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# Financialization of Values – An Institutional Anatomy of the Financial Crisis

## INTRODUCTION

Whether we like or not, we all live in the world of finance. It has taken over the markets, governments, the news and our lifestyles as the truth is: we all depend on it. Yet the crisis that rolled over the global economy like a tsunami beginning in the USA demonstrated that in the midst of the debates on its possible causes we have to arrive at a distressing conclusion that at its essence the crisis is primarily of values. Moreover, it demonstrated that institutions matter more. They shape patterns of behavior and set awards and punishment for those who follow the patterns or fail to do so. Above all, the economic downturn proved over and over again that all economic has to have a sound ethical and moral rooting.

## CLEARING THE GROUND

The notion of *institutions* has been widely recognized in the social sciences for a long time. Its earliest known use dates back to as early as the 18th century [Hodgson, 2006, p. 1]. With reference to economics, the term has made way to the foreground of economic theory in the beginning of the 20th century. Works by Thorstein Veblen, John R. Commons and Wesley Mitchell attracted attention to the idea of institutions and their role in shaping the economic outcomes. One of the most fundamental propositions was that the collective behavior of society is not a mere summation of the behavior of all its constituent members. Although there is no consensus about the precise definition of institutions, they came to be regarded as *the constraints that human beings imposed on human interaction* [North, 1993, p.1], or more precisely *an array of social conventions,*

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*rules, and norms affects the ways in which we act in our everyday lives* [Knight, 1992, p. 1] or else *a set of rules, compliance procedures, and moral and ethical behavioral norms designed to constrain the behavior of individuals* [North, 1981, p.201–202]. In a social context institutions are also understood as *a regularity in social behavior that is agreed to by all members of society, specifies behavior in recurrent situations, and is either self-policed or policed by some external authority* [Schotter, 1981, p. 11]. In a nutshell one could regard institutions as regularities or kinds of social (not individual) human behavior that are spontaneous and not passive elements of historical, political and physical background [Angandoña, 1991,p. 2]. Institutions are approved of by society, inasmuch as all or at least a majority of society support and share them. Following the restrictions to or denotation of behavior they impose, a regular and predictable pattern of conduct/behavior is established. In this way, institutions provide a valuable information about other people's (agents') anticipated behavior. Institutions are auto-policed, socially policed or policed by an external authority [*ibid*., p. 2–3]. The most prevalent institution is the State with its legal and economic system, yet others, including formal and informal ones, like organizations (e.g. companies), language, money, culture, values, family values, traditions and customs shape people's behavior, too. The rise of institutions on the socio-economic agenda has helped to lower transaction costs and dynamize contracts. By regulating the means people communicate, and enter/sustain relationships, and are able to interpret data on others' behavior, institutions help identify persons that might otherwise be not credible enough and thus more risky to enter into relations with. All in all, institutions help to establish a more friendly and predictable environment and increases people's trust in the surrounding.

There is no a universal pattern of institutions. Specific countries have developed various institutional designs which affect their economic systems with various degree of efficiency. Yet, some features of these designs are common and they tend to play a role to greater or smaller extent in different societies and economic systems they belong to [Williamson, 1985, p. 388]. It is an institutional matrix that provides for a model of such an institution-building process.

## INSTITUTIONS ON THE MOVE

As the challenges of times change, institutions tend to remain stable; yet, it does not imply that they do not change. Actually, the analysis of changes in institutions sheds light on the role of the values in the process of institutional change. There are three main causes of institutional change [Angandoña, 1991, p. 4]:

– *changes external to the agents*: the issue of great relevance is that as external factors change (e.g. population growth/decline, the endowment of resources, the market size, etc.), culture and its set of relevant values are believed to en-

force the institution best suited to the society interests. However, there is no guarantee that the optimal institution will be identified, neither the institution will win the approval of the majority nor the process will be undisturbed and costless;
– *policy(authority)-induced changes*;
– *value-induced changes* as well as changes in attitudes: the outcomes need to be evaluated in terms of their ethical impact as there is no guarantee that such changes produce a socially acceptable situation in moral terms.

