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The State in the Triangle of Interests. Toward a Subordination or Coordination?[1]

ABSTRACT

The recent crisis of 2008-2010 has shown better than ever that modern capitalism does not rest on two pillars any more. The classic concept of countervailing powers by John Kenneth Galbraith does not mirror the reality of modern capitalism accurately enough. Instead of binary opposition between labor and capital we observe rather a triangle of interests. The game goes on between a) national market economy agents, b) international financial capital, and c) the democratic state.

While constructing this configuration we were inspired by the vision of social historian Fernand Braudel who introduced a clear cut division between market economy and capitalism. He perceived the former as local activities and the latter as an engine of ongoing internationalization by means of detaching accumulated capital from local markets. Respectively, in times more contemporary than those studied by Braudel we recognize their successors in national market economy and internationalized (mostly financial) capital. We argue that with reference to the former the state's functions are to create and enforce rules of the game and coordinate interests as well. However, the role of the state as a mediator and /or animator of events seems now to be challenged by the latter group of actors aiming to subordinate the state. Multinational and financial players, though interested mainly in international operations, keep the national obligation-free anchor as they require state's support in terms of bailouts, legislation, and possibly even military power (usually a threat of use is enough). Taking the state as a hostage promises control over these features. This would mean that the balance within the triangle of interests is at danger, which may bring destructive consequences for social order and economic development.

We present our point focusing on two strings binding the state and internationalized capital. First, the state listens to financial markets because it is in debt and in constant need of external financing. And second, at least since the 1990s financialization is perceived as a vehicle of economic growth mostly due to so called wealth effect. We argue that the very same strings may be adversely used because the bounds at stake are a double-edged sword.

[1] We would like to thank the participants of International Summer Seminar in Vlotho, Germany, 10-25th August 2014 for valuable comments and critical insights.

INTRODUCTION

The recent crisis of 2008+ has shown better than ever that modern capitalism does not rest on two pillars any more. The classic concept of two countervailing powers does not mirror the reality of contemporary capitalism accurately enough since a third party of interests has returned to power. Save from traditional interests of domestically-linked capital and labor we witness today a heyday of power of international capital, which expresses different aims and interests than its local counterpart. The rise of its power would not be such a troublesome challenge for societies and governments if it were locked within national boundaries and regulations, but its very nature is global and hardly restricted by any national set of laws and norms due to high mobility, considerable power of political pressure and a recently popular 'too big to fail' mantra. Global financial actors are thus generally detached from national sets of rules, yet at the same time focus their actions on national economies and public finance when necessary. For these, however, the benefits are highly fragile and uncertain, while potential risks are solemn and destructive (see Foster 2007, Palley 2007).

The above indicates that the balance of interests has shifted on behalf of international capital. We claim that in the new matrix of interests the state is torn apart between serving the national economy as a provider of public goods and supervisor of legal and institutional framework on the one hand and responding to the demands of international financial markets on the other hand. This new stage of capitalism's evolution reminds of Fernand Braudel's discrimination between market economy and capitalism. In this contemporary configuration, however, state's position is not that of coordinator of events standing above the actors but rather a bewildered agent sitting on a fence trying to satisfy conflicting interests. We believe that the triangle of interests: national market economy – internationalized capital – democratic state is a key to understand the nature of modern capitalism and the challenges it poses to the future of democratic societies. Due to limitations of space, we have decided to focus on the relations between the state and international financial capital as we believe this issue to be pivotal.

The paper is organized as follows. The second section sketches the background of analysis; it refers to the historical division between capitalism and market economy which is complemented by the approach of institutionalist political economy. Next, we define the main collective actors of the drama and describe the triangle of interests that we believe constitutes the framework of modern capitalism. The third section discusses channels of subordination understood as pressures that internationalized capital exerts on the state in order to pursue its interests. The fourth section scrutinizes these relations and underscores their ambiguous and reverse nature. The fifth section concludes.

THE TRIPARTITE NATURE OF MODERN CAPITALISM

What is capitalism? As historian Fernand Braudel in his seminal works on Mediterranean world showed (2008 [1985]), it ought to be defined rather in opposition to market economy than in accordance with it. In historical perspective, market economy contained basically

exchange developed between production and consumption. It was closely bounded to the place of exchange – local markets, bazaars, periodic fairs, cities, and finally regional and national markets. In contrast, the essence of capitalism lied not in the exchange of goods and services, but in financial profits gained from a variety of operations which were not limited to any particular place or territory. If a shipping of spices and textiles from India to Europe provided higher profits than participation in local production, the involvement of capital shifted. When a development of textile industry seemed more promising then spice trading, the capital shifted again with no respect to former business relations and consequences for local partners and societies. The same happened when any other kind of activity enabled by technological or institutional change allowed for gaining comparatively higher financial returns. Links to national markets and geographical boundaries are thus of secondary meaning, they matter only for legal and logistic reasons. Capital does not commit itself to a persistent production of a specific good or to repetitious trade transactions. Its ontology should be rather portrayed by a constant movement and hunt for opportunities. The heart of capital consists not of emotional or national bounds, but of mobility and profit seeking. It is thus no wonder that the 'core' of capitalism has so far moved at least eight times starting from Bruges through Venice, Anvers, Genoa, Amsterdam, London, Boston, New York to Los Angeles always moving to those places which offered the best opportunities for reaping high profits (Attali 2009). Capitalism has thus always been detached from its market economy base, but paradoxically enough could not exist without it – its customers, suppliers, and production base.

