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It is with great pleasure that we are able to publish Volume Eleven of *Oeconomicus* for the 2009-2010 academic year. *Oeconomicus* begins its second decade of publication it is safe to say that the ideas contained herein are as creative and robust as ever; something that should make the previous editors and individuals who worked on the journal as proud as ever. There are many people who deserve thanks.

To begin, the editors would like to express their gracious appreciation to all the authors who submitted papers for this year’s edition of *Oeconomicus*. The selection process was competitive which resulted in a journal of high academic quality.

Next, the editors would like to express the sincerest gratitude to the individuals who served as anonymous referees for this issue. These people, in no particular order, would be Shama Azad, Lief Erickson, Mitch Greene, Yeva Nersisyan, Stephanie Sheldon, and B.J. Unti.

Third, we would like to thank the publisher Print Tekk Printing and Mailing and the Economics Club for their contributions and flexibility in helping meet the journal’s needs so as to bring these ideas to you. So sit back, put your feet up, and enjoy reading some of the new heterodox economic ideas.

The Editors,
Devin Rafferty
Karol Gil Vasquez
Behind the Veil of Money:  
An Inquiry into the Institution of Money

By Will Fisher  
University of Missouri-Kansas City

Introduction
The nature and role of money within capitalist economies has been a contentious issue for theoreticians for centuries, stemming back to at least the ancient Greeks. Throughout history the issues surrounding money have continually resurfaced, from ideas as expansive as the functions of money to questions surrounding distributive justice. However, as one would expect, the debates over the nature and role of money have become amplified with the advance of capitalism, a system whose existence revolves around the use of money.

The battle over money that has lasted for the last century and a half can, without too many exceptions, be divided into two primary and antithetical camps. The first camp is mainstream economics, who view money as a neutral phenomenon, whose nature resides in its embodied value and role lies in exchange, and believe that the long run effects of money have no ramifications on the “real” economy. The opposing camp, comprised of most schools falling under the unfortunately vague heading of “heterodox” economics, maintain a diametrically opposed perspective on money. Money for heterodox economics plays a vital, and perhaps, the most important role in capitalist economies. Monetary phenomena influence the level of output and employment, the stability of the system (crisis), distribution of income and power, etc. It would be safe to say, from a heterodox perspective, that nearly every facet of capitalist economies is directly or indirectly affected by monetary phenomena.¹ As a result of this emphasis, heterodox economics has generated a vast literature that spans nearly all aspects of

¹ This statement should be received with some caution as the spectrum of money’s effects on capitalism varies widely depending on which school of thought within heterodoxy one is dealing with. With that said, I think it is a fair and accurate statement to say that one method of demarcation between heterodoxy and orthodoxy is the particular perspective each takes on money.
money, from its origins to primary functions, in an effort to answer the question ‘what is money and what role does it play in capitalism?’ (see Wray 1998).

Now that the reader is thoroughly intrigued, a slight of hand will be undertaken. This essay will not delve deeply into the origins of money or the role that money plays in capitalist economies, as that story has been extensively told elsewhere. There will be evidence provided in support of Dudley Dillard’s claim that money is “the key institution of contemporary capitalism”\(^2\) (1984, p. 421), as this will lend credence to the importance of the primary motivation of this paper. With that said, the primary objective of this paper is to answer the question, “what is the institution of money?”

This question leads us directly into the structure of this essay. In order to understand the “institution of money”, it stands to reason that one should have a sufficient understanding about what an institution is. Despite such a need, the literature revolves around such a question is vague and sometimes contradictory. So the first objective is to provide a concise explanation, if possible, of key characteristics of institutions, in addition to a workable definition of what an institution is. The second section will further develop the argument put forward first section to provide an understanding of the institution of money. Furthermore, the second section will draw out some of the characteristics that most thoroughly embedded institutions maintain, of which money is certainly one, and the invidious influences that the institution of money has on society. As a result, the analysis of institutional influences naturally leads to analytical concepts developed by “the original institutionalist, Karl Marx” (Dillard 1987, p. 1644) whose insights will greatly enhance our understanding of the opaque nature of money. The final section will point out key ideas relating to a monetary theory of production, which, without accounting for money, economic theory cannot attempt to describe the capitalist systems that dominate the world in which we live.

**Defining an Institution**

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\(^2\) Many Marxists would contend with the statement that money is the key institution in contemporary capitalism. The key institution in capitalism from a Marxian position is wage-labor. We would argue that money and wage-labor are, in essence, two sides of the same coin. While this is certainly a topic that deserves a full paper to fully elaborate this relationship, a few key ideas that lead to this conclusion will be articulated below.
Institutions are to economists what pornography was to Supreme Court Justice Potter Stewart—they are hard to define, but they know it when they see it. The difficulty lies partly in the very abstract nature of institutions and partly in the mystifying effect that these relationships have on surface level phenomena. As Hodgson points out, “the term [institution] has a long history of usage in the social sciences…However, even today, there is no unanimity in the definition of this concept” (2006, p.1). Any definition of “institution” will certainly be seen by some as deficient, not capturing their vision of what an institution is. With that said, it is not an insurmountable task to define an institution. This is necessary, as Hodgson correctly articulates, because “it is not possible to carry out any empirical or theoretical analysis of how institutions…work without having some adequate conception of what an institution…is” (ibid.). The most natural starting place for an inquiry into a useful definition of institution is the literature from which an entire school of thought in economics gets its name—Institutional Economics. This literature will help us isolate a workable, and hopefully intuitive, definition of an institution and will enhance our ability to see through the fog of the institution that is money.

In an exploration of the literature on institutions it becomes very apparent that the various definitions of an institution cover a wide spectrum, many of which seem to obscure more than enhance one’s understanding. The early institutional economists tended to give basic definitions that are more manageable than those generated in the middle and latter half of the twentieth century, yet even many early definitions seem difficult to dissect. For example, Veblen defined an institution as “the settled habits of thought common to the generality of man” (1909, p. 626). Furthermore:

men [sic] order their lives by these principles and, practically, entertain no question of their stability and finality…But it would be mere absentmindedness in any student of civilization therefore to admit that these or any other human institutions have this stability which is currently imputed to them or that they are in this way intrinsic to the nature of things (ibid., pp. 626-627).

However, in a footnote in Absentee Ownership, Veblen provides a more convoluted definition than the one above, stating that “an institution is of the nature of a usage which has become axiomatic and indispensable by habituation and general acceptance. Its
physiological counterpart would presumably be any one of those habitual addictions that are now attracting the attention of the experts in sobriety” (1964 [1923], p. 101; see Neal 1987, p. 1177).³

Another prominent early Institutional economist, John R. Commons, provides a very broad definition more geared towards organizations that represent institutions. Commons says ‘we may define an institution as Collective Action in Control of Individual Action.

Collective action ranges all the way from unorganized Custom to the many organized Going Concerns, such as the family, the corporation,…the trade union, the Federal Reserve System,…the state…

Collective action is even more universal in the unorganized form of Custom than it is in the organized form of Concerns’ (in Neal 1987, p. 1178). Another definition is provided by Wesley C. Mitchell: “‘Institutions’ is merely a convenient term for the more important among the widely prevalent, highly standardized social habits” (quoted in ibid.). Finally, the most Byzantine definition is attributed to Walton Hamilton, who states that an institution:

    connotes a way of thought or action of some prevalence or permanence, which is embedded in the habits of a group or the customs of a people…In this continuous process of the adaption of usage and arrangement to intellectual environment an active role is assumed by that body of ideas taken for granted which is called common sense…[Furthermore it is] a folkway, always new yet ever old, directive and responsive, a spur to and a check upon change, a creature of means and a master of ends (quoted in Waller 1982, pp. 761-762).

As these citations highlight, many early Institutional economists concerned themselves a great deal with defining the term institution. However, none of these definitions provide the clarity we are searching for in an intuitive and workable definition of the term.

More contemporary institutional economists, for example Ayers and Foster, have tended to focus on the functional aspects of institutions, leading to the bifurcation of institutions, commonly known as the “Veblenian dichotomy”, into that which is

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³ Walter Neal (1987) provides a clear survey of the different definitions of “institution” put forth by earlier Institutional economists.
progressive and useful (instrumental) and that which retards progress (ceremonial) (see Waller 1982). While this research develops useful tools for the analysis of existing institutions, in the same way that philosophy helps in thought organization, it has tended to render enigmatic any attempt at defining an institution.

This is not to say that there have not been any straightforward, useful, contemporary definitions. Hodgson provides a lucid definition that will guide the rest of this paper, stating, “we may define institutions as systems of established and prevalent social rules that structure social behavior. Language, money, law, systems of weights and measures, table manners, and firms (and other organizations) are thus all institutions” (2006, p. 2; emphasis in original). While some may see this definition as far too broad, institutions cover a broad spectrum of social interactions. In addition, this definition provides a workable, intuitive explanation and can be refined to deal with the specific institution under analysis.

Elaborating on the definition, Hodgson goes on to say that “the term rule is broadly understood as a socially transmitted and customary normative injunction or immanently normative disposition, that in circumstances X do Y” (ibid., p. 3). Or in plain language, rules are the standards that social customs establish that are enforceable, by formal decree or informal authority, and are passed on through the members of society. “Rules include norms of behavior and social conventions as well as legal rules” (ibid.). In addition, the rules that comprise institutions “can usefully create stable expectations of the behavior of others. Generally, institutions enable ordered thought, expectation, and action by imposing form and consistency on human activity” (ibid., p. 2). Furthermore, surrounding these social rules are social conventions, defined “as a particular instance of an institutional rule. For example, all countries have traffic rules, but it is a matter of (arbitrary) convention whether the rule is to drive on the left or on the right” (ibid.).

As stated above, institutions can be established by formal rules imposed on society or by informal arrangements; however, “there are laws that are widely ignored and have not acquired the customary or dispositional status of a rule. Ignored laws are not rules. For new laws to become rules, they have to be enforced to the point that the avoidance or performance of the behavior in question becomes customary and acquires a
normative status” (ibid., p. 6). Thus, as a set of social rules, institutions become embedded in society through the process of habituation. Habits are a necessary condition for the establishment of an institution. As Hodgson states, “a habit is a disposition to engage in previously adopted or acquired behavior or thoughts, triggered by an appropriate stimulus or context” (ibid.). In other words, an institution cannot come into being without enforcement, so that it becomes a repeated behavior or way of thinking, brought about by certain situations that emerge through social interaction. An example may be in order to clarify these abstract ideas. The institution of racism will serve this purpose.

Racism was alive and well in the Jim Crow south during the 1950’s and 1960’s. Segregation existed under the erroneous auspices of the “separate but equal” doctrine of the Jim Crow Laws. The rules laid forth by law designated where African Americans could live, eat, drink, be educated, etc. These developed into habitual patterns of behavior and thought, developing into social norms, that both whites and blacks followed. Whites developed longstanding beliefs in the inferiority of African Americans. These patterns of behavior that became habits could be seen through the civil rights movements. When African Americans tried to eat at “white only” restaurants they were refused (or much, much worse). However, following Hodgson, if whites were among other whites, and African Americans were following the social “rules”, many whites would not act based upon their racist habits. It was only when the rules were broken, which “triggered…appropriate stimulus or context” that whites would “engage in previously adopted or acquired behavior or thoughts” (ibid.). Even when the Supreme Court of the United States, in Brown v. Board of Education, outlawed segregation in 1954, the institution of racism and habits of behavior and thought persisted. Thus, the ruling by the Supreme Court did not become a rule until such laws were enforced and people’s behavior changed. 4

There are some other important ideas that Hodgson presents regarding institutions that will be particularly relevant to our exploration into the institution of money. One is

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4 This blatant oversimplification of a particularly dismal historical epoch is used only to highlight the ideas in Hodgson. The history is obviously much more complex and much violence was perpetrated even if the so-called “rules” were followed.
that we can only observe institutions through “manifest behavior” (ibid., p. 3). Or, in other words, we can only see the affect institutions have on human beings by the behaviors exhibited by those people. Second, institutions affect the behavior of individuals and yet are dependant on those individuals for their perpetuation. In addition, “any single individual is born into a pre-existing institutional world which confronts him or her with its rules and norms” (ibid., p. 7). Third, “the institution…offers a link between the ideal and the real” (ibid, p. 8). Finally, and probably most importantly for our purposes, some institutions are comprised of rules that “concern commonly accepted tokens or meanings” (ibid p. 4) though the representation of the rule, the token, is not the institution itself.

Now that we have a basic understanding of some of the important aspects of institutions and a workable definition, we can proceed with our primary examination; the institution of money.

**The Institution of Money**

The institution of money is perhaps the most embedded institution in capitalism. As a result, it is also probably the most misunderstood institution in economics, politics, and conventional discourse. This section will attempt to provide some ordering to the puzzle by exploring the institution of money and bringing to the fore the social rules, conventions and habits that comprise such a fundamental institution. In addition, some Marxian concepts will be utilized that will help us understand why the institution of money remains so opaque as well as elaborate on the social ramifications of the institution of money.

There is no doubt that money is an institution. As such, money must be “a system of established and prevalent social rules that structure social behavior” (ibid., p. 2). If we start from the premise that money is necessarily a debtor creditor relationship (Innes 1913), we can more easily see the rules that govern the social behavior surrounding money. Money is an “I owe you” (IOU) that represents claims on the social product. A debt is a particular social arrangement that establishes that one person gets something today but is obligated to provide something of a particular value in the future. Thus, as we can see, the institution surrounding these claims must be in the form of recognized social obligations by each party. As a result, “money” is the social relationship, or the
ideal that lies behind the credit/debt. Thus, the institution of money is intangible. It cannot be otherwise.

What separates the monetary economy from the barter economy is that an established unit of account governs the relative values of what is given today for what is “paid back” in the future and it is the accumulation of these units of account, wealth in the abstract, that becomes the goal of individuals in society. As Heilbroner notes in *The Nature and Logic of Capitalism*, this accumulation of wealth in the abstract is particular to the epoch of capitalism:

When wealth is realized in objects that directly embody prestige or power, there is no objective means of measuring the amount of personal or social enhancement represented by any given element of riches. But under the regime of capital a strict calculus emerges with respect to prestige or power—namely, the extent of money capital. Moreover, by its very abstract nature there are no bounds imposed on the size of the wealth by which power and prestige are symbolized, in contrast to the limitations often imposed by the sheer physical bulk of material riches (1985 p. 55).

One reason for money’s obscurity stems from the fact we can only view the institution of money by the “manifest behavior” of money users in society. Orthodox economists focus on the exchange of the representation of money, the “money thing”, in social transactions, which has led them to the belief that the “thing” is money and not the social relationship. The result of this surface level analysis leads to the accurate characterization of orthodoxy provided by Marx in a footnote to Volume I of *Capital*, where he states:

vulgar economy, which deals with appearances only, ruminates without ceasing on the materials long since provided by scientific economy, and there seeks plausible explanations of the most obtrusive phenomena, for bourgeois daily use, but for the rest, confines itself to systematizing in a pedantic way, and proclaiming for everlasting truths, the trite ideas held by the self-complacent bourgeoisie with regard to their own world (1906 [1867], p. 93).

Surely debs can be written down on a thing, say paper, and can be denominated in any unit of account, say the dollar, pound, or ounces of barley, but the debt is the
understanding that one gets something now in return for an obligation to deliver something in the future. The paper that the debt is written on has no intrinsic value, but the socially recognizable contractual agreement, enforceable by an authority, written on the paper has value (the same way the title to a piece of property has value in what it represents) (Heinsohn and Steiger 2000).

The vast majority of money in circulation today is bank money and debt is the very social relationship/idea behind bank money (or all money for that matter). What is bank money if not a debt owed to the bank by another social participant? The circuitist school of Post Keynesian economics most clearly elaborates the creation and destruction of bank money in capitalism. Money is created endogenously through the extension of loans to firms to pay their wage bill (see Godley 2004; Lavoie 2004). These loans create deposits denominated in the unit of account and are used to purchase labor (in the simplest models). Workers use these deposits, paid to them in the form of wages, to purchase their subsistence back from the capitalist class. However, the only thing that has been transferred throughout the entire process are debt claims, or one can think of them as transfers of a certain number of units of account. Thus, all that reside in the deposits in one’s bank account are these “imaginary” claims, or intangible social obligations.

It may cause people a great deal of consternation to know that if all the customers of a bank uniformly attempted to get their “cash” out of their bank they could not. The bank does not have enough cash to fulfill their monetary obligations. And yet the bank certainly has every customer’s money. How can this be? This is because cash is only one of the physical representations of the money ideal. Money is the relationship, the debt of one person or bank to another. Bell articulates this point clearly:

Though it is certainly true that anyone can create money, it is somewhat misleading to say that the problem is to get money accepted. [a minor critique of Hyman Minsky’s definition] This is because, based on the notion that the creation of money is a two-sided balance sheet operation, money cannot exist until acceptance has occurred. Viewed this way, an offer to go into debt (to add a liability to a balance sheet) does not materialize into money until another party
Will Fisher

agrees to hold that liability (to add it to the asset side of its balance sheet) (2001, pp. 150-151).

This citation highlights the fact that money is not the “thing”, it is the relationship that lies behind a debt. However, while any debt can become money through another’s acceptance, it cannot become institutionalized money without becoming readily accepted by members of society, standardized, and sanctioned by an authority who declares where and how these debts are cleared.

Now that the inherently social aspect of money has been established, we must elaborate on the “rules” aspect of our definition of an institution. As stated above, for something to be a rule it must be accepted and followed by members of society. The rule cannot be established through simple declaration, as “there are laws that are widely ignored and have not acquired the customary or dispositional status of a rule”. The establishment of a rule by law requires that the law be “enforced to the point that the avoidance or performance of the behavior in question becomes customary and acquires a normative status”. This fits nicely with the Chartalist approach to money, where taxation and its enforcement drive the demand for state money. Articulated by Knapp (1924 [1905]), money only comes into being when the state declares a money and is only willing to accept that which it has decreed in the payment of taxes. While some may quibble with this definition of money, it is highly useful in understanding the solidification of money as an institution. With money being imposed by the state, and coercively legitimated through the power relationship that the state has over its subjects, the power to punish those not willing to use its’ debt in the payment of taxes, the state solidifies the institution of money. Only when this is established and the majority of society denominates their debt in the unit of account, can money become an institution. Over time this institution becomes second nature and operates without question, everyone interacting with the same idea in mind. This is what Dillard means when he says, “[t]here is an old saying that everyone knows what money is except economists” (1987, p. 1623). Money is a “habit” in that everyone uses money every day and knows what money is, without “understanding” what money is.

However, the institution of money is deeper than its everyday use in purchase and sale. Money has become the all-encompassing social metric. The institution of money
governs the very way people view the world. “Monetary institutions span the social spectrum from the individual and mundane (e.g., activities like purchasing groceries with cash) to the very apex of social and political power (e.g., international monetary diplomacy among sovereign states)” (Carruthers 2005, p. 643). As Simmel articulated, the institutionalization of money allows for the quantification of everything, turning everything into an “arithmetic problem” (1950 [1908], p. 419). Furthermore, “by discovering in all objects—indeed in nearly all activities—an abstract dimension of money equivalences, it insinuates a limitlessness into the calculation of wealth” (Heilbroner 1985, p. 56). This rational calculus has dramatic social implications. Some examples may clarify this phenomenon.

The cost of war is talked about in dollars and cents, not in terms of how many lives may perish or the social ramifications of human dislocation. Fighting global climate change is said to be too costly, though it threatens human existence. On a less extreme level, the status of human beings in society, as stated above, is measured by their ability to accumulate abstract units of account. The richest in society are seen as good, revered and emulated by the masses regardless of the methods used in acquiring such fortunes. Furthermore, those who cannot accumulate are viewed with contempt. They are lazy, ignorant, and not industrious. Moreover, money establishes the quality of the goods one purchases. The Lexus is of far greater quality than the Honda. The thirty dollar bottle of wine is three times better than the ten dollar bottle of wine and those consuming the former are of better social standing than those consuming the latter. With such great social importance placed on money, conventions have arisen to keep track of these social obligations.

