FINANCIALIZATION, OSTENTATIVE CONSUMPTION AND MACROECONOMIC INSTABILITY

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“The scheme of reputability in the pecuniary culture comprises not only the imperative duty of acquiring something more than an equitable share of the community’s wealth, but also the dutiful privilege of spending this acquired wealth, and the leisure that goes with it, in a reputedly conspicuous way, according to the ritual of decorum in force for the time being (pp.120-121)”. Thorstein Veblen, The higher learning in America, 1918, pp.120-121

1 – Introduction

So-called ‘financialization’ is one of the major features of current capitalist development, and it can be regarded as the basic device allowing the realization of money profits in a neo-liberal regime, at least before the current global crisis (see, among others, Bellamy Foster and Magdoff, 2009). The Bureau of Economic Analysis certifies that rents increased by 40% from 2000 to 2008 while profits rose by more than 80% in the same period. Mainstream economists support the view that financialization produces positive social outcomes, for two main reasons. First, following Friedman’s argument (1956), it is maintained that the financial sphere, insofar as it includes rational agents, acts as a macroeconomic stabilizer, so that the price of financial assets tends to converge on the ‘fundamentals’ of the economy. The Neo-Keynesian view is largely based on the conviction that agents operating in the financial sphere tend to ‘select’ the most efficient firms. As regards the causes of this phenomenon, it is suggested that the increasing weight of finance depends on an alteration of agents’ preferences and more specifically on the fact that investors are becoming less and less risk lovers and increasingly risk averse. By contrast, ‘heterodox’ economists emphasise that “Financialization transforms the functioning of the economic system at both the macro and micro levels. Its principal impacts are to (1) elevate the significance of the financial sector relative to the real sector, (2) transfer income from the real sector to the financial sector, and (3) contribute to increased income inequality and wage stagnation” (Palley, 2007). Moreover, the increasing political power of the rentiers is also taken into consideration in explaining the decline in wages due to rentier pressure on Government for the purpose of producing a more favourable income distribution to their benefit (Palley, 2007). As regards the causes of financialization, Bronars and Deere (1991) among others, suggest that the management of firms may find it convenient to

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1 Our elaboration on NIPA tables. See http://www.bea.gov/national/nipaweb/SelectTable.asp?Selected=Y (Table 2.1. Personal income and its disposition. Table 6.16D. Corporate profits by industry).
2 As Epstein and Power (2003) stress: “There is no commonly accepted definition of rentier income. Most authors use a definition to denote income that accrues from financial market activity and the ownership of financial assets rather than activity in the “real” sector or the holding of “real” assets such as real estate or capital equipment. For example, Keynes, in his General Theory, refers to the rentier as “the functionless investor,” who generates income via his ownership of capital, thus exploiting its “scarcity-value”. For this paper, rentier income will be defined the way Michel Kalecki used the term: it represents the income received by owners of financial firms, plus the return to holders of financial assets generally”. In what follows, and in line with Keynes’ view, rentier income is defined as derived from the ownership of “real” assets.
(seemingly) reduce profits – via their allocation to ‘unproductive’ uses – in order to thwart workers’ claims for wage increases.

The aim of this paper is to provide an interpretation of the causes and the consequences of financialization considered within the theoretical framework of the monetary theory of production (hereafter MTP) and with reference to ‘radical’ Institutional issues. On the methodological plane, the exercise provided here is designed to graft elements of the ‘macrofoundation of microeconomics’ onto the MTP. This is to say that individual behaviours are explicitly taken into consideration, but, unlike the mainstream view, they are not treated as being generated in an institutional vacuum, profoundly affected by group affiliation, and by norm-driven behaviours (i.e. what is also labelled ‘weak individualism’). This is in line with a line of research within the MTP approach. As Zazzaro (2003, p.220 and pp.230-231) points out: “Methodological individualism, if we understood in a weak form, is not the exclusive domain of neoclassical theory”. This is because “adopting a weak individualist perspective means only denying that interpersonal entities, like institutions, organizations or social classes, are endowed with anthropomorphic properties, with their own wishes, aims and driving forces that are distinct and independent of those of individuals who constitute and belong them. This amounts to saying that phenomena that involve such impersonal entities and their evolution can only be explained by making reference to the actions of a single individual or group of them, which at least in part are intentional”. As a result, the acceptance of ‘weak individualism’ does not mean excluding classes or social groups from economic analysis.

