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Book Part — Manuscript Version (Preprint)

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Suggested Citation: Hager, Sandy Brian (2012) : Investment Bank Power and Neoliberal Regulation: From the Volcker Shock to the Volcker Rule, In: Overbeek, Henk van Apeldoorn, Bastiaan (Ed.): Neoliberalism in Crisis, The Bichler and Nitzan Archives, Toronto, pp. 68-92, <http://bnarchives.yorku.ca/330/>

This Version is available at:

<https://hdl.handle.net/10419/157984>

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Investment Bank Power and Neoliberal Regulation: From the Volcker Shock to the Volcker Rule

Sandy Brian Hager

‘The bank is something else than men. It happens that every man in a bank hates what the bank does and yet the bank does it. The bank is something more than men, I tell you. It’s the monster. Men made it, but they can’t control it’

–John Steinbeck, *The Grapes of Wrath*

‘I’m doing God’s work’

–Lloyd Blankfein, CEO of Goldman Sachs

Introduction¹

In 1941 Paul Sweezy (1910-2004), a founding member of the ‘monopoly capital’ school of Marxism, published an article on the power of US investment banks in light of the 1929 stock market crash and ensuing depression. His assessment of their relative position and future prospects within the corporate hierarchy was bleak. Although the major investment banks had survived the turbulent 1930s, Sweezy

¹ This is an author-edited pre-print of a chapter published in 2012 in Henk Overbeek and Bastiaan van Apeldoorn (eds), *Neoliberalism in Crisis*, Basingstoke, UK: Palgrave Macmillan. Earlier versions of the paper were presented at the 2009 Rethinking Marxism conference at UMASS Amherst, the 2010 International Studies Association conference in New Orleans and the 2010 Eastern Economic Association conference in Philadelphia. The paper has benefitted from the insightful comments and criticisms of many people, especially Bastiaan van Apeldoorn, Joseph Baines, Joe Francis, Elif Genc, Jeremy Green, Brenda McComb, Jonathan Nitzan and Henk Overbeek. The usual disclaimers apply.

argued that they failed to reassert the dominance they secured during the initial transition from competitive to monopoly capitalism around the turn of the twentieth century (see Veblen 1923). Firms that once embraced the guidance of investment bankers had matured into giants capable of expanding their operations through internal financing. As a result, most of the securities market activity that took place involved routine refunding operations that required little investment bank expertise, while those few securities that were newly issued were privately placed with increasingly powerful institutional investors.

Taken together, Sweezy (1941: 66; 1942: 265–269) suggested that these changes signified a ‘simple atrophy of functions’ for investment banks, whose remaining business was ‘being carried on to an increasing extent by new methods and by new agencies better suited to the task’. Investment banks played a crucial role in the consolidation of monopoly capitalism. Yet once this process was completed, Sweezy (1941: 67–8; emphasis in original) argued that they ceased to ‘play a *special* role in the economic life of the country’. The power vacuum left in the wake of their decline would likely be filled by the state and family-controlled industrial empires.

Forty years later, Sweezy followed up the themes of this original article by reassessing the power of investment banks during the heyday of monopoly capitalism: the postwar ‘Golden Age’. Investment banking had proven to be highly profitable in this period, but the community of large investment banks, Sweezy (1981: 249) claimed, had still not ‘regained any of its old aura as the aristocracy of the business world’. Competition for underwriting and merger services had become increasingly fierce. And the diffusion of power created by competition was further aided by the growing tendency towards conglomeration. Much like corporate legal or auditing services, Sweezy (ibid: 250) suggested that investment banks played an essential role in the ‘smooth functioning of the corporate system’. But this did not provide them with a position of power relative to their corporate clients; nor did it stem their relative long-term decline within the financial sector. In short, Sweezy reaffirmed his earlier claim that investment bank power was a transitory phenomenon strictly confined to an earlier phase of capitalist development. And upon reaching this

unambiguous conclusion, Sweezy never again revisited the issue of investment bank power and its implications for US capitalism.

What is most remarkable about this final assessment is that it came on the cusp of what Sweezy and other members of the monopoly capital school would later identify as a new phase of capitalist development in the US. This phase, which emerged in the early 1980s and which now appears to be drawing to a close with the global financial crisis, has recently been referred to as ‘the age of monopoly-finance capital’ (Bellamy Foster 2010). According to monopoly capital theorists, the main feature of the monopoly-finance phase is the ‘financialization’ of capital accumulation: a process that involves the stagnation of investment in the ‘real’ productive economy and the explosion of ‘fictitious’ claims to wealth. And while Keynesianism was the ‘ideological counterpart’ of monopoly capitalism, neoliberalism, with its free market mantra of ‘sound money’, liberalization and deregulation, has emerged as ‘the economic policy most conducive to today’s monopoly-finance capital’ (Bellamy Foster and McChesney 2010: 52).

The monopoly capital school argues that this shift to financialization and neoliberalism has led to the resurgence of ‘financial capital’.² Power, according to this argument, is increasingly wielded by large finance, insurance and real estate sector (FIRE) corporations at the expense of the industrial giants that dominated the postwar period (Sweezy 1994; Bellamy Foster and Holleman 2010). This argument seems to conflict with Sweezy’s earlier claims about investment bank decline. Investment banks are, after all, a part of FIRE, so doesn’t the apparent resurgence of that sector suggest that investment bank power is not in fact a ‘transitory’ phenomenon confined to an earlier phase of capitalism, but a very real part of the contemporary period? Sweezy provides us with little insight into this question because, as was noted above, the issue of investment bank power was completely neglected in his work after 1981. Unfortunately,

² Of course the monopoly capital school is not the only school of Marxism to analyze the dynamics of financialization and the rise of finance capital over the past three decades. An exhaustive review of this literature is outside of the scope of this chapter. But many of the critiques that I make here, especially concerning the problematic bifurcation between the ‘real’ and ‘nominal’ spheres, could apply equally to these other accounts.

the works of other monopoly capital theorists are also of little help. The few brief references that are made to the power of investment banks merely reassert Sweezy's original arguments (Bellamy Foster and Magdoff 2009: 149).

How do we explain this indifference, especially given the monopoly capital school's recent emphasis on financial power? The answer may lie in the enduring influence of Sweezy's conclusions. With this justifiably influential figure reaching such unambiguous conclusions about the transitory nature of investment bank power, it is little wonder that others working within the monopoly capital school tradition since then have never seriously re-examined the issue. Another reason may have to do with the growing trend towards conglomeration, which Sweezy (1981) not only regarded as a further sign of investment bank decline, but which he also saw as eliminating any meaningful distinctions between financial firms. If investment banks are indeed indistinguishable from other financial services conglomerates then there is little need to re-examine the power of investment banks as a separate category of firms.