5 For a fantastic account of the methods used by early American capitalists to acquire vast fortunes, see, Gustavus Meyers (1936), History of the Great American Fortunes. Many of the subjects—J.P. Morgan, Vanderbilt, Carnegie, Rockefeller, etc.—who plundered their way to fame and fortune are still held in high esteem today as a portion of their booty is donated through charitable foundations.

6 Unfortunately, economists tend to lack precision in demarcating the institution of money from conventions arising in support of the institution of money. Carruthers and Babb, for example, state that “money is a social convention” (1996, p. 1557). However, the convention of money pertains to the money thing, or as Keynes stated “the money-of-account is the description or title and the money is the thing which answers to the description” (1930, pp. 3-4). The money thing is the “particular instance of an
The Balance Sheet

The balance sheet is the most important convention in contemporary capitalism that has arisen from the institution of money. Money is necessarily a balance sheet phenomenon. As Bell states, “it is because money is at once an asset (credit) and a liability (debt) that it is treated as a balance sheet operation” (2001, p. 150). Because money is an asset to one and a liability to another, or the representation of a social relationship, the balance sheet is, thus, the method for “recoding this social relationship” (ibid.). While this may seem mundane, the significance of the balance sheet cannot be overemphasized. As a method for “keeping score” of these accumulated units of account, the balance sheet becomes the representation of one’s ability to access the social product in addition to one’s standing within society.

Taken from the standpoint of the firm, the balance sheet establishes the health of the organization. A firm with a “healthy” balance sheet obtains access to bank credit more easily, maintain higher share value, can float debt at a lower cost, can maintain cordial relations with suppliers, and thus, can maintain or expand production. For a firm with an “unhealthy” balance sheet exactly the opposite is true. In addition to the ills facing a firm by the inability to access bank credit, etc., at some point a firm may become insolvent and forced into bankruptcy, all of which is decided by the firm’s balance sheet. This is what led Boulding to state “the balance sheet is to a firm what its “state” is to a body: it describes the structure of the firm in terms of various quantities of its parts…for everything that affects the firm in any way will effect changes in the balance sheet” (1962, p. 27). In addition:

profit is the lifeblood of capitalism…Profits are for capitalism the functional equivalent of the acquisition of territory or plunder for military regimes…They are the concrete representation of the intangible structure of power, hierarchy, privilege,…In all depictions of the business system profits are the key economic variable, but in any depiction of the regime of capitalism they must be the parameters of its central historical task (Heilbroner 1985, pp. 76-77).
Most importantly, “balance sheets and profit-and-loss statements are kept in monetary terms, as are the documents that determine the success or failure of the business transactions…All this is simple but fundamental” (Dillard 1987, p. 1627). However, the balance sheet not only pertains to firms but can also be applied to non-profit organizations, states\(^7\), municipalities, and individual households.

In analyzing the individual household two accounting statements should be utilized. The balance sheet is more appropriate for the wealthy, as they are able to save money and invest in assets. The balance sheet reflects their net worth and their net worth establishes their social standing. With wealth comes status. The income statement is more appropriate for the middle and lower classes, because these groups consume most of their income. (The income statement shows how much money an entity brings in and how much money they spend). If the latter is larger, they must go into debt (or spend their accumulated savings), putting a financial burden on them in the future. If the debt becomes more than they can bare, they must default and go into bankruptcy.

Thus, one can see the import of such accounting conventions. If the institution of money is the established set of rules that govern the social relationship that is money, the balance sheet is the method for accounting for the acquisition, use, and accumulation of those social obligations. The two are intimately related and the balance sheet is the most important manifestations of the institution of money, as it does not obscure the social relationship the way the “money thing” does.

There are two core concepts in Marx that are very relevant to understanding the effects of such an embedded institution as money. These also bring to light the difficulty that one encounters when trying to examine and potentially alter institutions as they exist. These two concepts are fetishism and alienation, ideas which are as relevant today as in Marx’s time. The following subsections will address these concepts as they pertain to the institution of money.

_Fetishism of Money_

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\(^7\) By state we mean individual states that do not operate on a sovereign currency. For nation states that operate on a sovereign currency the standard constraints of the balance sheet do not apply as the nation state cannot be forced into bankruptcy (see Wray, 1998).
The conventional wisdom within the minds of the populace, and many academic economists, is that money is a thing. Most argue, that the value of money resides in some valuable content embodied within the money commodity. In addition, “money has been called a ‘garb’ or ‘veil’ of the things that really matter…Not only can it be discarded whenever we are analyzing the fundamental features of the economic process but it must be discarded just as a veil must be drawn aside if we are to see the face behind it” (Schumpeter; quoted in Ingham 1996 p. 511).

Money, conventionally conceived, is a veil. However, it is not a veil over the “real’ economy. Money is a veil over money. More properly, the “money thing” is a veil over the institution or social relationship that is money.

In capitalist society, Marx argues, material objects have certain characteristics conferred on them in virtue of the prevailing social relations, and take on the appearance that such characteristics belong to them by nature…The illusion of fetishism stems from conflation of the social characteristic and its material shapes; value seems inherent in commodities, natural to them as things. By extension of this elementary fetishism, in the role of MONEY, one particular thing, for example gold, becomes the very incarnation of value, pure concentrate apparently of a power that, in fact, is social (Geras 1983, p. 165).

If one can discard from their mind the particular representations that the money thing embodies, they can attempt to understand the underlying social relationships of money. Thus, the mainstream conception of money mentioned above is a fetishism of money. Gold is no more money than are cigarettes, shells, or any other commodity. Money cannot be a commodity because, as articulated above, money is a social relationship. An example may clarify the idea of fetishism further.

In William Golding’s (1954) novel The Lord of the Flies, the conch shell takes on a particular importance for the resident children of the island. Whomever holds the conch is bequeathed with the right to speak in an assembly. As a result, this item takes on powerful significance, the shell itself being viewed as having the power embodied within its material form. Thus, the conch is fought over by the different inhabitants of the island and eventually broken. However, no social scientist would argue that it was the material composition of the conch that gave it power. Surely certain characteristics made
the conch a potential candidate for representing the underlying social relationships; the
shape, rarity, and its ability to make noise to gather everyone together, but to think that
the conch itself held within it the power is nothing but reification.

So why is money so widely fetishized? For the same reasons that other commodities are. The money thing that answers to the definition of money (Keynes 1930) is what we see. In other words, the money thing is the “token” we see in the “manifest behavior” of society.

**Alienation**

The concept of alienation in Marx is closely related to the concept of fetishism and is vitally important in understanding the effects of thoroughly embedded institutions. While alienation takes on different meanings in Marx, we will be concerned primarily with two such meanings. First, “alienation is a condition in which human creations escape conscious control and instead become forces which govern their creators” (Howard and King 1985, p. 18). That is, something which is a human construct becomes viewed as a phenomenon that lies above human beings. For example, “god is a human creation and has no other basis for existence than in the imagination of the devout. Nevertheless, once created, His dictates actually govern the activity of His creators and operate as an alien force independent of them” (ibid.). Money is the demiurge of capitalism.

This example of alienation is of particular importance to the functional finance approach first articulated by Abba Lerner and carried on by the neo-chartalist school of thought. For this school, understanding the institution of money allows one to see behind the veil of the money thing and realize that money is a construct of human beings. As such, there is nothing inherent within the money thing that gives money value or dominance over humans. Furthermore, recognizing the nature of money as a human construct not in possession of “natural” qualities allows the functional finance approach to accept that, if created by humans, money can be manipulated by humans for collective social gains. In short, the functional finance approach attempts to bring money back under the control of human beings. However, this school also recognizes the difficulty in altering the perceptions of the public regarding an institution as thoroughly embedded as money.
Another aspect of alienation that is directly applicable to the institution of money resides in the capital labor relationship. For Marx, the thing that separates human beings from other animals is that they must produce in order to survive. However, the particular modes of production that have developed over human history take on dramatically different forms. Under capitalism, the laborer, separated from the means of production, must sell his/her labor power in order to survive. The sale of this labor power allows access to the means of subsistence. In nearly all circumstances in contemporary capitalism, what is labor power exchanged for? Money. The predominance of money destroys the previous social relationships that existed prior to capitalism. “In money relationships, in the developed exchange system (and it is this semblance that is so seductive in the eyes of democrats), the ties of personal dependence are in fact broken, torn asunder” (Marx quoted in Howard and King 1985, p. 18). Through this process the laborer is immediately alienated from the product of their own labor. Money plays a vital role in this process. The laborer can now only access the social product by acquiring money in the form of wages and then using this money to purchase back from the capitalist their subsistence. The underlying exploitation becomes mystified through the “free exchange” of commodities, of which labor power is one, for money. Through this type of widespread use, which, it should be added, is not voluntary, one can see how the habit of using money becomes pervasive and thus the institution of money becomes so deeply embedded.

**Monetary Theory of Production: Marx Veblen and Keynes**

Statements such as, “Money isn’t everything it is the only thing” (Minsky, quoted in King 2002, p. 210), “Money may not be the root of all evil, but it is the root of economic science” (Mitchell 1916, p. 157), and that money is “the key institution in contemporary capitalism” (Dillard 1984, p. 421), are predominant within much of the heterodox literature. Marx, Veblen and Keynes all developed a monetary theories of production, understanding that money plays dominant part in the behavior that drives the capitalist system. This section will be short, as no new ideas are presented.

As articulated by Marx, Veblen and Keynes, capitalism is a monetary production economy in which money is needed to start the production process and more money is the ultimate goal at the conclusion of the production process (Wray 1993, p. 548).
author has as the basis of their analysis of capitalism the idea that the production of use-values, in Marx’s terminology, is a mere technicality that must be satisfied in the production of a saleable commodity. What really matters to the capitalist is exchange-value, how much money a commodity can fetch on the market. “The value of ‘real’ output of a private producer is not ‘real-ized’ until it is sold for money. Somewhat paradoxically, money is real wealth to the business firm; it makes money only by selling real output for money” (Dillard 1980, p. 258). Furthermore, “service to the community is incidental and subordinate to moneymaking. Production is ‘monetary’ in that realization of money gains is the objective, the motivation, of the process” (Dillard 1987, p. 1627). This is the cornerstone on which any monetary theory of production rests.

Maintaining a monetary theory of production dramatically alters the theoretical conclusions of Marx, Veblen and Keynes. As Marx explicitly stated, under capitalism, “a man who has produced does not have the choice of selling or not selling. He must sell. In the crisis there arises the very situation in which he cannot sell or can only sell below the cost price or must even sell at a positive loss” (Marx quoted in Kenway, 1983, p. 156, emphasis added). Keynes (1936) furthered this type of analysis with what is arguably the most important contribution in *The General Theory*, his analysis of money and the refutation of the classical dichotomy.

Keynes links the essential characteristics of money with expectations about the future and the willingness and ability to withhold money from the economy. If the capitalist knows that he/she must sell his/her output for money but does not think this possible at a rate high enough to bring sufficient profitability (a marginal efficiency of capital below the interest rate), he/she will not invest. In other words, they will decide to hold wealth in money’s form. This will show itself in an increased liquidity preference and higher interest rates. More importantly, by withholding money from the system, or a lack of investment, this situation will lead to crisis and unemployment. One major contribution from Keynes is the role of expectations in this process. It is not the realized profits of entrepreneurs that play the key role, though current profits may affect expectations of future profits, it is the mere expectation of future profits that will cause entrepreneurs to withhold or provide employment.
Veblen holds many of the same positions as those held by Marx and Keynes. However, perhaps his most important contribution to the understanding of contemporary capitalism, and a monetary theory of production resides in the effects of developed financial markets (credit and capital markets) on the behavior of the Business Enterprise (Wray 2007). No longer is the exchange-value of tangible commodities the most important concern of the entrepreneur, but the exchange-value of intangible financial assets is the *modus operandi* of the Business Enterprise. Access to credit money is the key to the increased capitalized values of financial assets and the divergence of capitalized values from their production values is the cause of economic crisis (ibid.).

This section, while brief, highlights some fundamental contributions made by Marx, Veblen and Keynes towards an understanding of contemporary capitalism. These ideas should be incorporated into economic theory, which should have as its foundational principle, a monetary theory of production.

**Conclusion**

Contemporary capitalism revolves around money. As a result, it is vitally important that theoreticians attempting to understand capitalist economies account for the affects that the institution of money has on output, employment and the stability of the system. Furthermore, the dramatic sociological ramifications pertaining to the institution of money, such as its affect on class and status, also need to be incorporated.

Yet, one cannot attempt to understand the institution of money without being able to see past the physical manifestations of the institution of money, or the money thing. All institutions are social constructs. They are the set of rules that govern social behavior. We hope that by providing a clear definition of an institution and using that to investigate the institution of money, we have aided in seeing behind the veil of money.

**References**


Will Fisher


Cap and Trade: Critical Observations on Market Making and a Better Way Forward

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In June of 2009 the U.S. House of Representatives passed the American Clean Energy and Security Act (ACESA) and in doing so created the possibility of placing the future of global climate change in the hands of financial professionals, assuming that the bill passes the U.S. Senate. At the ideological heart of the bill is a movement generally called cap and trade in which a hard cap, or limit, is set by the government which mandates the absolute level that utilities firms’ may emit pollution. Next, emissions permits are issued to the various enterprises. If a firm’s emissions fall short of its allotted allowances for that particular period it is then issued carbon credits which measure the carbon dioxide equivalent of six major greenhouse gases in metric tons. Upon receiving the credits, the firms are allowed to exchange the credits on financial markets to companies whose emissions had exceeded its allowances for that period. Finally, over time, the absolute cap level will be reduced: by 2012 emissions must be cut by 6% of 2005 levels, 9.5% by 2014, 13% by 2016, 16.5% by 2018, 20% by 2021-2039 and 80% by 2050 (HR 2454; Carey). Additionally, there is another market for a product called carbon offsets in which an entity that states it was going to pollute but no longer intends to do so will be issued a carbon offset which it may then trade to a second entity looking to reduce the size of its own carbon footprint.

The backlash created by this bill has been incredibly polarized from both the American political left and right. For liberal left observers, ACESA and the financialization of climate reform in general has been seen as another avenue through which Wall Street’s interests can be satisfied by creating another asset price bubble which, in this instance, can affect the vast majority of production through its influence on energy input prices. On the right, the reaction has mostly taken the form of either of two
arguments with the first being that ACESA will be restrictive on American business and the communities they reside in while the latter contention is that utilities’ companies will simply pass along the higher prices or production to consumers. The contention of this paper is that all three critiques of ACESA are valid and that this legislation is inherently flawed by an inability of its creators to understand how a market economy fundamentally functions. While elsewhere the left’s critique of ACESA as another Wall Street financial bubble waiting to happen will be presented and analyzed in greater detail, the purpose of this paper is to examine from a sociological-economic perspective whether ACESA will accomplish its intended goal of climate reform while not entailing increased utilities costs to consumers. In doing so, it will be shown that ACESA will not create an environment conducive to climate change while it will cause consumers to pay higher prices. As a result, in the third section, some alternatives that have been proposed are discussed and it is shown that there are far superior methods of achieving climate improvement without having to implement ACESA. First, however, some economic terms must be defined so as to put ACESA into a proper economic historical framework to explain why it is most likely designed to aid financial interests at the expense of legitimate climate reform.

**Section I-Debt Deflations and ACESA**

For every financial asset there is a corresponding liability; hence in order to service the debt there must be an income stream that can be used to fulfill the liability portion of the asset so that it may be discharged at par. If this income stream fails to materialize then one of two alternatives must happen. The first scenario involves default which occurs when the borrower cannot repay any of the liability portion and the entire asset’s value must be taken as a loss; something that all individuals attempt to avoid at all costs. The second scenario is called a debt deflation in which an investor attempts to liquidate his or her position in order to meet other financial liability commitments. This is typically done by selling the best assets first which pushes down their price because the supply is now greater than the demand for them which causes the owner of that asset to take a loss. If the money generated from the first sale is insufficient to fulfill the commitment then the next best asset will be sold and so on, until the investor is stuck holding illiquid assets that cannot be sold for money while the prices of the assets that were sold are now far below the levels they were previously trading at. The end result is
that now asset prices have been pushed down and many different individuals are forced to suffer losses due to the interrelated nature of a complex financial system. This is somewhat analogous to a ‘haircut’ in which the owner of an asset is willing to accept payment of a portion of the liability so as to avoid a total loss, say, $0.70 cents on the dollar. Moreover, since many investors would have recently suffered losses there will be a reluctance to channel funds back into finance markets which will lead to a tendency for the economy to stagnate as businesses cannot obtain loans to pay for investments and/or their respective wage bills.

It is the contention of this author that ACESA is primarily designed to avoid a debt deflation which will occur throughout the entire American financial system as opposed to being a model of climate change that can be successfully applied. In other words, ACESA is not so much a policy designed to achieve significant climate change as it is a plan designed to allow the financial sector of the American economy- which now can simply be characterized as a bubble economy- to avoid a full scale debt deflation or default that could rival the Great Depression. At first sight, this would appear to be a major proposition as to the federal government’s actual intentions for ACESA and, as a result, further explanation is necessary.

Ever since the late 1980s, non-financial companies have been engaged in a process known as zaiteku in which the firm’s treasury becomes a virtual investment house in which it attempts to procure windfall profits by investing in the financial markets or what Krippner called the ‘financialization of the American economy’ (Krippner, 2005). The end result is higher levels of trading activity, volatility, and financial asset prices. Unfortunately, this bonanza cannot continue forever because, as stated above, each financial asset has a corresponding liability and so the financial sector can only outpace the real sector for so long since there is an underlying income stream that is needed to service the financial debts. At that point, either a default or debt deflation must occur, or the real sector must grow fast enough so as to catch up relative to the financial sector\(^8\). There is a fourth option, however: before a debt deflation’s trough

\(^8\) For those who are unaware of just how far the financial sector has outpaced the real sector, the total amount of financial derivatives in existence is now approximately $600 trillion dollars. In comparison, the size of global GDP is just over $60 trillion dollars.
has been reached another bubble can be created which will allow investors who have idle funds to channel them into an emerging market. It is argued that this is the purpose of the ACESA legislation in that it will help alleviate the economic strains resulting from the subprime meltdown in the same way that the stock market boom of the late 1990s solved the stagnationist problem of the ‘Jobless Recovery’ of George H.W. Bush’s Presidency and the subprime meltdown associated with booming real estate prices in the early 2000s solved the debt deflation that resulted from the 1990s stock market bubble bursting. Now, with another Jobless Recovery on the horizon seen as a real possibility it seems that Washington is attempting to legislate the creation of another asset price bubble\(^9\) as opposed to implement changes that will successfully reverse and/or slow down global warming. In the following section, socio-economic evidence will be presented to support this argument at the market making level and demonstrate why ACESA- and any plan that advocates using financial markets to achieve climate change- are fundamentally flawed initiatives.

**Section II-Market Making**

When a market is first formed, there is a large degree of uncertainty as to what are acceptable actions as well as how many different buyers and sellers will eventually be present. As a result, normal levels of production are difficult to gauge until there is some form of market governance that is more or less universally agreed upon and adhered to. Financial markets are no different in that when formed not only is there a large degree of uncertainty surrounding the new product itself\(^10\) but there are also credibility issues related to who the dominant players or market movers will be, how deep or liquid the market will eventually become, and what the regulatory status of the market looks like.

\(^9\) While it is more contentious to argue that Washington explicitly recognizes the need for a new asset price bubble, it is less argumentative to state that they certainly have been acting in this manner.

\(^10\) This statement reflects the ‘important’ role that credit ratings agencies played in the subprime crisis. Although most of the securities were doomed to fail from the very beginning, investors never bothered performing due diligence on the products as a result of the AAA ratings given by the ratings agencies. Thus, as opposed to ensuring they weren’t buying garbage, investors simply assumed that a ratings agency was acting benevolently on their behalf. This reflects the importance of having an implicitly agreed upon set of rules that financial markets deem acceptable to reduce uncertainty, even if the rules are completely flawed from the beginning.
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pertaining to different time horizons. These four topics will be the focus of this section with regard to how the cap and trade markets are being formed, with an explicit focus on the American market at the Chicago Climate Exchange (CCX).