On the analytical plane, it will be stressed that financialization is one of the main devices for enabling the monetary reproduction of the capitalist system in a neo-liberal regime. It will also be shown that financialization is itself a source of macroeconomic instability. Following a recent contribution by Hein (2008), a theoretical model will be presented, aiming at showing that rentiers’ income is part of aggregate demand and the higher it is, the higher aggregate net money profits are. This conclusion is reinforced by the assumption made by Veblen that rentiers (i.e. the Veblenian “leisure class”) compete in consumption. As Veblen pointed out: “The custom on which it rests is traceable to the habit of making an invidious [...] comparison” (Veblen, 1975 [1899], p.100) – and that total demand grows in the event of an increase in financial rents:


The exposition is organized as follows. Section 2 deals with the basic schema of the MTP, and the role of rentiers’ consumption in creating a monetary surplus. In section 3 a theoretical model is presented, where the rentiers’ consumption affects aggregate money profits. Section 4 shows how the accumulation of financial rents can produce macroeconomic instability, and section 5 concludes.

2 – The monetary theory of production

The MTP describes the economic process as “a circular sequence of monetary flows” (Realfonzo, 2006, p.105). The MTP derives from a methodological approach based on a continuist reading of Keynes’s major works, in particular of the Treatise on Money (TM) and the General Theory (GT). In addition, contemporary scholars find significant similarities between Veblen’s theoretical framework and Keynes’s approach. Vining (1939) for example argues that Veblen should be counted as one of the authors who ‘anticipated’ Keynes’s theory of effective demand. Dillard (1987) emphasizes that

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3 See for example Fontana (2003), Seccareccia (2004) and more recently Forges Davanzati and Realfonzo (2008). MTP scholars read the TM as the theory of reproduction of the capitalistic economy in equilibrium, where money is employed as a means of payment; while they regard the GT as the explanation of economic crises, generated by lack of aggregate demand and where money has reversed its role in the store of value.
Veblen’s dichotomy between industrial and pecuniary employment is a key issue of the MTP and that relevant analogies between Veblen’s and Keynes’s views of the functioning of monetary economies are to be considered (Dillard, 1987, p. 1646). In comparing Veblen’s and Keynes’s thought, Mouhammed (1999, p. 26) stresses that ‘Keynes’s contribution to the monetary theory of production develops further Veblen’s finding’. In particular, he maintains that ‘Veblen believes (as Keynes does) that the money supply is used to control the economy by the vested interests’ (Mouhammed, 2003, p. 268). He also attributes to Veblen the Keynesian principle of effective demand, arguing that a ‘vent for surplus’ argument via imperialism is important in Veblen’s thought (p. 273 ff.). In similar vein Nayyaradou (2005) points out that – in the Veblenian theoretical framework – ‘bankers become the guardians of the absentee ownership’, and bankers – that is, the ‘captains of finance’ – finance the production process ‘via the ex nihilo credit’. In this connection, Wilson (2006, p. 1031) points out that both Veblen and Keynes shared the conviction that ‘credit finance constrains investment and the scale of output’, and that Veblen ‘provided the conceptual basis for a general theory of credit-based market economy’.

