The long arm of finance: Exploring the unlikely financialization of governments and public institutions
Hendrikse, R.P.

Citation for published version (APA):

General rights
It is not permitted to download or to forward/distribute the text or part of it without the consent of the author(s) and/or copyright holder(s), other than for strictly personal, individual use, unless the work is under an open content license (like Creative Commons).

Disclaimer/Complaints regulations
If you believe that digital publication of certain material infringes any of your rights or (privacy) interests, please let the Library know, stating your reasons. In case of a legitimate complaint, the Library will make the material inaccessible and/or remove it from the website. Please Ask the Library: http://uba.uva.nl/en/contact, or a letter to: Library of the University of Amsterdam, Secretariat, Singel 425, 1012 WP Amsterdam, The Netherlands. You will be contacted as soon as possible.
THE LONG ARM OF FINANCE

EXPLORING THE UNLIKELY
FINANCIALIZATION OF GOVERNMENTS
AND PUBLIC INSTITUTIONS

ACADEMISCH PROEFSCHRIFT

ter verkrijging van de graad doctor
aan de Universiteit van Amsterdam
op gezag van de Rector Magnificus
prof. dr. D.C. van den Boom
ten overstaan van een door het college
voor promoties ingestelde commissie,
in het openbaar te verdedigen in de Agnietenkapel
op donderdag 26 november 2015, te 14:00 uur

door

REIJER PIETER HENDRIKSE

geboren te Dordrecht
This research was made possible through financial support by the Department of Geography, Planning and International Development Studies and the Amsterdam Institute for Social Science Research, Universiteit van Amsterdam.

ISBN: 978-94-6182-619-0
Design and Layout: www.marinedelgado.com
Original Cover Image: Reijer Hendrikse
Printed by Offpage, Amsterdam.

All rights reserved. No part of this publication may be reproduced in any form, by print, photo print, microfilm or any other means, without prior written permission from the author (reijer@mail.com).
# THE LONG ARM OF FINANCE

**EXPLORING THE UNLIKELY FINANCIALIZATION OF GOVERNMENTS AND PUBLIC INSTITUTIONS**

## TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>SECTION</th>
<th>1-6</th>
<th>7-36</th>
<th>37-62</th>
<th>63-94</th>
<th>95-122</th>
<th>123-150</th>
<th>151-172</th>
<th>173-176</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreword</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Roller coaster</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Introduction</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exploring the unlikely financialization of governments and public institutions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chapter One</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>How finance penetrates its other: a cautionary tale on the financialization of a Dutch university</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chapter Two</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial wizardry and the Golden City: tracking the financial crisis through Pforzheim, Germany</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chapter Three</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Back to the future: exploring the financialization of Germany’s leading Landesbank</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chapter Four</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Entangled geographies “Irish” finance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Conclusions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The long arm of finance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dutch Summary</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>De lange arm van de financiële sector</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The word that best describes the long period culminating in the thesis in front of you is *roller coaster*. Because indeed, it has been quite a journey.

The investigations underlying this thesis started in 2010, amidst a brewing Greek drama which soon became known as the euro crisis. For three hot summers it periodically seemed that the eurozone was destined to disintegrate, yet each time the threat appeared imminent the integrity of the monetary union was ‘saved’, resulting in a profound centralization of Europe’s fragmented geography of sovereign power. Seemingly convinced by these efforts and the promise that the eurozone would be kept together – ‘whatever it takes’ – for roughly two years global financial markets seemed to believe the worst was over. It did not last.

Early in 2015, a progressive alliance won the Greek elections upon a promise to alleviate the country’s economic misery. For months, the logic behind technocratic rule, perpetual austerity and bailouts without debt relief was resisted by *Syriza*, only to be forcefully crushed in the early days of another hot summer, during another dramatic bend-or-break weekend. Once again, the face of Europe had changed, with Europe’s leading politicians now openly advocating a Greek exit from the euro. In one fateful night, the idea of one ‘European family’, which for decades had guided European integration, had been thrown out of the window: in neoliberal Europe, there is little place for alternatives, especially those put forward by academic amateurs and left-leaning dreamers. As a result, Europe’s political forces continue to polarize towards the left and right – beyond the veil of a ‘middle ground’ now unmasked as extreme center – seeing the multilayered elastic holding Europe together stretched to a maximum. As of writing, the cord has not yet snapped, but who knows how long it will last.

This thesis is therefore the product of unexpected events. That is to say, ongoing financial turmoil in Europe and beyond has shaped the direction of this thesis. Seemingly never-ending events of financial panics, rescues and scandals kept us all occupied, and frequently disorientated. That
said, the ongoing single crisis of financialized capitalism – a crisis of financialization – demanded the continuous investigation of events, each time leading me into new aspects and dynamics of high finance, each time generating new questions and explorations. This, however, was not wholly unexpected, as my broad interest in what David Harvey labels ‘the state-finance nexus’ is by definition a moving target, and particularly in times of crises. In other words, starting my research amidst the aftermath of a financial meltdown whose repercussions were now seriously challenging the flawed architecture of the eurozone, from the very beginning it was obvious I had my work cut out.

Besides the turbulent research topic, professional life also proved a roller coaster journey knotted together by unexpected events. During the first year of my employment the faculty of social sciences announced a massive funding shortfall, necessitating a number of unpopular measures. Luckily, as the budget allocation model was magically tweaked the shortfall was reduced, seeing the acute panic amongst staff eventually wane. However, some of us decided to investigate the deeper reasons behind this episode, the outcome of which now featuring in the book in front of you. Partly prompted by ongoing funding pressures, one surprise was that my main supervisor had decided to leave university for a more affluent academic climate in the tropics. But more astoundingly, by the time this thesis was nearly completed a group of students had come to occupy a number of university buildings to protest the climate of accelerating austerity. Inspired by this unexpected event, hundreds of colleagues including myself were suddenly drawn into an unprecedented academic uprising. Naturally, these developments have all impacted the development of this thesis.

Finally, personal life equally proved a roller coaster. Over these years I have been fortunate to travel to many countries and experience some memorable encounters, and some of these travels changed my worldview in profound ways. One truly startling event occurred to me mid-summer 2012 on the remote Greek island of Anafi – a name said to be given by Apollo, meaning ‘to see the light’. Where beautiful Greece had become a laboratory of brutal austerity and heartless technocracy, invoking all kinds of vulgar responses on both ends of the eurozone, to me Greece will forever remain a place of endless stars and the unexplained – revealing dimensions to life well beyond the reach of the scientific method. The fact that I have since then become both a husband and a father further underwrites the fact that one’s journey through life cannot easily be explained or planned, even if random events sometimes feel as if they were prearranged. If anything, perhaps the main lesson I have learnt over these years is that life itself is a roller coaster, best embraced by expecting the unexpected.
This thesis would not have been completed without the support of a wide range of people. First, I thank my supervisors, among whom Virginie Mama-douh proved the most constant factor. Dear Virginie, as co-promotor you were always available to assist and guide me – to discuss another draft, or to help me out with administrative or teaching duties. I cannot thank you enough for the advice and support you have given me over these years. Halfway through the research period Ewald Engelen became my second main advisor, having been co-promotor from the start. Ewald, your advice – often frustrating, always right – proved invaluable to the development of this thesis. It has been a privilege to work with someone who studies the financial roller coaster as intensively as you. The fact that I have become associated with ‘The School Engelen’ – whatever that might imply for those who coined the term – fills me with pride. Lastly, my thanks go out to James Sidaway, my initial main advisor who actually was foolish enough to hire me for the job. James, although your departure came as a surprise, you actually never left the project. I am thankful for your friendship, your continued advice and the many professional opportunities you have given me over the years. I have no doubt our paths will cross again.

Next to my supervisors there are more colleagues – in the department, the research institute, the university and the wider academic community – who deserve a special thank you. First, I thank my colleagues in the Geographies of Globalizations (GoG) research group led by Robert Kloosterman, not least Manuel Aalbers, Anna Glasmacher and Zaya Enkhbold who all proved to be great companions over the course of my employment. A special thank you goes to Rodrigo Fernandez for all the collaborative work we have conducted over the years. Like my supervisors, you proved to be an invaluable guide into the world of finance, academia and beyond. I also thank all my colleagues and staff at the Department of Geography, Planning and International Development Studies (GPIO). A special thank you goes to the administrative support at the department: Puikang Chan, Marian Haman, Marianne van Heelsbergen, Barbara Lawa and Guida Morais e Castro Ermida. I also thank the chair of the department, Joos Droogleever Fortuijn, not least for extending my contract to make up for some lost time due to an unexpected health issue.

Outside the department, I especially wish to thank Jeffrey Harrod and Daniel Mügge for assisting me in writing the initial research proposal for the project. To put it bluntly, without your help it seems unlikely that I would have acquired the job. In addition, I thank all my colleagues liaised to the Amsterdam Institute for Social Science Research (AISSR), with whom I followed a range of intriguing methodology, theory and writing courses, and with whom I had the privilege to spent a number of memorable PhD weekends. Frankly, there are simply too many persons who deserve special
mention here. Circumventing the risk of forgetting particular individuals, I hereby simply thank you all. Lastly, I thank the many hundreds of students and staff who have been involved in the recent Maagdenhuis revolt, especially Humanities Rally, De Nieuwe Universiteit and Rethink UvA. Parallel- and invoking insurgencies elsewhere, a wide range of people, currents and ideas suddenly came together in the wake of the Bungehuis occupation, unexpectedly yet forcefully waking up the Dutch polder elite out of their neoliberal pipe dreams. If our alleged amateurism, naivety and aloofness does indeed set us apart from the spinners and tricksters who consider themselves professional experts, I strongly suggest we take it with pride. Make no mistake: we have only just begun.

The various periods of fieldwork underlying the research in front of you would not have been possible without the assistance and generosity of others. In this regard, I especially thank Veit Bachmann and Agnieszka Leja for their kind hospitality, respectively offering me a place to stay in Frankfurt and Cork during various periods of fieldwork. In similar fashion, I thank the National University of Ireland in Maynooth (NUIM) and the National University of Singapore (NUS) for offering me a place as a guest researcher. Both institutes offered highly stimulating environments to work on the investigations underlying this thesis. Last but not least, I also thank the more than fifty interviewees who were all willing to talk with me over the course of this research. Without their crucial guidance and insights, writing this thesis would have proved impossible.

My journey into academia led to many encounters with a wide range people – academics, activists, journalists and editors. In this regard, I especially thank Benjamin Wilhelm and Andrea Lagna who both proved great companions during the various COST-Action workshops. Likewise, I thank the editors and reviewers of the academic journals that have been instrumental in getting my research published. Besides these outlets, I thank AGORA editors David Bassens and Michiel van Meeteren for the publishing opportunities they have offered me. A similar thank you is in order for Jesse Frederik and Eric Smit of the Dutch website Follow the Money, offering a non-academic platform to put my thoughts out in the open – a refreshing experience in contrast to the slow-moving publication of academic knowledge. Likewise, I thank the people I have collaborated with at Real World Economics, putting up the good fight against rigid economic ‘science’ underlying the larger neoliberal myth machine. I also thank Marine Delgado for her eternal patience, formatting the articles and drafts underlying this thesis into a beautiful integrated style and book. Lastly, my eternal gratitude goes out to geographers Georgia Alexandri and Venetia Chatzi for making Athens my home on various occasions – ευχαριστώ, I will remain Greek for the rest of my life.
Obviously, this is also the place to thank friends and family for their love and support. Again, there are just too many people to thank in this regard, and I will refrain from listing them all. That said, those who know me well understand that I am speaking of them. A special thank you goes to my direct family who have always supported me in my life’s choices, however unforeseen some these choices might have been for them. My father Albert, my mother Marjan and my brother Wijnand have all made me who I am, and I am grateful to always have them close to me. The beauty of life is that many of its unexpected turns eventually become part of its inescapable cycles. For with time our roles change and new cycles begin. Having met Raquel on the very first day after the world was said to come to an end, we have never parted since. On the contrary, a year onwards we were well underway to build a family of our own. Again, just a few years ago who would have thought that today I would have both a beautiful wife and daughter in my life? I surely didn’t. Unexpectedly, however, you have rapidly become the most cherished and wonderful beings in my life.

Dear Evi Juno, sweet summer wonder, I will always be expecting you.
INTRODUCTION

EXPLORING THE UNLIKELY FINANCIALIZATION OF GOVERNMENTS AND PUBLIC INSTITUTIONS

It is often claimed that the power of finance is pervasive and omnipresent, yet the delicate ways in which financialization exerts its will across space remain relatively little explored. In fact, such claims obscure the fact that financial development constitutes a profoundly uneven process – both across and within national political economies, regions or localities. Put differently, some institutional domains appear less hospitable to the forces of financialization than others. This thesis advances four case studies, which are to varying degrees considered least likely to fall prey to financial seduction, logics and authority. The cases explore the financial activities of four European institutions in various ways tied to the state: a Dutch public university, two local governments in Germany and Ireland, and a German regional public bank. The expectations defining their least likely nature are informed by theory, including the literatures on financialization and comparative institutionalism.

The cases reveal that despite expectations the long arm of finance has managed to penetrate these domains, necessitating a number of theoretical advances in the foregrounded literatures. Despite institutional variations in state structures, financial systems, organizational templates, functions and capacities, incessant neoliberalization of state policy has gradually lured if not ‘forced’ these governments and public institutions to adopt financial products and logics. As such, binary depictions of liberal and corporatist states or national bank- and market-based financial systems do not do justice to the ways in which these ideal type ‘containers’ have evaporated or hybridized. Although the cases indicate how financialization is pervasive, the literature is in need of more empirical detail, particularly cases outside the Anglo-American heartland. As will be argued in the concluding chapter of this thesis, only by generating more theoretically grounded empirical accounts on the manifold ways in which state institutions become subject to financial power can the literature start to unmask and theorize the encroaching financialization of the state itself.
This introductory chapter sets out the rationale and structure behind this research, detailing an integrated literature review and research design guiding the four case studies comprising this thesis. The next section offers a literature review of the main concept under investigation: financialization. Subsequently, this introduction discusses a number of spatial lacunae in this developing literature, underscoring the rationale and expectations guiding this research. As the case studies presented in this thesis have in various ways been selected on the basis of their least likeliness, this introduction consequently sets out the logic behind the applied research strategy, methods and case selection. Finally, the introduction details the structure of the book.

**FINANCIALIZATION: INTEGRATED PATCHWORK, SINGLE LOGIC**

Making sense of the notion financialization is a challenging exercise. In fashion since the 1990s, although tracing a longer genealogy, the mounting literature offers an array of competing perspectives, definitions and metrics. These range from materialist to cultural accounts, foregrounding a wide variety of data or mere theoretical constructs offering empirical or normative evaluations on the dominant role of finance. These perspectives, in turn, are scaled, stretching from the heights of the global political economy down to households and the body. As the cases featuring in this thesis each explore specific developments indicative of financialization having unfolded in a diverse set of least likely institutional domains, the aim of this section is “to explore the meaning and significance of financialization by triangulating an understanding from different fields as a basis for mixed-method empirical research“ (Erturk et al 2008: 24).

First, situating financialization requires the unpacking of a wider conceptual space, as the notion is tied up with concepts such as globalization and neoliberalization (e.g. Engelen 2008; Foster 2007). In particular, there is considerable overlap between financialization and neoliberalization (Peck and Tickell 2002), whereby the latter development should be seen as a more general process that often appears as a prerequisite for financialization to take root. In any case, “the two processes are constituent of one another” (French et al 2011: 800). As argued by Duménil and Lévy, “most, if not all, analysts on the left now agree that neoliberalism is the ideological expression of the reasserted power of finance” (2005: 17). Alternatively, there seems to be little difference between what Piketty labels “financial globalization” (2014: 42) and financialization.
Adding to the conceptual confusion, the definition of financialization is contested, as is typically the case with large social science concepts. In fact, as the literature “covers a wide range of phenomena” (Stockhammer 2008: 184), seeing the concept “stretched and pulled in myriad directions” (Martin 2002: 8), there are limitations to a definitional approach. To paint a picture, some scholars derive “at least” seventeen distinct understandings of financialization (Lee et al 2009: 728), whilst others distill a range of schools and approaches (French et al 2011; Pike and Pollard 2010). With its roots in economic geography, since the turn of the millennium the ‘sub-subdiscipline’ of financial geography has also come to embrace the concept (Aalbers 2015a). In other words, financialization is multidisciplinary concept, seeing a range of perspectives based on distinct research traditions foregrounding varied explanatory mechanisms, including function, power, interest and legitimacy (Engelen 2008). As a result, there equally exists “no consensus on the metric of financialization” (Engelen and Konings 2010: 609). Added up, some argue that the literature comprises “a series of separate specialist arguments running in parallel rather than as an integrated whole” (Watson 2009: 256), whilst others maintain that the various arguments remain tied up with one another (Dore 2008). Appreciating both claims, the literature is arguably best viewed as an integrated patchwork:

“If the aim is to construct a concept and analysis of financialization, we find ourselves like medical doctors trying to make sense of presented symptoms and episodes which are bewilderingly diverse and beyond the expertise of any one specialism” (Erturk et al 2008: 3)

The late nineteenth-century laissez faire era is generally regarded the first global epoch of high finance and financialization, a time during which many institutions and ideas shaping present-day finance came to fruition, resulting in critiques of the conspicuous rise of financial capital, the corporation and rentiers (e.g. Berle and Means 1932; Hilferding 1910; Veblen 1923). In contrast, postwar cross-border finance was heavily curtailed in a system of embedded liberalism in which national states enjoyed relative autonomy in managing their economies, exerting meaningful control over their respective financial systems. However, this began to unravel with the 1960s rise of the offshore Euromarkets (e.g. Bell 1973; Dickens 2005), eventually leading to the collapse of the postwar Bretton Woods order. Over the course of the 1970s a novel political-economic order emerged, which eventually became known as neoliberalism (e.g. Harvey 2005; Hendrikse and Sidaway 2010), heralding the return of cross-border finance and financialization.
Although financialization can be sliced into many subcomponents, the two
dominant strands defining the contemporary literature are political economy
and cultural economy: where the former strand focuses on macro develop-
ments, especially ‘hard’ material aspects of financial accumulation, innova-
tion and risk taking, the latter strand focuses on meso and micro develop-
ments, especially the ‘soft’ power of financial narratives, performativities
and rationalities (see Erturk et al 2008). Although a definitional approach
has its limits, from a political economy perspective financialization is con-
ventionally defined as “the increasing role of financial motives, financial
markets, financial actors and financial institutions in the operation of the
domestic and international economies” (Epstein 2005: 3). Meanwhile, Kripp-
nier considers financialization as an outcome rather than a process, defining
it as “a pattern of accumulation in which profits accrue primarily through
financial channels” i.e. the FIRE sector comprised of financial services,
insurance and real estate firms (2005: 174). Palley, in turn, defines finan-
cialization as “a process whereby … financial elites gain greater influence
over economic policy and economic outcomes” (2007: 2). In other words,
the concept speaks to both processes and outcomes. Put differently, as noted
by Aalbers, “sometimes financialization is the explanandum (the pheno-
menon to be explained), sometimes the explanans (the thing that explains)
and at other times it is not even clear which of the two it is” (2015: 2, em-
phasis original). This then constitutes one of the main critiques of the finan-
cialization literature – it is somewhat eclectic or chaotic.

In the wake of the cultural and poststructuralist turn in the social sci-
ences, not least informed by the work of Michel Foucault (2008), cultural
scholars such as Callon (1998) and De Goede (2005) argue that economic
discourses and financial models do not merely observe but rather format and
shape economic dynamics, including processes of financialization, working
as “an engine, not a camera” (MacKenzie 2006). For example, Froud et al
provide an analysis of the “management strategy of giant firms” having
witnessed “the intrusion of the capital market, signaled by the increasingly
vociferous investor demands for shareholder value”, seeing organizational
structures transformed to attain these typically “utopian objectives” (2006:
4). In similar fashion, Martin (2002) identifies a range of cultural dynamics
shaping the financialization of households and individuals. As indicated,
these are but a few definitions, perspectives and explanations, covering
process and outcome; functioning as explanandum and explanans, emphasiz-
ing material and cultural significance:

“To be useful to any comprehensive understanding of a complex
world, financialization must refer to many different processes at
once. The different dynamics would seem to operate apart from
each other, but the burden of a useful analysis is to show how they work together” (Martin 2002: 9)

The political and cultural economy strands arguably constitute the major divide in the literature, resulting in an enduring dispute over causal linkages between structure and agency, or macro and micro levels of abstraction (Langley 2007; Konings 2011). However, these categories are not mutually exclusive. On the contrary, “each bearing a potent conceptual lens” (Martin et al 2008: 130), the two strands augment each other. Therefore, any triangulated understanding ought to appreciate that – in the last instance – financialization constitutes a single overarching development, process and outcome, comprised of material and cultural particles, altering “fundamental aspects of capitalist micro and macro dynamics” (Goldstein 2009: 453). Incorporating these concerns, a broad yet concise working definition has been formulated to guide this research:

*Financialization is defined as the increasing dominance of financial markets, instruments, actors and rationalities over the functioning of political economies, civil society and daily life.*

**EXPECTATIONS: ON GEOGRAPHY, THE UNEXPLORED AND UNEXPECTED**

Having set out a concise literature review, this section details a spatial critique of the financialization literature, underscoring the rationale for this research. In addition, the geographical lacunae identified in this section culminate in four general expectations guiding this research.

Resembling the ways in which industrial Taylorism and Fordism represented “revolutions in standardization” (Tate 2001), financialization might equally be seen as a process/outcome of standardization, achieved through innovations in- and the cross-border convergence of financial instruments and technologies derived from improvements in calculation, securitization, and so forth (Martin et al 2008). Culturally, for example, it could be argued that the discourse of shareholder value shapes the financialization of firms along a standardized menu of corporate governance. Taking these developments together, financialization fuels cross-border integration – of banks, financial institutions and financialized corporations (Vitali et al 2011), including legal and accountancy professions (e.g. Faulconbridge and Muzio 2009; Nölke 2011; Suddaby et al 2007), as well as the convergence of financial discourses and rationalities. As a result, cross-border finance is
steadily calibrating along a globalizing standard, or along an Anglo-American financial logic (e.g. Engelen et al 2010; Konings 2008, 2011), seeing economic exchange and social life increasingly governed by Anglo-American financial markets, actors, products, metrics and principles:

“While financialization theorists disagree about the precise causal pathways involved in their research focus, they tend to agree in viewing financialization as a generalized trend, to be found in most Western national political economies. It thus supports the modernist thesis of institutional convergence: in context of the rise of financial markets, the creation of new financial products, and the appearance of new border-crossing financial agents, the relevance of national institutional differences is supposed to be declining” (Engelen and Konings 2010: 608)

The idea of institutional convergence is equally found in the literature on global and world cities (e.g. Friedmann 1986; Sassen 1991; Taylor 2004). For example, in line with the premise that financialization sees financial elites “gain greater influence over economic policy and economic outcomes” (Palley 2007: 2), one of the key tenets in the global cities literature is that processes of globalization and neoliberalization have resulted in a shift in authority, or “command and control functions” (Sassen 1991), drifting away from the bureaucracies of national states into the offices of private corporations, banks and professional services firms clustered in the world’s leading global cities. In line with the premise that financialization unfolds along Anglo-American lines, the world’s leading global cities housing the largest agglomerations of these players are London and New York (e.g. Cassis 2006; Kindleberger 1974). The implicit assumption locked up in this perspective is that borders have been eroded, or that the national state as a mediating filter between globalized capital and “the scale at which we live our daily lives” has evaporated (Taylor 1982), suggesting that the rise of finance has indeed heralded “the end of geography” (O’Brien 1992). Another way to explain the aforementioned shift in authority and the alleged end of geography is the devolution risk and its management (e.g. Beck 1992; Hacker 2006), moving away from the national state container toward businesses, households and individuals. That is to say, during the immediate postwar era:

“[N]ation states and a range of national institutional arrangements both absorbed some risks and balanced out a range of other risks within a national territory. Risk about price changes in the future was to some degree socialized” (Bryan and Rafferty 2006: 7)
In the neoliberal era, however, financial institutions have increasingly come to offer a range of financial risk management products and services to fill the void left by the gradual withdrawal of the state as a collective risk manager, leading scholars to equate financialization with the rise of financial risk (Hardie and Howarth 2009) and risk management (Martin et al 2008). But has the emergence of a global risk society really run its course? Put differently, does financialization indeed pose a universal development across space whereby the role of geography, place or the state can be fully discounted? Is there no societal domain left that remains relatively protected from the imposing logic of finance?

Although an integrated global political economy has in part come about, neoliberalization and financialization have unfolded unevenly across space (e.g. Hendrikse and Sidaway 2010). For example, although neoliberal state reforms have resulted in a general process of “glocalization” – seeing the national state as collective risk manager give way “to new configurations in which both the local/regional and the transnational/global scale have risen to prominence” (Swyngedouw 1992: 40) – this process is neither finished, nor has it unfolded uniformly across space. In other words, the image of a borderless world in which finance uniformly exerts its will from above is by no means established fact. On the contrary, it arguably is the result of a lacuna in the literature.

The financialization literature is dominated by political economy perspectives, which typically offer macro accounts with little attention to spatial nuance and variation. Moreover, in so doing the literature largely focuses on Anglo-American economies, reflecting the wider Anglo-American hegemony in academia (Aalbers 2004; Aalbers and Rossi 2006). As a result, the literature remains “too generic when it comes to the particularities of processes of financialization elsewhere” (Engelen et al 2010: 57). This is unfortunate, as it is “difficult to understand financial change without paying ample attention to the often quite distinctive institutional specificities at the very heart of financialization processes” (Engelen and Konings 2010: 609). Yet too often, however implicit, the literature suggests that financialization poses a universal phenomenon across space. However, this picture is perhaps not a reflection of reality, but rather an indication that the literature has left financialization elsewhere unexplored – perhaps it is not the world being flat but rather the literature itself. In the words of French et al (2011: 814), although financialization poses “a profoundly spatial phenomenon” pushing finance forward, “space and place are accorded only a passive role” in the literature. To anticipate and possibly correct for the relative spatial blindness in the literature, this thesis foregrounds the first general expectation:
Financialization does not pose a uniform development across space but manifests itself differently in a structured way.

Besides a neglect of developments outside the Anglo-American heartland, the financialization literature reveals more spatial lacunae in need of exploration. Although financialization has been investigated at numerous scales – global and national economies (e.g. Epstein 2005), industrial sectors and firms (e.g. Froud et al 2006), households and individuals (e.g. Martin 2002) – these studies largely focus on market developments, or investigate the ways in which finance has come to play a dominant role in civil society. To varying degrees, these areas all constitute for-profit domains, comprising the ‘natural habitat’ for financialization to take root and unfold. Crucially, however, although some scholars classify rising public debts (e.g. Streeck 2014) or the cultural capture (e.g. Kwak 2013) of government officials by financial logics as indicative of financialization, the ways in which states advance financialization, or how state institutions become subject to financial authority, remain relatively underexplored (Güngen 2012; Krippner 2011; Lagna 2013; Weber 2010 are some exceptions).

As noted by Krippner, cultural scholars typically leave the state “exogenous to the analysis” whereas in political economy the “canvas is arguably too broad” to capture “the concrete mechanisms and institutional details” by which the state shapes financialization (2011: 14). Moreover, if the state is discussed, it is typically framed as opposed to- or constraining markets, neglecting the ways in which states might facilitate financial expansion in “a process of mutual constitutive interaction” (Engelen et al 2010: 56). After all, functioning in multiple capacities – as contract enforcer, financial actor, fiscal arbiter, guarantor, lawmaker, monetary authority and regulator – the state delineates the canvas upon which financial development unfolds. Put differently, the rules of the state and the shape of the financial sector are inherently tied up with one another.

This thesis is based on the premise that the state, via its policies and institutions, does impact and shape “different paths or trajectories of financialization” (Engelen and Konings 2010: 617). Having said this, although neoliberalization has unevenly reworked the functioning of the state and its institutions in the image of the for-profit corporation (e.g. Hood 1991; Saint-Martin 2000), leading some to speak of “the retreat of the state” (Strange 1996), this thesis expects that there are real limits to the working of the market in the public non-profit realm. Put differently, institutions comprising the state are generally based upon different operating logics and funding mechanisms that are less exposed to market pressures, including exposure to financial markets, instruments and logics. In the words of Walras,
reverberating with others (e.g. Kuttner 1997; Sandel 2012), it is expected that “the principles of free competition applicable to the production of things of private interest is not applicable to the production of things of public interest” (Walras quoted in Dardot and Laval 2013: 218). This then constitutes the second general expectation underlying this thesis:

*State institutions are generally less prone to financialization compared to institutional domains tied to the economy and civil society.*

As will be discussed in more detail in the section on case selection, the institutional setup of states varies considerably. For example, there are more or less centralized and decentralized states, typically comprised of two or three tiers of government, resulting in various distributions of functions, authority and autonomy. Moreover, besides variations in local, regional and national governments states are comprised of innumerable additional (semi-) public institutions – each with their own specific histories, organizational templates and functions; each in different ways tied to their respective governments and with variable insulation from market pressures, resulting in varied institutional capacities and financial undertakings. Therefore, as financialization is expected to manifest itself unevenly, it is equally expected that this also is the case for the unlikely financialization of state space. To this end, the third expectation guiding this research specifies the first expectation in light of the second:

*Financialization does not pose a uniform development within and across states but manifests itself differently across state institutions in a structured way.*

Again, as will be elaborated in the section on case selection, deepening this thesis’ focus on institutional domains where financialization is considered least likely, the thesis puts particular emphasis on state institutions located in jurisdictions which are – on the basis of the intersection of the literatures on financialization and comparative institutionalism (e.g. Amable 2003; Hall and Soskice 2001) – not or less dominated by financial markets. That is to say, as financialization typically is seen to depend on institutional characteristics of Anglo-American financial markets (Engelen et al 2010), it is expected that state institutions situated in jurisdictions elsewhere may be better shielded from financial intrusion. Again, in so doing it is expected that states, by means of their institutional setup and preferences, shape financialization. This then constitutes the fourth and final expectation guiding this research:
State institutions situated in corporatist jurisdictions without market-based financial systems are particularly well shielded from financialization.

**RESEARCH STRATEGY AND METHODS**

Having detailed a review and spatial critique of the financialization literature, informing the general expectations guiding the research, this section discusses research strategy and methods. To do so, this section first sets out the reasons for structuring the research along the logic of the crucial least likely case study. Subsequently, this section elaborates on the reasons why the research strategy adheres to a causes-of-effects approach, whereby the cases are purposefully selected on the basis of a specific effect or outcome in order to gain exploratory insights into the underlying causes and mechanisms. Finally, this section discusses the set of methods applied for data collection.

**THE LEAST LIKELY CASE STUDY**

As indicated, the main research strategy employed to explore or ‘test’ the expectations informing this thesis is the case study – a logic of inquiry well suited to investigate complex phenomena (e.g. Ragin 1999; Yin 1984). Within the range of possible case study setups the crucial case study offers most leverage to explore and possibly modify the financialization literature for its lack of spatial sensitivity (see Eckstein 1975; Gerring 2007). For crucial case studies “usually end up by reformulating the theories under investigation ... Modification, not falsification, is the usual purpose of studies focused on a crucial case” (Gerring 2001: 221). The usefulness of the crucial case study is dependent on the quality of the theory under investigation, whereby law-like theories typically allow for a strict (dis) confirmatory setup of the case. However, as the financialization literature does not embody any law-like features, the crucial case study employed in this research is of a ‘softer’ exploratory nature, not seeking to prove if a theory is strictly true or false, but rather questioning “under what circumstances, or to what extent, a theory is true or false” (Gerring 2001: 232, emphasis original).

The leverage of the crucial case is that it provides “what is perhaps the strongest sort of evidence possible in a nonexperimental, single-case setting” (Gerring 2007: 115). The strategy is also known as the *Sinatra inference*, based on the premise that “if I can make it there I can make it anywhere”
Crucial cases can be divided into *most likely* and *least likely* cases (see Gerring 2001, 2007). As this research is based on the premise that financialization poses an uneven development across space, with certain institutional domains considered better protected against financial intrusion than others, this thesis adheres to the logic if the least likely case study. In so doing, the independent variables shaping the institutional domains under investigation have been purposefully selected on the basis of their *least likeliness* i.e. ‘inputs’ expected to limit financialization. As noted by Gerring, “[a] “least-likely” case is one that, on all dimensions except the dimension of theoretical interest, is predicted not to achieve a certain outcome, *yet does so*” (2007: 115, emphasis added). This suggests that the setup of the least likely case study is equally informed by the outcome, or the effect.

**THE CAUSES-OF-EFFECTS APPROACH**

As suggested in the citation above, besides purposefully selecting the ‘inputs’ on the basis of their least likeliness, the outcome or dependent variable – *least likely financialization* in our case – has been equally selected on purpose in order to gain exploratory insights into the underlying causes, contexts and mechanisms shaping the financialization of these unlikely domains. Admittedly, this strategy suggests of a selection bias, cherry picking cases on the basis of a desired outcome. However, in the qualitative culture “scholars often start with events that have occurred in the real world and move backwards to ask about their causes” (Goertz and Mahoney 2012: 42). It is therefore this thesis adheres to a *causes-of-effects approach*, whereby the researcher asks “[w]hat Xs explain Y for one or more specific cases?”, emphasizing that “causal factors are context dependent and operate together as overall packages” (Goertz and Mahoney 2012: 43, 60). In other words, there are good reasons to select cases on both inputs (Xs) and output (Y). Reverberating with the logic of the Sinatra inference, “some cases are more important than others for the purpose of testing a theory” (Levy 2008: 12) or, in our case, the premises of a literature.

In selecting cases on the basis of specific in- and output variables, the method of process tracing (see George and Bennett 2005) has been adopted to explore the causal chain under investigation. Closely tied to the causes-of-effects approach, process tracing allows for the identification of the relevant key moments and pathways i.e. the “intervening causal processes – the causal chain and causal mechanism – between independent variable (or variables) and the outcome of the dependent variable” (George and Bennett 2005: 206). Amongst others, as is the case with crucial case studies, process tracing is typically applied for theory testing and development. In
applying this method, process tracing has led the research to a range of data sources, sharpening the understanding of the explored causal chain each step of the way:

“Process tracing has a comparative advantage in the empirical analysis of decision making at the individual, small group, and organizational levels, including the analysis of leaders’ perceptions, judgments, preferences, internal decision-making environment, and choices” (Levy 2008: 11)

METHODS

Besides adhering to the logic of the least likely case study and the accompanying causes-of-effects approach, this research is based on the premise that “most research designs … cannot be reduced to single method” and that empirical investigation is better served with a healthy dose of “method-eclecticism, rather than fixed rules of procedure” (Gerring 2001: 240, 242). Underscoring the method-eclecticism underlying this research, data generation has oscillated between a range of methods, interacting in no-preixed manner. Besides sourcing information from a wide variety of secondary data sources – e.g. financial press, policy documents, annual reports or court orders – this research is based on more than fifty semi-structured interviews with a range of informants. These have been augmented with observations, amongst others collected during a number of fieldtrips. The collection of primary data through interviews and observations further sharpened the understanding of the causal processes under investigation, each time generating new opportunities for data collection.

Both interviews and observations are two qualitative approaches falling under the rubric ethnography (Cook and Crang 2007). Although ethnography is applied to investigate micro processes, a micro focus equally illuminates macro phenomena. Put differently, through focusing on the interactions of concrete ‘micro’ domains of the state with the ‘macro’ dynamics of global finance, the outlined process of glocalization might reveal itself. Because of ethnography’s emphasis on qualitative richness, the method is limited to small samples. This allows for the comparison between theory and reality – both within and between cases (see Gilbert 2001). This latter exercise speaks, again, to process tracing, the causes-of-effects approach and the least likely case study.

As will be elaborated in the final section of this introduction, in their own distinctive ways – not least depending on issues of access – each case
study advances a range of insights derived from the application of this general methodological toolkit. The general approach therefore offers a “triangulated research strategy” based on multiple sources of evidence to improve the validity of the research (see Kitchin and Tate 2000; Tellis 1997). In order to further augment the validity of this research, the next section sets out the reasons behind the selection of cases, resulting in a focus on four institutional domains tied to the state which are to varying degrees considered least likely to be prone for the lure of finance, yet have nonetheless proven to be subject to its spell.