In none of the above cases, institutional change warrants efficient economic outcomes nor pursuance of values cherished by society (ethics) [Angandoña, 1991, p. 5–6]. Institutional change becomes even more problematical as institutional arrangement—though subject to constant adjustment to new conditions–is always strongly related to the past [Hodgson, 2009, p. 9–10]. A revolutionary, dramatic change of the system is not feasible, yet some elements of the system may be displaced relatively promptly; others take hundreds of years to change [Williamson, 2000, p. 597]. The problem of change, continuity and integrity of institutions and particularly institutional balance is of vital importance for successful socio-economic development [Wilkin, 2007, p. 41]. Informal institutions are these elements of the system which require a lot of time to evolve. In this case the process is slow as they necessitate a change of worldview. Evolution of informal rules is gradual, unplanned, chaotic and subconscious. The process takes place before individuals are able to realize the extent of the advantages yielded by the change [Ahrens, Jünemann, 2007, p. 4]. In this sense, the above considerations will provide a theoretical framework for further analysis of the ethical causes of the financial crisis.

## A TWIST OF STATE, ECONOMY AND VALUES

One of the most fundamental institutions, including the economic sphere, is State. It is a unique institution, which serves the interest of the whole community otherwise regarded as a nation living under a single system of government. It imposes the most formal rules, norms and constraints that regulate human behavior. The State takes the responsibility to provide all the public goods such as education, health care, infrastructure, social security. However, the most overriding function of the State is to provide for formal rules of the land by writing laws, enforcing contracts and property rights. This legislative function is a supra-economic function. In this way, the State establishes rules of economic competition applying to all market entities, consumers, and the government itself. Hence, the State constitutes laws and regulations which altogether determine a framework for the functioning of the economy.

Legislative responsibility of government is not an element of the economic game itself but serves much wider purposes; namely, it reflects a socially accepted system of values. This informal, contrary to the political and economic institutions, set of beliefs and norms are deeply instilled in the identity of a given nation. The values communicate dominant in a given society system of rules and norms of social behavior. The features of the system characteristic for the Anglo-Saxon countries focus and promote [Inglehart, Welzel, p. 2005]:
– *individualism* (at the expense of *collectivism*) as the major force behind human activity, i.e. selfish pursuit of own interest is the primary motivation of economic activity and contributes to the *spirit of capitalism*;
– *freedom* (at the expense of *order*) as the foundation of market economy for it provides for unbounded business opportunities;
– *self-expression* (at the expense of *conservatism*) which entails activity, dynamism and openness to changes;
– *stratification* (at the cost of *equality*) when people accept social diversification as a result of their benefit-yielding efforts in a competitive system.

All these values are intrinsic in culture and they permeate into other institutions, like a system of laws and regulations, and affect human actions and behavior in order to yield benefits to the members of society. The above identification of values is crucial for realization of the fact that they all affect human actions in the economic sphere and the institution of the State itself.

Overemphasis on individualism, neglecting the social aspects of business wealth accumulation and failure to place a human being in the very centre of the process of production are among the main underlying causes of the crisis that sparked in 2007. This adverse reliance on individualism brought *financialization* of institutions of the State, economy, society and its values since it lifted virtually all constraints on what can be traded – after all, everything can become a subject of trade [Kołodko, 2010, p. 89]. The idea of *financialization* mentioned above is frequently referred to as one of the key processes that brought the collapse of the world economy in the beginning of the 21$^{st}$ century. The term has been used by several authors [*inter alia* Arrighi, 1994; Phillips, 2002; Krippner, 2005; and Dembinski, Beretta, 2014] yet they were the latter two that presented a more detailed evidence for the phenomenon. Financialization is defined as *a pattern of accumulation in which profits accrue primarily through financial channels rather than trade and commodity production* … and … *financial refers to activities relating to the provision (or transfer) of liquid capital in expectation of future interest, dividends or capital gains* [Krippner, *ibid.*].