The MTP general schema involves three macro-agents: banks, firms and workers. The banking system creates purchasing power; firms buy inputs and produce commodities; workers supply labour power and buy commodities. The circular process of monetary economy starts with the bargaining in the credit market between banks and firms. Banks supply firms with initial finance; firms need purchasing power in order to buy labour power and to start production. Firms use bank finance to purchase labour power, paying workers the previously negotiated money wages. After the production process has taken place, firms fix the price level, so that real wages are known ex-post. The monetary circuit closes with the repayment of the initial finance to banks, i.e. the ‘destruction’ of the purchasing power originally created. In the simple schema, without external interventions, firms recoup the total amount of the initial finance but they are not able to generate profits. The failure to create a monetary surplus can be seen as a theoretical problem if one rejects the conviction – supported, among others, by Graziani (2003) – that a “normal” level of indebtedness on the part of firms toward the banking system is a key feature of contemporary capitalist economies. It is worth noting that the paradox of profits is not something which pertains to the logical structure of the MTP and, hence, it should not be conceived as a pure logic puzzle. On the contrary, it focuses on a key problem of the capitalist system, namely the problem of the realization of a monetary surplus (see Bellofiore, Forges Davanzati and Realfonzo, 2000). One can argue – depending on historical and social conditions – that capitalism solves the problem in different ways, and these ways – not being a mere ‘outside factor’ used as an ad hoc assumption in circuitist models – are, as a matter of fact, social devices that serve for the reproduction of the system. In this sense, the MTP approach provides an ‘open’ model, where the closure of the circuit depends on ‘outside factors’ which are historically, institutionally and socially determined, as well as empirically/factually significant. It should be added that – by its very nature – the problem of making a monetary surplus is a macroeconomic problem. Schematically, in recent history, capitalists have solved the problem of making a monetary surplus in two ways. First, in a Keynesian regime, aggregate money profits are guaranteed via public expenditure, in view of the ‘monetary crowding in effect’ (see Kalecki, 1971). Second, in the liberal regime, the same result is obtained via private indebtedness, wage reduction and the reduction of public intervention (see Forges Davanzati and Pacella, 2010). Moreover, under a liberal regime, capitalist reproduction – and hence the realization of a monetary surplus – is also guaranteed by means of increasing financial

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4 See also Parker Foster and Ranson (1987, p. 228)
5 See also Mouhammed (2003, p.279) and the previous works by Dillard (1987) and Parker Foster and Ranson (1987).
6 Following Kalecki (1971 pp.138 ff.), one can argue that since policies of deficit spending increase the employment rate and capitalists aim at maintaining a stable level of unemployment (both for political reasons, i.e. in order to preserve their power to ‘discipline’ workers, and for economic reasons, i.e. in order to maintain the power to cut wages), capitalists tend to prefer devices designed to allow them aggregate money profits which exclude State intervention.
rents. In what follows, a model will be proposed in order to show that ‘closure’ of the circuit is guaranteed by the expenditure on the part of the rentiers via purchasing power supplied by banks. The main assumptions are that i) the economy is formed by a sector producing wage-goods (type-1 firms) and a sector producing luxury goods (type 2-firms), ii) rentiers only consume this second kind of goods, and – following Veblen – iii) rentiers’ consumption is competitive consumption. Table 1 depicts the money circuit when rentiers obtain purchasing power from banks.

Table 1: Rents and the money circuit

At the beginning of circuit (step 1 and 1’) banks supply the purchasing power demanded by firms (financing of production) and by rentiers (financing of luxury consumption: Rents). Then type-1 and type 2 firms spend their purchasing power on buying the labour force needed to produce wage and luxury goods (step 2 and 3). In the next step firms sell wage goods to workers (step 4) and luxury goods to rentiers (step 4’). Then the wages of workers employed in sector 2, insofar as they consume wage goods, enters the type-1 firms generating a monetary surplus, and the rentiers’ purchasing power enters the type-2 firms producing a monetary surplus. In conclusion while the wage bill of type-2 workers becomes gross profit for type-1 firms, rent becomes gross profit for type-1 firms.

3 – Financial rents and the ‘closure’ of circuit

The model presented below sets out to show how the basic schema of the MTP can be integrated with a reaction function on the part of individual agents, on the basis of a ‘macrofoundation of microeconomics’ approach. In this context, this particularly applies to the analysis of the behaviour of the rentiers, who aim to consume luxury goods, not for the sake of consumption in itself, but for the sake of ostentation and competition. In a world of this kind, there is nothing ‘natural’ in the pursuit of consumption: it is a radically social phenomenon, where – in particular – a pivotal role is played by imitation.

The model presented here takes into consideration the idea supported by Lavoie (1992, pp.152 ff.) and Hein (2008, pp.100 ff.) that the ‘closure’ of the circuit is guaranteed by the expenditure on the part of the rentiers. An extension of this approach will be provided, based on the idea that, as stated

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7 On the nature and size of demand for money expressed by firms and rentiers see section 3.
8 Hein (2008, p.74) refers to “payment commitments to rentiers’ households”.
above, the economy is formed by one sector producing wage-goods and one sector producing luxury goods with rentiers only consuming this second type of goods, and that rentiers’ consumption is competitive consumption. The luxury goods considered here are the type acquired for pure ostentation and are not destroyed (such as houses, jewels, works of art, rarities, collector’s items, etc.). Investments are exogenous. The unitary money wage is a given and workers’ propensity to consume is equal to 1. Moreover, firms fix prices under the mark-up rule, including the interest rate \( i \) i.e. \( p = (w/\pi)(1+r)(1+i) \). Banks finance both production and rentier consumption: in the first case, they are perfectly accommodating and, in the case of rentiers financing, they face the constraint of rentiers’ guarantees. Finally, the interest rate is assumed to be equal for both sectors and for rentiers.