**CASE SELECTION: DIVERSITY AMIDST LEAST LIKELINESS**

Having set out the research strategy and methods guiding the empirical explorations, this section elaborates on the set of specific ‘inputs’ and ‘outputs’ upon which the four least likely case studies have been selected. In so doing, where the review and critique of the financialization literature introduced some large concepts – chiefly ‘finance’ and ‘the state’ – this section breaks down and operationalizes these concepts into manageable chunks to be explored through the outlined research strategy. As suggested, the rationale behind the selection of inputs or independent variables shaping the institutional domains of interest have been theoretically informed – besides the financialization literature including insights from state theory and comparative institutionalism. In turn, the selection of the output variable – the unlikely financialization of these institutions – has been informed by real world events. In short, where the selection of input variables follows an inductive logic, the selection of the output variables adheres to a deductive rationale. In so doing, case selection has sought to generate substantial diversity between the in- and output variables defining the four cases. Besides selecting four diverse institutional domains tied to the state, which are to varying degrees expected to be relatively immune to financial authority, case selection has equally sought to generate diversity in the ways in which the unlikely financialization of these domains has come about. As such, besides triangulating literature and methods the research equally triangulates different data derived from diverse in- and outputs. This multiple triangulation approach – of theory, methods and data derived from diverse sources and settings – aims to maximize this research’ validity (see Flick 2004).
The state comprises a complex concept. Apart from accepting that the state is best conceptualized as “a process”, continually taking on “new forms, with new capacities and functions” (Jessop 2009: 416), this thesis does not aim to contribute to the large literature on state theory. Instead, therefore, this section breaks down the composition of the state into a diverse set of concrete institutional domains to explore empirically the ways in which these institutions have become subject to financialization.

“While the notions of the local state, regional state, and the national state remain appropriate for referencing specific tiers of state power within a multiscalar institutional hierarchy, I believe that the generic concept of the state has become increasingly problematic” (Brenner 2004: 4, emphasis original)

States are comprised of multiple levels, or geographical scales (e.g. Delaney and Leitner 1997; Smith 2004; Taylor 1982), via which state authority is distributed, maintained and exercised. The division of authority over these various scales, in turn, is dependent on the extent of centralization of state power, whereby centralized states exert many functions from the center in a top-down architecture, and decentralized states allocate many functions to lower scales in a bottom-up structure (e.g. Mamadouh 2001). Amongst others, these structural differences impact levels of autonomy and authority enjoyed by regional and local governments, including leeway in financial management and undertakings. In addition, multilevel governments comprising states are typically organized as a body of institutions, or delegate tasks to a range of adjunct public institutions – each with their own specific histories, organizational templates, functions and capacities; each in different ways tied to their respective governments and insulated from market pressures, resulting in varied institutional capacities and financial undertakings:

“What our combination of comparative institutionalism and financialization studies suggests is a need to distinguish conceptually between different paths or trajectories of financialization – not just in the sense that universal processes of financialization are refracted differently in different institutional contexts, but rather as shaped by the contingent outcomes of actors’ political struggles and compromises over how to negotiate the financial opportunities and pressures with which they are faced” (Engelen and Konings 2010: 617)
Having split up the state in various structures, scales and functions, this research zooms in on the subnational remits of the state, specifically its governments and public institutions. In so doing, the research aims to augment the financialization literature through a focus on spatial detail and the ways in which state institutions might be entangled with financial power. This subnational focus allows the research to investigate the extent to which processes of glocalization can be observed in these least likely settings, illuminating financial macro developments through a micro institutional focus. Furthermore, a subnational or local focus also ‘fits’ best with the outlined research strategy and methods, offering good opportunities to generate empirical richness through access to the set of actors operating in these domains.

The institutions adjunct to central government can be categorized as the local state, denoting “the set of institutions of the state that have subnational territorial remits”, including “elected local government as well as local agencies of public administration and public service provision and local regulatory and judicial authorities” (Gregory et al 2009: 423, see Duncan and Goodwin 1988). A broader term appropriate for this research is the locality, denoting “a place or region of sub-national spatial scale” with an emphasis on “the process of socio-economic restructuring and the role of place and spatial variation within in it” (Gregory et al 2009: 425). As noted by Massey, the empirical focus zooms in on “the quite contrasting ways in which local sets of social relations were being transformed: how they were ‘becoming’” (1991: 275, emphasis original). As constitutional settlements periodically change through devolution of public functions or creation of new government tiers (e.g. Brenner 2004), the local state and locality are not fixed entities. Loosely combining these terms, this research foregrounds a diverse set of governments and public institutions to varying degrees tied to the local state and embedded in a larger locality.

**INPUTS:**

**LEAST LIKELY FINANCIAL SYSTEMS**

As the rules of the state and the shape of the financial sector are inherently tied up with one another, this research puts special emphasis on subnational governments and public institutions located in states with financial systems that are expected to hamper financialization. Although the European Union (EU) has advanced neoliberalization across Europe, with the euro in particular accelerating financialization throughout the eurozone (e.g. Lapavitsas 2012; Engelen et al 2011a), in the wake of the financial crisis many European politicians praised the superiority of Europe’s strong states, corporatist
structures and social models, sharply contrasting with the Anglo-American heartland of freewheeling capitalism. In fact, some argue that the EU and the eurozone emerged as a corporatist alternative to Anglo-American capitalism (e.g. Connolly 1995). Likewise, in the literature on comparative institutionalism, also known as the varieties of capitalism paradigm (e.g. Hall and Soskice 2001), the continent is similarly portrayed as being comprised of strong states exerting a relative dominant role in shaping economic dynamics, not least financial systems (e.g. Amable 2003) and the accompanying professions (e.g. Faulconbridge and Muzio 2012). Therefore, in seeking to explore governments and public institutions considered least likely to be prone to financialization, a focus on the corporatist states of Europe is pertinent. In this regard, the European state that is typically presented as the Anglo-American ‘other’ is the Federal Republic of Germany:

“Germany has always been the literature’s most prominent example of what one may call, with a somewhat neutral term, “nonliberal” capitalism … Germany has long been considered a “model” for countries unwilling to subject themselves to the rule of the market in the same way and to the same extent as Anglo-American countries” (Streeck 2009: 21)

Given that the financialization literature suggests that cross-border financial integration leads to a convergence of financial dynamics along Anglo-American lines, a focus on Germany is pertinent as it can be expected that this development is limited due to the presence of an institutional setting that does not lend itself to financialization. For example, besides market-based finance being less developed in bank-based Germany (e.g. Amable 2003), it is argued that German civil law is less suited to financial innovation as compared to Anglo-American common law jurisdictions (e.g. Beck et al 2002; La Porta et al 1998). It for these reasons Engelen and Konings argue that Germany represents a case of “contested financialization” (2010: 618). Having said this, although the authors specify the ways in which financialization unfolds across national jurisdictions, the literature on comparative institutionalism – including perspectives on the celebrated ‘German model’ – is itself subject to a geographical critique:

“The approach is limited by its methodological nationalism, a tendency towards static analysis and latent institutional functionalism, and by an inability to adequately balance (sub-, added) national specificity and path-dependency on the one hand with common underlying tendencies in capitalist restructuring on the other” (Peck and Theodore 2007: 731)
In other words, merely correcting the financialization literature for national variations does arguably not go far enough to distill the delicate ways in which finance exerts its logic across space. Particularly in the case of large and decentralized Germany, the mere specification of the national institutional setting conceals subnational differences between the sixteen regional Länder [states] comprising the federation in shaping regional economies, let alone the many ways in which municipalities are managing their public finances and local economies. As noted by Peck and Theodore, the varieties of capitalism debate “has barely scratched the surface of deeper forms of geographical differentiation and spatial dynamics” (2007: 760). Next to adding spatial depth to the financialization literature, therefore, this research’ focus on institutions with clear subnational remits equally intends to augment this literature.

**OUTPUTS:**
**DIVERSE MEANS TO FINANCIALIZATION**

Having detailed the logic behind a focus on subnational governments and public institutions to varying degrees considered least likely to be prone to financial power, this section discusses the range of financial developments having actually unfolded in these settings. Put differently, having inductively selected the ‘inputs’ underlying the cases in order to explore and ‘test’ the expectations, this section deductively sets out the events which have informed case selection on the ‘output’ – that is events indicative of financialization.

“Those who study how finance capital operates… imply that it thoroughly imposes its will from above, leaving little space for variation or agency on the ground. But a generalized pressure to attract capital does not mean that local governments have been equally financialized across space” (Weber 2010: 252)

As the generation of diversity has thus far guided case selection, the explored events indicative of financialization have been equally selected on this basis. As much as the state needed unpacking, so does finance comprise an unwieldy concept in need of operationalization. However, as much as this thesis does not engage with state theory, a full-on engagement as to what constitutes finance is plainly impossible for the present purposes. Therefore, case selection has merely sought to identify a diverse set of financial developments indicative of financialization in order to explore the underlying causes and mechanisms – the causal chain – having led to the unlikely
financialization of these domains. As a result, the four cases exploring the financialization of governments and public institutions focus on different financial entanglements, products, logics and dynamics, ranging from classic land speculation and real estate development up to an embrace of modern-day securitization techniques and derivative products.

Again, the focus on specific financial developments having unfolded in these least likely domains brings the concept of glocalization to the fore. Put differently, as noted in the section on methods, a focus on financial micro processes in these domains brings in financial macro phenomena – chiefly, in our case, the workings of ‘global’ finance. For the fortunes of the explored domains and their localities have all been shaped by developments elsewhere, in particular financial developments conducted out of financial centers elsewhere.

THE FOUR CASES

Having detailed the considerations behind the in- and outputs shaping case selection, this section details the actual cases. As indicated, the predominant focus of this research is on nonliberal Germany. However, two additional cases situated outside Germany have been included to generate diversity between the four cases, enabling the triangulation of the research findings in the concluding chapter of this thesis.

In decentralized Germany, the local state – comprised of two subnational tiers of local and regional governments – enjoys substantial autonomy from central government, providing local and regional public officials ample leeway in shaping their economies. As proclaimed in the German constitution, for example, the municipal “guarantee of self-government shall extend to the bases of financial autonomy” (Article 28.2 German Basic Law, quoted in Weber and Häuser 2008: 76), providing German local and regional officials a relatively large degree of autonomy over financial matters. It is for these reasons this thesis foregrounds two case studies set in the German political economy – one focusing on the financial entanglements of the local government of the city of Pforzheim; the other focusing on the financial undertakings of a publicly-owned bank tied to the regional government of Baden-Württemberg. The real world events informing the selection of these cases were two articles in the financial press – one detailing the financial predicaments of a range of European cities including Pforzheim (Katz 2010), the other discussing the unexpected bailout of the public bank (Newman and Bettinga 2009).

Given that “the autonomy of local state actors varies considerably according to the legal, constitutional and fiscal framework within which local
introduction (Gregory 2009 et al: 423), case selection has sought to identify another European local government embedded in a radically different context. On these dimensions, the Republic of Ireland represents the opposite end of the spectrum: where Germany comprises a large decentralized jurisdiction, Ireland is a small “centralized unitary state” (Mamadouh 2001: 479), seeing Irish local authorities exercise relatively few functions, keeping local public officials relatively dependent on central government (see Callanan and Keogan 2003; Roche 1982). In addition, where Germany is comprised of three layers of government, the Irish state is essentially comprised of two tiers (Boyle 2000). As outlined, these structural differences are expected to impact their financial maneuverability, hence potentially impacting the financialization of these domains.

The event informing the selection of this particular case was a newspaper article discussing the failed ambitions of Cork to develop a financial center on its riverbanks (Riegel 2008). In focusing on the financial delusions of Cork City Council, it should be noted that Ireland’s financial system shares many institutional traits typical of Anglo-American financial markets. Admittedly, as noted by Engelen and Konings, these economies typically comprise cases of “consensual financialization” (2010: 617). However, as the Irish case study offers geographical depth to these national typologies, not merely contrasting with the German cases but equally augmenting them, the fact that this case is situated in a context conductive to financialization is regarded a strength rather than a limitation.

Finally, as a case that perfectly fits between the opposing state structures, political autonomy levels and financial systems of Germany and Ireland, the fourth case presented in this thesis focuses on a Dutch university — a semi-public institution loosely linked to the Dutch state, also known as a “state near” institution [staatsnahe in German] (Schmidt 2006). The event informing the selection of this case was an unexpected funding shortfall at the Faculty of Social and Behavioral Sciences. In contrast to Germany and Ireland, the Netherlands is classified as a “decentralized unitary state” (Mamadouh 2001: 479). Furthermore, although the Dutch financial system shares characteristics with liberal market economies like Ireland, on a range of other institutional dimensions the Netherlands is comparable to corporatist Germany. With regard to financialization, therefore, Engelen and Konings argue that the Netherlands comprises a case of “compartmentalized financialization” (2010: 619).

Taken together, the four cases offer substantial diversity: in geographical contexts, institutional settings, organizational templates, functions and financial dealings. Moreover, these institutions are in very different ways tied to central government, with the Dutch university being formally autonomous or independent from the state. In fact, two of the four cases
actually are of a hybrid nature: the German regional public bank operates on the interface of the state and the financial marketplace, whereas the semi-public Dutch university can also be seen as a halfway house – a semi-public institution on the one hand still heavily dependent on diminishing government funding whilst on the other increasingly operating independently, having to find its way in the marketplace. Taken together, these differences exemplify the multivariate fabric of the state.

Before moving to the final section of this introduction, some notes are in order to outline the specific time frame underlying the four cases. The notion that best captures the time frame of interest to this research is the conjuncture (Braudel 1982), denoting “multiple, intertwined temporalities moving at different speeds so that conjunctures or temporary configurations are embedded within a long durée” (Engelen et al 2011: 48, emphasis original). Specifically, this thesis focuses on two adjacent conjunctures: one of hubris and one of crisis. The ‘boom-time’ conjuncture in the lead up to the financial crisis of 2008 can be characterized by a great belief in financial innovation, seeing financial intermediaries organize themselves around novel “coupon instruments” centred on “leverage, derivatives, SPVs [special purpose vehicles, added], and structured investment vehicles (SIVs) around securitized residential mortgage and other assets” (ibid: 51). In contrast to this period of financial euphoria, with the break of the crisis of “financialized capitalism” (Aglietta 2012) – also understood as a “crisis of financialization” (Lapavitsas et al 2012) – the confidence in financial innovation quickly collapsed, heralding a new conjuncture defined by uncertainty and panic. Broadly structured along these two conjunctures, this thesis seeks to illuminate the extent to which the crisis has been a turning point in the financialization of these cases.

**STRUCTURE OF THE THESIS**

The remainder of this thesis is comprised of the four case studies followed by the conclusions. As an upfront disclaimer: since the individual cases have been published in different academic journals, the collective body of cases is somewhat eclectic, both as stand-alone articles and in relation to each other. That is to say, the four case studies reveal differences in presentation, not only in conceptual and empirical content and emphasis, but also in methodological emphasis and style. This is partly a consequence of data access – where primary data generation proved relatively easy in two cases, it proved much harder elsewhere. As such, although the general toolkit of methodologies and methods has been applied in all four cases, uneven levels
of access have resulted in a set of cases that advance different data sources. For example, where chapter three almost exclusively relies on an elaborate reading of financial reports and policy documents, chapters one and two offer rich sets of primary data.

What follows is a brief outline of the remaining structure of the thesis: Chapter one offers a rich empirical account of the unlikely financialization of the University of Amsterdam (UvA). Classified as a semi-public institution – a halfway house between non- and for-profit motives – embedded in a strong corporatist state, until the mid-1990s the UvA fell under the protective wings of the Dutch state. Ever since, however, the UvA has been increasingly ordered to self-govern its organization. In this case, the devolution of real estate functioned as the Trojan horse for financialization. As the UvA real-estate portfolio required substantial upgrading, culminating in a large debt-financed real estate project, the organizational culture and structure of the university have been reorganized and realigned to the wishes of the new financiers, one of which is Deutsche Bank. As a result, where academic professionals once ruled the Maagdenhuis head office, today a new managerial class comprised of financial professionals is calling the shots, seeing financial considerations increasingly override the university’s core tasks of education and research. This chapter is conceptually minimalist and advances an array of empirical insights as to how finance penetrates its other.

Chapter two moves into the heartland of corporatist Europe, exploring the unlikely financialization of the German city of Pforzheim, also nicknamed the Golden City. Although this chapter explores the literature on comparative institutionalism in light of financialization in order to frame the case, the main body of this chapter details a rich empirical account on the speculative derivatives dealings of a German local government. Specifically, through semi-structured interviews this case explores the ways in which a local government set in a bank-based political economy has come to interlace its budgetary plight with the wonderland of interest-rate swaps – arguably one of the defining financial instruments through which modern-day financialization comes about. Despite expectations, financial wizardry in the Golden City reveals that even public institutions in corporatist Germany have since the turn of the millennium massively bought into ‘innovative’ financial products offered by JP Morgan and Deutsche Bank, with the latter featuring as the Trojan horse of the financialization of the German political economy, selling Anglo-American financial products in its own backyard.

Chapter three moves to Stuttgart, half an hour’s drive from Pforzheim. This case details the financial travails of Germany’s largest public-sector bank: Landesbank Baden-Württemberg (LBBW). As the very embodiment of Germany’s bank-based financial system, this case features the archetypal
'other' in comparison to private institutions operating in Anglo-American financial markets. Where lending to regional firms constitutes the bank’s core function, LBBW is expected to be less prone to the lure of market-based financialization. Yet despite the fact that this hybrid public/banking institution is renowned for its risk adversity, reflecting a wider cultural trait of region, and despite the fact that the bank’s functions are historically tied to state objectives rather than mere for-profit motives, this case reveals that the bank delved deep into Anglo-American capital markets, buying and selling an array of complex securities. Although the financial crisis marked a turning point in the financialization of LBBW, today the bank is merely attuning its market-based activities, seeing the long arm of market-based finance penetrate the heartland of the German economy. Guided by a range of perspectives on the financialization of the German financial system, this case study seeks to augment the spatial lacunae in the literatures on financialization and comparative institutionalism.

Having set out two cases in within Germany, chapter four focuses on the financial delusions of a local government situated in a jurisdiction conductive to financialization. Specifically, it focuses on Ireland’s Rebel City Cork where public officials, mesmerized by debt-fuelled real estate development ignited by Anglo Irish Bank, aimed to establish a riverfront financial center in the image of Dublin’s International Financial Services Centre (IFSC). Couched in literatures on comparative institutionalism and global/world cities, besides investigating the ways in which financialization has come to shape Irish local and central government policy, this case study seeks to illuminate how financialization has altered the geography of finance, investigating the respective explanatory values of the foregrounded literatures. The research findings contradict some of the dominant premises of comparative institutionalism, as Irish banks blew a giant bubble through relationship banking, a trait typically assigned to Germany’s bank-based financial system, and German banks operated out of Dublin’s IFSC to conduct their arm’s length market-based financial operations. In short, this chapter seeks to illuminate the entangled geographies of “Irish” finance.

Finally, the concluding sections of this thesis revisit the four cases, triangulate the findings, and foreground the key commonalities. Amongst others, all four least likely domains unexpectedly confirm that they have been seduced, pushed and drawn into the world of finance, seeing financial markets, products and professionals penetrate the European fabric of governments and public institutions. The cumulative effects have been detrimental to the core functions of these institutions. Despite variations in state structures, financial systems, organizational templates and institutional capacities, incessant neoliberalization of state policy has gradually lured if not ‘forced’ these governments and public institutions to adopt financial products and
logics. As such, binary depictions of liberal and corporatist states or national bank- and market-based financial systems do not do justice to the ways in which these ideal type ‘containers’ have evaporated or hybridized. Although the cases confirm that financialization is indeed pervasive across space, the literature is in need of more empirical detail, particularly on cases outside the Anglo-American heartland. Only by generating more empirical accounts on the delicate ways in which governments and public institutions become subject to financial power can the literature start to unmask and theorize the encroaching financialization of the state itself.
REFERENCES


CHAPTER ONE

HOW FINANCE PENETRATES ITS OTHER:
A CAUTIONARY TALE ON THE FINANCIALIZATION
OF A DUTCH UNIVERSITY

ABSTRACT

If any organization ought to be immune to the forces of financialization, it is a publicly funded university in corporatist Europe. Shielded from the intrusion by financial metrics, values and professionals through a strong historically rooted tradition of self-management by powerful professional guilds, continental universities should largely have avoided the marketization and managerialization of Anglophone universities. Not so, this case study of a Dutch public university suggests. From 1995 onwards, a shift in real estate management—devolving responsibilities from the Dutch state to universities—served as a Trojan horse for financialization, triggering changes in organizational culture and a power shift from teaching and research professionals to accountants, real-estate developers, financiers and their ilk. This case suggests that the power of finance is such that no societal domain is immune. The paper ends with a call for more non-metropolitan case studies of financialization and argues that the only hope for salvation is a more self-conscious defense of traditional academic values by the guardians of higher learning themselves.

Chapter published in Antipode. Written in collaboration with Ewald Engelen and Rodrigo Fernandez. Full reference to the original article:
On 20 November 2012, there was a bout of panic at the headquarters of the University of Amsterdam (UvA). That day the Minister of Education sent a report of the National Teaching Inspection Board on the size and nature of the derivative portfolios of Dutch tertiary education institutes (universities, polytechnics, vocational training facilities) to the Dutch parliament. The media were quick on the take up and zoomed in on the claim that it was the UvA whose derivative exposure was particularly worrisome. According to the Inspection Board, the UvA faced margin calls to the tune of €44 million on “naked” interest rate swap contracts written out on future loans for planned real estate projects.

The UvA was quick to reject this claim. The Inspection Board had it all mixed up, according to the UvA. Yes, the UvA did possess a total portfolio of €225 million worth of interest rate swaps, and yes, that was the largest nominal amount of any Dutch university, polytechnic and vocational training institute in the Netherlands, but no, none of those swaps were “naked” and hence none of them faced margin calls. It quickly appeared that the Inspection Board had made an Excel mistake: it was not the UvA that was in financial trouble because of its naked derivatives, but the Free University (VU) also headquartered in Amsterdam.

The VU was not alone in this. Together with two other universities, three polytechnics and two vocational training institutes—ie one in ten of all Dutch higher education institutes—faced margin calls over “naked” derivatives. In each of these cases, the margin calls were connected to interest rate swaps, protecting buyers against the risk of increasing interest rates while obliging them to post collateral (margin calls) in case interest rate levels drop below a specified threshold, as obviously, was prone to happen in a post-crisis context where budgetary stimulus (austerity) was off limit and monetary stimuli (zero interest rates and “quantitative easing”) were by default the only remaining policy options.

Just as not everything is supposed to be for sale, as is famously argued by Michael Sandel (2012) and others (Kuttner 1997; Radin 1996; Walzer 1982), so not every institute or every jurisdiction is supposed to be prone to processes of financialization to the same extent. No matter your take on universities, with their strong rootedness in decade-long traditions of guild-like professionalism (Abbott 1988; Johnson 1972; MacDonald 1995) they should be the organizations par excellence to be immune to financialization. For financialization, or for that matter commodification and marketization, consists of organizational penetration by a set of metrics and values that are
“carried” from the “outside” to the “inside” by financial specialists—bankers, accountants, real estate managers, economists, consultants—whose “logics” would immediately conflict with those of the teaching and research professionals who, historically, used to largely self-manage universities (Collini 2012). Processes of financialization would hence automatically run up against well entrenched professional interests in non-change and would hence have an especially hard time “penetrating” institutes of higher learning such as universities.

This would particularly be the case, so we surmise, in universities embedded in jurisdictions and institutional contexts that, according to the comparative political economy literature, are less prone to (financial) market forces. Following the categorization of Hall and Soskice of the Netherlands as a less market-based and a more negotiated, coordination-oriented political economy (2001), we would hence expect Dutch universities to be well protected against the forces of financialization to which UK and US-based universities are especially subjected (see Brown and Carasso 2013; Slaughter and Leslie 1999). While we are fully aware of the hybrid nature of some aspects of the Dutch business model, as we ourselves have spelled out elsewhere (Engelen et al 2008, 2010; Engelen 2014), we feel confident that the Dutch welfare state as such, of which higher education is a part, has proven to be relatively immune against the twin eroding influences of neoliberalism and financialization as is demonstrated, for instance, by a relatively large public sector and a relatively high level of employment protection in the Netherlands (OECD 2008).

Not so, as the anecdote above referencing our own Alma Mater forcefully demonstrates. For this episode clearly suggests that Dutch universities have become big consumers of investment banking products and have not been above a bit of speculation (on rising interest rates) themselves. This implies a strong need for more detailed and more critical analyses of the subtle and not so subtle ways in which finance has penetrated its “other”. Since most of the literature on the commodification, managerialization and neoliberalization of universities draws on UK and US empirics (see Castree and Sparke 2000; Pollitt 1990; Power 1994, 1997), we have set this paper up as an “informal comparison” with that literature, based on the logic of a “most unlikely case study” (Gerring 2007). The “informal” part of this methodological formulation means that we have not conducted a full blown comparison of the recent changes in the landscapes of higher learning in the US and the UK vis-à-vis the Netherlands as a representative of Hall and Soskice’s population of coordinated market economies, but rather have written up the story of the financialization of a single Dutch university, to wit: the University of Amsterdam (UvA), which we, as (former) employees, simply know best, and have done so against the backdrop of the extensive
Anglophone literature describing and discussing changes in US and UK universities which highlight strong similarities despite huge differences in institutions, histories, cognitive templates and established practices.

The “unlikely” nature of this case—universities being mostly publicly funded on the European continent, including the Netherlands; being controlled by vested, well established professional guilds with strong state backing, as befits corporatist (corpora being the Latin word for guild) political economies (Krause 1996); and being embedded in a jurisdiction with a “strong” state being permeated to a much more limited extent by the forces of financialization than is the case in Anglophone jurisdictions—suggests that if even in this unlikely case we can trace fundamental changes in its professional “logics” due to the influx of financial metrics, values and competing professionals, we have to conclude that nothing is safe and sacred any more for the pernicious effects of financialization and—in a more traditional academic vein—that the Anglophone slant of most financialization studies misses out on the fact that this is a much more “universal” phenomenon, crying out for more non-metropolitan case studies (eg Hendrikse and Sidaway 2013). If our story suggests anything it is that we now truly “live in financial times”, to borrow the banner of the Financial Times, from which there is no longer any refuge, unless, that is, if we, the inhabitants of these collective repositories of the long history of human knowledge and wisdom, wake up to these facts and start using our professional resources politically in a long overdue attempt to kick the bean counters and their managerial allies out of our temple.

This paper tells this cautionary tale through a conceptually guided reconstruction of the financialization of the UvA and consists of three parts. The first gives our take on the burgeoning financialization literature, highlighting those elements that are functional for our argument. The second presents the empirics of our case study. And the third part concludes, spelling out negative consequences and dangers, and ending with a call to arms.

**FINANCIALIZATION CASE SPECIFICALLY OPERATIONALIZED**

Financialization, like most social science concepts, is contested (see Engelen 2008; Engelen and Konings 2010). Most of these contestations relate to boundary issues: how, in what way, is financialization different from commodification and marketization and, subsequently, how does it relate to other large, process-like concepts such as globalization and/or neoliberalization? Here we have no intention at all to waylay these issues once and for
all. Rather, we try to be conceptual minimalists by using, pragmatically, only those dimensions, known to be linked to financialization, that are functional for the task at hand, namely to determine the level, extent and modes of financialization of our case. To do so, we start from a fairly straightforward and widely accepted definition, which states that financialization refers to societal changes which result in an “increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies” (Epstein 2005:3). This definition is sufficiently wide, or unspecified if you wish, to capture both the “hard” materialist side of the financialization literature, focusing on accumulation and innovation typically based on aggregated economic data and comparisons, and the “softer” culturalist accounts focusing on narratives and performativity typically based on more ethnographic methods and single case study logics (eg Froud et al 2000, 2006; Krippner 2005, 2011; Langley 2007; Martin 2002; Martin et al 2008; see Ertürk et al 2008 for an overview and categorization of the literature).

Next we have to operationalize the abstract concept of financialization in a number of steps of incremental concretization to make it applicable to the case at hand. Here we inevitably meet techniques, metrics, values and professional expertise that figure in more than one conceptual field. For instance, the case of the UvA clearly demonstrates the influx of typical neoliberal policy instruments such as New Public Management (NPM), widely understood as “schemes of organization and control... imported from business” (Connell et al 2009:334; see Pollitt 1990; Saint-Martin 2000), to which public services, and even the state, more widely have increasingly been subjected. Universities, as has been widely noted, have not been exceptions to this. Here, however, we are not so much interested in organizational mimicry (DiMaggio and Powell 1983) of the behavior of private for-profit firms, but rather in the taking up of specific financial managerial practices and techniques within the governance structure of the UvA. This is hence the first indicator we use in this paper to determine its extent of financialization: have financial metrics affected the governance regime of the university? Second, as is suggested by the empirical literature on financialization, there is always a “something” that serves as the Trojan horse for financialization: a specific financial technique, a changing environment (eg the retreat of the state; Hacker 2006) or a particular asset. As is indicated by the Great Financial Crisis, and what has historically proved to be the case (Reinhart and Rogoff 2011), the perfect Trojan horse for increasing the dependency of citizens upon financial markets, and hence increasing their vulnerability to financial market volatility, is real estate. There is now a budding comparative political economy literature on residential capitalism or real estate financialization spelling out the long-term consequences of
(the bursting of) real estate bubbles for national political economies (Schwartz and Seabrooke 2008). Similarly, in a more culturalist, micro-sociological vein there is also a wealth of material on the “performative” effects of real estate investments in the form of replacing citizenship subjectivities by investor subjectivities (Langley 2008): during real estate bubbles subjects have a tendency to ascribe to an investor rationality and to take on accompanying identities. Again we will use the extent to which organizational decision-making at the UvA became hijacked by real-estate-based considerations as well as the degree of self-identification by the governors of the UvA with real estate interests as an indicator of financialization.

Finally, as suggested in the introduction, the penetration of organizations by financial metrics is by necessity accompanied by interprofessional contestation, since these metrics are adopted, institutionalized and legitimized by distinct professions (see MacKenzie 2006; Whitley 1986). This insight derived from the sociology of professions suggests that, especially in the case of guild-like organizations such as universities (but courts, law firms, hospitals are no exception), one would expect both aggregate changes in the professional composition of the governance structure, ie a power shift between representatives of different, competing professions (from professional self-management to increasing subservience to financial managerial professionals), as well as increasing instances of inter-professional strive. So the indicator simply reads: do we see this occurring in our case?

With this minimalist conceptual apparatus in place, we now turn to our case history, going through our three indicators in causal order. So we start with an analysis of the extent to which the organizational logic of the UvA has over time become burdened by real estate considerations. Next we turn to a discussion of the extent to which financial metrics have come to dominate internal organizational practices. We end with indications of inter-professional strife.

THE CASE:

HOW DID FINANCE CONQUER THE UNIVERSITY?

REAL ESTATE AS TROJAN HORSE?

As student populations rapidly increased from the 1960s onwards, public funding rose accordingly. Total expenditure on Dutch higher education as a percentage of GDP reached its maximum of 1.6% in 1977, as a result of rapidly rising student numbers and facilitated by a state that had not yet run
How Finance Penetrates Its Other

into the fiscal crisis of the early 1980s. This rapid increase was accompanied by extensive state-sponsored building activities. Although figures differ substantially per university, most of the real estate currently owned by Dutch universities dates from that period. For our case it is estimated that 64% was built in the 1970s (Den Heijer 2011). This percentage is important because it dictates much of the current real estate costs of the UvA. With an average economic life cycle of 40–50 years, many Dutch university buildings are currently in need of replacement or renovation, adding substantially to the financial woes of Dutch universities.

The most vivid illustration of the neoliberal reorientation of the state towards Dutch universities and hence a key moment in our story was the 1995 decision to transfer the ownership of public real estate wholesale to universities (and schools, hospitals and other semi-public organizations), having a dramatic and immediate impact on university balance sheets. Figure 1 details aggregate solvency ratios, total real estate investments and debt levels of Dutch universities from the late 1990s to 2010. Debt and investment are expected to peak around 2015, as most current building activities by Dutch universities are planned around that period. However, the years preceding the expected peak reveal how debt and investments have exploded while solvency ratios have declined.

The buildings of the UvA were mainly located in Amsterdam’s historic city center. Policy documents from the 1990s onwards demonstrate that this was seen as being crucial to the identity of UvA, which as a so-called city-university was seen to generate a competitive advantage over other,
campus-based universities in the war on talents and students (UvA 1994; 1996). However, the property portfolio was widely scattered over the city, increasing the cost structure. As such, clustering the future physical layout of the UvA in a limited number of locations to contain real estate costs became the central strategy from the outset.

![Map of UvA clusters and Maagdenhuis head office](image-url)

**Figure 2.** The four UvA clusters and the *Maagdenhuis* head office
Prior to 1995, education and research requirements had been the sole considerations feeding into real estate planning, and universities simply requested funds from the Ministry according to these requirements. After the real estate transfer in 1995, real estate planning would be guided by core activities and what was then called a “commercial real estate approach” (UvA 1997a). The first step consisted of an inventory of the available data and the formulation of a more detailed set of management principles. The exercise revealed large difficulties in projecting future needs in terms of floor space and costs per faculty. For one, real estate planning is a long-term venture while student numbers are prone to short-term fluctuations, which are hard to extrapolate. By 1997 student and staff numbers had declined significantly, which the UvA believed to be structural, whereas in fact it marked a turnaround after which student numbers have annually increased.

The 1998 real estate investment plan envisioned a reorganization of the UvA into four clusters—the natural sciences in a new complex in the East of Amsterdam (Science Park), the medical sciences (AMC) on the Southeastern periphery (Bijlmer) of Amsterdam, the social sciences in the Eastern part of the city center of Amsterdam (Roeterseiland) and the humanities in the heart of the city (Binnengasthuis) (see Figure 2)—reducing total floor space from 255,100 square meters in 2000 to 239,000 in 2015 (UvA 1998b; 1999). The projected costs were 1 billion guilders (€455 million). While the period to realize the plans was estimated to be 15 years, the financial burden would weigh on the UvA balance sheet until 2030, with investments peaking in 2010–2014 (KPMG 2000; UvA 2000b). Of course, a project this size could not be financed through mere savings. In fact, a 1999 inquiry by the Ministry of Education revealed that the property transfer created an estimated deficit of 1.6 billion guilders (€725 million) for Dutch universities and gave a number of rules of thumbs for prudent financial management to overcome this deficit (Koopmans 1999).

The UvA chose to ignore these rules for two reasons (UvA 2000b). First, because the norms for asset management and debt levels (current ratio and solvency ratios) were based on aggregate figures regarded “unfit” for the UvA for reasons of size, age, dispersion and location of its real estate. Second, because the governing board of the UvA did not want to wait for the state to come up with compensation for existing deficits and wanted to keep its fate in its own hands. The result was that its real estate investment plan had to work with ceteris paribus clauses. In fact, it assumed that state budgets would not be cut, that student fees would not decline, that interest rates would remain unchanged, that building cost increases would not exceed inflation, and finally, that excess capacity could be rented to third parties at market price. These assumptions, of course, proved way too optimistic.
In 2002, the state decided to cut the overall budget for universities by 4%. This was framed as “efficiency cuts” to be achieved through productivity increases, keeping research and teaching output targets stable. It boiled down to an annual loss of income of €14 million for the UvA having a decisive impact on its real estate plans, as its governors frantically sought to reduce costs by 5% (UvA 2002a). Since its launch, a number of smaller real estate projects under the real estate investment plan of 2008 had already been realized, but the bulk of it was still in the planning stage. The 2002 audit report concluded that while the vision was clear, the financial strategy was not (UvA 2002b). A complication was the discovery of asbestos in a number of buildings, with removal costs initially budgeted at €72 million (UvA 2004). Although the final costs came to a third of this amount, it added to the increasing financial burdens of the UvA.

In fact, asbestos removal turned into a larger organizational (and financial) problem. It demonstrated how the different steps of the real estate project were intertwined, as one part of the project could not go ahead until others were finished. The result was a costly 2-year delay, underscoring the complex task of coordinating processes moving at different speeds. To ensure better process management, two teams were created, each consisting of UvA managers and specialized external consultants. One team was responsible for delivering the required data, including future costs and floor space use of each faculty. The other team would be responsible for describing the steps ahead and managing the actual real estate development, which was, at the time, outsourced to commercial real estate developers such as Trimp and Van Tartwijk. The first team can still be traced to the UvA head office unit known as Strategy and Information, whereas the second team was the precursor of what is now known as Real Estate Development.