Financialization was a gradual process that had taken decades prior to the crisis and brought a significant change to the structure of the economy. As Figure 1 presents data on relative industry shares of corporate profits between 1950 and 2001 for manufacturing, FIRE (finance, insurance and real estate) and ser-

vices. We can observe a dramatic decline of manufacturing and the rise to the dominant position in the economy of FIRE with services accounting for a relatively small share of total profits [Krippner, *ibid.*].. It makes an evidence of a profound shift in the economy and its financialization.

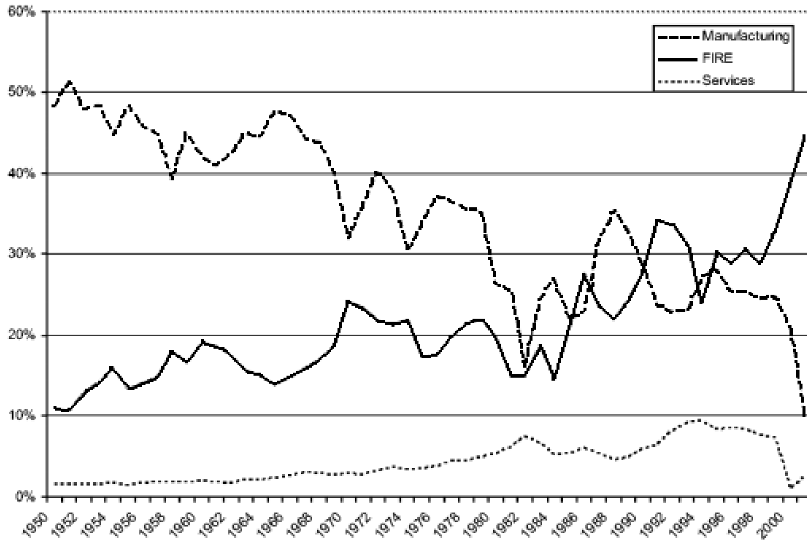


**Figure 1. Relative industry shares of corporate profits in US economy, 1950–2001**

Source: [Krippner, 2005, p. 179].

The process of financialization has subdued the State to the logic of market financial operations. The main ideological tool which advocated for the change was neoliberalism. The doctrine made the State the public enemy and demanded a "minimal" role of the State in controlling the economy, in absolute disregard to the fact that it is the State which is the only, apart from the market, fundamental supra-institution of the economy today [Kołodko, 2010, p. 89]. A good representation of the situation is the data that reveals the degree to which today's State is surpassed by the size of major corporations as the major actors in the financial sector of the economy. As much as 11 per cent of the world's total GDP (in US dollars) is yielded by the 800 largest global corporations, and this equals approximately as much as total GDP of the 144 least developed countries altogether [Dembinski, Beretta, 2014, p. 46–48]. Other data provided by the United Nations Conference on Trade and Development (UNCTAD) shows that nearly 80 per cent of total direct foreign investment and international trade is related to a small group of global financial actors [*ibid.*]. Yet the most striking evidence concerns the data on capitalization of financial stock value. In 2000 the market value of the 800 corporations (including their market shares) was capitalized at

the level of nearly 60 per cent of the global value of shares listed in all the stock market exchanges in the world. That means that two of every three dollars in the stock markets belong to the 800 corporations which affect roughly over half of the world's GDP [*ibid.*]. In this sense, the level of control of the corporations of the State both in the national and global dimensions is profound.

In fact, only market-State synergy can ensure a long-term economic development. For the sake of it, the State is required to intervene into markets not only to stabilize them but also to improve the quality of institutions which are the intrinsic parts of it the economy. However, the idea is far from neoliberalism as it necessitates adherence to the socially accepted values which are absent in the doctrine [*ibid.*]. As Kołodko [2013, p. 164] emphasizes *economy without values is like life without meaning* [translation mine].

