

*Finance: Servant or Deceiver?
Financialization at the Crossroads*

Paul H Dembinski
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Broad social changes rarely occur all at once or as the result of a single dramatic event. More often, these changes are precipitated by a new set of ideas that gains currency as men and women, one by one, accept the ideas. And having accepted the ideas, these same men and women begin to make decisions, one by one, that over time alter the structure or trajectory of their society. As we participate in these decisions and the changes they bring about, we rarely think of the implications of our choices and so we rarely recognize the consequences. The thesis of this book is that during the twentieth century, and especially in its closing decades, a set of fundamental changes, which may be gathered together under the term “financialization,” have profoundly reshaped the economic arena.

Paul H Dembinski, an economist by training, is a professor at the University of Fribourg in Switzerland and one of the founders of the Geneva-based Observatoire de la Finance, which for more than a decade has explored issues related to finance and the common good. In this slender volume, Dembinski sets out to explore the phenomenon of financialization and its implications for the welfare of individuals and society.

A healthy financial sector serves both the common good of the society (and indeed the global community) as well as the well-being of individuals who participate in it. When it functions well, it ensures a reasonable stability in

money and prices, it frees up wealth (liquidity) and matches it with productive capabilities (investment), and it diminishes and manages a variety of risks. But when it functions poorly it becomes, as the title suggests, a faithless servant and, at its worst, a merciless master.

Dembinski contends that the post-war years have seen a gradual but dramatic transformation in the theory and practice of finance, a process which he calls "financialization." By this he means, in general, a set of changes in which the principles of finance become exaggerated, distorted, and extended to virtually every dimension of the economy. In this tightly written book, he provides an impressive analysis of this transformation that includes historical, philosophical, and economic elements and data. In doing so, he brings into focus and illuminates the relationships of a variety of phenomena that might be innocent in themselves but taken together result in a toxic mixture.

A short review cannot do justice to the complexity of the subject but perhaps we can highlight some of the essential elements.

One critical transformation is a shift in the dominant mode of thinking from a focus on a world of praxis to a focus on a world of theory. The world of theory is a world of mathematical precision, where financial objects, relationships, and risks are quantified. What is not quantifiable is not important, however crucial it may be in the world of praxis (which we actually inhabit). As finance embraces a more and more theoretical perspective, it focuses more intensely on quantifiable results.

There are several consequences of this. One is that finance becomes increasingly detached from the society and the larger environment within which it operates. It is no longer understood to be an element of a well-ordered society which supports both the common good and the well-being of individual investors.

Another, related consequence is that participants in the financial marketplace, especially those engaged in its operations, come to adopt an "ethos of efficiency." Here the means become the end and technical goals (such as maximizing return on assets) become both the objective and the standard of measuring performance. At its most extreme, this ethos of efficiency has no capacity to evaluate the impact of the pursuit of maximum return (which, in any event, is a theoretical construct, not a practical objective) on real human beings. At times, then, we are left with the absurdity of such things as forcing the layoffs of large numbers of workers so as to increase the value of their pension portfolios.

Another factor underlying these changes, though Dembinski does not dwell on it, is a shift in our understanding of persons and property. Where once we had a

more robust notion of persons as essentially and necessarily embedded within communities and dependent for their well being on the health of those communities (i.e., the common good), financialization assumes that persons are radical individuals in pursuit of the resources they require to achieve the goods they have chosen. This, in combination with the ethos of efficiency, leads to a diminishment of stable human relationships in favor of mere transactions.

This is nowhere more evident than in banking. Traditionally, banks made their money principally from the difference in interest rates paid to depositors and collected from borrowers. This was facilitated by long-term relationships and trust. Now, As Dembinski asserts, banks owe an increasing share of their profitability to a strategy of “originate and distribute,” whereby they simply process and service lending but no longer retain an ownership interest. The question in evaluating a loan, as we have seen recently in the mortgage market, is whether it can be sold, not whether it is sound in itself.

Which leads us to another crucial transformation, which concerns the foundation of the value of assets. A real-world perspective gives considerable attention to the objective conditions that underlie an asset and its capacity to generate a stream of income. A financial perspective, on the other hand, tends to focus only on the transactional value of an object (and virtually anything can now be made a financial object), which is to say its potential to be purchased by someone else. As long as a government agency, for example, is willing to buy bundles of mortgage loans without regard to traditional financial soundness, these loans have value in transaction.

The result of all this is a shift in the direction of a make-believe world in which efficiency becomes an end in itself, real productivity is marginalized, and little account is taken of the risks imposed on real people and institutions.

Dembinski has offered a fascinating and compelling account of our current state of affairs and the process that has brought us here. His diagnosis of the problem is persuasive in most regards. What is less rewarding is the slender section at the end of the book in which he offers suggestions for remedies. Nevertheless, anyone interested in a sophisticated but accessible critique of modern finance will be rewarded for the time he spends with this book.