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6: FINANCIALISATION AND THE "NEW NORMAL". AT THE ROOT OF THE AGGREGATE DEMAND PROBLEM UNDERMINING NEW CAPITALISM

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1. Introduction

This chapter focuses on how financialisation contributes to the so-called "New Normal" (NN) in developed countries, that is to the current, post-Great Recession scenario, characterized by relatively slow growth, low inflation, high asset prices, high inequality, low aggregate demand and welfare cuts.¹ The NN is the product of the deep structural change that has occurred since the 1980s within the current stage of growth, or regime, of capitalist development, conveniently labelled as "New Capitalism" (NC) (see e.g. Sennett, 1997).

¹ There is no generally agreed definition of financialisation in the literature. It is a multi-dimensional concept that can be defined in different ways according to the emphasis placed on specific issues, such as a new regime of accumulation, shareholder value orientation and how finance affects people's everyday life. For an overview of the relevant literature, see e.g. Lapavistas and Powell, 2013; Sawyer, 2016; van der Zwan, 2014. Here we regard financialisation mainly as acceleration of financial transactions, growth of the stock of financial assets relative to GDP, and growth of financial incomes compared to non-financial turnover, assets and incomes.

In contrast with Modern Capitalism (MC), the NC involves a higher degree of interconnectedness between changes in “objective” phenomena – such as financialisation, globalisation, the introduction of information technology, the diffusion of deregulation moves – and changes in “subjective” factors such as agents’ collective perceptions of key dimensions (including those of “market”, “value”, “space” and “time”).

This chapter holds that, mainly because of this higher interconnectedness, NC turns out to be more unstable than the MC, rather than a golden age – the so called Great Moderation – celebrated by standard theorists until the outbreak of the crisis. More specifically, this chapter’s contribution is to stress two points. First of all, financialisation plays a key role in NC because it dramatically increases its interconnectedness; secondly, the latter accounts for the persistent lack of aggregate demand in this growth regime.

To discuss these issues, the chapter is organized as follows. Section 2 focuses on the interconnectedness of NC. Section 3 analyses how financialisation contributes to this phenomenon. Section 4 deals with the link between financialisation and the aggregate demand problem in NC.

2. The interconnectedness of New Capitalism

In contrast with modern capitalism (MC), NC presents several structural, irreversible changes. Here I place the emphasis on two basic novelties. The first is the acceleration of key trends, such as financialisation, globalisation, the introduction of information technology, the diffusion of deregulation moves – neoliberalism – as well as postmodern cultural factors, such as the

performativity of standard theory, which amounts, for example, to the fact that society as a whole takes standard theory in general as the only scientific approach to economics, “the only game in town”, providing a secure anchor to agents’ expectations and policymakers’ choices (see e.g. Metcalfe, 2017).

The second novelty of NC is the fact that such trends appear more strictly interconnected than ever before to the point of defying traditional classifications. Indeed, as pointed out by postmodernist authors such as Bauman (2000), NC can be labelled as a “liquid” society in which rigid separations – such as those between economic sectors (e.g. financial/real), between different spheres of society (e.g. cultural/institutional/ economic) or between different temporal trends – break down. In particular, in NC a key form of interconnectedness acquires special significance, namely that between the objective trends and subjective features governing agents’ behaviour, such as their perceptions of these trends. I refer to “coordinates”, such as those of the “market”, “value”, “space” and “time”. It can be argued, for example, that the new technologies and globalisation stimulate a new perception of “time” (e.g. short-termism), “space” (e.g. the “world is flat” metaphor used by Friedman, 2005) and “value” (e.g. the acceptance of greater inequalities in income distribution); moreover, the performativity of standard theory has changed people’s perception of the “market”, leading to the widespread acceptance of markets as the ultimate mechanism to allocate resources. A more complete analysis of such perceptions will be provided in the next section, in the light of our account of the role of financialisation in NC.

