Forum

Finance and Society
2020, 6(1): 87-94

10.2218/finsoc.v6i1.4412

Macro-finance and the financialisation of economic policy

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In his terrific book, *Crashed*, Adam Tooze (2018a) narrates the shock of the 2007-8 financial crisis for policymakers on both sides of the Atlantic Ocean. He shows how a faulty policy framework led them not only to miss the oncoming crisis, but also then repeatedly misdiagnose the nature of the problem they were meant to address. We are still dealing with the profound aftershock of this cognitive dissonance. Since the crisis, central bankers have been experimenting with different ideas aimed at helping them come to terms with a financial system that has radically changed.

Of particular importance is a new set of ideas that come under the heading of 'macro-finance'. The term reflects an ambition to renovate an antiquated macroeconomic policy framework and bring it up to date with an evolving economy that is increasingly shaped by global finance and the dominant transnational banks at its centre. One can read this shift to macro-finance as an attempt to financialise economic policy by moving away from the productivist framework of macroeconomics. In contrast to the latter, macro-finance proposes to feature financial activity more prominently in economic reasoning, policy analysis, and economic modelling (Cochrane, 2017; Pavlova and Rigobon, 2010).

This involves two important changes to the traditional macroeconomic framework. The first is the adoption of a *money view* on finance that focuses on liquidity (Mehrling, 2010). Post-war economics, to the extent that it considered finance, was mainly concerned with the problem of solvency and whether loans would prove profitable or not. By contrast, recent discussions tied to macro-finance focus instead on liquidity. They revolve around the ability of financial agents to monetise their assets and get the money they need when payments are due. As Minsky (1977) highlighted, financial agents usually collapse because of their inability to make payments and meet their liabilities, rather than because they are insolvent. Liquidity should thus be taken as the more pressing issue for financial governance. Analytically, this money view often emphasises balance sheet analysis, which makes it easier to track the production of new monetary claims in highly meditated financial systems with overlapping clearing mechanisms. Politically, it has motivated calls for repurposing the infrastructure of governance to manage liquidity in a more active way, in line with macroprudential policies.

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This emphasis on the 'endogenous' dynamics of finance requires more generally a second adjustment: shifting away from the national units of macroeconomics in favor of a transnational and global perspective on banking.[1] The national emphasis of macroeconomics was a legacy of a distinct form of economic organisation that took shape in the late nineteenth century. Yet the financial system is now dominated by 15-20 big banks that mostly operate at a transnational level. According to those championing macro-finance, the activities of these banks can only be understood with a global perspective on banking that transcends the limitations of national perspectives and their accounting templates.

Reflecting on the broad ambitions of macro-finance, I argue here that the commitment to placing finance at the centre of our economic conceptions comes with significant risks that speak directly to the politics of financialisation. By redirecting the focus of economic governance towards finance, macro-finance may consolidate rather than challenge the problematic trends of global finance. More specifically, I argue that the focus of the money view on liquidity has contributed to depoliticising financial governance and aligning it further with the demands of financialisation. To bring power back into the picture, I propose to frame the analysis more tightly around a *banking view* of finance (rather than a money view), which puts emphasis on the leveraging practices of financial institutions rather than their liquidity constraints.[2] While these two views are not exclusive, I make the case for why it makes a big difference to examine power as a product of leveraging rather than as a product of liquidity through the lens of a hierarchy of money. For it is the new capacities to raise liabilities that is key to the very story that Tooze so powerfully charts, rather than the more general concept of liquidity tied to the dealing of assets (or collateral). In what follows, I reflect on the parameters of macro-finance and the possibility of deriving a critical form of macro-finance by asking three questions meant to probe different aspects of this project.

What is new about financialisation?

The idea of macro-finance rests on the premise that there is something radically new about financialisation which forces us to change our analytical lenses. However, the defining feature of this new policy environment, or social context, remains underconceptualised in the literature on the subject. Part of the challenge is that, for all the in-depth analysis of the plumbing of finance, there are still few conceptual expositions of macro-finance as an approach, and those that do exist remain overly general. Tooze (2018b), for example, invokes general themes when presenting macro-finance that do not capture what is new about financialisation (the endogenous nature of money, the fact that the financial system is profit driven with procyclical tendencies, or that it is backed by state interventions). References to the hierarchy of money or the emphasis on liquidity may offer valid frameworks for analysis (although see below), but they remain evasive about the distinctive features of the current financial system that motivate macro-finance.

