Political capture
by the financial industry

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Since the 2007 outbreak of the financial crisis the visible political dominance of the financial industry has become an issue of major concern for civil society. This essay unpacks the precise sources and diverse mechanisms of financial political power within the contemporary global economy. It illustrates this power over the policy-making process with specific reference to the case of the European Financial Transaction Tax, a policy which has been pursued by European authorities since 2009. This initiative is currently poised for defeat by the financial industry however, because of extensive watering down of the original proposal. The failure of this policy initiative is not an isolated event but indicative of a broader trend of successive political victories for the industry since the crisis.

The paper proceeds first with a brief overview of the political protection of the financial industry since the global economic crash, specifically in the policy-making domain of financial regulation. Second, I provide a brief theoretical overview of the distinct sources of financial political power within the global economy: 'instrumental' power involving conscious political mobilisation and direct lobbying; 'ideological' power involving a broadly neoliberal policy consensus among elite political groups; and 'structural' power involving the threat of capital flight and disinvestment, exacerbated in the context of contemporary 'financialisation'. Third, I illustrate the concrete manifestation of this power, highlighting the case of the European Financial Transaction Tax. I conclude by suggesting that efforts to overcome the economic dominance of the financial sector necessarily depend upon simultaneously curtailing the political influence of financial actors and markets over the policy-making process, and offer some brief suggestions for how this may be achieved.

The political protection of finance and regulatory failure

More than six years after the largest financial crash since the Great Depression, the global economy remains stagnant. Impeding recovery are extensive austerity programmes in developed nations and fiscal retrenchment designed to retain the confidence of, and ensure continued access to, international financial markets. With the burden of post-crisis adjustment falling squarely on the shoulders of states and ordinary citizens, the contrasting fortunes of the financial industry could hardly be starker.

Stubbornly high debt levels of governments and households continue to undermine domestic economic growth while offering ever-increasing monetary transfers to financial creditors. Most egregiously, financial institutions have benefited directly from large bailout and recapitalisation programmes with total guarantees for the G20 financial system accounting for roughly 11 per cent of combined gross domestic product (GDP). Globally, the number of people living in extreme poverty has risen by 80 million as a direct result of the economic crash, while unemployment ballooned from 178 to 205 million people during 2007-2009.[1]

By contrast, global financial markets have been momentarily disturbed by the crisis rather than fundamentally transformed. At the end of 2010 the value of global financial stock actually surpassed its 2007 peak before the onset of the crisis, to reach $212 trillion.[2] Banking profitability also returned with a vengeance with major firms continuing to reap the benefit of implicit guarantees from national governments due to their size, complexity and systemic interconnectedness. Similarly, shadow banking (unregulated elements of the global financial system, e.g. hedge funds or private equity funds) has expanded from $62 trillion in 2007 to $67 trillion in 2011, with its share of total financial intermediation remaining relatively stable at 25 per cent.[3]

Unconventional monetary policy by major central banks – such as the European Central Bank, the US Federal Reserve, the Bank of Japan and the Bank of England – has also been highly favourable to the financial industry post-crisis. Policy initiatives such as prolonged low interest rates, extensive liquidity provision and asset-purchase intervention all contributed to propping up asset prices, buttressing stock market earnings and providing cheap cash for speculation.[4] The distributional consequences have been clear as the profitability of major internationally active banks was boosted significantly throughout the 2008-2010 period as a result of extensive monetary easing.[5]

Perhaps the most confounding development in the aftermath of the financial crash has been the failure of policy-makers to follow through on commitments regarding financial regulation. Despite promises of a complete overhaul, reforms have been piecemeal, incremental and restricted.[6] This watering down of regulatory proposals has occurred at the global, regional and national levels. Globally, Basel III requirements – international agreements on prudent banking capital and liquidity standards – have been significantly weakened while the banking industry has been given until 2019 in order to prepare for the introduction of more stringent standards. In the case of shadow banking reform, the International Monetary Fund admits that "a firm consensus has yet to emerge on what, if any, regulatory action is needed", despite reform proposals put forward by the G20 in late 2008.[7] Other globally driven measures such as the regulation of over-the-counter derivatives (risky trades that are conducted without supervision) has been subject to continuous delays and fragmentation in implementation across different jurisdictions. Similarly, issues such as accounting convergence standards and the creation of a cross-border resolution regime for failing banks have proven too difficult for regulatory authorities to coordinate in any meaningful manner.[8]

