

Liberalisation and the Political Economy of Financial Bubbles

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This paper criticises the tight association in the political economy literature of speculation with liberal forms of governance. Having emphasised liberalisation, it is argued, scholars who ascribe to such a view are too often left without an institutional account of speculative dynamics. The paper then sets out the foundation for a political economy of speculation; one which emphasises the various forms speculation has taken and how these are rooted within specific institutional structures. In order to do so, the paper develops a distinction between premodern and modern speculation and uses it in order to contrast British and American finance. This contrast then serves as a basis for challenging the idea that speculation emerges from liberal forms of governance.

KEY WORDS Finance, Speculation, Anglo-Saxon capitalism, Financial crises

Introduction

There is a long tradition of presenting speculation as a product of open market economies. For those who subscribe to this view, liberal economies tend to use their resources in unproductive ways because they allow financiers to channel capital towards speculative ventures. Often couched within the context of a broader discussion about Anglo-Saxon capitalism, these analyses have come to forge a tight association between speculation and liberal forms of governance, often depicting the ebb and flow of speculative finance as being directly related to the fluctuating levels of state intervention, or more precisely to the degree of ‘embeddedness’ of finance (Ruggie 1982). This type of reasoning has led many to conclude that the recent shift towards speculation with neoliberalism can be ascribed to liberalisation which would have freed financiers to invest on speculative ventures.¹

While these critiques of speculation rightly put into question financial developments which have proven highly detrimental to large sections of society, their association of speculation with liberalisation too often construes speculation in a-social terms. As I will argue, these interpretations often underestimate the formative role of states in the development of speculative finance by suggesting that these financial practices thrive mostly in liberal economies. More importantly, by tracing speculative finance back to the weak institutional context of these economies, scholars often suggest, even if unwittingly, that speculative practices take place in somewhat of a social vacuum. Having emphasised liberalisation, they are too often left without an institutional account of speculative dynamics.²

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The failure to properly contextualise speculative dynamics partly explains the widespread tendency to 'psychologise' financial bubbles (Kindleberger 2000; Shiller 2000).³ For numerous commentators, these bubbles are disconnected from the parameters of the 'real economy' and seem often driven by irrational exuberance. Having emphasised the unregulated nature of the economy, there is little left to contextualise these dynamics. Unsurprisingly, speculative markets are then often characterised as 'losing touch with reality' as scholars fall back on the irrationality of financial actors to account for phenomena that seem to lack any proper grounding in social institutions. For this reason, speculation appears too often as a matter of hype and overconfidence while the crisis is framed on the contrary as one of loss of confidence.

As I will argue, this recourse to liberalisation as a means to explain speculation is symptomatic of a difficulty to come to terms with the socially constructed nature of speculation. Such characterisations of speculative bubbles deprive scholars of a proper social angle to 'problematise' the development of speculative practices. It hinders the development of a proper political economy of speculation. Hence, it is the contention of this paper that even if scholars emphasise the social nature of financial practices, they have mostly failed to construct speculation as a proper object of historical and social enquiry. Largely seen as a dysfunctional and mostly episodic development, it is too often presented in cyclical terms (a recurrent pattern) rather than in evolutionary terms. Even when scholars list various factors which can contribute to financial bubbles, there are few attempts to properly historicise such practices and highlight the different forms they take historically.⁴ As scholars dwell on the unsustainable nature of these practices, speculation appears as a short lived phase with little lasting legacy other than regulatory (i.e. restrictions imposed on speculation to avoid its resurgence). Speculation may seem here to have a past, but it has no history.

Moving away from such depictions of speculation, this paper seeks to resituate speculative practices in their specific social context. To do so, it focuses on the financial history of Britain and the US, showing how these trajectories have been 'conveniently' constructed as to reinforce the association of speculation and liberalisation. Based on the historical contiguity between the so called liberal features of Anglo-Saxon economies and the fact that London and New York have been the last two dominant financial centres in the world, scholars have often come to see the liberal nature of these economies as the key variable to understand speculation. But this apparently straightforward conjunction hides a more complex reality which belies some of the key assumptions of the literature. More specifically, I argue, that such readings conceal the significant specificities of US capitalism.

This paper is divided into three sections. The first section establishes a distinction between premodern and modern forms of speculation which relates to a profound transformation of finance in the late nineteenth and early twentieth centuries. As I will argue, premodern speculation was historically linked to the development of arbitrage and was for that reason more elitist, being reserved to a limited set of financial actors. Modern forms of speculation, by contrast, revolve around an increasingly collective form of speculation, one that involves a greater range of investors and which is usually illustrated by the idea of financial bubbles. On the basis of this distinction, I take a first step in the process of historicising speculation by highlighting how these different sets of practices involved distinct imperatives and led to specific forms of innovations. In doing so, I focus on the stock market which in many ways has come to epitomise financial bubbles. This distinction will, in turn, help to specify some of the more recent changes in speculation that can be associated with US finance.

