No more cakes and ale: banks and banking regulation in the post-bretton woods macro-regime

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March 2016

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Banks and Banking Regulation in
The Post-Bretton Woods Macro-Regime

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Abstract

There is a broad consensus that financialization has brought many disadvantages and few benefits. This raises a simple question: How did it come about? Why did professional observers allow it to happen even though financialization was not a hidden process? Can we identify sources of legitimation for financialization? To limit the scope of our analysis, we focus on the role of banks to answer these questions. We study changing expectations towards banks from a transdisciplinary perspective, using insights from macroeconomics, sociology and political science. We find that the legitimation of financialization has been multi-faceted. However, at many crucial junctures, the perceived but doubtful need to "increase competition" for banks has tipped the scale in favor of the policies underlying it. The disciplining effects of competition though, have not resulted in less cakes and ale for banks.

"If deregulation looks like such a bad idea now, why didn't it then?"

(Brad Delong, 2011)

I. Introduction

The play "Twelfth Night" (or "What you will") features one of Shakespeare's most notorious characters, Sir Toby Welch. He is the uncle of Olivia, a noble lady and one of the main characters of the play. Olivia is an object of desire. Many characters of the play have a share in her material and immaterial wealth, as she employs them, provides for them or represents a source of "meaning" for their existence. She is not unrestrictedly sympathetic, though. She seems to enjoy her self-indulgent melancholy until others help her in escaping from it.[1]

Because of her wealth and beauty Olivia attracts various suitors. She also attracts a number of no-goods that just want to enjoy living in her house and on her wealth. Sir Toby, her uncle, is one of them. He invites others, such as foolish Sir Andrew. Sir Toby is a drunkard, enjoys ribaldries, carousing, and making fun of other people. He brings chaos to the house and does not forego any opportunity to do so. But he is not unrestrictedly dislikable, in fact, it is a lot of fun observing him and being around him.

Narratives about the financialization of post-modern capitalism (see Kay 2015 for an idiosyncratic introduction for economists, Epstein 2005 as well as Noelke et al. 2013 for a more general treatment) have many things in common with Twelfth Night. They are rather colorful, entertaining and full of ambivalent characters. On the one hand, there is the "real economy" (which we might

[1] Apart from own visits of the play in various theaters, some of the information on "Twelfth Night" was taken from http://www.sparknotes.com/shakespeare/twelfthnight/

want to identify with Olivia). Everybody wants to participate in her wealth and be close to her. But she is not entirely stable and sometimes even double-minded. Some (in particular liberal economists) have a naïve ideal in mind when they think of her. Realistically, however, she needs governance by others to find her way.

The financial economy (Sir Toby) brings not only cadgers but also chaos to the real economy's house. Isn't there anybody to protect Olivia from Sir Toby and his rout? In fact there is one person that tries, even if for mostly self-serving purposes: Malvolio, Olivia's steward. At least visibly, he is Olivia's biggest fan. He wants Sir Toby to abide by the principles of Olivia, at least as he understands them. Confronted with Malvolio's self-important righteousness, Sir Toby responds:

> *"Dost thou think, because thou art virtuous, there shall be no more cakes and ale?"*

He continues as before and in fact will device a plot that will make Malvolio look really stupid at the end of the play: By making him believe that Olivia is interested in him, he unmasks Malvolio's true nature and foolishness. Malvolio is labeled as insane.

In our narrative of financialization, Malvolio represent professional observers. He illustrates their attempts to keep finance in check. Malvolio stands for major parts of the economics, regulatory and supervisory public, on the watch of which financialization has occurred. The famous quote above, in turn should in our view be translated in the following way:

> *"Do you really think that the theories and principles that might work for the real economy (such as competition, market discipline and relying on the information content of market prices) are going to prevent me to dance until the music stops?"*

The global financial crisis has exposed many of these theories and principles as false or at least naïve. They have neither prevented a steady increase in the incidence of financial crises nor the big crisis that started in 2007. Perhaps more importantly, they have not been able to prevent a financialization of economies. The financial sector has grown to an extent that has made him a major social risk factor.

Ironically, one of the main benefactors of this development has been Malvolio himself, i.e. the economics and regulatory profession. The influence of those on the watch of which financialization has occurred has further increased. Even though the economics has been criticized for not foreseeing the risks that were accumulating, it has also been tasked with explaining the crisis to politicians and the public. It has even been provided with funds to analyze and treat itself, for example by institutions such as the Institute for New Economic Thinking. Together with central bankers and supervisors, economists still form an important part of the epistemic community shaping regulatory decisions, for example within the Basel process.

The other social sciences have been quite irritated by this development. Being much more self-reflective, they know that everybody is her or his own blind spot. Why then, are economists allowed to treat themselves? Against this backdrop, non-economist have teamed up for research projects with economists. They aim to take a look beyond economists' explanations for the crisis. And they want to understand better the financialization assumed to be behind it, and the "Ökonomisierung" assumed to have fueled both.[2] This paper is part of such a research project, financed by the German Federal Ministry of Education and Research.[3]

Nowadays, nobody is a friend of financialization. There is a broad consensus that it has brought many disadvantages and few benefits. This raises a simple question: How could it have happened? Why did professional observers allow it to happen even though the incidence of crises rose steadily from the beginning of the 1970ies to the 2000s? Put differently: Can we identify sources of legitimacy for financialization? What kind of arguments have been instrumental in either supporting certain elements of financialization or in weakening the case against it?

Until recently, attempts to answer these questions have been largely confined to the realm of individual social sciences (for an example, see Callaghan 2013). However, some pertinent issues require a collaboration of economics, sociology and political science. Financialization is a transdisciplinary project. Regrettably, the methods from sociology needed to bring the pieces of the puzzle together have convincingly shown that transdisciplinary work is futile. We try nonetheless.

To limit the scope of our analysis, we focus on banks as a major player in financialization. This also motivates the title of our paper. Banks have been frequently told that the time of "cakes and ale" would be over: When interest rate ceiling were abolished, when money market funds were allowed to compete for deposits, when savings & loan institutions in the U.S. and Spain were made fit for competition, or when Glass-Steagall was repealed because of the excess profits of investment banks (that effervesced even more in the years after).

The next section of this paper shows that, up to a certain point, the changing nature of banking in recent decades can be explained as part of the emergence of a new macro-regime (Klüh 2015). Even though the concept of macro-regimes already is transdisciplinary in nature, it reaches its limits when it comes to issues usually analyzed in the realm of financial sociology. We look at these issues in Part III and learn that financial sociology provides indispensable insights in the legitimation of financialization. Interestingly, both the macro-regime approach and financial sociology highlight the importance of a very economic concept: Competition.