Rentiers own real assets inherited from the previous periods, and each of them competes with others in the accumulation of luxury goods. This behaviour is justified by their attempt to excel in their status. Here we find the relevance of the Veblenian argument that competition – in the contemporary economy and with regard to the upper classes – is above all a ‘struggle to excel’ more than a ‘struggle for survival’ (see Forges Davanzati, 2006): in this context, rentiers internalize a habit of thought – i.e. an institution in the Veblenian sense – that moulds their actions leading them to perceive a person’s value in terms of how much he displays an accumulation of luxury goods. Acting in a monetary economy they need purchasing power to enter the luxury goods market so they first enter the credit market to get what they need. This behaviour is justified by their attempt to accumulate luxury goods. Although they can obtain purchasing power immediately by selling a part of their assets, the access to credit allows them to benefit – at least in the short run – from an actual increase in assets (see below). In so doing, a further source of short-term ‘initial finance’ is considered (cf. Hein, 2008, p.101). At the same time, however, banks supply purchasing power, tying it to the real value of the assets given by rentiers as collateral.

For the purpose of defining the rentier’s demand for credit we formalize their emulative behaviour by identifying the banks' reaction since the actual possibility of rentier consumption depends on the value of their assets. The single rentier is supposed to take two kinds of rent into consideration: a) competitive rent and b) actual rent. The competitive rent for the single rentier \( i \) can be expressed as follows:

\[
R_{c,i} = \gamma R_{m,c,i}^{n,e} \tag{1}
\]

where \( \gamma \) is the coefficient of emulation and \( R_{m,c,i}^{n,e} \) is the average competitive rent expected by rentier \( i \). It is assumed that \( \gamma \) and \( R_{m,c,i}^{n,e} \) are exogenous givens. Note that the intensity of competition in consumption grows as the amount of information acquired by the individual rentier on the behaviour of the other members of the same group grows. The competitive rent measures the amount of credit the single rentier would like to have in order to compete in the market of luxury goods. On the macroeconomic plane (given \( n \) rentiers in the economy), the total competitive rent \( R_c \) becomes:

\[
R_c = \gamma \sum_{i=1}^{n} R_{c,i} \tag{2}
\]

It could be noted that – although in this context it is assumed as exogenous - \( \gamma \) is significantly affected by the public nature of ostentation, and hence by \( i \) the accessibility on the part of the individual rentiers to the consumption of the other members of their group (which affects the perception of the average value of rentier consumption) and by \( ii \) how fast this information is

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9 Note the interest rate is intended as average cost of financing here.

10 With \( \gamma \geq 1 \) and \( R_{m,c,i}^{n,e} \geq 0 \).

11 The ability to collect information on behaviour of other rentiers fundamentally depends on the ostentation of consumption since ostentation in fact serves as an observable signal of social status. On this point Veblen remarks (1975 [1899], p.46): “[Rentiers] are even more immediately and obtrusively presented to the observation, and they therefore are more widely and more imperatively insisted on as required evidences of a reputable degree of leisure”. 
transmitted. On the sociological plane, as shown – among others by Robertson (1992) – ‘globalisation’, in the form of increasing speed of information transmission, exerts a significant impact on the value of $\gamma$ so that the increasing pace at which information is spread is likely to increase both the desired rents and, insofar as rents are at the basis of capitalist reproduction, also aggregate money profits in the commodities market (see below).

It should also be observed that unproductive consumption on the part of rentiers constitutes waste, for the following reason. On the microeconomic plane, if one admits that rentiers are homogeneous (i.e. they have an equal initial income and an equal bargaining power in the credit market), competition in consumption ends with a relative consumption among them equal to that enjoyed at the beginning of the process. However, the process itself of imitation involves expenditure, which is non effective for the purpose - of each individual rentier – of “keeping up with the Joneses”, since, in relative terms, the relative consumption after competition equals the relative consumption before competition starts.