The result was a new investment plan that kept total floor space at 239,000 square meters while granting a new role to the faculties, which would be transformed into co-owners of the real estate. Financially, this meant faculties had to take on 10% (€50 million) of total investments, to be realized through a novel incentive scheme consisting of an owner-tenant system in which real estate costs were added to the internal price faculties were charged for real estate use.

Furthermore, it became apparent that the new project-based financing of research demanded more flexible office space. As the phase of finalizing the project description came nearer, so did the level of detail, yet large uncertainties remained, in particular those relating to student numbers and basic budgetary parameters.

Despite these contextual uncertainties, the governing board of the UvA decided to pursue its real estate plans and started credit negotiations with four banks (ING, ABN AMRO, Rabobank and BNG, a state bank owned by Dutch
How finance penetrates its other

municipalities), discussing an array of different financing schemes. In 2002 the total investments were estimated at €525 million, and total credit needs at €230 million over a 30-year period. The negotiations focused on three dimensions. The first was a choice between public (BNG) or private funding (the other three at that time). The second was loan flexibility. As the project was complex and uncertain, it was difficult to know in advance when and how much credit was required. Either the loan could be split in tranches, so-called “bullet loans” to be taken out at different intervals, or a flexible deal could be arranged in advance for the lump sum. The third concern was the degree to which interest rate risk could/should be hedged with derivatives.

Tied to the financing schemes was the issue of how to design the UvA legal structure so as to minimize fiscal obligations. As a foundation the UvA was not liable to pay corporate income tax, meaning that value-added tax (VAT) and interest could not be deducted. One solution was tax planning combined with financial engineering. Off balance sheet vehicles and sale-and-lease-back constructions tied to the real estate activities offered fiscal relief, reaping the tax deduction benefits of a private company while the holding retained its status as a public entity. Although we do not know to what extent the UvA adopted such savvy constructions, it reveals how banks come to rewire the organizational setup of their (non-profit) clients. Yet despite such considerations and efforts, a 2004 report by Brink Groep concluded that the existing real estate plans were untenable, chiefly for financial reasons: the consultants were skeptical whether the overall indebtedness could be kept below a maximum debt threshold of €230 million and above what at that moment in time was seen as a critical solvency ratio of 35%.

This all changed in 2008, in the midst of a nationwide real estate boom which was on the verge of collapsing, as was indicated by an early, albeit largely rejected warning from the IMF in its April 2008 World Economic Outlook (IMF 2008). Suddenly cost considerations were no longer the main concern. Instead, a new report conducted by AT Osborne determined the financial feasibility of a qualitatively upgraded real estate vision. The expectation was that, by following a new “small in big” campus orientation—a cosmetic reframing of the original four cluster plan—the UvA could become a winner in the future war on talent, implying that its financial possibilities were much larger than earlier assumed. As a result, estimated costs could be increased to €617 million, up from €525 million in 2005 and €455 million in 2000 (UvA 2009). And while the 2005 plans required a maximum credit of €230 million, the 2008 plans doubled the stakes up to €400 million (UvA 2007, 2010).

The key performance indicators, or KPIs as they are called in managerial newspeak, allowing for these amplified real estate ambitions were two-fold. First, total costs of real estate—eg servicing the loans, maintenance,
temporal housing, moving costs—should not exceed 12% of the total budget. This threshold was the outcome of a benchmarking exercise based on the real estate costs of English universities with similar cost profiles. Second, the solvency ratio and debt service coverage ratio (DSCR), ie the ratio of debt service costs and cash flow—closely watched KPIs by bankers—should remain within their respective limits: 20% for the solvency ratio and 1.2% (now 0.5%) for the DSCR. While the 12% total budget parameter is set internally, aiming to limit the total real estate burden upon teaching and research activities, the solvency and debt service coverage ratios are critical to the UvA credit rating.

Concerning the solvency ratio, the valuation of the existing real estate stock is critical, as it co-determines the value of the equity of the UvA, and quantifies the estimated income the university is to receive once certain buildings are sold on a net present value base. In case the ratio declines, more debt has to be acquired to keep the project going. Ultimately, such a scenario might force the UvA to exceed its 12% threshold, resulting in a redirection of cash flow from teaching and research to servicing debt. Thus far this has not happened. However, in the current context of depreciating real estate values in the Netherlands, the pressure to use more lenient accounting principles in order to maintain a good equity share, and hence a satisfactory solvency ratio, is progressively increasing.

WHAT ABOUT THE METRICS?

As we suggested above, the property shift of 1995 posed more stringent demands on the information flows within the UvA related to costs, profits, assets and liabilities than were needed in the much smaller and much more simple self-managed university of yesteryear. The diktat of accounting metrics to reorganize an organization—caused, in this case, by the sudden need to manage a sizeable stock of real estate—is a classic stratagem in the consultancy industry, first developed by James McKinsey of the eponymous firm (McDonald 2013). The post-1995 UvA proved to be no exception to this consultancy rule. This, in our view, is the first, most striking way in which the devolution of responsibility for real estate to the universities set in motion a process of internal reorganization to produce the transparent cash flow metrics that were required to service the rapidly growing real estate debt. The 1997 reorganization of the UvA governance structure (of which later more) aimed to create “inner market functions” (UvA 1997b). Instead of lump sum financing, the different units comprising the UvA—education, research and services—would receive funds based on a small number of KPIs. In doing so, academic output was tied to budget allocation,
requiring a system to measure, validate and register output. Whilst teaching could easily be adapted to an output-oriented system (combining student inflows, numbers, graduations, and study points), research could not and was excluded from reform at this stage. It was believed that the move towards an output-oriented system involved learning-by-doing and that, over time, the cost structure of research would be uncovered, enabling a similar quantification of research output (UvA 2000).

The underlying premise was that a market-oriented system would increase transparency and, importantly, would put in place the right incentives (UvA 2000a). This would enhance research quality, attract more students, and increase the competitive position of the UvA at home and abroad. While the executive structure was centralized to satisfy the need for professional project development, real estate management and their financing, internal flow of funds were increasingly decentralized and tied to centrally determined output-oriented KPIs. Faculties and their staff were largely bypassed in the new scheme. Instead, funds would be directly allocated to the underlying departments, research and teaching institutes. Although implementation would be lengthy, the move towards linking funds to output and the need to set up a broad, centralized control system was clearly key to the new governance system. Part of the system was a set of covenants between faculties and the governing board, embodying a more “businesslike” culture based on “arm’s length management” from the side of the governing board (UvA 1995). It also set out to create “markets for staff” at sub-faculty level. Staff and budget allocation were split into distinct “profit centers”—departments, institutes and support units—all hiring staff and/or services from one another, using an internal cost budgeting system that allowed for more and better central control of internal cash flows (SEO 2001; UvA 1998a). The income of each profit center was determined by separate performance metrics as set out in the covenants (UvA 1997b). The (professional) dean of each faculty was responsible for the functioning of the sub-faculty “markets”, and reported to the governing board.

Although the promise was greater transparency and more efficiency, in practice the excessive complexity of the system largely undid any efficiency and transparency gains (UvA 2000). Path-dependent historical legacies had created a complex archipelago of chairs, funds, research units, specializations, departments and “special relationships” (some professors were more equal than others) that did not easily “fit” this straightjacket. As a result, reconfigurations in the cost model automatically produced “winners and losers”, resulting in more, not less, political infighting, and in a more, not less, politicized fund allocation (UvA 2000).

In 2006 all the elements were in place to transform the UvA from a self-managed anarchical archipelago of small faculties into a set of
interlinking “internal markets for staff and stuff”, centrally directed by the governing board through a series of covenants spelling out output-based KPIs. This new university model consisted of a legal holding managing a large number of independent profit centers—eg ICT, library, real estate, manpower agency, research institutes (SEO), a publisher (AUP)—as well as seven faculties. The holding receives state funding on the basis of a weighted mix of enrollment figures and graduation numbers. These funds are subsequently reallocated internally according to a model based on student inflows, a point-based teaching output model as well as numbers of graduated master students. The faculties, in turn, pay the other profit centers for services delivered.²

A similar structure has been set up for research. The outcome has been an increasing need for quantitative metrics to measure (teaching and research) output, resulting in a steep increase of the administrative burden for teaching and research staff, more pressure to standardize courses and their management, adverse incentives to beef up output, in both teaching and research, as well as infusing academic practices with a subtle bias towards “normal” science which generates quick and easy returns in the form of measurable increases in scores such as the H-index or number of publications and quotations in the web of science for promotion purposes and a downgrading of research outcomes (books, multidisciplinary papers, op-ed pieces) that do not fit these metrics. One unintended consequence has been the increasing politicking over these metrics among staff, especially when new metrics are being introduced (“valorization”) or when research assessment exercises are just around the corner.

An even more pernicious (indirect) and more relevant effect of the property shift for the self-image, self-understanding, internal organization as well as longterm sustainability of the university has been the need to buy itself—lock, stock and barrel—into the universe of investment bankers, derivative products, risk management, solvency ratios and cash flow management. To appreciate this, consider the UvA borrowings. In 2008 the UvA took out its first bullet loan of €55 million. As a result, the UvA, for the first time in its history (established in 1632) became a net debtor (UvA 2009). In 2011, total outstanding debt had increased to €136 million, and is now expected to reach a stunning €400 million in 2018 (UvA 2012).

The two banks with which the UvA ended up doing its business—BNG and ABN Amro (HBU division, now Deutsche Bank)—were quick to warn the governing board of credit risks and convinced the UvA that it should take out derivatives, interest rate swaps, to hedge the interest rate risk linked to the loans. In 2002 the UvA bought its first swaps, to the tune of an underlying notional value of €35 million. As Figure 3 demonstrates, the derivative portfolio quickly increased, demonstrating an enhanced vulnerability of the
UvA to financial market abuse (eg interest rate fixing) and financial markets shocks on the back of its real estate loans.

Since 2002, the underlying notional value of its derivative portfolio increased from €35 million to €255 million. Currently the UvA owns 10 interest rate swaps. All of these swaps “exchange” variable (1 or 6-month EURIBOR) interest rates for fixed interest rates, thereby exchanging uncertain future interest payments for a secure flat rate of maximum 5% on the underlying loans. As variable EURIBOR rates have remained extremely low over the course of the crisis, the market values of the swaps have progressively produced losses: from €22 million in 2008 to €63 million in 2012 (and counting). However, these losses are “paper losses” only, reflecting their fair value to be paid in case the contract matures or the UvA wishes to unwind the contracts.\footnote{As the swaps serve as risk management tools to secure fixed rates only, the UvA has no intention to undo these contracts, most of which have a maturity until the mid-2020s or beyond (UvA 2013:122). Furthermore, the UvA is not required to put up collateral for negative market values, as is the case with “naked” derivatives such as those owned by the VU.}

Having said this, this does not mean that the UvA does not run financial risks on its derivative portfolio. In 2013 the first swap expired. According to the 2012 annual report, the 2012 year-end market value of this swap was minus €1.3 million (UvA 2013:122). Moreover, as a result of Dutch accounting practices the UvA (as well as other non-publicly quoted firms and semi-public organizations) is able to exclude paper losses on its derivatives portfolio from its annual profit and loss (P&L) accounts, leaving the crucial solvency ratio on which so much hinges unaffected. However, this exception to the international rule has increasingly come under pressure. If existing rules were to

![Figure 3. Notional and market values of UvA derivatives portfolio](image_url)
change to conform to international conventions, the UvA might be required to reserve €63 million now to absorb future losses on its derivatives. Needless to say, this will negatively impact the crucial solvency ratio, potentially setting in motion a chain reaction that could jeopardize its real estate plans.

**WAS THERE AN INTER-PROFESSIONAL SHIFT OF POWER?**

As we suggested above, financialization entails a fundamental transformation of the “logic” of an organization as a result of the increasing penetration of that organization and its administrative apparatus by financial metrics. In the section above we encountered two examples of such organizational change-by-metric. However, metrics do not penetrate on their own account but require “carriers”, in the same way infectious or sexually transmitted diseases require “spreaders”. As we indicated in the introduction, we expect universities to be rather immune to change-by-financial metrics due to its well developed professional ethos, which does not easily allow for a shift of power from the bulwarks of self-management (professorial guilds) to financially savvy outsiders. In this section we present some proofs of such a power shift in our case. We begin with a bit of context.

The self-managed university in the Netherlands was very much a product of the cry for more grassroots democracy of the student protests of the late 1960s. The legal response to this call, reflecting a well tried Dutch elite strategy of de-escalation by accommodation (Kennedy 1995), was the 1970 Academic Governance Act. This Act gave staff and students equal voting rights on academic affairs and allocated most decisions to the faculty level, which in those days were small-scale affairs. However, on the back of increasing student numbers in the 1970s and 1980s, this proved to be increasingly cumbersome, leading to near endless political battles between students and staff or between different factions of staff, while leaving the university-level governing board without any means for long-term strategic planning. In the context of the mid-1995 real estate shift this became untenable.

The response was the 1997 Modernization of the Academic Governance Act. This piece of legislation radically broke with the grassroots logic of its predecessor and installed a mode of governance which closely mimicked the corporate governance model of the publicly quoted limited liability corporation, concentrating decisionmaking power in a professional executive board composed of full-time managers, with supervision being delegated to a board of professional supervisors. Even more important was the associated power shift from the faculty level to the board level, while the number of faculties was gradually reduced to seven and was brought under professional, full-time management too. In one big legislative sweep, staff and students
were disenfranchised, as decision-making power was concentrated in the hands of a small number of professional managers.

This had immediate consequences for the composition of the board. While formerly the governance board of the UvA consisted mostly of older professors with a knack for circulating at social events where the Dutch policy-making elite tends to meet and with social networks to match, after 1997 the UvA increasingly came to select former politicians, experienced managers from other public services as well as former partners from law, consultancy and accountancy firms, not to forget the stray retired professor of course. The 2013 board, for instance, consisted of a former dean of the Faculty of Psychology of the UvA, two professional managers coming from other semi-public institutes, and a former partner from Deloitte, one of the “Big Four” accountancy firms — and this is fairly typical of Dutch universities. Indicative of the kind of “professionalization” the corporatization of Dutch universities has initiated are the transformations that the staff departments of the head office of the UvA have undergone. The property shift required a better, more transparent information system for the university as a whole, to deliver the data that are required to keep track of the key figures linked to financing the huge real estate projects that the UvA planned to undertake from the late 1990s onward. The increasing interaction with commercial real estate developers, accountants, consultants and (investment) bankers resulted in a strongly felt need to possess in house the kind of expertise that is required for these interactions. To put it bluntly, due to its increasing indebtedness the UvA needed to up its game in order not to be slaughtered by its new, for-profit partners.

As a result, what used to be a relatively small head office, dedicated mainly to Academic Affairs — formulating the strategic goals related to teaching and research, maintaining contacts with institutes like the national research council — over time developed into a powerful command and control center dominated by real estate, finance and accountancy professionals. A case in point is the history of the internal audit unit. Set up in the mid-1990s, it consisted of a mere handful of professionals, mostly with a public sector background. In 2006 it was relabeled Concern Control, reflecting the concentration of power at the level of the board (“concern”) caused by the implementation of the new governance Act. It now consisted of over 10 professionals, some with a private sector background, with a still large portfolio of responsibilities, ranging from real estate management to auditing, internal information provision and strategy.

Initially, the concentration of responsibilities was facilitated by the outsourcing of real estate development to a commercial real estate developer, Trimp and Van Tartwijk. However, when Trimp and Van Tartwijk became entangled in the largest corporate fraud case in Dutch history in 2008 (Van
der Marel and Van der Boon 2010), the UvA was forced to insource its real estate development and reorganize and professionalize its staff functions. The outcome—in 2011—was a new corporate structure, consisting of separate units for the different functions that the older Concern Control unit used to undertake. Real Estate Management, Finance and Control, and Strategy and Information are now the largest and most important units of the UvA holding. Of the 201 employees working at the Maagdenhuis, the headquarters of the UvA (see Figure 2), eight are working in Strategy and Information, 13 in Finance and Control and no less than 21 (!) in Real Estate Management, making it the largest unit of all. In contrast, Academic Affairs fields only seven employees.

Even more telling is the professional background of many of these newly hired professionals. As far as possible we have tracked their CVs through professional networks like LinkedIn. Many of the new staff have worked for the “Big Four” accountancy/consultancy firms. Some appear to have lived the nomadic professional lives of consultants and interim managers and have moved from project to project, in this case from real estate project to real estate project. Many more than used to be the case have worked for the private sector, some for publicly quoted corporations. The most striking addition to the Maagdenhuis-based workforce is a Chief Risk and Security Officer who doubles as a Corporate Risk and Insurance manager and has a background as a broker for Generali, the big Italian insurer.

Not only are most of these employees new hires—many of them started at the UvA with the onset of the 2011 reorganization—suggesting a rapid increase in staff numbers on the back of perceived information and expertise disadvantages as real estate development and its financial needs truly took off, it also suggests a willingness on the side of the UvA to adapt academic salary scales to the norms of the (para-) financial sector, in fact creating a two-tiered salary structure, with teaching and research staff subsumed under the union-dominated collective agreement-based wage system and the financial professional staff, as well as the governors themselves, belonging to a separate, private sector conforming one. A forceful indication that finance and its “spreaders” now run the show.

**CONSEQUENCES, DANGERS, AND WHAT TO DO**

The story so far clearly suggests a strong penetration of the UvA by financial values, metrics and professionals. Financial professionals have largely taken over the apex of the organization, have succeeded in transforming its
organizational matrix as well as its information and cash flows in such a way that it became “legible” to financial outsiders (read: banks), and have been able to do so without much contestation due to the disenfranchising of staff and students by the new, legally prescribed corporate governance structure of 1997. The effects for staff and students were mostly negative: less professional autonomy, more administrative chores, more overhead, more standardization, higher throughput and less academic exchange.

And indeed, as we already surmised in the introduction on the back of the historical financial crisis literature, the lever proved to be property shift of 1995, forcing universities to take up responsibility for their own real estate and effectively driving them into the hands of big banks and their minions (accountants, consultants, lawyers, real estate specialists). In that sense, our case serves as a cautionary tale: the corrosive and seductive powers of finance are indeed so strong that even in the highly unlikely case of a European continental university we can observe far reaching changes in its organizational logic due to the influx of financial values, metrics and professionals. Form an academic point of view this suggests a need for more non-metropolitan studies of cases of financialization in order to draw out more general statements about what in these “financial times” is similar across jurisdiction and what is different (see Engelen and Konings 2010 for a similar plea). Of course this case is of more than mere academic interest. The story so far suggests that financialization is not without danger. In our judgement, the combination of (over) ambitious real estate development, increasing indebtedness and the concomitant dabbling in financial engineering through interest rate swaps makes for a highly toxic mix that could easily blow up in the face of the highly paid financial professionals occupying the Maagdenhuis, with huge consequences for teaching and research. We can imagine a number of nightmarish scenarios: ongoing negative market sentiment and/or continued low interest rates; a book loss and/or depreciation on property values; changes in accounting conventions resulting in a downward revaluation of real estate and a weakening of the crucial solvency ratio.

None of these things are predestined to occur. But because of its real estate ambitions and its overextended balance sheet the UvA has progressively lost the capacity to determine its own fate. As an institute of higher learning, with teaching and research as its societal mandate, it has become dangerously dependent on financial market developments over which it has no control. The result is an organization that increasingly has to resort to smoke and mirror-like accountancy gimmicks in order to guard the sacred solvency ratios required by its house banks.

For instance, in 2007 the UvA revalued its real estate stock upwards with €48 million by moving to a different valuation method (UvA 2008). Of course, the move was legitimated by a storyline that suggested that the
new method was more in line with market practice—but conveniently beamed up the solvency ratio of the UvA too. While inflated real estate values were beneficial for the solvency ratio, they simultaneously implied higher depreciation costs, biting into annual cash flows available for interest rate payments and hence crucial for determining the loan ceiling. In order to counter this effect, the accountants of the UvA simply doubled the depreciation period—from 30 to 60 years—with a stroke of the pen. The prima facie rationale was the introduction of a new calculative system, based on a so-called “component method”, which calculates variable write-down periods for different real estate intervention, eg building, renovation and maintenance. But again it conveniently deflated the depreciation costs, enhanced annual cash flows and positively affected the financial indicators that banks use to determine maximum loan capacity. It indicates that the UvA, by extending its leverage and balance sheet, is in danger of strangulation by debt, risking the funding streams to the activities for which it was established: teaching and research. On any measure this should be deemed unacceptable.

Just as risky is the way in which financialization interacts with the managerialization of universities, deepening the disenfranchisement and deprofessionalization of the teaching and research staff. There is now an extensive literature on how these processes have increasingly turned the university into a Fordist production machine for academic certificates, making a parody of what academic teaching and research should be about, namely non-interested, curiosity-driven additions to and reproduction of the collective repository of systematically corroborated insights that we call academic knowledge. Here is Stefan Collini in a recent contribution to the London Review of Books, which may stand for many such complaints:

The logic of punitive quantification is to reduce all activity to a common managerial metric. The activities of thinking and understanding are inherently resistant to being adequately characterised in this way. This is part of the explanation for the pervasive sense of malaise, stress and disenchantment within British universities… It is the alienation from oneself that is experienced by those who are forced to describe their activities in misleading terms. The managers, by contrast, do not feel this, and for good reason. The terms that suit their activities are the terms that have triumphed: scholars now spend a considerable, and increasing, part of their working day accounting for their activities in the managers’ terms (Collini 2013; see also Collini 2012)
The UvA is no exception. As we demonstrated, the property shift caused a simultaneous power shift in the organizational structure from bottom to top and from teaching and research professionals to a new phalanx of financial professionals hired to manage the newly acquired real estate portfolio and the financial and strategic responsibilities and obligations it entailed. In order to determine its loan ceiling, organizational information flows had to be made transparent and hence had to be standardized, to make the internal organization “legible”—in a literal Scottian version (Scott 1999)—to creditors. The result was a top-down imposing of market-like output metrics, which did not fit the historically grown academic conventions and hence required a slow but steady process of redesign of courses, administration, didactics and research. In that sense, finance is almost literally like a venereal disease transmitted by professional “spreaders” such as accountants, lawyers, bankers and real estate developers, who, on the back of different kinds of real estate events (the property shift of the Netherlands of 1995, the “ownership society” of Clinton and Bush, the “property owning democracy” of Thatcher or the stakeholder theory-driven increase in home ownership of the Netherlands), slowly but inevitably pervert the intrinsic values of venerable institutes like universities, building societies, municipalities, households and individuals.

Thus, what is happening to contemporary universities, on the European continent as well as in Anglophone countries, is typical for a wider, societal enslavement to financial values, metrics and professionals, which, paradoxically, has not weakened after the crisis but strengthened, due to the financial logic of growing indebtedness on the back of deflating real estate values, resulting in increasing incidences of almost eighteenth century financial indenture. Indeed, students are nowadays forced to transform themselves into “financial subjects” to enjoy education. Given the excessive legal protection of creditors in European jurisdictions and the steely constraints of financial obligations it generates, there is no easy way out. A Jubilee for instance is, alas, not on the horizon.

However, given the organizational resources still available to academic professionals, the best location to initiate a counter insurgency from the bosom of the public sector remains, without doubt, the university. For the same reason that it is the most unlikely case to suffer financial contamination, it is the best place from which to start an immunization offensive. Through demonstration effects it could then, partially, roll back the fateful process of financialization of the last two decades. Who, when and where this will start is of course hard to predict. The only thing we know for sure is that resistance starts with recognition. If we have raised awareness among our Anglophone and non-Anglophone readers of the extent of and way in which finance has penetrated its “other”, this paper has succeeded in its aims.
NOTES

1. This paper draws on archival research, public documents, newspaper clippings, observations as well as 10 semi-structured interviews with (former) UvA governors, colleagues and real estate and accountancy experts.

2. The sheer madness of this scheme is vividly demonstrated by the payment per chair of €1.50 that Room for Discussion, a monthly economic discussion forum initiated, led and conducted by economics students, has to pay to the central facility unit in order to allow its audience to be seated during its lunch hour discussions.

3. Alternatively, the fair value losses on the derivatives portfolio reflect the additional (fixed rate) interest paid over 1 or 6-month EURIBOR. Unfortunately, as we have been unable to see the swap contracts, we can merely speculate on the details.

4. The rest is made up of so-called “university professors”, the members of the board of governance, those of the supervisory board as well as their secretarial and administrative staff.

REFERENCES


**Collini S** (2012) *What are Universities For?* London: Penguin


POLICY DOCUMENTS


– (2000a) Implementatie “Voortgang Herinrichting Bestuurlijke Organisatie”.
– (2002b) Rapport financiën huisvesting; onderzoek naar de beheersing van de financiële planning en control m.b.t. de huisvesting bij de UvA. Concern Control August.
CHAPTER TWO

FINANCIAL WIZARDRY AND THE GOLDEN CITY:
TRACKING THE FINANCIAL CRISIS THROUGH
PFORZHEIM, GERMANY

ABSTRACT

The global financial crisis is complex and uneven. This paper focuses on the propagation and mediation of the crisis via a case study of the city of Pforzheim, in southwest Germany. In 2004 the municipality signed a number of derivative contracts with Deutsche Bank, aiming to limit interest payments. However, since the early days of the crisis these contracts have produced heavy losses. Attempts to restructure them (involving the world’s largest derivatives dealer JPMorgan Chase) compounded losses. This study explores the making, unfolding, interpretation, negotiation and contestation of this crisis, enabling wider critical analysis of state–finance relations across the bounded spaces of local government, through transnational firms and intersecting varieties (and scales) of capitalism.

MUNICIPAL FINANCES AND DERIVATIVES:
LOCAL MANIFESTATIONS OF A GLOBAL CRISIS

Clearing up after the mess will be a long, slow process.
It will involve many false starts… (Cogan 2012, 267)

Attributions of responsibility, interpretations of the making, and arguments about appropriate strategies for dealing with financial crises matter. Such interpretive strategies and political machinations are integral to attendant fiscal, social and state restructurings (Horner 2011; Kelly 2001; Sidaway 2008). Hence, in his wideranging account of the unevenness of the financial crisis and responses to it, David Harvey critiques those who see the crisis in cultural or even nationalist terms. Politicians and popular press in Germany and France depicted the crisis as a distinctive Anglo-Saxon disease, rooted in a culture of financial speculation on Wall Street and in the City of London (practises that German bankers would supposedly not tolerate). (2011, 3)

Literature foregrounding the socio-spatial trajectories of the crisis depicts complex webs of origins and reactions (Aalbers 2009; Clark 2011; Engelen and Faulconbridge 2009; French et al. 2009; Martin 2011; Wyly et al. 2009). In Europe much attention has been focused on a series of national financial bailouts, as well as the continuing sequence of supranational debt-crisis ‘resolutions’ in the Eurozone. However, this paper focuses on how the crisis is mediated through the subnational (local) state. To do so, moreover, we travel not to the fraught peripheries of the Eurozone, but examine a case from just beyond its Rhineland core (Loriaux 2008): the German city of Pforzheim.

Commenting on the uneven indebtedness of German cities, the German daily Die Tageszeitung observed that Germany’s troubled cities ‘are like Greek islands within Germany having slowly but surely drowned in their debts over recent years’ (2010, np). Similarly, in late December 2010, British daily The Guardian reported how US cities and states were holding a cumulative debt of approximately $2 trillion that might spark ‘a municipal meltdown’ (Moya 2010a). Numerous European cities – including Istanbul, Naples, Madrid and Barcelona – were facing difficulties to service mounting debts (Moya 2010b). Although fiscal crisis of the local state has a long pedigree¹, during the latest crisis the fiscal squeeze has been compounded via losses on financial products known as derivatives.
Derivative purchases by European municipalities have grown markedly since the turn of the millennium, as banks pitched them as ‘the easiest way to reduce costs on fixed-rate loans’ (Katz 2010). By late 2005, some of these had already accrued losses due to interest rate swings. In Italy ‘an estimated 519 cities and towns are facing more than $1.3 billion in losses from derivative deals’ (Faiola 2010, np). In France, approximately 1000 local authorities have ‘€11 billion in outstanding notional amounts of derivatives’ on their books of which many contracts have turned increasingly costly (Dodd 2010, 33). Unfortunately, accurate data on such losses are hard to come by. In decentralised Germany, national consolidated data on derivative purchases by local governments are particularly obscure (Deutscher Bundestag 2010, 2). Estimates of their scale vary. For example, the IMF reports that some 50 German cities ‘have derivatives transactions with Deutsche Bank alone’ (Dodd 2010, 33). However, the regional German newspaper *Stuttgarter Zeitung* reported that 200 local governments across Germany have purchased one particular derivative from Deutsche Bank (Heller 2007; Holger 2008; Koch-Widmann 2009). Subsequently, the *Financial Times* reported that up to 700 towns and cities in Germany ‘are said to have entered such deals with various banks’ (Wilson 2011, np). Besides Deutsche Bank, which has since been exposed as involved in a series of alleged misleading valuations and outright frauds\(^2\), other financial firms that sold derivative products to German local governments include Commerzbank as well as some of Germany’s regional public banks known as the *Landesbanken*.

**Derivatives** are comprised of

a financial contract whose value depends on or derives from
– hence the name – an underlying reference item, such
as a stock, bond, currency, or interest rate. (Dodd 2010, 33)

Ultimately, any reference item can serve as underlier provided they are ‘volatile, produce risk, and can be given a price’ (LiPuma and Lee 2004, 36). Popular derivatives include futures, options and swaps – the latter having been purchased by hundreds of local governments across Europe to lower interest payments. In essence, an interest-rate swap exchanges asset flows between two parties such as ‘the exchange of a fixed stream of income for a floating stream’ (Dodd 2010, 33). In particular, under the interest-rate swaps popular in Europe,

A bank would agree to cover a locality’s fixed debt payment and
the government or agency would pay a variable rate, thus
gambling that its costs would be lower and taking on the risk that
they could be many times higher. The deals were often based on
differences between short – and long-term rates. (Sorkin 2010, np)
Besides straightforward ‘plain vanilla’ deals, swaps can be extremely complex. Some local governments signed interest-rate swaps that generate upfront cash at the expense of more risk exposure and/or higher future payments. Others purchased swaps known as ‘constant maturity swaps (CMS), swaptions, and snowballs’, which are more complex and opaque and usually do not hedge risk but aim ‘to generate higher income by taking on more risk’ (Dodd 2010, 34). A CMS is a contract swapping fixed and variable payments derived from the underlying spread between short–and long–term interest rates plotted on a yield curve:

One side’s payment is based on a short-term benchmark rate such as three-month LIBOR plus a spread and the other side pays, say, the 10-year swap rate in effect on each payment date during the life of the swap. It essentially is a bet on the slope of the yield curve – which plots the relationship between the income an investment yields and its maturity. (Dodd 2010, 34–5)

While interest-rate swaps comprise the biggest slice of global derivatives trading, they are by no means the most controversial instruments. In *Fool’s gold* (2009), Financial Times editor Gillian Tett describes the making of the financial crisis through a focus on how bankers at what is now JPMorgan Chase invented credit derivatives, eventually reshaping the risk distribution of global finance in significant ways. She notes how, during the early 2000s, Deutsche Bank became ‘enemy number one’ in the eyes of JPMorgan, challenging its credit derivatives empire (2009, 109). Following the (subprime) credit bubble of the 2000s, instruments such as collateral debt obligations (CDO), credit default swaps (CDS), and their synthetic offshoots, became deeply implicated in the global financial crisis, leaving many governments around the globe with severe headaches (Greenberger 2010). In the US, these were the days of frantic negotiations between US Treasury, Wall Street firms and the Federal Reserve (see Blackburn 2008; Sorkin 2009). What emerged is that ‘no one – not even government regulators – fully understood the size and interconnections of the derivatives market’ (Story 2010, np).

This is the alluring but murky arena of global derivatives trading that Pforzheim entered in the 2000s. It began when the city purchased a set of interest-rate swaps from Deutsche Bank – Germany’s largest financial conglomerate and ‘among the most influential’ global derivatives dealers (Story 2010). Deutsche Bank sold hundreds of derivatives contracts in Germany, having resulted in a multitude of court cases challenging the legality of such contracts. Pforzheim therefore serves as an instructive case study of broader and contested processes. To this end, this paper sketches the making, unfolding, negotiation and contestation of the city’s derivative deals that combined
what are termed ‘information asymmetries’ (where one party to a deal has more/better information than the other) with high finance. In turn this informs reflections on the intersections of scales and forms of financial capitalism. The next section paves the way through elucidating this conceptual frame and our methods.

**FOLLOWING FOOL’S GOLD: CONCEPTUAL FRAMING, METHODOLOGY AND STRUCTURE**

… conceptualizations of markets and authority emerged from a 20th century relationship between physical geography, political authority and economic activity. They have today become cognitive shortcuts that no longer correspond well to the realities of global governance… (Newman and Posner 2011, 16)

Over recent decades, a growing literature has charted typologies or varieties of capitalism (e.g. Hall and Soskice 2001; Wilkins et al. 2010). Registering this, Morgan charted

a remarkable resurgence of interest in the differences between market economies and their roots in contrasting institutional arrangements. Whether comparing business systems, social systems of production, forms of regulation or varieties of capitalism, many studies have emphasized the viability and persistence of distinctive systems of economic coordination and control… (2005, 1)

Subsequently, Chan describes how ‘The literature on the importance of local histories, institutions, states and cultures in forging divergent capitalist trajectories is burgeoning’ (2012, 97). Such typologies have served as the kind of cognitive shortcut that the quote from Newman and Posner signals; describing modes and varieties of regulation, commerce and polity. Among these putative variants was ‘Rhineland’ capitalism, depicting the postwar West German model as one of coordination between firms, state and labour, and banks that supplied ‘patient’ capital to industry (Elsas and Krahnen 2004). However, this pattern has seen substantial change since the 1970s (Crouch 2005; Streeck 2010). Streeck even goes as far to argue that Modell Deutschland – a term coined by Chancellor Helmut Schmidt in the 1970s – no longer exists (2010, 113). The restructuring of finance constitutes a key part of its undoing (Dixon 2010; Engellen et al. 2010). The evolution of Deutsche Bank from a largely German (Haus) bank to a global financial services provider might be taken as exemplary in this
the long arm of finance

regard (Beyer 2003; Jaschinski 2011). Although the German model is tradition-
ally depicted as ‘bank based’, whereas the Anglo-Saxon model is regarded
‘finance’ or ‘market based’, such a ‘dichotomic opposition’ often proves insuf-
ficient in explaining the wider subtleties of contemporary finance (Amable 2003,
142). Dixon’s call to ‘move away from more simplified convergence/divergence
debates’ (2011, 199) becomes imperative to understand an evolving multifaceted
German financial system (see Clark and Wójcik 2007; Krahnen and Schmidt
2004). The case study that follows charts this landscape through examining the
trajectory and changing fortunes of a locality. In so doing, we examine the role
of what Crouch has termed ‘institutional entrepreneurs’ who

constantly seek ways to do things which until now have been
impossible. They cast around for elements of institutions that they
could recombine in unusual ways at opportune moments in order
to produce change. Recombining has become a much noted process
ever since geneticists began to work on recombinant DNA (or
rDNA). In this process, DNA from two or more sources, using
matching genetic components from each, is incorporated into a
single artificial, recombinant molecule, which has different
qualities from those sources. (2005, 3)

Lubricated by finance, such interactions and uncertain hybridisations are at
the heart of the account that follows. In particular, it foregrounds what
Engelen and Konings (2010, 617) have termed ‘paths or trajectories of fi-
nancialization’. In turn these embody shifting relationships between fractions
of capital and transnational re-configurations of class and state power (Pijl
1998). The evolution of the crisis in/through Pforzheimer’s institutions, budg-
ets and agents reflects the intersection of such pathways,

not just in the sense that universal processes of financialization
are refracted differently in different institutional contexts, but
rather as shaped by the contingent outcomes of actors’ political
struggles and compromises over how to negotiate the financial
opportunities and pressures with which they are faced. (Engelen
and Konings 2010, 617)

The intersection of varieties/pathways with shifting and scaled lattices of
power, politics and agency has enabled fiscal-governance openings, attendant
risks and financial ruptures. The connections between these powers and
scales are challenging to disentangle and describe. Our paper can only
scratch the surface and is consciously eclectic in drawing on and establishing
dialogue between literatures on varieties of capitalism, pathways to
financialisation and scale. Reflecting on several decades of debate on the latter, Jonas describes how ‘the relationship between scale, process and explanation continues to pose enormous challenges for received conventions of narrative, theory and epistemology’ (2006, 400). Likewise, MacKinnon (2010, 21) insists that scale *per se* is less important than the differential scaling of *processes* and political economies.