We analyze the role "competition" has played in crucial phases of financialization in part IV and argue that it has been a central legitimizing force whenever (i.) the issue of financial instability surfaced and became a public issue; (ii.) obstacles or resistance on the trajectory for a more deregulated, market-orientated financial system arose; (iii.) deregulation pessimists engaged in deregulation (such as in the case of the push for deregulation in the U.S. of the late 1990ies). Competition has played this role even though economic science itself raises many doubts about its effects on financial stability. We summarize these at the end of part IV and ask why the *concrete* arguments against a more competitive financial sector have been often sacrificed for the *general* arguments for it.

[2] There does not seem to be an English word for the increasing predominance of the economic system over the rest of society yet.

[3] In some sense, these projects assume the role of the fool named Feste in Shakespeare's Twelfth Night. There is even a scene in which Malvolio is locked into a small, dark room because of his supposed madness. Feste pretends to be a priest examining Malvolio, declaring him definitely insane. Sir Toby intervenes, opens a line between Malvolio and Olivia, in which the former asks to be released.

II. The Post-Bretton-Woods macro-regime

The beginning of the 1970ies is a watershed between two ways of organizing economic activity in capitalist societies. The end of the Bretton-Woods system did not only change the way exchange rate movements and international capital flows are organized. A "regime change" occurred that led to a dynamic adjustment of capitalism, in which the increasing importance of finance (financialization) features prominently.

Regrettably, there have been only few attempts to characterize these two phases of economic history holistically. Most accounts focus on the monetary system, some try to enlist the changes that occurred since the 1970ies, and only a few try to lay bare the relationship between the key drivers of the developments. The concept of macro-regimes introduced in the next section can serve as a useful framework for organizing respective research. Two examples of macro-regime narratives before and after the breakdown of Bretton Woods are provided to illustrate the concept. Furthermore, a brief description of central bank role models in different regimes is included, to give a better sense of the basic internal mechanisms characterizing regimes. Finally, we present an account of the changing nature of banking during the consolidation of the new regime.

1. Macro-regimes defined

Klüh (2015) introduces the concept of macro-regimes as a framework for analyzing macroeconomic aspects during periods of large social transformations. Building on approaches from political science (Krasner 1982) he defines regimes as arrays of implicit or explicit principles, norms, rules and decision-formation procedures that lead to a convergence of actor expectations. Through the combination of these individual elements, regimes develop a "core" with the ability to imperfectly control their internal dynamics and to couple with other social systems, where the term "system" refers to the concept originally developed by Parsons and further detailed by Luhmann (1984). Both the convergence of expectations (i.e. the emergence of regimes) and the divergence of expectations (which usually marks the beginning of a regime switching) are reflected in specific characteristics of time series.

Macro-regimes are concretizations of this general description:

- Macroeconomic assumptions assume the role of principles. Examples are the assumption that inflation is a monetary phenomenon, the assumption that an increase in public debt is usually inflationary or that the social cost of inflation always exceeds its benefits.

- Macroeconomic standards of behavior take on the role of norms. An example is that the actions of the central bank should be aimed at a restriction of money growth to curb inflation risks. Another example is that fiscal policy should be disciplined and be subject to certain rules.

- Legal boundaries to macroeconomic management assume the role of rules. An example are the mechanisms to guarantee the independence of the central bank or debt brakes anchored in constitutions.

- Well-defined or even standardized processes assume the role of decision-making procedures. For example, certain procedures are important for the work of central bank councils, the International Monetary Fund or the European Fiscal Compact.
- Macroeconomic variables and time series allow a characterization of regime emergence, regime stability and regime switches. These variables can be prices or quantities, but also quantified institutional characteristics (such as the extent of its central independence).

The core of the regime cannot be directly observed. It manifests itself in the effects of the regime on other social sub-systems and can be re-constructed through social science.

Two archetypal macro-regimes are "the" gold standard, and "the" currency regime. Polanyi's analysis of the Gold Standard in *The Great Transformation* (Polanyi 1944) may therefore be considered one of the most impressive examples of macroeconomic regime thinking. Polanyi documents the emergence of a "control regime", as more and more social sub-systems are forced to link up with the principles, norms, rules and decision-formation procedures of the Gold Standard. Its preservation becomes the pre-dominant determinant of social developments.

The example of the Gold Standard raises an important question: Do macro-regimes have a general tendency to subordinate social relationships to economic logic, exert excessive control over other social subsystems, thus leading to a process of "Ökonomisierung"? A look at the recent experience with "currency regimes" supports this conjecture. For example, Gürtler (2010) reflects on the meaning of the term "currency regime" in the following way (our translation):

> *"In macroeconomic expert circles the word sounds innocent and neutral: According to a handbook of financial economics, a currency regime 'is basically a particular set of rules, which may include international cooperation, but should be conceptualized at the national level. These rules determine the way in which the exchange rate is determined'. [...] as soon as you step onto the political stage, the term immediately loses its innocence. There, the term does not describe a set of rules, but a form of rule, often an ugly one. In a military regime, it is the military that rules, in a terror regime it is terror. Consequently what prevails in currency regimes – is: the currency."*

Are macro-regimes, therefore, the "one ring which can rule them all"? Not necessarily. It is helpful to distinguish two fundamentally different types of macro-regimes. The pathological variant leads to a submission of most parts of a society under a dictate of economics. In addition to currency regimes such as the Gold Standard, examples include periods (or regimes) of hyper-inflation or chronic inflation. In its healthy variant, macro regimes are able to permanently but loosely couple different parts of society to make their self-reproduction consistent with economic necessities. The communicative logic and environmental conditions of other social subsystems continue to be relevant. The internal workings of social subsystems dominate the loose coupling among systems. In this way, healthy macro regimes play an important function in the stabilization of social expectations.

2. The Bretton Woods macro regime and its successor

Between the Second World War and the beginning of the 1970ies, most capitalist societies saw themselves as part of a specific global macro-regime. The main features of this regime were transcribed onto national macro-regimes, which therefore shared many characteristics. The development of this structure is usually seen to have been strongly shaped by the agreements of the United Nations Monetary and Financial Conference in Bretton Woods in 1944. We will therefore refer to it as the Bretton Woods macro-regime (BWM).