To make this argument, the rest of the paper focuses on a comparison of British and American finance. In discussing these two different trajectories of speculation within the ‘Anglo-Saxon world’, I seek to debunk the notion that speculation was the product of the loose and more liberal nature of their regulation. On the contrary, one finds that finance was highly politicised and regulated in both countries (Knafo 2008a; Konings 2007; Seabrooke 2001). This, at least, problematises the notion that speculation can be associated with liberalisation in itself. Moreover, this comparison will serve to put into question the idea that Anglo-Saxon countries share similar speculative features as if the US was simply an extension of the British liberal trajectory. If anything, I will argue that England, at the turn of the twentieth century, came closer to continental Europe in terms of speculative practices. Indeed, a study of England demonstrates how its speculative practices owed more at the time to what I define below as premodern forms of speculation by contrast to the practices which emerged in the United States. In the third and last section, I focus more specifically on American finance in order to argue that new forms of speculative practices have emerged in the US that mark a fundamental shift in the development of finance. Indeed, the developments of flexible and highly leveraged practices of finance have profoundly transformed capital accumulation in the US. They made speculative bubbles relatively more resilient and central to economic development.

Premodern and Modern Speculation

One can get the impression, looking at the political economy literature on finance, that speculation is somewhat of a natural tendency for financiers, and one which tends to dominate financial activities when they are not put in check. While few may hold explicitly to such an idea, it is a logical corollary of conceptions that see speculation as a product of advanced and deregulated forms of capitalism. The fact that Anglo-Saxon countries are often characterised by their limited regulation and the importance of their speculative markets consolidates this assumption, as if one could read them as revealing the more ‘natural’ tendencies of financial capitalism. Indeed, once we characterise these economies by the relative absence of institutional constraints, it is difficult not to see in them markets which are ‘left to develop on their own’. It is, for example, such an idea which transpires in Gerschenkron’s (1962) influential work according to which the lack of institutional discipline contributed to the development of more speculative practices in contrast to continental countries, most notably Germany.

There is, of course, a rationale behind this idea. From an abstract perspective, speculative practices do seem to have inherent advantages. They benefit from a quicker turnover than ‘productive’ investments, seem to offer higher rewards and often provide greater control for financiers over their own investments. When compared to the complex and slow maturation of investments in industry, speculation seems to be naturally advantageous for financiers, especially considering the limited knowledge about manufacturing that most financiers have had historically. However, whilst speculation can certainly offer yields that are incomparably higher than other forms of investments when successful, these considerations miss the most fundamental point about the development of speculation. Far from being an option amongst many that financiers can simply pursue, speculation requires a complex set of institutions to be viable. Hence, as I will argue, speculation generally represents the product of a slow maturation. It involves a complex process of social

construction rather than being the easy option towards which financiers can naturally gravitate when ‘allowed by a liberal context’.

In this regard, it is interesting to evoke Braudel’s observation that ‘capitalist development . . . seems, by reaching the stage of financial expansion, to have in some sense announced its maturity: it [is] a sign of autumn’ (1984: 246). The fact that financial speculation emerges in late phases of economic development, or more specifically in dominant economies which have benefited from a long period of economic growth, is a direct sign of the slow maturation that is required for speculation to become viable. For many financial historians this can be mostly explained by the fact that speculation is the luxurious privilege of the powerful (Arrighi 1994); one which becomes possible when a centre of economic growth becomes sufficiently important as to attract the activities of others. There is certainly some truth to this. But, instead of focusing on the central position of a city or country in the world economy and the power that it provides, I wish to set the parameters of this problem in institutional terms. As I will argue, the fact that speculation seems to flourish only in the ‘mature’ stages of the development of an economy is an indication of the difficulty involved in constructing speculative practices; of the dense institutional foundations it requires before it can take off.

We often forget that financial actors generally spring out of non-financial activities. At first, future financiers rarely conceive of themselves as such and develop financial practices to supplement other operations they pursue. With time, they may be led to specialise in financial activities. However, this trajectory, with its non-financial origin, shapes the form of their practices. Such a development not only requires that these actors gain a certain credibility to attract resources in capital, but also that they develop practices which allow them to project their operations in new spheres of activities or new locations. These leaps towards more flexible financial practices are very difficult to negotiate. Building on old activities in order to develop new speculative practices requires a difficult balancing act that can be only achieved through institutional innovations. This explains why speculation does not emerge naturally, why it is always context dependent and why institutions are crucial to the construction of speculation. The notion also highlights that speculative practices never transcend the lineage from which they emerge. New innovations always rest on the institutions and practices of the past. For this reason, speculative episodes do not simply replay the same script, as if there was a natural speculative logic that could be gleaned from historical patterns. On the contrary, behind the apparent similarities of these recurrent phases of speculation lies a complex diversity that is too often neglected when scholars theorise about speculation. It is this diversity that needs to be brought back, not simply as a mass of historical details worthy of interest for the curious, but as key considerations when one conceptualises speculation. Constructing a political economy of speculation thus requires a comparative perspective to highlight how speculation takes different forms (Knafo 2008b). Only this can help convey the socially constructed nature of this type of activity and offer a conceptual grip on the process of social construction. In short, only such comparisons can allow scholars to appreciate what difference institutions make in shaping different dynamics of speculations.