Capitalism is not a single discipline phenomenon and does not refer solely to the field of economics. It is not only a matter of capital accumulation and a specific mode of production. As Wolfgang Streeck has recently argued 'capitalism denotes both an economy and a society' (2012, p. 2). It is 'a system of social action and a set of social institutions' which makes it more of a sociological field of inquiry than of conventional economic approach. Streeck believes that, as a matter of fact, rediscovering sociological aspects in classic economic texts would probably contribute much more to understanding modern capitalism than pursuing mainstream economic research. The very nature of capitalism is thus hard to uncover without relating to social background and power relations. This is not to suggest that economists have always neglected this aspect of reality in their research. Many of them referred to politics, history, and social forms in their analyses instead of contributing to the creation of 'pure economics' (see for example Hodgson 2001, 2004).

An essential contribution to economic theory in this vein was made by John R. Commons (1936, 2012 [1924]), who instead of concentrating his research on goods exchange and value creation preferred to focus on analyzing conflicts of interests and the ways of overcoming them in order to build effective social and economic institutions. He maintained that a reasonable social order needed a careful design of institutions rather than their creation in a process of laissez-faire competition. Moreover, the infamous interests groups were crucial for reforming capitalism, because by exerting pressure on politicians and keeping capital owners in check they contributed to a rise of more just and more fair socioeconomic system.

Commons' approach was continued by John K. Galbraith who in his famous work on American capitalism (1993 [1952]) elaborated on the concept of countervailing powers formed by labor unions and employers' organizations. His very idea was that in the face of dominating economic power of employers, workers decided to form their own counter-monopoly which controlled the supply of labor. Galbraith realized that in modern times 'since competition had disappeared, all effective restraint on private power had disappeared' (p. 111). The world was no longer characterized by competitive relations between buyers and sellers which used to constrain the exertion of power similarly to the model of perfect competition, but evolved into concentrated power on one or both sides. So in order to provide stability and in fact to save future of the capitalist system, 'private economic power [was] held in check by the countervailing power of those who [were] subject to it' (p. 111). The counterbalance was thus a result of self-generating phenomenon of collective action, which proved crucial for capitalism's dynamics and eventual survival.

The state is in the very center of this confrontation of group interests. However, the state's role of impartial beholder and referee was possible only due to historical separation of intertwined powers (Ingham 2008). After long-lasting political and military quarrels merchants' rights to privately own and control economic resources were acknowledged by rulers in exchange for tax contributions and shifting the legitimized use of force exclusively to the state. Thus the state ceased to be a warrant of monopolistic positions in exchange for financial support, but could act as an arbiter between labor and capital and a provider of legal and institutional framework. Spontaneous struggles between labor and capital became with time animated and arbitrated by the state, which heavily contributed to long-lasting social peace and a creation of systems of welfare. Today, however, the landscape has changed even further. Researchers of modern capitalism have to adopt the perspective of global dimension of capitalism, which largely sustains the logic of markets and capitalism, but challenges the role of the state. In present-day capitalism 'political science, conceived narrowly as a discipline specialized in the study of public governance to the exclusion of corporate governance, NGO governance, and the governance of transnational networks, makes less sense that it once did' (Braithwaite 2008, p. 27). The relations of modern capitalism are nowadays global and surpass the arena of national markets and politics thus creating a new matrix of interests that affects all other actors acting in the economic and social world. One cannot therefore understand modern capitalism without referring to politics and power relations, because they have governed and still govern what kind of and how transactions are made, they influence the distribution of economic and political power, and they ultimately determine winners and losers of economic game (Galbraith 1983;. Acemoglu and Robinson 2006).

For that reason we adopt in this paper the approach of institutionalist political economy (Streeck 2011; cf. Chang 2002), which views capitalism as a specific type of social order. According to Streeck (2011) capitalism is thus not 'a self-driven mechanism of surplus extraction and accumulation governed by objective laws, but a set of interrelated social institutions (…), a historically specific system of structured as well as structuring social

interaction within and in relation to an institutionalized social order' (p. 139). Capitalism is therefore ruled through socio-economic institutions, which are subject to pressures from interest groups and limited by existing institutional framework. Institutionalist political economy allows thus to analyze how economic interests influence policy, politics and other aspects of social life through creation, preservation and destruction of particular institutions. The institutional framework does not, however, develop in a social vacuum offering a set of objective laws that contribute to general welfare, but is forged by pressures exerted by influential interest groups and/or external events (like technology change or military conflicts) that shift the distribution of powers. It is the perspective of these groups that is most supportive for understanding the shape of modern capitalism, the challenges it poses, and the future it may bring.