Section II.A- Uncertainty

When discussing uncertainty surrounding a new financial product in cap and trade terms, there are two different levels of uncertainty that need to be considered. In addition, it must be understood that all market participants desire a given level of certainty; that is, all markets are constructed so as to give actors a reasonable degree of confidence that their actions are based on a more or less known probability distribution so that the possibility of failure is minimized. First, it must be considered whether or not cap and trade is going to occur in the form proposed by the ACESA bill. If the bill is indeed passed by the U.S. Senate, this type of uncertainty will vanish. Secondly, there is a high degree of uncertainty pertaining to the possibility of manipulating and securitizing carbon credits and how futures markets will be used in hedging risk. This type will never vanish from the various climate exchanges no matter how much regulatory legislation is created due to the inherent nature of a decentralized market system. These two types of uncertainty will be discussed in turn.

It is universally recognized that global warming is occurring and therefore some type of legislative measures must be taken so as to slow the warming of the globe. On the other hand, it is less certain whether carbon credits are the proper way to implement a solution to the problem despite the fact that the ACESA bill has already moved out of the House and onto the Senate floor. Consequently, firms are not scrambling to gain early entry onto the exchanges; currently the CCX consists of only three hundred fifty-eight companies despite some of them being very powerful such as Goldman Sachs, Bank of America, Ford, DuPont, and IBM. Nonetheless, as mentioned above, most firms recognize that something to reverse climate change is inevitable and presently ACESA is the proposal that has been most seriously accepted by Congressional members. As a result, it would appear that the majority of utilities firms are simply delaying action so as

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11 Indeed, this has resulted in alternative proposals being presented to members of U.S. Senate’s Committee of Finance by individuals that have been working on effective climate change legislation despite only being considered in a window dressing type fashion.
to make sure that their future investments are ones that are in compliance with federal mandates so as to avoid regulatory fines and wasting funds on investments that turn out to be either illegal or less efficient than their competitors. Therefore, should the legislation subsequently become signed into law this type of uncertainty will become obsolete and the current reluctance of many firms to adopt the necessary emissions reducing technology will vanish as firms struggle to remain competitive for their respective market shares.

The second type of uncertainty refers to the inability of individuals to accurately predict the actions of other which could possibly lead to adverse market developments like those the economist Hyman Minsky spent a career chronicling. This type of uncertainty can be far more dangerous to market participants since it refers to many different possibilities. First, in order for a non-financial firm to plan on producing a normal level of output, it must be able to calculate how much energy it is going to need to use as inputs. If it is required to obtain carbon credits for a certain percentage of these inputs, it may not be able to effectively calculate whether it can gain access to such credits. If it is able to gauge how many credits it may need, it may not be able to correctly calculate how much the total cost will amount to. In other words, if the credits are cheaper than expected the enterprise might wish to expand production and vice versa. Unfortunately, since financial markets have flexible prices, the prices of carbon credits will be constantly fluctuating and an accurate calculation will be hard to attain. As a result, the possibility of incessantly fluctuating production levels is a realistic possibility.

Of course, in order to prevent the developments described above derivatives markets were created so that producers could lock in a predetermined price. However, derivatives markets are largely unregulated and operate as OTCs which hardly make them transparent. Thus, they are easily subject to both legal and illegal manipulation since the positions of the players in those markets are never fully disclosed. In this area, some mention of reform has been discussed such as applying H.R. 3795- the Over the Counter Derivatives Markets Act of 2009- to the climate exchanges. In doing so, OTC transactions would be required to trade on more transparent exchanges and cleared with a central clearinghouse authority as long as the purchasers of the products are not the end
users. This, it is believed, will reduce the uncertainty that a cap and trade bill would have on production levels. However, there are no provisions that regulate the ability of banks and other financial institutions involved on the exchanges to, among other things, securitize carbon credits, resecuritize carbon credits, or set up special holding companies explicitly designed to manipulate credit prices. As a consequence, utilities companies may not be aware of what pollution levels they are entitled to in a given time period due to the complex nature of exotic financial products. This, in turn, could have spillover effects for other enterprises that demand energy inputs in order to undertake their normally planned levels of production. In addition, it does not forbid financial institutions from purchasing utilities companies and then operating them in the interests of the parent company. Hence, while one of the objects of ACESA is to reduce uncertainty associated with climate reform, it would appear that the conclusion of this brief evaluation is that it fails to accomplish this task.

Section II.B- Conceptions of Control

The second aspect of a newly emerging market to be considered is who the major players will be. Since a market based economy inherently results in a search for stability by firms, actions are taken based upon ensuring the survival of the firm and therefore allowing it to reproduce itself (Lee, 2002). In doing so, firms want market power because it provides them with the best opportunity for long term growth (Lavoie, 1992). Therefore, there is no mechanism ensuring that equilibrium will automatically be

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12 Loopholes to these possible provisions will be discussed elsewhere and are only presented here because of their relevance to the discussion of how uncertainty is believed to be reduced by proponents of the ACESA bill. In actuality, these provisions are extremely weak which will increase uncertainty and manipulation.

13 Securitization, a buzzword that became popular during the subprime crisis, is when a financial company purchases various debt contracts such as a carbon credit, deconstructs the individual components of each contract, and reassembles them into another security. For instance, securitizing a mortgage would mean that each interest and principal payment can be individualized and sold to as many different payment streams for any number of newly created securities. It would be as if Investor A receives the first month’s interest payment, Investor B receives the first month’s principal repayment, and so on. In addition, Resecuritization would mean that Investor C receives payments based upon the values of the securities that Investors A and B own by combining the original two securities into one.
reached; instead, all markets are socially structured in a way that reflects the interests of the first few participants into it (Fligstein, 1996, 2001).

When a market is newly formed, it can be described as fluid in that there are no rules or conceptions of control which just means that there are no incumbents whose power can be challenged. Instead, when a new market is created, the first few firms that enter are the ones who get to create the conception of control which delineates, “a worldview that allows actors to interpret the actions of others and a reflection of how the market is structured” (Fligstein, 1996). In other words, a conception of control implicitly reveals how actors view the market to be constructed. It is in this manner that actions shape the habits, rules, and normally accepted behaviors in the market which allows it to become stable when most of the actors share common conceptions of control (Fligstein, 1996, 2001). Naturally, the conception of control created will be configured so as to benefit those that have created the market.

Of the three hundred and fifty-eight companies currently listed as members of the CCX, eighty are financial institutions. In other words, while the climate exchange itself is still in its infantile stages, over 22% of the members are participating from a financial perspective. By comparison, the only category with more members is the offset aggregators who have one hundred fifteen participants, or slightly over 32%. It is worth a moment’s digression to discuss what offset aggregators do, since they comprise the largest section of the exchange.

When an entity announces that it will voluntarily pollute less than expected, it is up to the aggregator to collect data and verify that a pollution reduction has in fact occurred. Once the aggregator has determined that a pollution reduction has occurred, a third party is required to verify the aggregators work. If it is determined that a pollution reduction has occurred, then offsets are issued and it is up to the aggregator to match a

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14 This may sound extremely similar to what credit ratings agencies performed for investment banks that created ABS. At the time, ratings agencies stated that everything was safe when it turned out that the banks and agencies had been working hand in hand to ensure both retained each other’s business. What makes Congress believe that under ACESA the situation will be different is beyond this author’s grasp.
sufficient number of offsets with a potential buyer such as a large industrial polluter. Interestingly enough, Keith Anderson of Carbon Reduction Offset Projects Ltd. and acting chairman of the Carbon Offset Suppliers Association of Alberta (COSAA) states that, “The basic role of an aggregator is to add value to a transaction between a buyer and a seller” (climatechangecentral.com). As to how the value is added to the transaction is beyond the purview of the central theme since there are many different ways of accomplishing the task. The point is that a chairman of an aggregator enterprise openly admits that his company’s job is not just to act as a broker in which the enterprise would be matching up buyers and sellers but to add value to the transaction which allows his company to profit. Hence, in addition to performing the carbon reduction verification for a fee, by acting as a brokerage house between seller and buyer of carbon offsets, aggregators intentionally add value- to which there is no predetermined limit- so that they may profit.

Further, the caveat involving carbon offsets is that the pollution reduction is done voluntarily. In other words, no actual pollution reduction has to occur; all that is necessary is that a company state that it intended to pollute. Naturally, this may seem incredibly open to manipulation. For example, a large landowning farmer could state that s/he intended to use his or her land for some production technique that would have resulted in polluting even though s/he never really intended to do so. Subsequently, the farmer would be issued offsets which s/he could sell even though no pollution reduction had taken place; all that occurred was that it was stated that pollution was expected to occur. Hence, fictitious offsets would be issued to cover supposed pollution reduction that never occurred while the entity that purchased the offsets would continue to pollute at its prior levels thereby failing to reduce overall emissions levels.

Returning to the broader discussion, it is now apparent that over 50% of the CCX is comprised of either liquidity providing financial institutions or carbon aggregators. Consequently, the conception of control that will most likely emerge will be that of a profit maximizing financial entity instead of one fixated on genuine climate change.

It should be noted that offsets are generally issued to smaller entities such as individuals or city governments looking to decrease their carbon footprints and is separate from the carbon credit creation under ACESA that applies to utilities firms only.
Moreover, the CCX owns 50% of the European Climate Exchange (ECX) and 100% of the Chicago Climate Futures Exchange (CCFE). Hence, if a company owns a stake in the CCX, it has leveraged itself into the ECX and CCFE markets, thereby accruing additional returns while not having to expend any additional money. Moreover, by holding such positions of ownership a particular enterprise’s conception of control is able to be implemented not only on the CCX but in the ECX and CCFE as well. In conclusion, it does not seem likely that the exchanges will be operated in compliance with the reasons they were initially created for.

Section II.C- Liquidity Providers

When a market is newly created, liquidity is also required because without liquidity- or how easily something may be sold for cash- actors will be reluctant to enter the marketplace due to startup costs, normal operating costs, and, most importantly, the risk of being stuck with excess inventory that cannot be sold. Hence, liquidity is essential to a market’s creation because it gives actors the confidence to know should adverse events develop there is a failsafe developed into the system which will provide the system with liquidity. This is where market makers become imperative; they provide inherent stability because they are large market players with large amounts of capital that can take extraordinarily large positions. Thus, should a crisis situation develop market makers will usually purchase the seller’s assets up to a certain target price and wait for the assets to subsequently rise in value at which point they have made a profit. This, of course, is in addition to fulfilling the more important function of acting as a stabilizer (Bookstaber, 2007).

In the context of the CCX, the liquidity providers serve to reinforce the dominant conception of control since they comprise approximately 20% of the newly forming exchange. In addition, they will be responsible for attracting customers to the exchange by demonstrating that any position a firm may take can easily become liquid. This will play the critical role in transforming the CCX from the single-digit trillion dollar market

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16 It should come as no surprise to followers of Goldman Sachs’ activities over the last twenty years that they currently own a 10% stake in the CCX.

17 If an example is needed to better understand this concept, one can think of how the Fed flooded the financial sector with funds in Fall 2008 as it dropped the Fed Funds Rate to 0%. In this case, the Fed was acting as a liquidity provider.
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it currently is into a multi-trillion dollar market in the future. Indeed, Merrill Lynch predicted that climate exchange trading could become, “one of the fastest growing markets ever, with volumes comparable to credit derivatives inside of a decade” while Louis Redshaw, the head of environmental markets at Barclay’s Capital, projects that it, “will be the world's biggest commodity market, and it could become the world's biggest market overall” (Chan, 2009; Kanter, 2007).

However, while liquidity providers may act beneficially by stabilizing the exchange if a small bubble is to develop and burst, when the focus is on trading for profit massive bubbles can form. In that case, liquidity providers will be unable to stop the slide in prices as a debt deflation engulfs the exchange. Moreover, if there is a conflict of interest in which a liquidity provider could own, say, a large industrial polluter company, the liquidity provider could intentionally manipulate share prices so as to provide its subsidiary with inexpensive energy credits to compensate for its pollution. It may not stop there either. If a liquidity provider was able to collect a sufficient number of credit contracts, it could begin securitizing them on its own and selling them on the exchange. Hence, a large investment bank would not even be necessary to bring securitization to the climate exchanges; liquidity providers could accomplish the task. Furthermore, if a liquidity provider was to purchase a carbon aggregator, it could easily have the aggregator sell it the share prices as a discount (or vice versa) which it could subsequently sell at a premium to a company desperately in need of carbon credits. If the desperate firm was a rival or owned by a rival it would only be icing on the cake. The main point of concern is that since liquidity providers are able to take enormous positions in financial markets, in the context of the CCX this may not be beneficial because the conception of control will be profit-oriented which will tend to emphasize financial gain at the expense of genuine climate reform.

Section II.D- The Role of Regulation

Finally, when a new market is created knowledge of the future course of regulatory standards is imperative. Failure to accomplish this task could result in unfavorable legislation which could decrease profits and even shut down the market that is being created. Accordingly, it is in the vested interests of all players to ensure that any
regulatory change is either neutral in that it does not affect the market’s structuring and affects all players in the same manner or is less restrictive for the market as a whole.

At first glance, ACESA would seem to be more restrictive on American business. This is not the case. It is restrictive on certain sectors of American business while allowing wealth to be transferred to other sectors. In addition, it allows the utility companies directly affected by ACESA new opportunities for mergers and acquisitions. Hence, while it is more restrictive for some of the less competitive utilities companies, it provides the larger corporations with an opportunity to expand their businesses. Therefore, it would appear that ACESA is most restrictive on the small utility firm.

The second aspect of regulatory conditions in an emerging market that has to be considered is the capture theory of regulation which proposes that key individuals who serve as representatives of the industry have greater knowledge and influence over the regulators and politicians with whom they deal with on a daily basis relative to the greater population. The result is that the industry is often conceded regulatory changes that the general public often would be opposed to. In the framework of ACESA this can have disastrous implications. For example, H.R. 3795- the proposed derivatives reform bill that envisions better control of derivatives markets- may slowly have its core content eroded through lobbyist efforts to deregulate the CCFE. This would translate into decreased transparency and the ability of previously indifferent enterprises to enter the market and take advantage of the lax regulatory standards. This is not to claim that this will happen, the only point is to show that it clearly could happen. Moreover, the last twenty years have shown that insiders are extremely accomplished at getting the results their constituents desire.

It should also be noted that this theory does not necessarily have to apply toward regulatory change. Instead, it could apply toward regulatory enforcement. When regulators and industry insiders work hand in hand on a frequent basis, a relationship develops- the dynamics of which can become very complicated. If an insider thinks that he has gained the trust of a regulator, s/he may look to exploit that trust. That is the essence of a control fraud and it can be undertaken successfully for years, as the S+L crisis identified. In addition, kickbacks can be provided so that the regulator permits the insider to take actions that would otherwise be reported. Thus, it should be very clear
that even if the appropriate regulatory dynamics are put into place they may not be enforced in the spirit of the original legislation\textsuperscript{18}. Nonetheless, in Section IV of this paper, it will be argued that the appropriate regulations are not going to be put in place and that ACESA is flawed from its very inception.

**Section III- Is There Another Way Forward?**

The above is not to suggest that all movements supporting genuine climate change will eventually materialize into an asset bubble and financial crisis; that is far from the truth. In point of fact, there are many different proposals that can produce the desired emissions reductions without culminating in an economic disaster. In the opinion of the author, these arguments have simply been discarded by certain policymakers because it is recognized that another financial bubble is necessary to stave off a massive debt deflation that has resulted from the financialization of the American economy over the previous three decades. On the other hand, if this provocative thesis is indeed unfounded and incorrect the following are some proposals that have been made which seem, in theory, to produce the desired climate change result without the possibility for financial fragility. A well formulated combination of the following arguments would be sufficient for achieving emissions reductions while eliminating the possibility of asset bubbles and helping those groups that will be most affected by climate change legislation.

In the author’s estimation, a policy known as cap and dividend is the most promising. With James K. Boyce of the Political Economy Research Institute (PERI) as its most outspoken advocate, cap and dividend policy recognizes that any emissions reduction legislation is going to inevitably raise the cost of production which will be passed on to consumers in the form of higher prices of consumption goods. In doing so, the higher prices are simply going to transfer wealth from consumers to the owners of carbon permits. To offset this effect, Boyce proposes auctioning carbon permits with the proceeds subsequently distributed to the public as equal per capita dividends through an ATM type device in which the individual’s bank account can be credited. Since wealthy

\textsuperscript{18} An obvious example of this would be the Second Amendment of the U.S. Constitution. Originally designed as a method of allowing the citizenry to retain firearms and act as a small militia should the federal government began acting in a tyrannical fashion, it is now used by gun advocates as a defense that the founding fathers of the U.S. supported lax gun control regulations.
individuals consume higher quantities of energy, this policy would act as a progressive tax (Boyce, 2009). In addition, this would not require secondary market trading and therefore there could be no trader profits misaligning incentives or direct speculation on carbon credit prices. To provide a useful analogy that Boyce reiterates, ‘why should carbon permits be tradable if gun and driving permits are not?’ (Boyce, 2009a). As an added bonus, since emissions reform legislation does not entail any automatic job creation mechanism, this policy would also help alleviate some of the strains placed on households, particularly those at the lower end of the income distribution. Further, in the first few years (which is when the policy will most likely have the harshest effects on certain communities), a portion of the auction’s revenues could be used as block grants to help the most distressed areas which would phase out over time as adjustments are made (Boyce, 2009a).

The second best method is the Clean Environment and Stable Energy Market Act of 2009 proposed by Representative McDermott which is another positive attempt at achieving climate change while eliminating the chance that it will be financialized. In the proposed bill, firms are entitled to purchase allowances at a set price which is periodically adjusted so as to meet an annual emissions cap. In addition, the bill would not allow for trading in primary or secondary markets and thus the establishment of carbon credits would not be permissible (Chan, 2009). Unlike Boyce’s proposal, however, there is no provision that intends to offset either adversely affected communities or offset the impact that emissions reductions will have upon consumer prices.

The next proposal is the author’s own which can be integrated rather well with aspects of Boyce and McDermott. The best way to achieving climate change is simply to set a hard cap for enterprises on an hourly basis, with the caveat that it cannot exceed a certain number of hours per day. In other words, regulation should be aimed at only allowing a polluter to emit for, say, eight hours per day. If this is adopted there is no incentive for firms to grow or shrink as there might be if cap levels were based upon a per employee or economy of scale type categorization system which would legislate an inducement for large enterprises to begin buying up smaller firms since there would be a differential advantage for companies that have the most employees or were able to
procure increasing returns through M&As. In addition, ‘massive’ tax credits should be provided for enterprises that invent ‘green’ policies. Further, once an emission reducing technique is created, the federal government should provide all firms in that industry with a subsidy which would make it easier for them to adopt the same technologies. An objection that may be voiced to this might be that this proposal will destroy the competitive incentive that a free market system provides by securing property rights to an invention and thereby allowing the entrepreneur to reap windfall profits. To compensate, the innovating enterprise would permanently accrue the original tax credit until a ‘greener’ method is discovered at which time the credit would shift to the latter enterprise and so forth.

There are two other proposals worth mentioning because, while not superior to the three mentioned above, nonetheless represent advances over ACESA. First, there is the Safe Markets Development Act of 2009 proposed by Representative Doggett which sets a hard cap by 2020 while an independent board is responsible for publishing a stable price index for taxes on allowances. In turn, the Treasury would hold quarterly auctions to manage the supply, ensuring that the target price is hit (Chan, 2009). However, the bill does not specify whether carbon credit trading would be permissible which can still leave open the possibility for market manipulation.