The characterization of this regime (and even more so the characterization of its successor regime, which we do not label yet) is a work in progress and a matter of continued debate. In fact, this paper should be seen as a contribution to the work program of deconstructing existing attempts to describe and understand macro-regimes. The process by which this is done uses existing characterizations as starting point and modifies them by adding or changing certain elements or institutional details.

Narrower characterizations include Rodrik (2011), who argues that the clash between domestic politics and globalization's rules witnessed by the collapse of the Gold Standard in 1931 forged a consensus on (Rodrik, 2011, p. 12):

- The need to create space for domestic policy requirements
- A preference for a limited globalization, that prioritized domestic needs
- The need to have room for Keynesian policies, welfare states, and activist industrial restructuring policies
- The need for capital controls and fixed, but adjustable ERs as well as
- Free trade arrangements that allowed for a large number of exceptions

The regime following BW is coined hyper-globalization (Rodrik, 2011a p.13). It is "ruled by organizations such as the World Trade organization", emphasizes "financial globalization" and "maintains that there would be strong enough global rules". If these do not materialize immediately, they "would catch up with markets eventually". They "would carry legitimacy even if they constrained democratic choices". The Post-BWM features a "legitimacy deficit", financial crises, and an uneven development record in which those countries sticking to the principles of the BWM (such as China) are those that play by the old rules.

Authors such as Schulmeister (2013) offer a broader perspective. Based on the varieties of capitalism approach (Hall and Soskice 2001) and post-Keynesian economics (as in Minsky 1981) he identifies two fundamentally different "arrays" of capitalism. The "Realkapitalismus" of the BWM is based on corporatism, the key players are the representatives of labor and real capital. Profit seeking focuses on the real sector. The relationship between the state and the market is described as complementary, and there are manifold objectives for economic policy, ranging from full employment to a more even distribution of income. The economic powerhouse are governments, Keynesianism rules and the main economic model is the regulated market economy. Growth rates usually exceed interest rates, and financial markets are expected to be calm and in the backseat.

The "Finanzkapitalismus" that emerges in the 1970ies, in contrast, is characterized by an alliance between real and financial capital. Profit seeking focuses on finance. The relationship between the state and the market is described as antagonistic, and there are only few objectives for economic policy: Low inflation and sound government finances in particular. Monetarism and Neoliberalism dominate economics, and the main economic model is the pure market economy. Growth rates usually are below interest rates, and financial markets undergo frequent boom-bust cycles. The center for economic policymaking are not governments, but central banks.

3. Understanding macro-regime emergence: The case of central banks

The role of central banks is a very good example for the way in which a new macro-regime is established and consolidated. It also helps to understand how and why regimes are characterized by a convergence of expectations and therefore how regimes "work". Finally, the changing nature of central banking highlights the fact that, at some point, the regime itself might lead to a situation in which expectations start to diverge and a regime switch occurs.

In the case of the BWM, traces of the role of central banking within the regime can already be found in the 1930ies. When Roosevelt came to power, he soon realized that only a shock therapy violating most if not all policy dogmas of the time would be able to generate the expectation shift needed to end the deflationary spiral caused by the policies of the Great Depression. Eggertson (2008, p. 1477) notes:

> *"…the US recovery from the Great Depression was driven by a shift in expectations. This shift was caused by President Franklin Delano Roosevelt's policy actions. On the monetary policy side, Roosevelt abolished the gold standard and -- even more importantly -- announced the explicit objective of inflating the price level to pre-Depression levels. On the fiscal policy side, Roosevelt expanded real and deficit spending, which made his policy objective credible. These actions violated prevailing policy dogmas and initiated a policy regime change…"*

While Eggertson's narrative is convincing, it neglects an important issue: Roosevelt could not trust Federal Reserve Banks to support a violation of policy dogmas. It was therefore necessary to place the central bank in the back seat of macro policy (see Klüh and Stella, forthcoming, for a description of the policies that finally led to this result). This marked the beginning of a period in which central banks' role was constrained and limited. Factors that supported (and were supported by) this role were the predominance of fiscal policy in macro stabilization, the close control that governments exerted on interest and exchange rates, the absence of financial instability (that made last-resort-lending a rare event) and the fact that high growth and low unemployment were considered more important than low inflation and high capital income.

Traces of the end of the BWM can again be found in a period when it was still strong enough to ensure convergence of actors' expectations. Since macro-regimes are transdisciplinary in nature, it is essential to look for these traces in a varied set of social contexts. To name only three examples:

- Market-based innovation (economic context): The establishment and growth of Eurodollar markets gave central bankers a topic only they could handle competently. It had to be monitored internationally, at first to ensure that the old regime would remain stable in the face of new possibilities to speculate against exchange rate movements and ways to circumvent national interest rate policies.
- Statehood (political context): The meetings on Eurodollar developments at the Bank for International Settlement in Basel form the nucleus of a new form of global governance which will partly replace forms of statehood that are based on national boundaries. Formed by institutions that are not constrained by national parliaments, the Basel complex of central banks, though relatively small and unknown, soon outmaneuvers other candidates

for a central role in coordinating the financial aspects of a globalizing world economy (Bosankic 2016).

- Epistemic communities (social context): As central bankers' expertise for macro policy was secondary to the expertise of government representatives, they focused on other, more market-related areas of knowledge. This gave them an edge when, beginning in the 1970ies, financial markets started to dominate economies and the economic policy discourse.

The 1960ies set the stage for these developments. The 1970ies are characterized by a high degree of volatility of macroeconomic aggregates and institutional settings. This volatility is partly the result, partly the origin of the very same forces that shaped the new role of central banks. Against this backdrop, the 1970ies can be described as an "inter-regnum between the subservience of monetary policies to government control, and the establishment of a free market system, with the Central Bank following a regime of inflation targeting" (Goodhart 2010, p. 2). In the 1980ies and 1990ies the new regime undergoes a period of consolidation. For example, central banks are granted an unprecedented degree of independence. In the 1990ies and 2000s, expectations have converged to a point were even outside observers learn that central banks have been key to ensure that macroeconomic aggregates now possess highly desirable time series properties (a phenomenon coined the Great Moderation).

The increasing reliance on central banks in the Post-BWM can be seen as a crucial element of a development that many view as key to understand the new macro regime: financialization. Banks are at the center of this process. On the one hand, this provides another explanation for the fact that the *central* bank evolves into the main control room of economies. On the other hand, it raises the question of the role of banks in shaping the emerging macro regime and the role of the macro regime in shaping banks. Interestingly, many accounts of financialization give banks only a bit part in their narratives. Perhaps, as banks are institutions to solve market failures, they do not fit easily in the standard description of financialization as a process of dis-embedded markets?