Braudel's discrimination between market economy and capitalism seems central for our line of thought, as it properly reveals both the clash of interests and the international factor. It is the clash of the interests of capitalism's agents and those of market economy's that adequately explains modern capitalistic social order and delineates the scope of social interactions overstepping national boundaries. Basing on Braudel's observation of historically supranational nature of capitalism, we pinpoint and define three groups of actors, which constitute the essence of contemporary capitalism. These groups not only compete between themselves pursuing their economic interests within a given framework delimiting possible maneuvers, but try to influence national and global politics in order to change the rules of the game in their own favor thus seeking for political rents as well. Their interests are therefore of contradictory nature and the scope of potential cooperation is put nowadays under growing threat.

National market economy (NME) actors. By this category we mean agents that are entirely or almost entirely involved domestically in production of goods and services, in exchange of this output for money and in consumption. It thus includes small firms and medium companies, households in their dual role of consumers and wage or salary earners, financial intermediaries like local banks or other companies which provide financial services to domestic actors and have their profits depending on their performance and solvency. What all these actors have in common is that they are embedded within national economy on which their survival and well-being depends. Households' earnings and spending capacities, firms' production and expansion perspectives, financial sector's soundness, they all hinge on stability, performance, and subjectively perceived expectations toward the future of domestic economy.

In the relations between NME agents the question of power is of outmost importance as the era of industrial and monopolist capitalism showed. Bargaining power of an individual was negligible against the concentration of power on both labor and goods market. Thus acting either as consumers or workers individuals were hardly maximizing their welfare against monopoly employer or monopoly seller. As a matter of fact, in 19th century it was rather a question of subsistence and survival than pursuing economic aims of wants and desires. This is how collective actions appeared creating countervailing powers against capital owners in

the form of labor unions and later consumer cooperatives. In response, many corporations also created their own employers' organizations. All of these organizations pursued collective goals of their members through even more power concentration and rising political pressure capacities. This picture of countervailing powers was well portrayed by the already mentioned Galbraith's classic work. The point is, however, that even though these actors struggle against each other in the process of economic and political competition, they formulate quite common goals toward the state. The latter is perceived as a creator and administrator of legal and institutional framework, a likely protector of national branches against tough international competitors, a supplier of public goods (including legislation, law execution, social order, basic infrastructure, sound currency etc.), and possibly an arbiter and mediator in social and economic conflicts. The state is supposed thus to provide a stable, predictable, and transparent economic and legal order that serves best an interest of the society, even though many interest groups do try to change the rules of the game in their own favor. The state is then a kind of 'external' agent in relation to NME actors (with the exception of public employment and government purchases naturally), which stands above the economy though steering its development and protecting national interests against foreign competitors.

International financial capital (IFC) actors vel internationalized capital. The second group of actors include companies or groups of companies interrelated on financial and functional basis doing business globally in production, trade, banking, and other operations, usually finance-related (like investment funds, insurance companies, brokers, rating agencies, etc.). We have qualified both financial international corporations and huge multinationals like GM or Siemens into this group due to their massive accumulation of capital and international perspective in doing business. Moreover, as recent research on non-financial companies, (mostly those originating from the US) shows their activities tend toward financialization (Krippner 2005, Crotty 2003) which is another reason for associating them with capitalism in Braudel's sense. However, we have decided to leave multinationals beyond the scope of this article, although their role in contemporary capitalism is also a promising field of research (Braithwaite 2008). Our focus here is principally on actors that are very loosely involved in real sector operations or are sometimes even exclusively committed to financial operations. It is these actors that constitute, in our opinion, the very essence of boundless and borderless capital, which characterizes capitalism and is the source of main threats posed against societies and traditional markets. Was it not a largely irresponsible behavior of international financial capital that caused the crisis of 2008+ (cf. Deutschmann 2011)? This group of actors enjoys the highest potential of capital mobility and is rather loosely bound to national economies; their main goal is to make profits on purely financial operations thus seeking for attractive opportunities throughout the world not hesitating to shift the allocation of capital on a day-to-day basis. They enjoy vast economic power in the sense that scales and complex networks of their operations make states succumb to their demands thus marking a contemporary stage of capitalism.

We are aware of the fact that this classification may bring up doubts of being imprecise and porous. Our principal caveat here is that the division between financial corporations doing

business globally and locally is rather unclear. The former often register their subsidiaries in certain countries with the perspective of doing business locally. On the other hand, there are national banks that decide to go global, but keeping in touch with their local identity and bounds. However, we proceed with the simplification to make the presentation more transparent in academic terms. To recapitulate, our perspective discriminates across financial companies that are focused on global activity thus belonging to the contemporary superstructure of capitalism and financial intermediaries that act and make profits mostly on local markets thus being a part of national market economy domain.