Lastly, there has been some discussion about simply limiting who is considered to be an eligible participant in carbon trading markets. Essentially, trading would be limited to regulated entities which would be classified as those who are prepared to accept physical delivery of energy commodities (Chan, 2009). Unfortunately, this would still allow for price manipulation and the possibility that financial companies could purchase firms that have been cleared to accept delivery. Consequently, this would require strict secondary market oversight and regulatory measures which would still be liable to the capture theory of regulation.

19 Admittedly, this is vague terminology but it is presented this way for a reason. The author is studying to be an economist and does not claim in any way to be an expert on chemistry and the scientific aspects of emissions levels. The proposal is simply that if a scientist or scientific body deems an emissions reducing investment project to be extremely beneficial and achieves significant reductions (as opposed to simply cutting corners or a ‘microscopic’ level of reduction), the firm should be rewarded accordingly for it.

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Section IV- Conclusion

In this paper, it was shown that ACESA is not legislation designed to achieve significant climate change as much as it is designed to stave off an enormous debt deflation resulting from the growth of the financial sector having outpaced that of the real sector over the last twenty years. In doing so, it was demonstrated how the American economy can now be characterized as a bubble economy in which the only way to avoid a debt deflation or default is to create another bubble into which idle funds can be channeled until the real sector may somehow catch up and keep pace with Wall Street. In making a case against ACESA at the socio-economic level four different aspects of the market were evaluated. First, the role of uncertainty and its effect upon market relations was discussed. Secondly, the topic of conception of control was presented and it was shown that the proposed ACESA bill will have a conception of control centered on profit making as opposed to climate change. This was followed up by analyzing the role that liquidity providers play in creating and maintaining a market and how this will only exacerbate financial entities’ vested interests in ACESA and cap and trade legislation. Lastly, the role of regulation and shortcomings to the proposed changes to its current structure was shown. In the final section, some alternative proposals were discussed which would seem to be superior to ACESA if genuine climate reform is to be implemented and achieved.

Works Cited


The Rise of Managed Money Capitalism within a World System: The Case of Mexico and the United States

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INTRODUCTION

“Watch out!: Whenever the United States gets a cold, we will get pneumonia,” a well known phrase among Mexicans, who see themselves destined to monitor the healthy state of its friendly neighbor. Throughout the past two centuries, México and the United States not have only shared the Rio Bravo, but also historical, political, economic, cultural, and social phenomena. Currently, both countries are deeply intertwined in most realms; influencing one another day by day in innumerable ways: from the vast amount of goods, services, and information crossing the most transited border between the “First” and the “Third” world to the latent cultural influence of an increasing Mexican-born population in the United States. México and the United States are destined to live next to each other, perhaps to consolidate into two divergent worlds living within a globalized unequal whole. Both countries have learned how to do so and have constructed the means that contribute to a tolerant coexistence; although such means have not been the most adequate in terms of an equal distribution of benefits.

Economically, México and the United States, and Canada have been formally brought together through the North American Free Trade Agreement (NAFTA) since 1994, a conduit that attempts to reap the benefits of a comparative advantage strategy and to assist México in its effort to become a “developed-industrialized country,” according to a Eurocentric model social and economic development. México and the United States have experienced the evolution of their economic systems; participating significantly in the rise of Money Managed Capitalism.

In the middle of the fuss of the most important financial crisis since the 1929 Great Crash, orthodox economists, centered on the epicenter of the financial earthquake (in the U.S. Financial System), seem to run out of feasible explanations to make sense of the debacle of the global economy. The orthodoxy has launched its arguments emphasizing the exogenous nature of the crisis; accordingly, laissez faire capitalism
works. The system is free of inherent flaws; the problems are the outsiders, the exogenous shocks of hedonist calculators.

Nevertheless, it is clearly observed that the impact of the financial earthquake runs endogenously throughout the world affecting many nations interconnected by established networks. These linkages have facilitated in the past thirty years inflows and outflows of goods, services and capital, market accessibility/creation, and the acquisition of “financial weapons of mass destruction, wiping out the long term life savings of U.S. retirees, job creation in Spain, and affordable food in African nations. Such networks have, in addition, changed the demographic composition of Western nations that have experienced in the past years massive immigration from mostly workers coming from the southern hemisphere whose nations have experienced a debacle in job creation (Massey et al., 1986).

In the past two decades, a series of institutional arrangements ensured the installment of Money Managed Capitalism throughout the “developing” world, exacerbating the inherent fragility of its financial systems and development process. By analyzing the endogenous nature of the financial crisis and the impact of the reign of the captains of finance in the United States, one can shed light and compare the emergence of the Ownership Society and the Predator State in the “developing world” through macroeconomic policies of stabilization and free trade agreements—elements that provided the fertile ground for the casino economy.

Based on a heterodox approach, this paper explores such institutional arrangements in México by considering economic liberalization and stabilizing macroeconomic policies in the analysis of Managed Money Capitalism located within a world system. This paper analyzes the rise of U.S. Managed Money Capitalism within a larger context which includes México with its own development of an Ownership Society and a Predator State, institutional components that have supported the interest of the world ruling class and consequently contributes to the financialization of the world economy.

**THE RISE OF MANAGED MONEY CAPITALISM: UNITED STATES AND LATIN AMERICA**
Heterodox theories define capitalism as a monetary system of production where money, not the production of use values, is the unique purpose. Production is not undertaken without the expectations of future profits; the element behind the instability of the system. The heterodox approach of the current financial crisis offers an evolutionary analysis of the current financial disaster which permits the study of the endogenous factors that make capitalism an inherently flawed system of production. In contrast to the conventional explanations of the current financial crisis, this paradigm emphasizes the intrinsic fragility of the financial structure (Minsky, 1986; Wray, 2009; Wray and Tymoigne, 2009), the stagnant tendency of the real sector, and the imperialist nature of the economic scheme (Sweezy and Baran, 1966; Foster and Magdoff, 2009).

The monetary system of production is located within a world system that is constantly changing adapting to social, cultural and political conditions. Its current stage is that of financial capitalism which is intertwined with its imperialist phase where the domination of the so called underdeveloped by developing economies is accomplished through its underlying feudalist social structures that have been maintained and deepened through institutions that perpetuate their reproduction. Financial capitalism is not perceived as concentrated in what is considered the “First World” but rather as interacting within a global structure that contains historical linkages of colonialism and dominance of the “Third World;” i.e. an imperial financial capitalism (Sweezy, 1963; Wallerstein, 1980; Magdoff, 2003).

The current financial crisis represents the full return of Finance Capitalism from the 1920s in the United States, a form of capitalism in which the financial community has dictated production and the conditions of the real economy by dominating the whirls of optimism of the animal spirits through the elimination of the regulations that have hindered its behavior (Wray, 2009). The capitalism of the past thirty years has been driven by the possibility of short-term profits and speculation. As described by Veblen (1906), goodwill or the confidence of investing has been rooted on the valuation of capital based on the expectation of future profits; severely overestimated compared to the actual face value of assets.

The 2007 U.S. financial crisis is situated in the post-1970s period of stagnation which led to the creation of innovating and dynamic investment outlets by the captains of
finance. Since the 1980s, the U.S. economy moved from one speculative bubble to the next, from the world-dot-com to the real estate bubble of the most recent years; the past twenty years have witnessed the rise of Managed Money Capitalism where the production of use values in the real sphere was replaced by the production of money out of money. This has been the epoch when—paraphrasing Keynes’ insights (1936)—enterprises became mere bubbles on a whirlpool of speculation and the capital development of an economy became a by-product of the activities of a casino.

The establishment of the U.S. Money Managed Capitalism—through the destruction of the institutions of U.S. Paternalistic Capitalism and the emergence of supportive mechanisms such as the Ownership Society and the Predator State—has not been an isolated phenomenon; rather, it can be considered as a global process that was transmitted from the developed capitalist economies to the developing economies. A process that was initiated and implemented as an alternative to pursue economic development, the stem of Managed Money Capitalism in Latin American countries, for instance, coincides with the implementation of the economic liberalization movement that emphasized the opening of financial markets in particular.

The deregulatory process undertaken by the United States can be considered an international phenomenon that gained force in particular regions of the world. While the United States has witnessed the raise of Managed Money Capitalism during the 1980s, the world was undergoing a period marked by the fall of the Berlin Wall and the Soviet Union, symbol of the market economy triumph over the planned system. A new world order was implemented in every sphere of the social structure, particularly in the political and economic apparatus.

A proposal was generated, well known as the Washington Consensus or the Neoliberal Model, which included a set of economic policies of a structural character with a tendency to facilitate the process of financial and trade liberalization. Formulated in 1989 by John Williamson, the proposal established ten points that included the principles of fiscal discipline, tax reform, deregulation, exchange rates policies, foreign direct investment, and important clauses on private property rights (Emergi, 1997).

Such policies were oriented towards the destruction of the Paternalistic Capitalism model that has apparently failed due to the debt crisis experienced by the developing
regions of the world in the 1980s—especially in Latin America—and further in the 1990s—Euroasia and Asia. The notion of freeing the economy was strongly enforced by the collapse of the “restrictive-control freak-planned system” in the USSR.

Since the late 1970s, the political economy of many Latin American nations has focused on export-led growth within the designed structural adjustment context; which appeared to be a successful strategy whenever Managed Money Capitalism in the United States raised expectations of future market profitability by increasing commodity prices (Ocampo, 2009). The region has been plagued not only by strong pro-cyclical capital flows but also by the predominance of macroeconomic policies that tend to reinforce rather than smooth out the transmission of external shocks to their economies. This predominance has been “self-imposed” and delegated to the historical relation of dependency that the region has with the developed economies to find mechanisms to transfer financial resources given their low levels of domestic savings: economic development was to be financed by external rather than internal resources.\(^\text{20}\)

Given the nature of the model, economic dependency has increased between the neoliberal economies and the developed capitalist economies, particularly with the United States, in the case of Latin America. Consequently, whenever the extraordinary conditions of the U.S. markets disappear, Latin American countries’ authorities are required to undertake pro-cyclical adjustments policies in order to prove strong economic fundamentals to their capital providers. It is argued that only in this way will developing countries be able to reap the benefits of international trade and capital inflows; a sort of way of proving their credit-worthiness.

As commodity producers, the boom of some Latin American economies has been fueled by extraordinary conditions orchestrated by the financialization of the U.S. economy, which allowed some Latin American countries to accumulate foreign reserves and maintain exchange rate stability. The region has been initially blessed in the first years of the 21\(^{st}\) century with an adequate international environment for the pursuit of its exogenous development strategy. Now, this part of the globe is increasingly vulnerable to the current conditions of the world economy. Following the principles of Managed

Money Capitalism, the region has become a mere market extension of financial capitalism; which has led to the destruction of its industrial sector, particularly in the most open economies.

An imperialist relation between some Latin American economies and the developed economies has been supported by the process of trade liberalization and the macroeconomic context which have encouraged perverse mechanisms to destroy their industries that were, at certain extent, developed in their periods of Paternalistic Capitalism. The region has been affected by the 2007 Financial Crisis in different magnitudes with some countries absorbing a greater shock than others, depending mostly in their level of interaction with U.S. Managed Money Capitalism. In the specter of economic liberalization, one finds, on one side, the planned economies of Venezuela, Bolivia, and Ecuador; countries that have experienced in the past decade strong changes in their political structure and consequently their economic strategies. On the other, one finds Mexico, Colombia and the CAFTA countries\(^\text{21}\) that maintain important commercial agreements with the United States and Canada. In the following section, the paper explores the biggest economy of the region—Mexico, one of the pioneers of the Neoliberal era in Latin America; the country that has obeyed diligently the principles of sound finance and believed the promises of deregulation and market efficiency.

**FINANCIAL CAPITALISM IN MEXICO**

In 2005,—the midst of the U.S. financial bubble—Mexico was considered by the World Bank as an advanced middle-income country with a strong ownership of its development strategy. According to the report, Mexico presented a satisfactory economic performance with outstanding figures of economic growth and macroeconomic stability. Despite the 2001 economic setback experienced in the United States, Mexico’s gross national income was the highest in Latin America, growing at an average of 4 percent with historic low inflation rates of 3.4 percent. Due to its impressive performance, Mexico became the only Latin American member of the Organization for Economic and Cooperation and Development (OECD), an international organization mostly integrated

\(^{21}\) Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua.
by the industrialized advanced capitalist economies of the Western Hemisphere: Mexico was entering the prestigious club of the advanced nations.

The country has embraced an export led model ignited by trade and financial liberalization and ‘sound finance’ macroeconomic policies to foster economic growth and development, an approach progressively implemented over more than twenty years. As a result, Mexico has become the most open economy of the world; having the greatest number of trade agreements which provides the mirage of a well connected economy with markets from all over the globe.\textsuperscript{22} As of 2005, free trade agreements represented close to ninety percent of Mexico’s trade; the North American Free Trade Agreement (NAFTA), alone, accounted for close to 90 percent of Mexico’s exports and 55 percent of its imports (Cruz-Vasconcelos, 2005). Evidently, the expansion of Mexican trade is concentrated in North America, particularly the United States. Having external and focused approach implies that any instability in the major source of aggregate demand for Mexican products represents a severe punch for its economy—the 2007 U.S. Financial Crisis represents this knock out.

Mexico’s vulnerability cannot be masked any longer with shallow indicators of low inflation, outstanding growth rates, and massive international reserves. With the bust of the financial bubble in the United States, economic growth rates have decreased; showing Mexican dependency on the U.S. market and a profound deindustrialization process. These factors have had detrimental consequences in its economy and social structure.

\textsuperscript{22} Mexico joined the General Agreement on Tariffs and Trade (GATT) in 1986. Since 1994 when the North American Free Trade Agreement came into effect, Mexico has signed eleven free trade agreements, listed as the following: Grupo de los Tres with Colombia and Venezuela (1993), Free Trade Agreement with Costa Rica (1995), Free Trade Agreement with Bolivia (1995), Free Trade Agreement with Nicaragua (1998), Free Trade Agreement with Chile (1999) Free Trade Agreement with the European Union (2000), Free Trade Agreement with Israel (2000), Free Trade Agreement with Guatemala, El Salvador, and Honduras, Free Trade Agreement with the Europeans of Free Trade integrated by Iceland, Norway, Liechtenstein, and Switzerland (2001), Free Trade Agreement with Uruguay (2005), and Free Trade Agreement with Japan (2005). Additionally, Mexico has shown interest in becoming an associate member of Mercosur, and has also started negotiations with South Korea, Singapore, and Peru.
Currently, the country finds itself at the edge of a social, political, and economic breakdown with increasing levels of unemployment, organized crime, poverty, social insecurity and upheaval. The escape valve—Mexican migration to the United States—is not an option any longer and the line of the unemployed and needy is increasing day by day. Despite President Felipe Calderon’s attempts to criminalize the poor and show the strength of the Mexican state through a militarized media campaign, social instability in the southern states (Oaxaca, Chiapas, and Guerrero), the poorest in the country, Mexico City’s every day massive workers’ demonstrations, and the failed drug-cartel war in the central and northern states (Sinaloa and Michoacán), question the President’s approach to solve a historical problem of unequal distribution of income, power, and justice.

Even though most of the economic and social dislocation has been accumulated in the past thirty years; the current financial crisis comes to aggravate a precarious situation of a country that did not eradicate detrimental social institutions and that relied on exogenous forces to dictate its strategy of economic development. An approach based on an Eurocentric model of economic and social modernization, as opposed to one that reflects its social, cultural, and historical nature; i.e. a country that holds a feudal castle with a capitalist facade\(^{23}\) (Fuentes, 1963).

Mexico’s current instability also represents a mirror of the actual implications of a Managed Money Capitalism located within a world system. A relationship exists between the emergence of Managed Money Capitalism in the United States and the rise of the

\(^{23}\) Carlos Fuentes, a well-known Mexican novelist, expressed the following in a text to be used in a public debate that never took place with Richard Goodwin, Assistant Secretary of Latin American Affairs for the Kennedy Administration, contrasting adequately Mexican and U.S. social structures: “You founded a society that, from its first moment, was identified with the historical reason of the times[…]. You started from zero, a virgin society, totally equal to modern times, without any feudalist ballast. On the contrary, we were founded as an appendix of the failing feudal order of the Middle Ages; we inherited its obsolete structures, absorbed its vices, and converted them into institutions on the outer rim of the revolution in the modern world. If you come from the Reformation, we come from the Counter-Reformation: slavery to work, to religious dogmatism, to latifundio (enormous expanses of land under the same landlord), denial of political, economic, or cultural rights for the masses, a costume house closed to modern ideas. Instead of creating our own wealth, we exported it to the Spanish and the Portuguese metropolis. When we obtained political independence, we did not obtain economic independence; the structure did not change” (Fuentes 1963:10).
Ownership Society (Wray, 2008) and the Predator State (Galbraith, 2009) in Mexico, as well; institutions of a feudalist nature already existent in Mexico that were reinforced with the *financialization* of the economy. These structures have rendered to the *captains of finance* not only the U.S. financial markets, but also access and generation of Mexican markets for the mere pursuit of profits, delegating the nation’s economic development at a secondary level.

In Mexico, two major mechanisms have supported the extension of U.S. Managed Money Capitalism: economic liberalization (NAFTA) and the policies of macroeconomic stability — which provided the fertile conditions to serve its interests at the expense of the Mexican economy. Basically, the expansion of Managed Money Capitalism in Mexico has replaced the purpose of economic development through a progressive shift from the Paternalistic approach of the Post-Depression period to a process of economic deregulation that started in the late 1970s. To support this transition, a series of macroeconomic policies were implemented to ensure the economy will maintain the environment for the “adequate” allocation of resources on benefit of the world rentiers.

**The Mexican Period of Paternalistic Capitalism: A Historical Review**

An exogenous economic development strategy has made the Mexican market economy an expansive channel of the capitalist models that have emerged its northern neighbor. In the United States, two stages of capitalism can be historically differentiated in the following periods: the Pre-1929 Crash, the Post-1930 or Post-WWII, and the Post-1970s economic systems with its 1980s subsequent legacy. The 1929 Pre-Crash and Post-1970s exemplified Finance Capitalism whereas the Post-WWII exemplifies a Paternalistic Capitalism (Wray, 2009). In Mexico, the fluctuations go along with those experienced by the United States. At the time of the Roosevelt Paternalist model, Mexico has had its own- Lázaro Cardenas; in the period of Reaganomics, Mexico had Carlos Salinas de Gortari.

Considered by Sweezy (1963) as another Great American, Cardenas, as his homologous, expanded significantly the participation of the government in the Mexican economy, that unlike the U.S. economy, was still struggling with feudal issues of land distribution in addition to the implications of the 1920’s U.S. Laissez Faire in Mexico—
i.e. the expansion of its monopoly power in Mexico. To solve the latter, in a historic move, by taking advantage of a long-term conflict that involved workers’ demand for better salaries and working conditions, Cardenas nationalized the oil and railroad industries. The former managed by the Mexican Eagle Company (a subsidiary of the Royal Dutch/Shell Company) which accounted for over 60 percent of Mexican oil production, and by Jersey Standard and Standard Oil Company of California, which accounted for approximately 30 percent of the total production. Most importantly, Cardenas established article 27 of the Mexican Constitution that asserted ownership by the state of all land and water within national territory including the subsoil and any natural resources discovered below ground. Under this law, foreign citizens could not own land within a specific distance from the set geopolitical borders.

Cardenas emphasized economic and social development. An extensive education reform was carried out throughout the country. In this reform, article 3 of the Mexican Constitution established the separation between the educative system and the religious institutions. The program also implemented the principles of a socialist type of education. Lázaro Cardenas established an educative system in the rural regions that promoted the formation of skilled workers that will help the development of communal land, where the youth acquired knowledge on activities related to the development of agriculture and cattle raising. Development programs oriented towards the agricultural sector included expansive land redistribution, which represented a genuine attempt to level the ground for the historically disadvantaged sector of the Mexican society: the impoverished mestizo farmers in the north but mostly indigenous groups that have remained at the bottom of the social strata ever since the Spanish Conquest in the southern region of the country.