Lacklustre developments have also occurred at the regional level where the efforts of the European Union stand out as particularly underwhelming. Important money market reforms (that would protect short-term access to credit) have been abandoned while others have been watered down, such as hedge fund and private equity regulation, credit-rating agency reforms, fund manager bonus caps and the Financial Transaction Tax initiative. Similarly, there has been widespread reluctance to tackle the persistent “too big to fail” issue whereby the future collapse of a large banking institution within an EU member state would threaten the entire economy and force officials to cover bailout with taxpayer funds. As it currently stands, large EU banking firms have either consolidated or increased their domestic market position. It is little wonder, then, that in June 2013 the European Parliament overwhelmingly approved a resolution condemning the slow pace and uncertainty surrounding regulatory initiatives, while rebuking the European Council and European Commission (executive bodies of the EU) for their lack of commitment to the financial reform process.[9] Despite this, the most recent attempts at European regulatory reform have resulted in the failure to implement long-awaited structural banking reforms (so-called Liikanen reforms) which aim to separate risky trading from more traditional lending practices at big European banks.[10]

Several explanations have been advanced for the lack of strong political action against the financial industry in the post-crisis era. One explanation identifies the lack of institutional capacity for coordination and collaboration on effective regulatory policy-making at the global level. A similar institutional ‘gridlock’ is replicated within the EU architecture. A second related explanation focuses on the role of diverse national interests among states in dealing with different sectors of the financial system. For instance, German, French and British reform preferences frequently diverge depending on the specificities of their internal economic structure and the prerogatives of their domestic financial actors. A third explanation maintains that the conservative and technocratic nature of regulatory bodies has led to the adoption of an overly cautious approach towards financial reform.

Each of these views is partly valid depending on the reform in question. However, particular attention must be paid to the exercise of financial political influence over the policy-making process. The political power of the financial industry has contributed significantly to weak regulatory outcomes and has been a major factor in the unequal burden-sharing of the post-financial crisis era.

Three dimensions of financial political power

In order to clarify the precise sources and mechanisms of financial sector influence over the policy-making process, it is necessary to make an analytical distinction between three basic types of power: instrumental, ideological and structural. A combination of these dimensions allows the financial sector to secure formidable leverage over political outcomes.

Instrumental

Instrumental power refers to conscious and formal political activity by financial actors, their institutions and associations. Needless to say, the material resources at the disposal of business groups are vast and generally dwarf those available to opposing interests. At the EU supranational level, 75 per cent of all active interest associations represent business in general.[11] Specifically in terms of finance, lobbyists outspend other interests at a ratio of 30 to 1, targeting a wide array of policy-making pressure points including: European Commission officials, European Council members (comprising heads of state), parliamentary MEPs, the Committee on Economic Affairs, advisory groups in official regulatory agencies, etc. The financial industry reports official figures of €120 million per year on EU lobbying expenses – most likely an underestimate – employing more than 1,700 lobbyists across 700 organisations.[12] Similar dynamics are evident at the national level.[13]

While such spending power can oftentimes 'buy' privileged access to policy-makers, it is by no means the only mechanism through which financial actors consciously mobilise to affect policy outcomes. Indeed, since the crisis, public representatives do not want to be portrayed as 'in the pocket' of large financial interests and thus, the industry frequently relies on a more subtle form of political leverage. This involves using their technical know-how and expertise to embed themselves within key policy networks in an effort to affect results directly. Given that financial sector regulation is highly complex and requires in-depth knowledge, it is particularly prone to the phenomena of elite 'revolving doors' and so-called 'regulatory capture'.[14]

Financial regulatory authorities in the EU, the International Monetary Fund and the Basel Committee on Banking Supervision, among others, value the technical skills that private sector actors possess and actively seek to incorporate this knowledge into their institutional functioning. On a consistent basis, private financial sector associations (such as the Institute of International Finance or the International Swaps and Derivatives Association) offer their services to key regulatory authorities on vital policy initiatives. Once access is secured, financial representatives work from the inside to water-down threatening parts of particular proposals while conveying a public image of pro-active participation in responsible global governance. Additionally, it is noteworthy that throughout their careers some key policy-makers go back and forth between the public and private sectors, tacitly reproducing dominant norms of conservative financial sector regulation.

