The Role of Position in Economic Networks

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The bets are as big as ever

In mid-May 2012, J.P.Morgan revealed that it had lost $2 billion on a large bet gone wrong. In its comment to this news, CNN Money noted: "Wall Street's risk appetite is back, and the bets are as big as ever".

The particulars around this story underscored that not much has changed within the financial markets since the near death experience of 2008. While lingering effects of the financial crisis keeps the real economy stuck in slow growth and high unemployment, the financial lobby has this far successfully kept all meaningful reforms at bay. After the bankers said "thank you" for the public money that bailed them out when it became clear that the crisis was shaking the whole of the financial edifice to its core, it didn't take long before the high-risk speculative bets was back in vogue, bets whose main social function is that they feed the avaricious bonuses of the traders.

The financial markets were not alone in their quick rebound; corporate profits were also quickly on the mend. The beauty of an economic crisis seen from the view of corporate leaders is that it always provides fertile grounds for squeezing labour costs. Thus, while sales were slow, costs were ruthlessly cut in many industries, allowing profits, and in particularly

CEO remunerations, to return to previously high levels. In this way, it was estimated that in the year following the bottom of the crisis (March 2009 to March 2010) U.S. corporate profits rose by $280 billion, while wages *fell* by $90 billion[1]. This reflected how many of the real economy corporations used the crisis to put yet another squeeze on labour and wages, while CEO compensation packages went back to their pre-crisis flight into the stratosphere.[2]

Thus, the process of wealth concentration only took a short pause at the depth of the crisis while it was figured out by the captains of the leading financial institutions how to use their political clout to ensure that the weight of the crisis would predominantly fall on the shoulders of average citizens and not severely interrupt the process of wealth accumulation, which is the primary economic function of capitalism and no less so behind its current face of a financialized economy rationalized by a neoliberal laissez-faire ideology.

Positional Factors in Wealth Accumulation

In order to see how the rising tide of wealth accumulation has come about, the starting point is to note that in a complex socio-economic system—as such which has evolved in post-industrial societies—the value of capitals, e.g. fixed capital assets, debt ownership, money, labour skills (including everything from the ability to perform simple manual labour, to a rocket engineer or a baseball stars' special skills), etc.—is dependent upon existing in a state where a possessed capital can be charged by ability to connect to enabling networks. In other words, that the capital exists in a favourable position with regards to the active socio-economic networks existing in fields where the given skills and assets can be productive.

The importance of connecting to networks enabling the capitals to prosper is generally not emphasized by standard economics. The fact is however that even the most liquid of all capitals, money, is dependent upon enabling networks. To use the classic example, the Australian bank robber who flees in a small plane but crashes in the Papuan Guinean Highlands will see the effective value of his loot goes to zero, due to the lack of a paper money enabling network (at least until he extricates himself from the Highlands).

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[1] Dhaval Joshi of the hedge fund RAB Capital as reported by Buttonwood in The Economist, March 2010.

[2] An illustrative case of post-crisis corporate behaviour is given by Caterpillar, which in Feb 2012 shut down a factory in London, Ontario, after workers rejected a 55%(!!) wage reduction (this according to Jim Stanford, a CAW economist involved in the "negotiations"). Conversely, Wall Street Journal reported Apr 12, 2012 that the compensation of Caterpillar Chairman and CEO, Douglas Oberhelman, jumped 60% in 2011, to a total of $16.9 million.

The consequence of this observation is that some capitals may be high in potential value but not be in a favourable position. They will therefore only be able to produce reduced utility-value compared to the average situation, or perhaps nothing at all. Conversely, low capitals might produce high returns by being in a favoured network position.

The element of position in economic relationships can only be discerned in a field-based analysis (as advocated by Bourdieu), and has therefore not come into the focus of attention in the neoclassical paradigm.

Favourable position can be the result of host of circumstances. Quite often, it will simply the consequence of accidental being in a location where the structures of the actuating networks interconnect, in which case the advantage of position can be quite lasting if that position can be exploited. For instance, a football (soccer) player with great skills might waste them in a small town where they might be recognized in the local community, but not taken any further.

In contrast to this, if the player lives in, say, Manchester, U.K., the skillful player will, even if he starts in a small district club, in sort of a natural process be guided on to one of the two top flight clubs the city (City or United) where high paying contracts quickly will be in the picture.

In other cases, the favourable position might be of an ephemeral character, in the proverbial case of being in the right place at the right time. A classic case, described by Michael Lewis in his tell-it-all book "Liars Poker", is how he gained access to job in a top-flight Wall Street firm by during a dinner for Americans in London sitting next to the wife of his future employer's managing director.

Whether the favourable position is of the more lasting type or ephemeral, the skillful agent should normally be able to work it into sustained profit or income streams. In the case of organizations, the leveraging power of position operates on two levels. Often it will be inscribed in the economic structures within which it can arise spurred by a variety of factors. It can be linked to patterns of symbolic oppression, for instance being member of the favoured group in networks governed by oppressive structures that inscribe inferiority based on ethnicity, gender, etc.