My purpose in this chapter is to challenge this indifference and re-examine Sweezy's arguments about the transitory nature of investment bank power. Through extensive qualitative-quantitative analysis, I argue that there has in fact been a rapid increase in the power of large investment banks from the early 1980s up until the current financial crisis. This power is wielded in almost every facet of financial market activity and therefore extends far beyond their traditional power in underwriting and mergers advisory. But this diversification of power, I suggest, does not render the distinctions between investment banks and other financial services conglomerates meaningless. The trend towards conglomeration is undoubtedly significant. And now with the disappearance of independent investment banks in the wake of the current crisis, the distinctions between FIRE firms may have been irreversibly erased. But I argue that the rapid rise of investment bank power over the past three decades, as well as its apparent decline with the crisis, cannot be adequately explained if investment banks are lumped together with the FIRE sector as a whole. Though functional boundaries between firms may have faded, the course of investment bank power over the past three decades has been bound up with the

unique ways in which they have manoeuvred within US financial regulation.

This alternative empirical account does not arise within a theoretical vacuum. The arguments here are developed out of an engagement with the theory of monopoly capital, and particularly with its conceptualization of the relationship between power and the central process of capitalist societies: capital accumulation. Specifically, the theory of monopoly capital relies on a bifurcated view of accumulation; one that separates capital into ‘real’ and ‘financial’ spheres. The interaction between these spheres is supposed to explain the power of investment banks. But as will be discussed in detail below, this bifurcated view is logically circular and empirically inoperable. And because of this, the monopoly capital approach is unable to explain or measure the oscillations in investment bank power over time.

My own approach, anchored within the capital *as* power framework pioneered by Jonathan Nitzan and Shimshon Bichler (2009), takes its point of departure in explicitly rejecting the real/nominal duality underlying monopoly capital’s theory of accumulation. Instead it argues that the central logic governing accumulation is capitalization: the discounting of risk-adjusted future earnings into present value. As a symbolic quantification of capitalist power to restructure society, capitalization provides an alternative starting point for investigating investment bank power. I argue that linking the quantitative architecture of capitalization to the qualitative manifestations of power provides a more compelling account of the changing power of investment banks since the 1980s.

Finally, this alternative theory of accumulation also leads to a rather different assessment of neoliberalism’s role within contemporary capitalism. For the monopoly capital school, neoliberalism is said to serve the interests of ‘financial capital’. Yet my empirical study suggests that this assertion is far too general (see also Kotz 2010: 6). Even if financial capital is narrowly equated with so-called financial intermediaries, the claim that neoliberalism has served their collective interests glosses over the ways in which neoliberal policies and regulations have at certain points served to enhance the competitive struggles *within* the FIRE sector (compare the chapter by Paul Lewis and James Perry in this volume).

The rest of the chapter is roughly organized into two halves. The first half offers a systematic critique of the monopoly capital school's approach to capital accumulation, and outlines an alternative approach based on the notion of capital *as* power. The second half then offers an empirical analysis of investment bank power since the 1980s, with particular emphasis on the linkages between investment bank power and the rise of neoliberal regulation. It then offers some tentative thoughts about US financial sector power and the limits and possibilities of new regulatory initiatives in light of the current crisis.

Finance, Power and Monopoly Capital

The monopoly capital (hereafter MC) school's explanation for the power of financial intermediaries is anchored within a theory of capital. Most of the time, this theory is not explicit in Sweezy's writings on investment banks. But it is still possible to re-trace how this theory informs Sweezy's arguments about the changing role of investment banks.

Before the rise of giant corporations in the early twentieth century, Sweezy argued that accumulation in the US was governed by Marx's competitive laws of motion, including the tendency for the profit rate to fall (Baran and Sweezy 1966: 72). It was in the nineteenth century within an environment of fierce competition that the investment banker, enriched from the financing of the Civil War and the construction of the railroads, began to exert incredible influence over the nascent US industrial apparatus. Desperate to stem the tide of excess output, deflation and falling profits, the industrial firms of this period welcomed the oversight that investment banks, led by J. P. Morgan, provided by sitting on corporate advisory boards, facilitating the combination of firms into holding companies, and underwriting new securities.

In orchestrating the combination of small firms into a tightly-knit network of colluding giants, the investment banks helped to restore these sectors to profitability. But Sweezy argued that in doing so the investment banks also planted the seeds for their own demise. As mentioned in the introduction, the once-feeble industrial corporations had become powerful by the early twentieth century, capable of self-

financing their operations. Growing profits meant that the industrial corporations were gradually able to shed their reliance on investment banks.

According to Sweezy, these developments had deeper implications for the US because they annulled the competitive tendencies that Marx predicted would bring about a collapse of the capitalist system. While the competitive phase was dominated by the tendency of the profit rate to fall, the monopoly phase was governed by a new tendency for the surplus to rise. Within this phase, the investment banker's position as the most powerful figure in the US was usurped by the large industrial corporation.

Space constraints prevent a thorough discussion of the tendency of the surplus to rise.³ But the basis dilemma of that tendency is that collusive, 'price-making' industrial corporations no longer face a problem of falling profits, but instead a shortage of profitable, productive outlets for their surplus. In order to counteract the tendency towards stagnation that this causes, capitalists come to rely on wasteful expenditures to absorb the economic surplus. The sales effort, government (especially military) spending and the 'financial superstructure' are all singled out as primary 'outlets' for surplus-absorption.

The growth of the 'financial superstructure' can be seen with the explosion of private and public debt, consumer finance, financial instruments, and the ballooning of the financial sector that intermediates the proliferating relations of credit and debt. As such, 'finance' still plays a role within advanced monopoly capitalist societies. But under monopoly capitalism, financial power becomes a dependent force since, as an outlet for surplus, the precise oscillations of the financial superstructure ultimately depend on, and can only be explained with reference to, the underlying oscillations in the industrial 'base'.

In MC's analysis of the postwar Golden Age, finance took a back seat to military spending and advertising as the predominant wasteful outlets for excess surplus. But from 1980s the MC school turned its attention to the re-emergence of finance as the 'largest countervailing

³ For more detailed explications of this tendency and its relation to the laws of motion of orthodox Marxism, see Baran and Sweezy (1966); Howard and King (1992).

force' to stagnation (Bellamy-Foster and Magdoff 2009). And since the early 1980s, MC has argued that stagnation, coupled with financial explosion, has caused the financial superstructure to de-couple significantly from the underlying 'real' economic base. As a consequence, financial intermediaries have moved beyond on their supporting-role as 'facilitator[s] of the production and distribution of goods and services' (Magdoff and Sweezy 1987: 20), to become the primary drivers of accumulation.

The MC school offers plenty of data to demonstrate the connection between industrial stagnation and financial explosion over the past three decades. But it is unclear to what extent this data actually supports MC's theoretical claims. One of the less serious problems has to do with diversification, which according to Magdoff and Sweezy (1987: 97), made it impossible '...to define or delineate the financial sector with any accuracy'. Since corporations classified as 'industrial' and 'financial' are both increasingly engaged in intermediation, it becomes difficult to separate their financial and industrial activities, and impossible to pin down the financial and industrial components of profitability.⁴

This ambiguity has its origins in a more pressing problem: MC's bifurcation of capital into 'real' and 'financial' spheres. This duality can be tied back to Marx's labour theory of value (LTV), which is supposed to explain the interactions between the two spheres. For Marx, the 'real' sphere of industrial capital is denominated in the universal unit of 'abstract labour' and the 'fictitious' sphere of money capital in prices. Because the LTV assumes that productive labour expended within the 'real' sphere is the source of surplus value, what happens within this sphere is meant to explain the epiphenomenal world of prices.