To investigate Pforzheim’s entanglements in what Jonas calls ‘complex and spatially co-determined sets of processes, structures, contingencies and outcomes’ (2006, 400), our paper draws on face-to-face interviews with key informants. These are combined with an extensive reading of media coverage and policy documents. Donald MacKenzie’s work on finance points to the complexity of attributing agency in respect of complex market–legal–state interactions that form socio–technical–legal combinations:

> An intrinsic aspect of making a deal – a commonplace intentional action in financial markets – is the taking on of commitments, for example to deliver securities or money (at least the electronic traces thereof). While traders may speak or type the words that bring a deal into being, those words commit not those who have spoken or typed them but the organizations of which they are members. Should the individuals in question leave those organizations, these obligations do not depart with them. (MacKenzie 2009, 21)

For this research therefore, a method of *process tracing* has been applied in order to identify ‘intervening causal processes’, ‘sequences of events’ and/or ‘key-decision points’ (Bennett and George 2005, 206–33), investigating how

> Actors move across multiple kinds of boundaries and cross over many different institutional spheres. This clearly points to the possibility of bricolage and recombination as significant of institutional activity. (Djelic 2010, 32)

To draw out such key moments and movements, secondary data (local and financial media reports in combination with relevant policy documents) were scrutinised. On-going legal contests have precluded us accessing some key documents (notably expert legal reports). We have therefore sought to trace key agents and construct a sequence of events through publicly available documentation and our interviews. In the quest for primary data, local politicians, administrators, journalists and academics were interviewed. Among the 15 interviewees who inform our paper, five are cited directly in the main text. However, all interview transcripts deepened our understandings of the
key moments, players and processes at work.

The next section provides a brief background on the city. The main part of the paper then traces the making, unfolding, negotiation and contestation of the crisis. Our conclusion returns to the wider uneven development of the financial crisis. We reflect on what Swyngedouw (1992) once termed ‘glocalisation’ – combining global/transnational, national, regional and local agency – is being mediated through interactions of finance and varieties of capitalism.

**PFORZHEIM: THE GOLDEN CITY**

The crisis in the eurozone is making headlines at the moment, but at a lower level another debt storm is slowly brewing. European cities and regions are expected to flood the market this year, all anxious to fund ballooning deficits. Local and regional government borrowing is expected to reach a historical peak of nearly €1.3 trillion. (Moya 2010b)

Bordering the larger Rhineland, Pforzheim is located on the northern edge of the Black Forest region – east of Karlsruhe, west of Stuttgart. The city of 120 000 is part of one of Germany’s most prosperous **Länder**: the south-western state of Baden-Württemberg. The city carries deep scars of conflict; the closing months of the Second World War saw more than three quarters of its buildings destroyed by Allied bombing and a fifth of its population killed (Schmalacker-Wyrich 1980). Despite a long association with craft industries in jewellery and watch manufacture (Pieper 1992) that earned Pforzheim the nickname *Goldstadt* [Golden City], Pforzheim is seen as an average national performer coming 214th out of 412 German cities and districts measured along 29 macroand socioeconomic indicators (*Handelsblatt* 2011; Prognos 2010). Within prosperous Baden-Württemberg, however, Pforzheim has long been among the lowest ranked cities on the basis of these indicators.

Local indebtedness in Pforzheim rose from €128 million in 2003 to more than €180 million in 2009 (Hermesmeier 2009, 2; Stadt Pforzheim 2011a). On top of its structurally deteriorating budget, the economic recession of 2009 hit Pforzheim’s economy hard. It suffered ‘the fastest-growing unemployment rate of any locality in the country’, rising to 9.8 per cent of the labour force (Kulish 2009). Tax income fell while social expenses grew. As elsewhere in Germany, Pforzheim’s fiscal squeeze was compounded by state restructuring – particularly since German reunification (see Reichard 2003; Wollmann 2000) – whereby local governments and Länder have
significant leeway. This shifting regulatory post-1990 German framework, however, also coincided with broader state–finance–firm changes.

Local developments in Pforzheim embody national trends. In 2010, the German federal government acknowledged the rising financial problems of German cities and municipalities as a combined €7.6 billion surplus in 2008 turned into a €7.2 billion deficit in 2009. According to the Bundesregierung, the ‘most-important reason’ for this precarious situation was a fall in local business tax income combined with rising local expenditures. However, it is noted that the consolidated picture conceals some ‘significant structural differences between cities and municipalities’ as many local authorities were unable to improve their budgets during ‘the good years’ prior to the crisis (Deutscher Bundestag 2010, 2). Such good years largely bypassed Pforzheim after the 1980s. In the words of a local administrator,

Pforzheim has a structural problem. We are a jewellery – and watchmaking city that has brought about a relatively monostructured economy. This industry has increasingly encountered difficulties due to global developments including the rise of the Far East. As a result, we have had a massive reduction in jobs. On the one hand, this has negatively impacted our tax incomes whilst, on the other hand, our social obligations have risen. We have yet to find a way to reinvent our economy to overcome these problems. (Interviewee C 2010)

Given the fact that the local economy has a shrinking business tax base, and that in Germany these taxes generally provide a third of local income (Weber and Häuser 2008, 80), Pforzheim sought novel ways to raise revenue and cut expenses. For example, in 2001 the city was close to selling off its sewage system to US investors through a cross-border-leasing (CBL) construction. Although the city council eventually decided against the idea with the smallest-possible majority, the city would have received €12 million if the deal had gone through (Interviewee E, 2010).

Pforzheim partly privatised other public facilities over recent years including the city hospital, public-transport and utility companies as well as ‘various public services that had little to do with the functions of local governments such as a public travel agency and a public undertaker’ (Interviewee E, 2010). However, these privatisations could not resolve the chronic deficit. Since interest payments on these debts were substantial, the city looked into ways to minimise them. As a result, in 2003 the city signed its first ‘plain vanilla’ swap contract with Commerzbank (Klimanski 2010). As The Economist has noted, the sale of interest-rate swaps ‘flourished at a time when local governments felt they were paying too much in fixed interest
payments as euro interest rates were falling’ (2008, np). It is with this move, however, that Pforzheim’s fiscal trajectory became more complex and, eventually, disastrous.


Pforzheim has been a customer of Deutsche Bank since 1946. The relationship probably dates back longer. However, documentation fails as everything was destroyed during the bombing. (Interviewee E, 2010)

THE MAKING OF THE CRISIS

In its quest to reduce interest payments on public debt, the local treasury signed the first of a series of more complex swaps with Deutsche Bank in 2004. In so doing, Pforzheim aimed to reduce interest payments swapping fixed for variable rates – the latter being derived from the six-month Euribor rate (Hermesmeier 2009, 2). Later that year the city purchased a CMS Spread-Ladder-Swap from Deutsche Bank with a notional value of €10 million. Satisfied with its initial performance, in August 2005 the city signed two additional CMS Spread-Ladder-Swap deals with Deutsche Bank with notional values of €20 million and €30 million respectively (2009, 3). As such, by mid-2005 Pforzheim ‘swapped’ fixed interest rates tied to €60 million of debt for variable rates by signing three CMS swaps with Deutsche Bank. The local treasury saw these deals as a sound hedging strategy that – at first – seemed a good bet:

The products […] offered to swap the fixed rates for floating, and based the level of these on the difference between two interest rates – most commonly the two-year and ten-year swap rate. So far so simple, but the actual floating rate was set by a mind-bogglingly complex formula: the interest-rate spread was subtracted from an arbitrary figure, doubled or trebled, and added cumulatively to the rate paid in the previous period. If the gamble went well, municipalities could theoretically make a return of 10% or so on the nominal amount. Except that, in most cases, Deutsche Bank could terminate the arrangement every six months after the first year, which would leave the customer with not much more than 2% profit. (The Economist 2008, np)
It should be noted that hedging is generally regarded as a ‘conveniently ambiguous’ concept in financial circles (Das 2010, 42). And indeed, where the local treasury saw the cumulative swap of fixed rates for variable interest rates as a diversification strategy (and interpreted this as hedging), others have since argued that the swap contracts – exchanging fixed payments with variable expenses – represented a speculative endeavour. Interestingly, both arguments carry some truth, and the firms involved played on this ambiguity to their advantage.

In Pforzheim, the three CMS contracts exchanged ten-with two-year rates. Since the mid-1990s, the spread between these rates had been substantial, providing the incentive to purchase these products. Furthermore, ‘termination of these deals was, as conventional, possible on every trading day’ (Hermesmeier 2009, 3). However, late in 2005 the market value of the city’s three CMS swaps altered dramatically for the worse.

**THE CRISIS BREAKS**

On 30 October 2005 the three CMS swaps had ‘an expected small negative market value’ of €800 000. However, ten days later the three swaps suddenly produced ‘a negative market value of €8.6 million’ (Hermesmeier 2009, 3). With hindsight, some informants argued this was the moment when troubles in the US housing market began to manifest. But it should equally be noted that late 2005 was also the moment when ECB interest rates halted their downward trend and started to rise, flattening the yield curve:

> We knew these things had a value and that their performance had to be monitored. We received monthly reports to do this. The report late October was still good. No alarm bells. Then Deutsche Bank called early November and suggested we should meet. They said there had been market disruptions negatively affecting the yield curve. I believe this had to do with the real estate problems in the US. It had a dramatic impact upon the market value of the swaps. (Interviewee E, 2010)

By this time the city was in too deep to cut losses. Furthermore, representatives of Deutsche Bank advised the city’s treasury department to keep the swap contracts and to extend their maturity (Hermesmeier 2009, 3) as the bank expected the market value to improve:
We had of course few possibilities to inform ourselves. We had to ask the bank what was going on. They said ‘don’t worry, it is only a short-term disruption’ and ‘keep up, it will get better’. And indeed, it did get better in the spring of 2006. (Interviewee E, 2010)

As such, the swaps were extended following the advice of Deutsche Bank. Notwithstanding the springtime improvements, the market value of the contracts deteriorated once again in the course of the summer. This time, however, the likelihood of a trend reversal was being downplayed by Deutsche Bank (Hermesmeier 2009, 3). This has been confirmed by those closely involved with the city’s finances:

A colleague of ours went to a conference in Potsdam which was also attended by many bank representatives. By that time, all of them were sure that the situation would stay like this making the yield curve flatter and inverse. Then we decided we had to get out of this mess. (Interviewee E, 2010)

By the summer of 2006, the swaps registered a loss of €20 million. Desperate to avoid further losses, the city sought the advice from ‘one of the most experienced banks’ in derivatives trading: US financial conglomerate JPMorgan Chase (Hermesmeier 2009, 3). To city officials, JPMorgan represented the obvious choice:

Another city treasurer recommended JPMorgan to us, arguing ‘they understand this business. They are the largest derivatives dealer in the world. If they do not understand this business then who does?’ And indeed, JPMorgan was very well informed. Naturally, they did not say ‘we will make these twenty million disappear’, but they did suggest alternatives through which we could manage the situation. We discussed a variety of options. We said that we would like to reduce the risks associated with the swaps. Furthermore, we wanted to diversify these risks so that a change in one parameter would not dramatically alter the value of the swaps. (Interviewee E, 2010)

**THE CRISIS COMPOUNDED**

The eventual agreement with JPMorgan was based on two components. First, the three swaps of Deutsche Bank were ‘mirrored’ by JPMorgan. That is to say, where the swaps of Deutsche Bank carried a cumulative loss of
financial wizardry and the golden city

€20 million, the three JPMorgan derivatives had a cumulative positive value of €20 million. In an analogy frequently voiced by our informants, the deal resembled a game of roulette whereby a player bets on red and black simultaneously. In other words, the swaps of Deutsche Bank and JPMorgan cancelled each other out. However, as JPMorgan effectively assumed the risk associated with the swaps of Deutsche Bank, JPMorgan and the city’s treasury agreed on a parallel arrangement whereby Pforzheim was able to finance the deal. As such, the second part of the deal was comprised of three additional ‘finance’ swaps labelled ‘CarryMAX’ with a notional value of €15 million, ‘MOMENTUS’ with a notional value of €15 million and ‘MOMENTUS Quattro’ with a notional value of €30 million. This complex agreement was signed on 23 November 2006 (Enderes 2010, 4; for more details on the ‘finance’ swaps see JPMorgan Chase 2007 2008a 2008b). Although these swaps restructured the risks to which Pforzheim was susceptible, they had a highly speculative character. Initially, things seemed to be stabilising, leading to further restructuring of the swaps on various occasions (Enderes 2010, 4; Hermesmeier 2009, 3). In doing so, the risks associated with the swaps were reduced:

The swaps of Deutsche Bank had no floor and carried unlimited risk. The three ‘finance’ swaps had a floor that we managed to minimise to €77 million. Although still terrible, this is was an improvement. (Interviewee E, 2010)

The swaps of JPMorgan were initially accompanied with additional speculative components with a short maturity of just three weeks. Among others, these included currency swaps linked to the Swiss Franc and Sterling in relation to the Euro exchange rate (Interviewee E 2010). In other words, the city gambled on the future values of foreign currencies of which the returns – Spekulationsgewinne [speculation profits] (Enderes 2010, 7) – were used to reduce the risks associated with the ‘finance’ swaps:

With these ‘in between’ swaps we managed to limit the risks related to the ‘finance’ swaps. The floor was heightened. We did not take out the money, which we could have done, but we used it to lower the risks on the other swaps. The floor or risk limit being of course a money value. (Interviewee E, 2010)

These ‘in between’ steps did not continue indefinitely. In the end, all three ‘finance’ swaps largely traced interest-rate developments ‘not just tracing Euribor but an index comprised of a variety of interest rates’ (Interviewee E, 2010). Specifically, the CarryMAX swap aimed to profit from differences on
the ten-year interest rates on government bonds in nine currency areas including the Eurozone, UK, Japan and the US. Based on volatile futures contracts, the strategy mirrors a carry trade (for a detailed description see Enderes 2010, 14–15). In turn, both the MOMENTUS Quattro and MOMENTUS swaps were comprised of a ‘deterministic algorithm’ stipulating a leveraged sales strategy that either goes long or short on a portfolio including Eurex-Bund, Euribor and Eurodollar futures contracts (2010, 15–16). Added up, all three swaps derived their market value from underlying derivatives, comprising an index of financial parameters, of which the value was calculated on pre-set trading days. As such, like the swaps of Deutsche Bank, the ‘finance’ swaps were synthetic, meaning that ‘there is no actual portfolio of assets to which any person is entitled or in which any person has any ownership interest’ (JPMorgan Chase 2008a, 23). Instead, the indexes depend on developments in various interest rates and currency markets.

In sum, the value of these swaps was calculated in similar fashion to the swaps of Deutsche Bank: all you need is ‘a point in time where the parameters are measured and a formula’ (Interviewee E, 2010). Whereas the market value of the three ‘finance’ swaps evolved in favourable fashion in 2007, the financial crisis of September 2008, which followed the epic fall of US investment bank Lehman Brothers, saw a sharp reversal (Hermesmeier 2009, 3). Suddenly, ‘all correlations broke down’ and the market values of the three ‘finance’ swaps took a nosedive (Interviewee E, 2010). It then became clear that the city’s restructuring strategy with JPMorgan had failed spectacularly.

By 2009 the losses on the three ‘finance’ swaps surpassed the €50 million mark. Since the average monthly loss on these contracts equalled €600 000 and their maturity was not due before March 2017 (Enderes 2010, 4–5), the prospect of the losses reaching the maximum of €77 million appeared very real. As such, city officials started to contemplate the possibility of an early exit. This was by no means an easy task: while the swaps of Deutsche Bank could be terminated at any point in time, the swaps with JPMorgan could not (Enderes 2010, 7).

Since we did not have a termination right on these contracts we could not really demand a lot. We were in the situation where we had to wait and see to what extent JPMorgan wanted to play along. (Interviewee C, 2010)
NEGOTIATIONS AND CONTESTATIONS: 2008–

PFORZHEIM IN WONDERLAND

This is complete virgin territory. There are no legal cases, which could provide guidance, or legal literature from which a conventional opinion could be derived. Everything is new. (Interviewee C, 2010)

Initially, city officials requested that JPMorgan cancel the swap contracts in exchange for Pforzheim repaying the losses over a long-term period at an agreed interest rate. JPMorgan agreed, subject to Pforzheim forfeiting all legal rights in relation to the swaps, thereby acknowledging that their products were legally sound. City officials decided not to agree to these terms (Enderes 2010, 7). As an alternative,

We wanted to take out a loan to pay the termination of the derivatives. However, state law prescribes that municipal loans can only be taken out for investments. Derivatives are of course not an investment. We have lobbied for an exception as it is the cheapest way to finance the termination given the low interest rates … However, the state denied us this option. (Interviewee C, 2010)

Eventually, both parties agreed to a Glattstellungsvertrag [liquidation contract] that does not preclude legal options to seek compensation from JPMorgan (Enderes 2010, 7). To this end, on 12 August 2010 the major of Pforzheim and a JPMorgan representative signed the liquidation deal. In doing so, the city agreed to pay out losses to the tune of €57.4 million (Pforzheimer Zeitung 2010). In other words, where Pforzheim originally aimed to reduce its interest payments on €60 million public debt via three swaps of Deutsche Bank, six years later it ended up paying roughly that amount to JPMorgan. What further aggravates the city’s treasury is the fact that ‘today the original Deutsche Bank swaps have a positive value of nine million euros. That is the irony of the story’ (Interviewee C, 2010).

Pforzheim’s strategy of seeking to resolve a local fiscal squeeze through financial innovation had ended up significantly heightening local deficits. And along the way, seeking to control risks via further financial derivatives ended up multiplying the scale of losses. Combined with the fiscal squeeze stemming from the 2009 recession, the immediate consequence was that Pforzheim sought €240 million of budget cuts for the period 2010–13.
Specifically, it needed to save €100 million on spending and cut €140 million in administration costs (Interviewee B, 2010). In the words of the city’s personnel director:

Savings in the investment budget have been largely realised for this year as well as next year and 2012. However, by and large we have scrapped investments that have to be made sometime. Our buildings and streets simply need maintenance and periodic renovation. As such, from 2013 onwards we have a big jam of investments that have to be made. Of the planned €100 million, perhaps €15 million comes under the rubric ‘nice to have’, for example cultural spending. However, around €70 million of the investment cuts represent planned investments such as school renovations [...] Many investments are simply unavoidable. For example, we planned to skip the renovation of city hall. However, this was not possible because of health and safety regulations. If we do not do these investments, we have to close the city hall. (Interviewee B, 2010)

Taxes were raised, subsidies cut and personnel costs trimmed, resulting in a recruitment stop. Crucially, however, none of these measures were sufficient to cover the one-off payment to JPMorgan:

The liquidation contract has been paid out of our reserves, which stood at €60 million, being largely the result of the sale of shares in our public utility company around the turn of the millennium. These reserves were planned to finance our investments for 2011 and 2012 [...] However, due to the derivatives termination this is no longer possible. As such, we need to find new ways to finance schools. To this end, we are now in the process of creating a sale-and-lease-back construction that involves the sale of public assets to a novel public entity that will subsequently lease back these assets to us. We receive money from this new entity and they go to the bank to get a loan to finance the operation. The money received can be used to finance our commitments. However, this will impact our credit portfolio which, in turn, affects our interest rates which, in turn, impacts our budget. (Interviewee B, 2010)

Informants note that this strategy is far more expensive than €57.44 million:
We had to pay €57 million to terminate the contracts with JPMorgan. However, if you calculate the additional costs involved with the sale-and-lease-back option, the total amount comes close to €100 million. Well, on a total budget of around €350 million, this is a large number. (Interviewee D, 2010)

A former mayor of the city (Interviewee A, 2010) described the situation as Wahnsinn [insane]. The sale-and-lease-back construction involves ‘tax specialists, consultants and lawyers’ – all costs that will end up in the investment budget. In the words of the personnel director, ‘although legally sound, I agree it is not pragmatic’ (Interviewee B, 2010). Nonetheless, this ‘solution’ enabled Pforzheim to operate within state law and to retain the prospect of legal action against the banks. To this end, the city sought legal advice. As it turned out, the legality of the city’s derivative deals is highly controversial.8

LEGAL CONTESTS

With regard to the swaps sold by Deutsche Bank, in 2009 Pforzheim commissioned an expert report from Jochen Weck, a Munich-based lawyer representing a variety of German authorities against Deutsche Bank. This is not in the public arena, but our informants confirm that the report argues that the city has good prospects to sue Deutsche Bank. It claims that the Deutsche Bank swaps were never suitable for interest-rate consolidation, had little to do with the city’s concrete credit facilities and Deutsche Bank neglected its legal duty as consultant (Hermesmeier 2009, 4). Informants closely involved in making the deals with Deutsche Bank underscore this argument. To put it mildly, they feel tricked:

Before we signed the derivatives, Deutsche Bank showed a ten-year yield curve from 1994 to 2004 during which the spread moved between 0.5 and 2.5 percent and was mostly above 1 percent … Later, however, we got the same graph from JPMorgan over 30-year time span. This was the point in time when we got very angry. Until that point we always thought that it was fate, bad luck or perhaps we had not been careful enough or whatever. But at that moment we realised that Deutsche Bank had tricked us … There actually were phases, not short but long phases, with an inverse yield curve. What we knew prior to this graph is that an inverse yield curve was unnatural and that it had not occurred over the last ten years. That was the information we had. The information we
The legal verdicts thus far are not uniform. There are businesses, municipalities and semi-public companies suing the banks. One needs to differentiate between them. Then you have the regional courts like Stuttgart and Frankfurt. Where Stuttgart has been fairly appreciative to the plight of municipalities, Frankfurt usually sides with the banks. (Interviewee D, 2010)
Deutsche Bank sought to take advantage of this disparity. In 2008, *The Economist* argued that Deutsche Bank – in contrast to other German financial institutions – has no intention to settle legal challenges and ‘decided to fight in court allegations that it had given “bad advice” on a product that pitched clients into potentially huge losses’ (2008). The newspaper noted how:

A string of lawsuits filed against it in Germany for selling hard-to-understand products to local authorities may seem like a minor nuisance. Yet like the subprime fiasco, they illustrate how gullible some investors were when confronted with startlingly opaque products. They also pose questions about a bank’s responsibility to ensure that its clients understand what they are buying … Lawyers on both sides believe Germany’s supreme court will have to decide on the appropriateness of selling such products, especially to municipalities. Some believe Deutsche may be testing claims in the courts in part to discourage further plaintiffs hoping to sue. Once a deal has run three years clients cannot file a claim. (*The Economist* 2008, np)

The legal situation is complicated by the status of municipalities like Pforzheim:

A private individual can speculate all he wants. It is perfectly legal if you want to bring your money to a casino. Local government cannot do this. That is the difference. And there exist few legal rulings with respect to local governments. Up until today there is actually only one ruling. With regard to private individuals there are more rulings as well as with regard to semi-public companies who might equally be bound to a similar legal status as private individuals. These companies are effectively a hybrid, as both a municipality and a private party own the company. The question here is which set of legal rules is applicable in this area: The local-government order or private law? Legally, this area is also different from the other two examples. (Interviewee C, 2010)

In late 2010 the city authorities decided to sue JPMorgan (Stadt Pforzheim 2010). The first encounter between city and bank was on 16 January 2012, where the advisory role of JPMorgan was probed (as it turned out, the bank charged a hefty €14 million fee for its services). The presiding judge proposed a settlement whereby JPMorgan would reimburse €19.14 million – a third of the losses (Koch-Widmann 2012). However, assured a better deal would be feasible, the city council decided against
this option (*Pforzheimer Zeitung* 2012a 2012b). Two court cases in particular are believed to have strengthened their case against JPMorgan. In March 2011 a landmark case between a German private company and Deutsche Bank came before Germany’s *Bundesgerichtshof* [Supreme Court] – the first of many to follow. The court summoned Deutsche Bank to reimburse *all* losses incurred on the interest-rate swaps sold to the company. According to the Pforzheim mayor, the ruling ‘sets a precedent’ that is ‘very hopeful’ (*Stadt Pforzheim* 2011b). Another recent case that has strengthened the plight of Pforzheim is the case between the Italian city of Milan versus Deutsche Bank, JPMorgan, UBS and Depfa Bank. The ruling found the banks ‘guilty of fraud for mis-selling derivatives to Milan that could set a precedent for hundreds of local governments to pursue’ (*Piovaccari and Aloisi* 2012). As of writing, litigation between Pforzheim and JPMorgan continues.

**CONCLUSIONS: INTERSECTING VARIETIES (AND SCALES) OF CAPITALISM**

What kind of domestic disturbances and instabilities start to appear when transnational agents and markets begin to exert control over economies once managed in and through the national state? (*LiPuma and Lee* 2004, 17)

Such a question is not new in Pforzheim when we recall that in the nineteenth and for much of the twentieth century, the city’s economy was dominated by jewellery and watch-making industries offering little hedge against the woes of the Weimar republic that were compounded by the fall-out of the 1929 Wall Street crash. Equally, the incorporation of West Germany into trans-Atlantic liberal capitalism after 1945 required a mix of domination and hegemony. However, since the 1970s, the once shining prospects of the Golden City’s rather mono-structured economy have faded. Simultaneously, a financial conglomerate such as Deutsche Bank is not the same institution as it was 40 years ago when the postwar recovery yielded a stable regime of accumulation in Germany. This came under heightened pressures during the 1990s, exacerbated ‘by the high economic cost of German reunification, the internationalization strategies of German firms’ and related shifts (*Bathelt and Gertler* 2005, 1). More than a decade ago, Clark *et al.* argued that
the German model is more fragile than commonly realized […] Anglo-American management practices have penetrated and affected German corporate (national and regional) institutions and regulations. The social market lauded by advocates of stakeholder capitalism is changing rapidly, at least in the sphere of large firms and global finance. (2002, 91)

Claims that German financial norms changed suddenly therefore need to be placed in context of international shifts that were years in the making and involved the interactions of states, markets and geopolitics; in particular the rise of complex mortgage-backed securities, derivatives and the wider securitisation string (Hyman 2010; Konings 2009). Writing about Germany, the American journalist Michael Lewis noted how

many observers initially believed German banks would be relatively less exposed to the crisis. The contrary turned out to be the case. German banks ended up being among the most severely affected in continental Europe … Everyone thought that German bankers were more conservative, and more isolated from the outside world, than, say, the French. And it wasn’t true. (2011, np)

Behind this are complex arrays of debt, responsibility, uncertainty, profits and losses, winners and losers. While Germany’s prime financial powerbroker is still named Deutsche Bank, it substantially decoupled itself from what was once labelled Deutschland AG. Today, Deutsche Bank no longer accrues most of its profits from loans to enterprises in Germany, but rather in London, Frankfurt and New York, where global financial flows are reshuffled, repackaged and redistributed. Most interviewees in Pforzheim, both those directly implicated in the derivative deals as well as those merely standing on the sidelines, were shocked to realise that Deutsche Bank sold high-risk products in their own ‘backyard’.

Citing a source in Germany, the financial journalist Michael Lewis attributes the shift there not simply to German embrace of financialised capitalism, but to the interactions between the German and Anglo-Saxon economies during the last decade, noting that ‘the border created by modern finance between Anglo-American and German bankers was treacherous’ (2011, np). Our examination of the Pforzheim case bears this out, but with Deutsche Bank acting as a kind of a Trojan horse – having assumed many of the traits conventionally assigned to Anglo-American finance. To extend Crouch’s (2005) metaphor of recombinant capitalism, the genetic code of the German model has been irretrievably modified. The changes in German capitalism since the 1990s soon went deeper than was appreciated at the
time. Key to the shift was less the straightforward arrival of Anglo-American financial practices in Germany or simply the convergence of German capitalism with an Anglo-American model, but the mode with which German norms interacted with Anglo-American ones. Here scale squarely enters the picture, in so far as these interactions parallel the scalar politics that McKinnon charts elsewhere: through ‘processes and institutionalized practices that are themselves differentially scaled’ (2010, 21). In other words, a nuanced consideration of scalar politics must be developed to understand the dynamics of how varieties of capitalism/financialisation interact.

In the case of Germany since the early 2000s, these interactions include those of an uneven and decentralised polity and Anglo-American forms of financial capitalism in tandem with – via the Eurozone – a complex and fraught experiment in monetary integration. As elsewhere (Marazzi 2011), the financial crisis in which Pforzheim became embedded is both a consequence and a catalyst of much deeper shifts, whose future trajectories are radically uncertain. Today, the city’s derivatives deals with Deutsche Bank and JPMorgan are history. However, they embody a wider trend, as other municipalities across Europe remain tied to similar contracts.

Meanwhile, the Eurozone has been struggling to cope with the consequences of a series of financial shocks, recalibrating state–finance relations. Among the institutions implicated in this process is Germany’s Constitutional Court in Karlsruhe – not far away from Pforzheim. There, the constitutional legality of changing state–finance relations ‘from above’, i.e. between (supra-) national-state structures and transnational finance is under scrutiny. Similar contests are also observable ‘from below’ between (sub-) national-state structures and transnational finance. Again, a key battleground will be Karlsruhe – but the clashes also run through the ECB, finance ministries across the Eurozone, the European Council and through ‘national’ political processes in the EU. Caught in a Zwickmühle, a multiscalar Germany – including cities like Pforzheim – is struggling to come to terms with the convoluted character of finance.

The case that we have investigated here may seem minor in comparison to the extent or depth of crisis elsewhere in the Eurozone. However, it is evident that the entanglements in a web of risk that the Pforzheim case embodies are symptomatic of how the crisis arose and has been negotiated via (often difficult to disentangle) links. The Pforzheim case bears witness to uneven pathways to financialisation. Rather than any straightforward financial convergence, complex multifaceted and uneven relations are at work. Even in the final instance, these never fully merge (cf. Brenner et al. 2010). Swyngedouw’s (1992) designation ‘glocalisation’ usefully captures an aspect of how Pforzheim became entangled with finance. However, the debacle in Pforzheim reveals manifold transformations/recombinations. The intricate
reworking of scales and polity that we have traced from/through Pforzheim may shed light on other cases of municipal debt, financial shenanigans and attendant ‘glocal’ displays of crisis. We fear that there will be no future scarcity of them.

In short, the saga of the Golden City refutes illusions regarding national typologies or resolutions to an entangled and multiscalar crisis. Parallels with the making of (and reactions to) the international crisis of the 1930s may well spring to mind. On the origins of that crisis, Karl Polyani argued that ‘The true nature of the international system under which we were living was not realized until it failed’ (1957 [1944], 20). In such critical comparative spirit however, it is perhaps also worth recalling how Marx reminded any readers who might perceive *Das Kapital: Kritik der politischen Ökonomie* to be only about the plight of the English working class and avarice of English capitalists and thus could not apply to their society, where things are not nearly so bad: ‘I must plainly tell him [sic], ‘De te fabula narratur!’ [It is of you that the story is told. – Horace]’ (1867, 1).
NOTES

1. See the analyses in O’Connor (1973) from the USA and Duncan and Goodwin (1987) from the UK of the 1970s and 1980s respectively. The role of derivatives in the largest municipal bankruptcy in American history (Orange County, CA in 1994) is richly dissected by Baldassare (1998).

2. In 2012, the weekly Der Spiegel questioned the practices of Deutsche Bank with two revealing cover stories. Early in the year (issue 5) the magazine branded Deutsche Bank as *Die Zocker AG* [the gambler plc], questioning the ‘dubious transactions’ of the bank. At the end of 2012 (issue 51) the magazine carried another cover story on *Die Deutsche Skandal-Bank* claiming that Deutsche Bank had ‘ruined its reputation’ in a year of exposés about its manipulations and frauds.

3. The study of information asymmetries has generated a large literature. However, the classic paper is Akerlof (1970).


5. We have labelled them interviewees A to E (on-going legal contest precludes naming them all). Those cited directly in the text are as follows:
   – Interviewee A: Becker J 10-12-2010 Former Mayor, Pforzheim
   – Interviewee B: Enderes B 10-12-2010 Director Personnel Department, Pforzheim
   – Interviewee C: Hermesmeier A 08-12-2010 Director Legal Department, Pforzheim
   – Interviewee D: Schüssler S 06-12-2010 Leader Green Party, Pforzheim
   – Interviewee E: Anonymous 13-12-2010 Former Treasury Employee, Pforzheim

   All interviews were conducted in German. Translation of these and other German-language text cited in this paper is by the authors.

6. Deutsche Bank started to bet against US subprime mortgages as early as 4 November 2005 (Lewis 2010). In other words, the very moment Deutsche Bank realised subprime mortgages were going to trigger turbulence coincides with the dramatic losses incurred on the swaps held by Pforzheim.

7. Adding another layer of complexity, modern derivatives are increasingly *atomised*, ‘combining futures, options, and swaps in innovative ways with respect to the underlier’ (LiPuma and Lee 2004, 36). The swaps of JPMorgan, labelled ‘finance’ swaps by our interviewees, are better known as *structured notes*, blending a variety of underlying derivatives (e.g. futures) into a complex, tailor-made and typically leveraged financial product.

8. There are a number of state institutions and legal orders of importance. First, there is the *Gemeindeprüfungsanstalt* (GPA) – a state institution that advises and oversees the legality of local administration in the state of Baden-Württemberg (www.gpabw.de; accessed 15 October 2012) – whose conduct is guided by the *Gemeindeordnung* [local government order] (Interviewee B, 2010) (www.landesrecht-bw.de; accessed 15 October 2012). The local government order prescribes a *Spekulationsverbot* [speculation prohibition] for local government. However, as ‘explicit legal
authorization for the use of financial derivatives is not included in the local-government order’ (Enderes 2010, 5), a Derivateerlass [derivatives exemption] was written in 1998 to provide additional clarity. Yet this clause equally does not provide a clear definition on derivatives, nor does it explicitly spell out an exemption for particular products. Having said this, deals generally regarded sound are products related to interest rates on concrete credit facilities, whereby interest rate risk is not yet hedged, provided that the nominal amount relevant to the deal equals the concrete credit facility. In other words, ‘the basis for derivatives deals ought to be an existing, concrete credit facility’ based on the Prinzip der Konnexität [connectivity principle] (Enderes 2010, 6). As noted in the main text, given one’s definition of hedging, these rules can be interpreted differently.

In the documentary Die Welt des Josef Ackermann [The world of Josef Ackermann] (http://www.youtube.com/watch?v=qMyYNtILJuI&feature=related; Accessed 15 October 2012), Pforzheim features as an example. Former Deutsche Bank CEO Ackermann notes that treasurers should not be that naive in their expectations when signing interest-rate swaps. However, in Pforzheim there are many who note that Deutsche Bank left the city in the dark. City officials might have been naive, but Deutsche Bank equally failed to fully disclose the potential risks involved. It might be said that the seductiveness of the deal rested on a frequent feature of derivatives. In the words of a landmark expose:

‘Beautiful lies’ are the lies that we like to believe; we know they are not true but everything makes us want to believe them – that is what makes them beautiful. The derivatives business is filled with them. (Das 2010, 53)

More generally, Satyajit Das notes, derivatives have always been about knowledge – people who knew, people who didn’t. If you didn’t know then somewhere along the line you would pay school fees to learn about the other side of derivatives (2010, 33).

In turn, contract and trust-based arguments are tied up with a wider variety in legal systems, whose role in varieties of capitalism and pathways to financialisation merit further research (for a pointer on the German case see Morgan and Quack 2010; Reyes and Vermeulen 2011).