4. Banks in the new macro regime

There is no lack of vivid illustrations of the changes that the banking sector has undergone in the transition from the BWM to its successor macro-regime (see, for example, Kay 2015). Banking under fixed exchange rates and capital controls is frequently described as the infamous "3-6-3 banking", "boring banking" or "Mary-Poppins banking", after George Banks, Mary Poppins's employer, who works at the Bank in the City of London, and returns home every day at exactly 6:01h.

With the breakdown of the BWM, a dynamic, multi-pronged process of change emerges. One prong consists of a continuous change in activities that make banks less boring, but also more prone to failure. The emerging new macro-regime offers numerous opportunities to open new business lines. With the breakdown of fixed exchange rates, currency trading and speculation become a main source of revenue for at least a subset of banks. Against the backdrop of skyrocketing oil prices, petrodollars flood the global banking system and lubrify the new business lines. A manifestation of the risks of these developments is the first global banking crisis of the new regime in 1974, culminating in the failure of German Herstatt Bank and the near-failure of a sizeable number of second-tier banks.

As a result of banking system instability, a second prong emerges: Banking regulation and policy become a much more active field, especially for central banks. As a consequence of the Herstatt crisis, for example, the Basel Committee is created. Within Germany, a committee of wise men is set up to study the role and regulation of banks. It is highly instructive to analyze the reports of these early attempts to regain control over a complex system (see Bosankic and Klüh 2016 for a more detailed account). Already at this stage, arguments are framed in a way that are consistent with the new macro-regime. For example, exchange rate volatility and international capital mobility are rarely mentioned as a source of banking instability, even though it had played a major role in the Herstatt crises. Also, a main focus is how to make banking policy consistent with the monetary transmission mechanism, which obviously needs to be re-calibrated to the new regime. Finally, transparency and liquidity of markets slowly become key concepts.

A third prong consists in a process by which banks gradually lose their privileges and their comfortable position. New players such as money market funds are allowed to compete for traditional bank business. This creates increasing pressures on banks to adopt to a new environment, save cost, increase their marketing, become sales-oriented and more reliant on fees, sales commissions and selling brokerages. While deregulation takes many forms in the decades after 1970, decreasing barriers for entry for less regulated players can be considered one of its main expressions. Deregulation and liberalization do not only create new competitive pressures. They allow an expansion of financial markets across borders, resulting in a highly international system of financial flows. While technology plays a role, structural change is dominated by the increasing importance and reputation of capital markets.

Naturally, all these changes affected national financial systems in different ways. In particular, social expectations as to "what banks should do" and "how banks should behave" change slowly. Bank-based financial systems such as Germany or Japan were and sometimes are reluctant to change their conception of the financial sector. In these countries, the idea that finance should mainly be an infrastructure (Lütz 2005) remains much more prevalent. There is an implicit expectation that the financial sector should not be transformed into a financial industry expected to contribute directly to value added.[4] To some extent, this is a reflection of the fact that national macro-regimes still do differ from each other in a number of important aspects. For example, the German industrial structure might still be more dependent on "patient capital" than the service industries of other countries.

Other necessities and "problem specifications" of national macro regimes have resulted in different national time frames and different versions of financialization.[5] In the U.S., for example, one reason for strong financial sector growth might have been the absence of a social safety net in combination with the distributional consequences of macro regime characteristics. Moreover, it should not be underestimated that the "varieties of financialization" have been also influenced by political attempts to influence the way a national financial system can benefit from global financialization, for example by establishing "financial centers".

[4] In Germany, the term „Finanzindustrie" sometimes even causes anger, as "Industrie" is reserved for "valuable" real sector activities.

[5] In this respect, it would be instructive to look at the financialization of those countries in which the macro regime did not buy into every ideological aspect of the global macro regime (such as China or a number of emerging markets).

In spite of national differences, many of the above described changes become global trends. Both the logic of bank business models and the logic of regulation are strongly influenced by these developments. Partly as a consequence and partly as a driver of regulatory change, banking evolves from a business that is strongly based on relationships to a business that is strongly based on data, statistics and quantitative analysis. For example, Basel II leads to a situation that forces banks to strictly separate front and back offices. The banks business models, which are still dependent on personal relationships undergo a period of radical change.

Regulation though, is only one factor in this development. It is itself forced to adopt to developments that go beyond political and economic concepts. Lütz (1999), for example, explains changes in the international coordination of banking regulation as a consequence of a changing nature of risk. While international regulatory policy had to solve distributional problems at first (and was thus a game between states), it becomes a "game against nature". This requires a replacement of negotiations by a learning process based on communication.

In fact, recent decades have been characterized strongly by a general re-assessment of the nature of risk and uncertainty. Their measurement and management were reconsidered society-wide. This also means that banks evolved from institutions that mainly bear risk to institutions that mainly manage risk. Management of risks in turn combines with another feature of the new macro regime: Increasing tradability. Risks are thus not only managed, they are managed as they are sold. Financial sociology has provided important insights into these developments.

III. Perspectives from financial sociology

… Rutulians, Trojans, are the same to me;
And both shall draw the lots their fates decree.
Let these assault, if Fortune be their friend;
And, if she favors those, let those defend:
The Fates will find their way.

Virgil, 19 B.C., The Aeneid, Book X[6]

Fears of financial speculation and the risks of reckless gambling were a central element of BWM. Following an era of relatively free markets in the 1920s and the Great Depression attributed to them, the MacMillan report of 1931 concluded that "[…] an era of conscious and deliberate management must succeed the era of undirected natural evolution." (970, quoted in De Goede 2005, p. 123). Thus, the environment was susceptible to the concept of political control over financial markets. Boring banking ensued, a time in which only the least ambitious of classmates would even consider a career in finance (Krugman 2009).