A useful first cut into this problematic is to establish a distinction between what could be labelled premodern and modern forms of speculation. It is indeed a central contention of this paper that there was a profound transformation of speculation in the late nineteenth and early twentieth centuries which changed the dynamics of speculation and the imperatives that drive them. The more traditional form of speculation, which I label

premodern speculation, consisted essentially in various types of arbitrage as speculators sought to exploit price differentials among various markets.⁵ Such financial speculative practices emerged with the commercial revolution in Italy, becoming particularly important from the thirteenth century onwards. By contrast to the ancient practices of usury which had hitherto dominated the financial landscape, the new practices were tailored to operations developed in the context of long distance trade. They were thus mostly based on currency exchange, notably through the development of the bill of exchange (de Roover 1953).

To succeed, financiers employing such strategies carefully followed the situation of different markets trying to spot opportunities to exploit. This arbitrage relied on gathering and conveying information along tight networks. It was historically managed within large family networks deployed in the main financial centres of Europe in order to anticipate and react quickly to diverging market trends (Boyer-Xambeu et al. 1986; Braudel 1982). The main challenge for these financiers was that which applies generally to arbitrage, that is the ability to move without others doing so. In short, profits were dependent on playing against the market.⁶ This involved considerable means in terms of financial techniques, strategies of management and political capital. Hence, this form of speculation remained the purview of mercantile and financial elites.

The second and more modern form of speculation revolves on a different logic, one which is even harder to produce. Its most recognisable form is the financial bubble – that is, a rapid process of financial asset inflation. Speculative bubbles have become increasingly important during the modern era, being particularly associated with late developments in capitalism.⁷ For this reason, I label these practices modern forms of speculation. The main feature that distinguishes these practices is their collective nature by contrast to the more individualised form of premodern speculation. Indeed, bubbles involve a social process by which investments become coordinated as everyone starts to profit from investing in the same direction. In other words, these dynamics rest primarily on a desire to play with the market rather than against it. As growing numbers of people invest in the same assets, prices soar, thus increasing the profits of those who resale their assets. Precisely because of this characteristic, there seems to be a virtuous circle to these bubbles as everyone appears to win in the process, at least until the crisis hits. It is important to stress that these modern forms of speculation have not displaced older forms but have added a new dimension to speculation which has qualitatively transformed its dynamic, as I will argue below.

Because of the spectacular nature of modern speculation and its devastating effects on the rest of the economy in times of crisis, it is generally the object of most theories of speculation and financial crisis (Minsky 1982). What makes this second form somewhat puzzling is the apparent virtuous cycle that animates it. If speculation encourages more people to speculate thus generating the very inflation on which it relies, it seems to have no end. Yet, this scheme possesses its own distinct imperatives which make it generally unsustainable (Boyer 2000). In simple terms, speculative bubbles are built, essentially, as a ‘pyramid scheme’. As investment strategies in a market become increasingly determined by the rising prices of financial assets, they require sustained inflation – the incessant increase in the value of speculative assets. This depends, in turn, on the ability to constantly inject new capital to sustain the process. But problems emerge because the amount of new investments needed to sustain a same rate of profit increases exponentially as the value of assets on the market increases. If one considers the matter from a purely monetary angle, a 5 per cent increase on \$10,000 of assets requires \$500 of new capital being injected into the

market. If the market reaches \$100,000 in assets, the new capital required for this same 5 per cent increase rises to \$5000. Speculation thus always faces an uphill battle. To maintain a same rate of profit, investors have to pour ever growing amounts of money into the market to sustain it. This basic structural imbalance explains why speculation has been, historically, so difficult to sustain. Generally, speculative waves of this sort have had only a very short life. This also explains why authorities have historically been keen to adopt regulations to counter such speculative developments.

The transition between these forms of speculation is complex and multifaceted. Modern forms of speculation did not replace older practices of arbitrage, but added a new layer to the financial system. In doing so, they established new fault lines that would profoundly transform the nature of finance. Already in the late nineteenth century, various financial innovations rocked the traditional financial architecture as new actors and unprecedented resources entered financial markets (Landes 1956; Preda 2001). They forced authorities to clamp down on speculation, leading to a series of tight laws being adopted, in France and Germany notably, which pushed these countries in a different direction than the one that would be taken in the US.

Until then the old representatives of premodern speculation, such as merchant banks, regarded speculative runs suspiciously and fought to restrict newcomers' access to their financial markets in order to consolidate their operations. Classically, the 'lay people' were perceived as being responsible for these 'bouts of madness' and thus carefully kept away, at least as much as possible, from financial institutions. This classic association of the 'common people' with irrational exuberance was not only a reflection of eliticism on the part of a mercantile elite wishing to protect its own purview, although this was certainly part of the story. It also reflected the fact that, far from being a desired outcome, speculative bubbles undermined the soundness of their speculative operations. It threatened the carefully balanced play of premodern speculation.