The democratic state. We understand the democratic state (henceforth in short: the state) as a social structure that wields law-making and coercive power over certain territory and population which has been given to it by political legitimization stemming from the very society by democratic vote. We focus on the key functions of the state which are the responsibility for creating and managing legal-institutional order as well as addressing society's preferences. Nevertheless, by no means we see the state as both impersonal and impartial administrative unit which acts in favor of vaguely defined general welfare. We share the public choice approach being aware that the state consists of individuals with their own expectations and interests. The state is a complex structure – it is not a centralized monolith organized in a single location and is not represented by central government and by central bank as well as by parliament and by supreme court alone, but consists of numerous agencies, civil service, public institutions, local governments, etc. However, we can roughly reduce the state institutions into two groups, namely politicians and bureaucracy. The public choice approach conceives them as actors pursuing their own particular goals that do not necessarily comply with the preferences of society nor people they represent and serve. In the democratic state politicians are mostly interested in keeping their political power and winning elections, whereas bureaucrats strive for maximizing budgets under their control (Buchanan and Tullock 1997 [1965]). Moreover, recent developments make it clearer than ever that politicians and bureaucracy share a common goal of financial stability of the state. Firstly, because it allows for financing state's expenditure on public goods thus gaining popularity for politicians among the voters, and second, because individual welfare of public bureaucrats in terms of employment and earnings depends on it.

In our opinion the three groups identified above form the triangle of interests which is critical for understanding contemporary capitalism. National market economy historically was and still remains interested in the state's roles of a coordinator and an enforcer of social order as well as a provider of public goods. Respectively, the democratic state is interested in votes of the NME actors which translate into political legitimation and power. In order to gain them (along with bureaucrats' aims mentioned above) it badly needs a financial stabilization and capabilities which can result from tax contributions and loans. For political reasons the state is more interested in the latter kind of inflows and therefore it has interest in maintaining correct relations with financial intermediaries, many of them operating internationally. As far as internationalized capital (IFC) is concerned, the state can be supportive to it in terms of exerting political pressures on foreign or domestic debtors or by encouraging other countries

to welcome financial players. When international financial markets become turbulent, like they did after 2008, the state is suddenly perceived as an insurer of last resort in terms of bailouts, easy credit or favorable legislation.

THE CHANNELS OF FINANCIAL SUBORDINATION

With this background in mind we claim that international financial capital strives for the subordination of the state exploiting seminal channels of pressure appealing to the interests of the state represented by self-interested agents[2]. Internationalized capital keeps the national obligation-free anchor in the sense that involvement of IFC in domestic matters, social or economic ones[3], is rather approached with extreme hesitancy as 'the market' does not appreciate such actions with instant high rewards. The goal is to subordinate or gain influence over the state in such a way that it would back up financial agents when necessary, yet at the same time would relieve them from any costly participation in solving issues of national economy or society itself. This would mean that the balance within the triangle of interests is at danger, which may bring destructive consequences for social order and economic development in the long run.

As a matter of fact the state is trapped. On the one hand it should address the expectations of NME agents which provide it with political legitimization, whereas on the other hand it feels obliged to listen to IFC due to financial dependency reasons. The exchange between the state and NME actors concerns a provision of public and social services in return for votes and public support. However, to meet voters' expectations the state needs to be financially solvent and so debts need to be sustainable. Alas, when the accumulation of debt begins to threaten the financial stability of the state, the interests of voters suddenly find themselves in opposition of creditors' interests. As Tomz and Wright (2013, p. 22) put it: 'when governments appropriate funds to service the foreign debt, they are making a political decision to prioritize foreign obligations over alternative goals that might be more popular with domestic constituents'. A likelihood thus appears that the outlays for public services may be dramatically constrained in the sake of paying back the creditors, which in turn translates to shrinking capability of meeting the expectations of voters and other domestic actors. A risk of social discontent arises, but the fear of shaking the 'state of confidence'[4] of state's creditors

[2] There is a widespread idea that the state is nowadays less and less a direct provider of public goods, while more and more a provider of guarantees for these goods to be supplied. This is to say the state is in position of a principal toward large corporations that are often among the agents who take such contracts. This seems to be in utter contradiction to our claim that the state is gradually getting subordinated to large corporations. This analogy is, however, misleading. The process we focus on refers to the state-financial agents relation, not on contracting in the real sector of the economy. In the latter case the contractors (private agents) are indeed in inferior position, but it is worth noting that in an event of opportunistic behavior the state may find itself in a position of a hostage.
[3] For example in terms of higher tax contributions, applying honest corporate social responsibility, contributions to fighting income inequality and poorly justified employment reduction in controlled companies, etc.
[4] We borrow this concept from Michał Kalecki, who in his famous paper on full employment (Kalecki 1943) mentioned that a 'state of confidence' is a very promising way of keeping governments in check by 'captains of industry'. He remarked that capitalists had 'a powerful indirect control over government policy: everything which may shake the state of confidence must be carefully avoided because it would cause an economic crisis. (…) The social function of the doctrine of 'sound finance' is to make the level of employment dependent on the state of confidence' (p. 325). Analogous mechanism works today.

often prevails over the obligations toward the society. Politicians are afraid of discontenting financial markets because it could escalate into political and economic crisis. Thus IFC can exercise an indirect power over governmental policies and the state becomes a hostage of their state of confidence.

