Blyth (2002), the notion of a 'double movement' through which the people of a disembedded society, market-oriented and commodified as a result of capitalism, utilized state authority to re-embed themselves (in other words, change the political and economic climate). Embedding and disembedding describe a process in which something is replanted or excluded (respectively) from a social dimension. In essence, as Streeck (2017) would describe it in the contemporary contexts of the debt state, it is the struggle between *Staatsvolk* and *Marktvolk* or the competing interests between the "general citizenry" and "people of the market" (p. 80). For Polyani summarized by Blyth (2002), re-embedding brought about political welfarism also known as embedded liberalism.

Since Polyani's meaningful contributions in the mid-twentieth century, there has been another political transformation, a double movement "reversal" or "counter double movement" as elaborated by Blyth (2002, pp. 4-5). Just as the 1920s and 1930s led to a shift from classical to embedded liberalism, the 1970/1980s led to one from embedded liberalism to *neoliberalism* (or from Keynesian to Hayekian economics), which like its conservative predecessor sanctifies the market and values massive capital movement and volume (Blyth, 2002; Streeck, 2017). Streeck (2014) describes this fairly recent counter double movement and noticeable triumph of *Marktvolk* by writing "business reorganized itself as a collective agent" and used their influence and power to push for the "demobilization of the state and labor as economic agents" (p. 14).

Around the same time as this neoliberal shift (in the 1980s), related processes of financialization and marketization took place (Streeck, 2014; 2017). Financialization is associated with an increasingly international scope of financial markets and the incorporation of improved technology in financial activity. On the other hand, marketization is a type of disembedding where market rationality permeates other (such as social or political) bounds. These developments of neoliberalism are integral to financial capitalism and have meant minimal regulation and a "hands-off" government in certain areas, which is why underhanded and irresponsible financial practices have been able to occur to such a gross extent.

The Financial Instability Hypothesis

In identifying the defects of applied capitalism, Keynes explored underemployment and inequality; since then, Minsky has expanded this list to also include *financial instability* (Minsky, 2008). Minsky's Financial Instability Hypothesis (FIH) considers the implications of financial capitalism or "money-manager capitalism" (2008, pp. xxii-xxiii), the critical components of which manifest endogenous instability and naturally-occurring crises. In clarifying FIH, Minsky (1992) specified two theorems: one which stresses the significant influence of financial institutions and regimes and another which, on a systematic level, indicates a tendency for "prolonged prosperity" to induce conditions that, in turn, causes instability (p. 8).

In order to better understand FIH, it is necessary to consider the underlying environment that Minsky observed. Under financial capitalism, liabilities are integral aspects of the investment process and movement of capital (Caverzasi, 2014). In investment activity, and particularly intensified by the financialization movement, "money is connected with financing *through time*" (Minsky, 1992, p. 3) meaning there is a "veil of money" (Keynes, 1932, as cited in Minsky, 1982, p. 61) amid real assets. In other words, money is also a "type of bond" (Minsky, 2008, p. 250) that entails speculation and is impacted by factors such as uncertainty, confidence, and perception. This is the key distinguishing feature of the functioning "Wall Street Paradigm" (in contrast to the "Village Fair Paradigm"), where a market is defined by complex financial institutions that interact with money in a way that far exceeds being "merely an expediter of transactions" (Minsky, 1982, p. 61).

In describing the context of financial instability, Minsky (1992; 1998; 2008) clarified different categorizations of finance including hedge, speculative, and Ponzi (see Table 1 for more detailed definitions). In relation to payment commitments, correspondingly they entail generating enough to pay principal/interest, just the interest (meaning rolling over debt), and not even the interest (meaning greater debt). It is under unsustainable speculative and, to a more

severe extent, Ponzi financing that structural conditions of a "deviation amplifying system" are propagated (Minsky, 1992, p. 7).

Table 1

Minsky's Types of Finance Units	
TYPE	**DEFINITIONS**
Hedge	➢ "cash flows from operations are expected to be large enough to meet the payment commitments on debts" (Minsky, 1982, p. 66)
Speculative	➢ "cash flows from operations are not expected to be large enough to meet payment commitments, even though the present value of expected cash receipts is greater than the present value of payment commitments" (Minsky, 1982, p. 66)
Ponzi	➢ "cash flows from operations are not sufficient to fulfill either the repayment of principal or the interest due on outstanding debts by their cash flows from operations" (Minsky, 1992, p. 7)

In addition to the role of money-managers and money and significance of the type of financing, also vital has been the increasingly blurred nature of commercial and investment banking, the distinction between which, Minsky (2008) indicated, has become "artificial" and is continually dissolving (p. 252). Indeed, Strange (1998) listed this, which she called the "end of banking," as one key transformation that has occurred in the international political economy (p. 9). In Minsky (2008)'s analysis, he also discussed the dominance of markets over banks and the increasing consolidation of banks as causes of concern.