In the case of nineteenth-century stock markets, dominant actors were mainly concerned with the issue of financial assets, rather than with secondary trading itself. In a speculative world where the leverage of the market was limited in its ability to sustain inflationary drives, the ability to negotiate loans with governments or companies and finance these loans by issuing stocks or bonds was one of the greatest opportunities for profit. It required great power and organisation and thus was reserved to the main financial houses. On the basis of their control of issuing, they mobilised carefully nurtured social networks in order to ensure that a sufficient critical mass would be reached and thus guarantee that bonds or stocks would be sold at high prices when issued on the market. The exclusive and competitive nature of such intermediation accounts for the momentous struggles that typified the nineteenth century, most notably between the Rothschilds and the Barings and later between the Credit Anstalt and the *Crédit Mobilier*. Such struggles forced merchant banks to evolve towards complex syndicates to minimise risks, not least from the manipulations of other merchant bankers seeking to undermine their competition.

In a world where speculation was highly codified and orchestrated, the advent of newcomers was always a threat and was strongly resisted. This did not mean that financial bubbles did not exist, but they mostly occurred in the margins of the great financial institutions of Europe. This form of speculation was never properly institutionalised and flared up generally for short periods of time. In other words, speculative bubbles remained episodic, informal and unsustainable. Preventing their outburst thus generally remained the main objective of the various regulators involved. It is not a coincidence then if many of

the early financial bubbles occurred in informal markets often operating in the shadow of the traditional institutions of speculation. For example, the great tulip crisis of Amsterdam occurred outside of the official stock exchange, while the various financial upheavals that shook the Paris Bourse were mostly tied to the *Coulisse*, the non official adjunct to the more tightly regulated Bourse.

In some cases, financial speculation was the product of state officials who ventured on speculative markets at key junctures of their own political history. The great South Sea Bubble of 1720, for example, was a classic example of officials trying to reappropriate the practices of financiers for their own interests (Harris 1994). Partly developed and sustained by officials linked to the Tory party, they were motivated by an attempt to establish a rival company to control public finance in reaction to the rising power of the Bank of England. The project rapidly failed because of the lack of proper institutional support to sustain it. Similarly the fiasco of John Law's bank had much to do with the attempt of the Orléanist party to create an alternative source of financing to circumvent the growing power of *financiers* in France (Luthy 1959). Such attempts led to short lived bubbles as lay people were caught up in the unsustainable dynamic of speculative bubbles. Hence, despite the spectacular features of these speculative crises, they never came close to the effects on the American economy of Wall Street's Crash in 1929 (Calomiris 1993). The South Sea Company bubble, for example, had virtually no impact on the rate of bankruptcy in England (Hoppit 1986). Hence, financial bubbles, if anything, remained relatively contained before the nineteenth century (Neal & Weidenmier 2002).

These remarks set up my main argument that the development of modern speculation, based on the sustained creation of financial bubbles, is a distinctively American phenomena in origin. The American economy developed a new set of institutions which have made this form of speculation an increasingly central component, one which can, despite its volatile nature, be sustained over unprecedented periods of time and which has been, in the past 20 years, revived relatively rapidly following the collapse of bubbles.

English Finance and Speculation

In order to appreciate the distinctiveness of US finance, it is useful to revisit the English case.⁸ As I will show, this comparison helps to 'problematise' the association between speculation and liberalisation that pervades the literature. The link with liberalism has come to rest on a selective view of history which has contributed to normalise certain features of speculation and its connection to Anglo-Saxon countries. Based mostly on the interpretations of key authors in the late nineteenth century and the first half of the twentieth century (e.g. John Hobson and John Maynard Keynes), this reading has generalised features specific to a period as being representative of Anglo-Saxon finance in itself. As a result, these readings have often led to a reconstruction of history that entrenches a conception of financiers as being inherently driven towards speculation. In this section, my aim is to challenge the assumption that the British economy bred speculation and that this form of finance was a product of the non-interventionist role of the English state, as often assumed by scholars such as Gerschenkron. In doing so, I wish to demarcate the British case from the American one as a means to better appreciate some of the profound transformation which came to distinguish American finance. This distinction will help set

up more clearly the focus on institutional features of US finance in order to understand how it produced a very different form of speculative accumulation.

The classic image of English finance can be said to be marked by the assumption that this society came closest to the idea of a *laissez faire* economy (Capie et al. 1994: 51). In that sense, England is often taken to represent a purer, or at least classic, form of capitalism with little state intervention. English society would thus have been subjected to market imperatives more than any other society, thus allowing us to examine concretely the effects of market economies when left more or less to themselves. Even in the institutionalist literature where there is a greater emphasis on institutions, there is a tendency to see British institutions as creating open conditions in which financiers were free to pursue their 'normal' inclination and invest in more speculative ventures. This literature assumes that the adoption of monetary institutions secured propitious conditions for financial speculation, most notably an anti-inflationist policy and a focus on stable monetary conditions to protect financial investments. The institutions in place, most notably the gold standard, are thus said to have reflected the interests of financiers. The result is then the same as presenting England as a liberal, deregulated economy since the relation between institutions and financiers is perceived in terms of freedom. Here, institutions are only conceived as preconditions to allow financiers to operate. This type of reading is best represented in the work of Alexander Gerschenkron but can be found in a wide array of literature (Cain & Hopkins 2001; Elbaum & Lazonick 1986; Rubinstein 1993), reinforcing the idea that liberal capitalism and speculation tend to go hand-in-hand. In other words, speculation would have evolved in England precisely because the state never disciplined finance. If anything it was in fact the lack of intervention which was decisive for the development of finance. As a result, there would have been a considerable divide between bankers and manufacturers as the former played little role in industrialisation (Ingham 1984).