Indeed, there are intriguing historical parallels with the way that firms and governments embedded in a different mode of production (state-socialism) in the Eastern bloc borrowed from the West in the 1970s, with momentous consequences for governments in Poland, Hungary and Yugoslavia and ultimately for the stability of the state socialist regimes (Kotkin 2010), whose subsequent post-socialist transitions have been determined by the uneven interactions of the socialist legacy with neoliberal capitalism (Drahokoupil 2009; Smith and Swain 2010; Stark 1996). Likewise China’s integration into the global commodity and financial systems since the 1970s has been mediated through the interactions of zones, cities, states and varieties of state-socialism and capitalism producing checker-boards of uneven development in China (Ong 2004) and feeding into their reproduction elsewhere (Peck and Zhang 2013).
REFERENCES

AAHBER S 2009 Geographies of the financial crisis Area 41 34–42

AKERLOF GA 1970 The market for ‘lemons’: quality uncertainty and the market mechanism The Quarterly Journal of Economics 84 488–500

AMABLE B 2003 The diversity of modern capitalism Oxford University Press, Oxford

ARRIGHI G 1994 The long twentieth century: money, power and the origins of our times Verso, London

BALDASSARE M 1998 When government fails: the Orange County bankruptcy University of California Press, Berkeley CA

BATHET H AND GERTLER M 2005 The German variety of capitalism: forces and dynamics of evolutionary change Economic Geography 81 1–9

BENNETT A AND GEORGE A L 2005 Case studies and theory development in the social sciences MIT Press, Cambridge MA

BRENNER N, PECK J AND THEODORE N 2010 Variegated neoliberalization: geographies, modalities, pathways Global Networks 10 182–222


BLACKBURN R 2008 The subprime crisis New Left Review 50 63–106

CHAN CS 2012 Culture, state and varieties of capitalism: a comparative study of life insurance markets in Hong Kong and Taiwan The British Journal of Sociology 63 97–122

CLARK GL 2011 Myopia and the global financial crisis: context-specific reasoning, market structure, and institutional governance Dialogues in Human Geography 1 4–25


CLARK GL, MANSFIELD D AND TICKELL A 2002 Global finance and the German model: German corporations, market incentives, and the management of employer-sponsored pension institutions Transactions of the Institute of British Geographers 27 91–110


CROUCH C 2005 Capitalist diversity and change, recombinant governance and institutional entrepreneurs Oxford University Press, Oxford

DAS S 2010 Traders, guns & money, knowns and unknowns in the dazzling world of derivatives rev edn Pearson Education Limited, Harlow
Deutscher Bundestag 2010 Antwort der Bundesregierung auf Drucksache 17/2573, Spekulative Derivatengegeschäfte von Kommunen Drucksache 17/2683 27 July

Die Tageszeitung 2010 Über die Wupper 10 May (www.taz.de/1/politik/schwerpunkt-nrw/artikel/1/ueber-die-wupper/) Accessed 27 December 2010


Dodd R 2010 Municipal Bombs Finance & Development 47 33–5

Drahokoupil J 2009 After transition: varieties of politicaeconomic development in Eastern Europe and the Former Soviet Union Comparative European Politics 7 279–98


Engelen E and Faulconbridge J 2009 Introduction: financial geographies – the credit crisis as an opportunity to catch economic geography’s next boat? Journal of Economic Geography 9 587–95


Engelen E, Konings M and Fernandez R 2010 Geographies of financialization in disarray: the Dutch case in comparative perspective Economic Geography 86 53–73


Hall P A and Soskice D eds 2001 *Varieties of capitalism, the institutional foundations of comparative advantage* Oxford University Press, Oxford


Harvey D 2011 Roepke lecture in economic geography – crises, geographical disruptions and the uneven development of political responses *Economic Geography* 87 1–22

Heller M 2007 Das Produkt ist für niemanden beherrschbar *Stuttgarter Zeitung* 4 August 13


Holger P 2008 Schlechte Noten für der Deutschen Bank *Stuttgarter Zeitung* 1 April 11


Jaschinski S 2011 *Das Deutsche Finanzsystem, Achillesferse der Wirtschaft?* Schäffer Poeschel Verlag, Stuttgart


Katz A 2010 The city that got swapped *Bloomberg BusinessWeek* 22 April (http://www.businessweek.com/magazine/content/10_18/b4176100989666.htm)
Accessed 30 November 2010

Kelly PF 2001 Metaphors of meltdown: political representations of economic space in the Asian financial crisis *Environment and Planning D: Society and Space* 19 719–42


Koch-Widmann A 2009 OB Hager last verlustreiche Zinsgeschäfte prüfen *Stuttgarter Zeitung* 8 October 28


Krahnen J P and Schmidt R H 2004 *The German financial system* Oxford University Press, Oxford


Lewis M 2010 *The big short* W. W. Norton & Company, New York


Marazzi C 2011 *The violence of financial capitalism* Semiotext(e), Los Angeles CA

Martin R 2011 The local geographies of the financial crisis: from the housing bubble to economic recession and beyond *Journal of Economic Geography* 11 587–618


O’Connor J 1973 The fiscal crisis of the state St Martin’s Press, New York


Pijl K van der 1984 The making of an Atlantic ruling class Verso, London
– 1998 Transnational classes and international relations Routledge, London


Polanyi K 1957 [1944] The great transformation: the political and economic origins of our time Beacon Press, Boston MA

Reichard C 2003 Local public management reforms in Germany Public Administration 81 345–63


Schmalacker-Wyrich E 1980 Pforzheim 23. Februar 1945: Der Untergang Einer Stadt Verlag J. Esslinger, Pforzheim


Smith A and Swain A 2010 The global economic crisis, Eastern Europe and the former Soviet Union: models of development and the contradictions of internationalization Eurasian Geography and Economics 51 1–34

Sorkin A R 2009 Too big to fail: inside the battle to save Wall Street Allen Lane, London


Stark D 1996 Recombinant property in East European capitalism American Journal of Sociology 101 993–1027


Streeck W 2010 Re-forming capitalism, institutional change in the German political economy Oxford University Press, Oxford


Tett G 2009 Fool’s gold Abacus, London
**THE ECONOMIST** 2008 Snakes and ladders: how careful should a bank be about what it sells to its clients? 21 February (http://www.economist.com/node/10734386) Accessed 30 November 2010

**Weber R and Häuser I eds** 2008 *Baden-Württemberg: a portrait of the German Southwest* Landeszenträle für politische Bildung Baden-Württemberg, Stuttgart


**Wollmann H** 2000 Local government modernization in Germany: between incrementalism and reform waves *Public Administration* 78 915–36

**Wyly E, Moos M, Hammel D and Kabahizi E** 2009 Cartographies of race and class: mapping the class-monopoly rents of American subprime mortgage capital *International Journal of Urban and Regional Research* 33 332–54
ABSTRACT

The evolution of Germany’s heterogeneous financial system is a widely debated topic. Recombining insights from the literatures on comparative political economy and financialization, this article explores the financial travails of Germany’s largest public-sector bank: Landesbank Baden-Württemberg (LBBW). Despite being the leading banker of small- and medium-sized enterprises (SMEs) in a region known for its cultural thrift, LBBW delved into a range of risky market-based practices prior to the financial crisis. Although numerous activities and dynamics indicative of conjunctural financialization have been wound down since, today LBBW continues to hold a large fraction of its assets for trading purposes, and continues to offer complex financing solutions to its regional SME clients. It is therefore argued that LBBW has not simply returned to its traditional banking model since the financial crisis, but has embraced a strategy of structural financialization – attuning market-based financial products and techniques to a regional bank-based economic context.
INTRODUCTION

The geographical spread of a localized problem related to US mortgages – morphing into a full-blown crisis of transatlantic magnitude – surprised many. Amongst others, it turned out that many scholars had simply missed out on a range of institutional and operational changes having transformed the financial systems of continental Europe. In the literature on comparative political economy (CPE), for example, it was typically assumed that German banks operated fundamentally different business models, considered better shielded from financial market pressures and shocks, as compared to their American counterparts. Likewise, the literature on financialization had largely missed out on the fact that the rising dominance of financial markets, products and techniques had spread well beyond its Anglo-American heartland. Yet even after the $700 billion bailout of Wall Street in September 2008, German finance minister Peer Steinbrück argued that similar interventions were not necessary in Germany – the crisis was an exclusive American affair (Benoit, 2008).

Combining insights from the CPE and financialization literatures, this article explores the financial travails of Germany’s largest public-sector bank: Landesbank Baden-Württemberg (LBBW). The exploration is guided by a set of expectations suggesting that state-owned LBBW should have been relatively well shielded from the forces of financialization. Yet despite being the leading banker of small- and medium-sized enterprises (SMEs) in a region known for its cultural thrift, LBBW delved into a range of risky market-based practices prior to the financial crisis. Although many of these activities have been wound down since, LBBW continues to hold a large fraction of assets for trading purposes, and continues to offer securitization solutions to its SME clients. It is therefore argued that LBBW has not simply returned to its traditional banking model, but instead is attuning market-based financial products and techniques to a regional bank-based economic context.

METHODOLOGY AND STRUCTURE

The research strategy employed in this article is the least likely case study, which “on all dimensions except the dimension of theoretical interest, is predicted not to achieve a certain outcome, yet does so” (Gerring, 2007, p. 115). The dimension of theoretical interest, or outcome variable, is LBBW’s exposure to financial market pressures, and its embrace of financial products and techniques – in short, financialization. Meanwhile, a range of theoretical
inputs, or independent variables, suggest that LBBW ought to be relatively well shielded from the forces of financialization. The method of *process tracing* has been applied to draw out key moments shaping the bank’s travails (George and Bennett, 2005). Next to popular and academic texts underlying the expectations guiding the investigation, the backbone of this article is based on financial and local media accounts, annual reports and policy documents. Furthermore, twenty semi-structured interviews have been pursued with LBBW employees and its public owners. Notwithstanding the exceptions, most targeted informants did not agree to an interview, confirming one interviewee’s remark that LBBW resembles a ‘black box’. As such, the empirics presented are largely drawn from publicly available information dispersed by LBBW, its owners and financial analysts. This has not been an easy task, since LBBW is the product of ongoing mergers, each year seeing new subsidiaries added to its accounts. In addition, accounting rules and disclosure standards are constantly subject to change, whilst key activities under investigation occurred off-balance sheet, and hence out of sight.

Despite these limitations, this paper dissects the financialization trajectory of LBBW accordingly: the next section details a literature review, discussing the concept financialization in light of the CPE literature. This review does not offer a complete engagement with both literatures, but merely highlights those perspectives, dimensions, processes and outcomes relevant to the case at hand. To this end, the literatures detailing the features of the German financial system and evaluating the extent of its (non-) financialization are equally discussed. Consequently, by zooming in on the state of Baden-Württemberg, including the genesis of LBBW, key premises of these literatures are further specified for the case at hand, culminating into a set of expectations guiding the case study. The third and main section of this article features the case study: first, this section highlights those financial activities and dynamics classified as *conjunctural financialization*, having largely been reversed since the financial crisis. Subsequently, a number of ongoing financial developments – not wound down since the crisis – suggest that LBBW is equally subject to *structural financialization*. By means of a conclusion, these findings are evaluated in light of the foregrounded expectations, leading to a modification of the some of the main perspectives and premises of the CPE and financialization literatures.
**VARIETIES OF FINANCIALIZATION**

The postwar welfare state is often described as a piggy bank, socializing an array of risks within the national territory. In this setting, different states pursued diverse ends. These are central to CPE scholars who study the configuration of national political economies along a range of institutional domains, jointly reproducing a set of complementarities allowing domestic firms to develop their core competencies. The paradigmatic firm-based approach, coming under the rubric of the varieties of capitalism school, groups national economies along two *ideal types*: coordinated-market economies (CMEs), with Germany as model case, and liberal-market economies (LMEs), with the US and UK as archetypes (see Hall and Soskice, 2001).

The associated financial systems are respectively known as bank- and market-based systems. Although more distinct features can be discerned, a key difference is that bank-based systems are characterized by ‘patient capital’ based on close (long-term) relationships between borrower and lender, whilst market-based systems are characterized by ‘footloose capital’ based on (short-term) arm’s length transactions (Allen and Gale, 2000). As integrated institutional structures, these ideal type financial systems traditionally come with distinct corporate governance models (stakeholder vs. shareholder orientated); ownership structures (concentrated vs. dispersed), legal operating systems (civil vs. common law), and accounting rules (less or more disclosure) (see Krahnen and Schmidt, 2004a). As will be discussed in more detail, it should be noted that ongoing financial integration has blurred this neat two-way depiction. Specifically, shifts from interest-based “originate and hold” banking models to fee-based “originate and distribute” strategies (Konings, 2008), and the associated cultural turn from “men who hate to lose” to “men who love to win” (Dunbar, 2011, pp. xi-xii), suggest that financial dynamics are converging along the market-based lines typical of Anglo-American economies. It is argued that these developments are conducive to— if not indicative of financialization (Engelen and Konings, 2010).

Although referring to innumerable processes and outcomes, financialization is commonly viewed as “the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies” (Epstein, 2005, p. 3; see Erturk *et al.*, 2008). Equally unspecified but helpful, financialization is equated with “the increased trading of risk” (Hardie and Howarth, 2009, p. 1017), or an increased focus on “risk management” (Martin *et al.*, 2008, p. 128). Specific indicators of financialization relevant to this case study include an increasing reliance of market funding and valuations; asset transformation into tradable securities, known as securitization; a related move away from traditional bank lending
to proprietary trading, and generally taking on “a more active role in complex financial constructions” (Engelen et al., 2010, p. 56; see Langley, 2004). Furthermore, corporate governance changes aiming to generate shareholder value, typically requiring more information disclosure to outside investors, are indicative of enabling financialization (Froud et al., 2000).

Both literatures are subject to substantial spatial criticism. First, the two-way depiction of capitalist variety has been criticized for its methodological nationalism and a relative neglect of finance (e.g. Engelen et al., 2010; Peck and Theodore, 2007). As a result, alternative CPE theories have come to offer more ideal types, some of which better attuned to capture financial complexities (e.g. Amable, 2003). Furthermore, there exist regional and sectoral models, shaped by subnational institutions “that differ from and may even ‘defy’ the overall national architecture” (Crouch et al., 2009, p. 655). Besides subnational models, on the fluid side of the CPE spectrum scholars speak of “recombinant capitalism” (Crouch, 2005) – signifying a blend of ideal types – whilst others simply stress the commonalities (Streeck, 2009). Concerning financial commonalities, Hardie et al. (2013, p. 694) argue that the paradigmatic bank-based approach suffers from an outdated “static conception of bank lending” in which banks are viewed relatively resistant to market pressures due to their reliance on customer deposits. Taking into account the aforesaid changes in cross-border finance, these scholars argue that a new type of banking model has emerged: a “market-based banking model” along which banks “have increasingly turned themselves into market intermediaries” (ibid.: 697, 700).

Likewise, although it is “increasingly difficult to understand financial change without paying ample attention to the often quite distinctive institutional specificities at the very heart of financialization processes” (Engelen and Konings, 2010, p. 609), the financialization literature equally reveals little attention to spatial diversity. As the literature focuses “primarily on Anglo-American economies”, it simply remains “too generic when it comes to the particularities of processes of financialization elsewhere” (Engelen et al., 2010, p. 57). As such, a combination of the CPE and financialization literatures is helpful to discern “different paths or trajectories of financialization” (Engelen and Konings, 2010, p. 617). Having set out the relevant tenets of the two literatures, the next section zooms in on Germany.

**GERMAN FINANCE TRANSFORMED?**

In line with the premises of the CPE literature, Germany’s “bank dominated” financial system typically comes with an “insider-control system of corporate governance” (Schmidt and Tyrell, 2004, p. 57). This universal banking
system is categorized along a “three-pillar model” consisting of commercial banks, (mutual) cooperative banks and public sector banks (Hardach, 2008, p. 13). Alternatively, the German financial system can be split into deposit and credit banks. Along this axis, the locally operating cooperatives and public Sparkassen [savings banks] dominate deposit taking, attracting two-thirds of savings. On the credit side, cooperatives and public sector banks typically finance Mittelstand firms [SMEs], whereas Germany’s multinational firms represent the domain of the Landesbanks and, above all, Germany’s large commercial banks (Jaschinski, 2011, pp. 71-72).

Public sector banks account for roughly half of Germany’s banking assets. The geography of the local Sparkassen, regional Landesbanks and their national associations mirrors the scaled setup of the decentralized German territory. In this setting, municipalities own the Sparkassen, whereas the overarching Landesbanks are co-owned by the federal Länder [states] and regional Sparkassen associations, hence not the federation (Poullain, 1972). Where the activities of the Sparkassen are tied to deposit taking and lending, there exists no single Landesbank business model as, to cite one example, regulatory stipulations vary substantially between Germany’s federal states (Engels, 2010, p. 16). Nonetheless, there are similarities: first, Landesbanks act as central banks for the Sparkassen within their regional territories. Second, Landesbanks act as state or communal banks. Third, Landesbanks increasingly operate like commercial banks, offering a full spectrum of services whilst increasingly trading on their own account (ibid.: 17-21). In other words, Landesbanks increasingly operate in a twilight zone between Marktsteuerung und Marktwirtschaft [market coordination and market economy] (Engels, 2010).

Numerous scholars have discussed the (non-) financialization of the German financial system, oscillating between divergence and convergence (e.g. Dixon, 2010; Engelen and Konings, 2010). Having said this, Hardie and Howarth identify a “transformation” due to financialization, not necessarily of the financial system but rather within German banks (2009, pp. 1017, 1034). This is underscored by Konings (2008) who argues that scholars need to be careful to equate the market-based practices adopted by German banks with the institutional convergence of its financial system. Added up, Krahnen and Schmidt note that the current status of German finance is “an extremely complex topic” and identify three stylized positions: markets only, banks-or-markets and the banks-and-markets perspective. Although refraining from taking a position, the scholars see prospects for an efficient banks-and-markets financial system developing between the poles (2004, p. 497-513). This roughly corresponds with Hardie et al. (2013), who argue that banks increasingly rely on market funding and valuations, resulting in market-based banking models.
BANKING IN BADEN-WÜRTTEMBERG

As indicated, national CPE models can obscure substantial diversity within national political economies. This is particularly true for the decentralized Germany, where Länder governments, not least through their co-ownership of the Landesbanks, enjoy ample leeway in steering regional economic development (Deeg, 1992; Herrigel, 1996). The economy of Baden-Württemberg proves a case in point.

“Globalization and the strong economic interconnectedness within the EU has led the economy of Baden-Württemberg, to a large extent, to focus on exports” (interview with Rülke, 8 December 2010)

The state of Baden-Württemberg houses Germany’s oldest Sparkasse, founded in 1749 in the town of Salem close to Lake Constance, also nicknamed the Swabian Sea. Besides offering a save opportunity to deposit earnings, in both the Grand Duchy of Baden and the Kingdom of Württemberg these institutions performed explicit communal and social functions (Boelcke, 2010). After the Second World War allied forces occupied southwestern Germany, crafting several states, merging into Baden-Württemberg in 1952. With public sector banks tied to their respective territories, the new state operated two regional giro banks (Landesbank precursors) and two regional savings bank associations (Deeg, 1992, p. 346). However, it took two decades before these banks began to consider consolidation, leading to the genesis of LBBW.

Together with adjacent Bavaria and Hessen, the state of Baden-Württemberg is one of Germany’s most affluent regions. Large firms are located in the Stuttgart area, the state capital, particularly automotive firms – Daimler AG, Porsche AG and the world’s leading automotive supplier Bosch GmbH. Bygone relations between Daimler and Deutsche Bank are exemplar of Germany’s national cross-holdings system between large banks and firms (Beyer, 2003), strongly speaking to the archetypal bank-based model depicted in the CPE literature. Yet in Baden-Württemberg such arrangements have always been an exception:

“Strong vertically organized production such as is typical of North-Rhine-Westphalia is rare in Baden-Württemberg. Large firms in this latter region are comparatively decentralized, relying on extensive networks of long-term subcontracting arrangements with local Mittelstand suppliers” (Deeg, 1992, p. 329, also see Streeck, 1989)
Besides many automotive suppliers, the region houses innumerable industrial machinery engineers and manufacturers. As a result, “reflecting the organization of production, the banking sector in Baden and Württemberg was dominated by a large number of widely dispersed savings and cooperative banks” lending to SME firms. Jointly, during the 1980s these banks held a whopping eighty percent market share in bank lending in the region (Deeg, 1992, pp. 334, 376). Offering vocational training and subsidies focused on technical modernization and innovation, the state of Baden-Württemberg has traditionally played a pivotal role in harnessing the Mittelstand. The 1970s triggered the idea among state politicians that a large bank in the image of Nordrhein-Westfalen’s WestLB was key to control regional economic development. At that time, Baden-Württemberg was the only state without a Landesbank.

Following decades of inertia and political hostilities against the creation of large bank, the late 1980s saw the birth of Sparkassenverband Baden-Württemberg – a public savings association headed by the Südwestdeutschen Landesbank (SüdwestLB), itself the product of two giro banks. What followed was a wave of mergers between the state’s dispersed public sector banks (Boelcke, 2010). The result was the birth of LBBW in 1999, through the merger of SüdwestLB, the Landesgirokasse and the commercial activities of Landeskreditbank Baden-Württemberg. This “vertical merger” was a novelty amongst Germany’s Landesbanks, as a substantial number of local retail branches were fully integrated into the regional Landesbank (LBBW, 2014a), making the institution less dependent on market funding through its relatively large deposit base. Today, the largest shareholders of LBBW are the state of Baden-Württemberg, the regional association of Sparkassen and the city of Stuttgart (Schrooten, 2010). Ownership figures have marginally altered since 1999.

**EXPECTATIONS**

Before delving into the actual case study, this section details the expectations guiding the investigation. First, derived from a reading of the CPE literature, it is expected that Germany’s bank-based financial system remains less conductive to financialization as compared to market-based systems. Second, within this setting it is expected that public-sector banks with specific state functions are better shielded from market pressures than Germany’s commercial banks. Third, as Mittelstand firms financed by cooperatives and public savings banks dominate the economy of Baden-Württemberg, it is expected that this small firm/bank constellation is less prone to financialization as compared to the national constellation of large firms/banks as
depicted in the CPE literature. Alternatively, given LBBW’s access to a relatively large deposit base, it is expected that LBBW is less prone to market pressures. Lastly, it is expected that both the bank’s and the wider region’s cultural thrift and risk averseness will hamper the financialization of LBBW.

It should be noted that much ink has been spilled on German banks inflating the US subprime housing bubble. As summed up in the wide-read accounts of Michael Lewis, “when you asked a smart Wall Street subprime mortgage bond trader circa June 2007 who was still buying this crap, he could say, simply, “Stupid Germans in Düsseldorf”” (2011, p. 154). Crucially, LBBW has typically been seen as the mirror image of banks in North Rhine-Westphalia: where the latter banks are portrayed as reckless, LBBW is traditionally viewed risk averse – a cultural trait typical for the Swabian heartland of Baden-Württemberg. As noted by a bond rating firm, “LBBW has historically shown a conservative appetite for risks” (DBRS, 2006, p. 2). In fact, in German politics the image of the ‘Swabian housewife’ is often invoked to emphasize financial prudence. Take the rhetoric of German Chancellor Angela Merkel, who visited Stuttgart late 2008 on an election campaign, lambasting the recklessness of banks having brought the global economy to a standstill:

“As we are in Stuttgart, you should ask a Swabian housewife … She would give us some short and correct advice, which would be this: ‘You cannot live beyond your means in the long run.’”
(Merkel quoted in Lynn, 2011, p. 75)

Such apparent regional varieties in financial risk appetites suggest that not every financial institution in Germany encountered seismic losses from risky deals. In turn, this would imply that processes of financialization have unfolded unevenly across Germany’s financial landscape. As such, it is expected that the following case study of LBBW should, for the foretold reasons, serve as a case in point.

**EXPLORING THE FINANCIALIZATION OF LBBW**

This section details the financialization trajectory of LBBW. To better explore and explain the various processes indicative of financialization at work, this section is split in two parts: the first part sets out an account of LBBW’s activities indicative of *conjunctural financialization*, as these activities and dynamics have been wound down or reversed since the outbreak
of the financial crisis. Crucially, however, these endeavours did not emerge out of nowhere. On the contrary, they grew out of more fundamental changes in both the German financial system as well as international financial intermediation. To this end, part two details an account of LBBW’s activities indicative of structural financialization. In contrast to LBBW’s conjunctural adventures, these activities preceded the immediate years before the crisis, and continue today. It should be stressed that LBBW’s market-based activities have traditionally been a minor component of its total operations: LBBW’s core activity remains Mittelstand banking, conducted though its subsidiary banks. Nonetheless, even these traditional banking activities are subject to change.

**CONJUNCTURAL FINANCIALIZATION**

Where the origins of German public finance can be traced back to the Swabian Sea, the modern adventures of LBBW also begin with a reference to Lake Constance demarcating the borders of Baden-Württemberg and Bavaria; Austria and Germany, as well as the European Union (EU) and Switzerland. Legally, the lake is an oddity – a ‘no man’s land’ – since the surrounding states cannot demarcate their exact borders. In the early 2000s LBBW set up an offshore financial network to navigate the waves of global finance. Like the actual lake, this infrastructure also resembled a no man’s land, as assets and liabilities transferred to this network vanished from the bank’s balance sheet. In this regard, the name for this program was fitting:

“Moody’s Investors Service has assigned a Prime-1 rating to the asset-backed commercial paper (ABCP) issued by Lake Constance Funding Limited under a newly established, partially supported, credit arbitrage ABCP program sponsored by Landesbank Baden-Württemberg, London Branch (LBBW). Lake Constance will use the proceeds from the sale of ABCP to invest in a portfolio of highly-rated asset-backed securities” (Moody’s, 2002)

The *Lake Constance Funding* program was comprised a network of special purpose vehicles (SPVs) domiciled in offshore jurisdictions (see Palan *et al.*, 2010) outside Germany. Two funding entities – one registered in Jersey, Channel Islands (UK), another registered in Delaware, US³ – financed other SPVs by issuing short-term ABCP. These other SPVs, in turn, used these funds to invest in long-term asset-backed securities (ABS) (LBBW, 2009a, p. 16). This credit arbitrage network capitalized on “the higher yield
typically paid on asset backed securities as compared with the yield on commercial paper” and brought “regulatory off-balance sheet treatment for the sponsoring bank” (Moody’s, 2002), enabling the bank to increase its leverage and boost returns. In 2004 most of the ABS products locked up in LBBW’s credit arbitrage network were collateralized debt obligations (CDOs) “carrying US credit risk” i.e. exposure to the American mortgage market. These products were typically bought from investment banks such as Deutsche Bank and Goldman Sachs:

“In the current year, LBBW again intends to concentrate largely on AAA-rated securities, an approach that has proved to be successful to date. The aim of active and timely risk management is to anticipate pending credit rating downgrades in good time and, if necessary, to sell the securities in question before share prices plummet” (LBBW, 2005, p. 127)\(^4\)

In 2005 little suggested that trouble was looming in the brave new world of credit arbitrage. As financial newspaper Börsen Zeitung noted, “the European credit market presents itself in an astonishing stable shape these days” (Johansen, 2005, p. 18). Meanwhile, LBBW’s balance sheet ballooned above €400 billion following takeovers of Landesbank Rheinland-Pfalz (LRP) and Baden-Württembergische Bank (BW Bank), the latter enlarging LBBW’s retail network and deposit base (LBBW, 2006). Nonetheless, LBBW’s dependence on market-based funding for its credit arbitrage activities rapidly expanded. Interestingly, the 2005 and 2006 annual reports no longer elaborated upon the composition of the securitization portfolio (LBBW, 2006; 2007). The absence of information underscores why these off-balance sheet activities have become known as shadow banking (McCulley, 2007) – these activities simply moved under the radar. However, this all changed during the course of 2007:

“After satisfactory earnings in the first six months of 2007, the tensions on capital markets worldwide changed [...] I am confident that these price fluctuations will again turn in the LBBW Group’s favour when the situation on financial markets returns to normal” (Jaschinski quoted in LBBW, 2008, pp. 4-5)

The year 2007 proved a two-faced episode. In a mere couple of weeks, seemingly calculable financial risks had transformed themselves into a wall of uncertainty following the collapse of the US housing market. To some, the correction was overdue (see Lewis, 2010), but for most investors it was as if they had been struck by lightning. Unfortunately, LBBW proved no
exception. As a result, where information on LBBW’s securitization portfolio had vanished from the annual reports, a range of three-letter acronyms suddenly reappeared in the 2007 accounts:

“[T]he effects of the financial market crisis mainly involved declines in the fair value of collateralized debt obligations (CDO), asset-backed securities (ABS), commercial mortgage-backed securities (CMBS), residential-mortgage backed securities (RMBS), and commercial papers” (LBBW, 2008, p. 69)

Since 2004 the value of LBBW’s securitization portfolio had doubled, rising to €18.1 billion. In addition, the credit default swap (CDS) portfolio to hedge LBBW’s ballooning credit risks had swelled to a nominal value of €90 billion (LBBW, 2008, p. 212). However, the fair value of these portfolios could no longer be determined as market prices were no longer available (LBBW, 2008, p. 146). Subsequently, LBBW’s credit arbitrage network – kept out of public scrutiny in 2005/06 – was brought back into the light of day, seeing seven SPVs consolidated in the annual accounts (LBBW, 2008, pp. 69, 144, 217).

LBBW was by no means the only German bank troubled by its ABS investments. In fact, problems were relatively minor. Two German banks were particularly hit hard: Deutsche Industriebank (IKB) in Düsseldorf and Landesbank Sachsen (SachsenLB) in Dresden. Similar to LBBW, these institutions faced a ‘maturity mismatch’ through holding long-term (and now impossible to price) securities whilst funding these with short-term commercial paper. As the quality of the former was in doubt investors shunned from buying the latter, forcing these institutions to purchase their own commercial paper. It proved ruinous for IKB and SachsenLB. The story of SachsenLB is particularly relevant, as East Germany’s sole Landesbank became the latest jewel in the crown of LBBW in the summer of 2007. SachsenLB provided new opportunities in the state of Saxony, and was seen as a jumping board for further eastward expansion (LBBW, 2008, 5). Although SachsenLB had been unable to fund its Dublin-based SPVs, LBBW CEO Jaschinski did not foresee further “risks of losses”. German media spoke with admiration of Jaschinski, calmly navigating his bank through market turbulence (Schwab et al., 2007). The confident CEO even looked into other options, including a merger with LBBW’s Düsseldorf-based archrival WestLB (Spiegel Online, 2007).

The year 2008 was one of records. LBBW’s balance sheet had swelled to an all-time high of €448 billion; the nominal value of its CDS portfolio stood at a record €102 billion, and its securitization portfolio had swelled to €29.7 billion (LBBW, 2009, pp. 158, 234; 2009a. pp. 4-5). To a large
extent, the latter’s increase was due to the SachsenLB takeover – rebranded Sachsen Bank in April 2008 (see Moody’s, 2009). Crucially, the largest chunk of the SachsenLB securitization portfolio was kept off-balance, locked up in a new Irish SPV – *Sealink Funding* – of which “a guarantee issued by the Free State of Saxony totaling EUR 2.75 billion bears the first loss” (LBBW, 2009a, p. 7). As another record, that year 23 SPVs were consolidated in the annual accounts (LBBW, 2009a, p. 4). The financial end result proved gruesome:

“[I]t was not only the group’s total securitizations, which stood at €29.7 billion at the end of 2008 … that were affected by the illiquidity and price erosion of structured financial assets, LBBW’s sizeable bond portfolios and CDS exposures were also hit by the financial market distortions, resulting in a large €2.48 billion operating loss” (Moody’s, 2009, pp. 4-5)

Interestingly, the bank’s operating loss would have been larger had the banking group not generated a positive result of €800 million via its classic bank-based activities, largely accumulated by LBBW’s subsidiary banks. Besides a minus of €1.1 billion of impairments and fair value losses on ABS trades and investments, CDS trading had produced fair value losses of €1.2 billion, and “contributed some three-quarters of the total €3.27 billion charged against the income statement” (Moody’s, 2009, p. 14). Few media pundits were aware of these losses. For example, late October 2008 the daily *Frankfurter Allgemeine Zeitung* still praised LBBW for being the best amongst its class, partly due to its conservative “Swabian mentality” having failed other *Landesbanks* (Soldt, 2008). However, ten days later reality hit home, with LBBW’s intention to seek a bailout out in the open (Soldt, 2008a).

The bailout of LBBW was based on two components. First, the bank’s public owners decided to support LBBW with a €5 billion ordinary share capital increase. Although a perplexed Peer Steinbrück had set up a €480 billion national rescue scheme to support Germany’s financial system (*Bundesgesetzblatt*, 2008), aid for LBBW was organized ‘in house’ by the state of Baden-Württemberg. According to state finance minister Willi Stächele, in so doing dividends would remain in Baden-Württemberg and, crucially, Berlin would not gain influence over LBBW (*Landtag von Baden-Württemberg*, 2008, 2008a; LBBW, 2009c). Second, the owners set up a risk shield – a €12.7 billion guarantee – to protect LBBW against further losses on its securitization portfolio. To do so, LBBW split its troubled securitization portfolio – as of mid-2009 valued at €27.6 billion – in two parts: the better half, valued at €12.3 billion, was not guaranteed by the state. The lesser half, valued at €15.3 billion, was guaranteed for €6.7 billion after a...
first-loss commitment by LBBW of €1.9 billion (LBBW, 2009b, pp. 4-5, 7). The remaining €6 billion guarantee aimed to release LBBW from the constant drain to refinance *Sealink Funding*. This too was a second loss guarantee, as the state of Saxony had guaranteed this vehicle for €2.75 billion (see Official Journal of the European Union, 2009; LBBW, 2009c).

Besides a multilevel range of German political actors involved, the European Commission also came in to see whether the bailout had not distorted competition. Although the Commission questioned the valuation methods used by LBBW, it approved the measures taken, provided LBBW enacted a set of rigorous changes: “LBBW will now focus its activities in financing German Mittelstand enterprises, away from risky investment activities” (Kroes quoted in European Commission, 2009). To do so, LBBW was ordered to “change its business model by focusing on its regional core banking businesses and reducing capital market activities and proprietary trading” (European Commission, 2009a).

“[B]alance sheet reductions will amount to about 40% compared to 2008 year-end figures. In addition, LBBW will implement a series of corporate governance changes with the aim of increasing corporate oversight and reducing the potential for undue influence on its day-to-day management. LBBW will – inter alia – change its current legal status to that of a joint stock corporation” (European Commission, 2009, emphasis original).

Although Baden-Württemberg politicians had already decided that the bank should part with its risky credit business, the Commission had nailed down the strategy for good. As noted in the Liikanen report on the reform on the European banking sector: “The restructuring implied that the LBs (Landesbanks, added) adjusted their business model back to being a regional service provider, which is actually closer to the original LB model” (Liikanen, 2012, p. 65). Although the bank has since then been caught up in the ongoing aftermath of the crisis – e.g. the euro crisis had a serious impact on its CDS positions and bond holdings (Jenkins and Stabe, 2011) – the subsequent years reveal that LBBW indeed reduced its capital market activities: the troubled securitization portfolio was written down, and the nominal volume of CDS contracts was equally reduced. In addition, LBBW was required to divest from some 70 holdings (Global Banking News, 2010), seeing many of its foreign offices closed down (e.g. McCaffrey, 2011). As a result, by 2015 the balance sheet total had indeed come down 40% compared to 2008 (LBBW, 2009, 2015). Furthermore, although the bank remains “an institution under public law” (LBBW, 2013, p. 16), some of the corporate governance arrangements, such as more information disclosure, were equally adapted
to the wishes of the Commission (LBBW, 2013, pp. 16-24; see LBBW, 2011). As noted by CEO Hans-Jörg Vetter, successor to Jaschinski who was ousted in the wake of the bailout: “[T]he process of restructuring … which we now have largely completed is being reflected in more stable earnings structures” (Vetter quoted in LBBW, 2013, p. 2). If anything, the bank had seemingly returned to normalcy.

**STRUCTURAL FINANCIALIZATION**

The story thus far suggests that LBBW has wound down its capital market adventures, returning to its business model of yesteryear i.e. lending to Mittelstand firms. This conclusion, however, would be a fallacy, for the overall financialization of LBBW has been a more structural phenomenon. For example, the bank remains more exposed to financial market swings: where the bank held 12.5% of assets for trading purposes in 2002, rising to in 30.9% in 2006, in 2011 LBBW still held more than 27% of its assets for trading (Hardie and Howarth, 2009, p. 1024; Liikanen, 2012, p. 124). On this indicator, LBBW remains substantially financialized as compared to the start of the 2000s: despite being a public sector bank, in 2011 it held more assets for trading than Germany’s Commerzbank (Liikanen, 2012, p. 124). In other words, where LBBW’s financialization trajectory had been halted on certain indicators, on others dimensions it does not pose a definite break. In fact, there are more telling indicators suggesting that LBBW’s operations have been subject to structural financialization.