3. Financialisation and the interconnectedness of NC

3.1. *Increasing interconnectedness in the financial sector*

As implied by the various labels used in the literature to categorize the recent stage of growth – such as, “finance-dominated capitalism” (e.g. Hein, 2012; Palley, 2013), “credit-led regime”, or “money-manager capitalism” Wray (2010) – the role of financialisation is crucial to understanding of the *modus operandi* of NC.² In particular, this chapter places the emphasis on a “qualitative” feature of financialisation, namely the fact that it increases the interconnectedness of NC.

Let us start by focusing on the financial sector itself. There is no doubting that this sector is “naturally” more interconnected than other sectors. Suffice it to note, for example, the “chain nature of financial systems”, according to which, for example, “a default by a borrower in turn puts lenders at risk” (Palley, 2012: 74) or that such systems generate a “web of debt” (see, Brown, 2012). However, one major novelty in NC is that financialisation generates a drastic acceleration of this natural tendency, as shown by the fast contagion seen in the recent crisis, where a relatively “local accident”, such as the subprime crisis in the U.S., has been very rapidly transmitted to the rest of the world. One reason for this contagion is that, because of the complexity of the new assets and the securitization process, financialisation generates longer chains of people involved in the income and profit generation process with respect to MC, as shown, for example, by the fact that in the recent “originate to distribute” banking business model

the cost of default is no longer borne by individual banks as in the traditional “originate to hold” model, but by the whole financial community and ultimately by the state (see e.g., Palley, 2012: 66).

3.2. *An endogenous mechanism ensuring the growth of the financial sector*

But there is also another reason why the financial sector is growing with respect to other sectors of the economy, thus increasing its interconnectedness: namely, the existence of an endogenous mechanism in NC that protects the financial system from cyclical fluctuations and deep crisis. This mechanism is fuelled by the interaction between various NC trends and relies upon a number of pillars.

1. The innovations in financial markets and instruments are strictly linked to the spread of new technologies and the performativity of economic theory (see e.g. Mackenzie, 2006, van der Zwan, 2014: 112). In particular, to counter the complexity of the new financial assets, agents rely on mathematical models of pricing and risk management.
2. Unlike industrial enterprises, financial institutions cannot fail because of the major interconnectedness of the financial system.
3. In case of market disruption, last resort “Keynesian” policies aimed at building powerful safety nets – such as public expenditure to finance bail out strategies and quantitative easing by central banks – are implemented, due to the greater interconnectedness between financial markets and state intervention.

² For a more complete discussion, see e.g., Togatti (2006, 2016).

4. The lack of inflation – due mainly to the influence of technological change and globalisation – allows such last resort policies to continue.
5. Higher leverage ratios and further growth of financial markets – to a large extent engaged in speculative trading, i.e. unconnected with productive use, and arbitrage activity – are thus possible.
6. The continual success of financial markets further stimulates the performativity of standard theory (in the shape of efficient-market hypothesis), which enhances the pervasiveness of financialisation; that is, it extends its influence well beyond the financial community to affect the system as a whole.

The significance of this mechanism for the working of NC cannot be overemphasized. It is mainly responsible for “locking in” proclivity to risk and other features of the new business culture linked to financialisation.³ The reason why such changes in agents’ perceptions – and the new conventions or business models they bring about – are persistent and seem irreversible (unlike cyclical features, such as pessimism and optimism) is that last resort policies concur to isolate the financial system from the business cycle.⁴ Indeed, these features have become almost

³ As noted by Palley, for example, one characteristic of financialisation processes in NC is that “there are evolutionary mechanisms that lock in proclivity to risk taking via success and promotion. Thus, managers and entrepreneurs who make profits come to dominate. Since risk takers tend to make more profit, cautious investment managers and entrepreneurs will tend to fall behind over time and the population of managers and entrepreneurs will be increasingly dominated by high rollers. (Palley, 2012: 65).

⁴ These changes in perceptions are often emphasized in the literature. Hein (2012: 2), for example, refers to “short-termism” and industrial firms’ “increasing preference for financial investment”. Similarly, Stockhammer

embedded in markets and society as a whole because of the interconnected nature of finance with policy. Taken all together, these pillars show the striking paradox underlying NC, namely that the continual success of financial markets – which is strictly linked to the performativity of standard theory based on the presumption of the efficiency of unregulated markets – is ultimately due to state intervention and the implementation of Keynesian policies.