The situation that state needs money and economic prosperity at the same time provides IFC with opportunities which are hard to dismiss. In this argumentation we perceive the relations between the state and internationalized capital with two strings attached. First, the state listens to financial markets because it is in debt and must settle the receipt while still requiring the external financing. And second, the state is keen to subordinate, because the financialization is perceived as a vehicle of economic growth mostly due to so called wealth effect. These two channels of influence constitute a sophisticated stick and carrot strategy. The stick is a threat that in the face of growing public debt attempts to reschedule it or negotiate on defaulting will cause a severe economic downturn and isolation on financial markets leading eventually to a financial collapse of the state. And the carrot is a promise of positive effects of spreading financialization on economic growth and development. The first case means that politicians take the blame for letting the state go bankrupt and the second would bring them votes and popularity for wise decisions and following prospective political visions.

The link quite easy to follow is indebtedness to foreign creditors (usually IFC agents) matched with an "iron rule" that debts must be paid back. Once indebted in foreign currencies the state is on the string of capital inflows and exchange and, as Braithwaite reckons (2008, p. 25), nowadays ‘large corporations do a lot of regulating of states’. The main stream of influence lies in capital movements which take place within corporate transnational structures and via financial assets markets. States need to assure their ‘state of confidence’ with relevant preferential conditions of business making or adequate steps within public finance. There are corporations specialized in setting credit ratings for government bonds issued in intention to be sold in international debt markets; the rankings indirectly evaluate state’s policies from financial markets’ point of view and make these information public thus encouraging benchmarking of states. However, IFC seem to be the most effective lobbying global institutions like the IMF, the Basil Committee, the European Central Bank, the World Bank or WTO and thus indirectly influencing specific spheres of states’ activity. If solvency of the sovereign debtors is concerned, the IMF and the World Bank are particularly effective in imposing suitable policy adjustments. According to Braithwaite ‘this leverage tends to be the greatest when states are applying for membership of an international club such as the WTO or EU from which they believe they would benefit’ (Braithwaite 2008, p. 25). Thus, international financial capital has created a global net of pressures and constraints which undermines the autonomy of indebted states and hampers their scope of political maneuvers in the sphere of public finance and economic policies[5]. The example of 2008+ crisis is very revealing in this matter. The sharp rise of public debt in many countries being together with a reduction of tax base very often a result of bailouts on which many IFC agents benefited, was in fact

[5] Compare Streeck’s (2014) brilliant argumentation on the ascent of a consolidation state as a result of tensions between democracy and contemporary capitalism.

advantageous for internationalized capital actors, because it provided them with even greater opportunities to exert pressure on states.

Here a commentary seems necessary. It does matter who are the creditors and in what currency debts are denominated. We are discussing relations between states and internationalized capital. Domestic financial institutions, however, are easier to be identified and the range of sensible arguments and common interests for cooperation seems to be much broader than in the case of IFC agents. Also households tend to be benevolent creditors, who rather do not exert pressure on the state (like in Japan). However, few states are in this comfortable position as usually creditors who control the access to capital are transnational agents. Another factor determining the flexibility of dependency concerns currency (cf. Nersisyan and Wray 2010). Persuading a national central bank in question (e.g. the Fed in the US) of increasing the monetary base or even buying out government bonds seems to be far easier than asking a foreign issuer (e.g. the EBC) for the same thing.

The second vehicle of subordination is a promise of economic growth due to financialization. According to the common wisdom stemming from orthodox economic theory this process is expected to provide a new engine of GDP growth due to higher economic efficiency, better allocation of resources and more optimal risk sharing[6]. This will in turn contribute to fall in unemployment and an increase in real investments. Moreover, the inflowing capital may be used to finance commercial operations of existing companies or establishment of new ones and the wealth effect will cause consumption to rise thus providing additional demand in economy. The relation between financialization and wealth effect is straightforward enough to be understood by a layman and therefore it is so powerful. When prices of financial assets rise, the propensity to spend on goods rises as well. Expenditures of private sector (consumers and firms) increase thanks to faith that individual wealth increases in value due to rising prices of financial assets. It is therefore no wonder that politicians perceive financialization as an attractive factor of gaining votes thanks to its assumed positive effects on real economy. The more dynamically economy grows and employment rises, the more satisfied are voters and the probability of winning elections is higher.

Internationalized capital seems to have little interest in creating another balance of powers, because imbalance has much more to offer in terms of profit maximization and political influence. Cooperation with NME actors cannot provide such opportunity especially that IFC got separated from the real economy. Gaining influence over the state is much more promising. This would guarantee a support from the state in times of market instability and contraction, as well as freedom of action when markets expand. Thus after a period of divergence between the state and capitalism in the era of welfare capitalism, we are witnessing a restoration of the preceding alliance originating from 19th century[7], yet not in a form of mutual cooperation between the two, but rather with the state on instrumental position and with IFC taking advantage of the state's political assets.

[6] See Palley (2007) for a short survey of benefits stemming from financialization according to conventional economic theory.