But there is one crucial difference between Marx and the monopoly capital school: the latter completely abandoned the LTV as a guide to quantitative empirical research (Sweezy 1942). Given that no one has been able to identify or measure abstract labour, it could be argued that the MC school, which has been careful not only to theorize but also empirically explore accumulation, made this move out of necessity.

⁴ On the problem diversification poses for profit accounting, see Nitzan and Bichler (2009).

But the abandonment of the LTV came at a hefty price. Recall that in the MC framework, what happens in the ‘financial’ sphere ultimately hinges on what happens in the ‘real’ economy. But without a ‘real’ unit of its own to replace abstract labour, all of MC’s empirical measures rely on national accounting data denominated in ‘fictitious’ prices. To make matters worse, ‘real’ measurements created by statisticians involve a series of circular assumptions about equilibrium and utility; liberal concepts that are antithetical to Marxism (Nitzan and Bichler 2009). Magdoff and Sweezy (1987: 94) recognized the impossibility of separating the ‘real’ from the nominal, but never considered the logical circularity of relying on nominal data to explain so-called ‘real’ phenomena.

Yet even if we take a pragmatic approach and assume that price measurements offer a meaningful proxy for ‘real’ capital, the explanation still runs into trouble. According to the theory, although the financial superstructure can de-couple from its ‘real’ base ‘to a considerable degree’ this cannot happen indefinitely (Bellamy Foster and Magdoff 2009: 72–82). And so the argument follows that periods of speculative excesses eventually unravel, and ‘fictitious’ capital comes crashing back to ‘real’ capital. But in order to know whether this actually is the case, we need to measure real and fictitious capital to determine if: (1) there was a coupling between them at some point; (2) periods of decoupling are eventually followed by re-coupling through financial crisis. To address these issues we first need reasonable and comparable proxies for ‘real’ and ‘fictitious’ capital. The MC has offered plenty of data on stagnation and financialization, but they have thus far neglected to bring measures for these types of capital together in order to analyze their long-term historical relationship.

By MC’s own definitions, ‘real’ capital is represented by ‘the stock of plant, equipment and goods generated in production’, while ‘fictitious’ capital is represented by ‘the structure of financial claims produced by the paper titles to this real capital’ (Bellamy Foster 2010: 6). Employing these definitions, we would have to compare some measure of the capital stock alongside the market value of debt and equity that has capitalized this ‘real’ wealth. In research that explores the thesis of a ‘mismatch’ between ‘real’ and ‘fictitious’ capital, Nitzan

and Bichler (2009) provide such measures. Figure 1 reproduces and updates their data, which analyzes the relationship between the rate of change in the current cost of corporate fixed assets ('real' capital) and rate of change in the market value of corporate equities and bonds ('fictitious' capital).

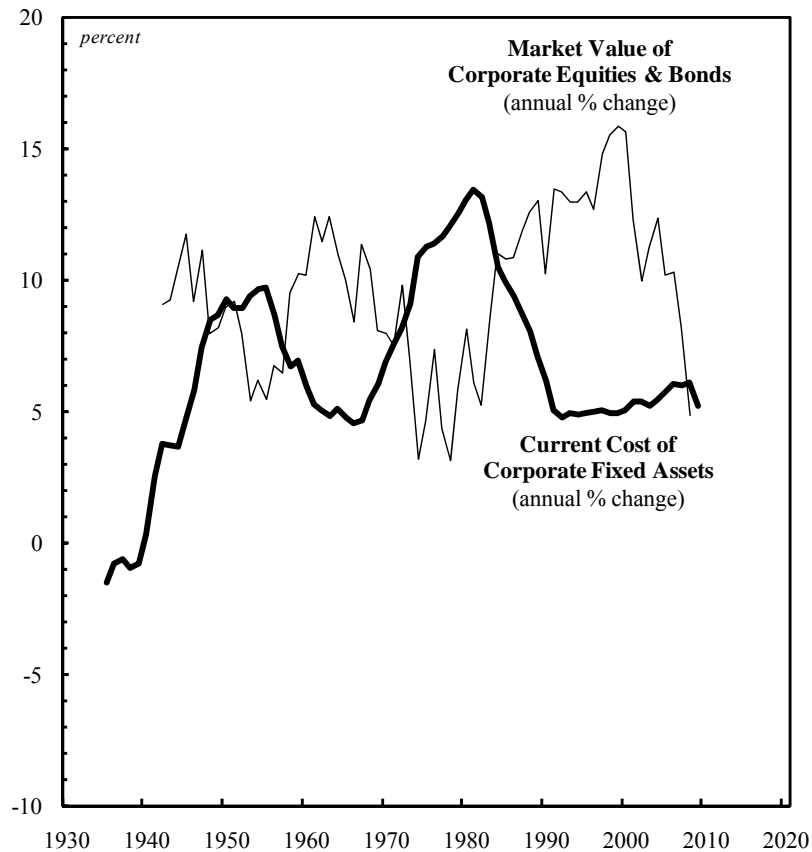


Figure 1 'Real Base' and 'Financial Superstructure'?

Note: Series smoothed as ten year moving averages.

Source: Nitzan and Bichler (2009); Global Insight (series code: FAPNREZ for current cost of corporate fixed assets).

According to the MC approach, in 'normal' times (i.e. prior to the 1980s), 'fictitious' capital is coupled with 'real' capital. Finance may become de-coupled from its real base for a while (i.e. from the 1980s),

but this deviation from the rule is short lived and eventually, through the onset of crisis, fictitious capital must come crashing down to its underlying base in the real economy.

The contemporary situation seems to support this account: from the early 1980s to around 2001 ‘fictitious’ capital accelerates while ‘real’ capital declines then stagnates. Throughout the 2000s, a series of crises have seen ‘fictitious’ capital come crashing down, while ‘real’ capital has continued to move sideways. Since we are dealing here with long-term trends that unravel over decades, it is too early to say with any certainty that the current crisis has led to a re-coupling of ‘fictitious’ and ‘real’ capital. But thus far the results seem to fit with the theory.

But how do we know that the situation since the 1980s has been a deviation from normality? And since it is too early to draw definitive conclusions about the current crisis, how do we know that past periods of financial deceleration actually resulted in a re-coupling of ‘fictitious’ and ‘real’ capital? To address these questions, we have to go back further. It is within the broader historical picture that the MC explanation starts to break down. Notice that the alleged coupling of finance with the ‘real’ before the 1980s never actually happened: finance has *never* been coupled with ‘real’ capital. And so what is explained as a ‘deviation’ from the norm since the 1980s is in fact the theoretical rule. Since the two are never coupled in the first place, there is no sense in talking about a period of de-coupling since the 1980s. Furthermore, this inverse relation between the two means that periods of financial decline have not resulted in its re-convergence with ‘real’ capital, but in upswings in ‘real’ accumulation!