3.3. The pervasive nature of financialisation

Ultimately, another major cause of the interconnectedness of NC is the pervasiveness of financialisation. This means that the latter affects all spheres of the economy and society by influencing the process of formation of agents’ perceptions of the environment, mentioned in the last section. As already noted a number of trends of NC are involved in this process. In this section, I place the emphasis on the major role played by financialisation. It can be argued that it exercises an influence on the following perceptions of:

- a) “time”, by stimulating short termism in all sectors of the economy, including industrial firms;
- b) “value”, by stimulating the dominance of a notion of “fair” value, which refers not to “objective” properties of things, but to the outcome of the valuation process based on the endogenous mechanism described in the

(2012) holds that financialisation has changed the behaviour of economic actors, i.e. businesses, banks, financial investors and households, who now tend to act more like financial investors who try to optimise their portfolios and have a preference for liquid assets (2012: 46). However, these authors do not carry out a systematic analysis of such perceptions and regard them as mere psychological features rather than enduring conventions as we do here in the light of the endogenous mechanism just described.

previous section, which accounts for an almost autonomous growth of financial asset prices, with respect to the dynamics of real production. In contrast with the traditional logic, according to which financial markets “mirror” the behaviour of the real economy, almost the opposite appears to be true. In particular, today the basic logic governing the financial system also provides the paradigm for managing industrial enterprises.⁵ But this is not all. Financialisation also influences the perception of value by changing the conception of fairness in income distribution (e.g. larger pay differentials between the financial sector and other sectors are justified as “normal” market outcomes).

c) “space”, by increasing the mobility of capital (i.e. the possibility of carrying out financial transactions at low cost throughout the world). Financialisation certainly contributes to the “flatness” dimension.

d) “market”, by changing people’s perception of its boundaries. For example, more areas of “everyday” life, such as housing, consumption, education, health, pensions, become prey to private finance (e.g., Lapavistas and Powell, 2013; van der Zwan, 2014).

⁵ This means that the production process itself must be fashioned in such a way as to generate returns that satisfy financial investors (see e.g., van der Zwan, 2014; Hein, 2012). For example, big institutional investors put industrial firms under strong pressure to obtain a high return on equity, even when the economy grows much less.

4. Financialisation and the aggregate demand problem in NC

4.1. *Alternative approaches to the demand problem in NC*

It can be argued that, as a result of its inter-connectedness, NC increases instability, interpreted broadly, namely, not as a cyclical phenomenon (seen as a deviation from equilibrium or as equilibrium fluctuation) but as a structural NN. I suggest that the ultimate roots of this greater instability should be found in the *modus operandi* of NC and in the new characteristics of its growth model with respect to past stages of capitalism. This point is widely stressed in the literature (see e.g. Boyer, 2012; Palley, 2012). As noted, for example, by Palley since 1980 (as result of neoliberal policy) the NN or stagnation is the result of a shift from a stable virtuous growth model based on full employment and wages tied to productivity growth to a new growth model based on low aggregate demand-stagnating wages, increasing inequalities, rising indebtedness and asset price inflation as a new source of aggregate demand.

In this section, I largely endorse this view, but I place special emphasis on two points. First, aggregate demand should be regarded as a “deep” cause of growth. In principle, this means that it represents both the “cause” and “effect” of key trends or phenomena, such as technological progress. On the one hand, it is clear for example that without a sufficiently high propensity to invest there can be no technological progress. On the other hand, there is no doubting that the latter does also influence aggregate demand. Due to a lack of space, this chapter focuses mainly on the “effect” side. Secondly, the

effects of key trends of NC on aggregate demand take place mainly through changes in agents' perceptions which influence the propensities to consume and investment. In what follows, I focus on those changes that are brought about by financialisation.

Based on this, the analysis of this phenomenon proposed here departs from other accounts for three reasons. First, financialisation is an autonomous cause of the demand problem, rather than just an effect of it as held for example by Palley (2012; 2013) according to whom low wages mainly cause insufficient aggregate demand, which indebtedness is insufficient to counteract; that is, financialisation does not cause the lack of aggregate demand but prolongs the neo-liberal model:

“... financial innovation and deregulation did not cause the crisis. The neoliberal paradigm was already going to fail owing to its internal contradiction, but financial innovation and deregulation kept the model going longer ... this extension resulted in the accumulation of large financial imbalances” (Palley, 2012: 43).