In previous work I have argued that this view of liberal governance and English finance suffers from two fundamental problems (Knafo 2008a). The first point is that the state did not simply establish preconditions for financial development, but shaped the nature of financial practices. Interestingly, until the late nineteenth century, financial and monetary regulations were often opposed by financial interests. For this reason, the role of the state cannot be said to have been benign, as often implied. When looking at the historical record, one sees in fact that this intervention created considerable constraints for merchants and financiers.

The most important fact is that it made it impossible for financiers to adopt the practices dominant on the continent in the early modern era. As I mentioned, continental practices remained mostly based on currency exchange because they were tied to commercial networks of European trade. Such practices, however, were blocked by the English state because they were seen as undermining the value of the currency. As a result, specialised financiers emerged very late in England. As late as the mid-seventeenth century, England was still without significant financial intermediaries despite being tightly woven into commercial networks of Western Europe. Only with the development of new financial techniques no longer reliant on currency exchange did specialised financial intermediaries finally emerge. The key here, as many have noted, was the development of banknote issuing and the rise of issuing banks (Ingham 2004). The most famous, of course, would be the Bank of England.

Hence, the notion that the regulatory institutions adopted in England were characteristic of an advanced capitalist economy seeking to secure the interests of financial capitalists is a profoundly a-historical one. As I point out, most of the features regarding

financial governance that we ascribe to Anglo-Saxon countries, such as their focus on fighting inflation, and more generally their emphasis on sound money, long predate the advent of capitalism. As various historians have pointed out, already in the late Middle Ages (Munro 1992; Ormrod 1999), if not earlier, England was distinctive in Western Europe for its striking monetary stability. In previous work, I have used this fact to argue that the association often made between monetary stability and financial interests reflects in fact the way in which these policies forced financiers to adapt to new conditions, leading to financial innovations which became characteristic of British finance. In this way, the link between financiers and sound money, and more specifically the gold standard, ran in the opposite direction as generally assumed. It was financiers who adapted to this regulatory framework, not the opposite (Knafo 2008a). It is only after having adapted to this new context that modern financial practices came to be seen as symbiotically linked to the framework of the gold standard. But historically, the stable monetary framework adopted in England represented an important obstacle for financiers and merchants as it closed off traditional strategies based on currency exchange.

The second point is that this development of English finance cannot be characterised as being driven by speculative interests, at least until the mid-nineteenth century. This is not to say that speculation was absent. The development of the stock market in England partly attests to the existence in the City of significant speculative, or at least rentier, activities. Yet the striking developments of English finance in the late eighteenth and early twentieth centuries had more to do with the rapid emergence of country banking in the provinces. This course was directly tied to the Industrial Revolution. Indeed, the widespread adoption of issue banking during that period was motivated by the rapidly growing monetary needs. As industrialists sought means of payment for their raw materials and for wages, they set up issuing banks in the provinces. Locally rooted and often connected to manufacturers or merchants, these banks served mostly a monetary function as they provided much needed means of payment to sustain the rapid process of monetisation that accompanied the industrial revolution (Presnell 1956). Hence, the development of the financial system in Britain can hardly be characterised by the supposed rift between manufacturers and financiers. Even if some sectors of the City remained aloof from industrialisation, the development of country banks and the rapid rise of discounts houses in London (which helped to transfer money to the capital and to provide liquidity in times of difficulties) attest to the important connections that linked the financial system to industrialisation.

This distinctive development of English finance led to a striking divide between English banking and continental banking, or more specifically continental merchant banking. The latter, often international in scope and based on various family outlets tightly connected in order to benefit from opportunities of arbitrage, was mostly based on premodern speculation. Because their profits depended on currency exchange pursued through a wide range of practices, their activities were more speculative as they relied on a savant exploitation of currency fluctuations. By contrast, English banking was characterised by small banks with few or no branches and their activities remained very limited in scope (*ibid.*). Based on practices of issuing banknotes on the basis of discounting, which involved holding on to financial assets for a period of up to three months, British financiers were poorly equipped to deal with fluctuating currencies which could rapidly deteriorate their assets structure. Partly for this reason, they failed to project themselves on the European scene. Hence, it is no coincidence if most of the famous merchant banking family which dominated the City in the nineteenth century came from the continent, or at least learned their trade on the

continent (Chapman 1984; Wechsberg 1968). Many of them moved to England in the late eighteenth and nineteenth centuries to exploit a niche left vacant precisely by a new form of finance which was poorly equipped to exploit these opportunities.

It is for this very reason that the rise of speculation in Britain, especially in the late nineteenth century, remained very close to its premodern European roots and was focused mostly on various forms of arbitrage. Ingham has highlighted the essentially commercial nature of this speculation, one which relied precisely on more traditional forms of arbitrages (Ingham 1984). Hence, London may have been an important centre of operations for financiers, but the practices of these financiers remained much more tied to premodern forms of speculation imported in Britain rather than being endogenously developed.