[6] Available at https://www.gutenberg.org/files/228/228-h/228-h.htm

In this setup, Malvolio was in charge of affairs: His ideal of "disciplined markets" would work. Financial speculation was seen as an activity akin to illegal gambling and pornography, which at the time were morally condemned and mob business (Economist 1976). Trading was slow and unexciting, frequently leaving traders with nothing to do but to read the newspaper on the steps of the soybean pit of the Board of Trade (Sullivan interview in MacKenzie 2006, p. 143). Skepticism towards financial speculation and risk taking were a deeply engrained. Malkiel (1999) captures the mood when he states (p. 24):

> *"A blindfolded monkey throwing darts at a newspaper's financial pages could select a portfolio that would do just as well as one carefully selected by the experts"*

Only three decades later, Alan Greenspan would refer to the expansion of financial derivatives as the "most significant event in finance" and a process that has "undoubtedly improved national productivity growth and standards of living." (Greenspan 1999). This extreme change still seems puzzling. How finance became the poster child of growth and prosperity in the western world even though skepticism towards financial practices was very deeply rooted before? What ended the era of boring banking? If we want to resolve this puzzle, we must understand the transformation of:

- The social construction of risk and uncertainty.
- The discipline of economics as the main mediator between the concepts and business practice.

Uncertainty always has accompanied human life. Throughout history there have been various strategies to cope with it. Frequently, harvest failure, pestilence, drought, and a wide variety of events has been attributed to agencies beyond human control, such as divine intervention (Taylor-Gooby and Zinn 2009, p. 1). One of the most prominent figures capturing the role of uncertainty has been Fortuna, the goddess of fate, luck and fortune. Much like Olivia in the opening story of this paper, she is described as being capable to bestow wealth and prosperity on those who gain her favor. However, Fortuna is also described as capricious and fickle. One could try to win her favor, but never be sure of it (De Goede 2005, p. 29 f.).

In the wake of the Enlightenment, man has strayed from the idea that it is up to the gods to govern his fate. Instead, mankind has set out to conquer nature and gain knowledge and develop technologies that would allow it to shape the path of the future and tame its dangers. A distinction emerges that still lies at the very heart of economic theory: the distinction between risk that we can know and uncertainty that we cannot know. Our contemporary economic order crucially depends on this distinction. On the one hand, we believe that we are not at the mercy of random blows of fate in planning of our economic endeavors. As we can influence the future as long as we take the right actions, we try to do so by measuring and managing risk. On the other hand, and whenever we fail to do so, uncertainty is there to rationalize events.

Making the distinction of risk and uncertainty comes very naturally to us at this day and age. At least is has done so up to the collapse of the financial system of 2008, which ironically has not been blamed to uncertainty but to the management of risk. Still, it has become a fundamental idea of the financial system that risk can be managed; we just have to get it right. That was not always the case. In practice, risk became more prominent as a category throughout the Middle Ages in reference to voyages in uncharted waters and the evolving concept of insurance (Taylor-Gooby and Zinn 2009,

p. 3 f.).[7] Both the notion of risk as a source of profit and the notion of risk as a danger have been important ever since.

However, the notion of risk has strayed from the notion of the bold voyager. In our contemporary financial system, risk-taking has become a task entrusted to men equipped with level-headed rationality, not to reckless adventurers in search of a fortune - at least that is what we like to believe. In fact, one of the longest debates surrounding finance and risk is how to distinguish between responsible risk management and reckless gambling. The moral and legal ambiguities between gambling, speculation, and the practices of financial exchange began to surge in the nineteenth-century U.S. (De Goede 2005, p. 58) and have resurfaced with every financial crisis ever since. These debates are frequently accompanied by claims of speculators harnessing the fruits of the hard labor of others, enjoying easy gains themselves (De Goede 2005, p. 58) - much like the men who enjoy the bountiful table of Olivia.

There have been many claims about greed dominating the financial sector. They offer simple and emotionally charged explanations for complex problems. Yet, before the crisis of 2008, positive descriptions of speculation abounded. First, a distinction between "the gambler" (who creates risks that would otherwise not be there) and "the speculator" (who is willing to take in and manage the risks that are inevitable byproducts of any business) emerges (Esposito 2010, p. 223). By and by, the second image starts to dominate the first. Especially in the aftermath of the collapse of Bretton Woods, many companies become dependent on speculators taking on the risk of fluctuating exchange rates and other economic contingencies. Being at risk of having their profit margins crushed by swings in the economic climate beyond their control, real sector representatives become appreciative of the doings of financial speculators.

This process has been reinforced by the transformation of the economic discipline. This transformation has been decisive in setting the foundation for the explosive growth of the financial sector. It has been described by Richard Whitley as the transformation of Business Finance into Financial Economics (Whitley 1986). Prior to the 1960ies, publishing in finance was mostly done in ordinary language. Finance was a field where academics played a limited role (Whitley 1986, p. 172 f.). By the 1980ies, the situation had changed drastically. Academics dominated the field, publications where focused on quantitative methods, and theoretical modeling drawn from orthodox, neo-classical economics became the gold standard of the discipline (Whitley 1986, p. 173 f.).

An important factor in this development was the rise of the natural science in the wake of the Second World War. The success of mathematics in dealing with military problems fueled the idea that "science" could be applied to managerial and business problems (Whitley 1986, p. 171). Pioneers of neoliberalism such as Friedrich Hayek already believed that markets could be described as information devices that gather all relevant information and build prices accordingly (Hayek 1945). The two inventions that turned out to mark a quantum leap for finance, however, were the Efficient Market Hypothesis and the Black-Scholes-Formula. In particular, the widespread

[7] Several possible theories attempt to explain the etymological origin of the notion of risk. Prominent points of reference are the Arabic *risq*, meaning something which has been given by God and from which you draw a profit, and the Latin *riscum*, the challenge posed to a sailor by a barrier reef (Merna and AL- Thani 2008, p. 9; Taylor-Gooby and Zinn 2009, p. 3).

adoption of the Black-Scholes-Formula eradicated accusations of reckless gambling and strongly improved the reputation of speculators:

> *"Black-Scholes was really what enabled the exchange to thrive. . . . It gave a lot of legitimacy to the whole notions of hedging and efficient pricing, whereas we were faced, in the late 60s–early 70s with the issue of gambling. That issue fell away, and I think Black-Scholes made it fall away. It wasn't speculation or gambling, it was efficient pricing. I think the SEC very quickly thought of options as a useful mechanism in the securities markets and it's probably—that's my judgment—the effects of Black-Scholes. I never heard the word "gambling" again in relation to options." (Rissman interview 1 quoted in MacKenzie and Millo 2003, p. 121)*

Mathematical models of financial economics delivered the arguments that rendered vast trading activities to be necessary and useful. They would be "rationalizable" as a contribution to public goods, such as a stable financial system (De Goede 2005, p. 131). Once being able to be an actor on financial markets became depicted as a matter of technical expertise, criticism of observers who lacked the same theoretical knowledge could be easily dismissed as naïve. It became almost a duty for the experts in financial markets to be a pro-active agent, so that "good money" could drive out "bad money". Business models based on formulas that assumed efficient pricing thus made efficient pricing more and more important. Any opportunity for arbitrage had to be exploited.[8]

In some sense, this was "No more cakes and ale". Managing risk became an active rather than a passive task, requiring hard work and technical expertise rather than luck and gut feelings. The mathematical models of economics made risk tangible and pioneered arguments in favor of market based competition in finance. It was thus not until economics set out to become a "hard" science that arguments in favor of market-based competition gained the momentum that they eventually had from the 1970ies onwards.