Now, it is true that NC generates low wages in western countries. Indeed, it appears as the age of “devaluation” of labour. On the one hand, the new technologies are labour saving and imply that the cost of labour represents a smaller fraction of total costs; on the other, the goods for which labour is important are subject to more intense international competition. In particular, by stimulating change in agents' perception of space, globalisation – through de-location and FDI – has shifted production abroad to places where labour costs are lower. Together

with the parallel erosion of welfare and other phenomena linked to the “fragmentation” of the productive process, such as labour market flexibility and intensification of work, this trend has put real wages in industrialized countries under pressure, thus favouring rising inequality. However, it is not sufficient to regard low wages as the main or exclusive cause of low aggregate demand. While certainly lowering consumption and investment (through the accelerator effect), I emphasize that aggregate demand is low also for other reasons that are linked to agents' changed perceptions, especially due to the influence of financialisation, which thus plays an autonomous causal role in the story of the Great Recession and the NN.

Second, financialisation is not an exclusive cause of the demand problem. In contrast with Minsky's endogenous financial instability hypothesis or Shiller's animal spirits hypothesis, for example, the demand problem is also rooted in real sector dynamics. As Palley notes the recent crisis is not a pure “Minsky” crisis:

“Minsky ... saw crises as the result of endogenous financial instability that developed over time. However, the current crisis is a crisis of the neoliberal paradigm. That paradigm fostered financial instability as a way of sustaining itself. Consequently, when the crisis hit, it took on the appearance of a classic Minsky crisis but its *real roots* lie in the neoliberal model!” (Palley, 2012: 43).

Third, financialisation brings about agents' behavioural responses or shifts undermining aggregate demand, this contrasting with authors who, instead, emphasize price

rigidities (e.g. negative real interest rate, e.g. Summers, 2014) and/or market imperfections of various kinds, such as asymmetric information and capital market imperfections (e.g. Stiglitz, 2016) or monopoly power (e.g. Hein, 2015). Indeed, the demand problem is due to the interconnectedness between objective and subjective factors that undermine the key propensities to consume and invest in the growth model of NC. This model is more unstable – or even potentially self-destructive – than the one underlying MC insofar as it generates permanently low or stagnant aggregate demand. In particular, this outcome is due to two main factors: a) the occurrence of both a consumer and an investor gap which mutually reinforce each other in a cumulative fashion by creating confidence crises; b) the lack of a stabilization mechanism due to the “confidence trap” faced by policymakers.

4.2. *The consumer gap*

One distinctive feature of the NC growth model is that it generates a consumer gap, which can be summarized as follows. First, one notes, for example, that in contrast with the MC, in the NC consumption plays a more autonomous role and tends to be more volatile, so that to understand its dynamics it is not sufficient to focus on a given propensity to consume out of current income. It is also necessary to understand the drivers of this propensity.

Second, NC trends stimulate consumers’ aspirations by generating powerful pressures to increase their propensity to consume. One may note, for example, that by shortening agents’ horizons, faster technological change creates a growing number of “artificial” needs by creating a larger variety of “luxury” goods – less durable and more

differentiated – for mass consumption, as well as the expansion of enterprises’ advertising budgets to induce consumers to buy. Moreover, by changing agents’ perception of space, globalisation encourages them to buy more foreign goods, which are, for example, more varied and cheaper than domestic goods.

Third, the reality of stagnating wages as well as inequality and joblessness generated by the key trends of the NC (see e.g., Cynamon and Fazzari, 2016) implies that this tendency cannot be accommodated and effective demand is bound to lag behind aspiration levels.

Fourth, financialisation helps to bridge the gap between consumers’ aspiration levels and their ability to pay by loosening their liquidity constraints. Indeed, as noted, for example, by Mazzucato and Wray: “consumers have taken over the role of debtor in capitalism which was played by entrepreneurs in the modern economy” (2014: 15).