Since the late 1990s, numerous changes have unfolded in all three pillars of the German financial system (Strüder, 2008, p. 8). With deposit taking dominated by cooperatives and Sparkassen, commercial banks started to press the federal government to strengthen market-based finance within Germany, leading to the modernization of Finanzplatz Deutschland (Vitols, 2004; Dixon, 2010). One initiative enabling banks to realign their operations was the abolition of capital gains tax on the sale of German industry stockholdings, seeing institutions like Deutsche Bank rapidly transforming itself from German Hausbank into a global financial services firm and investment bank (Beyer, 2003). Lawmakers actively encouraged these changes. As noted by a banker summoned to Berlin in the late 1990s: “We should get on with it, get into more risk, expand the derivatives and structured finance products, finally get modern” (quoted in Scally and Bittner, 2013).
been strongly resisted by *Land* governments” (Hardie and Howarth, 2009, p. 1020, emphasis original).

Under pressure from above and below – by deposit takings by the *Sparkassen* and cooperatives, and the credit business of the commercial banks – like many of its *Landesbank* peers LBBW decided to ‘get modern’ and delve into market-base finance. Crucially, however, the bank’s adventures into global capital markets actually preceded the immediate years prior to the crisis. For example, with the 1980s creation of one of the precursors of LBBW – SüdwestLB – the bank had already put a focus on global investment banking operations by opening offices in London and New York – one of the first indicators suggesting a structural shift from regional banking toward cross-border market-based finance. With the birth of LBBW in 1999, these activities continued. As noted by a former LBBW board member:

“Developments in investment banking have been shaped in the Anglo-American region. In America some eighty percent of business financing occurs via the capital market and just twenty percent via classic bank lending. In Germany this division is the other way around – for now” (Schreiner quoted in LBBW, 2000)

Another crucial development having a direct impact on Germany’s *Landesbanks* was the 2001 abolition of the *Anstaltlast* [deficiency guarantee] and *Gewährträgerhaftung* [maintenance guarantee], underwritten by the federal states. During the late 1990s commercial banks had filled a compliant with the European Commission: these guarantees provided the *Landesbanks* with low financing costs, which distorted competition (Dixon, 2010; Fischer et al., 2011). According to former CEO Jaschinski, investors saw little difference between bonds issued by the federation and those issued by the *Landesbanks*. As a result, the *Landesbanks* capitalized upon “the privilege of long-term and low-cost refinancing for their own credit business”, becoming the world’s “most important institutions for the allocation of long-term credit” (Jaschinski, 2011, p. 77). In anticipation of the abolition of the guarantees in 2005, the four-year transition period saw many *Landesbanks* issue large amounts of debt in anticipation of higher funding costs. Crucially, this period coincided with sluggish growth within Germany, with little demand for ‘real’ credit. As a result, numerous *Landesbanks* devised market-based strategies to put their borrowings to work. LBBW proved no exception. In fact, the massive purchases of toxic ABS products were a direct result of the cheap borrowing costs of the early 2000s. “The liquidity was bought when the state guarantee was still in place” (interview with Schlachter, 14 November 2011). Put differently, the conjunctural financialization of LBBW was a direct result
of LBBW being forced to deal with the future whip of the market with the end of the state guarantees in sight:

“It’s clear that with the elimination of state guarantees, institutions will be less and less like a classic German Landesbank, and instead be compared by the international financial markets with other European issuers” (Jaschinski quoted in LBBW, 2006, p. 4)

It was within this rapidly changing financial landscape that LBBW started its embrace of the capital market. As such, with the commencement of the Lake Constance Funding program in the early 2000s, LBBW did not merely start to purchase securitized financial products for credit arbitrage. On the contrary, besides ABS investments the bank equally started to arrange ABS transactions for its Mittelstand customers. For example, in 2004 numerous SPVs were added to the Lake Constance Funding program for arranging ABS transactions, specifically the securitization of trade- and interest receivables of regional SMEs, banks and leasing firms (LBBW, 2005, p. 69). In other words, where LBBW bought ABS products as an investor at the end of a long securitization chain, it equally started to securitize ABS products at the very beginning of the securitization chain, operating as an arranger. This was seen as a perfect strategy for the vertically integrated banking group:

“We are the somewhat different Landesbank: strong enough to embrace ambitious investment banking projects – yet because of the distinctiveness of our own retail branches and those of the Sparkassen we operate very close to the customer – and we remain customer-oriented after an agreed investment banking solution” (Schmidt quoted in LBBW, 2000)

Taking advantage of its unique setup, LBBW head office offered ABS solutions to SME clients via its local subsidiary banks. Amongst others, the bank marketed its so-called ABS Kompakt solutions by emphasizing their balance sheet reduction impact, leading to a higher equity ratio, which in turn resulted in better financing possibilities. Targeting SME clients with an annual turnover of €150 million, ABS Kompakt was marketed as “an instrument to finance a firm’s growth without a parallel rise in indebtedness” (Jaschinski and Schielke, 2003, p. 645). Like the SPVs issuing commercial paper to buy those toxic CDOs backed by US mortgages, SME customers who securitized their trade- and interest receivables also acquired anonymous access to the capital market by issuing commercial paper. In so doing, LBBW gradually moved away from “simple, classic corporate financing towards innovative financing instruments” (LBBW, 2006, p. 46). Having said this, the value of
the bank’s ABS investments far outpaced the value of the arranged securitizations.

Crucially, whereas LBBW’s investments in securitized products have been wound down since the crisis, the bank continues to arrange ABS transactions for its SME customers. In fact, in the wake of the crisis the bank marketed its ABS Kompakt solution as “an attractive off-balance sheet refinancing possibility” and a good alternative to avoid credit or liquidity squeezes (Zender and Chevalier, 2009). To this end, as the Lake Constance Funding program for ABS investments was wound down in 2010, a new commercial paper issuing entity was subsequently created in order to finance the SPVs that arranged ABS transactions for SME customers: Weinberg Capital (LBBW, 2010; Moody’s, 2010). Today, this program is alive and kicking, using the very offshore infrastructure which had brought about the bank’s financial troubles: in 2012 eighteen SPVs were not consolidated on the balance sheet – three of which were Weinberg entities domiciled in offshore Delaware, Dublin and Jersey (LBBW, 2013, p. 217). Although ABS Kompakt has been running flat since 2008, in 2013 the bank was exposed to transactions of €2.7 billion (LBBW, 2013a, p. 5).

“ABS financing is mainly available to large enterprises, and it is still an exception for it to be offered in its traditional form to small and medium-sized companies. In our role as a partner to these enterprises we have therefore developed a slim-line ABS solution especially for the SME market, ABS Compact” (LBBW, 2014)

Given these ongoing developments, to argue that Landesbanks like LBBW have “adjusted their business model back to being a regional service provider, which is actually closer to the original LB model” (Liikanen, 2012, p. 65) is only half the story: that is to say, if LBBW has moved back to its original banking model, it has also achieved this by moving back to the future.

CONCLUSION

This study of LBBW has revealed that Germany’s leading public sector bank has not been immune to the forces of financialization. Partly due to political decisions elsewhere, partly due to its own choices and desires, the bank has gradually been exposed to increasing market pressures, embracing a range of financial products and techniques that do not correspondent with the paradigmatic bank-based model as depicted in the CPE literature. Despite expectations suggesting otherwise, these findings suggest that Germany’s
financial system has incrementally become more conductive to market-based finance, particularly Germany’s credit institutions, which enjoy limited access to customer deposits. Next to Germany’s commercial banks, these also include the publicly owned Landesbanks. In other words, Germany’s traditional bank-based financial system has gradually financialized, partly transforming into a banks-and-markets financial system (Krahnen and Schmidt, 2004) or – alternatively – a market-based banking model (Hardie et al., 2013). Having said this, as Germany’s deposit-taking cooperatives and savings banks continue to operate on a traditional basis, the financialization of the German financial system primarily involved the credit institutions. Given this asymmetrical development, Germany is arguably best depicted as a case of compartmentalized financialization.

Concerning the CPE literature, not only does the archetypal bank-based model neglect a range of financial changes having unfolded since the 1990s, it also conceals substantial regional variety within the German political economy. Instead of large industrial firms being financed by equally large banks, Baden-Württemberg’s economy is characterized by a sizeable presence of SME firms, largely financed by dispersed local cooperative and savings banks. These findings suggest that scholars ought to scrutinize CPE typologies for any inherent methodological nationalism, especially when exploring financial dynamics in large, decentralized states such as Germany. Yet again, although it was expected that Baden-Württemberg’s regional constellation of small firms/banks was better shielded against financialization – an expectation augmented with the region’s cultural thrift – this study has revealed that even Germany’s Mittelstand firms are subject to more complex and risky market-based financing products and techniques. This is arguably the result of LBBW’s vertical structure, combining characteristics of both deposit taking and credit banks: through its ownership of local savings banks, LBBW has been able to sell securitized solutions to its SME customers.

Although many financial activities indicative of conjunctural financialization have been wound down since the crisis, LBBW has not simply returned to its business model of yesteryear. Instead, LBBW has embraced a strategy of structural financialization: first, despite having access to a relatively large deposit base, LBBW has become more dependent on market-based sources of funding. This development has been augmented by the abolition of the state guarantees, seeing the bank become more exposed to financial market discipline. Second, despite the crisis LBBW continues to hold a large percentage of assets for trading, resulting in a structural dependency on market valuations. Third, some of the corporate governance changes required by the European Commission, such as more information disclosure, suggest that LBBW is becoming more like its for-profit peers. Although the bank remains publicly owned, governed under public law, these changes
signal that LBBW might one day become a joint-stock company under private law, as requested by the Commission. These developments correspond with the more fluid side of the CPE spectrum – perspectives open to incremental change. The CPE literature should pay more attention to processes of convergence enacted above the national scale, without neglecting continued spatial diversity within national jurisdictions. Put differently, the quest for parsimony – often an unstated aim of CPE scholars – should not conceal empirical reality. Having said this, although scholars need to be careful to equate change within banks with change within financial systems, the market-based banking model (Hardie et al., 2013) does capture the structural financialization of LBBW.

The emergence of a new, recombinant banking model – built out the features of bank- and market-based financial systems – is also revealed in the ongoing effort to arrange securitized financing solutions for LBBW’s customer base, confirming a move away from traditional banking into more complex arrangements, suggesting of a novel blend of financial intermediation: on the one hand, the bank is creating liquid securities by securitizing trade- and interest receivables of its customers – a process indicative of market-based financial systems – whilst, on the other hand, this is achieved via LBBW’s long-term customer relations – the classic feature of bank-based financial systems. The difference between the bank’s securitized customer transactions and investments (backed by US mortgages) is significant. The bank’s securitized investments are an example of arm’s length transactions typical of market-based finance. LBBW had little clue about the quality of the underlying assets, and the bank paid a high price for its foolish investments. In contrast, although the securitized solutions offered to LBBW’s clients are manufactured via the same offshore shadow banking pipework that triggered the crisis, in this case LBBW does have a good understanding of the quality of the underlying assets due to its long-term customer relations. Crucially, this activity then does not correspond with the static bank- or market-based models as stipulated in CPE theory. Instead, what emerges is a hybrid form of financial intermediation, built out of the DNA and constitutive interaction of both ideal type models.

Although the value of LBBW’s securitized customer transactions represents a tiny part of its balance sheet, it aptly reveals the extent to which market-based practices have come to penetrate a regional institutional setting once regarded to be inhospitable to such practices. Furthermore, developments in the European Union (EU) – not least the looming realization of an integrated capital market union (CMU) (see European Commission, 2015) – suggest that the production of securitized financial products has not been a conjunctural affair. On the contrary, this suggests that the rise of market-based financial products and techniques has only just begun on the European
continent. These developments, in turn, reveal that not only the national state has a say in the institutional makeup of financial systems. In case of LBBW, next to the regional government of Baden-Württemberg, and Germany’s federal government, the European Commission also has a dominant say in the makeup of the bank. Given that the European upscaling of bank oversight and regulation has accelerated since the crisis, national CPE typologies might stand to lose additional explanatory value.

In similar fashion, the literature on financialization should recognize that the reach of financial markets – its actors, products, techniques and logics – have spread far beyond its Anglo-American heartland, increasingly penetrating the economies of continental Europe – including the German financial system; including its leading public sector bank. Despite its relative large deposit base; and despite the alleged cultural frugality of bank and region, LBBW has increasingly become dependent on market funding and valuations; resulting in a substantial financialization of its activities. Where the bank overplayed its hand, haplessly accumulating toxic securities, the bank has long securitized the income streams of its Mittelstand customers, and continues to do so. By hardwiring the pecuniary faith of regional firms with the global ebbs and flows of capital markets, LBBW has partly changed from being a classic banker into a financial market intermediary.

In order to catch up with reality, both the financialization and CPE literatures are in need of more empirical detail, as to fine-tune their main perspectives and premises, some of which appear hopelessly outdated. Only through careful examination can the extent of the financialization of a given institution or institutional setting really be explored. Within Germany, the financial picture is heterogeneous, fragmented and asymmetrical. Without doubt, instances of both (bank-based) divergence and (market-based) convergence can be found, depending on the object of study: which financial pillar(s) of Germany’s financial system are explored? Which institution(s) in which region(s)? And which processes are being foregrounded? The results might well differ from bank to bank, from region to region. For even in the Landesbank sector, the setup of LBBW is unique, leading to the genesis of unique financial services.

As was the case at the turn of the millennium, Germany’s Landesbanks remain in limbo. Out of the original pack of eight before the crisis, LBBW and Hessen’s Landesbank Helaba did relatively well, only because their Landesbank peers performed so poorly. Next to the absorption of SachsenLB into the LBBW network, LBBW’s arch nemesis – Düsseldorf-based WestLB – has been wound down in the wake of the crisis, providing opportunities for LBBW and Helaba to scoop up business in North-Rhine-Westphalia. However, even for the remaining Landesbanks – six as of writing – their future remains a big unknown (e.g. Hilgert et al., 2011). Although the
possible privatization of LBBW has been discussed in the state parliament of Baden-Württemberg (Die Grünen, 2010), this appears unrealistic for the foreseeable future. The long political game that has led to the birth of LBBW continues today, with many stakeholders voicing opposite preferences in shaping the future of the bank. This typifies German politics: change in the German political economy is slow (Streeck, 2009). Having said this, slow change is change nonetheless, and one thing seems certain: the bank will not return to its old ways.
NOTES

1. Two interviewees are cited in this text: Eugene Schlachter, leader of the Green party in Baden-Württemberg (interview conducted 14 November 2011), and Hans Ulrich Rühlke, leader of the liberal FDP party in Baden-Württemberg (interview conducted 8 December 2010). The author has conducted the translation of these interviews, in conjunction with other German texts.

2. In addition there is a fourth pillar of specialty banks (Hackenthal, 2004, pp. 85-86). These too have been hit hard by the crisis, with Hypo Real Estate leading the troubled pack (see Hendrikse, 2013).

3. For Lake Constance Funding Ltd registered in Jersey, see JFSC Companies Registry [www.jerseyfsc.org] and do a company search. Regarding Lake Constance Funding LLC registered in Delaware, see State of Delaware [delecorp.delaware.gov/tin/GINameSearch.jsp] and do a company search. Both jurisdictions are corporate havens offering tax incentives and light-touch regulatory environments (see Palan et al., 2010).

4. Note that annual reports are published in the subsequent year e.g. annual report 2004 (LBBW, 2005).

REFERENCES


Moody’s (2002) Rating Action: Moody’s assigns rating of P-1 to commercial paper of Lake Constance Funding Limited, Global Credit Research, 22 September.


POLICY DOCUMENTS


– (2008a) Für die Kapitalaufstockung bei der Landesbank Baden-Württemberg die Bundeshilfen nutzen, Drucksache 14/3772.

CHAPTER FOUR

ENTANGLED GEOGRAPHIES OF “IRISH” FINANCE

ABSTRACT

This paper dissects the financial crisis through an analysis of financial development in Ireland. Although a single system, Irish finance is split in two. Illustrative of national financial developments, this paper details how public officials aimed to create a financial center in Cork. Exemplifying transnational developments, the role of Dublin’s financial center is detailed, focusing on the risky activities of German banks. The analysis of “Irish” finance reveals the convergence of European finance along Anglo-American lines and highlights the problems underlying Europe’s debt crisis. Literatures on comparative institutionalism and global/world cities are recombined to come to terms with “actually existing” finance.

Chapter published in Eurasian Geography and Economics. Full reference to the original article:
INTRODUCTION: UNPACKING “IRISH” FINANCE

Following the outbreak of the 2007 credit crisis, the Republic of Ireland witnessed the unraveling of an unprecedented property bubble. In the wake of the collapse of US investment bank Lehman Brothers in 2008, the Irish government guaranteed the liabilities of its financial sector, shifting debts of bankers and builders onto Irish taxpayers. Two years later, with a gaping hole in its public finances and its banks kept comatose via central bank funding, Ireland entered a bailout program: “Having obtained our political independence from Britain to be the masters of our own affairs, we have now surrendered our sovereignty to the European Commission, the European Central Bank (ECB), and the International Monetary Fund” (Irish Times 2010, 21).

This paper dissects two spatially distinct episodes of what is regarded as “a single crisis of financialized capitalism” (Aglietta 2012, 15) through an analysis of financial development in Ireland. Although comprising a single system, Irish finance can be split into national (domestic) and transnational (cross-border/foreign) components. Besides an empirical justification – the discrepancy between Irish gross domestic product (GDP) and gross national product reveals the large presence of foreign capital in Ireland (e.g. Stewart 1987) – splitting Irish finance in two has heuristic value for this study. Illustrative of national financial developments, this paper details how public officials and debt-fuelled builders aimed to establish a financial center in the city of Cork. Subsequently, exemplifying transnational financial developments, this paper details the history, place, and role of Dublin’s International Financial Services Center (IFSC) and discusses the shadowy activities of German banks that unfolded there. Initially, national and transnational developments contributed to the outbreak of two spatially distinct financial crises – a national banking crisis and a transnational credit crisis – which nonetheless have since fused into a single private balance sheet/public debt crisis in the context of the eurozone. Recombining literatures on comparative institutionalism and global/world cities, a spatial analysis of “Irish” finance reveals the amalgamation of European financial activity along Anglo-American lines and lays bare some of the key issues underlying Europe’s ongoing financial crisis conundrum.

This paper is divided into three parts. The following section details the key premises of comparative institutionalism and global/world cities. Amongst others, these texts advance distinct spatial parameters central to the argument set out in this paper. The main body of this paper details a short
history of Irish finance. Shaped by its British neighbor across the Irish Sea, Irish finance since the eighteenth century has grown out of local merchant banks into nationwide banking networks, which later developed along and hybridized with transnational or “global” finance. To underscore these developments, this paper details two recent examples from Cork and Dublin. With variable success, both cities aimed to establish themselves as financial centers: where the case of Cork is illustrative for national financial developments, the Dublin case speaks to transnational finance. Although the two examples contributed to the outbreak of two spatially distinct financial crises, both have since fused into a single crisis and, in the last instance, it is argued that both developments were always part of a single financial whirlwind. Finally, the concluding part evaluates the current state of Irish finance in light of the two foregrounded literatures in order to assess their respective explanatory values (Engelen and Grote 2009) and concludes with a call for a recombination of both literatures in order to come to terms with the entangled geographies of “actually existing” finance.

The method of process tracing has been applied to pinpoint the “intervening causal processes” that explain financial developments in both Cork and Dublin, distilling “a sequence of events” comprised of “key moments” having shaped the path-dependent episodes (George and Bennett 2005, 206–233). To draw out a set of key moments, I examined a comprehensive range of secondary data, including popular and academic literature, financial and local media coverage, and policy documents. In addition, I interviewed approximately thirty informants – academics, administrators, journalists, politicians and writers – during the course of 2011–2012 in order to deepen my understanding of Irish finance. Finally, besides semi-structured interviews, a number of observations from both Cork and Dublin inform this paper.

**CONCEPTUAL FRAMEWORK: TWO SPATIALITIES OF FINANCE**

This paper combines two literatures, both offering leverage in the study of the spatial development of finance: comparative institutionalism, also known as the varieties of capitalism school (Hall and Soskice 2001), and the literature on global and/or world cities (Taylor 2004; Sassen 2012). Both literatures advance distinct spatial bounds. Comparative institutionalists study the arrangement of national economic institutions, including national finance, viewing national institutions as key sites for economic organization; whereas the global/world cities literature is built upon the premise that
leading cities benefit from the transnationalization of economic activity, including finance, seeing national institutions as key sites for economic organization weaken. Where comparative institutionalism theorizes economic organization within the confines of national state/scale, the global/world cities literature looks at the city’s economic vigor and place within a networked transnational (global) economy.

A defining approach of comparative institutionalism groups national economies along two ideal types: liberal-market economies (LME) with the United States (US) and the United Kingdom (UK) as typical cases, and coordinated-market economies (CME) with Germany as model case. Known as the “Boston or Berlin” debate in the Irish context, most scholars agree that Ireland belongs to the LME category (Hall and Soskice 2001, 19–21; Crouch 2005, 29; O’Sullivan 2010, 20–21). Within these ideal types, domestic firms are said to rely on national institutions to coordinate their activities with other stakeholders “to develop … core competences” and exploit “comparative institutional advantages” (Bohle and Greskovits 2009, 359–360). The associated national financial systems for CMEs and LMEs are respectively classified as bank—or market-based. Although a variety of distinct features might be discerned, a key difference is that bank-based systems are typically characterized by close relationships between borrower and lender, whilst market-based systems are based on arm’s length transactions (Allen and Gale 2000). Alternatively, it could be argued that bank-based systems are chiefly based on (long-term) interest-based lending whilst market-based systems are based on (short-term) fee-based intermediation. Amongst others, these financial systems are usually couched in different corporate governance structures and legal systems (e.g. Porta et al. 1998; Reyes and Vermeulen 2011).

This two-way depiction of capitalist variety has endured criticism: methodological nationalism and relative neglect for (cross-border) finance are two of them (Engelen et al. 2010), and scholars have demonstrated that bank-based systems such as in Germany are partly converging along Anglo-American lines (e.g. Dixon 2010). As an alternative, the two typologies might be upscaled beyond the national state, as they approximate a wider “distinction between Anglo-American and continental European models” (Engelen et al. 2010, 57). Alternatively, other approaches offer larger sets of ideal types, some of which are arguably better aligned to capture financial complexities (Amable 2003). Furthermore, on the fluid side of the comparative spectrum, some speak of “recombinant capitalism” (Crouch 2005) – signifying a blend of ideal types – whilst others stress “the commonalities of capitalism” (Streeck 2009, 1), following the ongoing transnationalization of economic activity and regulation.
This observation opens the door to the literature on global and/or world cities (Taylor 2004; Sassen 2012). It should be noted that the conceptual contrast between city and (national) state is not as sharp in practice, as historically “cities and states have proved indispensible to each other” (Tilly 1990, 2; Braudel [1963] 1995). In fact, a stable divide between city and state is hard to maintain in any real sense, as power tends to oscillate between one and the other, hence reinforcing their combined grip.

Most cities … are not part of the new transnational urban systems. Typically, urban systems are coterminous with nation-states, and most cities exist within these national geographies … Although this is still the most common view, there is now a growing scholarship that allows for the possibility that intercity networks can cross national borders directly, bypassing national states as these entities now have reduced gatekeeping functions. (Sassen 2012, 59)

Where rigid approaches of comparative institutionalism portray stability, key texts on global/world cities denote change. Among other factors, finance is viewed as a key driver of change “that binds cities across borders” (Sassen 2012, 79). With the gatekeeper state on the retreat, the world’s leading cities have emerged as key nodes of control over an increasingly financialized transnational economy, sometimes at the expense of second-tier financial centers (Fernandez 2011). The rise of global/world cities is tied up with the advance of modern capitalism and its accompanying financial centers (Arrighi 1994; Braudel [1963] 1995). To Braudel, financial centers do not operate in isolation, but need other cities as “necessary nodes in conduits of flows” (Braudel quoted in Taylor 2004, 14).

Today, leading financial centers sit on top of a networked hierarchy directing global capital flows. Key texts on financial centers (Cassis 2006; Palan et al. 2010) and global/ world cities yield similar scorecards of cities captaining transnational finance. Assessing headquarters functions and numerous links between cities, such rankings typically identify London and New York as principal global/world cities and financial centers (Wójcik 2013). As is the case with comparative institutionalism, there are many approaches falling under the rubric global/world cities. For the purpose of this paper, Camagni’s (1993) hierarchy of city-networks is used. As Taylor affirms:

The argument is theoretically sophisticated because he combines three ‘logics of spatial organization’ – territorial (state), competitive (hierarchical) and network (co-operation) – into a single argument … The result is a hierarchy consisting of three layers of
city networks with ‘world cities’ perched firmly at the top, ‘national cities’ in the middle, and ‘regional cities’ at the bottom. (Taylor 2004, 34)

This hierarchy appears well suited to guide this paper, as the cities of Cork, Dublin, and London (UK) respectively feature as regional, national, and global/world cities.

**A SHORT HISTORY OF IRISH FINANCE: FROM LOCAL TO TRANSNATIONAL NETWORKS**

Before addressing developments in Cork and Dublin as examples of national and transnational finance, this section contextualizes the evolution of Irish finance through an historical analysis. Due its long entanglement with British power, Irish finance has taken on many traits typical of its neighbor, trailing a wider set of institutions (Foster 1988). Irish banks have long been focused on London, perpetuating the relative underdevelopment of Irish finance, as capital flowed from imperial periphery to core (e.g. Barrow 1975; McGowan 1990; Carey 2011; McGrath 2011). Resonating a familiar postcolonial trend, the economic history of sovereign Ireland reveals a continuation of old patterns: Irish banks retained a focus on London, and Ireland’s new currency remained tied to sterling at parity (McCabe 2011). In fact, Ireland has operated an independent monetary policy for only a brief moment of time (1993–1998) following the collapse of the exchange rate mechanism preceding the euro. From a long-term perspective monetary policy has moved from a British –to a German-dominated currency area (McGowan 1990; Leddin and Walsh 2003). Continued dependence on sterling resulted in a relatively expensive currency – good for Irish banks, yet arguably detrimental to the development of indigenous industry. This, in turn, explains Irish efforts to attract foreign investment ever since the 1950s. Initially aiming to attract industry, during the late 1980s the Irish government embarked on a policy to attract financial services to the derelict Dublin docklands. The effort was perceived as both a big initiative (Bourke and Kinsella 1988) and success (Reddan 2008). During the 2000s the republic’s second city equally set out to attract finance to its own docklands, much in the image of Dublin and waterfront regeneration schemes elsewhere (O’Callaghan 2008, 2012). This ensuing episode is exemplary of national financial developments.
NATIONAL FINANCE:  
THE BROKEN DREAMS OF “REBEL CITY” CORK

Property prices tripled between 1994 and 2006, making the Irish real estate boom the most dramatic of any advanced economy in recent times … A speculative mania centered around property gripped the country. (Carswell 2011, 30)

Built around a natural deep-water harbor, the city of Cork – also known as Rebel City³ has long been connected with merchant trade; chiefly exports of agricultural produce sourced from the rich Cork hinterland. Its spoils formed the basis of Cork’s local merchant banks, and late eighteenth century merchant banking in Cork ranked second to Dublin. However, the early nineteenth century saw radical change in the makeup of the local scene as small merchant banks vanished in the wake of a severe crisis and were replaced by large joint-stock banks operating nationwide networks (Bielenberg 1991, 129). In this novel setting, the Bank of Ireland – the Protestant bank with strong London ties – reigned supreme (Barrow 1975; McGowan 1990). A development of similar importance would wait until the 1960s: next to six Irish banks amalgamating in two large “pillar banks” – Bank of Ireland and Allied Irish Bank – foreign banks entered the scene (Ó Gráda 1997). The first foreign banks were North American: Citi in 1965, Bank of Nova Scotia in 1966, Bank of America and Chase Manhattan in 1968. European banks arrived during the early 1970s (Reddan 2008, 62). Their entrance followed the opening up of the Irish economy and anticipated Ireland’s accession to the European Economic Community.

Since the days of Cork merchant banking, moneyed business clustered on South Mall, a prominent Georgian city-center street paralleling the river Lee. Today, South Mall remains Cork’s chief place of business. Domestic banks operate branches here with the two pillar banks operating the largest offices. In addition, a limited number of foreign banks and insurers are located here. These firms are accompanied by a variety of smaller businesses, including stock and insurance brokers. Furthermore, the usual acolytes of finance are clustered on South Mall: law firms, registered auditors, and chartered accountants. Finally, finance’s inherent nexus with real estate is instantly observable: in addition to numerous estate agents there are property auctioneers, property consultants, and architects. Much like the old days, South Mall primarily has a local/ regional function, servicing the economy of Cork city and county.

As in the late eighteenth century when the Cork merchant class dominated political life through control of the municipal corporation (O’Flanagan 2005), dealings between developers and the Cork Corporation (rebranded
Cork City Council in 2001) are crucial to understanding the city’s quest to fuel growth and attract financial services. Irish local government is characterized as weak, executing a limited number of functions and highly dependent on central government funding (Roche 1982; Adshead and Tonge 2009). Although overseen by elected councilors, executive functions are delegated to a non-elected management team captained by a city manager – “the chief executive officer (CEO) … in his bailiwick” (Roche 1982, 111). The attitude of Joe Gavin, Cork city manager during the property bubble, captures the very essence of the time: “Gavin’s description when he came to Cork was that tower cranes were a barometer. He counted few in the skyline and was determined to change that, which he did. The tower cranes rose and fell with his reign” (interview with Barker, 19 May 2011).

Revealing the extent to which Irish officials – administrators, politicians, regulators – were attracted to the marvels of finance, the state apparatus gradually became geared toward and dependent upon debt-fuelled property development, much to the delight of Irish bankers (Ross 2009) and builders (McDonald and Sheridan 2008). To Gavin, the best prospect to bring in the cranes in was the redevelopment of the Cork docklands: a 420-acre site designated to become a post-industrial utopia comprised of apartments, shopping centers, and offices. In 2005 the city set up the Docklands Directorate to assemble a “growth coalition” (Fainstein 1983; Harding 1991) to streamline relations between city and developers and accelerate development. In particular, the city teamed up with Howard Holdings, a fast-growing local property developer fuelled by what had rapidly become the third force in Irish banking, the Anglo Irish Bank. In late 2005 Howard Holdings purchased a 12-acre docklands site for €26.5 million to develop its biggest scheme yet – the Atlantic Quarter. As Howard Holdings unveiled the scheme early 2008, Ireland’s chief newspaper noted how:

The IFSC is to get a €1bn rival as the ‘Atlantic Quarter’ development was formally unveiled in Cork – the largest development ever planned for the city. The giant project – masterminded by Howard Holdings – was hailed yesterday as the spark for a ‘New Cork’ with its revitalized docklands serving as a strategic counterweight to Dublin. (Riegel 2008)

Echoing a “second city” syndrome typical of the Rebel City, local business elites had long called for the development of a Cork financial center (Business Cork 2004), hoping to challenge Dublin’s financial clout. Likewise, a study commissioned by the Docklands Directorate encouraged Cork “to target financial services … and develop prestige property to attract Irish headquarter functions,” amongst others targeting financial institutions who viewed Dublin too expensive (Cork Docklands 2007, 47).
The €26.5 million loan to purchase the docklands’ site was provided by Anglo Irish Bank. Founded in 1964, following decades of mergers and acquisitions the Dublin-based bank was listed on the Irish stock exchange in 1987 (Carswell 2011, 5–15). Loyal to its developer clients, the bank rapidly became the envy of Ireland’s two pillar banks following the property market’s ascent in the mid-1990s. Anglo’s business model was simple: quick assessments of commercial real estate projects in return for hefty fees. The bank enjoyed close relationships with developers in Dublin and beyond (Kelly 2010), and Howard Holdings was their darling in Cork. “Anglo was underwriting them all day,” noted a veteran Cork property consultant (interview with Cohalan, 23 May 2011). In the words of a local journalist: “Anglo would throw money at everyone and Howard Holdings were their creation in Cork” (interview with Barker, 19 May 2011). Anglo’s phenomenal growth and profits led its competitors to emulate its relationship model (Carswell 2011, 31, 57–58), leading to reckless risk-taking across Irish banks. Anglo directors—including CEO David Drumm—were aware of this, yet failed to act upon it:

We made a decision in 2004 to reduce our land and development exposures, particularly in Ireland, because right at that time we saw intense competition coming in from other banks, we saw land prices going up a ridiculous rate, and we made a conscious decision to pull back from it. We failed to execute on our own plan, and we never pulled back. That was because of the strength of the relationship, we just had very strong, longstanding relationships with our borrowers and we couldn’t stand back from them. (Drumm quoted in Quinlan 2010)

Instead of curtailing speculative lending, during the height of the property bubble the bank ramped up its credit facilities to its developer clients without a single executive in charge of either risk management or treasury operations (Carswell 2011, 78, 93–94). For a while, the party seemingly would never end – until it did.

In November 2009, the 12-acre docklands site was revalued on behalf of the Irish government, who had reluctantly nationalized Anglo Irish Bank earlier that year. Following a leading Cork property consultant, “it is more than likely that its value was something like 5 or 6 million.” Revealing the huge leverage built up in Irish banks, “a haircut [write down] of 80% would be very accurate” (interview with Frank, 30 October 2012). In Dublin, similar events unfolded, albeit on a larger scale. For example, deep in the Dublin docklands lays the Irish Glass Bottle site: bought with loans from Anglo Irish Bank and others for €412 million at the very top of the bubble, it was later revalued at €50 million (Carswell 2011, 288). Amongst others, the
epic burst of the property bubble reveals the failure of Ireland’s “light touch” regulation. This approach is part of a wider government effort to attract transnational finance. To appreciate these efforts, the next section zooms in on Ireland’s capital city.

**TRANSNATIONAL FINANCE: LIEBE GRÜSSE AUS [SWEET REGARDS FROM] DUBLIN**

The offshore world is an endlessly shifting ecosystem. Each jurisdiction offers one or more offshore specialities and attracts particular kinds of financial capital; each has its own … infrastructure of skilled lawyers, accountants, bankers and corporate officers to cater for their needs. (Shaxson 2011, 22)

Where the tower cranes have yet to rise in the Cork docklands, the Dublin case is instructive as to what kind of business Cork sought to attract, as Dublin embarked on a similar quest in the 1980s. Similar to Cork, Dublin has long suffered its own “second city” syndrome. With its origins in imperial interconnections and cultural crossbreeds, this “second city” syndrome is understood as a sustained obsession with London. This syndrome can be traced back to the eighteenth century New English, Anglo-Irish Dublin elite known as “the Ascendancy” (Foster 1988), whose landed fortunes were dependent on lawmakers in Westminster. In addition, it might be argued that the Irish “middleman or comprador class” (McCabe 2011, 59) finds its origins in the historical relations with absentee landlords from imperial Britain. Amongst others, the development of the IFSC in the Dublin docklands can be seen in this light. In fact, the IFSC was built in the image of London’s very own “second city” in the London docklands: Canary Wharf (Merrifield 1993; Moore 1999; Gordon 2010). Yet before detailing the birth of the IFSC as a second city in its own right, the financial comeback of the original City (of London) is first set out.