[7] It was critically analyzed inter alia by Karl Marx, Walter Eucken or Joseph Schumpeter.

THE AMBIGUOUS ADVANTAGES OF FOLLOWING COMMON WISDOM

Capitalism is at the stage which may bring destructive consequences for economic development and social order created in post-war era. First symptoms of this threat could have already been observed in rather unsuccessful attempts to overcome the crisis of 2008+ with internal devaluations leading to contracting economies and rising unemployment in several countries, yet assuring the repayment of debts. The disappointing progress of reforms discussed in the face of recent crisis suggests that thinking solely of new tools is insufficient for changing the course of events in the long run. Failures to introduce unanimously Tobin tax or to hit "too-big-to fail" banks via European banking union did not have its source so much in technical details, but in thinking patterns that followed the already beaten tracks. What indeed needs to change are thus institutions understood not only as 'rules of the game' of typical Northian approach (North 1991), but more of 'a system of shared beliefs about how the game is played' (Aoki 2001, p. 26). It is therefore a question of cognition that induces us to change our minds and later on modify the formal rules of the game. We are going to show now that the vehicles of subordination just depicted may actually be adversely used, and thus the pressure of the financial stability argument on governments can be considerably lessened. We argue that firstly, public debt repayment appears no immediate imperative and it is often international creditors who badly need to adjust as past evidence of foreign debt restructurings shows[8]. And secondly, welcoming attitude of governments toward internationalized capital is rather short-sighted, because financialization of economy has little to do with economic efficiency and rising standards of living.

The cost of sovereign debt default revised

Debtor governments should be less influenced by the argument of financial stability as well as more assertive in defaulting. Having said this we do not mean that this practice should be more widespread, whereas sovereign defaults are common, recently even pervasive. According to dataset on debt restructurings of developing countries since the 1950s sovereign debt restructurings amounted to 600, and most of them were carried out post default (Das et al. 2012, p. 5-6). Normally they are a sign of less developed countries' distress, however they do happen in the developed countries too, as historical records show (Aguiar and Amador 2015). This observation and recent Greece's experience make some authors claim they can become a problem of fully-fledged market economies as well. Defaults happen even in waves; recent cases of multi-country debt crisis include the Great Depression, the Latin American crisis of the 1980s, and the ongoing European crisis. According to Reinhart and Rogoff (2013) a belief that it is only the economic growth that will provide a 'soft exit' from all the accumulated debt is rather too optimistic. A return to debt restructuring, as well as tolerance toward higher inflation and various forms of financial repression, seems more and more plausible with the predicted debt overhang. Governments do default, and these practices are no marginal phenomenon.

[8] We consciously do not refer to speculation on states' insolvency.

The most common motivation against defaulting are costs that have to be borne in consequence of the default. Our point is that costs invoked by sovereign defaults are not evenly certain for both parties that is for the state and for the creditors. In theory, costs for the state resulting from default are known and widely discussed. These include: increased borrowing costs, exclusion from capital markets, losses in terms of output and trade, drop in FDI flows and private sector access to credit, negotiation costs and fees (Das et al. 2012). The relationship between sovereign debt default and economic performance, however, is puzzling when it comes to comparing standard economic theories with actual data (Tomz and Wright 2007; see also Aguiar and Amador 2015 for a survey of recent findings on sovereign debt default and overhang). Moreover, once it comes to counting it turns out that it is creditors who can easily estimate the amount of losses they will have to bear when a debtor defaults[9]. All measures of creditors' losses in the present value of their claims to be found in Tomz and Wright (2013, p. 17), despite the differences in definitions, give similar quantitative results, that is ca. 40% market haircut. Costs of restructuring and default to governments are not so obvious and straightforward, and evidence is mixed. An exception is a broad consent that borrowing costs are considerably higher during the years after default. According to some sources an average defaulter paid 3-4% more to borrow than non-defaulters (Tomz and Wright 2013, p. 18-19). In general, an opinion about lower likelihood of re-accessing capital markets is expressed (Das et al. 2012, p. 66), however particular tests show that exclusion from capital markets is temporal. Moreover, re-accessing markets following the default takes less time than before: 4,7 years has turned to 2,9 years more recently (Tomz and Wright 2013). As far as drops in GDP and trade flows after debt restructurings are concerned it is difficult to conclude that these are causal effects rather than correlations (Das et al. 2012). Interestingly, Levy-Yeyati and Panizza (2011) argue that defaults are rarely followed by output contractions. It is rather the postponing of default that is more costly than the default itself. The impact of defaults on commercial credit is brief and not sufficient to explain the total drop in trade (Borensztein and Panizza 2008, 2010; Tomz and Wright 2013, p. 20). It is broadly assumed that foreigners might be less willing to make foreign investments or enter into trade agreements etc. with the offending state which may result in a drop in FDI and can be associated with a decrease in external borrowing to private sector. While some sources report there is evidence for such negative “top-down” risk spillovers from the sovereign to the private sector (Sandleris 2012), other sources consider them "plausible, but few have tried to test it empirically" (Tomz and Wright 2013, p. 21). In sum, the risk borne by a defaulting government in terms of costs seems to be vague while haircut of its creditors seems to be immense. In the light of these findings the creditors might appear on a relatively weaker position than the debtor-country which is normally placed at the focus of analysis..