The realistic case where banks do not finance the rentiers with an amount of credit higher than the monetary value of their assets (given $m$ assets) is given by:

$$R_i = \beta \left(1 - \frac{\partial p}{p}\right) \sum_{j=1}^{m} B_j$$  \[3\]

where $\beta$ is the index of rentiers’ bargaining power, which mainly affects their possibility to obtain a fraction of the real value of assets and their possibility to obtain better conditions of payments such as lower interest rates and extensions on the reimbursement of their debt. The rentiers’ bargaining power is mainly affected by the degree of competition within the banking system, in the sense that the bargaining power of rentiers increases as the intensity of competition among banks increases (cf. Fang, 2000), and, above all, it depends on rentiers’ ‘reputational capital’. The rationale for this argument lies in the fact that banks tend to ‘discriminate’ agents also on the basis of their ‘reputational capital’, which is normally linked – as this is the case – to their real wealth. As regard to rentiers’ reimbursement of debt, one can suppose that the accumulation of luxury goods – by their very nature (and hence durable goods, whose value tends, as a norm, to increase over time) – will constitute, in the ensuing production processes, further real guarantees which allow rentiers to obtain further credit. Given their (high) bargaining power in the credit market, it is reasonable to assume banks do not claim for the reimbursement of debt until bank profits decline to below their ‘normal’ value.

\[12\] The rationale for this argument can be described as follows. If A and B are two individuals belonging to the leisure class, with approximately the same budget constraint ($Ra^*=Rb^*$), so that A’s aim is to reach $Ca>Cb$, and B’s aim is to obtain $Cb>Ca$. Starting from an initial condition where both individuals consume the same amount of luxury goods (i.e. $Ca/Cb=1$), by spending $R^*>R^*$, as A starts consuming more – thus increasing the ratio $Ca/Cb$ – B is forced to consume more. However, since they have the same budget constraints, at the end of the competitive process, the same result occurs ($Ca/Cb=1$), with more expenditure than the initial condition ($Ra^*=Rb^*$).

\[13\] Literature has often treated the reputational capital in the specific form ‘behavioural reputation’ in the sense that it mainly looks at agents’ reputation formed on the basis of repeated and observed behaviours which reduce adverse selection and moral hazard risks (see i.e. Kreps and Wilson, 1982; Milgrom and Roberts, 1982). In the credit market, Diamond (1989, 1991) points out that payment conditions – such as interest rates and monitoring costs of contracts – are particularly onerous for those without a successful personal credit history. As he remarks (1989, p.858) “If there is sufficiently widespread adverse selection [...] borrowers will be of low average quality and the interest rates [...] will be high [...]. A fraction of those [...] who are able to continually repay their loans [achieve] a good reputation. As a borrower achieves a good reputation the interest rate falls” (see also Gorton, 1996). Moreover Vercammen (1995, p.475) adds “explicit credit history restriction[s]” prevent the sustainability of reputation itself in the long run since ‘bad’ borrowers are pushed to “altering the lender’s belief” compromising the credibility of ‘good’ borrowers.

\[14\] As shown by Zezza (2007), a further source of income, for rich households, was the capital gains deriving from the acceleration in home prices.
On the other hand \( B \left( 1 - \frac{\partial p}{p} \right) \) is the real value of asset \( j \) where \( B \) is its nominal value and \( \frac{\partial p}{p} \) the inflation rate\(^{15}\). In detail, actual rent measures the amount of credit the single bank supplies to the single rentier. Its level then depends on the real value of assets given as a guarantee weighted by \( \beta \). On the macroeconomic plane, the actual rent \( R \) becomes:

\[
R = \sum_{i=1}^{n} R_i \tag{4}
\]

In the same time we can identify the amount of debt linked to the actual rent for the single rentier \( D_{R,i} \) in the following terms:

\[
D_{R,i} = (1+i)R_i = \beta \left( 1 - \frac{\partial p}{p} \right) (1+i) \sum_{j=1}^{m} B_j \tag{5}
\]

Where \( i \) is the interest rate linked to the actual rent. On the macroeconomic plain the aggregate rentier debt \( D_k \) is:

\[
D_k = (1+i) \sum_{i=1}^{n} R_i \tag{5'}
\]