From a sociological perspective, however, Black-Scholes was not so much a method for discovering true prices as it was for establishing a common practice for generating prices. In return, this created a convergence in pricing methods, becoming a central paradigm of financial economics (MacKenzie and Millo 2003, p. 109). This development has greatly transformed expectations towards the financial sector and banking. It now seemed possible to "get it right", as long as risk management was sound. This also allowed for explicitly commercializing contingent futures up to a point where the derivatives market exceeded the worldwide GNP by a ratio of 10:1 (Esposito 2010, p. 231).[9]

In the wake of this process, both the approach of the financial sector towards risk taking and the risk taking of individual investors has changed immensely. The downside of risk modeling in finance is that it is quickly forgotten how a measurement is produced once it is produced. In fact, measuring the social world often involves a paradox. On the one hand, we have actors who understand how they are being measured and begin to act accordingly. At a certain point, they even begin to manipulate the measurement. On the other hand, the same actors take the outcome of the measurement at face value, as if they were dealing with meteorology.

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[8] Even though there clearly are limits to arbitrage, see Shleifer and Vishny (1997).

[9] Also allowing to profit from credit independent of its repayment, most strikingly illustrated by the issuance of so called NINJA-loans, loans for people with "no job, no income, and no assets".

In economic sociology this would be described as *performance* and *counter-performance* (Lockwood 2015). Actors will adapt their behavior in order to produce the right data (Salais 2012, p. 60) and neglect factors that are not considered by the measurement. Measuring risk involves both. Actors behave according to measurements up to a point where they are "gaming the system". VaR models will be manipulated in order to reduce the implied capital charge. Individuals engage in (legal) behavior that results in better credit ratings without any fundamental change (Lockwood 2015, p. 737 f.). Banks will manipulate the fixing for important reference rates. At the same time actors take the resulting values at face value. For example, the contribution of the banking sector to overall GDP is put forward as an objective argument for saving the banking sector as an industry (Christophers 2011).[10]

Investors have been left with expectations of guaranteed gains without dangers, fostering a sense of a natural right to profit. This has even affected parts of the so called middle classes (Deutschmann 2008, p. 515). The financial sector was more and more expected to deliver just that. It is the expectation that every day can be a *normal* day in finance where everybody wins and goes home with a tidy surplus. In part, this expectation reflects how financial deregulation is situated in the contemporary macro-regime.

The policies of President Bill Clinton illustrate this change. When efforts to reduce the fiscal deficit by stimulating growth failed, Democrats lost the Congressional majority in the midterm elections of 1994. Clinton turned to a policy of austerity including deep welfare cuts along with deregulating financial markets (Streeck 2011, p. 16 f.):

> *"The Clinton strategy of social-conflict management drew heavily on the deregulation of the financial sector that had already started under Reagan and was now driven further than ever before. Rapidly rising income inequality, caused by continuing de-unionization and sharp cuts in social spending, as well as the reduction in aggregate demand caused by fiscal consolidation, were counterbalanced by unprecedented new opportunities for citizens and firms to indebt themselves." (Streeck 2011, p. 17)*

In part, the erosion of the welfare state was made possible by the deregulation of the financial sector. Contingent futures were commercialized and substituted for social policy (Streeck 2011, p. 17). Despite wage cuts and a reduction in benefits, even individual consumers contributed heavily towards growth by what has been dubbed "private Keynesianism": A debt-financed growth based on individual instead of sovereign debt (Crouch 2009).

Financial liberalization and fiscal consolidation through austerity are thus inter-related, as prospects of social unrest are buffeted by new financial opportunities, such as cheap bank credit. Both the expectations of guaranteed gains and a seemingly indefinite capacity to take on risk through securitization create an increasing dependency on profits and growth of and through the financial sector. Not just individual consumption becomes depended on low threshold credit. Even insurance companies and pension funds are in need of the seemingly promised returns from the financial sector to finance themselves and provide social services.

The idea of banking as a social deed has been frequently evoked throughout history, even in the mid-nineteenth century. When criticized for their profits, claims about benefits for the otherwise

[10] Economic measurements have overall gained importance in various areas, a process that Robert Salais refers to as the substitution of government by law through governance by the numbers (Salais 2012, p. 57).

poor and indigent rentier were put forward, such as widows and orphans (Engelen et al 2011: p. 97). Under the contemporary macro-regime, the links between banking and welfare have become all the more concrete. An important side effect is that anyone eager to regulate finance shares in the ungrateful task of telling those who are kept afloat through the liberal issuance of credit, that tighter regulation means "no more cakes and ale" for them. This might be visible in the social unrest of recent rounds of austerity policies, as they have not been softened by liberal consumer credit.

Viewed from another angle, banks and financial actors have been endowed with the task of creating financial *normality* based on risk management in an uncertain world. The underlying theory of the workings of the market lends itself to calls for more competition whenever this *normality* is disturbed. This again brings us to one of the stronger points of critique sociology directs towards financial economics when it comes to the treatment of risk and uncertainty:

> *"The problem is not that VaR is unable to predict the unpredictable - an unfair critique - but rather that it makes the unpredictable unimagined." (Lockwood 2015, p. 745)*

Even though framed with respect to certain risk management technology, the argument is much broader in spirit: Every day in financial markets is a *normal* day until it is not.

IV. Legitimizing financialization through competition

The macro regime framework and financial sociology can yield important insights into the changing role of banks during the last four decades. But do they provide a satisfactory answer to the question posed by Brad Delong at the outset of the paper? If financialization (and the ensuing deregulation) appear to be bad ideas now, why didn't it then? Why was there relatively high acceptance for and low critical potential against financialization from academic and other professional observers during the time?[11]

Interestingly, a closer look at the process of financialization reveals that the potential for putting the macro-regime on alternative trajectories was not as small as suspected:

- Countries such as Germany resisted change for a long time. Reasons varied. For one, the Bundesbank held the belief that the structure of the German banking sector was instrumental, especially for the transmission of its policy (Detzer and Herr 2014). Moreover, the political economy of the three-pillar system provided a substantial amount of stability to non-financialized ways of doing business, as did the industrial structure of Germany.