Fifth, in this way financialisation favors levels of consumption that prove to be unsustainable.⁶ A credit boom clearly cannot go on forever. Indeed, as Cynamon and Fazzari point out, when “limits on further borrowing for the bottom 95%” were imposed, they “ultimately forced a historic collapse of consumption leading to the Great Recession” (2016: 374-5).

⁶ Sapir underlines that credit expansion softened otherwise unbearable social tensions. It was “a response to a change in the social situation: the disappearance of the middle-class and the resurgence of a true Veblenian world dominated by the Leisure Class.” (Sapir, 2013:16). On the link between household spending, consumer debt and rising economic inequality, see Cynamon and Fazzari (2016).

Sixth, asset price inflation – representing the revenge of the *rentier* – acts in principle as a new source of aggregate demand. However, given the strong polarization of income and wealth distribution brought about by the NC trends, together with a relatively low propensity to consume of the highest income groups, this new source of demand is bound to replace only partly relatively stagnant mass consumption.

4.3. *The investor gap*

Another distinctive feature of the NC growth model is that it also generates an investor gap. This time, the relevant gap is between favourable economic conditions, such as low interest rates and easy credit, and the perceptions of investors, which remain negative. One notes, for example, that, by influencing their perception of space, globalisation stimulates enterprises to invest abroad. Moreover, by influencing their perception of time, the new technologies generate larger and faster information flows, thus increasing uncertainty about future scenarios. Below I place the emphasis on how investors' perceptions are influenced by financialisation.

First, financialisation stimulates a new perception of value which influences negatively firms' real investment because it generates "higher" and "safer" returns than those that could be derived from investment in the real sector. On the one hand, these returns are "higher" because financialisation implies the creation of ever more complex financial assets (further removed from underlying real assets and thus even more difficult to value than previous ones), which greatly favour the determination of asset prices on the grounds of a pure "internal" market assessment (guided by formal models). These prices tend to

be "validated" ex-post by policy moves – such as the current historically low interest rates ensured by quantitative easing – due to the interconnectedness of the financial sector and policy. On the other hand, financial returns are "safer" than those obtainable in the real sector. The point is that while financial institutions operate under the insurance granted by bail-out strategies, which lower the risk of bankruptcy, non-financial corporations do not normally have such insurance.

Second, for both reasons, in NC financial returns set a benchmark for returns in the real sector. In particular, the so-called "fundamentals" of the real sector, such as profits, are driven by financial returns, rather than the other way round. Non-financial corporations' investment seeks to converge round this benchmark both by turning themselves to financial activities and by seeking to shape the productive process by following the principle of shareholders' value maximization.⁷ This leads them to penalize investment in R&D, new technologies and new plants, as well as in wage levels and work conditions. They use financial resources not to make new investment but to eliminate competitors.

Third, non-financial business firms may be unable to achieve the exogenous benchmark return set by financial markets. The logic of aggregate demand is that real returns may be low due to low investment caused by financialisation.

⁷ In more general terms, financialisation "crowds out" entrepreneurship because financial sector "values" tend to predominate in society as a whole, both in cultural terms (i.e. the social prestige attached to jobs in this sector) and economic terms (e.g. artificially highly paid jobs in this sector). For both reasons, the financial sector tends to attract the best talents.

4.4. *The general confidence problem*

While for standard theorists the lack of confidence is due to institutional failures – such as policy moves raising the moral hazard problem or the fact that institutions turn extractive rather than inclusive (e.g. Acemoglu and Robinson, 2013, Johnson, 2013) – the Keynesian perspective advocated here underlines the fact that the confidence problem is endogenous to the economy. More specifically, all NC trends make conventions more fragile and bring about not only significant shifts in agents' perceptions but also a worsening of the collective confidence problem, which further undermines the drivers of aggregate demand. There can be no doubting, for example, that, by causing joblessness, the new technologies and globalisation make a large contribution to weakening collective confidence (in particular, the erosion of social capital in the shape of "national" identity or ties).