On condition that rentiers reimburse debt after \( n \) periods in a lump sum, type-2 firms’ aggregate money profits in the commodities market are:

\[
\Pi_i = R - wN_{i2} (1+i) \tag{6}
\]

where \( i \) is the average financial cost for type-2 firms and \( wN_{2} \) the wage bill which is their initial finance. Equation [6] shows net aggregate money profits in the commodities market for firms producing luxury goods are higher: \( a \) the higher \( R \) is, which presupposes a high value of competition on consumption (\( \gamma \)) combined to a high value of rentiers’ assets, \( b \) the lower the financial cost on initial finance of firms, \( c \) the lower the money wage bill and \( d \) the more rentiers can postpone the reimbursement of debt.

Aggregate money profits for type-1 firms are:

\[
\Pi_i = w(N_{2} - iN_{i1}) \tag{7}
\]

Aggregate money profits in the commodities market are shown thus:

\[
\Pi = R - iwN \tag{8}
\]

Equation 8 shows type-1 firms are in the position to obtain a monetary surplus only insofar as a sector producing luxury goods exists since this sector employs workers who acquire wage goods. To describe the level of aggregate profits in the commodities market when rent is reimbursed\(^{16}\), the gross rent at period \( n \) (\( GR_{R,n} \)) for the single rentier \( i \) can be conceived as follows:

\[
GR_{R,n,i} = \left( 1 - \frac{\partial p}{p_n} \right) \left( \sum_{j=1}^{m} B_j + \sum_{j=1}^{r} B_j \right) \tag{9}
\]

Equation [9] shows the beginning of the ensuing circuit. At period \( n \) the gross value of rentiers’ assets increases thanks to the amount of assets owned at step 1 (see Table 1 and [4]) plus the new amount of assets \( \sum_{j=1}^{r} B_j \) obtained at step 4’ (see Table 1) which are however weighted by the new inflation rate. Note rentiers cannot supply gross rent to banks as a guarantee to obtain the new amount of credit since they have to pay their previous debt (see [5]). First they have to collect the money they need to repay debt, so they start to sell assets. In this case, two solutions are in order. First, rentiers can reimburse banks in real terms, by selling them luxury goods. Second, rentiers can

\(^{15}\) Note \( B \geq 0 \).

\(^{16}\) For the sake of simplicity let us assume the constancy of competitive rent over time, as well as the constancy of \( \beta \) and \( B \).
recoup the monetary value of their debt by selling the goods they possess to firms. This second solution is made possible in the event capitalists become more interested in consumption than in accumulation, i.e. if the “motivation to accumulate” declines. They sell part of their assets for a value equal to the debt they can repay and in the same time they can ask for fresh credit. Obviously having sold part of their assets the new rent given as collateral is the gross rent minus the debt they have reimbursed. As a result, the new level of credit they obtain is less than the previous one and equal to the following net rent:

\[ NR_{i,n} = \beta_s (GR_{i,n} - D_{i,n}) = \beta_s \left( 1 - \frac{\partial p_n}{P_n} \right) \sum_{j=1}^{m} B_j - \beta \left( 1 - \frac{\partial p}{p} \right) (1+i) \sum_{j=1}^{m} B_j \]  \[ 10 \]

On the macroeconomic plane \[ 10 \] becomes

\[ R_n = \sum_{i=1}^{n} NR_{i,n} \] \[ 10' \]

The new level of profits in the commodities market is now:

\[ \Pi_n = R_n - iwN_n \] \[ 11 \]

Equations \[ 8 \] and \[ 11 \] show that financialization – in the form of increasing rentiers’ income - can be a device for the realization of a monetary surplus for firms as a whole, and thus – on the theoretical plane – a relevant factor for the ‘closure’ of the monetary circuit. In this context, capitalist reproduction requires the existence of an unproductive class, which consume without directly contributing to the increase of production. This conclusion is in line with the ‘radical’ Institutional view, that – following Veblen – emphasises the necessity of unproductive consumption and the existence of a social class with the “taboo” on labor (Veblen, 1975 [1899], p.69) for the realization of a monetary surplus (see, among others, O’Hara, 2000, p.81).