[11] Partly, the explanation is probably just that not all analytical underpinnings of financialization were wrong. The authors, for example, do not think that the only viable financial innovation of the last decade was the ATM. It is most likely that in a couple decades, there will be research on the question why financialization was viewed so unanimously negative by some groups. In fact, economics itself has a tendency to excessively blame the financial sector whenever capitalist societies undergo serious crises (see Klüh 2014).

- Heterodox economists such as Minsky (1981) highlighted the relationship between the role of banks, the importance of finance, Keynesian stabilization policies and Neoliberalism early on. Though heterodox, they were received quite broadly by scholar from what is now called mainstream economics.

- Perhaps more surprisingly, orthodox economic research provided many justifications for traditional views on banking and financial markets: Relationship banking was introduced to economic theory exactly at the time when relationships were downgraded. The double-edged nature of competition and concentration in banking that was a strong belief during the BWM received substantial theoretical and econometric support. Most of microeconomics was concerned with models of information that casted serious doubts on the efficiency of financial markets.

Thus, financialization was by no means a process that remained uncontested. Therefore, sources of legitimation for letting it develop or even fostering it should be considered crucial.

Partly, the macro-regime has been a source for such legitimation: As expectations converge around certain principles, norms, rules and decision-formation procedures, certain developments appear to follow the "There is no alternative"-paradigm. Moreover, necessities emerge, such as in the case of fostering home ownership as a means to pacify social relationships. Finally, the fact that the macro regime leads to a certain regularity and stability in time series behavior (both the BWM and its successor had their golden ages, their specific form of "great" moderation) often validate the regime principles, at least as long as they are not used as the basis for policy rules (Goodhart 1981).

Other sources of legitimation are provided by financial sociology, as shown above. Interestingly, however, both the macro regime approach and financial sociology point to the importance of another level of reflection. On this level, economic concepts become key in shaping financialization. In our view, it is particularly one concept that both need for their narratives of financialization: "Competition". In the case of macro regimes, the focus on competition is one of the main differences between the two variants discussed above: In the transition from the BWM to its successor, trade policy stops to see itself as a shelter for home industries against foreign competition, labor market policies stop favoring corporatist solutions and regulatory policies focus increasingly on creating level playing fields. In the case of financial sociology, positive attitudes towards speculation, for example, cannot be defended as long as bad speculators are not driven out of the market. Moreover, positive attitudes towards people mainly living from financial capital income require that these are seen as either survivors of or participants in a tough competitive environment.

The importance of competition as a source of legitimation for financialization is visible in many crucial moments of financialization. An interesting example is Germany, as it resisted many aspects of financialization for quite some time. However, the importance of competition as a source of legitimation is present early on: Startled by the failure of Herstatt bank, the German government sets up a commission to study "Fundamental Issues in the Banking Sector". (Bosankic and Klüh 2016, discuss the impact of the Herstatt failure on expert communities). A recurrent theme when the commission is faced with policy issues that cannot be solved collaboratively (as the commission consisted of representatives of all three pillars of the German banking system, the government, regulatory bodies, and the scientific community) is to rely on competitive forces. For example, discussing the potential conflicts of interest in universal banks, the commission concludes: „A disregard for customer benefits will be prevented by the competition among banks"(Bundesministerium der Finanzen 1979, p. 7, our translation).

After Herstatt, Germany still resists many forms of financialization. Together with other stakeholders of the financial sector, the Bundesbank seems to prefer a non-competitive but stable system. The specific characteristics of the German macro regime, such as the Bundesbank's view of monetary transmission, seem to play an important role in this respect. Detzer and Herr (2014, p. 15):

> *"..the Bundesbank was aware of those problems [the problems caused by shutting out foreign banks from the market] but prioritized its target of monetary stability. Only in 1985 after an internal paper of the Bundesbank stated that the German banks were sheltered by prevailing regulation from the 'draught' of international competition a major change took place. The paper stated that the Bundesbank was supporting monopoly rents for the banking industry and that the prevention of financial innovations in Germany drove residents to use foreign financial markets."*

From this point on, foreign banks are granted more access to Germany. More generally, Germany slowly pivots towards more financialization.

This process is reinforced by the fact that European and global initiatives start to dominate German Banking regulation. Obviously, all EC and later all EU initiatives have a strong bias towards increasing competition. The global initiatives conveyed through the Basel process appear to be much more careful when mentioning competition, though more research is needed to validate this conjecture. Many aspects play into the respective documents, some of them being a clear reflection of the issues discussed in section III. Still, the Basel accords do increasingly reflect a strong concern for competition. One of the main objectives of the Accords has been to enhance "competitive equality" (e.g. Basel committee 1999, p. 5). Kay (2015) argues that Basel I has been largely an attempt by U.S. and British banks to prevent "unfair" competition from Japanese players. Basel II then formalizes the role of competition for financial stability through its third pillar.

Even the financialization of those societies that have deeply engrained competition as a desirable aspect of the social set-up appears to rely on it as a legitimation device. Delong (2011), for example, explains the push for financial deregulation during the late 1990ies in the U.S. He sees four reasons why even members of the democratic political spectrum (that is usually in favor of government intervention) supported a repeal of the legal separation of investment banking from commercial banking, a relaxation of banks' capital requirements, and an encouragement of a more aggressive creation and use of derivatives:

- The assessment that it had been "more than 60 years since financial disruption had had more than a minor impact on overall levels of production and employment". He attributes this to the ability of "modern central banks" to handle "deflationary shocks", in reminiscence of the now infamous Lucas (2003) quote (see Klüh 2014).