Below I focus on how financialisation contributes to this problem. By bridging the consumer gap, financialisation apparently favours stability. However, if one considers that consumers' aspirations are "impossible" to realize (given the creation of ever new desires in NC) and that the indebtedness of individual households cannot grow forever, their greater dependence upon debt offers only a temporary and partial solution to the gap and ultimately raises their "unhappiness" or frustration, which weakens the confidence background underlying conventions and makes consumption more fragile, more dependent upon the "state of the news", a bit like investment in the past. Moreover, consumers' unhappiness is clearly stimulated by their feeling that they are treated unfairly as debtors. They mistrust the financial world – where fraud and false

accounting go hand in hand with the fabulous pay rises and bonuses earned by top managers – and are deceived by the asymmetric behaviour of governments apparently ready to save banks but quite incapable of saving homeowners (see e.g. Johnson, 2013)

The tendency of consumption to become more unstable in NC naturally affects negatively investment, as underlined by the "normal" accelerator effect. This worsens the investor gap – highlighting the vicious circle created by financialisation (low investment – lower interest rates – more intense financialisation – still less investment), hence the general confidence problem.⁸ Strictly speaking, the very existence of the investor gap is a measure of the enterprises' lack of confidence that undermines investment decisions. All NC trends combine to make it more difficult for enterprises to estimate expected returns on investment. However, it is clear that financialisation greatly contributes to this estimation problem, and more in general, to the collective confidence (or "unhappiness") problem underlying NC. Suffice it here to make two remarks. First, by stimulating firms' short termism – their defensive move in the face of their estimation problem – financialisation weakens collective confidence by encouraging social irresponsibility of investment (i.e. disregard for work

⁸ In line with Keynes's analysis in the *General Theory*, our discussion focuses on how "nominal" interest rates affect investment, either directly or indirectly (through financialisation). However, many new Keynesians' accounts of current stagnation tendencies in OECD countries stress the role of "real" interest rates instead, in line with neoclassical theory. In particular, authors like Krugman and Summers emphasize that investment is low also because real interest rates are too high due to lack of inflation. There is no room here for a full-blown discussion of this important point. What is relevant here to note is that for Keynes too low inflation reduces investment, although not by keeping the real interest rate high but by reducing directly the marginal efficiency of capital.

conditions, the ecological wealth of the planet or so called Living Capital, see e.g. Kurtzman, 1993). Secondly, by influencing both the consumer and investor gaps, financialisation may be held responsible for the cumulative effects that such gaps tend to have on collective confidence: what we might call “confidence trap”.

4.5. Stabilization mechanisms and the “confidence trap”

One implication of the analysis carried out so far is that the NC tends to generate a structural lack of aggregate demand and high unemployment as well as low quality of jobs for most, in contrast with the promises of the “new economy” or “society of knowledge”. While contributing to shift the engine of private demand growth from wages into asset price inflation and borrowing, financialisation is ultimately unable to solve the demand problem in NC. Strictly speaking, it is bound to make it worse, especially as a result of the confidence trap, i.e. the vicious circle between the consumer and investors gap it generates. Moreover, financialisation may also contribute to lower exports for western countries, due to the growing volatility of financial markets and exchange rates, as well as the faster transmission of financial and real disturbances across countries produced by the combination of all the NC trends.

One key feature of NC is the absence of adequate stabilization mechanisms to counter this private demand problem. In principle, the confidence trap could only be broken by rising public expenditure for accumulation or welfare purposes, i.e. by a kind of Keynesian environment, such as that of MC. However, the logic of NC drives governments’ policy in the opposite direction, thus undermining the prerequisites for sustained levels of

growth. Indeed, while in MC there was a monotonic increase in this kind of public expenditure, the NC is characterized by a retrenchment therein, due to the existence of a number of constraints. Among these, an important part is played by the performativity of mainstream economics, crucially stimulated by financialisation itself.

The paradigm of efficient-market theories – their performative nature – has succeeded in influencing not just the growth of financial markets but also the economy at large by stimulating thinking whereby economies can be shaped like the benchmark of perfect competition and the demand problem can be simply ignored by systematically tracing the causes of dramatic events, such as the Great Recession, to “structural” problems in individual markets or government or institutional failures. More specifically, according to standard theory governments should stick to conceptions of orthodox finance – i.e., seek to balance their budgets, especially for fear of “market punishment”, and should reduce welfare expenditure (in particular, for pensions and health), while lowering tax for the rich and firms (e.g., van der Zwan, 2014).