The complications created by diversification, the logical circularity of using prices to measure ‘real’ phenomena, and above all, the absence of a meaningful relationship between proxy measurements for ‘fictitious’ and ‘real’ capital, should be enough to raise serious doubts about monopoly capital’s bifurcated theory of accumulation. Without a meaningful way of distinguishing between the ‘real’ and financial spheres, MC’s explanation of the precise movements of finance and the historical changes in the power of financial intermediaries breaks down. Sweezy’s research provides useful insights into the changing role and power of investment banks from the turn of the twentieth century through the postwar period. But these insights are inevitably limited by

the theoretical assumptions that underpin his account. Though the MC school draws linkages between power and capital accumulation, their explanation of these linkages lacks theoretical coherence and empirical grounding. Consequently, it is not sufficient to uncritically adopt the tools of MC in order to update Sweezy's analysis of investment banks. Instead we need to first re-think the linkage between power and accumulation.

Capital as Power

In this section, I outline some features of a capital *as* power (CasP) alternative. Like the MC school, CasP explicitly rejects the quantitative dimensions of Marx's LTV, precisely because of the logical and empirical impossibility of the theory's underlying unit of abstract labour. But it goes further in also abandoning the circular assumption that the quantities of price are somehow representative of unmeasurable 'real' quanta that are supposed to explain them. The problem with the real/nominal duality is that it assumes an impossible *dual quantity* relationship between values and prices.

Instead CasP argues that there is only one universal quantitative reality for capitalists, and that is the market value of their assets.⁵ As a system of commodification based on private ownership, capitalism is particularly amenable to numerical ordering: anything that can be privately owned can be priced, and that is why the history of capitalism has witnessed an exponential expansion of the price system.

While prices are the fundamental unit of the capitalist order, the central logic governing this order is capitalization: the discounting of risk-adjusted future earnings into present value. Of course earnings have a lot to do with production. But they extend far beyond the factory floor; anything that is expected to impact the course of future earnings can be capitalized. Since the fundamental unit and pattern of the capitalist order are financial, capital accumulation itself is to be understood with reference to a single rather than a dual entity: capital is finance and only finance.

⁵ My overview of CasP in the next five paragraphs draws on Nitzan and Bichler (2009; 2010).

But why capital *as* power? The answer can be traced back to the institution of private property. As was mentioned above, anything that can be privately owned can be priced, and the price of that asset is determined by discounting its risk-adjusted expected future earnings. To understand the nature of private ownership, Nitzan and Bichler (2009: 228) argue, we need to look no further than the root of the word private, whose etymology can be traced back to the Latin ‘privatus’, meaning ‘restricted’. It follows that since private ownership is organized around the principle of *exclusion*, the ability to exclude others from using that property is itself a matter of organized power. Since accumulation is impossible without this institutionalized exclusion, power needs to be integrated into our definition of capital from the very start.

Though capitalization is usually treated as a benign technical exercise in mainstream theories of finance, it is recast within the CasP approach as a symbolic quantification of capitalist power to restructure and reshape society. Whether capitalists own claims on the earnings of governments, consumers, industrial or financial corporations, their goal is always to accumulate by having the capitalized value of their assets grow over time. This dynamic process is inherently relative: capitalists seek to increase the value of their assets relative to some average benchmark. As capitalists boost their capitalization relative to other capitalists, they accumulate *differentially*, and as a result, augment their power.

The universalizing struggle to achieve differential accumulation provides the point of departure for CasP. Though this process is mapped quantitatively, its effects are always manifested qualitatively. Thus in place of Marx’s *quantitative* (labour) theory of value, CasP offers a *qualitative* (power) theory of value that analytically links together the quantitative architecture of capitalization with an account of the broader societal manifestations of power. The link is always speculative. But its advantage is that, unlike Marx’s LTV, it provides both a theoretical explanation *and* empirical tools for exploring the nature of contemporary capitalist power.

Investment Banks: Differential Accumulation

So how does this framework help us to explore investment bank power since the early 1980s? Figure 2 provides the starting point for such an investigation by plotting the differential capitalization and profits of the top five US investment banks relative to a proxy for what Nitzan and Bichler refer to as ‘dominant capital’: the top 100 US corporations (ranked by market capitalization).⁶ Both series indicate rapid growth in favour of the large investment banks.⁷ In 1973, the relative capitalization and net profit of a large investment bank were a paltry 0.08 and 0.1 times the dominant capital average. In 1981 when Sweezy was sounding the final death knell of investment banks, they were still insignificant. But since then, both measures have increased rapidly and steadily, so that by 2006, the differential net profit of the top five was slightly *larger* than the dominant capital average. From this high point in 2006, we see the impact of the crisis on the differential profits of the investment bank, which fell back down 0.8 times the average in 2008.

The differential capitalization of the large investment banks mirrors the pattern of differential profits, but its overall magnitude is lower. This suggests that, due to the perceived differential riskiness of investment bank earnings, investors have been reluctant to translate the increases in profits into equal increases in capitalization. But still, at 59 percent of the dominant capital average in 2007, and even taking into account the crisis-era decline to 54 percent in 2008, the differential capitalization of the large investment banks has seen a marked upsurge over the past three to four decades.

⁶ Differential measures are calculated as a ratio of the average market capitalization (or net profit) of a top 5 investment bank relative to the average market capitalization (or net profit) of a top 100 corporation.

⁷ Whether we focus on the top five investment banks or all investment banks in the Compustat database makes little difference because the top five is clearly dominant. For example, in 1971-1975 they held 85% of the net profits of the sector and 93% in 2004-2008.