4 – Financial rents and macroeconomic instability

Starting from the schema proposed here, it can be seen that financialization produces instability and, as a result, cannot guarantee a continuous realization of aggregate money profits. To show this let us analyse the effects of rent on prices. Given \[ 8 \] the rate of profits before rentiers reimbursement is

\[ r = \frac{R}{wN} - i \] \[ 12 \]

So the level of prices becomes

\[ p = \frac{w}{\pi} \left( 1 + \frac{R}{wN} - i \right) (1+i) \] \[ 13 \]

The conditions under which prices increase are

\[ \frac{\partial p}{\partial R} > 0 \forall R > 0 \] \[ 14 \]

\[ \frac{\partial p}{\partial i} > 0 \forall 0 < i < \frac{R}{2wN} \] \[ 15 \]

Condition \[ 14 \] shows that the higher the rents, the higher the prices. Rent is a demand component for firms, so the increase in rate of profits via the increase in rent produces an increase in prices. On the other hand when interest rates raise, profits decrease since financial costs for firms increase. This leads to a double consequence.

\[ 17 \] As Hein (2008, p.114) remarks, this variable is strictly connected to the intensity of competition, “independently of the development of distribution, effective demand, monetary or financial variables”, and it is a key variable explaining economic growth.
1. An increase in the interest rate significantly above the rate of profits may encourage capitalists to allocate part of their capital for unproductive uses\textsuperscript{18}, especially in the cases where their motive for accumulation is weak and when previous profits are above their ‘normal’ levels. This, in turn, increases the number of individuals belonging to the class of the rentiers and, as a result, consumption rises, producing a short-run increase in profits for type-2 firms. This conclusion – as opposed to the mainstream view – leads to maintain that, as a general result, restrictive monetary policies may increase consumption, not savings, and they are likely to reduce investments not because of the higher costs of financing, but because monetary policy is likely to affect class composition. In the event the rate of profits becomes higher than the rate of interest, it becomes more profitable for capitalists to invest, thus generating a cyclical movement involving consumption and production.

2. In view of the arguments above (and particularly with reference to equation 15), prices have a cyclical movement. As we have seen above, the reputational capital of rentiers is high when the real value of their assets is high. The increase in monetary value of rent reduces its real value because of the increase in prices due to the increase in the rate of profits (see equation [12]). Because of the reduction in real value of rents the reputational capital of rentiers decreases. This pushes banks to curtail the reimbursement time on rentiers’ debt so as to obtain money profits sooner. At the same time due to the reduction in the real interest rate, banks react by increasing monetary interest rates. The shorter the reimbursement time on rentier’s debt and the higher the interest rate, the lower the net rent. Note that interest rates are the same both for firms and rentiers so the higher the prices, the higher the financing costs. Since net rent decreases and the interest rate increases, the rate of profits decreases. However as long as the profit rate is higher than the interest rate (\textit{prevailing rent effect}) prices continue to increase. Instead, when the interest rate is higher than the rate of profit, prices start to decrease (\textit{prevailing cost effect}). Table 2 and 3 depict in more detail the price dynamic.

\textit{Table 2: Rent effect and cost effect on the price dynamic}

\begin{center}
\begin{tikzpicture}
\draw[->] (0,0) -- (6,0) node[below] {$i$};
\draw[->] (0,0) -- (0,6) node[left] {$p$};
\draw (0,0) circle (3cm);
\draw (0,0) -- (3,3) node[above] {$p_{max}$};
\draw (3,0) -- (3,3) node[above] {$r=i$};
\draw (0,3) -- (3,0) node[left] {$i^*$};
\draw (0,0) -- (3,3) node[above] {$r>i$};
\draw (0,3) -- (3,0) node[left] {$r<i$};
\end{tikzpicture}
\end{center}

\textsuperscript{18} In this theoretical context, this may occur when capitalists offer part of their real assets (i.e. the fixed capital operating in their firms) and/or the property of the firms as warranty to the banks in order to obtain credit for consumption purposes.
Specifically, there are three conditions that affect the price dynamic depicted by Table 2: a) if \(0 < i < i^*\), \(r > i \Leftrightarrow R > 2i = 2iwN \Rightarrow \frac{\partial p}{\partial i} > 0\). In this case the effect of rent on the profit rate overcomes the cost effect of firm’s financing. b) if \(i = i^*, r = i \Leftrightarrow R = 2i = 2iwN \Rightarrow \frac{\partial p}{\partial i} = 0\). In this case the rent effect on the profit rate is neutral to the cost effect of firm’s financing. Finally c) if \(i > i^*, r < i \Leftrightarrow R < 2i = 2iwN \Rightarrow \frac{\partial p}{\partial i} < 0\). Table 3 shows the mechanism of macroeconomic instability deriving from the increase in financial rents.