American Finance and Speculation

As I will argue in this last section, the case of American finance illustrates again that the association of speculation with liberalisation is misleading and too often leads to an asocial explanation that relies on psychology, or more specifically confidence, to account for complex social and institutional processes. Doing so flattens out a complex diversity of speculative practices. It frames speculation as something that is irrational and which, since it takes place in an institutional vacuum, seems to follow a same logic across time. Emphasising the role of institutions and discourses, I will argue that the rise of American finance marked a profound departure from premodern speculation by its ability to sustain speculative bubbles on a radically new scale. In this process, the relationship of the financial establishment to these bubbles has evolved and transformed the nature of regulation. Indeed, regulating authorities have come to tailor institutions and regulations to the requirements of sustaining these bubbles rather than stemming them, even when the discourse has been apparently opposed to speculation.⁹ The reason for this is precisely that this financial speculation is not a malignant outgrowth of poorly regulated sectors which could be shut down through regulation. On the contrary, speculation has become deeply embedded within the institutional fabric of this economy with the result that attempts by regulating agencies to stabilise economic activity are contributing to the consolidation of this modern form of speculation.

The work of Martijn Konings is of great use here to show that the incredible development of speculative finance in the US did not stem from the so called 'liberal' nature of US finance as it is too often assumed, but rather its gradual institutionalisation (Konings 2008). Against the assumptions that pervade discussions of 'Anglo-Saxon' finance, he has demonstrated that American finance was very politicised and as a result highly regulated. There was indeed a long history of populist attacks against the financial establishment, which were directed at financial institutions seen to be channelling savings away from peripheral regions. These social forces opposed to the financial establishment were responsible for regulations adopted to counter the growing influence of north-eastern banks, and especially the gravity pull of New York. This led notably to various measures to block the concentration of financial resources and their direct use for investing on the stock market.

The result of such regulations was a highly fragmented and institutionalised financial sector which made it difficult for financial institutions to access financial resources (Konings 2006: 153). This explains why so many of the financial innovations in the US were aimed at facilitating the access to new funds. It was this very process, Konings argues, which

made securitisation such a characteristic feature of American finance. As banks and other financial institutions became mainly concerned with gaining access to funds that were initially put out of reach by financial regulations, they became adept at employing other channels, such as going directly on the market to find funds rather than depend on deposits as it was the case in Europe.

This was aggravated by a second consequence of regulation: the inability to develop a proper discount market where financial institutions could get liquidity in times of financial difficulties (Konings 2006). Forced to keep significant resources to protect themselves from problems of liquidity, but reluctant to keep these funds idle, banks were attracted to the call loans market which developed in New York. Through this market, funds could be lent on call for short periods of time and for significant interest rates. The funds were then used to fuel the stock market. Hence it was the very adoption of regulations to limit concentration and speculation which would prompt innovations on these two fronts (i.e. securitisation and speculation on asset prices) and forced American institutions to develop highly flexible strategies. As an unintended effect, it would thus become a crucial linchpin for the development of a new speculative nexus.

It is in this broad context that a crucial nexus took shape at the heart of the financial system as financial institutions became increasingly tied to the speculative activities in New York. More generally, I argue, that modern forms of speculation took shape through new institutions, mainly predicated on three types of innovations, which made it possible to generate and sustain a process of controlled inflation. The first set of innovations involved the leverage that financial institutions built by involving an ever-growing amount of people on financial markets. What Leonard Seabrooke (2001) refers to as the socialisation of high finance, especially since the 1920s, was a key component of this development. Speculation which had traditionally been perceived and protected as an exclusive realm for an elite was now widely expanded as financial institutions encouraged a wide array of people to hold stocks in various ways. Through various marketing schemes and new financial instruments, financial firms sought to include growing numbers of people on the stock market (Aitken 2007). In the 1920s, the amount of stock holders jumped from between 500,000 to 2 million holders before the First World War to about 10–20 million in 1929 (Geisst 1990: 4). This widespread involvement resulted in a sizable growth in the quantity of new monetary resources injected into the financial system by outsiders which contributed to the inflation of speculative assets. This has been brought since to a new level with the growth of mutual and pension funds, especially since the 1980s, through which colossal sums of money are pooled and injected on various speculative markets (Blackburn 2002; Harmes 1998). In all these cases, the issue was not so much one of access defined in terms of ‘openness’ (i.e. liberal features). In a way, access to the New York Stock Exchange (NYSE) was more restricted than for other stock markets in the nineteenth century as it remained the purview of an exclusive club (Neal & Davis 2005). It was again various institutional innovations which enabled financial agents outside the stock market to accumulate funds and redirect these funds towards the stock market so that the wealth of outsiders would come to bear on the activities of ‘insiders’.