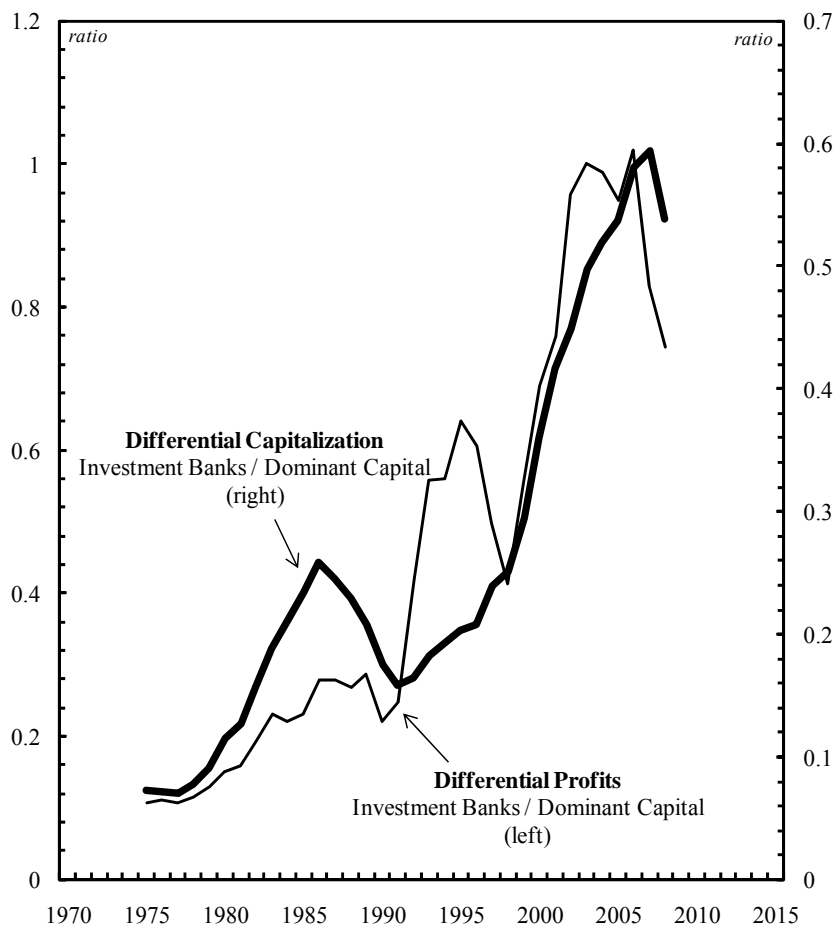


Figure 2 Investment Bank Differential Accumulation

Note: Series smoothed as five year moving averages.

Source: Compustat through WRDS (series codes: CSHO for common shares outstanding; NI for net income; PRCC_F for price close - fiscal).

As a first step, the data in Figure 2 bring into serious doubt Sweezy's 'transitory power' thesis. Investment bank power appears instead to be rapidly growing feature of contemporary capitalism. From their subordinate position in the 1970s and early 1980s, the large investment banks have achieved rapid differential accumulation, the levels of which are now comparable with the uppermost echelon of dominant capital.

The task that remains is to offer some explanation for this remarkable transformation. We can start by exploring how the power of contemporary investment banks differs from their predecessors. At the turn of the twentieth century, investment banks wielded their power over corporations who sought financing in securities markets. In this ‘traditional’ role as agents, the earnings of investment banks are dependent on the fees and commissions they charge for bringing together the two sides of securities market transactions. If we look at the pricing power over these activities, there is evidence to suggest that investment banks no longer dominate them. For example, average brokerage commissions on the New York Stock Exchange have fallen 60-80 percent since fixed commissions were abandoned in 1975 (Hoover 2005). During the heyday of investment banking in the early 1900s, common stock underwriting spreads were as high as 20 to 25 percent, and for bonds ranged from 5 to 10 percent (Calomiris 2000: 280).⁸ The spreads on underwritten common stock declined around 11 percent for the years 1945 to 1949, and 7.5 percent in 1963 (Mendelsohn 1967: 408-9) Recent data published in Morrison and Wilhelm Jr. (2007: 25) show that in 2000 bond underwriting spreads fell to 0.5 percent. Data from Thomson SDC indicate average common equity spreads in the U.S. of just 4.5 percent in 2008.

The decline in pricing power has gone hand in hand with the movement of foreign banks and domestic commercial banks onto investment banks’ traditional territory. In 1990 all of the top ten underwriters of common stock in the U.S. were stand alone investment banks, and by 2003 this was reduced to five (Merrill Lynch, Goldman Sachs, Morgan Stanley, CS FirstBoston and AG Edwards), as three U.S. commercial banks and two foreign banks entered the league table rankings (Morrison and Wilhelm Jr. 2007: 17).

In response to the decline in their traditional power, large investment banks have moved far beyond their role as securities market agents, to become significant principal actors, lending and committing their own capital in transactions. The extent of this shift away from this traditional agent role is shown in Table 1.

⁸ The underwriting spread is the difference between the price paid by the investment bank to issuing corporation for its securities, and the price the issue is then sold for in securities markets.

Table 1 Large Investment Bank Revenues (% of Total Revenues)

<i>Period</i>	<i>Commissions and Fees</i>	<i>Investment Banking Income</i>	<i>Interest and Related Income</i>	<i>Principal Transactions</i>
1982-1986	17.7	13.2	46.8	13.6
1993-1997	13.8	9.7	50.5	16
2004-2008	6.4	8.8	59.7	16.3

Note: The cut off point for large investment banks in Table 2 is determined by annual revenues. From 1982 to 1990 the cut off point is revenues of \$1 billion or higher. From 1990 to 1999 it is \$1.5 billion or higher. For 2000 to 2008 it is \$3 billion or higher.

Source: Compustat through WRDS (series codes: CFBD for commissions and fees; IBKI for investment banking income; IDIT for interest and related income; PTRAN for principal transactions; REVT for total revenue).

Large investment banks' investment banking and commissions business has been halved from 1982-1986 to 2004-2008, while their income from interest and principal trading (from their own inventory of securities) has jumped from 60 to 76 percent over the same period. These trading operations now take place on a global scale, and include everything from asset-backed securities, currencies and derivatives to commodities, insurance and real estate (The Economist 2007).

In the past, investment banks relied primarily on the obedience of corporations to seek out their services, which allowed them to exact a substantial mark-up for these services. Yet the long-term reduction in spreads and fees for investment banking services indicates that this pricing power has declined significantly; while the decreased reliance of investment bank revenues on traditional investment banking

suggests that their power is now wielded in other areas. Investment bank power has become diversified into many other facets of global securities markets. And the growing complexity of these markets means growing complexity for investment bank power relations.

Consider, for example, the investment banks' recent role in global commodities markets. Since the early 1990s, Goldman Sachs in particular has been buying heavily into 'long' positions in commodities futures, leading some to suggest that it played a key role in orchestrating the dramatic spikes in oil and wheat prices in 2008 (Taibbi 2009; Kaufman 2010). Regardless of whether Goldman Sachs single-handedly orchestrated these price spikes or not, it is clear that their power now extends far beyond corporate finance into areas that impact the very survival of humanity: food and energy.

It could be suggested that this diversified power is now qualitatively indistinguishable from the power of other financial conglomerates. This may be the case as far as functions are concerned, especially with the disappearance of independent investment banks in 2008. But if we want to explain why investment banks rose from insignificant players in the early 1980s to diversified giants in the 2000s, then I argue that it still makes sense to analyze them separately. This is not because of any distinctiveness in their functions, but due to the rather unique ways they have manoeuvred within, and also shaped, the global shift towards neoliberal regulation from the 1980s to the current crisis.