Ideological

Ideological power refers to the overarching neoliberal policy consensus that exists among senior elements of the corporate and political worlds (including elements of the mass media). Such policies closely align with the prerogatives of major financial institutions and investors who benefit immensely from the opening up of new market opportunities through privatisation, an anti-inflationary fiscal policy and the implementation of austerity that shifts the burden of post-crisis adjustment upon the population. Although the crash of 2007/2008 did much to de-legitimise the liberalising, monetarist and especially deregulatory agenda that characterises neoliberal governance, it is clear that key policy-makers remain broadly wedded to this policy paradigm. For some policy-makers, neoliberal reforms are the only plausible response to the challenges of contemporary globalisation, while for others they reflect true-believer preferences premised upon supposed efficiency gains derived from an open-market economic programme.

Policy-makers in the EU largely embrace this approach. While small divisions persist over the precise handling of the European crisis, virtually all mainstream EU political parties and officials accept the inevitability of fiscal restraint and the necessity of implementing structural reforms (i.e. labour market flexibility) to increase competitiveness. In complementary fashion, the European Central Bank maintains hawkish control over monetary policy while the European Commission tightens its budgetary surveillance of member states. Thus, influenced prominently by German policy prerogatives, the EU remains committed to free-market globalisation, albeit tweaked by new forms of (macro-prudential) regulatory governance.

As is happening across other major economies, inflation rates remain historically low despite a loose monetary policy, while meaningful fiscal expansion is kept firmly off the agenda. Such ideological leanings are premised upon the financial industry acting as the driving force of the contemporary global economy, geared as they are towards financial market preferences: cheap credit, maintenance of asset values (e.g. property prices), state retrenchment, inflation targeting, etc.

However, none of this is to say that the neoliberal consensus goes entirely unchallenged – rather, it simply remains pre-eminent. Indeed, the crisis has opened up considerable opportunity for popular forces to advocate against these policies and push for reform initiatives that have the potential to rein in the political dominance of the financial sector.

Structural

Structural power refers to the persistent threat of capital flight and capital relocation that hangs over public representatives when making delicate choices about the conduct of economic policy. Simply put, if governments do not adhere to policies favourable to financial sector interests, they will be punished 'automatically' through capital disinvestment. As such, this dimension of power refers to the unconscious and impersonal influence of global financial markets determined by an aggregation of market-driven investor sentiment; there is no *intentional* pursuit of political influence on the part of financial actors. As one of the leading scholars of international political economy, Benjamin Cohen, puts it:

> "Few knowledgeable observers of the decentralized decision processes of the marketplace would argue that the pressures now exerted on governments are somehow designed with conscious political intent. An informal kind of veto over state behaviour has emerged. But it is a power that is exercised incidentally, through market processes, rather than directly in pursuit of a formal policy agenda."[15]

In the context of contemporary globalisation, there are two specific features of the world economy that exacerbate the influence of financial structural power over the policy-making process. First, the progressive 'financialisation' of advanced market economies, and second, the stagnant recovery conditions of the post-crisis era.

The relatively recent phenomenon of financialisation denotes the growing prominence of financial motives in all aspects of economic life. More specifically, financialisation refers to several pronounced trends that characterise the functioning of advanced economies such as the EU, the US, Japan and increasingly, a number of emerging nations. These processes involve: the rise of shareholder value (prioritising short-term maximisation of corporate profits over other stakeholders); a general shift from banking-led finance to capital market-led finance (further integrating state, household and corporate borrowing with international capital flows); the increasing financial market participation of non-financial corporations (tightening the interests of productive firms with financial firms); and the explosion of speculative activity within the financial sector itself (promoting the creation of complex financial instruments that are difficult to regulate).

Many of the dominant accumulation, investment and consumption patterns within advanced economies have become fundamentally intertwined with these processes of financialisation. Thus, any effort to limit the salient role of financial activity and credit flows runs a very real risk of undermining the growth and employment prospects of individual economies.

Relatedly, stagnant recovery conditions in the post-crisis era puts additional pressure on leading policy-makers to avoid a clamp-down on financial sector activity. The logical fear is that aggressive action may worsen credit provision and thus impede the funding of productive firms – in particular small and medium size enterprises that generate the bulk of internal domestic employment. Furthermore, the growth of a thriving and high-income earning financial industry within most advanced economies means that policy-makers are loathe to damage the competitiveness of this dynamic sector of their domestic economy (e.g. the US and UK's jealous protection of Wall Street and City of London interests). Hence, the prolonged weakness of post-crisis recovery buttresses the political position of financial actors, strengthening their claims that cautious and piecemeal regulation is a more prudent course of action and propagating the view that national states are 'structurally dependent' on the vitality of a liberalised financial system.