It is important to note, however, that another crucial constraint to the rise of public expenditure for accumulation or welfare purposes is the very nature of the financial system in NC, namely its interconnectedness, which potentially lead governments to face what they now regard as the most dramatic challenge: namely, the meltdown of financial markets, an event which would be capable of worsening the fundamental confidence trap underlying NC. To avoid this scenario, governments feel they have no other option than to accommodate almost

whatever arrangements or conventions the financial system may choose to adopt at any given moment in time. Bail-out strategies setting a floor to asset prices and ruling out the “discipline” of capitalism within the financial system are simply the recognition of this kind of political impotence.

A similar accommodating, last-resort defensive stance characterizes the conduct of monetary policy. While inflation-targeting still represents the formal goal pursued by central banks, in a world with no inflation these banks’ true goal is the stability of the financial system, which they prepare to pursue by promising to do “whatever it takes” – for example, by engineering new massive injections of liquidity – to achieve it. However, central banks too are bound to fall into the confidence trap. On the one hand, low interest rates granted by ever new forms of quantitative easing do not favour real investment (on the contrary, they may well reduce it by widening the investor gap). On the other, in the absence of inflation, central banks cannot readily go back to “normal” monetary policy for fear of destroying market trust.

Conclusion

A few key conclusions follow from the analysis of this chapter. First of all, I underline the fact that the so-called New Normal is due to the growth model implied by New Capitalism (NC). This model is based on a higher degree of interconnectedness between key trends, including financialisation, which plays a major role in bringing about greater instability (i.e. a low aggregate demand) and constraining policy moves.

Secondly, low aggregate demand is explained in terms of the interconnectedness between key objective trends and agents’ perceptions of such trends, which accounts for shifts of the demand drivers, such as the propensity to consume and invest and important features of NC such as the growing gap between indicators of economic performance like the GDP, and agents’ “happiness”, reflected in the recent “going beyond GDP” move, both at the theoretical and policy level.

Thirdly, financialisation plays a key role in creating this gap: while raising current GDP, though not as much as it could (i.e. it partially crowds out real growth directly, for example, by setting too high a benchmark return for real investment) – undermines future GDP growth indirectly through the consumer and investor gaps and their interaction.

Fourthly, in NC there is no adequate stabilization mechanism capable of addressing this GDP/unhappiness gap. Indeed, due to the basic interconnectedness of the NC, governments cannot avoid falling into the confidence trap. Both bail-outs and quantitative easing are “necessary” accommodating policies that, while restoring confidence temporarily, end up by favouring the further growth of financialisation and the performativity of standard theory, which are at the root of the low demand problem. By saving financial institutions and putting a floor to asset prices, they ensure the ex-post validity of the financial paradigm as a driver of both real sector dynamics (undermining private demand) and of orthodox economic policies addressing the low aggregate demand problem in ways – i.e. in terms of structural market reforms and cuts to public

expenditure for welfare and accumulation – that tend to aggravate it even further.

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7: FINANCIAL MERCANTILISM AND SUSTAINABLE DEVELOPMENT

Gianni Vaggi

Prologue

On July 2014 a “vulture” fund Themis Capital and Des Moines won a case against the Democratic Republic of Congo which should now repay 18 million dollars of an original debt plus 70 million as interest (The *Financial Times*, 27th November, 2014). The debt had been contracted in the early 1980s by Mobutu, but Themis Capital was not among the original creditors, it bought Congo’s debt years later at huge discount on face value, but now should be repaid at full nominal value. Congo has an income per capita of 430 dollars, 71.3 per cent of the population below the national poverty line and most of its people were not born when the debt was contracted.

Introduction

International financial markets are characterized by Financial Mercantilism, FM. There are many similarities between the operation of the 17th-century merchants and today financial intermediaries. Resorting to notions derived from history of economic ideas and in particular from Smith and Marx the chapter identifies the features which