Diversified Power and Neoliberal Regulation

The 'Volcker Shock' (1979-1982) is often considered to be a 'founding moment' in the history of neoliberalism (Panitch and Gindin 2009: 23). Little consensus exists as to the exact causes of the 1970s inflation, nor as to what allowed the Federal Reserve under Paul Volcker to raise interest rates in order to combat it. But one important consequence of the Volcker Shock seems clear-cut. The Federal Reserve's 'sound money' crusade, which saw prime lending rates increase from 7 percent in 1976 to 19 percent in 1981,⁹ irreversibly disrupted the 'live-and-let-live compact' that had up till then existed between investment

⁹ Data is from the IMF through Global Insight (series code: A111L60P.A).

and commercial banks on opposites of the Glass-Steagall Act of 1933 (Hayes and Hubbard 1990: 110).¹⁰

Volcker's interest rate hikes had a negative impact on the commercial banking side of the Glass-Steagall wall. Interest rate ceilings on bank deposits imposed as part of Glass-Steagall's Regulation Q served as a particular disadvantage to commercial banks, whose deposit base was being stripped away by the investment banks' money market mutual funds. These investment vehicles proved popular in the context of high interest rates, offering market rates of return and all the basic features of a bank account. On the assets side, rising interest rates made bank loans more costly relative to securities markets, and the issuance of commercial paper became a favoured option in corporate financing. This directly benefitted the investment banks that underwrote these and other debt issues.

The commercial banks started to voice complaints that Glass-Steagall was being applied unevenly to the benefit of investment banks. But they did not respond by advocating the re-establishment of Glass-Steagall barriers. While they may have been negatively impacted by the onset of neoliberalism, the commercial banks felt that neoliberal financial deregulation would help restore their once-dominant position. As Thomas G. Labrecque, former president of Chase Manhattan, put it, '[t]he solution is not to rid ourselves of the invaders on our turf ... Rather we've got to be allowed to compete more fully in the marketplace' (cited in Bennett 1982: 12). In other words, commercial banks wanted access to securities market business that the neoliberal monetary policy had made so appealing.

Some commercial banks tried to invade investment banking turf by exploiting loopholes within the legislation (Bleakley 1984). But this was staunchly resisted by the investment bankers' main professional association, the Securities Industry Association (SIA), and led to protracted legal battles (Hall 1986). During this time, the weight of the government was firmly tilted in favour of the investment banks. Federal Reserve chairman Paul Volcker (1979-1987) and Treasury Secretary Donald Regan (1981-1985), a former Merrill Lynch CEO,

¹⁰ The most important feature of the Glass-Steagall Act was that it barred deposit-taking commercial banks from engaging in the securities underwriting and trading undertaken by their investment bank counterparts.

were lukewarm towards dismantling of Glass-Steagall barriers (Schlesinger 2002). In 1981 the government did, however, agree to phase out Regulation Q. But this was done only gradually over a five year period, and by the time the final ceilings were abandoned in 1986, the damage to commercial banks' deposit base had already been done. Even though inflation was 'tamed' and interest rates declined through the early to mid-1980s, there was little sign of commercial banks recapturing their traditional business back from securities markets (Hager 2010).

Government reticence towards dismantling Glass-Steagall underpinned the investment banks' power to exclude commercial banks from their business. But to what extent did this actually impact accumulation? The accumulation trajectories of investment and commercial bank during the early phase of neoliberalism were impacted by a myriad of factors. As a result, any attempt to empirically assess the impact of the Volcker Shock on their accumulation is necessarily speculative. Issues concerning regulation were, however, constantly debated in the financial press during this period; and for some, the regulatory barriers of Glass-Steagall were regarded as the 'most urgent issue for the US financial community' (The Economist 1987: 5).

With this in mind, there is evidence to suggest that the ushering in of the neoliberal era, specifically the switch to monetarism and deregulation, lead to the dramatic restructuring of power from commercial banks to investment banks. Figure 3 plots the differential capitalization and profits of the top five investment banks relative to the top five commercial banks (again ranked by market capitalization).

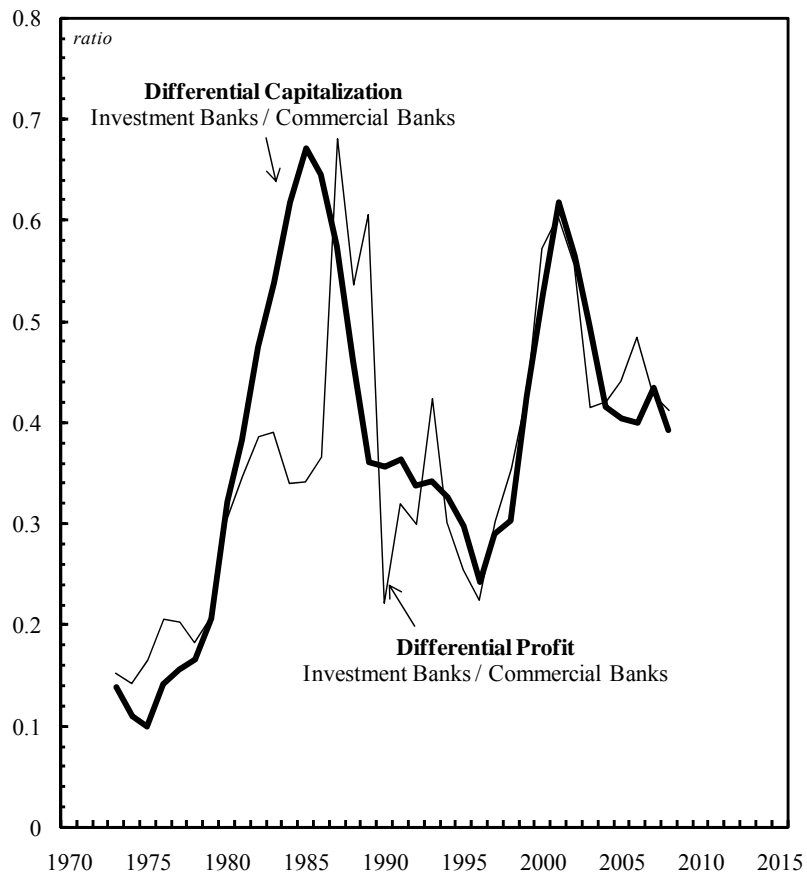


Figure 3 Differential Accumulation: Investment Banks vs. Commercial Banks

Note: Series smoothed as three year moving averages.

Source: Compustat through WRDS (series codes: see Figure 2).

Here we see that from 1975 to 1985 the differential profits of the investment banks doubled from 0.17 to 0.34 times commercial banks, before doubling again to 0.68 in 1987. Meanwhile their differential capitalization rose from 0.1 in 1975 to a high of 0.67 in 1985.

In the early stages of the 1980s ‘bank wars’ (Prins 2004), investment banks were the clear victors. Yet as Figure 3 also shows, by the mid-1980s the course of accumulation would turn against them. Reeling from the 1987 stock market crash and insider-trading scandals, the differential capitalization and profits of large investment banks started to plummet. The onset of this fallout was doubly-fortuitous for

the commercial banks as it coincided with the 1987 appointment of Alan Greenspan, the high priest of neoliberal deregulation, to replace Volcker as Federal Reserve chairman. Greenspan, who previously held posts on the board of directors for commercial banks J.P. Morgan and Morgan Guaranty Trust, immediately set his sights on dismantling Glass-Steagall. The Fed never made reference to the disadvantaged position of commercial banks in trying to justify deregulation. Instead it argued that Glass-Steagall stood as an unnecessary barrier to the more efficient forces of free market competition (Greenspan 2007). And given deregulation in other parts of the world, the Fed feared that Glass-Steagall was hampering the global competitiveness of the US financial system (Rosenstein 1989). Soon new provisions were passed allowing commercial bank subsidiaries to underwrite some securities. From a position of weakness, the investment banks, led by the SIA, finally dropped their opposition to Glass-Steagall reform in 1989 (Bush 1989).