Cardenas’ Paternalistic Capitalism contributed to the development of a more equal country that is more endemically imbalanced than its neighbor given the nature of its formation and historical evolution. Unlike the United States, Mexico has preserved throughout the years severe regional and ethnic inequality mainly characterized by a poor south and a rich north. The southern region, mostly rural and agricultural, has been inhabited in its majority by an unskilled/indigenous population; which contrasts the

24 Out of the Mexican Revolution of 1910, most of the land was owned by foreigners
northern and central urban regions, the richest parts of the country where industrial development and the service sector emergence took place, mostly populated by the mestizo and European offspring population. Under Lázaro Cardenas’ agrarian reform—that followed Zapata’s principles—more than 18 million hectares were distributed to communities and communal land owners, constituted by mostly impoverished peasants, aiming to build small productive units with self-sufficiency capacity.

Following Cardenas’ strategy, the subsequent executive administrations supported the development of Paternalistic institutional arrangements such as the Mexican Institute of Social Security (IMSS)—the Mexican social security agency; The National Confederacy of Farmers, and a Temporal Working Program for Mexican Farmers in coordination with the U.S. government; institutional structures that shaped a more equal society. Mexico’s Paternalistic approach to economic development, via the Import Substitution Industrialization (ISI) policies, was oriented towards internal consumption, intensive production in capital, and protection of the domestic industry. The “infant industry” shielded from exterior competitors, laid the foundation for Mexico’s industrialization. President Miguel Aleman (1946-1952) established a full-scale Import Substitution Program that stimulated production by boosting internal demand, establishing import controls on consumer goods, and investing heavily in road infrastructure.

The ISI model required strong governmental intervention and the existence of an apparatus of central coordination that guaranteed the distribution of adequate incentives for investment. Due to lack of capital markets and the limited functioning of financial intermediation, Mexico’s financial market presented essential problems of lack of information of creditors’ solvency and consequently credit rationing. In order to cope with this issue, Paternalistic institutional arrangements were implemented. The Banco de Mexico was founded in 1925 and Nacional Financiera was established in 1934, public institutions that provided credit to domestic enterprises during the 1940s. Moreover, Cardenas established in 1934 Banjidal (National Bank of Communal Land Credit) destined to capitalize the agricultural productive units. An extensive participation of the financial sector on economic growth during this period – in particular from the Commercial Bank and the Development Bank- were an essential aspect of the period.
known as *stabilizing development* (Vasconcelos-Cruz, 2005). The Mexican economic policy of *stabilizing development* translated into a proliferation of state owned enterprises mixed with private enterprises that were located in the branches of intermediate or capital goods.

During the *stabilizing development* period, most of the developed capitalist economies were concentrated on the war and post-war reconstruction efforts; this situation allowed countries like Mexico to initiate the production of consumption goods that were previously imported. As a result, Mexico’s export composition changed drastically. In 1939, the manufacturing sector represented only 7 percent of the total exports by 1945 the segment represented 38 percent. Real public investment increased at an annual rate of 15 percent and combined with a fast increase in private investment created a productive base that allowed for the expansion of production. Overall, public and private investment increased at an average rate of 13 percent. During this period, the manufacturing sector remained the country’s dominant growth sector, expanding 7 percent on average annually, boosting urbanization and raising considerably the living conditions of many Mexicans (Cardenas, 2003).

Economic development in Mexico took place under conditions of price stability with a stable exchange rate and low interest rates between 1958 and 1971. Cárdenas (1996) divided this period into two sub-periods: one period starting in 1950-1962 and the other from 1963-1971. From 1950 to 1956, internal savings financed a great part of the total investment; high levels of financing of the public investment were with governmental resources. However between 1957 to 1962, domestic savings decreased, whereas external savings participation in financing total investment increased. Exterior factors were involved in the internal savings decline levels, given the export-oriented strategy, a shrink in the U.S. demand for Mexican primary goods and a decline in the price of agricultural products in the international markets led to the first currency devaluation in 1953. This situation prompted a credit request in 1956 to finance the public deficit on attempting to avoid a considerable decline in the country’s international reserves. Despite this setback, the Mexican economy experienced the major economic growth recorded during the 1960s; averaging an annual increase of 7.1 percent between 1963 and 1971 (Cardenas, 1996).
Despite the significant positive contributions of the ISI model, the approach presented its weakness based on its reliance on the exterior market rather than the internal market. The positive implications of this model were greatly favored by the golden era of capitalism in the industrialized countries that were boosted by the bellicose conflicts investment levels. Within this context, Mexico continued throughout its dependency on foreign technology and investment capital to foster its development. The dependency to exterior aggregate demand and capital imports triggered endemic problems, which defined the path of the following decades (Vasconcelos-Cruz, 2005).

**Mexican Managed Money Capitalism: The Predator State and the Ownership Society**

Like its neighbor, Mexico experienced an abrupt economic breakpoint in the 1970s. Affected by a volatile international environment characterized by inflation and the emergence of financial crises in the U.S. capital markets (Wolfson, 1994), Mexico continued to hold a dependency on foreign technology and external savings to finance investment; which led to an increase on the national debt burden; the hallmark of the Mexican economy and the major impediment to support a Paternalistic form of capitalism in the future.

The dependence on foreign capital increased exchange rate instability, which caused severe currency devaluations and a pronounced slowdown on economic activity. Further debt acquisition was embraced in order to maintain the economy at an adequate shape to keep attracting capital to finance industrial development. This process ended up in debt-payment failures of Mexico, Argentina, and Brazil that contributed to U.S financial fragility that shaped the 1980s Savings and Loans Crisis in the 1980s. According to Wolfson (1994),

The threat of a default by Mexico posed a very serious problem for banks in the United States. Of the approximately $80 billions that Mexico had outstanding, $24.9 billion, as of June 1982, was owned to U.S. banks. In addition, the nine largest U.S. banks had loans to Mexico totaling $13.4 billion, which represented nearly 50 percent of the nine banks’ total capital of 27.1 billion; of the $13.4 billion, $7.6 billion was due within one year. (89)
Given the deregulatory process of this period in the U.S banking system, which in addition triggered a series of control frauds (Black, 2005), Mexico acquired credit that did not have the needed supervision. U.S. banks desperate to find profitable outlets that were inexistent in their domestic markets, issued credit to several Latin American countries already situated at safe financial positions. Consequently, an increase of the international interest rates made Mexico unable to service its outstanding debt to U.S. commercial banks and other creditors. Rescued by the Federal Reserve that acted as an International Lender of Last Resort, Mexico increasingly compromised its sovereign power to drive economic policy in the future.

Ever since the 1980s, Mexico’s reliance on external capital to finance its development meant catastrophic consequences for its real sector that intensified its dependency on international capital markets and monetary institutions (International Monetary Fund and World Bank), which facilitated in the following years the implementation of the Neoliberal model. The world captains of finance have ultimately dictated the macroeconomic context adequate for the pursuit of their interest in the past twenty years. As established by Keynes (1930) and emphasized by Kregel (2006), external capital flows have determined domestic conditions and trade flows, rather than the other way around in Mexico.

a) The Predator State

During the 1980s, as in the United States, the arrival of the Predator State and the Ownership Society evolved broadly in Mexico. The Predator State (Galbraith, 2009) started to emerge in the late 1970s in the United States. In Mexico, this state was constituted by a new class of politicians known as the technocrats—a parallel to the U.S. neoconservatives, given their political agenda and ideological attachment. Technocrats were politicians holding high educational degrees from prestigious U.S. universities—hosting academic programs that strongly support Laissez Faire Capitalism—in “specialized” areas of study such as business and public administration, economics, and finance. Such trend is clearly observed in the degrees held by the former Mexican
presidents since the 1980s.\textsuperscript{25} This tendency embodied the implementation of a neoliberal ideological think-tank in the governmental ranks and consequently the rise of a state that will support economic liberalization and the interest of the international rentiers who have shaped on its way the stagnant political structure of the country that culminated with the historical triumph of PAN, the conservative party, in 2001.

Former president Carlos Salinas de Gortari initiated a privatization of public enterprises by curtailing governmental participation in the economy and putting an end to the land distribution system, food and fuel subsidies, and modifying the laws of private property. Salinas constructed the path to the most successful mechanism that expanded the market for U.S. Managed Money Capitalism –NAFTA, by “liberating” the financial and goods markets, a process that included the controversial amendments of articles 3 and 27 of the Mexican Constitution, symbols of paternalism that have ameliorated social and income inequality. Galbraith (2009) writes,

Mexico chose a different path, following the stolen election of 1988 and the rise to power of the U.S. oriented business elites headed by Carlos Salinas de Gortari. Following the leadership of Miguel de la Madrid, who took Mexico into the GATT in 1986, Salinas decided to negotiate a treaty of economic integration with the United States and Canada[...] The NAFTA’s essence was the reduction of Mexican import barriers to manufactured goods and agricultural staples from the United States, combined with a new willingness to accept foreign investment and even

\textsuperscript{25} Miguel de la Madrid (1982) lawyer graduated by the National Autonomous University of Mexico with a Master Degree in Public Administration from Harvard University; Carlos Salinas de Gortari, holding a M.A. in Public Administration and a Ph.D. in Economics from Harvard University; Ernesto Zedillo, a Doctor in economics from Yale University currently the director of the Yale Center for the Study of Globalization, Vicente Fox holding a Master in Business Administration from Harvard University and former CEO of Latin America Division of Coca-Cola, and President Felipe Calderon holding a Master Degree in Public administration from Harvard University.
foreign domination of the Mexican industrial and financial sector.[…] The result was an investment boom in northern Mexico for the last half of the 1990s, bringing to power the right-wing political party, the PAN, which has been created to serve the purposes of the northern business elites. (80)

In the past two decades, the emergence of the Predator State has facilitated the expansion of the Mexican Ownership Society, which has affected income distribution regionally and ethnically\textsuperscript{26} in a peculiar way that reflects the economic activities and the regions that absorb most of the generated income. In its 2009 list of the world wealthiest men, Forbes included the name of nine Mexicans, business owners concentrated in the communication, mining, and banking sectors as well as the leader of an infamous drug cartel. Among the wealthiest Mexicans figure: Jeronimo Arango, co-founder of a Mexican supermarket chain and stock holder of Wal-Mart Mexico; Roberto Hernandez Ramirez, president of the Mexican Stock Market and current adviser of CitiGroup; Ricardo Salinas Pliego, president of Grupo Azteca, a business consortium constituted by banking and communications enterprises oriented to low-income consumers, and the drug-trafficcker Joaquin Guzman Loera “El Chapo Guzman” the leader of the Sinaloa cartel (See Table 1).

The 2009 Forbes list proudly features Carlos Slim Henu, the third richest man of the world that shares the podium with Warren Buffet and Bill Gates, who made his

\textsuperscript{26} According to the Indigenous Peoples, Poverty, and Human Development in Latin America: 1994-2004, a study published by the World Bank, the incidence of extreme poverty in Mexico is higher in indigenous than in non-indigenous counties. Extreme poverty among indigenous households is 68.5 percent compared to only 14.9 percent among non-indigenous households. Mexican society is a polarized one, divided into two worlds that of the northern and urban regions that embrace the miracles of free trade agreements with their expansive service sector and cultural ‘modernization’, and the other, the poor rural and southern areas that strive to survive mostly through the mechanisms of employment in the informal sector, delinquency, and undocumented migration to the United States.
fortune during the economic collapse of the 1990s by purchasing the state-owned telecommunications enterprise Telmex; establishing a current monopoly in the telephony industry. In the midst of the financial crisis, Slim bailed out the New York Times in an attempt to refinance its financial debt; he moreover acquired 70 percent of a new “public” company, the Impulsora del Desarrollo Economico de American Latina, an institution on charge of boosting economic development south of the Rio Bravo (Forbes, 2009).

Rising inequality in the past three decades can be indubitably observed in the rising tide of the migratory wave of the unemployed, rural, with low levels of education Mexican males who arrived to the United States in the past years thirty years (See Figure 1). The number of Mexicans migrating to the north accelerated during the 1970s. By the 1990s, the Mexican population residing north of the Rio Bravo doubled. A dramatic increase in migratory inflows has taken place which doubled the population of Mexican born living in the United States once again in 2000 (Passel, 2005). By 2003, Hispanics have surpassed African Americans representing the U.S. largest minority group —mostly constituted by Hispanics of Mexican origin. In 2005, conservative figures estimated that 12 million undocumented Mexican immigrants were working in the United States, close to 8 percent of the Mexican population.

*The Stabilizing Macroeconomic Model: The Instrument of Money Managed Capitalism*

The macroeconomic policies oriented to ensure capital inflows have had a negative implication on economic growth and industrial development in Mexico (Huerta, 2009). Financial liberalization’s main priority is macroeconomic stability. Fiscal and monetary policies follow the lineaments of the orthodoxy opposing the principles of functional finance (Lerner, 1943; 1947): inflation is always and everywhere a monetary problem and public deficits crowd out private investment, particularly foreign private investment. Under this framework, monetary policies are oriented towards inflation targeting and maintaining exchange rate stability. Such policies emphasize the importance of high interest rates, fiscal discipline, and currency exchange appreciation, controlled conventions that leave no room for Paternalist maneuver.
According to Huerta (2009), restrictive monetary policies prioritize the accumulation of international reserves denominated in dollars to ensure exchange stability (based on a belief of a straightforward relationship between money supply and international reserves) in order to be able to maintain foreign capital in the country and to further attract capital inflows (See Table 2). The more capital enters the country the more the peso is appreciated; the national currency becomes stronger. Such policy favors financial capital at the expense of the competitiveness of national production –imports become cheaper, domestic products more expensive, which affect the dynamics of capital formation in the productive sector.

A high interest rate increases debt cost as well as the debt burden of the private sector, favoring exclusively the financial sector; the exchange rate policy is not in favor of the Mexican market and industry. Working with flexible exchange rate cannot be adjusted around price differences because this would affect the financial capital yield and would cause inflation pressure –due to the high coefficient imported from demand and from external debt payment. This rate is only flexible to capital movements. Within the financial liberalization context, exchange rate comes to be determined by capital flows (Kregel, 2006).

Under the current political economy, the governmental “sovereignty” is controlled by institutions—Banco de Mexico—initially established to favor economic development but now serving the interest of Managed Money Capitalism. Sound finance policies are required under the macroeconomic stability framework; which have detrimental effects on the level of aggregate demand and the development of an internal market. The Mexican Predator State favors the mechanism of distribution—macroeconomic stability policies—mainly through a high rate of interest, that works for the interests of the international capital destroying the productive sector. Historically, the current mechanism of distribution, on favor of the international capital, represents a shift in an idiosyncratic circuit of capital from (a) to (b):

a) $M$(capital inflows and domestic capital formation, public deficit)$-C[(\text{Mexican labor, foreign technology})]...P(\text{national/state owned enterprises, private sector})...C'(\text{exports, domestic consumption})-M'(\text{capital formation, capital outflows})
b) $M$\text{(international capital inflows)} - $C$\text{[(Mexican labor(service sector), technology(foreign))] - $M'$\text{(capital outflows)}}$

The first circuit (a) represents the circuit of the Mexican paternalistic stage (1934-1970) where the Mexican government was an active participant of the economy; which generated a stabilizing period of growth and development with the assistance of capital inflows; these investment funds were actually channeled to the production of use values for exportation and domestic consumption; a stage significantly favored by the conditions of international markets and regulatory mechanisms. The second circuit (b) is that of Managed Money Capitalism—given the country’s debt burden and government lack of participation—where the interest rate determines capital inflows that will purchase labor and means of productions (often imported from abroad), and exit the country in the form of capital outflows given the current socio-political institutions—the Mexican Predator State and Ownership Society—and instrumental measures—stabilizing macroeconomic policies. Similarly, the circuits represent a shift, like in the United States, from the Mexican Industrial State to the financialization of the Mexican economy or the dominance of the financial sphere over production of use values.

**The Financialization of the Mexican Economy**

The Mexican Managed Money Capitalism, like in the United States, has been characterized by a lack of industrial development and a shift to the expansion of the service sector, a deregulatory process in the financial and goods market (NAFTA), and a “going-foreign” process of the banking industry. The role of the paternalistic institutions of economic development —Banco de Mexico and Nacional Financiera—has been relegated to the flows of foreign direct investment and foreign banks. Unfortunately, the intended consequence—economic development—has not been the final outcome. As indicated by Kregel (2006), Mexico has lost policy space. Currently, Mexico runs a trade deficit with most of the nations that it is involved in commercial agreements, the banking sector does not facilitate credit to domestic business owners, and capital inflows have not financed the industrial sector (See Table 3 and 4). It has been indicated that the process of
the worldwide capital liberalization presents an even more vicious pattern; having a significant part of the capital resources moving from developing countries to developed countries, primarily to the United States, creating exchange rate instability and rising debt service that inflates the public deficit (Puyana-Ferreira, 2005).

a) Speculative Capital Inflows

In Mexico, capital inflows have not been utilized to finance the real sector or long term investment to boost the generation of employment and income; instead, such inflows are often short-run based on the expectations of profits emerging from the change of value of the financial assets, in other words, of a speculative nature. In a recent note, according to the Banco de Mexico, following the global trend of financialization and securitization of the foreign owned Mexican market, the derivatives market has been the most developed area of international business with global subsidiaries operating in Mexico. Its nominal value has represented more than 100 percent of Mexico’s gross domestic product, and is at least four times the total value of banks’ assets. The greatest portion of these instruments is made of interest rate swaps, having 65 percent of their counterparties overseas (Correa and Secareccia, 2009).

Economic liberalization has, in addition, diversified and widened the community of investment institutions—private pension funds, insurance companies, mutual funds, and corporate treasuries—facilitating the exchange of inter-frontier financial instruments (Correa and Secareccia, 2009). According to Puyana-Ferreina (2005), only a small segment of the developing nations that receive significant inflows of net capital share information on the received capital. Consequently, instead of channeling these inflows to finance capital accumulation on developing nations, international capital flows have financed the trade deficit in the United States (47).

\[\text{27For example “in the credit meltdown in developed financial markets caused a decline in their stock markets where credit was frozen and unexpected significant capital outflows took place. The capital outflows developed through two channels, an expected one –flight to quality (which meant mostly US Treasury bonds)–and an unexpected one –the sales of assets through the world to finance the withdrawal of resources from mutual and hedge funds in the USA. Brazil, Chile and Mexico became countries with the highest exchange rate instability; in developing countries, financial crises lead to capital outflows” (Correa and Secareccia 2009).}\]
In the last three decades in Mexico, the credit issued by commercial banks to the manufacturing sector has decreased whereas the consumption credit has increased significantly. On one hand, credit destined to manufacturing, has represented 16.8 percent of the total in 1995; by 2007 the share has decreased to 10 percent. On the other hand, consumer credit has increased sharply from representing 6.2 percent in 1995 to 24 percent of the total in 2008 (Huerta 2009); figures that sustain the pervasive patterns of imperialist financial capitalism that is the shift from M-C-M’ to M-M’ kind of activities. In contrast to the Paternalistic period (1939-late 1970s) when the Mexican economy grew 6.1 percent; the economy has only grown 3.6 percent in the current context (1996-2007).

b) Employment Generation

By looking at the pattern of economic activities of the Mexican Ownership Society, most of the employment created by the managed money model has been concentrated in the service sector, which generates job posts that require training and skills limited to the urban population and those able to pursue the required levels of training and education. The rest of the population, considering the disparities on regional development, is left with job opportunities that are, in majority, low remunerated and with precarious labor conditions. The job creation strategy in some sectors has forced migration from the southern-rural to the northern and central urban regions—e.g. the Manufacture Industry for Exportation has been conglomerated in the border-urban centers, which has increased the migration of the southern rural population into these cities; currently facing the problems of organized delinquency and crime. For instance, the infamous case of the Women of Juarez and the development of the illicit drug industry in the northern states have been a result of the disarticulation of the productive sector throughout the country.