It has not helped that the mainstream literature on macro-finance (Shin, 2012) has essentially replayed the globalisation debate of the 1990s (Castells, 2000; Held, 2000; Sholte, 2005). Its critique of the national economy as a unit, its loose references to network analysis, and its emphasis on financial actors evading regulation all represent worn out lines of argumentation. The problem with globalisation theory was that it failed to yield rich social insights into globalisation because its focus on transnational flows made it difficult to keep sight of concrete and specified social contexts. Facing a wide array of practices coming from different parts of the world, with their diverse institutional and cultural settings, one quickly became paralyzed with complexity. With so many things to take into account, where would one

https://doi.org/10.2218/finsoc.v6i1.4412 Published online by Cambridge University Press

start? Hence, the problem was not necessarily that this approach had exaggerated the extent to which economic activity was globalising, but rather that in starting from this standpoint, it could not find a way to contextualise in meaningful ways the practices it sought to analyse (Knafo, 2018). This is why, more often than not, globalisation scholars ended up treating social context in generic ways and were forced to cast globalising trends as various processes of disembedding.

Critical scholars of macro-finance have taken steps to avoid such a fate and help contextualise financial developments (Gabor, 2016). An emphasis on the Americanisation of finance, for example, is a useful specification (see Gabor, 2020). Yet scholars of macro-finance remain wedded to the generic framing of 'market-based' finance (or banking) as a way to capture this distinctive American approach to finance. This term encapsulates a wide array of practices and thus makes it difficult again to contextualise financialisation. While the term market-based finance may 'fit' the evidence, it does little to help us make decisions about what evidence to examine (Beck and Knafo, 2020). Considering that many of the 'market' practices we now associate with financialisation have a longer history (repo lending, securitisation, derivative instruments), then what exactly marks out recent developments in finance? Arguably, the current conceptual tools of macro-finance remain too blunt to navigate this tricky question.

If macro-finance is going to be more than a fashionable label, we need to tighten the analytical lens. Along with Mareike Beck and Sahil Dutta, I have suggested that we turn instead to *liability management* as the distinctive feature of financialisation (Beck and Knafo, 2020; see also Beck, 2019; Dutta, 2019). Building on a banking view of finance that frames the analysis by starting from the practices of banks (i.e. the most important financial actors), we have argued that it was a revolution in funding that took place in the late 1960s which completely transformed how banks leverage their operations. Through liability management, banks have relied extensively on money markets for funds, counting on other financial intermediaries rather than depositors for their funding. Tracking this transformation in the United States (US) and its complex effects, we argue, provides a richer standpoint from which to think about the specific features of this Americanisation of finance, and to specify the social context framing the analysis of financialisation.

Should we be worried about the politics encoded into macro-finance?

The problem of specifying the perspective that critical macro-finance affords us is vital given the political implications of seeking to (rightly) challenge key parameters of macroeconomics. For all the accolades that are justifiably directed at Tooze, it is curious that critical scholars in the field of International Political Economy (IPE) have made so little of Tooze's explicit debt to the economists of the Bank for International Settlements (BIS) and the International Monetary Fund, such as Tobias Adrian, Hyun-Song Shin, Claudio Borio, Piti Disyatat, and Richard McCauley. Should we not be more wary of embracing ideas that spring directly from intellectual networks tied to central banks? While the shift to macro-finance and macroprudential policy are certainly of great interest, there is a real risk in following central bankers that we end up normalising financialisation.

To be fair, IPE scholars have not gone down this path blindly, as reflected in the moniker of 'critical' macro-finance, which highlights how some scholars have been explicit about their desire to keep a distance from mainstream macro-finance (Gabor, 2020; Pape, 2020). In particular, there is a strong critique of attempts to re-legitimate the practices of securitisation and repo funding that figured so prominently in the last crisis (Braun, Gabor, and Hübner,

https://doi.org/10.2218/finsoc.v6i1.4412 Published online by Cambridge University Press

2018). But generally, Tooze and other scholars writing about macro-finance have remained ambiguous about their relationship to the BIS economists. More specifically, there is no critical discussion of mainstream macro-finance scholars that I can think of which spells out these differences.