Financial political power and the EU Financial Transaction Tax

The Financial Transaction Tax (FTT) policy was brought onto the political agenda by a range of high profile figures such as former UK Prime Minister Gordon Brown, former French President Nicolas Sarkozy and former German Minister of Finance Peer Steinbrück at the G20 Pittsburgh meeting in 2009. In the wake of the financial crisis, it was deemed appropriate that the financial sector should contribute towards the costs of the crisis. Given the high mobility of financial capital, the global level was seen as optimal for implementation. Nevertheless, Tim Geithner, then US Treasury Secretary, dismissed this idea out of hand, responding to the loud concerns of Wall Street firms at the possibility of a new global taxation charge.

Undeterred, the EU pushed ahead in the hope that it could design a FTT that would demonstrate the effectiveness of such a policy to the broader international community. However, the policy initially failed at the EU level as the new UK government led by the Conservative Party (and flanked by finance-dependent economies such as Luxemburg, Ireland, Cyprus, etc.) vetoed the idea in late 2011. Nevertheless, in 2012 a group of 11 member states including Germany, France, Italy and Spain (EU11), opted to go it alone under conditions of 'enhanced cooperation' – a legal device allowing nine member states or more to pursue legislative policy without the approval of other members.

Persistence with the FTT policy by leading member states and other European authorities is a testament to the partial decline in ideological support for finance in the post-crisis era. The European Commission, despite its initial reluctance towards the idea, has been a particularly vigorous supporter. Such willingness to support a FTT policy emerged primarily from the commissioners' role as 'political managers' who were forced to deal with a severe fiscal crisis affecting Europe. Such a predicament led them to re-evaluate their previous unwavering commitment to financial sector interests. Furthermore, in their search for credibility in the eyes of the European population they sought to demonstrate a willingness to combat the worst excesses of financial misbehaviour. As a part of this shift, the Commission has frequently attempted to insulate itself from the barrage of lobbying conducted by financial sector groups in the post-crisis era.[16]

The reputational damage to finance also allowed a wide range of civil society groups across the EU to maintain political pressure for the taxation initiative because it garnered huge public support: majorities in 24 out of 27 member states polled in favour of the proposal.[17] Popular support emboldened the Commission to take an aggressive stance with regards to the details of the FTT policy. Proposing a charge of 0.1 per cent on shares and bonds and 0.01 per cent on derivative transactions, the Commission estimated the FTT would yield €34 billion in annual revenue across the EU11.

More importantly, the charge was designed to incorporate the widest possible scope of financial activity in an attempt to prevent tax avoidance and capital relocation (termed the 'AAA approach' encompassing all actors, all instruments and all markets). Furthermore, legal measures were incorporated to ensure that EU11 firms could not escape the charge simply by moving out of the EU11 jurisdiction.[18] Instead, what matters is 'who' is trading, rather than 'where'. Such anti-avoidance measures mean that the only way for financial firms to escape the charge would be to avoid commercial interaction with EU11 countries entirely; a highly unprofitable – and hence, unlikely – global trading strategy.[19]

This carefully crafted FTT proposal was initially set to be implemented in January 2014, yet eventually faced postponement and extensive watering down. The explanation for this outcome lies in the complex interaction of *instrumental* and *structural* financial political power. Across the EU, a plethora of transnational financial sector trade associations began to mobilise vigorously against the charge. The dominant tactic was to push for various exemptions across different sub-sectors of the financial industry in order to narrow the scope of the tax.

Well-funded organisations such as the Association for Financial Markets in Europe and the Swaps and Derivatives Associations lobbied MEPs and European Council members relentlessly, citing highly technical industry assessments and highlighting the negative impact the charge would have upon the competitiveness of the EU financial sector, employment, lending flows and the vitality of the EU economy more broadly. Given the determination of the Commission to see the charge implemented, financial actors concentrated their lobbying attention towards specific heads of state represented within the Council.