The agricultural sector, previously supported, has experienced aggressive privatization; a situation exacerbated by NAFTA’s greater inflows of cheaper food staples from the United States. La Crisis del Campo (the crisis of the Mexican Land), has added to the large numbers of Mexican migrant workers in the United States, the neighbor that has been absorbing the reserve army of the unemployed Mexicans. The undocumented workers have had a primary role in the Mexican-U.S. Managed Money
Capitalism; i.e. to balance the distribution of income in favor of the most disadvantaged sector of the Mexican society—impoverished rural agricultural communities—by sending across the Rio Bravo the income generated in the U.S. financial economy. The remittances sent by these workers have seen an unprecedented increase in the last decade, particularly in the years of the U.S. house market bubble when these surpassed the capital inflows of foreign direct investment.  

\[28\]

\textit{c) A Foreign Banking Industry and Modifications in Productive Chains}

After the 1994 economic crisis and the aftermath of the Tequila effect, the Mexican banking industry has undergone a “going-foreign” period. This is a process of merging and acquisition of the financial sector by foreign consortiums such as Citibank, J.P Morgan, and the Spanish bank Bilbao Viscaya. This period is also characterized by the merging of national and foreign enterprises and the purchase of national enterprises by foreigners. This process has built a new productive structure of the economic sectors that determines its participation in the domestic and international markets. Once domestic enterprises are owned by foreign consortiums; they experience technological, organizational, and market changes. Therefore, their long term economic objectives do not coincide with that of the national economic development; rather with the objectives of the foreign private sector (Rodriguez-Lopez, 2005).

According to Correa and Seccareccia (2009), the Mexican economy has historically had a high level of income concentration among households and in the ownership of business in the most modern and dynamic activities—i.e. communications, information technology, and finance. This conglomeration initially deepened with the

\[28\] In 2006, remittances sent to Mexico totaled $22 billion an increase of 125 percent since 2002. By 2007, remittances represented 2.7 of the gross domestic product of the Mexican economy and 128 percent of foreign direct investment (INEGI 20007). It has been estimated that 52 percent of the Mexican families that received remittances were found in communities with less than 2,5000 inhabitants and they received an average of 2,372 dollars per year (CONAPO, 2004)
spread of privatization, the opening of trade and financial markets, and the internationalization of many of the largest domestic corporations. Such centralization is clearly seen in the Mexican financial system where:

- The four largest financial groups (all subsidiaries of foreign banks) hold 74 percent of total bank assets; the five largest investment banks control 60 percent of their market; the five largest insurance firms control 51 percent; five companies control 60 percent of the automobile insurance market; and 60 percent of workers’ pension funds are concentrated in the hands of the five largest operators[…] In terms of traditional deposits, 0.3 percent of accounts represent 58 percent of all deposits, whereas 80 percent of accounts represent only 1.6 percent of the total […] the three hundred largest clients receive over 80 percent of total loans . (89)

- Bank lending to the household and business sector only represents 14 and 27 percent, respectively. The financing of domestic private non-financial enterprises represents 16 percent of GDP out of which 9.3 percent was lend to domestic borrowers and 6.7 percent went to foreign borrowers. Given the high interest rates and the current levels of income inequality, the traditional banking role is limited; encouraging local corporations to seek external financing; a situation that entails greater foreign exchange risk. Small and medium local enterprises unable to reach the international markets “are far from attaining sufficient financing at a sustainable cost from domestic banks and the financial capital markets. This aspect further strengthens the tendency of growing financial capital exports of local corporations and, along with them, the permanent dollarization of profits” (Correa and Seccareccia: 91).

**CONCLUSIONS**

The rise of Managed Money Capitalism is not an isolated phenomenon concentrated in the most developed capitalist economy of the world; rather, one can argue, this model was born in the United States and transmitted to other economies, particularly those historically intertwined, through the progressive destruction of their paternalist institutions and the implementation of supportive mechanisms—the Ownership Society and the Predator State. The case of Mexico exemplifies clearly this
relationship; a country that has followed an exogenous strategy for economic development and social modernization; that is destined to observe the economic and social conditions of its neighbor to define the conditions of its existence.

The Mexican-U.S relationship is a dependent one, an institutional arrangement enforced by financial and commercial liberalization (NAFTA), which has relegated industrialization, job creation, and equal distribution of income and justice and has subjugated the sovereign instruments available—macroeconomic policies—to the desires of the world captains of finance in the past twenty years. Assisted by an undemocratic Predator State—that represents mostly the Mexican plutocracy well connected with international capital—and the Ownership Society—focused on the most “innovating” sectors of the economy—the Mexican economy has become a market extension available to the casino economy.

The overlapping of two stages of capitalism—financialization and imperialism—sheds light on the underlying mechanisms that were built in the past three decades to ensure the maintenance of a dominant relationship between the developing and developed economies; which has been determined by the lack of a primitive accumulation process in the Non-Western world. The Non-Western or developing world has relied, in order to catch up with the West or the so called developed world, on external resources, rather than internal, to finance its economic reproduction and growth. This reliance has increased in the period of Managed Money Capitalism in Mexico. In the period of Paternalistic Capitalism, Mexico started to generate internal resources that were channeled to boost industrial and agricultural development. This period was also favored by the formation of a Paternalistic Capitalism in the United State out of the debris of the 1920 laissez faire economy. During this period in Mexico, adequate conditions were being created to start a catching-up process.

Nowadays, the Mexican Money Managed economy is more dependent than before on external markets, less sovereign, less industrialized, and unequal with an increasing polarized social structure that is carrying the burden of demographic dislocation, unemployment, and delinquency. The experience of Mexico exemplifies the detrimental implications of the neoliberal model imposed on a developing economy with historical linkages of political, cultural, and economic domination; i.e. increasing external
debt, trade deficits, over-valuation of the national currency, large international interest rate differentials, financial sector weakness, reversal of capital flows, exchange rate crisis, and the loss of policy space (Kregel 2006). Essentially, the experience of a nation holding a feudal castle with a capitalist façade that has not experienced the required destruction of the mechanisms to embrace an economic system that aims social provisioning rather than the allocation of resources among competing ends—a revolutionary change that might be forthcoming, a needed watershed for the replacement of Managed Money Capitalism for a new form of economic system that best suited all Mexican peoples—a system that might emerge from the debris of the 2007 Financial Crisis, as occurred after the 1929 Great Crash.

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### Appendix

#### Table 1

<table>
<thead>
<tr>
<th>Mexico Ranking</th>
<th>World Ranking</th>
<th>Name</th>
<th>Age</th>
<th>Fortune*</th>
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<tbody>
<tr>
<td>1</td>
<td>3</td>
<td>Carlos Slim Helu</td>
<td>69</td>
<td>35</td>
</tr>
<tr>
<td>2</td>
<td>83</td>
<td>Alberto Bailleres</td>
<td>76</td>
<td>5.7</td>
</tr>
<tr>
<td>3</td>
<td>124</td>
<td>Ricardo Salinas Pliego</td>
<td>53</td>
<td>4.2</td>
</tr>
<tr>
<td>4</td>
<td>178</td>
<td>Jeronimo Arango</td>
<td>83</td>
<td>3.4</td>
</tr>
<tr>
<td>5</td>
<td>246</td>
<td>German Larrea Mota Velasco</td>
<td>55</td>
<td>2.6</td>
</tr>
<tr>
<td>6</td>
<td>601</td>
<td>Roberto Hernandez Ramirez</td>
<td>67</td>
<td>1.2</td>
</tr>
<tr>
<td>7</td>
<td>701</td>
<td>Joaquin Guzman Loera</td>
<td>54</td>
<td>1</td>
</tr>
<tr>
<td>8</td>
<td>701</td>
<td>Emilio Azcarra Jean</td>
<td>41</td>
<td>1</td>
</tr>
<tr>
<td>9</td>
<td>701</td>
<td>Alfredo Harp Helu</td>
<td>65</td>
<td>1</td>
</tr>
</tbody>
</table>

*Billions of dollars

#### Table 2

<table>
<thead>
<tr>
<th>Year</th>
<th>R1/M1*</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>59.6</td>
</tr>
<tr>
<td>2001</td>
<td>60.3</td>
</tr>
<tr>
<td>2002</td>
<td>67.7</td>
</tr>
<tr>
<td>2003</td>
<td>78.8</td>
</tr>
<tr>
<td>2004</td>
<td>66.3</td>
</tr>
<tr>
<td>2005</td>
<td>75.7</td>
</tr>
<tr>
<td>2006</td>
<td>74.7</td>
</tr>
<tr>
<td>2007</td>
<td>81</td>
</tr>
<tr>
<td>2008</td>
<td>88.0</td>
</tr>
</tbody>
</table>

*M1 represents bank notes and coins the public sector holds; check accounts in national
currency from home banks and also in foreign currency, bank deposits of saving societies and loans. Source: Huerta (2009) Banxico Data

**Table 3**

Mexico: Issued Credit by Commercial Banks by Economic Sector

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>Manufacture</th>
<th>Construction</th>
<th>Consumption</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>100</td>
<td>16.8</td>
<td>7.6</td>
<td>6.2</td>
</tr>
<tr>
<td>2000</td>
<td>100</td>
<td>15.8</td>
<td>3.7</td>
<td>3.9</td>
</tr>
<tr>
<td>2001</td>
<td>100</td>
<td>15.1</td>
<td>3.7</td>
<td>5.6</td>
</tr>
<tr>
<td>2002</td>
<td>100</td>
<td>14.3</td>
<td>3</td>
<td>7.9</td>
</tr>
<tr>
<td>2003</td>
<td>100</td>
<td>13.6</td>
<td>3</td>
<td>10.3</td>
</tr>
<tr>
<td>2004</td>
<td>100</td>
<td>12.9</td>
<td>2.9</td>
<td>14.8</td>
</tr>
<tr>
<td>2005</td>
<td>100</td>
<td>12.5</td>
<td>3.2</td>
<td>20.6</td>
</tr>
<tr>
<td>2006</td>
<td>100</td>
<td>10.2</td>
<td>3.4</td>
<td>26.1</td>
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<tr>
<td>2007</td>
<td>100</td>
<td>10</td>
<td>6.1</td>
<td>28.2</td>
</tr>
<tr>
<td>2008</td>
<td>100</td>
<td>11.1</td>
<td>9.2</td>
<td>18.6</td>
</tr>
</tbody>
</table>

Source: Huerta (2009)

**Table 4**

Mexico: Total trade deficit, Manufacture and agriculture trade deficit vs. oil surplus, 2003-2008

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Deficit</th>
<th>Manufacture Deficit</th>
<th>Agriculture Deficit</th>
<th>Oil Industry Surplus*</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>-5,779</td>
<td>-14,614</td>
<td>-2,891</td>
<td>12,444</td>
</tr>
<tr>
<td>2008</td>
<td>-16,838</td>
<td>-27,759</td>
<td>-6,360</td>
<td>26,180</td>
</tr>
</tbody>
</table>

*Hydrocarbons trade balance.
Figure 1: Major Latin American Countries Contributors' of U.S. immigrants

Figure 2: Mexico 2003-2008: Capital Inflows
Mexico 2003-2008: Capital Inflows

- Workers Remittances
- Credit Investment
- Direct Foreign
- Oil Exports
- Total

Years: 2003-2008

Millions of Dollars

2003: [Diagram showing capital inflows for each year]
From Economic Man to Playing Man: New Perspectives on Entrepreneurship in Civil Society

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1. Introduction

Entrepreneurship was, and in many ways still is, an uncomfortable rash for mainstream economics, some scholars even proclaim that neoclassical economics is entrepreneurless (Baumol 1968). However, starting in the 1990s society’s need and apatite for entrepreneurship seem to have grown exponentially, and with this apatite followed a liberation of entrepreneurship that injected aspects of mainstream economic thinking into the very core of entrepreneurial scholarship. Hjorth (2003) refers to this development as the rise and implementation of an enterprise discourse and its central apparatus, management, in entrepreneurship. I believe that this enterprise discourse has been especially noteworthy in applications of entrepreneurship in civil society i.e. social entrepreneurship. The key predicament is not the existence of such a discourse but its current dominance. Leaving it like this, unchallenged and intact, would be a great loss because it reduces the fabulous, creative, passionate and visionary into managerial practices that in turn dilute the transformational power of social entrepreneurship into yet another management reform.

This article will outline and describe some of the pivotal issues and features of the economically rooted enterprise discourse in social entrepreneurship and nonprofit organizational studies. It will also suggest that by opening up to alternative economic influences, exemplified by the work of Knight (1921), Hayek (1945), Veblen (1898 1914) and Eliasson (1990 2005), it is possible to move in a different direction of thinking about social entrepreneurship. Notice, the purpose here is neither to provide an “answer” nor to argue that management is irrelevant for entrepreneurial inquiries of nonprofit organizations, but to stimulate interest and initiate a discussion about the meaning and genesis of social entrepreneurship.
2. Entrepreneurship Liberated

Entrepreneurship, from a historical perspective, has long fascinated economists. One economic scholar who left a significant imprint on this topic is Joseph Schumpeter (1934). In contrast to many of his fellow economic colleagues Schumpeter spent a considerable amount of time analyzing entrepreneurship, which he found unsuitable for both theorizing as well as rationalizing as it ultimately is a study of practical knowledge (Hjorth 2003). In particular, Schumpeter was captivated by the creative and numinous entrepreneur who created and implemented new combinations i.e. innovations that propel and transforms the economy in a different direction. This notion of creativity as actualization of ‘what could become’ is a disturbance that was difficult for both mainstream economics and management scholarship to grasp, which help explain the absence of entrepreneurship in neo-classical economics as well as management theory for much of the 20th century (Hjorth 2004). Then something remarkable happens, the entrepreneur and entrepreneurship emerges from its marginalized position to suddenly be described and included, in the words of Busentiz et al (2003), as a field within management.

Hjorth (2004, pp. 417-418) tracks this shift of location of entrepreneurship to the expansion of economic thinking into new areas of society. He quotes Gordon that describes this as “attempts to construct a culture of enterprise have proceeded through the progressive enlargement of the territory of the market – the realm of private enterprise and economic rationality – by a series of redefinitions of its objects.” The rise of the enterprise discourse is what liberates entrepreneurship from its disturbing properties and permits mainstream economic thinking to enter and capture the entrepreneur, and in the process reproduce the dominance of management knowledge. There is no room to explore the historical or philosophical roots of this development in great detail here (see Hjorth 2003). Instead I will focus on its consequences and implications by first describing the general aspects and later bring in a nonprofit and civil society perspective.

Running the risk of being overly simplistic, I would argue that there are three interdependent features expressed in Gordon’s comment above that ultimately help us understand how the enterprise discourse are able to liberate entrepreneurship from Schumpeter’s original work. First, there is an expansion of the market concept into new
areas of society including the government sector and the nonprofit sector (see Osborne and Gaebler 1992). This expansion becomes the symbol for necessary change embedded in neo-liberal agendas and ideologies such as Reaganism, Thatcherism and the Washington Consensus. Second, if entrepreneurs can be reduced to yet another economic agent that operates in a market setting we can analyze them just as we analyze any other economic agent or activity, by assuming the properties of homo oeconomicus. “The ‘market’ is the world of and for homo oeconomicus” (Hjorth 2003, p. 55), which leads to more and more things being analyzed as matters of cost, efficiency and effectiveness. Hjorth (2003) connects this development to the work of Gary Becker where homo oeconomicus crowds out other human types. However, Hjorth (2003, p. 55) also indicates that the neo-liberal version of economic man adds an essential part “homo oeconomicus is manipulable man, man who is perpetually responsive to modifications in his environment.” Third, entrepreneurship and organizational scholars quickly establishes a subject for manipulable homo oeconomicus; the manager, the architect responsible for organizing and structuring opportunities and possibilities for action for others.

Taken together these features give rise to the idea that there is nothing that cannot be managed and that everything should be managed. As pointed out by Ingersoll and Adams (1986, p. 366), this idea is based upon the premise that:

[…] 1) all work processes can and should be rationalized, that is broken into their constitutive parts and so thoroughly understood that they can be completely controlled, 2) the means for attaining organizational objectives deserves maximum attention, with the result that the objectives quickly be subordinated to the means, even to the extent that they objectives become lost or forgotten, 3) efficiency and predictability are more important than any other consideration.

The liberation is now complete, via the enterprise discourse and its key apparatus management the managerial entrepreneur is born i.e. the entrepreneur of the formal organization (Hjorth 2003 2004). Long gone are the disturbing features of Schumpeter’s entrepreneur and with the re-description discussed above the enterprise discourse is now able to introduce entrepreneurship as the cure and remedy for all kinds of organizational problems and situations (Kanter 1989) or put differently, the managerial entrepreneur; the person who are “serving control and predictability in new ways” (Hjorth 2003, p. 78).
The literature is full of examples of this managerial entrepreneurship (Kanter 1989; Osborne and Gaebler 1992; Peters and Waterman 1982), and perhaps the most influential perspective come from Peter Drucker (1985) when he argues that entrepreneurship must become a “normal” and ongoing everyday activity, and that the way to do this is through systematic innovation and not searching for big ideas. Celebrating the work of Schumpeter and using his experiences from studying management, Drucker invites the reader to search for principles, practices and the discipline of entrepreneurship. Notice how Drucker dismisses the myth of creativity in favor of work and predictability, precisely the type of rationalization of entrepreneurship that Schumpeter warned about due to its practical knowledge nature.

3. The Nonprofit Enterprise Discourse
To illustrate the impact of the enterprise discourse I now turn to applications of entrepreneurship in a civil society context, more commonly referred to as social entrepreneurship. Let me begin by offering a description of civil society: “a sphere of our communal life in which we answer together the most important questions: what is our purpose, what is the right way to act, and what is the common good. In short, it is the sphere of society that is concerned with moral formation and with ends, not simply administration or the maximizing of means” (Elshtain 1999, p. 21).

One of many social agents within civil society is the so-called non-governmental (NGO) or nonprofit organization (NPO). These agents are expressions of social, moral and philosophical values found in civil society. They are often the first or early responders to socio-economic needs, problems and challenges. Also, NPOs fulfill a role as social entrepreneurs that create and sustain social capital, and in many ways “nonprofits may be more capable than government or market organizations of generating social norms of trust, cooperation, and mutual support due to their noncoercive character and appeals to charitable and social motives” (Salamon quoted in Eikenberry and Kluver 2004, p. 137). To return to Schumpeter, an NPO fulfills the role of the creative and numinous social entrepreneur that creates and implement new social value i.e. social innovations that propel and transforms civil society in a different direction.
What is important to remember is that NPOs represent a key infrastructure of civil society together with other organizing entities such as social movements, networks, coops, unions etc. Thus, they form a unity that offers opportunities to move beyond the dichotomous perspective of state versus market. In the United States, NPOs have added both complexity and a deeply rooted belief in volunteerism into civil society. Indeed, nonprofits resonate well with the Shumpeterian notion of starters and shifters of the societal fabric.

However, the enterprise discourse would not just conquer entrepreneurship as it applies to firms and business enterprise but also extend deep into civil society and social entrepreneurship. This nonprofit enterprise discourse rests on the same features as discussed earlier but is further enhanced by two additional developments. First, from being solely viewed as a business enterprise concept the idea of management finds its way into the operational aspects of NPOs. Once again we find Drucker (1990, p. xv) leading this thrust; “They [nonprofit organizations] know they need management so they can concentrate at their mission. Indeed, there is a ‘management boom’ going among the non-profit institutions, large and small.” This need of management in civil society had a profound impact on NPOs. As Light (2000, p. 13) concludes: “Whether the sector’s class is half full or half empty, a nearly unanimous consensus has emerged that nonprofit organizations have to improve their performance.” The thrust of management also led to a shift of perception, from the empowerment and transformational impact of civil society to effectiveness, efficiency and outcomes of individual NPOs. Second, given that the nonprofit sector is a novice of management it can and should look to the business enterprise sector for best practices. While NPOs are not seeking to maximize profits they can learn from firms and businesses how to maximize outcomes by paying more attention to their business model and develop business plans, in short, they need to “think” more like for-profit businesses. Hence, it is not the ends of NPO activity that needs to be reformed but the means (Edwards 2008).