One of the particular outcomes of this silence is that there is considerable ambiguity over whether macro-finance refers to changes in governance or to a new analytical lens for analysing these changes. Is it an *object* of analysis or a *framework* for this analysis? The difference is important. As an object, or something we analyse, macro-finance represents a new project of governance pushed by central bankers and economists attached to central banks, notably through the BIS. As a framework, it represents a critical reflection on these transformations; a lens through which we can interpret them. While there is certainly much to learn from the excellent work of researchers such as Adrian, Shin, McCauley, or Borio, a critical macro-finance is only possible if we clearly take analytical distance from the former.

What does this mean concretely? I want to highlight two different aspects of macro-finance borrowed from the mainstream that have problematic implications for a critical perspective. The first is the priority that macro-finance has given to financial crises; a by-product of its interest in the way assets lose liquidity in difficult times. What was once used to challenge the promotion of financial markets has now been turned into a justification for greater support of these same markets. With the macroprudential turn, the policy establishment has essentially normalised crisis as a recurrent aspect of the economy that needs to be managed. As a result, analyses of crisis now provide justifications for lubricating the workings of finance, rather than challenge what is being done through this financing. We know from experience that new institutional buffers which consolidate the financial system often make it easier for financiers to take even more risk, as reflected in the seemingly unavoidable problem of moral hazard (Vielma et al., 2019). By framing the analysis *first and foremost* as an attempt to avoid or manage crises, we thus risk playing into the hands of the financial and political establishment.

The second aspect I want to highlight is the emphasis of the money view on liquidity. As I mentioned, the work to re-centre economic analysis around finance has largely been done by promoting liquidity as a macro concept and framing device. This focus has helped better understand the dynamics of crisis and of course played a vital role in the rise of macroprudential policy. However, the concept of liquidity arguably frames our analysis in economic rather than political terms, because it pertains to the market quality of an asset rather than to the power relations it instantiates. In short, concerns with liquidity tend to focus on different modalities of the herd effect on financial markets when a loss of confidence leads to a rapid depreciation of assets and damages the balance sheets of financial actors. It directs our attention to mass movements on markets, rather than helping us identify power struggles between actors within these markets. The challenge of governance is then framed as a matter of ensuring a level of liquidity in the system, but too often this comes at the cost of a reflection on the way this leverage is used to anchor power relations.

Whether a critical approach to macro-finance can find its footing when the problem is posed in these terms is questionable. For critical macro-finance to speak to the aspiration of a critical political economy, it must clarify its relationship to the more established intellectual positions of mainstream macro-finance. The point is not to reject dogmatically what are valuable contributions from this literature, but to recognise that its narrower concerns with stabilising the economy have resulted in real silences that need to be interrogated. In particular, it is important to realise that the concern with balance sheets and liquidity has too often led us to a money view that is more concerned with the balancing of financial activities than with enquiring into the purposes of finance. For all the studies of the complex mechanisms of financing found here, there is a curious silence on what this financing is being used for. This leads us to the question of power.

Where are the power relations in macro-finance?

The limitations of mainstream macro-finance reflect something political economists have known for some time: economics is not very good at thinking about power. The challenge is particularly acute when it comes to finance because leveraging poses tricky analytical trade-offs. Put simply: are highly leveraged financial agents *powerful* because of their ability to do a lot with limited capital, or *weak* because any change in the current market climate can bring them crashing down? The very flexibility afforded by finance is thus difficult to interpret since, by definition, it opens the door to a potentially greater moment of reckoning.

As Sahil Dutta (2017) argues, this duality in the nature of financial power has long troubled analysts and too often led them to see vulnerability where there is in fact great power (see also Sgambati, 2016). This was certainly the case with the high leveraging of banks before the subprime crisis, or indeed the great financial and monetary imbalances in the US since the 1980s (Hudson, 2003). It is common to interpret whatever defies our expectations about what is possible or 'normal' as a development that is unsustainable and thus bound to end. But this same quality can also be read as a sign of new capacities that have lent power to some agents now able to do something no one could do before them (Knafo, 2013).