![Diagram](image)

Table 3: Financial rents and distributive dynamic.

An increase in rents produces the following effects:

a) In view of equation 8, it generates an increase in money profits, which, in turn, determines an increase in the rate of profits in both sectors. As a result, the mark-up increases and so does the price level. For a given money wage, real wages decline (section [a] – Table 3). This confirms the result that – in a monetary economy, such as that described in the MTP - a negative relation between financial rents and real wages occurs (see, among others, Hein, 2008, p.136). Moreover, real profits decline as well, which is in line with the Keynesian distributive conflict between ‘financial’ and ‘industrial’ circulation (cf. Keynes, 1971 [1930]). At the same time, the price increase reduces the real interest gained by the banking system and, provided that they are in a position to react by increasing the money interest rate, this increases the financial burden for firms, thus contributing to a further decline of profits (section [c] – Table 3).

b) The increase in the price level reduces the real values of the rentiers’ assets. This leads to a reduction of money rents and, as a result, via the reduction of rentiers’ consumption, to a reduction of aggregate money profits (section [b] – Table 3).

These cumulative processes endogenously stop when – due to the decline of the rate of profits – prices decline, thus giving rise to a rise of real wages, real rents and real profits (section [d] – Table 3). However, for the process to stop without implying an economic crisis, it must happen that the decline of profits does not lead firms to bankruptcy, which – in this theoretical context – is not guaranteed by any endogenous variable. Accordingly, i) the higher the fall in real rents, due to the inflationary process that the accumulation of rents itself produces; and ii) the more the banking system is in the position to react to the decrease of real interest by increasing the money interest rate\(^{19}\), the more probable it is that bankruptcies will occur.

\(^{19}\) Note that this schema can be extended by considering the links between the accumulation of financial rents and monetary policy. This may happen because – to expand Minsky’s argument (see, among others, Tymoigne, 2008) – in expansionary phases, when demand increases and so do the prices of real assets, due to the increase of nominal values of estates, banks tend to ‘over-finance’ rentiers. In these circumstances, competitive and ostentatious consumption increases. In an institutional context where the Central Bank fixes an inflation target, it is reasonable to imagine that it react to prices increases via an increase in the base interest rate, thus generating the opposite result. The burden of debt...
5 – Concluding remarks

This paper dealt with financialization within the theoretical framework of the MTP, integrated with some ideas inspired by ‘radical Institutionalism’ and, in particular, by the work of Thorstein Veblen. It has been shown that – in a two-sector economy, where wage goods and luxury goods are produced – the existence of an unproductive class (i.e. rentiers) which consume luxury goods – without directly contributing to production – is a necessary condition for capitalist reproduction. A theoretical model has been presented, where rentiers are assumed to compete in consumption for ostentative purposes and, as a general result, the higher their number and the higher the intensity of competition in consumption, the higher the aggregate money profits in the commodities market. We have seen that the amount of aggregate money profits depends on the amount of rents, which represents the bank financing the luxury consumption both in sector 1 and 2. Rents, in turn, depend on the coefficient of emulation among the rentiers, as well as on their number. Moreover, the real value of rentiers’ assets, and their bargaining power with respect to the banking system, also contribute to the determination of total rents and, hence, on the magnitude of aggregate money profits. As a result, profit is higher: i) the higher the coefficient of emulation and the number of rentiers; ii) the higher their assets at the beginning of the production process, and the higher their bargaining power in the credit market. Finally, it has been shown that the accumulation of financial rents can be a major source of macroeconomic instability, due to the fact that it modifies the price level and the interest rate, thus giving rise to a double distributive conflict, involving the inverse relation between financial rents and profits, and the inverse relation between financial rents and real wages.

References


for rentiers increases and, if banks cannot finance them for paying their debt, the solvency condition does not hold yet. A reduction of banks’ profits derive and, possibly, a ‘credit crunch’ generated by a “ultraspeculative finance”.


Veblen T. B. (1904), The theory of business enterprise, New York, N.Y., Scribner’s.