Governments are in fact in much better position than it appears at the first sight. Lysandrou (2013) has recently argued that investors are nowadays quite tied to government bonds due to virtual lack of alternatives. In post-crisis times private assets have lower profitability to risk

[9] We do not refer here to financial sector implications in form of banking sector distress and financial sector instability which needs a separate deliberation (see below). We mean creditor losses in a sovereign default in accounting terms.

ratio than government bonds when it comes to safe, long-term allocation of capital. It is also incredibly difficult to designate a threshold of public debt that becomes a real threat to state's financial stability (Lysandrou 2013; Nersisyan and Wray 2010) contrary to the famous Reinhart and Rogoff (2009) thesis. One cannot also imagine that contemporary creditor-related countries would use military intervention to enforce debt contracts. There is also little evidence for state's assets to be seized after the default since sovereign debt is typically not backed by any collateral and only few attachable government assets are located outside national borders. However, even when they are located in foreign jurisdictions legal principles such as sovereign immunity protect sovereign assets (Das et al. 2012, p. 50). All this puts deliberations on default on external debt in a different light.

A counter-default argumentation follows along financial-stability lines. Possibly, governments cannot repay their debts selectively discriminating across foreign and domestic creditors (Tomz and Wright 2013, p. 22-23). Default on external debts can endanger domestic financial sector stability and contribute to a credit crunch at home because of complex links between foreign and domestic agents within the financial sector. For instance, since bonds are traded inter alia in secondary markets it is hard to trace who owns the debt; therefore the government would find it hard to repay locals at the expense of foreigners. True, that debt restructurings such as in Russia in 1998 have contributed to banking sector distress causing bank failures and bank runs (Das et al. 2012). On this basis it is presumed that default on external debt, apart from foreign creditors and bondholders strikes also at banks, insurance companies, and pension funds operating domestically, and therefore governments should restrain the temptation. Financial sector implications are regarded in this reasoning as the country's costs rather than as political risks born by private companies. However, the power of this argument depends on how intense links between foreign and domestic actors in sovereign debt market are indeed. These can be easily over-estimated, as recent case of Poland suggests. The post-2008 turbulence in international financial markets and consequent distress of few European parent-companies invoked concerns that they would try to rescue their balance sheets at cost of their banking subsidiaries in Poland. Profit transfers abroad or total capital withdrawal from Poland might have invoked financial instability in the country where ca 70% of assets in banking industry is owned by foreign banks. The links between domestic and foreign actors in this case, although extremely tight, turned out to be irrelevant in terms of domestic financial stability. The pessimistic scenario has never come true. Besides, nowadays sovereign debt amounts merely to 19% of global financial assets (Tomz and Wright 2013, p. 7) so there is hardly a chance that debt restructurings would destabilize the whole financial system of the world.

In sum, arguments against sovereign default with financial-stability argument at the front should not be taken for granted. Undoubtedly, it is no costless operation, but with regard to costs for the country there is much uncertainty about how big they could be and even whether some of them would actually appear. Data regarding costs for private creditors and bondholders seem to be more hard. Losses are more obvious, since haircuts may be estimated relatively easily. On the other hand, sovereign debts and even minor the defaulted sovereign

debts seen as share of global financial assets seem hardly a threat to stability of international finance. Having realized this, the governments should present more bold attitude whenever confrontation with the IFC comes.

Growth effect illusion

The second channel of exerting pressure on governments or in fact a juicy carrot refers to financialization of economies. However, recent research indicates that the effects of financialization are in contradiction to the hopes of its proponents. Assa (2012) has examined 34 OECD countries between 1970 and 2008 and found out that 'each percentage of increase in financialization[10] is associated with between 0,49% and 0,81% more inequality (…), 0,2% slower GDP growth, and between 0,12% and 0,74% higher unemployment' (p. 38). Sawyer (2014) finds that even if the relation between financialization of economy and GDP growth used to be positive, it became much weaker and contestable during the last three decades. There exists even a possibility that this relation is today reversed and further ballooning of financial markets may contribute to destroying the value instead of its creation. Freeman (2010) and Stockhammer (2012) claim that it is financialization that is overtly responsible for the 2008-2009 crash, which has caused permanent lost in employment, reduction in public goods and poor economic growth. Instability is an inherent feature of the economy which offers 'high-powered incentives' for rent-seeking in the financial sector instead of financing real economy activities. And as we have recently witnessed it, 'financial markets can destroy economies, whereas labor markets cannot' (Freeman 2010, p. 179). Since late 1980s the relation between rising productivity and workers' compensation has been broken, which unsurprisingly coincides with sluggish GDP growth compared to the 'troubled' decades of 1970s and 1980s (Palley 2007). Finally Orhangazi (2008) finds a negative relationship between financialization and real investments. The latter are crowded out by financial profit opportunities which change the incentive structure of managers and by decreased availability of internal funds that had been shifted to financial operations. Results obtained by Demir (2009) confirm that this tendency has reached emerging markets, which should be more interested in accumulating real wealth than financial one. This review suggests that the impact of financialization on economic development does not really meet enthusiastic expectations, and may actually be detrimental rather than favorable to the real economy. Benefits of financialization in terms of GDP growth and unemployment reduction are thus illusory and remain rather in the sphere of optimistic hopes than hard facts.