A second form of practice which reached a high level of sophistication in the US was the coordination of investments through various means in order to maximise the inflation of specific assets. Having a lot of capital flooding the market is no guarantee that speculation can flourish. Without organisation, the leverage of this injection of new capital can be nullified in a disorganised market as investments go in different directions. Hence, another

key feature of US finance is its ability to coordinate investments in order to accentuate the leverage of capital. By concentrating on fewer assets, one could increase the leverage of capital. Hence, in 1893, for example, 14 per cent of the stocks listed on the NYSE accounted for 84 per cent of total stock sales that year (Michie 1987: 232), thus increasing the inflationary leverage of speculators. With time, the financial system became increasingly adept at channelling resources towards specific assets, as a whole series of institutions were put into place to steer investments. Innovations such as technical analysis or bond rating agencies have been crucial for this purpose.¹⁰

Interestingly, these institutions and norms are often accused of bringing irrationality and herd behaviour to the market. From this perspective, these institutions incite financiers to operate in a way that takes economic fundamentals less and less into account. But as technical analysis or the rise of rating agencies is being berated for creating irrational swings on the market, analysts are missing what these institutions are actually producing. Hence, while one can certainly challenge the claims by institutions such as Moody's to be informing us about the true value of specific assets, it is arguable that their purpose has little to do with their official justifications. Rather, the development of bond rating agencies provided key signals around which investors can rally (Sinclair 1994). Similarly, the generalisation of technical analysis led to a wide array of investors adopting similar models of financial analysis based on market trends. This provided a powerful speculative tool to gear strategies according to fluctuations in prices. More importantly, it served a key role in coordinating investments by socialising common templates that helped consolidate expectations.

Finally, a third component of this speculative framework has been the development of various financial instruments which have given great leverage to financial institutions. This has been done, notably, through a process of debt creation which has helped to dramatically expand the money supply and sustain speculation. Perhaps, the most defining feature of US finance has been the practice of securitisation which helped financial actors to pass on their liabilities in order to generate new resources for further transactions. By generating debt irrespectively from the levels of savings, new monetary resources were generated at a high pace, thus fuelling the inflation of specific assets. Combined with the other two types of innovations, securitisation provided a key institutional foundation for the development of speculation and its increasing centrality in the American economy (Krippner 2005).

These remarks offer a first attempt to articulate a political economy of speculation based on institutions and the social struggles that crystallise around them; by this I mean an approach to speculation as an object of study in its own right with its own distinctive imperatives. Previous accounts, I argued, often conflate various parameters of the question within a quasi-normative reading aimed at showing the unsustainable nature of speculative runs. In such cases, the analysis is limited to the ways in which these institutions derail the economy (their biases), instead of examining what they actually produce. In doing so, the literature never assesses speculation on its own terms and too often conflates the institutions that regulate its growth (enabling speculation) with the cause of its demise. This conflation of two distinct even if related issues (the construction of speculation in the US and the crises to which it gives rise) blurs the analytical parameters of the problem. Hence, what is seen too often as a cause of dysfunctionality and crisis is in fact a condition of sustainability for speculation and must be understood as such. Those who miss this important point are otherwise caught with the problem of explaining why these institutions would be adopted in the first place and why the very institutions which make a practice sustainable become

dysfunctional beyond a certain point. Having insisted on unsustainability, they are left to look at the psychology of the actors involved in order to account for these incomprehensible shifts.

This in turn raises important considerations regarding the new constraints regulators are now facing as they adjust their target. Working within the assumptions of premodern speculation which saw regulators meet financial crises with regulations aimed at hindering future speculative bubbles, analysts are poorly equipped to grasp the ramifications of the current crisis. We literally have no historical precedent that is adequate to build expectations of the future. Starting from a conception of speculation as simply dysfunctional, we interpret the challenge for regulators as being simply a matter of eradicating speculation. However, if speculation is increasingly integrated and central to the nature of capital accumulation, regulators may very well be caught having to consolidate the networks of speculation rather than eradicating them. Arguably, the famous turnaround of Alan Greenspan in the late 1990s, when he moved away from his initial condemnation of the irrational exuberance of finance, represents an example of the realisation of the growing importance of this speculative motor. While the extent of this change remains an open issue, we must bear in mind that governments may be increasingly forced to devise regulatory resources to consolidate speculative practices. The extent of the support given by government to financial institutions in the current crisis illustrates the growing entanglement of this speculative apparatus with the so called 'real economy'. Not only has the wealth effect, most notably associated with the housing bubble, served to bolster consumer demand (Brenner 2004), it has also been a growing engine for non financial firms who have devoted growing amount of efforts to financial strategies (Duménil & Lévy 2004; Krippner 2005). For this reason, the current crisis of finance may very well serve to solidify a financial configuration that is increasingly fuelled by speculative bubbles, rather than the opposite as it is often assumed.

Conclusion

I have argued in this paper that the association of liberalism and speculation has contributed to the construction of a largely a-social perspective on speculation. Without a proper conception of the institutional foundations of such practices, speculation too often appears as an irrational development which remains mostly peripheral to the development of capitalism. Whilst it can affect negatively the development of capitalism, it seems to have little lasting effects on the transformation of capitalist accumulation.

In proposing a distinct political economy of speculation, this paper puts forth a historicist conception of speculation which can serve as a foundation for understanding speculative dynamics on their own terms. More importantly, the aim is to develop conceptual resources in order to historicise speculation as a set of practices which take different forms depending on their social and institutional context. As a first step, the distinction between premodern and modern speculation offers a first stepping stone towards a political economy of speculation.