Confronted with this problem, the macro-finance literature has mostly followed in the footsteps of economics by casting leveraging agents as risky financiers which are vulnerable to a change in the financial climate. Following the idea of a hierarchy of money, running from well-established and easily monetisable assets to more specialised and less liquid instruments, this approach sees powerful agents as those who have prized assets in this system because of their liquidity (e.g. institutions that can issue highly liquid assets such as bank deposits). The result of this perspective is a curious inversion, where power remains tied to the production of high-powered money (cash, deposits, or short term government debt), when in fact the striking development of financialisation has been the ability of agents to gain great influence and leverage by operating at the lower echelons of the hierarchy of money, where they live off leveraging (e.g. private equity firms, hedge funds). Without denying the structural strength that agents such as banks can derive from their position in this hierarchy, the striking fact about financialisation is that dominant banks have shifted away from their role as creditors. What distinguishes the power they wield under financialisation is their newfound ability to leverage, not the fact that they issue money in the form of deposits.

When privileging the angle of liquidity and crisis, mainstream macro-finance focuses our attention on the potential vulnerabilities of finance and what could happen in times of crisis, but this conceals the power wielded by finance in 'normal times'. Prioritising the exceptional crisis over the normal working of finance thus directs our gaze away from the power relations that animate finance. The rise of private equity firms, subprime lenders, and hedge funds testifies to the growing power that leverage provides and its vital role in reshaping the global economy. That these agents have vulnerabilities is certainly true, but they are not simply a function of risk taking. They reflect the way some financial agents have been able to leverage their position in order to exert great power. A mainstream macro-finance approach, with its inverted perspective on the issue of power, is thus ill-equipped for a radical critique of finance and risks serving the interests of the powerful when thinking about sustainable leveraging, rather than enquiring into the purpose of leverage in the first place.[3]

This highlights an important point that has been systematically downplayed by the money view informing macro-finance. For the issue is not simply that financial agents are leveraging in dangerous ways that threaten the delivery of financial services, but more importantly that the very nature of power and who is empowered through debt has changed in ways that challenge how we think of politics and governance. Taking macro-finance in a critical direction thus requires that we begin to focus on the politics of leveraging in a more systematic way (Sgambati, 2019).

Conclusion: Towards a critical macro-finance

Macro-finance has opened important new avenues for rethinking how we see the global economy and how we understand its politics. The calls for renovating macroeconomics so as to make space for finance, as well as the endogenous approach to finance, the insistence on the question of funding in the study of finance, and the reliance on balance sheets to track monetary claims and the complex entanglements of market-based banking have all contributed to setting out a promising research and political agenda for critical political economy.

However, I maintain that the development of a critical macro-finance has been hindered by its reliance on a money view of finance. While useful to think about financial crises, it has made it difficult to bring the politics of financialisation into focus. Critical scholars should thus be careful not to adopt too readily the depoliticising lens of economists in their rightful eagerness to delve into the technicalities of finance. Finding ways to make the social context count, to avoid the functional concerns of macro-finance, and to conceive leverage as a source of power, rather than simply as a function of risk taking, is paramount for the project of developing a critical approach to macro-finance. This can be done, I have argued, by shifting from a money view to a banking view, which frames the analysis around a clear conception of what is new about banking under financialisation (i.e. liability management) and uses this to reframe our account of its politics.

Notes

1. This policy framework was born in the early twentieth century out of the struggles to establish national economic systems of governance and placed an emphasis on the impact the balance of payment could have on currencies (Mitchell, 2008). It was an approach central to the era of Bretton Woods, when the main concern was to secure relatively recent national currencies (Knafo, 2006).
2. I follow in part the path pioneered by Stefano Sgambati (2016, 2019) in a series of articles highlighting the importance of banking practices and leveraging. Another author who has pursued a similar path is Carolyn Sissoko (2019), although her project is to reclaim the ideas of the nineteenth-century banking school. Still, she rightly highlights the importance of studying more specifically differences in banking practices and how they have reshaped global finance.
3. This emphasis differs from Konings' (2018) concept of leverage, which he uses as a twist on the notion of structural power. Konings examines leverage as a product of the way in which some agents can become part of the infrastructure upon which others depend. This then binds others to the fate of these agents, forcing them to work in order to improve the situations of the established financial agents. An example he uses is a 'too big to fail' bank that is propped up by government and other financial actors. By contrast, I am more interested in an agential conception of leverage,

focusing on the capacities built by banks through the new practices of liability management and how this has transformed what these banks are themselves able to do.

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https://doi.org/10.2218/finsoc.v6i1.4412 Published online by Cambridge University Press