## MONEY V. VALUES

The drive towards increased efficiency and maximization of profit has brought a significant change to the perception of money and its relationships with human values – another adverse change at the advent of the crisis and in the years following it. The money has risen to a status of a value on its own and become institutionalized. Simmel [2006, p. 51] aptly commented on the situation stating that that money gets in between people, between a man and a good to serve a role of a middleman which reduces all values to a common denominator to enable successive exchange into another value. Ever since the establishment of the market (money) economy, we no longer get in touch with the objects of economic exchange directly; our interest is first attracted by the medium of money; *homo oeconomicus* considers their value not in terms of our own values but in terms of this intermediary stage, just as if it was the goal of our actions. However, the values that we really care for slip away unnoticed. The contradiction is that only the values we pursue can bring us fulfillment [*ibid.*]

## TRANSACTIONS V. RELATIONSHIPS

In the world of the overwhelming trend to increased efficiency, all relationships have been replaced by administrative or market transactions. The roots of this trend were noticed however several decades prior to the 2007 crisis. Following Polanyi's [1944] idea of embeddedness of economy in society and subordinating it to religion, politics and social relations, he observed that human relationships suffered as a result of the Industrial Revolution and market economy. The new circumstances reversed the historically normal pattern of subordinating the economy to society; instead the laissez-faire system of self-regulating mar-

kets necessitated subordinating society to the logic of the market. The control of the economic system by the market is of overwhelming consequence to the whole organization of society: it means no less than the running of society as an adjunct to the market. Instead of economy being embedded in social relations, social relations are embedded in the economic system [*ibid*., p. 60]. Excessive reliance on free market and price mechanism undermined social ties, endangered civilizational development, atomized societies and left people virtually defenseless in the face of lack of guidance from governments and cultural institutions. The fact that the system of self-regulating markets destroyed social relationships and subordinated society to the logic of the market produced a series of cataclysms like the two World Wars, the Great Depression, and the rise of fascism. We could also add, and contributed to the economic crisis.

The same idea of the breach of relationship and substituting them with transactions in the markets is relevant since transactions are war-like anonymous and depersonalized whereas relationships are bonds of cooperation. The latter can be established and/or survive if the actors can understand each other. This implies that most relationships are dynamic which makes them the opposite of self-sufficient and static transactions. Relationships by definition reflect imbalance whereas transactions arise on the grounds of equal exchange. The real problem is that is transactions are merely tools while relationships call for personal involvement and carry a moral value, either positive or negative. Transactions ideally suited to the idea of immediate efficiency, thus capable of delivering any obtainable good. At the same time relationships are a space of productiveness since they balance the fruits of our past efforts with the seeds of our future results [Dembinski, Beretta, 2014].

## COMPETITION V. COOPERATION

In the view of the decline of institution of personal relationships surpassed by market transactions, there comes its elder brother, the victorious competition, the essence of market economy. Although it is hard to question the logic of cooperation in the market economy, it is worth remembering that it is the very excessive reliance on market-oriented institutions and values that have largely contributed to the financial crisis in the past decade. A number of economists, sociologists and business people [*inter alia* Axelrod, Hamilton 1981; Boaz 2011; Taylor 2015; Soros 1997; Branderburger, Nalebuff 1996; Nowak 2012; Ims, Jakobsen 2010; Deutsch 2011; Tyler 2011; Patchell 1996; Rubin 2014] observe that we could all gain more if we emphasized and focused on the cooperative side of the market to a greater extent. Quite representative in this respect is an observance that market should rather be perceived as a place where competition … *happens as a series of genuinely cooperative decisions, every time*

*a buyer and seller come together in a mutually agreed-upon and voluntarily made transaction* [Taylor, 2015].

The role of cooperation as the essence of society and economy was emphasized early on in the twentieth century. The idea that a human being is primarily a social construct pursuing cooperation, prestige and enhancement of social capital was advocated by Polanyi [1944]. Relationships and cooperation between people are the essence of both society and economy:[..] *man's economy, as a rule, is submerged in his social relationships. He does not act so as to safeguard his individual interest in the possession of material goods; he acts so as to safeguard his social standing, his social claims, his social assets. He values material goods only in so far as they serve this end* [Polanyi, 1944, p. 48].