Speaking to the global/world cities literature, Palan et al. (2010) and Shaxson (2011) are indispensable reads, for many financial centers also function as offshore tax havens and secrecy jurisdictions. Shaxson applies these terms interchangeably, defining them as a “place that seeks to attract business by offering politically stable facilities to help people or entities get around the rules, laws and regulations of jurisdictions elsewhere” (2011, 8). To Shaxson, offshore finance emerged with the 1950s collapse of the British Empire, which paralleled the rise of the Eurodollar market (Bell 1973), seeing the international financial system under strict public control slowly make way for private transnational finance. Amongst others, the Eurodollar
market saw US banks setting up shop in the City of London, bypassing US regulations, and resulting in the world’s largest offshore dollar market. As such, the City’s revival does not imply a renewed sterling supremacy, but is arguably better understood as the ascent of a key financial node in the transnational development of American finance (Konings 2011). Having said this, an array of jurisdictions steadily aligned themselves in the emerging offshore satellite network centered on the City of London. Today, this network is the world’s largest: it contains “about half the world’s secrecy jurisdictions” along a “layered huband-spoke array of tax havens” approximating the contours of Britain’s former empire (Shaxson 2011, 14–15). Its geographical setup is structured accordingly:

The City’s offshore network has three main layers. Two inner rings – Britain’s Crown Dependencies of Jersey, Guernsey and the Isle of Man; and its Overseas Territories, such as the Cayman Islands – are substantially controlled by Britain ... The outer ring is a more diverse array of havens ... outside Britain’s direct control but nevertheless have strong historical and current links to the country and the City of London. (Shaxson 2011, 15)

Shaxson squarely locates Dublin’s IFSC – established in 1987 – in the outer ring of the City’s offshore network (Shaxson 2011, 17). The establishment of the IFSC trailed another revolution ignited in London: the 1986 Big Bang in financial services deregulation. In fact, Shaxson notes the IFSC development was actively encouraged by City financiers (2011, 295). However, the birth of the IFSC fits a longstanding Irish pattern of attracting foreign capital through fiscal policy (McCabe 2011). For example, the Shannon exporting zone was established in 1959 based on a similar fiscal platform (Palan et al. 2010, 144). Although Dublin redeveloped its docklands to attract foreign finance, the first banks to move into the docklands were Ireland’s two establishment banks, taking advantage of its attractive fiscal regime (Ó Gráda 1997, 178).5 However, with time many transnational financial operations – headquarters, branches, subsidiaries, outsourced administrative and management functions, conduits or mailboxes – located in Dublin, which gradually became a key node in transnational financial and corporate networks, offering tax and regulatory arbitrage (Stewart 2008a, 2008b, 2013) which are “at the very core of offshore” (McCann 2006, 1). As in the City of London, US financials led the way. This can be seen as part of the wider 1990s expansion of American multinationals in neoliberal “Celtic Tiger” Ireland (see Kitchin et al. 2012) – a highly competitive economy with well-educated workers, offering a common language and similar legal tradition, and access to the single European market.6 Furthermore, signifying the “most
important feature” of tax havens, financial interests enjoy key access to the Irish government (Shaxson 2011, 9–10). In this regard, the clout of the Clearing House Group – the chief IFSC lobby club – is revealing (McGee 2012). The IFSC falls under the office of the Irish prime minister, not the ministry of finance, and experts concur that the IFSC enjoys “preferential access to the government decision-making machine, to the finance bill and to the revenue clauses” (interview with Stewart, 19 November 2012). The composition of the Clearing House Group reveals some of the key players operating in the IFSC:

The group is chaired by … the secretary general of Government. The main body and its subcommittees meet in Government Buildings. Civil servants and representatives from State agencies… sit on it. The rest are made up of a who’s who of banking, financial and legal giants: JP Morgan, Citi, State Street, IBF, Barclays, Bank of Ireland, KPMG, Bank of America, Deloitte, AIB, William Fry, Ernst and Young and PWC. (McGee 2012)

As indicated, financial centers typically offer a number of key specialties. Concerning the IFSC, “it is perhaps in fund management that Dublin has most earned its global reputation in financial services” with some €689 billion (41% of worldwide figure) of “alternative investment funds” e.g. financial derivatives, hedge funds, private equity and venture capital coming from the UK (46%) and the US (39%) parked in –and flowing through Dublin for legal and/or tax purposes (Europe Economics 2011, 5). Likewise, a Financial Services Ireland study (2010, 3) identifies a number of key sectors in the IFSC, such as asset management, corporate treasury, and securitization (see also Stewart 2013). As the latter technique enabled the 2007 credit crisis (Blackburn 2008), this paper focuses on this sector. As noted by Irish law firm Arthur Cox (2002, 1), Ireland became “a popular jurisdiction for the establishment of special purpose vehicles (SPVs) for securitization and other structured finance transactions” (see also Financial Services Ireland 2010, 23). As a result, during the 2000s the IFSC became a key hub in shadow banking (Pozsar et al. 2010), as banks bought (long-term) asset-backed securities – typically stuffed with poor-quality mortgages and financed by short-term paper. Many off-balance-sheet SPVs trading these assets were domiciled in and administered from the IFSC: an offshore, light touch, cost-effective, and tax friendly jurisdiction managed by a “middle-man” class (McCabe 2011, 59) of accountants, bankers, consultants, lawyers, and stockbrokers, supplemented with accommodating lawmakers. As has been well documented (e.g. Lewis 2010), the 2007 credit crisis unfolded through this pipeline. Amongst others, German banks were hit hard.
Although conducting their main operations out of Frankfurt, London and New York, German bankers have long favored Dublin as a key site to conduct exotic ventures. In 1991, Commerzbank was one of the first to move into the IFSC (Ó Gráda 1997, 178). Furthermore, in the lead up to the credit crisis a variety of German public and specialty banks moved their shadowy operations to Dublin. Once panic broke in 2007, German banks including IKB Deutsche Industriebank and SachsenLB were among the first hit (Stewart 2008b, 2013; O’Toole 2009) seeing their holdings of “triple A”-rated paper parked in Dublin-based conduits lose their inflated values. Although many of these products were bought from American investment banks, Europe’s largest financial institution – Deutsche Bank – has been rather active to stuff German banks with dubious paper. For example, Dublin-based SPVs operated by SachsenLB contained some €1 billion of assets bought from Deutsche Bank (Bartsch et al. 2012). However, to appreciate the extent to which German banks were lured toward Anglo-American finance, the travails of “public finance specialist” DEPFA Bank (DEPFA Bank 2003, 4) are instructive. Once a boring publicly owned German bank specializing in the production of “super save” asset-covered bonds known as the Pfandbrief (Mangan 2001), it was privatized during the 1990s and subsequently embarked on a rollercoaster journey in Dublin (see Mehr 2011 for an overview of DEPFA’s history and its Dublin adventures). Where IKB, SachsenLB and other German banks operated conduits out of Dublin, in 2002 DEPFA Bank moved its entire headquarters to the IFSC.

As good guardian of the IFSC, the Irish government accommodated DEPFA, writing a novel piece of legislation known as the DEPFA Act, allowing the bank to manufacture public utility bonds under a common law regime – a novelty at the time (Finance 2000a, 1, 2000b, 1; Mangan 2001). Prior to the credit crisis, DEPFA enjoyed record years – a return on equity over 25 per cent was not uncommon – yet the bank progressively engaged in risky transactions, financing its long-term investments with short-term paper (Stewart 2013). However, at the time IKB and SachsenLB ran into trouble in July 2007, DEPFA was taken over by the German bank Hypo Real Estate (HRE) – itself a 2003 spin-off of from Germany’s HypoVereinsBank stuffed
with troubled property loans. “There are rumors that not all is well at DEPFA Bank,” a German trader noted at the time (Handelsblatt 2007). A year onwards HRE (read DEPFA) proved to be Europe’s deepest financial black hole.

**THE GREAT RISK SHIFT: THE CRISIS CONUNDRUM**

Having outlined two spatially distinct financial developments, it must be noted that the two illustrations in the last instance were always part of a single financial system. Although simply impossible to set out all the events that have unfolded since 2007, this section sets out how two distinct developments fused into one or, better still, were always part of a single financial whirlwind – the costly consequences of which having been shifted onto unsuspecting taxpayers: “In contrast to the United States, where much of the growth in property-related lending was driven by … the securitization of mortgages, Irish property lending … was traditional. Only the scale was new” (Honohan 2009, 209).

As John Galbraith (1990) demonstrates, financial euphoria is inherent to capitalism. In various guises, through classic mechanisms or novel techniques, bubbles come and go. Where the credit crisis was spatially dispersed in transnational space via securitized mortgages and derivative products, the Irish property bubble had a classic signature of reckless lending by conventional means. Where Wall Street operated a model known as “originate and distribute,” Irish bankers preferred the old model of “originate and hold,” ramping up borrowings on the back of rising property prices — the collateral underlying their loan books. Having said this, the commonalities of these episodes are at least as significant as the distinct mechanisms through which they shaped up: liquidity was cheap, risk underpriced, and credit was put to work one way or another. As Galbraith contends, what is typically celebrated as “innovative” is, “without exception, a small variation on an established design” (1990, 19). In other words, behind the mesmerizing facade of innovation lies a simple truth: both episodes were fueled by cheap credit and underestimations of risk and were based on the assumption that real estate prices would rise indefinitely. Reduced to its core, both national and transnational developments were riding a single wave of credit. Finance has a habit of making things complex but, in reality, it is as simple as that.

In Cork and Dublin, lax lending standards by Ireland’s national banks directly fuelled docklands regeneration schemes as designated playgrounds for transnational finance. Indirectly, however, non-Irish institutions increasingly underwrote the bubble. As noted by others (Regling and Watson 2010; Nyberg 2011; O’Riain 2012), the Irish bubble was fuelled by both national and transnational dynamics – the latter including a lax global credit regime
and convergence of eurozone interest rates, seeing foreign borrowings by Irish banks escalating from 10 to 60% of GDP over the period 2003–2008 (Honohan 2009, 209). In other words, the Irish property bubble (Kelly 2009) simply coincided with – or was part of – a wider credit bubble and speculative euphoria. In this regard, a number of shared features are discerned, such as “irrational exuberance, capital bonanzas, regulatory imprudence, and moral hazard” (Connor et al. 2010, 21). Furthermore, it might be said that the Irish property bubble grew in the shadows of the IFSC: as much as the Irish regulator did not police transnational finance in Dublin, it equally failed to detect the huge risks built up in its domestic banks. In other words, national and transnational financial institutions made use of the same institutional setting. Where Anglo Irish Bank faced refinancing problems in 2007, the bank lobbied the government to adapt the 2002 DEPFA Act in order to use commercial mortgages as collateral for covered bonds. As was the case with IKB, SachsenLB and DEPFA, Anglo was increasingly “borrowing short to lend long” (Carswell 2011, 94–95). Likewise, Irish banks were joined by non-Irish institutions in the quest to finance Irish developers and households – the Bank of Scotland instigated a “mortgage war” in 1999; one of the first signals of the reckless lending streak that was about to commence (Ross 2009, 139). As has been argued by others, it therefore appears more appropriate to view both national and transnational developments and the subsequent crises as “a single crisis of financialized capitalism” (Aglietta 2012, 15).

Having said the above, events following the collapse of Lehman Brothers suggest that it remains worthwhile to maintain a focus on national dimensions of finance, as political responses to stem financial panic largely unfolded along national lines. Suddenly, the national state, supposedly on the retreat as gatekeeper, made a comeback as the guardian of troubled finance. In Ireland, in late September 2008 the government guaranteed the debts of the six Irish financial institutions, seeing private liabilities transferred to the taxpayer. Guided by the consultancy of bankers, accountants, and lawyers (Carswell 2011), the Irish government came to guarantee banks deposits and liabilities to the tune of €440 billion. Where bankers were brash in good times, the government – following valuations by PricewaterhouseCoopers – grossly underestimated the problem. For example, “five different attempts were made to estimate the final bill for bailing out the Irish banks, which grew from €5.5 billion in December 2008, to €46 billion in September 2010” (Kirby and Murphy 2011, 85). The estimated costs have risen since. Following (more sensible) crisis responses elsewhere, in October 2008 eurozone leaders confirmed that each national government was to erect its own bailout program and protective shield for institutions incorporated within their respective jurisdictions. Although following the common currency rulebook at the time, “this decision was the trigger for the euro crisis” (Münchau 2012a).
Increasingly reliant on central bank emergency financing whilst progressively unable to refinance its debts at reasonable interest rates, in November 2010 Ireland entered a bailout program (IMF 2010), thereby equally “heading for the quasi-protectorate status of Greece, under the tutelage of the IMF-ECB-Commission troika” (Gardner et al. 2010). Despite efforts by German politicians and cohorts to frame Europe’s crisis as one of fiscal imprudence, behind the rhetoric resides another problem: European banks – not the least German institutions – continue to face (and/or conceal) large capital shortfalls (Mehr 2011; Bowman 2012; Verma 2013). As noted by a German member of parliament, “the Irish population will probably have to spend decades bleeding for the speculation of German banks” (Wagenknecht quoted in Scally and Bittner 2013). Stuffed with distressed securitized assets, troubled bonds, and non-performing loans, the backside of Europe’s public debt crisis is a private balance sheet crisis of European banks. Having swelled on a wave of cheap credit, it is these balance sheets that are being serviced via eurozone bailout programs and ECB monetary gymnastics. As the troika remains adamant that these debts cannot be written off – a strategy reversed in case of Cyprus where (Russian) deposit holders, not (German) bondholders, were hit – Ireland continues to face a debt overhang from which it remains doubtful it can recover.  

Since 2008, the redevelopment of the Cork docklands has come to a standstill. The Atlantic Quarter will, in all likelihood, never materialize. The 12-acre site is today owned by the state, and Howard Holdings has been liquidated. In its wake, the Irish state embarked on a strategy of austerity to avoid its own default and, as a result, Cork City Council has also been forced to enact severe cuts. For example, central government funding via “the local government fund” has seen a 37.8% reduction over the period 2009–2012 (Cork City Council 2011, 4). Whilst expenditures on “Agriculture, Education, Health & Welfare” saw a 76.5% cut, the 2012 budget did not decrease “Development Management” costs, which includes expenditure on the Docklands Directorate (Cork City Council 2011, 15). If anything, these budgetary decisions reveal the city’s desire to mend its broken dreams:

I think you have to take a fairly long-term view with this and not get too caught up with the short-term stuff. Because at the moment Docklands isn’t costing anybody anything per se. We spent about €40 million on it in the last 5 or 6 years and we are probably committed to spend another €30 million. (interview with Ledwidge, 11 May 2011)

Despite such optimism, rents for office space in Dublin are today comparable to Cork (interview with Frank, 30 October 2012), making it all the
harder to attract financial institutions to Rebel City. In fact, where the financial ambitions of Cork remain in the doldrums, the IFSC has witnessed a remarkable recovery: Although investment “fell slightly” in the wake of the Lehman Brothers bankruptcy, since then the IFSC has resumed its growth trajectory and in 2011 investment in the IFSC was at a record high (Stewart 2013: 6). In closing, where national finance remains depressed, transnational finance – although its “No desk. No Staff. No tax” business model is subject to increased scrutiny (O’Brien and Barr 2013) – has seemingly resumed “business as usual”.

CONCLUSION: RECOMBINING TWO SPATIALITIES OF FINANCE

This paper has detailed two recent examples of national and transnational financial developments in the Republic of Ireland. For conceptual guidance, two literatures have been examined; comparative institutionalism and global/world cities, based respectively on national and transnational spatial bounds. The concluding section of this paper returns to these literatures, evaluating their respective merits in light of the examples, and concludes with a call for a recombination of both literatures in order to come to terms with “actually existing” finance.

The historical evolution of Irish finance reveals a widening spatial pattern: where the nineteenth century saw local merchant banks being replaced with nationwide bank networks, the twentieth century witnessed the ascent of a two-tiered/hybrid financial system comprised of national and transnational components. Cork aimed to adjust itself to this new financial reality: where South Mall services the financial needs of the city and region, the Atlantic Quarter aimed to service transnational finance.

Both the history and current state of Irish finance reveal that the national state is not a natural unit in the analysis of finance. In fact, transnational financial development has long preceded it: the wealth of local merchant banks was derived from cross-border trade, and Irish finance has long been imbedded in a political space centered on empire. Even since independence, Irish banks remained focused on London and, since the 1980s, transnational finance has once more come to dominate “Irish” finance (Amable 2003). In summary, transnational dynamics long preceded national developments, much as the city precedes the national state, as the key site of economic activity and organization (Tilly 1990).

This is not to say that national institutions no longer matter. On the
contrary, most approaches of comparative institutionalism do have merits. However, concerning the two ideal types depicting bank –and market-based financial systems, there have been some oddities observed. As discussed, Irish finance is typically classified as market-based. Whilst this might well be true on most indicators, Ireland’s property bubble was partly fuelled by traditional lending practices based upon a (curious) type of relationship banking – a feature normally assigned to bank-based financial systems. In contrast, where German finance is typically seen as bank-based, German banks have been hurt badly through arm’s-length transactions – partly conducted out of the IFSC – usually viewed as part of market-based financial systems. As others have shown (e.g. Dixon 2010), these findings suggest that enduring and rigid portrayals of national financial systems (Hall and Soskice 2001) do not reflect reality, as both financial systems have partially crossed these conceptual bounds. Above all, these approaches are insufficient to capture the reality of cross-border, transnational finance.

Approaches best equipped to capture today’s financial realities are to be found on the fluid side of the comparative spectrum, where commonalities (Streeck 2009) and recombinations (Crouch 2005) are foregrounded; i.e. depictions not enduring or closed, but rather changing and hybridizing. This does not imply that the two ideal types have no value at all. On the contrary, it might be fruitful to upscale their tenets beyond the national state (Engelen et al. 2010, 57). For example, in contemporary Europe the “battle of the systems” appears no longer fought between national states – say Germany and the UK – but arguably between their “extended empires”: the eurozone/ EU vs. the offshore City. It is not crucial that one ideal type prevails over the other: whilst continental financial institutions have partly assumed Anglo-American traits, the eurozone/ EU is coordinating fiscal policy along German lines – implying the rise of a supranational recombinant model.

Likewise, approaches in the global/world cities literature that discount the weight of national state institutions do not do justice to their continued, albeit modified, importance. As set out, the literature generally pays scant attention to “the dark side” of financial centers, with many equally operating as secrecy jurisdictions and tax havens revealing a substantial political capture by financial interests. Therefore, theories best equipped to capture these and other complexities are those that view city and state not in strict dichotomous pairs, but rather as a two-headed and ultimately single construct.

Camagni’s (1993) hierarchy of city-networks, depicting a city hierarchy of respectively global, national, and regional cities, matches the observations detailed in this paper: the regional city of Cork (exhibiting local/regional financial functions whilst chasing transnational ambitions) aimed to become a back-office function to Dublin. Likewise, the national city Dublin (exhibiting both national and transnational financial functions) developed the IFSC
as a back-office function to global/world city London. In addition, Camagni’s “three [interrelated] logics of spatial organization – territorial (state), competitive (hierarchical) and network (co-operation)” (Taylor 2004, 34) do justice to the continued weight of the national state. The success of the IFSC, as is the case for the City of London and other financial centers, remains highly dependent on territorial politics: a stable institutional setting comprised of a comparatively favorable fiscal and regulatory environment set in a flexible jurisdiction with access to lawmakers. For financial networks, although highly mobile, are always embedded in scaled jurisdictions. In this regard, although pronouncing Camagni’s approach “sophisticated,” Taylor criticizes the approach for its reification of scales (2004, 34). However, as financial flows and networks are laced through jurisdictions offering key comparative advantages, an approach that is considerate of scaled jurisdictions seems appropriate.

In addition, the two remaining logics of Camagni’s spatial organization – competitive (hierarchical) and network (co-operation) – can also be observed when analyzing the IFSC. Denoting the hierarchical networked setup of transnational finance, the IFSC is as a back-office hub to the City of London where key decisions are made and most revenues are generated. Additionally, the IFSC competes with the likes of Luxemburg – Europe’s largest hubs in shadow banking (Bakk-Simon et al. 2012). In contrast, from a cooperative angle, with regard to tax planning and/or transfer pricing jurisdictions like Ireland and the Netherlands function as “Siamese twins” in a strategy known as “the Dutch sandwich” (interview with Stewart, 19 November 2012).

As much as Europe finds itself in a recombinant flux of “upscaled” capitalist models and hybrid financial systems, this paper calls for new conceptualizations of finance. To this end, this paper advances a recombination of the two foregrounded literatures on comparative institutionalism and global/world cities. Making a start in this direction, what has been observed is that transnational finance works through the continuous and dynamic recombination of both scales – perhaps better understood as jurisdictions instead of national institutions – and transnational financial networks through which capital flows. This entails a combination of both literatures, as an overemphasis for one or the other conceals key insights. Recombining comparative institutionalism with the global/world cities literature reveals that transnational (financial) corporations seek to acquire comparative advantage through a cherry picking of (national) jurisdictions. Amongst others, comparative institutionalism should revisit perspectives that link up financial systems with legal traditions, as a common law tradition is viewed more flexible and adaptable to “innovative” finance (Porta et al. 1998; Cassis 2006, 263; Reyes and Vermeulen 2011; interview with Stewart, 19
November 2012). The added benefit of access to public lawmakers appears to make such a jurisdiction especially attractive, not least for financial institutions domiciled in jurisdictions that seemingly lack these capacities (e.g. Germany). In this sense, the German financial system might itself not be converging along Anglo-American lines, but German financial institutions are instead emulating Anglo-American strategies by relocating key activities to Anglo-American jurisdictions (Konings 2008). In contrast, the global/world city literature should pay attention to the continued, albeit modified and changing importance of (national) state territory in financial dynamics (Palan et al. 2010; Shaxson 2011). Above all, the subdiscipline of financial geography should rise to the occasion.

In closing, the “actually existing” financial picture that emerges is complex: Irish finance has been historically tied to London. Today, albeit in a different guise this partly remains the case. However, the City of London has changed since, and today it is better understood as a central hub in (Anglo-) American finance (Konings 2011). Likewise, American financial corporations dominate Dublin. In parallel, however, Ireland is part of the eurozone, and finds itself “embedded” in an increasingly German-led Europe. With numerous continental banks such as DEPFA taking advantage of the introduction of the common currency (Mehr 2011) and operating key activities out of Dublin in a manner not possible in their home jurisdictions, what can be argued is that European financial institutions have incrementally assumed Anglo-American traits, with the ECB – another institution in flux – “as protector of financial interests and guarantor of [the uneven] financialization in the eurozone” (Lapavitsas et al. 2012, 3). Added up, it might be argued that transatlantic finance, including its governing institutions, have converged along Anglo-American lines under the guidance of the City, the ECB and, ultimately, the US politico-financial apparatus. Neither “Boston nor Berlin” but rather bang in the middle, the entangled geography of “Irish” finance might well prove to be our window to the future.
ENTANGLED GEOGRAPHIES OF “IRISH” FINANCE

NOTES


2. For example, Taylor’s world city network details a hierarchy of cities housing the world’s top accountants, bankers, financiers, insurers, lawyers, and management consultants (Taylor 2004, 215–217). For recent world city scorecards, see Globalization and World Cities Research Network (http://www.lboro.ac.uk/gawc/). Likewise, Sassen’s (2012) global cities thesis is based on scorecards comprised of similar metrics.

3. Although the exact origins of Cork’s nickname remain somewhat of a mystery, it finds its origins in its long entanglement with British rule. Some trace the nickname back to Cork’s support for two pretenders to the English throne, Lambert Simnel and Perkin Warbeck. In the late fifteenth century, both men led failed invasions of England seeking to dethrone Henry VII (O’Maidin 1978, 8). In another account, however, the nickname is traced back to the eighteenth century Whiteboy movement, a rebellion against the “enclosure of common pasture land” (O’Brien 2004, 192). The nickname Rebel City gained further currency following the rise of republican sentiments in the nineteenth and twentieth centuries.

4. It should be noted that loans on development sites constitute lending of the most speculative kind, seeing the largest haircuts or write-downs in order to adjust inflated book values to plummeted market values. According to Ryan, in Cork, “for what we call investment properties, properties with an income, prices are down about 50%. Properties that are empty are down about 60%. And development property, which is basically development land, is probably down seventy-five percent” (interview with Frank, 30 October 2012). Developments at Dublin’s Irish Glass Bottle site revealed the intimate relationships between the planning body—the Dublin Docklands Development Authority and Anglo Irish Bank—as Anglo’s chairman sat on both boards (see Carswell 2011).

5. Today, this fiscal regime applies to the whole of Ireland. For an overview of the (evolution of the) IFSC fiscal regime and legal environment, see http://www.financedublin.com/the_ifsc_story.php.

6. As noted by Jim Stewart, “Ireland is very attractive because we have a similar corporate law system as the US. So for US companies to use Ireland … they have to comply with Irish tax law, Irish corporate law, US tax law and US corporate law … It would be more difficult … for Germany or other countries, partly because of our common law system” (interview with Stewart, 19 November 2012). As noted by Richard Murphy (2012) of Tax Research UK, Google and other US multinationals “float around freely” above Ireland, which he describes as “an aircraft carrier” between the US and Europe.

8. The setup of the various public rescue mechanisms reflect the intricate involvement of bankers and lawyers (Sherwood 2009), resulting in intriguing replications of shady off-balance-sheet-structures, SPV entities, and structured products that brought finance to its knees (see Gurdgiev 2011 on Ireland; Mehr 2011 on Germany, or Bowman 2011 on the creation of the European (Financial) Stability Facility/Mechanism).

9. For the profile and scale of Irish public debt, see Killian et al. 2012 and Whelan 2012. On Ireland’s overall (public and private) debt sustainability, see Lucey et al. 2012. Early 2013, the public debt profile again changed, taking ECB monetary gymnastics to a whole new level, with the controversial promissory notes transformed into sovereign bonds (Münchau 2012b).

10. As explained by Jim Stewart, “The Netherlands often features in the tax strategies of multinational companies in Ireland … A widely-used feature of multinational corporations in Ireland is that they are a branch plant of a Dutch parent company. They are incorporated in the Netherlands but operate here … They do that for tax reasons because Ireland and the Netherlands are like Siamese twins. We tax trading profits at 12.5%. That is the nominal rate. The effective rate is about 4% … But we tax profits from financial investments at 25%. The reverse is in the Netherlands … So if you can marry or incorporate a Dutch trading or holding company into an Irish corporate structure you can reduce your tax quite a bit. This is what Google does. This is the so-called Dutch sandwich” (interview with Stewart, 19 November 2012).

REFERENCES


This thesis advanced four case studies, which are to varying degrees considered least likely to fall prey to financial seduction, logics and authority – in short, financialization. These cases explored the financial activities of four European institutions in various ways tied to the state: a Dutch public university, two local governments in Germany and Ireland, and a German regional public bank. This concluding chapter revisits the cases and is organized in four sections: first, the chapter summarizes the cases and foregrounds the main findings. Subsequently, by triangulating the findings, the key commonalities between the four cases are discussed and explained. Third, by revisiting the expectations set out in the introduction, the research findings and commonalities feed into a number of theoretical implications. In other words, where the introduction worked its way downwards – from a general overview of the literature toward a concrete set of ‘least likely’ institutional domains – these concluding sections work their way upwards: from the specific cases, to the commonalities and explanations, to the theoretical implications. In addition, the last section offers an research agenda to explore the possibilities of what in the future might become a fascinating category within the literature: the financialization of the state.

SUMMARIES AND FINDINGS

The first case study presented in this thesis explored the financialization of the University of Amsterdam (UvA). Situated in a strong corporatist state, traditionally self-managed by a guild-like clique of professors, the case was based on the expectation that this publicly funded university was relatively well shielded against the forces of financialization. However, the study revealed that financial professionals, practices, products and techniques have
nonetheless come to penetrate, alter and arguably dominate the ways in which the UvA is governed, seeing the centralized decision-making machinery increasingly dominated by real-estate considerations and the accompanying debt burden. The financialized academic regime is today sanctioned by a new caste of financial and managerial professionals. As a result, the novel financialized regime wielded by the UvA head office regularly overrides academic concerns, and increasingly threatens to corrode the quality of the university’s core functions.

Moving into the heartland of corporatist Europe, the second case study explored the unlikely financialization of the local government of Pforzheim, in southwest Germany. Specifically, this case foregrounded the unexpected ways in which a local authority interlaced its budgetary plight with the wonderland of interest-rate swaps – arguably one of the defining financial instruments through which modern-day financialization shapes up. Financial wizardry in the Golden City revealed that local governments in corporatist Germany, a jurisdiction typically characterized by a non-market-based financial system, have since the turn of the millennium massively bought into the promises of derivatives offered by JPMorgan and Deutsche Bank. The pecuniary consequences for the city have been profound, with Pforzheim seeing a growing slice of its structurally deteriorating public budget dedicated to servicing its financial commitments, with negative effects for the city’s core duties.

The third case moved to the state capital of Baden-Württemberg, Stuttgart, exploring the financialization of Germany’s largest public bank: Landesbank Baden-Württemberg (LBBW). Situated in a region renowned for its cultural thrift and risk averseness, embedded in a national jurisdiction expected to be less conductive to financialization, this study revealed that LBBW had nonetheless bought into the promises of high finance via a range of market-based strategies – delving into Anglo-American capital markets by originating and trading derivatives and securitized products. In so doing, the bank exposed itself to the risks of financialization, eventually leading to a bailout by its public owners. However, since the financial crisis LBBW has merely attuned its financialized activities to the new realities, and continues to offer securitized solutions to its regional clients. Couched in literatures on financialization and comparative institutionalism, this case explored the ways in which the long arm of finance has penetrated German banking, adding spatial depth to the aforesaid literatures.

Lastly, the fourth case study explored the travails of Ireland’s Rebel City Cork, where public officials mesmerized by debt-fuelled real estate development aimed to establish a financial centre in the image of Dublin’s International Financial Services Centre (IFSC). Couched in literatures on comparative institutionalism and global/world cities, besides investigating
the ways in which financialization has come to shape local and central government policy in Ireland, this case explored the ways in which the rise of cross-border financial markets has impacted the respective explanatory values of both literatures. Unexpectedly, the findings contradict with some of the dominant premises of comparative institutionalism, as Irish banks blew a giant bubble through relationship banking – a trait typically assigned to bank-based Germany – whereas German banks operated out of Dublin’s IFSC to conduct market-based financial operations. Taken together, this case study sought to illuminate the entangled geographies of “Irish” finance.

**COMMONALITIES AND EXPLANATIONS**

Despite purposefully selecting the four cases on the basis of institutional variations in state structures and financial systems, as well as institutional differences in organizational templates, functions and capacities, the four governments and public institutions featuring in this thesis have nonetheless all come to buy into financial products, logics and rationalities indicative of financialization. Having set out the summaries and findings, this section details and explains the key commonalities between the cases. Specifically, this section concludes the triangulated research strategy set out in the introduction by identifying key material and cultural common causal conditions underlying the cases, which as configurations of factors or variables jointly explain the unlikely financialization of the explored governments and public institutions.

As noted in the introduction, neoliberalization typically is seen as a precondition for financialization to blossom. For the institutions featuring in this thesis, neoliberalization has been chiefly enforced from the national center e.g. in the form of budget cuts dressed up as ‘devolution strategies’ enacted by upper layers of government, downloading public tasks (hence financial liabilities and risk) to lower levels of government and adjunct public institutions. For example, in the Netherlands central government transferred real estate ownership and management to a set of institutions since then known as the semipublic sector (e.g. housing associations, hospitals, universities). As a result, the UvA has come to source and adopt a range of financial advisors, managers, products and techniques to manage its new tasks. Likewise, in Germany central and regional Länder governments downloaded a range of public tasks to underlying municipalities, without additional funding, as in the Netherlands following the neoliberal blueprint of New Public Management (NPM). This strategy, in turn, has in both cases led to rising indebtedness, seeing decision makers in both
Pforzheim and Amsterdam buy a range of interest-rate swaps to manage these burdens, further increasing their dependence on financial markets.

In similar fashion, the accounts from Cork and Stuttgart equally reveal that neoliberalization paved the way for financialization, although not achieved through classic NPM blueprints. In Cork, the municipal authority has long been governed by a technocratic/unelected city manager, arguably limiting the need for neoliberal managerial reform. Having said this, indicative of a shift from government to neoliberal governance, the Rebel City set up a Docklands Directorate in order to streamline its interactions with debt-fuelled real-estate developers. On the national level a similar development has been observed, with relations between central government in Dublin and the financial world rationalized under the Clearing House Group – a financial lobby organization through which the world’s largest banks and accountancy firms enjoy structural access to government policy. Meanwhile, a state-owned bank like LBBW has also become subject to the neoliberal spell of competition – in this case not via central government but rather through the orders of the European Commission – leading to a particular expulsion or ‘retreat’ of the state as the bank’s guarantor and underwriter (until the 2008 financial crisis), suggesting that the European Union (EU) has also become a neoliberal catalyst in transforming the institutional landscape of its member states. In other words, all four cases underscore the observation that neoliberalization has indeed come to open up and fertilize the public-sector soil for financialization to take root.

Obviously, processes of neoliberalization go well beyond the public sector. The neoliberal turn not only transformed the institutional fabric of the state but in parallel elevated the reach of the financial sector, resulting in a particular ‘double movement’: where the national state stepped back, cross-border financial markets came to the fore. As a result, Anglo-American financial institutions, practices and techniques have come to penetrate bank-based Germany, as much as German banks have moved their operations to jurisdictions elsewhere to replicate market-based strategies. Taken together, the combination of a neoliberalizing state and expanding financial markets brought about novel institutional balances and realities, new opportunities and constraints, for public officials and financiers alike. In this setting, all four cases witnessed the intrusion of financial logics, brought in by financiers and their ilk – through sourcing loans, signing derivatives contracts, or purchasing structured products. As a result, the pecuniary plights of the explored institutional domains have become increasingly independent upon financial market developments, through rising debts and ‘trial and error’ arbitrage or adjustments to these new realities.

These changing institutional balances between ‘state and market’ resulted in large information asymmetries between public officials and
financial intermediaries. As a result, in Amsterdam UvA management has become structurally dependent on the advice and expertise of outside bankers and consultants. In Pforzheim, similar developments actually led to a situation where public officials had to be regularly updated by Deutsche Bank about the fluctuating status of their budgetary health. In Stuttgart, LBBW equally underestimated the potentially toxic nature of the structured products it had purchased, revealing that there are also information asymmetries within the financial sector, or between financial institutions – seeing Wall Street banks take advantage of lesser financial mortals. Finally, a range of real estate consultants sketched the optimistic scenarios fuelling the Irish bubble, including the real estate plans of Cork. In all four cases, the information asymmetries appear rather large, underscoring the notion that under incessant neoliberalization bankers, lawyers, accountants and consultants have effectively become rulemakers.

As a result, the pecuniary plight of these institutional domains has become more dependent on the health of global financial markets. In Amsterdam and Pforzheim, public budgets have through derivatives contracts become increasingly subject to financial market sabotage and volatilities. Likewise, in Stuttgart the massive purchases of structured products made the health of LBBW increasingly dependent upon the swings of global finance, rather than the health of regional firms. In Cork, public officials had few options other than buying into the speculative fever that had grabbed the Irish state since the introduction of the euro. In each case there were toxic combinations of trickery and seduction at work, paralleling a pervasive common sense that indeed there is no alternative, apart from buying into the promises (and perils) of finance. Once the governments and public institutions had bought into the brave new world of finance, it proved difficult if not impossible to escape from its imposing logic – a development that typically appears to deepen with the passing of time and changing market sentiment. The case of Pforzheim bears this out to the fullest, where poor financial decisions led to panic, more risky actions and a deepening of the financial troubles.

It should be noted that the explored governments and public institutions were not only passive victims of the neoliberal turn. On the contrary, in all cases the relevant decision makers came to enthusiastically adopt and internalize a cultural logic that fuelled their unlikely financialization. In Cork, the local executive – the city manager – came to measure his success by counting the number of cranes he could see from his office window, unaware that he was firing up an epic property bubble. In Germany, local treasurers encouraged their peers to procure interest-rate swaps, and federal politicians pushed public sector banks to ‘get modern’ by replicating the capital-market activities of Wall Street’s finest. In other words, the cases reveal that there
was a degree of ‘copycatting’ at work i.e. replicating the financial and/or real estate strategies of cities and institutions elsewhere: for example, the UvA came to benchmark its real estate planning with a set of English universities, whereas Cork wished to transform its docklands in the image of Dublin – a development which in turn has been informed by developments in London. Mesmerized by what with hindsight can only be seen as financial hubris, public officials were seduced by the magical workings of finance, adopting investor-like rationalities.

As a result, not only have these decision makers adopted logics conducive to financialization, with time the institutional machineries they captained have also been transformed in the image of the financialized corporation. The case of the UvA bears this out the fullest: having built an entirely new management machinery under the board of directors, the new managerial caste no longer seems to directly manage the quality of higher education and research, but rather focuses on the quantitative management of cash flows, liquidity and solvency ratios to see the university’s budding financial commitments serviced and real estate projects completed. In other words, the penetration of financial logics has in all four cases been accompanied by a real believe in the financial wizardry of the money masters, seeing these organizations penetrated by- and transformed along the wishes and image of the world of finance.

The adoption and internalization of cultural logics conducive to financialization typifies the conjuncture prior to the financial crisis, although the financial transformations of the UvA and LBBW are of a more structural nature. The material outcomes of the variegated financialization processes, in turn, have all been strikingly similar. Whether through the creation of ambitious real estate plans and financing schemes, the signing of derivative contracts or the purchase of structured products – all these activities and developments have led to situations where a growing slice of public budgets has been usurped by financial intermediaries, in each case coming at the expense of the core functions of these institutions. In Amsterdam, teaching and research are increasingly at risk of having to subsidize debt-financed real estate developments. In Pforzheim, the signing and restructuring of interest-rate swap agreements to minimize interest payments led to a situation in which the Golden City had to pay millions to buy itself out of its predicament, with severe consequences upon the city’s budget and investments. In Stuttgart, LBBW’s wild adventures into the global capital markets resulted in a public bailout, seeing billions of public funds dedicated to keep the bank afloat, resulting in a similar set of opportunity costs. In Cork, the local authority spent millions to develop the docklands for the creation of a financial centre. With the onslaught of the crisis these plans failed to materialize, and Cork witnessed a drastic reduction in its budget, as the Irish state had come to
guarantee the unprecedented hubris that had captured the state. Again, these developments had massive financial effects on the city’s core functions.