With dominant financial intermediaries now united in pushing for neoliberal deregulation, the Glass-Steagall Act was gradually chipped away throughout 1990s and officially repealed in 1999. The deregulation wave of the 1990s was accompanied by a wave of merger/conglomeration that effectively removed most of the remaining functional and regulatory distinctions between commercial and investment banks. The ‘main divide’ was no longer between commercial and investment banks, but between giant financial conglomerates and their smaller, less diversified banking counterparts (Johnson and Kwak: 2010: 86).

The data suggest that the repeal of Glass-Steagall did not have a negative impact on investment bank accumulation. Relative to dominant capital as a whole (see Figure 2), the differential capitalization of the investment banks grew rapidly in the 2000s. And relative to dominant commercial banks (see Figure 3), the investment banks were able to ‘tread water’ from 2003-2007 after a decline which likely had more to do with the dot com crisis than with the repeal of Glass-Steagall. But as the current crisis has now made plain, the ability of investment banks to keep up in the post-Glass-Steagall world was built upon an edifice of (leveraged) sand. Like the initial rise of investment bank power, the collapse of the independent investment

bank model can only be explained with reference to the unique ways in which investment banks experienced neoliberal deregulation. In other words, the analysis here suggests that the generally accepted explanation of neoliberalism as a class project of ‘finance’ in general, or of ‘big finance’ in particular, is misleading insofar as it neglects the inter-sectoral power struggles between financial firms over the course of regulation.

After the demise of Glass-Steagall commercial banks remained subject to the regulations of the Federal Reserve, the Federal Deposit Insurance Corporation and the Comptroller of the Currency, whereas investment banks continued to be supervised by the Securities and Exchange Commission (SEC). It was during this time that the large investment banks wanted to expand further into booming businesses such as asset-backed securities and derivatives (Labaton 2008). The only thing that stopped them from doing so was the SEC’s ‘net capital rule’ which required investment banks to limit debt to twelve times their equity. This rule made it difficult for the investment banks to compete with commercial banks in the increasingly complex world of finance. Despite the long-term decline of their deposit base, the balance sheets of commercial banks were still significantly larger than the investment banks, and this allowed them to take significant investment positions without resorting to excessive leveraging (Prins 2009). Led by Goldman CEO Henry Paulson, the investment banks began in 2000 to lobby for changes to the net capital rule.¹¹ In a now-infamous decision in 2004, the SEC gave into pleas by the ‘big five’ investment banks to self-monitor their investment positions through their own risk models (Ritholz 2009).

Investment bank leverage increased 42 percent from 2002-2007, and by 2007 assets were 31 times equity (Roxburgh *et al* 2010). This explosion was funded primarily through short-term instruments (70 percent of total assets 2006) such as repurchase agreements (repos). Under stricter regulations and with bigger balance sheets, commercial bank gross leverage actually decreased three percent from 2002-2007, and at the height of the 2007 boom the ratio of commercial bank assets

¹¹ Paulson would later go on to serve as Treasury Secretary from 2006-2009. For an eye-opening account of the revolving door between Goldman Sachs and the US federal government, see Johnson and Kwak (2010: 92–94).

to equity was 12 to 1, and only 11 percent of their funding in 2006 was short term.

The precariousness of this situation became painfully obvious with the onset of crisis in 2007-8. As doubts about the quality of the mortgage-backed securities held by investment banks grew, repo market creditors began to demand more collateral in exchange for financing (Gorton and Metrick 2010). Faced with difficulties in rolling over their debt, the investment banks were pushed towards insolvency in 2008. The smallest of the big five, Bear Stearns, was taken over by J.P. Morgan in March. Unable to orchestrate a similar commercial bank takeover, Lehman Brothers collapsed in September. Merrill Lynch then agreed to be taken over by Bank of America. Meanwhile the two survivors, Goldman Sachs and Morgan Stanley, voluntarily converted into bank holding companies in order to gain access to the Fed's emergency lending facilities.

In the course of several months in 2008, any of the remaining vestiges of the seventy-five year old regulatory separation of commercial and investment banks vanished. One of the most notable outcomes of the crisis has been the sudden disappearance of independent investment banks from the US corporate landscape. This collapse, as well as the dramatic rise in investment bank power that preceded it, are intimately bound up with the neoliberal project's own rise and descent with the current crisis. Faith in neoliberal deregulation has been shaken, and as a result, calls for reform of the US financial system have been growing. Some of the more far-reaching proposals have even called for a restatement of the Glass-Steagall Act. But how serious are these proposals? Is financial regulation entering a new phase 'after neoliberalism'? My task now will be to outline some of the possibilities and limitations of this regulation drive.

From the Volcker Shock to the Volcker Rule

If the collapse of independent investment banks was one of the most notable outcomes in the early stages of the crisis, one of the more notable outcomes since then has been the rapid recovery of the FIRE sector more broadly. The extent of this recovery can be seen in Figure

4. After seeing their share of total US market capitalization fall from 23 percent January 2007 to 13 percent March 2009, the US FIRE sector had by the summer of 2010 recovered nearly half of their market share. This would come as little surprise to some analysts. With the disappearance of their main competitors, and with the support of government bailouts, there is a widespread belief that survivors have become *more powerful* as a result of the crisis (Stephens 2010). Simon Johnson (2009: 49), former chief economist at the IMF, argues that the crisis has laid bare the existence of a ‘financial oligarchy’ in the US; one that possesses political weight ‘not seen in the U.S. since the era of J.P. Morgan (the man)’.

Even before this recent FIRE recovery, calls for regulation were gaining support. But persistently high unemployment, coupled with the record breaking profits and massive executive bonus announcements by firms such as Goldman Sachs, have served as the real catalyst rallying public support for regulation. In the financial press, the merits of reinstating the Glass-Steagall Act are constantly debated. But even most progressives claim that Glass-Steagall is ill-equipped for the complexities of modern finance (Kregel 2010). There are, however, some other proposals that aim to combat the power of financial conglomerates by erecting regulatory barriers between various financial activities. One such proposal has been spearheaded by none other than former Federal Reserve Chairman and now presidential advisor Paul Volcker. In its original formulation, the ‘Volcker Rule’ would ban deposit-taking banks from owning or investing in hedge funds and private equity firms, as well as prevent them from short-term trading with their own capital (‘proprietary trading’). This provides a somewhat ironic twist to the history of neoliberal deregulation. It was, after all, Volcker’s shock that is thought to have provided the initial stimulus for the emergence of the neoliberal project. But he was reticent on the issue of deregulation in the 1980s, and now in the current environment of scepticism towards unfettered markets, Volcker’s ideas on regulation have again gained political currency.