The idea that cooperation is intrinsically intertwined with competition in the market was advocated by several authors more recently. The mutual relationship of cooperation and competition should be observed as […] *cooperation is as much a part of the system as competition, and the slogan "survival of the fittest" distorts this fact* [Soros, 1997]. Moreover, there is a need for balance between the two as [t]*oo much competition and too little cooperation can cause intolerable inequities and instability* [*ibid.*] The intrinsic mutual reliance between cooperation and competition should rather be seen as complementary. This kind of thinking about competition and cooperation was strongly supported by the seminal book by Brandenburger and Nalebuff [1996] under a tell-telling title *Co-opetition*. The fact that companies establish (or at least hope to) continuing and lasting relationships and communication with their customers (they benefit when customers provide them with truthful feedback on their goods and services) and their suppliers and help them implement innovative solutions proves that competition cannot do without a great deal of cooperation.

## CONCLUSION

The institutional change that took place in the values underlying the global economic system brought enormous distress to global markets and societies. Both the data and the analyses demonstrated by numerous authors show that people's perception of values has changed indeed. The drive towards profit maximization and increase in efficiency strengthened by a range of inherent in the Anglo-Saxon societies market conducive values like individualism, freedom, self-expression, stratification society severely undermined the values they societies cherished in the past. The change is possible yet we have to set the priorities and reassess what values should give momentum to our personal lives, societies and economy. A solution is return to the fundamental values like, e.g. good relationships, cooperation, honesty, integrity, family [Dembinski, Beretta, 2014]. The change is possible if responsible and daring political decisions will be made:

politics can change a culture and save it from itself [Harrison, 2006]. The problem is not a lack of awareness or knowledge to introduce the change but actually our own willingness to attempt for it. We know the ways and means. The real challenge is to step forward. A leap of faith?

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*Summary*

The aim of the paper is to present the idea that values inherently affect economic outcomes, and hence can be considered a powerful economic institution. The change of values consequently imposes a shift in economic institutions. The testing ground for examination of the above thesis is the economic downturn which began in the USA in 2007 and spilled all over the global markets. Commencing with reference to authors defining institution and their role in economy and society, the article goes on to present how values were capable of bringing change to the way markets operated by means of several mechanisms of institutional change, Financialization, understood as removing all norms and constraints on what can be traded, of the world values and consequently

economic (market) and political institutions (the State) was the key process that linked all these elements and adversely affected the global community. The cited instances of the decline of values that followed suit were the rise of the role of money (at the cost of values), decline of human relationships (at the expense of transactions), and disregard for cooperation (taken over by competition) as a vital element of the economic institutions.

*Keywords*: values, institutions, change, crisis, economy

## Finansjalizacja wartości – analiza instytucjonalna kryzysu finansowego

*Streszczenie*

Celem artykułu jest prezentacja poglądu, że wartości trwale wpływają na efekty działań w sferze gospodarczej, a w związku z tym mogą być uznane za istotną instytucję ekonomiczną. Zmiana wartości w rezultacie wymusza przekształcenia instytucji ekonomicznych. Powyższa teza została poddana weryfikacji w odniesieniu do kryzysu gospodarczego, który rozpoczął się w USA w 2008 roku, by następnie rozprzestrzenić się po całym światowym rynku. Zaczynając od odniesienia się do autorów definiujących instytucje i ich rolę w gospodarce i społeczeństwie, artykuł następnie przedstawia, jak wartości dokonały zmiany w sposobie funkcjonowania rynków za pomocą mechanizmu zmiany instytucjonalnej. Finansjalizacja systemu światowych wartości, rozumiana jako usunięcie jakichkolwiek norm i ograniczeń w kwestii przedmiotu handlu, a w konsekwencji instytucji zarówno ekonomicznych (rynku), jak i politycznych (państwa) legła u podstaw procesu, który połączył ze sobą wszystkie elementy, a następnie negatywnie wpłynął na globalną społeczność. Przykładami upadku wartości, jaki nastąpił w rezultacie były wzrost roli pieniądza (kosztem wartości), upadek relacji międzyludzkich (na korzyść transakcji) oraz lekceważenie roli współpracy (która została podporządkowana konkurencji) jako nieodzownego elementu instytucji ekonomicznych.

*Słowa kluczowe*: wartości, instytucje, zmiana, kryzys, gospodarka

JEL: B25, F01, G01, Z1, Z13, O51