To sum up, the title of this thesis is obviously a metaphor: *the long arm of finance* is better understood as an exhaustive set of typically interlinked capacities, or tentacles, centred on large banks and financial corporations commanded and controlled out of a limited number of hierarchical financial centres. Ultimately, however, the unique selling point of state-licensed banks is an ability to create credit and issue debt (Duncan 2012). This then constitutes the final commonality underlying each of the four cases: the real estate ambitions and delusions in Amsterdam in Cork, as well as the structured products and derivatives in Stuttgart and Pforzheim, were all built on growing mountains of public and private debt. Put differently, notwithstanding the specifics underlying the financial developments outlined in this thesis, in all four cases debt appears to be the central mechanism through which the long arm of finance has come to exert its sway over the institutions tied to the state (see Lazzarato 2015).

Having set out and explained some of the outstanding material and cultural commonalities shaping the financialization of the four cases, the next section builds on these findings to shed light on the four theoretically informed expectations set out in the introduction.

**THEORETICAL IMPLICATIONS**

Besides issuing debt, banking and larger financial power is based on scale, law and a particular set of ideas. Jointly, these material and cultural institutions define the pace, shape and ‘reality’ of the financialized incorporated universe at the heart of the global political economy. As argued, the geographical epicentre of global finance is clustered in financial centres, a hierarchy of global cities wherein London and New York reign supreme. In cultural and material terms, these two capitals of Anglo-American finance – housing the world’s leading banks, accountancy and law firms, consultancies and so forth – function as the sun in the financialized solar system. For these cities are the world’s prime command and control centres manufacturing the products and rationalities propelling the liturgies and realities of financialization forward: the interest-rate swaps of Pforzheim (and, although unknown, possibly of the UvA) were registered in Ireland and calculated or priced out of London trading rooms; LBBW embarked on its capital market activities out of Dublin and London, and Cork wished to emulate Dublin which, in turn, transformed itself into the image of-, and continues to function as a satellite of, the City of London.
Although the cross-border integration of financial markets already commenced during the 1950s with the emergence of the offshore Euromarkets, and political integration started that same decade on the European continent, since the 1980s governments in Europe and beyond have massively accelerated financial integration by ongoing neoliberalization. As a result, national state containers have steadily opened up through deregulation, liberalization and privatization – leading to both the upscaling and externalizing of a range of state functions. Again, neoliberalism indeed appears to fertilize the soil upon which financialization blossoms, for it has been on waves of neoliberalization that the rhythm of Anglo-American finance globalized and intensified across and within jurisdictions, cities and localities, seeing the reach of finance spread well beyond its traditional home. Yet despite these advances, signalling a process of cross-border institutional convergence, this thesis has been built on the premise that:

*Financialization does not pose a uniform development across space but manifests itself differently in a structured way.*

Geographers have long criticized grand macro perspectives for their relative neglect of spatial questions. The canvas of political economy, for example, is by definition a broad one, typically leaving little room for spatial variations. To varying degrees, this critique also applies to the literatures on financialization and global and world cities. Indeed, if financialization is to be seen as the spread of Anglo-American financial markets and practices across space, the geography of finance should broadly resemble the image portrayed in the global cities literature, seeing private corporations located in these cities progressively assume day-to-day management tasks over economic and social exchange at the expense of a transformed neoliberal state. Yet crucially, there continues to exist a wide range of cultural and material *path dependencies* across space, resulting in deeply rooted institutional structures and preferences, which prove hard to penetrate, transform or undo. Put differently, as neoliberalization unfolds unevenly across space, so does financialization spread its logic uneven ways across the cities, regions and states comprising the global political economy.

Yet despite purposefully selecting the four cases on the basis of institutional variations in state structures, financial systems, organizational templates, functions and capacities, the explored governments and public institutions featuring in this thesis have all come to buy into financial products, logics and rationalities indicative of financialization. As indicated, the outcomes have all been strikingly similar, seeing public budgets and balance sheets deteriorate with negative effects for the core functions of these institutions. Crucially, however, the ways in which these outcomes have
developed and shaped up in these domains varied considerably, which is partly a result of the variations in both in- and output variables upon which the cases have been selected. In other words, processes of financialization do indeed not pose a uniform development but manifests itself differently across space in a structured way. If anything, the literature should pay more attention to the variegated ways in which financialization shapes up in different institutional domains.

*State institutions are generally less prone to financialization compared to institutional domains tied to the economy and civil society.*

To explore the extent of the long arm of finance this thesis has focused on a set of specific institutional settings expected to be relatively immune to the forces of financialization. The guiding strategy has been the least likely crucial case study, offering a suitable tool to test breadth and depth of financial power. The rationale behind this logic is known as the *Sinatra inference*: ‘if financialization can make it there, it can make it anywhere’. Based on this approach, this research has focused on a range of non-profit governments and public institutions with clear subnational – regional and local – remits, which are to varying degrees tied to the institutional apparatus of the state itself.

Crucially, the explorations underlying this research suggest that state institutions are not better protected against financial intrusion. As indicated, one common explanation leads back to neoliberalization. As neoliberalization saw national state containers make way – opening up, ‘retreating’ and transforming – for cross-border economic activity, seeing a range of its functions upscaled and externalized, *within* neoliberal states a similar transformation is easily detected. Again, central state functions were devolved, downscaled and externalized. Here too, the gospel of competition led to incessant privatization of a range of public assets, and the shrinking set of institutions that more or less remained public property was effectively ordered to behave as if privatized. The promises of NPM, the blueprint for the neoliberalization across the (semi-) public sector, saw these institutional domains adopt the logics of the for-profit corporation. With the state and its adjunct apparatuses transformed along neoliberal premises – seeing a range of national state ‘filters’ evaporate paralleling the rise cross-border financial markets – the long arm of finance progressively managed to enter this unlikely set of institutional domains. If anything, what has been observed is that the state is not against nor constraining financial markets.

On the contrary, the investigations put forward in this thesis reveal that ongoing neoliberalization has led to what might be called a ‘retreat’ of the
state as risk manager: where the postwar state broadly functioned as collective risk manager by socializing a range of risks, from the 1980s onwards financial risks internally devolved from upper to lower tiers of government and adjunct public institutions, whereas risk management once assumed by the state was progressively externalized and taken up by financial market actors (in this regard, the outbreak of the financial crisis in 2007/8 marked the sudden return of the state as risk manager – not for citizens but for financial institutions like LBBW having overplayed their hand). With financial risk spreading down- and outwards, risk management has progressively become a glocal phenomenon – bypassing the intermediating filter of the national state. In this setting, financial institutions and their financialized acolytes came to offer a range of products and services to manage an array of financial risks, such as derivatives. In parallel, governments and public institutions adopted and internalized governance principles from the business world, and came to purchase and solicit financial ‘expertise’, products and services, in one way or another tied to ballooning debts.

In other words, instead of constraining markets the neoliberal state has actively encouraged the financialization of these unlikely domains, by pushing these institutions into the arms of financiers and their ilk. In sum, based on this research it can be concluded that state institutions are equally, not less, prone to the long arm of finance compared to institutional domains tied to the economy or civil society. The literature should pay more attention to the fact that states are the key shapers of financialization, allowing financial agents to increasingly discipline citizens and businesses alike. In fact, ongoing financialization has incrementally made the very authority of the state itself subject to the disciplining logic, promises and perils of financial markets.

Financialization does not pose a uniform development within and across states, but manifests itself differently across state institutions in a structured way.

In revealing that state institutions are not less but equally prone to the sway of finance, it logically follows that the answers to the first expectation can be reconfigured in light of the second, in order to answer the third expectation detailed above. That is to say, a careful distinction between financialization as a process or outcome or, alternatively, between the thing to be explained, the explanandum, and the thing that explains, the explanan(s), is helpful here: where the explored processes of financialization have indeed been wildly diverse, the outcomes were all strikingly similar. Put differently, financialization as the thing that explains has been readily if not uniformly identified, yet the ways in which this outcome has come about,
the process, has in each case been unique, necessitating detailed description and explanation.

A clear example in this regard can be found in the similarities and differences derived from the cases of Pforzheim and Cork. These two local governments are embedded in two radically different institutional settings – located in decentralized and centralized state structures respectively – resulting in different institutional capacities and degrees of autonomy at the local level. Where decision makers in Pforzheim could and did buy into the seductive world of financial derivatives, the highly centralized setup of the Irish state does not grant Irish local officials such leeway. However, where Golden City Pforzheim saw a growing slice of its budget appropriated by financial intermediaries due to poor financial decisions, Rebel City Cork equally saw a growing slice of its budget evaporate due to poor financial management, next to its own spending on docklands development chiefly the result of decisions taken at the level of central government. In other words, where the Pforzheim case offers an account of direct financialization, the Cork case offers a story of indirect financialization. As such, although the outcomes are strikingly similar, the ways in which these outcomes have come about are radically different. This is a result of the varied in- and output variables upon which the cases have been selected. Nonetheless, despite of these carefully selected differences, a degree of equifinality has been readily observed, underscoring the overall validity of this research. As the saying goes, ‘many ways lead to Rome’ – the literature should pay more attention to the many pathways in which financialization comes to penetrate its other.

State institutions situated in corporatist jurisdictions without market-based financial systems are particularly well shielded from financialization.

As noted in the introduction, the literature on financialization predominantly focuses on the US and the UK – the heartlands of market-based finance. Furthermore, the dominant perspective found in the literature on comparative institutionalism argues that corporatist states with bank-based financial systems have less developed financial markets, suggesting that these jurisdictions are less hospitable to the forces of financialization. Nonetheless, this research has revealed that binary depictions of liberal and corporatist states, operating national bank- and market-based financial systems, do not do justice to the ways in which these ideal type ‘containers’ have evaporated or hybridized. As a result, even supposedly strong corporatist jurisdictions without market-based financial systems are not better protected against financial intrusion. If anything, rigid depictions of capitalist varieties
increasingly suffer from methodological nationalism, neglecting the ways in which neoliberalization has *glocalized* the institutional terrain within which financial markets, governments and public institutions operate. Furthermore, not only is the literature relatively blind for financial developments ‘above’ the national state, it is also neglects enduring variation within national jurisdictions (e.g. Crouch et al 2009).

In Amsterdam, the corporatist state offered little protection against the intrusion of finance into academia, revealing that the protective cocoon of the Dutch state has partly eclipsed due to incessant neoliberalization. Where the real estate transfer triggered financialization in Amsterdam, in Pforzheim Deutsche Bank acted as a kind of Trojan horse, mesmerizing the local authority with financial products and practices not typical of German banking but rather of Anglo-American finance. Likewise, in supposedly risk-averse Baden-Württemberg, the epitome of German public banking actually adopted a capital markets strategy – with those toxic securitized products functioning as Trojan horses – more in line with private banks operating in Anglo-American jurisdictions. Finally, the findings from Ireland are completely at odds with the dominant premises of comparative institutionalism: German banks including LBBW conducted market-based activities out of Ireland, contradicting bank-based conceptions of German financial institutions, whereas Anglo Irish Bank collapsed following a curious type of relationship banking, a trait typically assigned to German banks.

What has generally been observed is that Anglo-American financial techniques practices have come to penetrate ‘other’ banking systems elsewhere. However, speaking of a straightforward convergence of bank-based systems along the configuration of Anglo-American financial markets would be a fallacy. Instead, German banks have themselves adopted market-based techniques, not least by conducting these outside the German jurisdiction. Furthermore, Anglo-American financial activities practices within Germany have been adapted to local institutional variations – the case study on LBBW bears this out to the fullest. As discussed in the Pforzheim study, it is in the interactions between German and Anglo-American financial norms that novel practices emerge. Furthermore, German financial products are also incorporated in Anglo-American contexts – the adoption of the German *Pfandbrief* under Ireland’s common law regime is a case in point – suggesting that financial convergence is not a simple ‘one-way street’, but rather unfolds in multiple directions. Having said this, within this multidirectional development Anglo-American finance is without doubt the dominant current, penetrating a range of institutional domains once regarded to be relatively inhospitable to its logics.

Based on these findings, it might be concluded that other literatures with better explanatory values should be sourced to crystalize the
Conclusions

contemporary differences between national financial systems and jurisdictions. To this end, the Irish case study has foregrounded the literature on offshore finance (e.g. Palan et al 2010) to supplement explorations of, say, contemporary varieties of financialized (offshore) capitalism. In addition, concerning the expectation that market-based financial systems are more conductive to financialization, it should be noted that financialization is ultimately based on debt, and this crucial ingredient is readily available in both market- and bank-based jurisdictions. In other words, if the crux of finance is debt, whether this debt is held by banks on their balance sheets or is traded on capital markets appears to be of secondary importance at best. All in all it seems that the literature on comparative institutionalism provides an incomplete and increasingly misleading idea on national financial varieties, overemphasizing the importance of national institutional settings with regard to financialization. More importantly, besides exploring the paths through which state institutions embrace finance, the financialization literature should put more emphasis on cases outside the Anglo-American heartland, or it will simply not be able to recognize the fact that financialization is a much deeper and widespread phenomenon than is generally acknowledged.

Financialization is defined as the increasing dominance of financial markets, products, actors and rationalities over the functioning of political economies, civil society and daily life.

To conclude, the broad yet concise working definition of financialization given in the introduction does not require any major revisions, as long as the reader fully takes to heart that ‘political economy’ includes the state. For the state is by definition the key shaper of the processes and outcomes of financialization, yet the ways in which it does so, and might become subject to financial authority as a consequence, remains relatively neglected. Furthermore, concerning the financialization of governments and public institutions, next to the structural intrusion of bankers and financiers in these domains, particular emphasis should be put on the dedicated involvement of the professions and related para-financial actors: accountants, consultants, lawyers, and so forth, for these actors do seem to pop up everywhere. In conjunction with financiers, these actors have come to structurally advise neoliberalized state institutions on their daily financial operations and future challenges. Not only has the procurement of outside financial ‘expertise’ become the rule rather than exception. In addition, these types of actors increasingly work within the (semi-) public sector, seeing public administrators turn into managers, and financial newspeak and worldviews take root within these domains, accelerating the cultural financial capture of these
institutions. In line with the premise of the global and world cities literature, the new ‘command and control’ rulemakers do not merely reside in global financial centres – these types of actors have also made the institutional fabric of the state their home.

RESEARCH AGENDAS: THE FINANCIALIZATION OF THE STATE

This research has merely scratched the surface of what in the future might become a fascinating category within the financialization literature: the financialization of the state. Although the cases confirm that financialization is indeed pervasive across Europe, the literature is in need of more empirical detail, particularly cases outside the Anglo-American financial heartlands. This concluding chapter therefore ends with a call for more empirical detail on ways in which the diverse institutional fabrics of states become subject to financial power. To this end, this section sets out an agenda featuring a range of research possibilities through which the financialization of states can be explored.

As indicated in the introduction, both state and financialization are large and complex concepts, and it follows that the future literature on the financialization of the state is bound to cover a wide range of topics, approaches and perspectives. To empirically explore events or developments that speak to- or are indicative of the financialization of the state, the general research strategy adhered to in this thesis offers some guidance. That is to say, by selecting (i) a specific domain liaised to the state, which is (ii) entangled in a specific financial development or event, the large and complex matter concerning the financialization of the state is operationalized. First, to unpack the state into manageable chunks, scale enters the equation, slicing up the state in various spatial dimensions. Second, particularly since the financial crisis of 2007/8 there are countless ‘real world’ financial events having unfolded within these domains worthy of empirical exploration. In this regard, this section can merely highlight some examples worthy of future study, for there are countless evolving structures and agencies, or material and cultural developments, speaking to the financialization of the state that are worthy of qualitative and quantitative investigations. Only by generating more empirical material on the ways in which governments and public institutions become subject to financial power can scholars start to fish out their recurring commonalities, and start to theorize the actual financialization of the state.
What follows are some pointers in this direction:

First, as this research has shown, at the local or subnational level there are countless governments and public institutions – most of which are likely to be indebted. Besides thousands of European local governments having solicited the services of investment bankers, these institutions typically own and operate a range of subdivisions, many of whom have likewise bought into promises and perils of interest-rate swaps, sale-and-lease-back constructions of public property, or similar exotic financial undertakings. In addition, (semi-) public or ‘state near’ institutions with national functions, such as the UvA, also have clear localized remits, and equally source all kinds of financial services. Climbing up the subnational architecture of the state, there are provincial or regional governments, whose functions are also typically structured along a range of divisions or adjunct bodies. In other words, this landscape is vast, full of unique financial events and stories. Through a micro focus on the financial travails of specific local governments and localized public institutions, the larger macro developments characterizing global finance are equally illuminated.

Besides institutions with subnational remits, the set of institutions comprising the national scale deserve special attention, for it is typically through the center that neoliberal state restructuring or financial de/reregulation is enacted. For example, fascinating insights could be distilled through researching the changing nature of finance ministries, including their adjunct public debt management agencies and tax collection offices (including networks of bilateral investment and tax treaties, tying the offshore world into financial intermediation), as well as the changing roles of national central banks. Likewise, the transformation or “hollowing out” of national democracies, including the changing roles of mass political parties, offer intriguing insights that might speak to the financialization of the state (e.g. Mair 2013). Financial events worthy of investigation include the many public bailouts of financial institutions in 2008, typically devised by the same law firms who assisted those very failed banks in hiding their debts: where law firm Arthur Cox devised emergency legislation and a ‘bad bank’ in Ireland (Ross and Webb 2012), in Germany law firm Freshfields devised the federal bailout (Bundesgesetzblatt 2008). Besides exploring the ways in which national financial systems change, especially in civil law jurisdictions like Germany it is fascinating to trace the evolution of legal practices potentially advancing the financialization of the state, in this case leading to the rise of large Anglo-German law firms (Beaverstock et al 1999; Luschin 2010). These and other investigations, centered on exchanges between (semi-) public and (semi-) private players on the national level, are pertinent to explore the extent of the financialization of the state.
Lastly, and of particular importance to Europe, there are intergovernmental and supranational scales of political organization where national member states ‘pool’ their functions. Again, the EU, eurozone and their adjunct bodies offer fascinating cases on how remits of the state become penetrated by financial power. As has been shown in this research, the European Commission has pushed LBBW out of its comfortable state cocoon. Likewise, the aim to reduce public debts to qualify for monetary union has been one of the underlying reasons for the devolution strategies observed in Amsterdam and Pforzheim, as much as Europe’s monetary straightjacket fired up the Irish property bubble. It is not without reason that scholars increasingly regard the EU as Europe’s neoliberal trailblazer, providing financial intermediaries with all kinds of opportunities (e.g. Anderson 2009). It should be noted that the institutional architecture of the eurozone in particular has witnessed substantial change ever since Greece ‘surprisingly’ revealed a gaping deficit late 2009 – transformations that merely underscore the fact that “the crisis of financialization” (Lapavitsas et al 2012: 1) has been countered by more financialization (e.g. Birch and Mykhnenko 2014; Hendrikse 2012).

Again, events and developments worthy of investigation are numerous: for example, the complex legal groundwork leading to the creation of the European Stability Mechanism (ESM) (De Witte 2013) – once again featuring law firm Freshfields (Bundestag 2012) – saw techniques of financial engineering having led to the crisis now being deployed to solve it (e.g. Bowman 2011). In fact, the handling of the euro crisis suggests that European technocrats increasingly adopt and replicate techniques from the financial world: whether looking at the workings of the secretive Eurogroup or the European Council, their operations effectively mimic the set of legal tricks shaping the financial offshore world, bypassing any parliamentary and judiciary oversight (see Curtin 2014), up to the point that these powerful groupings can effectively do whatever they please as they do not even exist on paper (Varoufakis 2015). This is hardly a surprise, given that many European officials are familiar with the revolving doors between public and (para-) financial domains – the budding list of Goldman Sachs alumni captaining the key nodes of Europe’s layered fiscal and monetary complex is a case in point (Foley 2011). Likewise, the structural outsourcing of public executive and supervisory tasks to a “golden circle” of elite financial players merits further exploration (e.g. Pop 2013). Again, developments and events like these all point to the encroaching financialization of the state.

Similarly, the nearby future also points to a deepening financialization of European states. For example, the looming capital markets union can be seen as the next step in the advance of market-based finance across the EU (European Commission 2015). Likewise, the prospect of the Transatlantic Trade and Investment Partnership (TTIP) between the US and the EU
Conclusions

(Pérez-Rocha 2015) – if implemented as foreseen effectively handing judicial power to (financial) corporations to challenge sovereign law making – will in all likelihood bring more financial convergence along Anglo-American lines across the continent – a continent that has already adopted English as its *lingua franca*; where banks increasingly source the English common law tradition as their legal method of choice to advance financial ‘innovation’, and where accounting rules set by private standard setters have long converged along the preferences of Anglo-American investors (Nölke 2011).

Yet despite ongoing standardization in financial practices, a wide range of path dependencies and institutional particularities continue to shape alternative financial practices, both in Europe and beyond. These ever-changing frontiers, potentially limiting the global reach of Anglo-American finance, offer fascinating vantage points for exploration: for example, (how) is financialization on the rise in places like Russia or China? And what about the possible financialization of those states, or their financial roles back in the Anglo-American heartlands and elsewhere?

Besides a metaphor, *the long arm of finance* is also a play on another saying: ‘the long arm of the law’, which in turn implies the state. Besides investigating the ways in which state institutions become entwined with- or subject to financial power, the ways in which states empower financial players also offer fascinating insights, often destabilizing conventional views depicting clear divides between state and market. For example, bankers, lawyers and accountants do all enjoy state-licensed monopolies granted by sovereign decree. Likewise, the rise of the financial offshore world – a world dominated by bankers, lawyers and accountants – is born out of “the commercialization of state sovereignty” (Palan 2002). In other words, these players have been handed specific functions by the state, or a slice of sovereign power, not least to maintain the state’s authority. In this capacity, however, the worlds leading banks, law- and accountancy firms have increasingly morphed into global players who, in turn, are now increasingly able to redefine the rules of the game (Büthe and Mattli 2013). Amongst others, bankers, lawyers and accountants doubling as lobbyists dominate the Brussels’ law-making machinery (Burley et al 2010). Theoretically, there are many liberal divisions between states and markets which, in reality, do not seem that clear-cut. The inherent links between- and possible unity of states and financial players offer intriguing paths to explore in light of the financialization of the state.

Once substantial empirical detail on the financialization of the state has been generated, it becomes paramount to explore the ways in which conjunctural developments and events speak to the *longue durée* advance of modern capitalism and the state (e.g. Braudel 1977; Tilly 1990). For if the state historically evolves in tandem with capitalism, what types of states
or statehood are today emerging alongside global financialized capitalism? Is it *Empire* (e.g. Hardt and Negri 2001)? A global state (e.g. Chimni 2004)? In any case, built by- and couched in state power, it might be worthwhile to explore the extent to which the financial word itself is operating and “seeing like a state” (Scott 1998). Amongst others, the employment of sovereign power (Agamben 1998) poses intriguing questions: although states and their governments remain the *de jure* beholders of state sovereignty – formally exercising sovereign power upon a popular democratic mandate – increasingly state sovereignty appears *de facto* enjoyed and exercised by the bankers, lawyers and accountants captaining the financialized corporate ‘mega machine’ (Mumford 1970) – up to the point where those who actually determine “the exception” to sovereign rule (Schmidt 2014) are not the public representatives you would expect.

Amongst other insights, what this research has shown is that the dividing lines between public and private domains, or states and markets, are not as clear cut as conventional theory typically suggests. What might therefore be worthwhile exercise is a critical reassessment of the underlying, typically liberal and dualist assumptions shaping dominant conceptions of the state (e.g. Bichler and Nitzan 2009). Are public and private, or state and market spheres, clearly separate domains? For one, public states and private corporations are both born out of sovereign decree; are both comprised of corporate bureaucratic bodies, and effectively define each other’s image and reach (Barkan 2014; Graeber 2015). In this integrated setting, bankers and lawyers enjoy a degree of sovereignty due to their state-licensed functions. Likewise, the rise of the offshore world – the ‘home’ of global finance – is the product of the sovereign rule of the state (Palan 2003; Palan et al 2010). In other words, the larger the empirical detail on the financialization of the state becomes, the more it becomes necessary to revisit and potentially modify the dominant set of assumptions shaping conventional outlooks and worldviews on the organization and functioning of states. Such investigations appear pertinent. Particularly in Europe, where the financial-come-euro crisis paradoxically seems to have accelerated the neoliberalization and financialization of the eurozone and its underlying member states.

In writing up these concluding remarks, one is reminded of the famous words of Mario Draghi – the former Italian treasurer and ex-Goldmanite now capturing the European Central Bank (ECB), promising London-based financiers to keep the euro intact. ‘Whatever it takes’, he reassured his audience late July 2012. Three years onwards, Draghi has effectively taken over the job of national finance ministers and Brussels’ technocrats, policing the eurozone without any democratic oversight, forcing Greece to service its unplayable debts upon the threat of a financial apocalypse. Are these developments indicative of what ‘whatever it takes’ meant to the uncrowned
sovereign of Europe? If so, the price of Draghi’s promise seems unbearably high, with the proverbial ‘pound of flesh’ being the abolition of democracy itself. Put differently, the price of Draghi’s promise seems to be the very development featuring in this thesis – a development that up until now has not received the academic attention it deserves. It is therefore high time that the financialization literature finally catches up with one of the most profound and worrying political-economic developments of our time: that the encroaching financialization of the state itself.
REFERENCES


CONCLUSIONS


Pérez-Rocha M (2015) The Transatlantic Trade and Investment Treaty [TTIP]: Why the world should be aware, Transnational Institute, working paper.


Vaak wordt beweerd dat de macht van de financiële sector verreikend en overal voelbaar is. Echter, de uiteenlopende manieren waarop financiële markten en actoren hun wil opleggen aan diverse landen, steden of instellingen is vooralsnog weinig onderzocht. Sterker nog, claims zoals hierboven verhullen dat financialisering – gedefinieerd als de toenemende dominantie van financiële markten, instrumenten, actoren en logica binnen het functioneren van politieke economieën, de maatschappij en het dagelijks leven – een fundamenteel ongelijk proces behelst, zowel tussen als binnen nationale en regionale politieke economieën, plaatsen of huishoudens. Anders gezegd, specifieke institutionele en ruimtelijke domeinen lijken beter beschermd tegen het binnendringen van financialisering dan anderen.

Dit proefschrift bestaat uit vier case studies waarvan op verschillende manieren en in diverse mate wordt verwacht dat zij relatief goed beschermd zijn tegen financiële verleidingen en macht. De studies verkennen en analyseren de financiële activiteiten van vier Europese instellingen die op verschillende manieren verbonden zijn met de staat: de Universiteit van Amsterdam; twee lokale overheden, respectievelijk in Pforzheim, Duitsland, en Cork, Ierland, alsmede een regionale publieke bank in Stuttgart, Duitsland. De financiële ontwikkelingen die in de vier cases een hoofdrol spelen variëren van klassieke financiële mechanismen als grondspeculatie en vastgoedontwikkeling, tot de omarming van hedendaagse financiële technieken en producten, te weten securitisatie en rentederivaten.

Het ‘minst waarschijnlijke’ karakter van de vier case studies is afgeleid van een reeks dominante theoretische aannames en perspectieven, onder andere gebaseerd op de literatuur over financialisering en het vergelijkend institutionalisme. Zo wordt verwacht dat overheden en publieke instellingen in algemene zin beter beschermd zijn tegen financiële marktprikkels dan particuliere ondernemingen. De verwachting is dat dit zeker geldt voor publieke instellingen in een land als Duitsland, waar een corporatistisch
ingerichte economie gedomineerd door banken zich minder zou moeten lenen voor de marktgedreven financiële dynamiek die als typische voorwaarde gezien wordt voor het intreden van financialisering.

Naar de gehanteerde ‘minst waarschijnlijke’ case study methode volgen de vier studies eenzelfde onderzoeksstrategie die gebaseerd is op het verzamelen van verschillende typen data. Zo zijn er naast de uitgebreide analyse van relevante mediaverslaggeving en beleidsdocumenten ook een vijftigtal interviews afgenomen met relevante beleidsmakers en andere betrokkenen. Daarnaast zijn twee van de vier case studies ook gebaseerd op rijke empirische observaties, en vertonen deze zodoende een etnografisch karakter. Door het trianguleren van verschillende typen methoden, data en bevindingen is gepoogd de validiteit van het onderzoek te optimaliseren.

Het eerste hoofdstuk van dit proefschrift behandelt de financialisering van de Universiteit van Amsterdam (UvA). Deze semipublieke instelling is gesitueerd in een sterke corporatistische staat, en wordt traditioneel aangestuurd door een gilde van professoren. Deze selectie van deze case is derhalve gebaseerd op de verwachting dat deze publiek gefinancierde instelling relatief goed beschermd is tegen financialisering. Desondanks laat deze studie zien dat de UvA sinds midden jaren negentig stapsgewijs is blootgesteld aan financiële actoren, technieken en producten om het utilitair vastgoed te beheren. De UvA wordt sindsdien als een regulier bedrijf geleid door een nieuwe kaste professionele managers. Gevolg is dat financiële afspraken, beperkingen, cijfers en modellen gekoppeld aan schuldgedreven vastgoedinvesteringen in toenemende mate het beleid bepalen, met alle gevolgen van dien voor de kerntaken van de universiteit, namelijk het geven en uitvoeren van kwalitatief goed onderwijs en onderzoek.

Hoofdstuk twee gaat over de financiële perikelen van de lokale overheid van het provinciale stadje Pforzheim in Duitsland. Dit hoofdstuk bestudeert de manier waarop een gemeente haar budgettaire lot heeft verbonden met renteswaps – één van de voornaamste financiële instrumenten waarmee particuliere bedrijven en publieke instellingen hun schuldposities en rentebetalingen beheren. Van gemeenten zou men echter mogen verwachten dat zij zich niet aan de bijkomende risico’s wagen. De financiële goochelkunsten van Die Goldstadt laten echter zien dat zelfs lokale overheden in Duitsland – een jurisdictie gekenmerkt door een niet-marktgedreven financieel systeem – sinds de eeuwwisseling massaal derivaten hebben gekocht van grootbanken als Deutsche Bank en JPMorgan. De financiële consequenties waren bijzonder groot toen de gemeente zich van deze contracten trachtte te ontdoen, met alle negatieve effecten van dien voor de kerntaken van de stad.

Hoofdstuk drie analyseert de financiële transformatie van Duitsland’s grootste publieke bank: Landesbank Baden-Württemberg (LBBW) met hoofdkantoor in Stuttgart. Omdat de bank midden- en kleinbedrijven
financiert in een regio die bekend staat om haar zuinigheid, en bovendien is ingebed in een gelaagde institutionele context die zich niet leent voor financialisering, is de selectie van deze case gebaseerd op de verwachting dat LBBW zich niet heeft ingelaten met risicovolle activiteiten. Desondanks laat deze studie zien dat ook LBBW zich heeft verslikt in de handel in complexe financiële producten. Hoewel deze activiteiten deels zijn teruggeschroeid sinds het uitbreken van de financiële crisis heeft de bank niet definitief afscheid genomen van de kapitaalmarkt. Zo is de bank nog altijd actief in het verkopen van gesecuritiseerde diensten aan haar regionale klanten. Deze bevindingen werpen nieuw licht op de literatuur over de financialisering van Duitse banken, bedrijven en het financiële systeem.

Het vierde en laatste hoofdstuk behandelt de lokale overheid van Rebel City Cork in Ierland, waar publieke beleidsmakers in tandem met schuldgedreven projectontwikkelaars een financieel centrum wilde ontwikkelen om de strijd aan te gaan met Dublin’s International Financial Services Centre (IFSC). De studie schetst de manieren waarop financialisering het Ierse overheidsbeleid heeft vormgegeven. Daarnaast laat ook deze case studie zien dat grensoverschrijdende financiële dynamiek een impact heeft op de dominante perspectieven van het vergelijkend institutionalisme. Waar de literatuur nog altijd spreekt over nationale typologieën van bank- of marktgedreven financiële systemen is het daadwerkelijke plaatje warriger. Sterker nog, waar Ierse banken een vastgoedzeepbel creëerden door duurzame klantrelaties – een typisch kenmerk van het Duitse bankensysteem – hebben Duitse banken massaal complexe marktransacties georganiseerd vanuit Dublin – een dynamiek die financiële systemen van Anglo-Amerikaanse signatuur karakteriseert.

Ondanks dat de vier cases op verschillende manieren zijn opgezet, met een bewust geselecteerde diversiteit tussen de verschillende in- en output variabelen, vertonen de onderzoeksuitkomsten een aantal opmerkelijke overeenkomsten. Zo laten de vier studies onverhuld zien dat deze vier ‘minst waarschijnlijke’ institutionele domeinen niet immuun zijn tegen financialisering. In tegendeel: ondanks de uiteenlopende institutionele variaties in de structuur van de bestudeerde staten en financiële systemen, en ondanks de diverse organisatorische blauwdrukken, functies en capaciteiten van de bestudeerde instellingen, heeft de voortdurende neoberalisering van overheidsbeleid in alle gevallen stapsgewijs geleid tot het adopteren en internaliseren van financiële logica’s en producten – deels door onnadenkendheid en verleiding, deels opgelegd door beleidswijzigingen elders. Deze bevindingen hebben dan ook een weerslag op de theoretische aannames.

Zo zijn deze met de staat vervlochten instellingen allerminst (beter) beschermd tegen financiële verleidingen, met alle gevolgen van dien voor de kerntaken van deze organisaties. Meer specifiek doen dominante
theoretische voorstellingen over het liberale of corporatistische karakter van
nationale staten, alsmede de bijkomende concepten van bank- of marktge-
stuurde financiële systemen, geen recht aan de diverse manieren waarop de
verschillende nationale containers inmiddels zijn ontmanteld en gemuteerd,
en geleidelijk onderdeel geworden zijn van een grensoverschrijdend financ-
cieel systeem. Hoewel de case studies inderdaad suggereren dat financialis-
ering overal voelbaar en verreikend is, heeft de literatuur dringend behoeft
aan inzichten over de variërende effecten van de lange arm van de financiële
sector. Daarvoor zijn in eerste instantie meer empirische voorbeelden nodig,
en in het bijzonder meer case studies gesitueerd buiten de Anglo-Ameri-
kaanse thuishaven van het gmondialiseerde financiële systeem.

Alleen door het verkrijgen van meer empirische materiaal over de al-
erhande manieren van het ‘hoe en waarom’ zelfs overheden en publieke
instellingen onderhevig raken aan het dictaat van financialisering kan de
literatuur beginnen met het ontmaskeren en theoreetiseren van wat misschien
wel één van de belangrijkste ontwikkelingen is van de afgelopen decennia:
dat is de oprukkende financialisering van de staat zelf.
It is often claimed that the power of finance is pervasive and omnipresent, yet the delicate ways in which financialization exerts its will across space remain little explored. In fact, such claims obscure the fact that financial development constitutes a profoundly uneven process – both across and within national political economies, regions or localities. Put differently, some institutional domains appear less hospitable to the forces of financialization than others. This thesis advances four case studies, which are to varying degrees considered least likely to fall prey to financial seduction, logics and authority. The cases explore the financial activities of four European institutions in various ways tied to the state: a Dutch public university, two local governments in Germany and Ireland, and a German regional public bank. The expectations defining their least likely nature are informed by theory, including the literatures on financialization and comparative institutionalism.

The cases reveal that despite expectations, the long arm of finance has managed to penetrate these domains, necessitating a number of advances in the foregrounded literatures. Despite variations in state structures, financial systems, organizational templates, functions and capacities, incessant neoliberalization of state policy has gradually lured if not ‘forced’ these governments and public institutions to adopt financial products and logics. As such, binary depictions of liberal and corporatist states or national bank- and market-based financial systems do not do justice to the ways in which these ideal type ‘containers’ have evaporated or hybridized. Although the cases indicate how financialization is pervasive, the literature is in need of more empirical detail, particularly cases outside the Anglo-American heartland. Only by generating more theoretically grounded empirical accounts on the ways in which state institutions become subject to financial power can the literature start to unmask and theorize the encroaching financialization of the state itself.