Being member of a favoured group—which is generally acknowledged in the literature on race relations—almost always links to economic benefits. This can translate into being favoured when open jobs have to be filled, getting higher pay, sometimes even when showing inferior job skills compared to members of an oppressed group. This of course refers to conditions in our societies that by now are both well documented and accepted as factual by the socially oriented literature.[3]

Favourable economic position can also, more directly, stem from power positions in parallel hierarchical systems. This can for instance be in political and military systems, or other forms of organizations where either the threat of violence (say, by criminal organizations that corrupt economic transactions), or symbolic oppression that can spring from religious or ideologically charged organizations that have acquired ability to wield various forms of influence on economic and social transformative activities.

Large economic accumulations, whether it is of money or real economy assets (with the capacity to generate cash flows) create their own, often self-reinforcing, power. Partly, the ability to generate self-reinforcing power stems from the potential of economic accumulations to absorb other power sources. The creates what Myrdal in the work mentioned in above note, "An American Dilemma", described as 'circular cumulative causation' where power ensembles emerge that are more than the sum of the originating parts due to self-reinforcing overlapping.

Enhancement of capitals can also arise from positions of centrality in the networks that transform the various power sources. Under such general conditions, position with regards to an active sets of enabling assets, whether this is small or large—perhaps even of global scope—has become a capital in its own right that combine with other assets to define the economic intensity that an asset assembly can command.

Abilities to acquire goals through engagement in economic activities are thus not only dependent upon possession of money, labour and other productive assets in the traditional sense, but also upon status and power positions within the socio-economic structures of the society, which will determine the effectiveness of possessions and derived activities.

Position thus relates to two aspects of the socio-economic structures. First, individual position within the, as mentioned, typically hierarchically structured economic transformative units (firms, banks, hedge funds, etc.). Second, the enabling network position of an individual, or the position of the economic agency unit, within which individual agency is active.

As a structural condition, the importance of position rises with the complexity of the social networks and institutions existing in a society. In simple exchange forms, the role of

[3] See for instance Gunnar Myrdal: "An American Dilemma: The Negro Problem and Modern Democracy" (1944), in which the relationship between race discrimination and economic outcomes is analyzed.

position is not great, since utilities (objects or services) are solidly anchored in social valuations (i.e., social relationships whose maintenance override economism), and moreover mostly are exchangeable directly between agents; that is, without intermediating middlemen in relatively open information environments. Although this is liable to in many cases create 'double want' problems (that each agent must have what the other wants before an exchange can take place), since economic goals tend to be subordinated to social purposes, at this level of exchanges such restrictions are generally not critical. For instance, in a farmers market relevant information and all opportunities are open and equally accessible to all participating agents. This leaves little room for outcomes biased by positional differentials or asymmetric information (which often is defined by position differentials relative to the origin of information that in a open market scenario is minimal). Thus, even a millionaire attending a farmer's market will face the same prices and opportunities as everyone else.

Farmer's markets, however, are a peripheral and somewhat archaic economic institution in today's societies, and are therefore not representative for the economic institutions that dominate modern developed economies. In modern capitalism, the networks that mediate the economic transformations have the followed typical characteristics:

A) Accelerating complexities.

B) Institutional structures dominated by large hierarchically organized corporations or public institutions.

C) Growing importance of financial elements relative to real economy units.

D) Low levels of public planning, oversight and regulation (in particular manifest in the North American version of modern capitalism).

Combining the above characteristics, we can map a general structure in which dominant influence over the functions of modern capitalism concentrate in the positions of central agents within large multinational corporations and, in particular, its financial sectors entities.

Within financial entities, the key factors that decide transformations—and thus profit-incomes opportunities—are information and control over liquid money forms, including the ability (structurally residing power) to transform expectations into credit money; that is, leverage directly held assets. Information is critical for the identification of opportunities as well as their risk assessments. Access to liquidity—either in the form of direct ownership of money, or control over assets that without restraints or significant costs can be converted to money, or ability to raise leverage—spells the ability to transform spotted opportunities into new accumulative payoffs.

The modern financial functions take place in chains that not only have more links between the eventual end-points in the real economy than in the past, but also are vastly more complex, as exemplified by the recent phenomenon of ability to create complex synthetic market positions through the uses of derivatives. Within the financial agency units, agents located deep inside their complex structures wield the principal transformative forces. These agents will typically be removed many steps from the agents positioned at the end-points of the economic chains where the real economy activities take place—original producers inputting labour and direct entrepreneurial design into the economy on the one side, and final consumers enjoying the utilities of the produced goods and services on the other.

The condition of position removed from chain-ending agents implies that agency roles in financial intermediating are not subject to, and perhaps even without any cognizance of, the social goals or conditions that set the chains in motion. In other words, goals of middle class life-style fulfillment, community-defined goals, or attempts to fulfill socially validated needs by public agencies—in short, all the conditions that cause the agents with positions in the real economy to engage in economic activities—will not tend to be part of the considerations of the agents who are in control of the core intermediating financial functions.