It is on this basis that I criticised the usual association of Anglo-Saxon countries with speculation. I argued that English financial speculation came closer in the nineteenth century to continental practices of speculation. Furthermore, this led me to stress the radical novelty of American finance and its highly institutionalised financial system which have

enabled a relatively robust and generalised form of speculation. Not only does this prospect raise important questions regarding the future of capitalism, it also prompts us to reconsider issues of regulations. Indeed, on the basis of this association of speculation and economic liberalism, people often oversimplify the challenge of disciplining finance. If speculative practices emerge in liberal settings when finance is freed from regulatory constraints, then policing finance is simply a matter of regulating it. This simplistic opposition completely fails to account for a historical record that shows financial development emerging from highly politicised environments where numerous regulations were imposed. This is not a coincidence. Regulation has been in fact a crucial linchpin of the specific form of accumulation which has come to crystallise around Wall Street. It is because financiers were forced to change their practices that they innovated. Hence, the issue of regulating finance is more complex than often portrayed. At a time when public finance is rapidly becoming entwined in this very model of development, we should be careful not to assume too readily that the current crisis is marking the end of an era of financialisation (Konings & Panitch 2008).

Acknowledgements

I would like to thank Andreas Antoniadis, Kevin Gray, Martijn Konings, Johnna Montgomerie, Duncan Wigan, Dinah Rajak, and three anonymous reviewers for their comments and helpful suggestions.

Notes

- 1 In criticising this association, my goal is not to deny various trends of liberalisation which have taken place in these countries. Liberalisation has indeed opened up access to various markets and made it possible for financiers to create new forms of financial instruments. However, this freedom is not a constitutive feature of their activities. To take advantage of these opportunities, they still need institutional structures on which they can base their operations. For this reason, I argue that liberalisation in itself is not useful as a defining feature unless it is related to underpinning institutional structures. Many would agree with this point, but unfortunately too often use liberalisation as a short hand to account for processes that have no significance in abstraction from their institutional context. When time comes to characterise financial developments, we must always turn to institutions (Konings 2008).
- 2 It is interesting in that respect to examine the wide range of institutionalists who work on Anglo-Saxon capitalism and finance. There, one can find a significant account of the role of institutions in shaping finance. However, the analysis of these institutions tends to emphasise their dysfunctional role in producing market exuberance and irrational herd behaviour, rather than properly account for the way it constructs speculative practices.
- 3 The emphasis on psychology often stems from the emphasis on the uncertainty of financial markets. From this perspective, uncertainty would lead to wild swings in the moods of investors as everything becomes exaggerated because of the lack of clear boundaries or fundamentals to direct financiers. However, this view, indebted to Keynes and reappropriated by Minsky, leaves key aspects of speculative dynamics in the dark by casting them as subjective dynamics which would thus be outside the purview of a social and institutional approach.
- 4 Financial historians too often seek in these bubbles elements to understand the present crisis on the basis that there would be a common logic to most of them. It is this assumption that stands behind the work of the main scholars in the field such as Kindleberger (2000) and Neal (1990).

- However, it is argued here that, on the contrary, we can learn about the specificity of current developments by understanding how they differ from one another.
- 5 Although I label these practices as premodern forms of speculation because of the long lineage of these practices, it must be said that this type of practices remains an important component of contemporary finance. It is most notably represented by the activities of some hedge funds. More fundamentally, it will be argued, the rise of modern speculation has profoundly changed the basis on which much of this arbitrage is conducted.
 - 6 Iain Hardie points out that all forms of financial activities are ultimately based on arbitrage. For him the distinction between noise traders and arbitrageurs does not hold because the performance of all investors is ultimately dependent on the actions of others (2004: 240). This point is true to an extent but misses an important nuance that is important to the argument here. In the case of premodern speculation, the ability to make profits was not mainly based on others having to invest in the same direction. On the contrary, having financiers following on the same path closed opportunities of arbitrage by eliminating discrepancies among discrete markets.
 - 7 I use the term ‘bubble’ here in a loose sense to refer to financial dynamics which are driven by the inflation of financial assets. Whether this inflation is deemed to be rational or not is of secondary importance because my objective is more strictly to study the social and institutional structures that generate such trends.
 - 8 My discussion here is limited to financial developments in England which were somewhat distinct from financial developments in Scotland and Wales. Monetary and financial regulations were different for each of these regions, thus explaining the need for clearly delineating the scope of the argument.
 - 9 Interestingly, the growing popularisation of finance has somewhat inverted the classical theme of financial responsibility, with the crises being increasingly pegged on the financial elites and their manipulations rather than the irrationality of the masses. In the US, the question of regulation is played out increasingly in terms of transparency rather than restrictions (Krippner 2007).
 - 10 They have also, in turn, put a high premium on the ability of financial actors to gage the market. The development of strategies for pre-emptive imitation (Hardi, 2004) have thus become key to strategies of arbitrage under modern speculation by contrast to older techniques of arbitrage.

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