The two developments described above created a fertile ground for a nonprofit enterprise discourse to emerge. Eikenberry and Kluver (2004) describe how the market came to be the place for nonprofit activity, and how the methods and values of markets and economic thinking started to guide and inform nonprofit organizational activity.
Indeed, this “marketization” alters the dialogue surrounding civil society by pushing the need for a greater understanding of the economic reality of NPOs. Similar to a firm or business enterprise, a nonprofit competes for scarce resources guided by its rational self-interest in order to maximize impact and favorable outcome (Edwards 2008). Comparable to the public choice school of thought or Gary Becker’s scholarship, which placed homo oeconomicus at the center of social analysis, one purpose of this marketization drive is to advance nonprofit organizational studies without romance. Parallel to marketization, NPOs also face more pressure for accountability and control. Fueled by a number of financial scandals and governance failures both public policy and public perception changed at the beginning of the 21st century demanding nonprofits to be more transparent, responsible and well managed (Gibelman and Gelman 2001).

The fusion of all these features results in a reinvention of what civil society and NPOs can and should do. To stimulate this reinvention the nonprofit sector is now hit by numerous tides of management reform (Light 2001), in which social entrepreneurship becomes an essential part.

*Rise of the Social Entrepreneur*

To summarize, the reinvention of civil society is held up by two main pillars. The first pillar is the demand for “good” governance which is inherent in management reforms such as scientific management and war on waste that are focused on efficiency, best practices and doing the right thing, and as Light (2001, p. 46) pint out are dominated by words such as should and must. The second pillar is the demand to come up with new ideas, means and methods that add value to existing services. The purpose is clear: “to get more mission out the door, sooner better, and in a more focused manner.” (Brinckerhoff 2000, p. 1). This demand is often accompanied by a warning, by not reinventing themselves NPOs are destined to chase dollars, make poor resource investment decisions, not be able to keep up with the changing needs of the market, be less competitive, and less mission-capable (Brinckerhoff 2000, pp. 24-26). Given these demands the obvious question is how to respond to them? Enter management and the managerial social entrepreneur, both remedy [control] and catalyst [inventor] of the nonprofit sector. The social entrepreneur and social entrepreneurship becomes the answer
for a new challenging environment. For example, social entrepreneurship is offered as the solution to (i) how to generate more earned income revenue streams so nonprofits can break their dependency on donative giving, (ii) how to get more mission for the money, (iii) how to become more sustainable and (iv) how to adapt to a more competitive environment (Eikenberry and Kluver 2004). It is not difficult to see the magnetism of social entrepreneurship. By emphasizing its managerial properties many NPOs are drawn to and attracted by the combination of economic effectiveness and efficiency, and managerial behavior and methods that promises speed, flexibility and innovativeness in a more complex nonprofit world. As Light (2001, p. 77) concludes:

[...] nonprofits will remain under pressure to become more businesslike and entrepreneurial. [...] Driven in part by what Gregory Dees calls the ‘pro-business zeitgeist’ across the world, and frustration and fatigue with project fund-raising, nonprofits cannot be faulted for wanting to control their own destiny.

Notice how the rise of social entrepreneurship has its genesis within the nonprofit enterprise discourse and is not a rewritten version of entrepreneurship the way Hjorth describes it in the business sector. Consequently we find, perhaps not surprisingly, Drucker as a major entrepreneurship scholar and influence in social entrepreneurial scholarship rather than economic entrepreneurial thinkers such as Schumpeter, Say and Kirzner. Not only is social entrepreneurship more managerial from the very start, it also shifts the level of analysis from society to organizations and even individuals and consequently rips the fabric that amalgamates NPOs and civil society. Again, this rip occurs as we embrace the managerial entrepreneur. Instead of social entrepreneurship that tells stories of how creativity, vision and imagination transforms civil society we are left with “[m]anagerial practices that tell the story of how control, normalization and strategic actions contribute to ongoing work, [...] as part of how individuals are made governable.” (Hjorth 2003, p. 49)

4. Alternative Economic Perspectives
Fredrik Andersson

Entrepreneurship is today a story written by managerialism. When that is the case the entrepreneur has
to get squeezed into the subject-positions available within the ‘manipuable economic man’ of
managerial governmentality. […] scholars describe entrepreneurship research as a fascinating, vibrant
and energetic field of study. But when they write on entrepreneurship, the stories are seldom
expressive of these aspects. Not least entrepreneurial subject positions are often reduced to economic
agents. (Hjorth 2003, p. 179)

We appear to be stuck, left with a nonprofit enterprise discourse that views management
as the path to social entrepreneurship. Consider Light’s (2001, p. 93) reflection regarding
how to handle innovation in a nonprofit context:

Wherever the journey takes place, whether in a hostile setting or in relative calm, only by managing
each stage of the process well will a single innovation succeed. The focus, therefore, is not on the
setting, but the management of the idea.

This approach to innovation is quite astonishing. In the end, what Schumpeter described
as the fundamental source for transformational change and creative destruction is nothing
more than another managerial task. This cannot be the only approach to social
entrepreneurship? What we need are alternative entry points, other influences, which
allow us to challenge and find space for thinking about social entrepreneurship beyond
the enterprise discourse. One could even argue that management is always about ‘what is
there’ and therefore unsuitable for explorations of social creativity and actualization. This
section will introduce three such entry points drawn from economic thinking outside of
mainstream economics. To put it somewhat differently, we need to bring the
uncomfortable, the jagged, the imaginary and the visionary to social entrepreneurship.

Uncertainty
The first step towards a more uncomfortable dialogue is to challenge the control and
predictive aspects of managerial social entrepreneurship. Given the failure rates of
organizational entrepreneurial efforts most people would probably agree that all types of
entrepreneurship involves some sort of risk. But entrepreneurs take on a specific type of
risk, what Knight (1921) refers to as uncertainty. What separates uncertainty from risk is
the removal of the assumption that events and outcomes can be modeled and predicted.
Hence, you cannot calculate or insure against uncertainty. Knight’s notion of uncertainty fits well with Schumpeterian innovation but is highly problematic for managers who want to control and rationalize entrepreneurial decisions since uncertainty postulates that the past is not a reliable predictor of the future. In addition, NPOs often operate in environments and situations that impose serious limits for predictability and control; lack of rigorous historical data, lack of computational competence, and dealing with numerous stakeholders simultaneously. These limits are further enhanced with the newness that comes with social entrepreneurial activities.

Why is uncertainty so important to consider in social entrepreneurship? Let us return to Schumpeter’s notion that entrepreneurship primarily involves practical knowledge. Hayek (1945) made the distinction between more stable and diffused knowledge [scientific knowledge], and dispersed knowledge [practical knowledge] where no two agents share the same knowledge or information about the operating environment because it is the "knowledge of the particular circumstances of time and place."

According to Hayek, the existence of such practical knowledge makes planning and control difficult and is utilized by entrepreneurs to develop and transform the economic system. Not only do managerial social entrepreneurship underestimate this knowledge element, practical knowledge is also a fundamental explanation of uncertainty and generates opportunities that can be discovered or created by NPOs and social entrepreneurs.

*Play and Curiosity*

The second step is to challenge the notion of social entrepreneurs are solely homo oeconomicus. If we believe that uncertainty and practical knowledge exists, the optimizing and rational managerial economic man appears to be limited in what he/she can accomplish. This is precisely why Baumol (1968, p. 67) reached the conclusion that neoclassical economic thinking and organizing is entrepreneurless:

[…] the entrepreneur has been read out of the model. There is no room for enterprise or initiative. The management group becomes a passive calculator that reacts mechanically to changes imposed on it by
fortuitous external developments over which it does not exert, and does not even attempt to exert, any influence.

However, Baumol notes that Veblen highlighted this issue long ago: “[economic man] is not a prime mover. He is not the seat of a process of living […]” (Veblen quoted in Baumol 1968, p. 67). To break the limiting chains of the managerial social entrepreneur Veblen (1898-1914) introduces the concept of idle curiosity. This instinct is what stimulates and pushes individuals to be creative, imaginary and fabulous [from Latin *fabula*, meaning story or play], which produces change, novelty and transformation in an evolutionary manner. Because people are endowed with this instinct we can catch a glimpse of the genesis of entrepreneurship that goes beyond even Schumpeter’s writings since he never explicitly explained why entrepreneurs would rise from the limiting state of equilibrium. Using Veblen we can move towards a different human type, in which human error and playful innovativeness and creativity constantly morphs to produce entrepreneurial outcomes and actions (Hobson 1914). Because homo oeconomicus is neither curious nor fabulous I support Hjorth’s (2003, p. 233) notion that economic man must be replaced with homo ludens, playing human:

[…] we need a language that doesn’t kill life. The focus is on actions that perform homo ludens; that experiment according to a passion for finding out what could become; that carry a playful attitude to ‘what is there’ and resist a dogmatic relation to ‘the real’ in favor of that which is not yet done.

Hjorth and Veblen both opens up entrepreneurship by emphasizing the curious individual, and provide space for play and imagination as a key aspect of nonprofit organizational entrepreneurship. I would argue that many of these human drives such as passion, imagination, and vision are essential for understanding civil society, volunteerism, philanthropy etc. and therefore core aspects of social entrepreneurship. Still, just as Veblen concluded that positive instincts tended to be corrupted by negative forces that adversely impacted the community i.e. pecuniary and emulative forces, the nonprofit enterprise discourse creates a similar effect. When we approach social entrepreneurship from a managerial perspective it turns silent and loses many of its unique aspects.
Experimentation
The third step is to defy the normality of Drucker’s principles and practices that transform entrepreneurial action into a managerial discipline and managerial action. If our perception of social entrepreneurship move from control, prediction and rationality to uncertainty and play, how can we understand NPO behavior in that space? As a key contributor to the so-called Swedish School of Growth tradition, Eliasson (1990 2005) challenge the utility of mainstream economic managerial thinking by placing the entrepreneur at the center of organizational and industry transformation. Rather than assuming scarcity of resources Eliasson (2005) suggests a world abundant with opportunities. In other words, what restrict agents are not necessarily the available resources but the competence of the agent to explore and exploit opportunities. Some opportunities may be better than others but it is impossible for the entrepreneur to know this eX ante so the only way to figure out the possibilities of a given opportunity is to try it out by launching an organizational experiment. Hence, entrepreneurs of all kind operate in what Eliasson calls an experimentally organized economy (EOE). There is no room to cover all characteristics of the EOE but three aspects are essential for our discussion. First, no single agent can survey all available opportunities at any given time, which relates back to the existence of practical knowledge and the evolutionary process of society. Second, when the entrepreneur (for example a NPO) acts it must be confident in the proposed organizational experiment or it cannot act in decisive manner. Third, due to uncertainty surrounding these opportunities NPOs must act decisive based on current and insufficient information as well as on intuition (or competent judgment see Eliasson 1990). Hence, organizational experiments are driven by passion, vision and actualization which mean that many experiments will be in error and that managerial mistakes are frequent.

It is not difficult to see the conflict between this approach and the managerial social entrepreneur. Still, I believe that Eliasson’s view more clearly articulates the premises of civil society and the world of the social entrepreneur. Indeed, civil society itself, especially in an American context, is often described as an experiment. The diversity and unique blend of community agents set the stage for the type of social laboratories
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Eliasson outlines. Driven by specific values such as equality, empowerment and justice, NPOs need to be creative and experiment to answer broad and complex challenges that government nor the market have found the answers to.

5. Towards a Different Understanding of Social Entrepreneurship

Taken together, uncertainty, homo lundens and experimentation form an alternative foundation for social entrepreneurship inquiry in the nonprofit sector. According to this foundation, understanding and researching social entrepreneurship in NPOs is both highly contextual and connected to the way we understand the uniqueness of organizational experiments with uncertain outcomes that NPOs conduct. This also repositions the part management plays in social entrepreneurship. As Hjorth (2004, p 430) so eloquently puts it “if management cannot learn to live with homo ludens as neighbour, it is difficult to see a role for management in organizational entrepreneurship.”

It is my belief that Hjorth’s (2004, p. 429) wish for a more “centrifugal orientation that follows the spontaneity, immediacy, passion and relational orientation of organizational creativity” is only possible if social entrepreneurship scholars invest time and effort to really read and understand entrepreneurship theory and thinking as formulated by Schumpeter, Veblen, Knight and Eliasson. Social entrepreneurship is a fabulous kaleidoscope, there are no best practices, no normal, no predictable path.

The purpose of this article was to describe and offer a different direction of thinking with regard to social entrepreneurship in nonprofit studies. I have suggested that a specific nonprofit enterprise discourse has generated a managerial social entrepreneurship perspective that in turn have crowded out the visionary in favor of the necessary, the playful and creative in favor of the predictable and rational, and the uncertain in favor of the controllable in NPO inquires. I believe that such a discourse denies social entrepreneurship much of its richness and usefulness as a scholarly discipline. By showing that alternative economic entries are both possible and even preferable we can shift from focusing on what is in favor of what could become and invite the creative, fabulous and visionary back to join social entrepreneurship.

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Fredrik Andersson


The American Economy as a House of Cards

By: Chris Keyser

**House of Cards**

During the past few years, people in the United States have been debating over a number of things from healthcare to homeland security. These debates have polarized large numbers of people and put them at odds with one another and the party lines have been clearly drawn. However, there is one major concern that affects every citizen of the United States as well as a great many people around the world that has rendered no clear opposition. This concern is the biggest financial crisis and economic downturn since 1929. With the unemployment rate topping ten percent and foreclosures still occurring on a regular basis, the recession is far from over. The odd thing about this major crisis in the United States is that there is no clear political positioning occurring. Of course there are some mainstream economic hard-liners that refuse to relinquish their position, even in light of the fact that it is a position proven wrong many times over. But to say that one takes a “conservative” position on the crisis is really not much different than taking a “liberal” position. Unfortunately it seems that both sides have the story mostly wrong and tend towards policies that would, at best, prolong the crisis and, at worst, send the economy into the next Great Depression. It is my goal to outline the causes of the current crisis, its effects on the economy, and propose some policy changes. Specifically, I will show how debt has played a major role in destabilizing the economy and how the manipulation of debt and subsequent risk (sometimes fraudulent), have made regulation a much more cumbersome, complicated task. These things, combined with massive financial speculation, have thrown our economy into dire straits and will continue to do so unless some attention is paid to them.

**How to Own a Bank: Households**

Americans have, since the second industrial revolution, been mass consumers. Private consumption, as a portion of GDP, in 2008 was over sixty percent [BEA, 2009].
In fact, ever since World War II Americans have seen a rise in consumption. However, the rise in consumption was not accompanied by a rise in income [Wolff, 2009]. This, inevitably, has to mean that more purchases were made on credit, hence more debt was piling up. From 1997-2005 consumer debt rose dramatically: from sixty-seven percent to ninety-two percent of GDP [Foster and Magdoff, 2009, p.47]. In order to service this debt, households had to take on new debt—a concept known as Ponzi finance. And the most popular way for households to leverage was to borrow against the most valuable asset they owned: their house. The most typical manifestation of household mortgage leveraging was the home equity line of credit [HELOC]. HELOCs work by stripping equity from a homeowner and issuing it back to them in the form of a deposit. This can be a safe and somewhat routine way to borrow. In addition, it is a relatively cheap way to borrow because the interest rates are often fixed and, in many circumstances, the interest paid on a HELOC can be deducted from taxes. Problems began to occur when HELOCs were taken out in massive amounts to fuel spending needs and pay down credit cards [Foster and Magdoff, 2009, p.35]. “It is of course the rapid increase in home-secured borrowing that is of the greatest macroeconomic significance, and that has allowed this system of debt expansion to balloon so rapidly” [ibid]. In fact, a common practice known as equity stripping occurred when homeowners took out more than the equity they had built up. This is, of course, a sure-fire way to lose everything29. However, that wasn't happening.

The Sky is the Limit

One significant marker of the economic period of the early 2000s is the rapidly increasing level of both real estate prices and home ownership in America. George W. Bush saw it as high priority to make everyone a homeowner—and most people were. Commercial banks were moving away from their traditional banking practices including the development of relationships with customers. They needed to grow quickly (Ponzi finance) in order to maintain solvency and, because everybody thought real estate prices would only continue to go up, homeowners could just sell or refinance if they found

29. And we all know how leverage works: great on the way up and devastating on the way down [Wray, 2009].
themselves in a pinch. If there was ever a phrase to signify an era of time, “refinance” would be the word for the early 2000s. Determining how popular something is can usually be done by turning on a TV. And in the early 2000s (and some still today) were a whole slew of TV shows dedicated to “flipping” a house which is a colloquialism for buying a house, fixing it up, and selling it for a profit. This concept captures the very spirit and optimism towards real estate during that period and is usually referred to as speculation. Speculation occurs when people invest in assets that they have no intention of using or keeping. This presents a particularly nasty problem when applied to private real estate because mortgages were considered to be a very safe loan due to the fact that no logical person would want to risk losing their home as a result of a missed mortgage payment. Hence, if it was not a house the flipper was actually living in then she would not be at risk of becoming homeless if the house was foreclosed upon; the most she could lose was the asset and her collateral—the asset itself. This is not to say that home flipping was the cause of speculation—it only added to the speculation. Speculation starts and ends in finance which will be discussed below.

**How to Own a Bank: Firms**

Another contributing factor to the increase in homeownership was the ease with which one might get a loan. Most Americans do not have $150,000 dollars sitting in a bank account ready to purchase a new home. Hence, the mortgage is, overwhelmingly, the way to buy a home. Logically, then, to buy a home one must be able to obtain a mortgage. This traditionally involved a good deal of underwriting and due diligence, but financial firms (banks, mortgage brokers, sub-prime lenders) relaxed this underwriting process to the point where it was not even performed at all [Black, 2009]. The firms were not performing the underwriting process because a large number of them were frauds or what Bill Black [2005] calls “control frauds.” “A control fraud is a company run by a criminal who uses it as a weapon and shield to defraud others and makes it difficult to detect and punish the fraud” [Black, 2005, p.1]. In 2007, the FBI issued a warning that

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30. The United States is one of the few countries that does not penalize borrowers for paying their mortgage off early.
31. Often times this meant that the flippers were servicing two mortgages for the duration of the flip and, if they couldn't sell the house, they were stuck.
there was a mortgage fraud epidemic [Black, 2009]. The most popular way to engage in mortgage fraud was to flat-out lie on the loan documents. For example, a sub-prime lending firm might operate on a volume-based commission system. In this case, the lender wants to make as many loans as possible so as to secure a larger bonus. If the lender is restricted to lending only to creditworthy borrowers the volume of loans she makes will be significantly less than if she can lend to everyone. So when a person walks into her office and wants to buy a home, she is not even going to bother asking how much money that person makes per year, how much outstanding debt he has, or what his credit history is. She will simply make the loan and book the fees. Many times these loans turned into more “risky instruments and practices, as “low doc” loans (less documentation required) evolved to “no docs” and to “liar loans” (borrowers were allowed, and even encouraged, to lie about income and other information relevant to the application process), and finally, to “Ninja loans” (no income, no job, no assets)” [Wray, 2008, p.21]. This type of practice introduces two things: Gresham's Dynamic and adverse selection. Gresham's Dynamic occurs when bad practices drive out good practices. This is the opposite of what neoclassical economics teaches such that the private market rewards those who cheat instead of driving them out of business [Black, 2009]. In order to compete, lenders had to follow suit with the ones that weren't doing any of the underwriting, thus stealing their market share. This lack of underwriting led to adverse selection. In the realm of home lending, adverse selection occurred when lenders did not charge the correct risk premium because they did not evaluate the level of risk involved in their loans [Black, 2009]. A quick illustration: Lender A is not engaging in underwriting while Lender B is engaging in underwriting. Lender A charges a single risk premium (10%) to all borrowers. Lender B charges one risk premium to riskier borrowers (15%) and a different risk premium to safer borrowers (5%). As a result, all of the creditworthy borrowers will go to Lender B because they will only be charged a risk premium of 5% while all of the risky borrowers will go to Lender A because they can borrow at a cheaper rate than with Lender B, who is charging a more accurate risk premium. Lender A would most-likely also be operating with a volume-based incentive program because it had to bring in more loans to cover the losses from the bad loans made earlier—a classic example of Ponzi finance. However, all of the questionable
lending practices were not caused solely by fraud, but also by the fact that real estate prices were continually rising so it did not matter whether or not the borrower could pay back the loan\textsuperscript{32}; they could just refinance [Wray, 2008, p.21].