Moreover, the status-charged environment typically met inside of financial institutions—pivoting around exhibiting conspicuous consumption such as driving Lamborghini, etc. to work (or at the very top, flying a helicopter to work, exhibiting the claim that there is an extreme socially validated money premium on their time, when in fact the financial intermediating functions they lord over increasingly are slowing real economy functions down). When such attitudes are prevalent within the financial institutions it tends to produce extremely de-socialized working environments. Thus, agent interactions are not likely to consider intra-societal relations in a broad sense, but will only add to the singular motivation of maximization of private money payoffs, as these are viewed from the agents' individual vantage point: that is, the profit motive of the agency interests they represents, mixed with as much private self-interests that principal-agent malfunctions will allow them to get away with. Moreover, at the highest executive levels of the financial corporations, risk management are executed under conditions rife with moral hazards, caused partly by the 'to big to fail' syndrome, partly by the irreversibility of paid-out performance bonuses. One consequence of this is that attempts to minimize principal-agent malfunctions seldom appear to be vigorously pursued.[4]

This goes to say that speculation with little regards for larger consequences have become the driving motives, in particular since all that the agents are likely to meet in their working environments, or specific field positions, are other agents with similar social outlooks. In other words, all the negative effects that their agency behaviour imparts upon society's real economy functions are rationalized away, a rationalization that is spurred on by living in an social micro-environment where the common perception (the collective *doxa*) is one that holds predatorily maximizing self-interests not only to be glorious, but even an economic necessity that is to the good of all.

The world that has emerged within the fields of financial intermediation is consequently one of hectic speculation and trading, unfettered by any strong restraints set by inter-agency controls, and in the neoliberal economy, neither by any serious public agency oversight. However, by virtue of the dominant position of financial intermediation in the hierarchical economic structures of modern societies, the agents populating the trading pits (or, more likely, sitting in front of the ubiquitous blinking computer terminals in large open-office spaces) have been able to gather rewards that invariably are in the upper end of the incomes spectrum, even for those in the systems lower positions who might not possess any special skills nor credentials.

For the top executives, rewards, even for paltry performances gauged by intra industry parameters, can reach astronomical figures. In the cases of top banking executives and hedge funds managers individual incomes have in good years been known to run into the hundred millions of dollars. In a few cases, hedge fund managers have even reaped billions in payouts, such as the now famous case of the 'big short': hedge fund manager John Paulson who successfully—that is with the right timing—shorted[5] the 2007-2008 collapse of the U.S. housing market.

[4] The losses by JPMorgan caused by an agent in their London office, nicknamed "Whale" is only the last in a list of cases where unmonitored speculative activities by subsidiary agents have led to extreme losses, other cases are Jérôme Kerviel in Société Générale in 2008, and Nick Leeson in Barings Bank in 1995 (causing its demise).

[5] A short is a financial speculative strategy that bets on the fall in value of some asset, or asset classes.

Conflicts of Goals

The hierarchical dominance that the complex intermediating financialized functions wields over the real economy will inherently lead to conflicts between the goals of the controllers of the financial transactions and end-point activities (including those managed in the public domain). Insofar the primary structuring power residing in the financial functions are in the hands of the top managers of large banks and funds—who often combine economic power with ability to influence political governance—conflicts are increasingly resolved to the detriment of both the interests of average citizens as well as public goals, a case in point being the reduced public investments in infrastructures and, in general, investments in the enhancement of livability of the common spaces of society.

The consequences of this development is that most of the social goals that—due to failures of private markets—only can be dealt with by public institutions are increasingly neglected in step with the diversion of resources into private hands by the wealth concentrating conduits of the financial sector. This diversion means that an increasing part of the broad social resources of society are being allocated to the exclusive use of conspicuous consumption of the 1%, or further added to the ongoing accumulation of speculative funds. Thus, one of the characteristics of countries in which laissez-faire financialization has reached its paradigmatic forms is that they experience a deterioration of their social and physical infrastructures set against—to use Galbraith's pithy term—the spreading of 'public squalor'.

In the neoliberal narratives, the increasing cost to society of financialization is rebutted with the claim that it enhances liquidity and shifts risks to those 'with the ability to bear them', thereby ensuring the efficient allocation of society's resources. In the big picture, the financial activities according to the standard neoclassical definitions must be to the benefit the overall economy.

This benefit is so valuable to society that the cost of the excesses, even considering the enormous rewards that the insiders of the financial markets carry away, is claimed to be fully worth it. This is essentially a rephrasing of the old trickle down claim that although unfettered markets might create inequalities, in the end they will 'lift all boats'. But, as it has sarcastically been noted, what is lifted by today's financialized economy is restricted to all yachts. For the rest of society, the cost is stagnation, high unemployment, environmental neglect, and, as mentioned, growing public squalor.