The strategy thus involved widespread instrumental mobilisation combined with the persuasion of several structural power arguments. Furthermore, the overlapping membership of financial firms across different trade associations allowed the industry to present a coherent and relatively unified front in their messaging to key policy-makers. British financial trade associations even convinced the UK government to take a legal case to the European Court of Justice citing the illegality of the Commission's aggressive policy proposal. Although the case failed, the legal action exacerbated the sense of political fatigue with the proposal at the European Council due to the level of diplomatic friction created between participating and non-participating member states throughout discussions.[20]

Central banks were a major site of intensive tactical lobbying by financial sector trade bodies. In mid-2013 financial associations began a concerted effort to convince prominent bankers that the FTT charge would hurt central bank monetary policy transmission as well as the competitiveness of European financial markets. Prompted by a flood of public letters and appeals, senior central bankers across Europe immediately began to speak out publicly against the charge. This included Jens Weidman of the Bundesbank (Germany), Mervyn King of the Bank of England, Christian Noyer of the Banque de France, Luis Maria Linde of the Bank of Spain and eventually, European Central Bank chief Mario Draghi who offered assistance to policy-makers for crafting a better policy proposal.[21] Unlike the Commission, the European Central Bank has not tempered its support for the financial sector since the economic collapse – from its controversial advocacy of large financial sector bailouts by member-states, to its refusal to accept private sector losses for bondholders, to its highly accommodating monetary policy.

Perhaps most importantly for the fate of the FTT, non-financial corporations also lobbied vigorously on behalf of the financial industry. Firms claimed that the FTT charge would hurt them in two ways. First, they claimed that the tax would increase their cost of raising funds on capital markets. Second, productive firms argued that their internal treasury operations (financial market transactions conducted during the normal course of business activity) would be hit significantly, raising their costs of operation. Such arguments bring up the important question of how 'financialised' large non-financial corporations have become in the contemporary world and puts into question the distinction that is often made between the interests of 'real' and 'financial' sectors of the economy. By the end of 2013, all large productive firms across Europe – including influential trade associations such as the European Roundtable of Industrialists and the major employers' associations within Germany and France – had united against the charge, prompting further anxiety among European Council members regarding the policy's wisdom.

Due to a failure of all EU11 member states to agree at the Council level on the precise scope of the FTT, the policy missed its intended January 2014 implementation deadline. Central to this failure was the role of France, which began to rethink its position on the Commission's broad-based proposal, especially as it related to the issue of derivatives (i.e. complicated financial transactions – often speculative – that 'derive' their value from the performance of another asset).

Constituting over two thirds of the estimated €34 billion from the proposed tax intake, derivatives were to be a crucial component of the policy's overall success. However, the politically troubled mid-term of French President François Hollande was characterised by re-engagement with the domestic business community, leading to an about-turn on the taxing of derivatives. Responding to fears of the French financial community, a charge on derivatives was now seen as severely damaging to the interests of Paris as a major financial centre within the global economy and indeed, undermined the new 'Place de Paris 2020' initiative (announced in mid-2014) to boost the French financial industry. Furthermore, a number of other Council members began negotiating for specific exemptions on products such as pensions or corporate and government bonds, thus opening the prospect of multiple exemptions to a future FTT.

In effect, the manipulation of policy-makers' fears by financial associations regarding the structural impact of a broad-based FTT had paid off. Subsequently, in an explicit effort to save face before the new parliamentary election in May 2014, European leaders agreed upon a rushed compromise that: 1) pushed back the start date of the FTT to 2016; 2) agreed that the charge would be implemented provisionally on a very narrow basis; and 3) was projected to raise just a fraction of the originally intended sum. The deal was criticised in harsh terms by a range of FTT civil society supporters, condemned as 'window dressing' for voters before the EU parliamentary elections and – crucially – involving a "tax base [that] is far too small to have any effect."[22]

Worryingly, the inclusion of specific exemptions for particular transactions and the rejection of the Commission's "AAA" approach open up the possibility that a future FTT will be subject to massive tax avoidance – putting at risk the already hugely decreased revenue estimates. As then European Tax Commissioner Algirdas Šemeta warned in January 2014, an FTT that is "full of holes" is one that has little chance of effectively combating relocation concerns in a world of highly mobile financial capital.[23] At the time of writing (January 2015), the FTT remains mired in a political stalemate as European Council members continue to negotiate on the precise form of the taxation policy. Although the EU11 countries still maintain their intention to implement the charge in January 2016, this deadline is becoming increasingly unlikely as key outstanding issues are proving difficult to resolve.