- The assessment that *"the profits of the investment-banking oligarchy (the handful of global investment banks, including Goldman Sachs, Morgan Stanley, and JP Morgan Chase, among others) were far in excess of what any competitive market ought to deliver, owing to these banks' deep pockets and ability to maneuver through thickets of regulations."*

– The assessment that *"the long-run market-return gradient – by which those with deep pockets and the patience to take on real-estate, equity, derivative, and other risks reaped outsize returns – seemed to indicate that financial markets were awful at mobilizing society's risk-bearing capacity."*

– The assessment that *"the poorer two-thirds of America's population appeared to be shut out of the opportunities to borrow at reasonable interest rates and to invest at high returns that the top third – especially the rich – enjoyed."*

Delong concludes (and thus answers his own question at the outset of this paper):

> *"More competition for investment-banking oligarchs from commercial bankers and insurance companies with deep pockets seemed likely to reduce the investment banking industry's unconscionable profits." (Delong 2011)*

It would be highly instructive to follow Delong further, as he attempts to look for a way forward. As a highly self-reflective economist, he has no problem to admit that he is still looking for answers to many questions. How could the entry of new competitors increase investment banks profits? Does central banking itself need drastic reform, as it failed to stabilize nominal income? How could the successors of Cornelius Buller forget the lessons that were already understood in 1825? Should we return to the more tightly regulated financial system of the first post-World War II generation?

Not all of these questions can be answered by economic theory and econometrics. However, economics provides numerous insights into the double-edged nature of competition in banking and finance. Much of this research has been produced during the establishment of the post Bretton-Woods macro-regime (see Grossman and Stiglitz 1976 for markets, Vives 2010 for a summary on banking, and Jiménez, Lopez and Saurina 2013 for recent evidence). Support for the theory that increased competition can lead to increasing instability has been an important element of most models rationalizing the fragility of banks, of most models looking at banks from an IO-perspective and of many empirical studies.

Against this background, explaining why competition was able to play the role it played becomes even more pertinent. How could it be one of the key sources of legitimation in spite of these arguments? Why did politicians and regulators listen increasingly to those researching financial markets and increasingly less to those researching financial institutions?

A simple explanation would be that core convictions of orthodox economics about the efficiency of markets have led them to a point where nobody burns his fingers on recommending more competition, regardless of the circumstances. It's like mothers' love, apple pie, and kittens-- who could oppose it? But that still does not answer why the economists that came up with reasons for caution did not raise alarm bells earlier or at least did not get through.

This paper is not an attempt to answer this question comprehensively. Klüh (2014) provides a number of explanations. Using theories of currency crises, he shows that the economic discipline has difficulties whenever heterodox insights of orthodox economists have to be translated into policy-relevant communications:

– Economics is as much science as it is an attempt to develop a language that allows the economic system in the sociological sense to communicate with itself. It therefore has a natural tendency to overemphasize the current communicative logic of the system.

- As it is a practical, moral science, economics develops a high proximity to the political system and its logic, too. It finds itself in a complicated double role of a language of its own and a translator of economic system dynamics to the political sphere.
- Economics itself has a very ambivalent relationship to the financial sector. On the one hand, financial markets are among the purest reflections of economic mechanisms. On the other hand, especially market-oriented economists have a tendency to blame the financial sphere whenever capitalist societies undergo periods of crisis.

This ambivalence is especially acute in the case of bank. On the one hand, banks' existence as institutions is a constant reminder that market failure might be the rule rather than the exception, as the microeconomic literature on banks constantly emphasizes. It is therefore not surprising that economists might favor financial systems in which markets dominate banks. Nonetheless, banks operate in markets for banking services. Moreover, they might be crucial for the functioning of the markets that are about to replace them, as markets have to be made. Finally, banks lend themselves more easily to personalization, and crises narratives seem to need personalization. If this cocktail is administered to politics, serious misunderstandings (and mismanagement of crises) can be the result. For example, in a speech in 2010 before the G 20 business summit, in which she calls for the reestablishment of an economic order of competitiveness, in which "money is not simply made but earned"), the German chancellor notes (Merkel 2010, our translation):

> *We cannot continue to explain to the electorate why it is the taxpayer that has to assume certain risks – and not those that earn a lot of money by incurring these risks. This is why the question, in how far we have to take the emotions (sic!) of markets seriously is a question of reciprocity. I beg the markets, which in some sense also have to be configured by persons, to be from time to time considerate of the political sphere.*

It is no more cakes and ale for banks, but an endearing call for friendship with markets. Luhmann (1994) paves the way for a further analysis of these aspects by deconstructing the role of competition for economic systems. He sees competition and the market as the environment of the economic system, not a system itself. It is thus akin to the political system, which also belongs to this environment. From the point of view of sociology, competition's main virtue is that it can function without interaction – competition is neither a conflict nor regulated conflict, it saves on conflicts. It might be this characteristic that can explain the increasing differentiation of the financial sector, its increasing speed and nervousness. "The sensitivity of the economic system and its reaction rate are based on the fact that the system saves on interactions. The reaction to events is not organized along chains and branches that connect interactions. Rather, there is a near simultaneous reaction of many to that which is supposed to be the reaction of others" (Luhmann 1994, p. 103, our translation). Financialization then, is both the culmination and perversion of this specific mode of reaction: It shares the logic of immediacy but is based on interaction, as the financial sector becomes a self-inflating network.

V. Conclusion

A number of crucial moments of the creation of the regulatory platform for financialization support the importance we attach to competition as a legitimation device. Each of them would require a much more elaborate transdisciplinary treatment and analysis, which we plan to carry out in future work. We are confident, though, that the objective of fostering competition has had a large impact on regulatory innovation. It played a decisive legitimizing role for further financialization:

- whenever the issue of financial instability surfaced and became a public issue (such as in the aftermath of Herstatt);
- whenever obstacles on the trajectory for a more deregulated, market-orientated financial system arose (such as in the case of the Bundesbank in the mid-eighties);
- whenever deregulation pessimists engaged in deregulation (such as in the case of the push for deregulation in the U.S. of the late 1990ies.

We thus believe that competition has been one of the main virtues that Malvolio wants Sir Toby to abide with. It has also been one of the concepts most laughed at by Sir Toby. Sir Toby knew that if competitive forces would drive him out of the house, there would always be an implicit guarantee (granted by Olivia) perverting competition.

There might still be laughter out there – cakes and ale do still abound. Instruments such as Contingent Convertibles (that build on the idea that competitive pressures will make you behave) do not make the financial system more stable. Basel III does still have a third pillar. Implicit guarantees and shadow banking are still around. We therefore conclude by emphasizing that recent attempts to bring the financial sector under control might be incomplete because they have not yet reflected sources of legitimacy for financialization sufficiently. In particular, recent attempts to re-regulate banks might be incomplete because they still suffer from trusting too much in a concept that *might* bring a lot of order to the real economy but could be a source of disorder for finance. Many observers still think that competition is an important mechanism for disciplining finance. But is it?

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