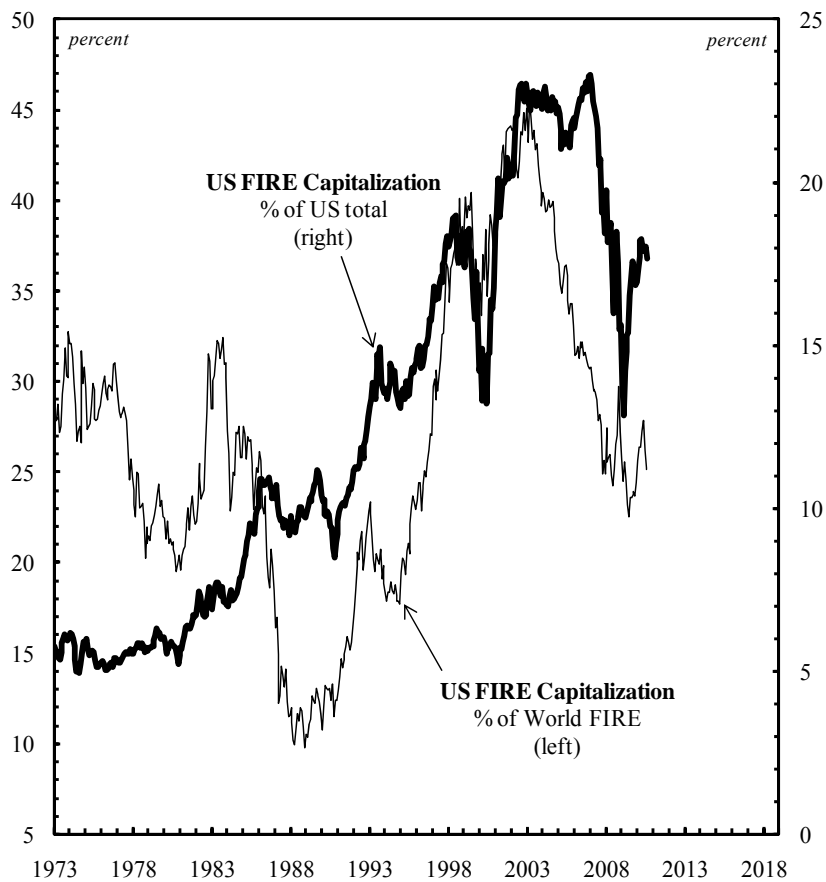


Figure 4 US FIRE's Share of Market Capitalization

Note: The final data point is for September 2010.

Source: Thomson Datastream (series codes: TOTMKUS(MV) for total US capitalization; FINANUS(MV) for US FIRE capitalization; FINANWD(MV) for World FIRE capitalization).

The Volcker Rule was passed into law as part of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* in the summer of 2010. Yet through months of intense political wrangling, the version of the rule included in the act was significantly watered down, and critics doubt whether the act will have any meaningful impact (Taibbi 2010). While most of the main tenets of neoliberalism were already being challenged well before the current crisis, the central pillar of neoliberal ideology, financial deregulation, has proven far more difficult to

reverse. And with FIRE now rebounding from a position of weakness, the opportunity for meaningful reform may have already passed.

Any assessment of the limits and possibilities for US financial reform must also take into account the wider global context. When anchored in the global political economy as a whole, a paradox surfaces: while FIRE's domestic *resurgence* appears to have limited the prospects for reform, the persistent *weakening* of US FIRE globally may serve to reinforce these limits. As Figure 4 illustrates, US FIRE's share of total world FIRE capitalization and its share of total US capitalization have both rebounded: the former by 12 percent and the latter by 38 percent. What matters here is not only that US FIRE's domestic rebound has been much larger, but also the longer-term historical pattern in which it has taken place. The decline in US FIRE's share of US capitalization is recent, cyclical and tied to crisis, whereas the decline in its share of world FIRE capitalization is long-term, secular, and already evident in 2003.

As was mentioned above, Greenspan's initial calls for neoliberal deregulation in the 1980s were motivated by concerns about the global competitiveness of US FIRE. Deregulation did have the intended effect: after losing its global market share in 1980s, US FIRE recovered through the wave of consolidation and conglomeration in the 1990s. How then can we expect re-regulation in a context similar to that in the 1980s and without a concerted effort towards global regulatory cooperation? Fears about US global competitiveness, whether justified or not, stand as a formidable obstacle to efforts aimed at reversing neoliberal deregulation.¹² The recent backlash towards the 'financial oligarchy' may point to a widening chasm between dominant FIRE and the wider population. But the widespread belief in the sanctity of global competitiveness helps to defray these domestic cleavages. When this global context is taken into account, Lloyd Blankfein's assertion that 'what's good for Goldman Sachs is good for America' finds few serious challengers (Brenner 2009).

¹² These are certainly the fears that are driving the Republican Party's resistance to the Volcker Rule. In the words of Republic congressman Spencer Bachus, '...the Volcker rule may spark a mass exodus of clients from US banks to banks based abroad' (cited in Braithwaite 2010: 15).

Conclusion

The analysis here has been framed primarily as an engagement with Sweezy's 'transitory power' thesis. Rather than merely updating Sweezy's analysis, it has developed new empirical tools for analyzing investment bank power based on a capital *as* power approach. The research results are unambiguous. They show with various differential measures that the power of investment banks grew rapidly alongside the rise and consolidation of neoliberalism through to the onset of the current crisis. What this analysis suggests is that investment bank power is not transitory, but transforming. The resilience of investment bank power is bound up with their abilities to constantly transform their accumulation strategies. Investment banks have diversified their activities far beyond their 'traditional' role as securities market agents. But the distinctive experiences of investment banks in manoeuvring to secure advantages within neoliberal regulation highlights the dangers of dwelling on the functional similarities they share with other diversified financial services conglomerates.

Whether or not the surviving investment banks will continue to transform and augment their power is an open question. The current crisis has brought the most serious challenges to the investment banks since the 1929 crash. And the collapse of three of the big five is evidence that the so-called 'Masters of the Universe' (Wolfe 1987) are by no means omnipotent. At the same time, the ability of surviving investment banks to not only weather, but in some cases also to profit from, the recent turbulence points to the resilience and flexibility of their power.

In the end, one of the main questions dividing those on the 'critical' side of political economy is strategic: should the goal be to harness power through regulation or eliminate power altogether? The alternative focus on differential capitalization suggests that regulation has a significant impact on power. At various points in the history of neoliberalism, the struggle over regulation has been at the heart of accumulation. It has not merely 'affected' accumulation from the outside. To the extent that regulation is perceived to impact the course of future earnings it becomes a key facet of accumulation. At the same time, the analysis also highlights how dominant capital groups are able

to effectively limit the imposition of meaningful regulatory change even through periods of crisis. Here too a focus on differential capitalization provides tools to analyze the ways that capitalist power shapes and limits regulation. Whatever the precise answer to the strategic question, the analysis here argues that in order to confront power we must first radically rethink our categories and concepts. And that involves rethinking capital accumulation: the process through which dominant capitalists actively re-shape and restructure society.

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