The primary conflict revolves around the scope of taxation and debate concerning what kind of derivatives (if any) should be included in a final deal – an outcome that France continues to oppose. However, even Germany's Minister of Finance Wolfgang Schäuble – one of the FTT's most prominent supporters – concedes that the "result [of negotiations] will be modest",[24] garnering just a fraction of the originally targeted €34 billion. Compounding these bleak prospects is the recent appointment of Pierre Moscovici as the new European Commissioner for Taxation, the former French Minister of Finance who was centrally involved in the Hollande government's sudden about-turn on the FTT.

Conclusion

The case of the European FTT is just one specific example of the potent political influence of the financial industry within the contemporary global economy. However, across most major policy proposals put forward since the financial crash, one can find such ubiquitous financial sector influence over the final outcomes. With this in mind, I conclude with two suggestions for civil society and activists to challenge the disproportionate political and economic position of the financial industry vis-à-vis other social groups.

First, the current ideological power of finance that promotes a neoliberal policy consensus is politically vulnerable and within that context, there is an opportunity to rein in the excesses of the financial sector. Nevertheless, the urgency for reform that prevailed throughout 2008 and 2009 has rapidly dissipated and official sector regulators have lapsed back into a status quo mind-set of conservative and technocratic tweaking of financial rules. This conservatism is partially a product of the fear of making the economic situation worse by taking strong political action against the financial industry.

Civil society groups need to reignite this sense of urgency for more ambitious policy action by *explicitly linking the absence of substantial financial sector reform with the lack of a robust economic recovery*. As long as financialisation remains the dominant form of economic accumulation, investment is systematically diverted from productive uses within the real economy towards speculative and socially dubious practices within the financial system.

This situation is most vividly reflected in the excessive reliance that authorities have placed upon monetary policy (i.e. money supply and interest rates) as the primary tool driving economic recovery as opposed to fiscal policy (i.e. government spending and taxation). Instead of stimulating flagging demand and prompting a new wave of productive activity, authorities are promoting the creation of new asset bubbles (in particular, property) and stoking excessive risk trading within the financial industry itself. These policies also allow major financial firms to remain heavily indebted and risk-taking, and exacerbate the prospect of another costly crisis in the not-too-distant future.

Emphasising these points, civil society groups should consistently argue that the path to durable economic recovery involves a highly chastened financial sector that plays a largely functional role in the global economy, providing funds to credit-starved businesses rather than driving new activity internal to the industry itself. Crucially, this must be complemented by a concrete public spending plan in infrastructure and services projects such as social housing, national transport, job re-skilling, 'green industry' research and investment, and other stimulus programmes premised upon the specific needs of individual economies.

Secondly, most arguments proffered by the financial sector depend upon some version of structural power; that is to say that political action against the financial sector will result in economic damage to the broader economy. Such arguments must be combatted vociferously by civil society. In many instances, financial sector representatives disseminate highly inflated figures concerning the economic repercussions of regulation premised upon dubious impact assessment reports. These reports too often go unchallenged and thus, exploit the genuine concerns of policy-makers who are unsure of the consequences. Such 'doomsday scenarios' must be repelled by activists in two ways: on the one hand, by constructing their own sophisticated impact assessments that challenge the anticipated negative impact on economic activity; on the other hand, by highlighting the positive benefits of financial reform such as stable credit flows, the discouragement of socially useless trading, the revenue-raising potential of particular measures (e.g. FTT), etc.

Of course, there is no simple way for civil society to develop the technical expertise required to counter the financial sector lobby – it requires a further prioritisation of time and scarce resources to these complicated issues. Nevertheless, activists have little option but to proceed with this task in the context of a deeply 'financialised' global economy.

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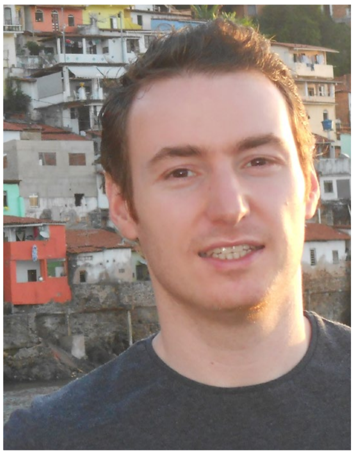

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