Considering such components, Minsky (1982) argued that drawn-out economic success and stability actually help create the problematic conditions under which a crisis may occur. For instance, optimism and confidence during economic stability may lead to a "shift of portfolio preference" towards speculative/Ponzi financing (Caverzasi, 2014; Minksky, 1982, p. 106). This shift from "fear toward greed" or from cautious and responsible to risky and unethical financing, was escalated due to false confidence spurred by public officials such as Alan Greenspan and policies such as the New Monetary Consensus, decreasing interest rates post-dot.com bubble burst, and the Long-Term Capital Management rescue (Minsky, 2008, p. xxiv). Furthermore, even when a crisis is curbed, dodgy practices are legitimized and likely to continue (Minsky, 2008). In the aftermath of the 2007-2008 crisis and then the recession, as mentioned by Drezner (2012),

discourse was still very pro-free-market. Also, recovery entailed quantitative easing (Drezner, 2012), which Streeck (2014) demonstrated is not sustainable. In these regards, "stability is destabilizing" (Minsky, 2008, p. xii) and *financial* capitalism is "dying… from an overdose of itself" (Streeck, 2014, p. 55).

As summed up by Minsky (1982), inherent instability is explained through two factors: "market relations that enter into the investment process" (illustrated by Money Manager Capitalism or the Wall Street Paradigm) and how "the liability structure commits the cash flows that result from producing and distributing output" (as seen in speculative/Ponzi financing) (p. xvi). Under the conditions and with the components of financial capitalism discussed, the ramifications (as in the case of the Great Recession for example) may include lacking oversight/regulation, securitization, continually risky practices, insufficient depositor surveillance, and more (Minsky, 1982; 2008).

A Global 'Good Financial Society'?

Minsky's solution for a better mode of capitalism lies in certain "circuit breakers" including "convention, constraints, and interventions" (Minsky et al., 1994 and Minsky & Ferri, 1991, as cited in Minsky, 2008, p. xvii). However, as recognized by Strange (1998) in reference to the 1990s, there may be "more understanding" but "no more willingness and less capability" (p. 90) in actually dealing with financial crisis. Although capability, through multilateral economic institutions and regimes, may be more robust and extensive, the issue of "willingness" still often prevails. Helleiner (1994) exemplified such a point in examining 1970s efforts to establish international cooperative controls; despite multilaterally acknowledging the dangers of rapid and unrestrained capital flows, controls were "politically difficult to implement" (p. 121). In end, the United States blocked such an attempt and instead pushed neoliberal policies to further liberalize the global economy. More recently, Streeck (2014) mentioned how the summits following the 2007-2008 crisis and up to that point were, in general, inconsequential and insignificant. Even if these 'circuit-breakers' prove themself politically practical in application, Streeck (2014; 2017) also noted a valuable concern in how increasingly delegating state authority to KIEOs (Keystone International Economic Organizations) also means insulating the delegated policy-making areas from democratic input.

Inevitability or Structural Tendency?

Although it has been established that the 2007+ recession was no random mishap, it would be problematic to simply label the occasional crisis as the inevitable and inescapable result of nature. The issue with this economic deterministic language is that it neglects the variable of agency and assumes permanency in a likely

impermanent system. Those throwing it around haplessly are also the ones making the "end of history" fallacy (referring to Fukuyama in Blyth, 2002, p. 4). As Minsky argued, saying "capitalism is inherently flawed" does not mean economic disaster might "need not happen" (Minsky 1982, p. vii). At the same time, crises and financial instability are the results of *systematic conditions* from which a *structural tendency* can be reasonably presumed.

Conclusion

The central argument explored within this paper does not lie within the conflict between pessimism and optimism (as Strange [1998] unfortunately worded it) or of being either an abnormality of a working system or an inevitable attribute of a faulty one. Rather, the major takeaway point is that financial instability and the possibility of erupting into financial crisis and recession is a *natural effect* of financial capitalism, a mode cultivated from the neoliberal counter double movement. The causes of the 2007-2008 crisis and recession, namely "over-hasty" liberalization and insufficient oversight, can also be observed in other crises (Strange, 1998, p. 81). The 2007+ case in particular as noted by Streeck (2014), however, showed that in this era of financial capitalism, firms are not just "too big to fail" but also "too big to jail" (p. 61).

Since the Great Recession's slow recovery, many of the components and conditions which bloomed into crisis still exist. Safeguards against economic disaster are not to be taken for granted, particularly if, as Minsky (2008) warned, "that dangerous 'free market' ideology came to dominate policy," which it has and continues to (p. xviii). Indeed, there have already been visible signs of dismantling post-crisis safeguards such as the ones in the Dodd-Frank law as a part of the Trump administration's agenda of deregulation (Rappeport & Flitter, 2018).

Taking into account the plethora of unethical and risky behaviors practiced in financial capitalism, Strange (1998) used the term "casino economy," its inhabitants "involuntary gamblers" (p. 5; p. 4). Like gambling, redistribution takes place, the greatest cost shouldered by the people of a lower economic class ("oligarchic redistribution" that Streeck discussed comes to mind [2014, p. 59]). Average citizens or *Staatsvolk* are the "true losers" of an "unfair game" (Minsky, 2008, p. 279). Nothing is really inevitable, but it can be likely to end poorly and, considering the issue of moral hazard, unevenly hurt those passive and unwilling gamblers compared to the apathetic dice-rollers (as was the case in 2007-2008). Using loaded dice does not ensure they will land a certain way, but it creates the conditions to gravitate toward one end. Similarly, financial capitalism is "loaded" in a way in which riskier types of financing and unethical banking practices are instigated and conveniently exist within an ideological paradigm that religiously advocates for deregulation and limited oversight.

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