Financial institutions, in particular commercial banks, were forced to innovate new ways of making profits because of Regulation Q that set a maximum rate they could pay on deposits. Commercial banks were also held to capital reserve requirements against their liabilities which meant that their capacity to make and hold loans was greatly reduced [Wray, 2009]. Banks, as always, found a way around this inconvenience. They implemented a strategy known as “originate and distribute.” Originate and distribute allowed banks to make loans without holding the necessary capital reserves because the loans were bundled, securitized, and sold to various investors such as hedge funds and pension funds [ibid]. This was doubly great for commercial banks because not only could they operate at a higher rate of leverage but they could also collect fee income from the origination process. And once the loans were bundled and moved off their books, they were no longer subject to the risk inherent in the loans (or so went the logic).

This posed two major problems. The first one is fairly obvious and was mentioned earlier: no underwriting took place. If the firm was just going to move the loans it made off its books, then it did not matter whether or not the borrower would be able to make any payments. The second problem was that many of the banks offered buy-back guarantees on the loans they securitized and sold off. These were known as “credit enhancements” (more on this later) [Black, 2009]. This was a big problem because now the banks were just as exposed to the credit risk in the loans as they were had they kept the loans on their books—but they were not receiving any of the income flows from the loan payments. To reiterate, this seemingly irrational behavior was actually perfectly rational given the calm nature of the market and the strong belief that real estate values would only increase.

\textbf{House of Cards: Construction}

The key to understanding the logic behind the products and practices that made up the FIRE (finance, insurance, and real estate) industry is neoclassical economic theory.

\textsuperscript{32} Many of the loans made by these institutions never even received the first payment.
Neoclassical economics believes that markets efficiently allocate resources and risk and that the consumers and firms are rational agents. This is to say that if regulation is removed and individual consumers and firms are allowed to operate freely, then the optimum conditions will occur. This rationale translated into FIRE terms is known as two things: securitization and derivatives. To get a better understanding of how important securitization was to this sector I point out a quote by Alan Greenspan at a 2004 Senate Committee on Banking, Housing, and Urban Affairs:

Asset-backed securities and the secondary markets in which they trade generally provide both households and businesses with excellent access to credit at an appropriate risk-adjusted interest rate. Moreover, credit supply is far more stable today than it was because it is now founded on a much broader base of potential sources of funds. The aspiring homeowner no longer depends on the willingness of the local commercial bank or savings and loan association to hold his or her mortgage [in federalreserve.gov].

Alan Greenspan was the most powerful banker in the world and he was in favor of mortgage securitization which meant that financial firms had the green light to get as creative as possible. And creative they were.

Derivatives were originally invented to help farmers hedge price risk. Lock in today's price for the grain sold in the future. If the price drops, then the farmer has successfully hedged. This is a classic example of a futures contract. It is a safe practice and makes sense in this case because the farmer is hedging an asset that he actually owns. Eventually, with the introduction of cash settlement came the trading of futures by other investors that were not farmers. From there the derivatives started to get out of hand with such instruments as credit default swaps (CDS), interest rate swaps, and other forms of what Warren Buffet called “financial weapons of mass destruction” [Das, 2006, p.19].

CDS are usually explained using insurance vernacular because the buyer of a CDS is paid if the asset specific to the CDS defaults. Hence, it would make sense for someone holding a bunch of securitized mortgages to hedge against credit risk by buying CDS on the mortgages they held. However, buyers of CDS by and large were not even minimally exposed to any of the risk in the assets they bought CDS on, which meant they were simply betting that the assets would default.
These instruments were created to extract and delineate the risk of the underlying assets using the logic that being able to bundle and trade risk would lead to optimal allocation by the market. The standard tool for delineation of risk was mathematics—complex mathematics. Often times the developers of the derivatives held advanced degrees in mathematics or astrophysics. This created two problems. First, the derivatives were very difficult to price which meant that the seller could give it whatever value they wanted and the buyer basically had to accept the price that was offered. This violates one of the fundamentals of private market efficiency which assumes perfect or at least close-to-perfect information when, in fact, the information was asymmetrical. The second problem arises when regulators try to keep the market under control. It is impossible to regulate that which you do not understand and that is exactly how the firms selling derivatives wanted it. By making the securities incredibly complex they could operate in a basically opaque market with no regulatory oversight.

Another attempt to allow the market to allocate risk was the collateralized debt obligation (CDO). CDOs are made of mortgages that provide income flows to the CDO from the payments made on the mortgages. The CDOs are partitioned into prioritized sections based upon the credit rating of the underlying assets. For example one CDO would have mortgages (or other loans) with a AAA rating in the first tranche then BBB rated securities in the next and so on until the final tranche (Z tranche) was reached which contained the lowest rated securities [Black, 2009]. The idea was that the top tranches would be paid before the lower tranches because they contained higher-rated securities. From the original CDO other CDOs were developed—using the Z tranche from the first CDO. And often times the new CDO (“CDO squared”) got a AAA rating on its top tranche that contained the toxic waste from the original CDO. This, often times, is known as financial alchemy because, magically, securities that were once considered toxic waste were given a AAA rating that is supposed to indicate extremely small or even no credit risk. This is obviously a problem because a security does not just go from being a junk security to a top-rated security at the whim of a credit rater. Another problem with this system is that the ratings were given to the securities in aggregations based on a statistical algorithm—not personal knowledge of the borrower [Kregel, 2008, p.12]. The ratings agencies were supposed to be the experts on risk
evaluation which gave the banks even more reason to completely skip the underwriting process—they would let the experts deal with it. This became common practice and only helped to legitimize the originate and distribute model [ibid].

**House of Cards: Collapse**

The housing market was going up with what appeared to be no limit. Credit was easy to come by and leverage was all the rage. Then one day housing prices stalled and it all came crashing down. This is the very nature of a speculative bubble: prices continue to rise because people buy with the expectation that housing prices will rise—akin to the self-fulfilling prophecy. Then once something happens to cause people to lose optimism, Murphy's Law kicks in and everything goes wrong. This is the final phase of a bubble, called the “crash and panic” phase—it is inevitable [Foster and Magdoff, 2009, p.97].

In July 2007, “two Bear Stearns hedge funds that held nearly $10 billion in mortgage-backed securities imploded” [Foster and Magdoff, 2009, p.98]. Bear was just the first of many firms to be hit with major losses. Of course, this took a majority of the people in the FIRE industry by surprise. They were suddenly struck with terror at realizing they were dealing with what Donald Rumsfeld coined as “unknown unknowns.” Recall that the method of many of the financial firms in pricing derivatives was to make the models and products extremely complex so as to give them whatever value they wanted. Also remember that they were able to do this because the market kept going up. They never had to realize losses. Now that the ship had started sinking everybody was scrambling to plug the leaks, but they could not even find the leaks in the first place.

“Much of the fear that swept through global financial markets was due to a system so complex and opaque that no one knew where the financial toxic waste was buried” [ibid]. The hope was that the ratings agencies could provide some insight into which assets were good and which were not, but it soon became apparent that they had no idea which ones were actually good and which ones were toxic.

When it was discovered that many of these assets were bad because the borrowers were not making the payments on the mortgages that provided their cash flows credit dried up. This only served to cause more of a problem. Many of the people that
took sub-prime mortgages had taken them because of a very low introductory “teaser rate.” During the growth of the speculative bubble, they could take advantage of this low rate and then refinance when the rate was about to be adjusted up. Once the bubble burst they were stuck paying an interest rate far too high on a mortgage much too large for them to even service, let alone pay down because the banks had tightened up their lending practices. Much of the fear today is of what will happen when many of the mortgages yet to jump in rate adjust up [Foster and Magdoff, 2009, p.99]. The tendency of a burst bubble is to send the industry, hence economy, into a downward spiral. Once the credit dried up and homeowners began to default, housing supply increased, thus decreasing housing prices. Decreasing housing prices meant that the people who were hoping to sell their house or refinance when their rate adjusted up were not able to do so. This led to more defaults and the cycle repeated *ad nauseam*. Not only did this hurt the people who had taken sub-prime loans, but many people who had actually taken legitimate loans suffered because the value of their home decreased, as well.

CDOs, which received income flows from their underlying assets (securitized mortgages), were hit particularly hard. As default rates increased, the ratings agencies were forced to reevaluate their original ratings “noting that their evaluation models of the risks of default on securitized mortgages had proven incorrect,” and “revalued and downgraded their ratings on an ever-increasing number of structures backed by sub-prime loans” [Kregel, 2008, p.19]. This caused a massive unloading of these instruments, notably by institutional investors forced to carry only investment-grade securities, leading to a further decrease in their value [ibid].

The banks that implemented the originate and distribute method were becoming increasingly pressured with liquidity crises. These banks had made as many loans as possible to anybody that wanted a loan and then moved them off their books. One way they were able to do this was by providing buy back guarantees or by selling credit default swaps (the “credit enhancements” referred to above). As defaults increased, the banks were experiencing enormous amounts of investors returning their mortgages and demanding cash [Kregel, 2008, p.19]. The credit default swaps were contractual obligations that did not require an investor to call upon them—the banks simply had to pay them once the loans defaulted. During the expansion of the bubble this was not a
concern. Every once in a while someone would default on a mortgage and the house would be repossessed, but the bank would just turn around and sell it—because it could. However, once the bubble collapsed, the bank was stuck paying on the CDS and buy-back guarantees. In return they received houses that had taken a major loss in value and were incredibly hard to sell. Faced with a liquidity crisis, the banks owing on bad mortgages quickly became insolvent which started a domino effect that led to some once-sound firms facing insolvency.

**Picking Up the Pieces**

When a major crisis occurs in any walk of life, the natural and logical reaction is to ask what caused such a catastrophe. In the case of the current financial crisis, there are three broad causes that cover a majority of the problems: massive debt, fraud, and speculation. Not only do these things call for a change in policy, but also a change in lifestyle.

The last thirty or so years have seen a stagnation of real wages, which has been a contributing factor in the rise of the American debt load [Wolff, 2009]. Americans have been buying on credit to keep their level of consumption at a comfortable level. We need an increase in the general level of wages and a redistribution of income out of the finance sector into the real sector. This needs to come through two things: private sector industry standards and government aid. Tax breaks should be provided to firms that create higher-wage jobs in the real sector. At the same time, firms need to raise wages, realizing that an increase in consumption by laborers means an increase in profits for capitalists *per se*.

Another major problem with the debt burden in America is that current bankruptcy law makes it very difficult for someone to get out of a mortgage they cannot pay [Wray, 2008, p.32]. Many borrowers of sub-prime loans were subjected to predatory lending practices and need relief. It does nobody good to have a large number of people out of homes, steeped in unbearable debt. Homes surrounding the foreclosures lower in value, crime goes up because people become more desperate, and the economy as a whole tends to slow. Mortgage relief must be given to the people that were victims of the lending practices that got them into loans they could never repay [ibid]. When standing in a burning room the first priority is not to find out who set it ablaze. The first priority is
to get out and extinguish the fire. The economy is burning up and the only way to slow the burn is to provide a way out for some people that made poor decisions.

The issue of fraud is one that has not been addressed nearly as much as others in the wake of this crisis, but is, I believe, a major concern. After Lehman Brothers was allowed to fail, a few large institutions were given bailouts in the form of TARP (troubled asset relief program) funds. The American taxpayers bore over $700 billion of the burden from the bad business practices of a relatively small number of wealthy individuals but none of the executives of the firms that drove our economy into the ground were fired. Indeed, there is a massive clean-out that must occur on Wall Street and in Washington. Timothy Geithner and Larry Summers should be fired along with the executives of the firms that are known to have been prolific dealers in derivatives and toxic assets and new legislation should be put forth that would ban executives at financial firms from taking regulatory positions in the government.

Another issue in fraud can be found in the ratings agencies. New regulation should be instituted that would force the ratings agencies to be completely transparent. They should be required to provide loan tapes and proof of due diligence on all ratings given with hefty fines for failing to provide the logical base for giving a particular rating.

The final issue is financial speculation. To negate some of the attention away from financial speculation, non-financial firms (GM using GMAC would be the prime example) engaged in more financial speculation than production should be put on a schedule to reduce the ratio of profit from capital gains to profit from the selling of actual products or services directly related to their industry by a certain date\(^{33}\). Along with non-financial firms adding to financial speculation, financial firms must be held in check, as well. The market for derivatives is extremely opaque and very difficult to understand. The types of instruments that have no determinable value should be banned from trading and to help ensure that they are controlled they should be traded on exchanges that have rules for trading.

\(^{33}\) Obviously, with an unemployment rate of 10.2% (as of October 2009), many people are not buying new cars, which is why government programs akin to the “cash for clunkers” program are needed to provide people with the means to purchase a car.
Chris Keyser

All of these things can help to reduce the impact of the crisis and help prevent another one from happening in the future. However, as Minsky points out, the capitalist system is inherently flawed in that it grows more volatile as expansion occurs. This is because firms and individuals take on more risk and more debt when times are good, expecting to be able to service it as long as things do not turn down. This is not just an inherent flaw in capitalism, but also American culture. Americans have been bred to love money and consume as much as possible. Thus, when times are good they amp up their spending. As long as “keeping up with the Joneses” is a common practice, Americans will be subject to massive debt burdens and face crises like this in the future. In order to ameliorate this problem, society must decide to move away from a lifestyle of materialism and seek true happiness outside of money.

Works Cited


In *Keynes: The Return of the Master*, Robert Skidelsky continues his work in chronicling the life of Keynes and his contributions to the economic profession. In this particular instance, Skidelsky successfully attempts to clarify the essential aspects of Keynes’ theory while subsequently juxtaposing it against ensuing theories that either claimed to be ‘Keynesian’ or sought to undo his theory by altering some of the fundamental assumptions which allowed for the elaboration of alternative conclusions and policy recommendations. Using the largest economic crisis since the Great Depression as his point of reference, Skidelsky sets out to show the relevance of true Keynesian analysis for today and how one economist provided answers for contemporary economic problems over seventy years ago. The book is divided into three sections; what follows below is a summary of each section. Finally, a critique is presented that identifies some shortcomings of Skidelsky himself in attempting to posit exactly what Keynes was trying to delineate.

The first part of the book, entitled *The Crisis*, begins by highlighting certain aspects of the present economic crisis and then proceeds to explain why the popular belief that ‘no one saw it coming’ actually exists. In the first chapter, Skidelsky highlights the various factors that came together to create the conditions for a financial crisis: a housing bubble, various financial innovations, a lack of effective regulatory authority, and governmental ‘cheerleading’ during the Great Moderation. Hence, once a financial solvency issue became a liquidity issue, the crisis propagated to the ‘real’ sector of the economy as exemplified by rising inventories and a decreased ability to secure external financing. This then translated into increasing unemployment and decreased levels of autonomous consumption. Subsequently, in order to get things ‘back on track’ there was a stimulus package of ‘Keynesian’ nature as well as bank bailouts which were followed up by politicians playing the ‘blame game’ so as to save face since ‘no one saw this coming’. But how could this be, one may ask. How is it that an entire profession,
economics, failed to identify that certain characteristics were present that could eventually lead to the development of a large economic bubble which brought on the greatest economic collapse since the Great Depression? Skidelsky’s answer is that the root of the problem lies in the fact that the economics profession has repeatedly failed to understand what Keynes, the master, said in his magnus opum *The General Theory of Employment, Interest, and Money*. As a result, succeeding economic theory has incorrectly described how an actual capitalist economy functions. In particular, Skidelsky identifies the development of rational expectations, real business cycle theory, and the efficient market hypothesis as central to undoing Keynes’ fundamental conception of a capitalist economic order where agents possessing uncertainty in a non-ergodic world makes inherent instability possible and thereby creates a situation in which an unemployment equilibrium is not only possible but likely. This chapter (Chapter Two) is particularly useful for an upper level undergraduate macroeconomics course.

Part Two of the book is an historical account of the ‘bastardization’ of Keynesian ideas; hence the title *The Rise and Fall of Keynesian Economics*. It begins initially by describing the many different sides of Keynes’ personality in an attempt to show how this framed his economic theory. In particular, it was his own experiences with the unpredictability of the stock market as well as the absence of any self adjustment tendency during the Great Depression that came to inform him as to current shortcomings in economic theory. This segues to a discussion of pre-Keynesian or Classical economic theory which involved dealing with principles of scarcity, the neutrality of money, and full employment equilibrium theory in relation to Keynes’ actual theory which is differentiated by its emphasis on uncertainty (with a natural extension that econometrics is inherently limiting), the necessity of stable and robust investment in a capitalist economy and its connection with the principle of effective demand, the rejection of loanable funds theory and the determination of the rate of interest via liquidity preference, and how Keynes was much more than just ‘sticky wages and prices’ which is something many American ‘Keynesians’ (read neoclassical synthesis) came to reduce his contributions to. Skidelsky then proceeds to evaluate whether the ‘Keynesian Revolution’ was in fact a success or failure. In doing so, he highlights how Keynesian
theory came to be undone by both theoretical attacks from Milton Friedman, the New Classicals, and the new Keynesians- which came to form the new neoclassical synthesis- as well as by the breakdown of the Bretton Woods system of fixed exchange rates and the stagflation of the 1970s. Consequently, many of Keynes’ profound insights were undone, ignored, or simply misunderstood.

The final segment of the book, *The Return of Keynes*, is an argument that Keynes’ theory is more relevant than ever and a return to his ideas is imperative if both the system and the economics profession is to be repaired and/or saved. In doing so, Skidelsky delves into something that mainstream economics has always shied away from- ethics. In particular, Skidelsky shows how Keynes’ ethics and notion of morality- which was heavily influenced by the philosopher G.E. Moore- came together to form the basic concepts Keynes proposed in economics. Next, the book transitions to a dialogue of Keynes’ views on politics and how, while sympathizing with the principals of liberalism and the freedoms it bestowed upon individuals, was simply incompatible with the essential operations of a capitalist structure. Instead, Keynes attempted to offer ‘a third alternative’ when faced with the decision between liberalism and Marx’s revolution: a system in which scarcity was replaced by abundance and eventually was able to be stabilized if the correct policies were implemented. This is what allows Skidelsky to conclude with Keynesian recommendations for contemporary society such as taming finance and anti-free trade policies in order to increase employment levels and therefore why Keynes is as relevant as ever.

Oddly enough, however, is the notable absence of a chartalist or state theory of money when discussing Keynes’ economic policy and the need to raise employment levels, particularly so for someone who has followed recent theoretical developments in economics as well as has clearly read *The Treatise on Money*. This absence is further demonstrated by Skidelsky quoting Niall Ferguson approvingly, an economic historian who continually argues for the opposite of Keynesian policy in that he sees the essential problem with America today in the size of the federal ‘debt’ and continuous federal deficits. Without the recognition of a state theory of money, it makes it more difficult to
implement a ‘socialization of investment’ - which is exactly what Keynes argues for in Chapter Twenty-Four of the *General Theory*. Further, it is not clear whether Skidelsky understands the *actual* dynamics of America’s trade deficit with China as opposed to popular media and mainstream economic accounts of China ‘financing’ America’s desire to be a net importer. Nonetheless, this book remains a very good account of Keynes’ fundamental ideas, how they were misinterpreted or rejected by the economic community, why Keynes came to propose a ‘third way’ when facing full fledged liberalism or a Communist revolution, and why Keynes - the master- should be returned to for answers when dealing with contemporary economic problems.
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