

## The Mundane Political Economy of Finance

Donald MacKenzie

An “anniversary” event such as this can be an occasion to take stock. Almost a decade ago, I summarized what I took to be widely shared precepts in what was then the new field of “social studies of finance” in the following list:

1. Facts matter.
2. Actors are embodied.
3. Equipment matters.
4. Cognition and calculation are distributed and material.
5. Actors are *agencements*.
6. Classification and rule following are finitist processes.
7. Economics *does* things.
8. Innovation isn’t linear.
9. Market design is a political matter.
10. Scales aren’t stable.

(MacKenzie, *Material Markets*, Oxford, 2009, chapter 1)

I wouldn’t want to disown anything on this list, but there is what now strikes me as a glaring omission: what (for want of a more elegant name) I would call the “mundane political economy of finance.” A simple way of explaining this is by analogy with the art market. The winning bid for *Salvator Mundi*, attributed to Leonardo da Vinci, was \$400 million, a very nice round number. The episode is entirely consistent with these precepts, even if, for example, the sciences that are *doing* things here – giving the painting its value – are art history (and the natural sciences and technologies it deploys), rather than economics. But what now leaps out at me is something different. The buyer is going to have to pay Christie’s \$450,312,500: the difference is Christie’s “buyer’s fee.” While the absolute size of the fee is unusually big, its relative size may actually be atypically modest: buyers at auction are normally charged a fee of 20–30 percent and sellers 5–10 percent (*Financial Times*, October 7, 2017). These fees seldom attract attention: they, and the income they provide to intermediaries in the art market, seem to be taken for granted.

The “mundane political economy of finance” signals the importance of loosely analogous processes in financial markets. I was first attracted to research LIBOR (the London Interbank Offered Rate) because, as a researcher coming from the social studies of science and technology, I knew that facts matter (Precept 1 above), and that “facticity” was a fascinating, complex, and sometimes precarious accomplishment. I quickly discovered that the people submitting inputs to the LIBOR calculation came from banks with financial interests that could be affected by the calculation’s result. The LIBOR algorithm (a “trimmed mean,” in which the first and fourth quartiles were omitted from the calculation) was, however, designed to pro-

tect against this, and furthermore the inputs to LIBOR were public, at least among the dealers and inter-dealer brokers of the London money market.

I therefore did not anticipate what subsequent litigation has revealed: the existence of concerted efforts to alter LIBOR. What I underestimated (a background in research on science and on nuclear weapons technology was not a good preparation for this) was a “mundane political economy of finance” consideration: money-market dealers such as Tom Hayes – currently serving an 11-year jail sentence – provide the brokers with their income. Brokers’ firms provide the screens that are the main minute-to-minute guide to movements in the money market, and brokers interact with multiple clients, some of whom provided LIBOR inputs. Brokers’ dependence on fee income created an incentive to do what dealers such as Hayes wanted (or at least to report that they had done so: paradoxically, some of their legal vulnerability, and that of their clients, may have arisen from their exaggeration of their influence on other dealers), an incentive I underestimated.

Much of my more recent research has been on high-frequency trading or HFT, which is proprietary trading (that is, seeking direct trading profit, not fees for executing others’ trades) that is algorithmic and ultrafast. HFT turns out – quite unexpectedly to me – to be a wonderful “natural experiment” in the mundane political economy of finance. I have been studying the development of HFT not just in the trading of shares (which nearly all the public discussion of HFT focusses on, as in the debate sparked by Michael Lewis’s *Flash Boys*), but also in futures, sovereign bonds, foreign exchange, listed options, and interest-rate swaps.

This comparative exercise reveals very large differences among these asset classes in terms of the extent to which HFT has taken hold, in the practices of HFT, and in the influence of the development of HFT on the pre-existing mundane political economy of trading. HFT is almost always a challenge to that pre-existing economy; in some cases, HFT is entirely blocked by it; in other cases, HFT overwhelms it; in yet others, HFT firms reach an accommodation with the incumbent order. That order frequently shapes HFT practices. And HFT has, of course, its own mundane political economy. Above all, this confrontation makes the mundane political economy of trading *visible*.

Does the mundane political economy of finance (fees; exclusionary mechanisms; the apparent details of trading; the priorities, practices, and rules embedded in the software and physical hardware of financial markets; and so on) matter? In my contribution, I will argue that it does, for at least two reasons.

The first is the role of the mundane political economy of finance in financial crises. When researching the 2007–2008 global financial crisis for MacKenzie (2011), I was struck by how low the profitability of some of the most fatal trades was. (Somehow, one would expect that trades that helped cause a giant crisis would have had attractively high profits.) A substantial contributor to the crisis was the “negative basis trades” in the super-senior tranches of ABS CDOs engaged in by global banks. Space constraints prevent an explanation of those trades (see MacKenzie 2011), but only one mundane aspect of them matters here. Within banks such as UBS they were judged eligible for “Day 1 P&L”: a trader entering into one of these negative basis trades could count the entire present value of the trade in their current year’s

profits (not just the trade's profit in the current year). An interviewee talked me through a typical negative basis trade: its annual profit was around "five basis points," in other words, 0.05 percent per year. Day 1 P&L, however, made this tiny sliver of profit attractive to traders. These trades had fatal or near-fatal effects on the global banks engaging in them.

The second reason I would cite here for the importance of the mundane political economy of finance is its contribution to excessive rewards and profits within the financial system and excessive costs to the wider economy. One of the most important recent contributions to our understanding of this is Thomas Philippon's painstaking historical analysis of the efficiency of the US financial system, and his shocking finding (see the figure on p. 4) that the system shows no consistent tendency to become more efficient through time (*American Economic Review*, 2015). It's a finding interrelated with finance's effects on inequality: in a crude interpretation, all the gains in the efficiency of the information and communications technologies underpinning finance (from the epoch of clerks writing on paper ledgers by gaslight onwards) have been captured, mainly in the form of the high incomes of well-placed intermediaries. That's precisely the kind of thing that the mundane political economy of finance needs to investigate and explain.

I would, therefore, now add an eleventh precept: the mundane political economy of finance matters. Of course, there are many other aspects to the political economy of finance: broader issues of the history of capitalism, epochal changes such as the breakdown of the Bretton Woods agreement, the influence of neoliberalism, and so on. I don't in any sense underestimate their importance. However, one must always be aware of the limitations of one's methodology. The "social studies of finance" of the kind I practice are rooted primarily in interviews, ethnographic fieldwork, and closely-focused historical research. Some of the above issues could indeed be investigated in this kind of way; others would require a different methodology. My argument is therefore more narrowly focused: that those of us who work in this way could productively keep the mundane political economy of finance at the forefront of our minds.

**Figure 1: Unit cost of financial intermediation in the United States, 1884–2012**



Data courtesy Thomas Philippon; for details, see Philippon (2015).

To get a sense of the meaning of “unit cost of financial intermediation,” imagine that person A deposits \$100 in a bank and earns \$1 per year interest, while the bank lends person B \$100, charging \$5 per year interest. \$200 of financial intermediation have been provided at a cost of \$4. The unit cost of financial intermediation in this case is therefore  $\$4/\$200=0.02$ .

## References

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