It is very difficult to estimate the impact of wealth effect on GDP growth. However, the impact of wealth effect on consumption (and thus GDP) is widely researched, although its results are highly inconclusive and sometimes even contradictory. On the one hand, Carroll et al. (2006) and Case et al. (2011) provide evidence based on the US economy that the wealth effect does have positive impact on aggregate consumption. In short term the marginal propensity to consume increases by 2% and in a long-term it does even up to 9%. This effect is much stronger for real estate than for other financial assets. On the other hand, when price

[10] Understood either as (1) a value added in finance to a percentage of total value added or (2) employment in finance to a percentage of total employment.

bubbles burst, the result for real economy is similarly strong. However, Calomiris et al. (2009) basing on the US data find that housing wealth has negligible effect on consumption, both in times of upturns and downturns of the economy. Interestingly the results for euro area seem to be reverse to those for America in some respects. A study by Sousa (2010) shows that it is the financial wealth that has leading impact on consumption, whereas the housing wealth effect is nil and not significant, and that this impact is by no means strong, namely a 10% increase in financial wealth causes 0,6-1,5% increase in consumption. Moreover, it is the exposure to financial markets that probably causes increased volatility of consumption. Nevertheless, even if the positive causation between rising wealth and consumption exists, Stockhammer (2013) suggests that 'it is misleading to speak of a wealth effect, rather it should be called a credit access effect'. Increased consumption in times of stagnating mass incomes is a result of rising household debt, which further adds to instability of national economies. Moreover, the positive effect in terms of GDP growth during prosperity phase gets abolished because of unavoidable bust. The gains can thus be negligible in the long run and adding to increased uncertainty (Stockhammer 2012). One can thus doubt whether the wealth effect has such a powerful and positive influence on GDP growth as suggested by leading politicians and decision makers.

In sum, financialization has little to do with economic efficiency and rising standards of living. Having put its illusionary effect aside one can find it to be rather unsustainable in terms of growth of domestic demand and production.

Such alternate thinking on channels of influence as presented above suggests adverse action, namely, constraining and confronting international financial markets, and this requires an alliance between the state and NME actors. Governments should be more resistant to the standard financial stability argument, be less inviting to IFC and be more assertive in negotiations with creditors. Such change of minds is thus only the first step, but may prove to become a pivotal one.

CONCLUSIONS

As we have attempted to show, the dichotomy between market economy and capitalism is still valid as it was over two hundred years ago. Their size and shape have naturally changed. Local markets have evolved into national economies and merchant capital turned into huge internationalized finance. Their basic logic has, however, remained the same. There is nevertheless a meaning vacuum in this analogy, which concerns the role of the state. In times studied by Braudel its role was negligible when it came to mediating between the interests of first capitalists versus interests of folk. Rulers were rather interested in securing the former as they got their share in rents and taxes. The evolution of industrial relations in the first half of 20th century has brought the state which spoke in favor of workers thus restraining further expansion and domination of capital. Recently, this order seems to get shaken by the rise of internationalized financial capital and its attempts to subordinate the state and to constrain it as sovereign rule maker and social mediator.

The state has found itself in a trap position which is reassured by continuous rhetoric of no alternative. Failures to service public debt and to financialize national economies are perceived as grave mistakes leading to the collapse of public finance and a lost chance for economic growth. Evidence to support such claims is mixed and rather weak. Thus there is no serious reason for the state to favor the demands of internationalized capital over the interests of national market economies in the sake of preserving 'state of confidence'. It is the latter that provide it with political legitimization, not the financial capital. We are hereby not saying that states *should* default or that the costs of defaulting are trivial, far from that. The point is that the attitude of states toward the threat of defaulting or unrestrained expansion of financialization should change, because otherwise states are becoming hostages of internationalized capital.

The key to do so is to realize that market economy and capitalism are different categories. Contemporary national market economy has become in fact overwhelmed by overgrowth of capitalism embodied in internationalized capital and untied to the real sector of economy. Such relation leads to hampering the development of national economies and weakens the state. It is thus a great opportunity for the state and NME actors to cooperate with each other in order to confront together the enormous power of internationalized capital. It has already been noted by Freeman (2010, p. 179) that 'reforming finance will be an uphill battle requiring the countervailing power of groups outside the [financial] sector in order to succeed'. This is not an easy task, but as history showed the appearance of countervailing power in industrial capitalism was a self-generating phenomenon. If it happened over hundred years ago, why cannot it happen again? It is very often just the thinking patterns that prevent us from doing things that are allegedly impossible, so they must be changed first. Institutions are a state of mind, are they not?

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