Futurity, Pro-Cyclicality and Financial Crises[1]

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Abstract:

Nearly a century ago, one of the leading forefathers of the school of evolutionary economics, John R. Commons, coined the term 'futurity' to describe an epochal change in late 19th advanced economies. Futurity refers to the re-orientation of economies towards the future, and specifically, to the fledgling practice of treating businesses as 'going concerns' and measuring its value in terms of their anticipated future profits. Curiously, the implication of such epochal changes on the performance of the financial system had rarely been discussed, let alone addressed. This article presents a theoretical argument that suggests that futurity encourages pro-cyclical dynamics that are pulling the financial systems in ever more violent and disastrous swings.

[1] The article draws on concepts and ideas that evolved in discussions I have had with Yuval Milo, Anastasia Nesvetailova, Jean-Philippe Robé, Amin Samman and Herman Schwartz. I would like to thank the anonymous referees for their helpful comments.

Introduction

Nearly a century ago, one of the leading forefathers of the school of evolutionary economics, John R. Commons, coined the term 'futurity' to describe an epochal change in late 19th advanced economies. Common's notion of futurity is somewhat ambiguous. For it combines a philosophical statement about the nature of economics as a social science, with specific set of observations about changes that were taking place in the American economy and society in late 19th century. Futurity refers, in addition, to the concept of time in economics as a social science, as compared to the concept of time in the physical sciences that served as the model for standard economics. In Commons' words, 'a flow of time in the physical sciences is a succession of events. But in economics, which is the science of human expectations, a 'flow' of time is an expected succession of events' (as quoted in Atkinson, 2009, 435). As sciences of human expectations, economics and political science is a study of what people think the future is likely to be, as opposed to theories that emulate the sciences that had no intrinsic interest in the individual events of concrete reality.[2] For Commons, the economic transaction embodies this complex relationship between institutional constraints and opportunities for future gains. Hence, he argued, the economic transaction is the 'unit of analyses' of economics (Commons, 1959 [1924]).

Futurity in the philosophical sense is typical of all economic activity, to the extent that even basic agriculture of even hunters and gatherers economies must plan for the future. Commons uses the concept also in a more specific sense referring to changes in the institutions, laws, regulations and practices of American capitalism of late 19th century that resulted in American, and subsequently businesses from other countries, valuations on the basis of their future earnings capacity (Commons, 1919; Commons, 1959 [1924]; Commons, 1961).[3] Futurity as a dominant feature of capitalist evaluation of assets is a more recent

[2] Commons was clearly influenced by Webber, Rickert and the debate on the difference between science and the social sciences that took place in late 19th century Germany. Oakes describes Rickert's position as follows: 'natural science is nomothetic. It has no intrinsic interest in the individual events of concrete reality. On the contrary, the individual datum is relevant to natural science only to the extent that it can be represented as a type.. The interest of historical science, on the other hand, is idiographic. Here the purpose of knowledge is to comprehend the distinctive properties of the unique events itself. History is interested in a phenomenon not because of what it shares with other phenomena but, rather, because of its own definitive qualities' (Oakes, 1988, 44).

[3] The concept of intangible is complex and highly contested (For discussion of economic impact see: Corrado, et al., 2006. John Commons traces the historical evolution of the meaning of property from the original common law conception of a physical corporeal thing held for one's own use to its current meaning of "intangible

development. Existing research, limited as it is, suggests that expectations of future earnings were incorporated systematically into current market value of assets only towards the late 19th century, and more specifically, primarily in the US (Allen, 1889) (Commons, 1919) (Kemper, 1921). Modern capitalist economy is thoroughly future oriented in that more narrow sense of the word.

Prior to the late 19th century, businesses were valued either on the basis of the estimated replacement value of the physical assets they owned; or on the basis of an estimation of the liquidation value, the estimated market price of the physical assets they owned at a given moment. In both cases businesses were valued as if they had ceased profitable activities.[4] These techniques of valuation best suited creditors' interests as they sought to protect their investments. These valuations placed limitations on available collaterals.

Businessmen, however, are interested in assets for their future earning capacity. They treat them, in other words, as organic, living things, or 'going concerns.' As at any point in time, the future is still to take place, asset value denominated against expectations of future earnings contain an 'intangible' element that cannot not be verified by the traditional instrument of economics. The accounting profession opted to enter such intangible value in the books by using an archaic Common Law concept of 'goodwill.' The economic theories of Veblen, Commons and their students, known otherwise as the Old school of Institutional Economics (OIE), (as opposed to New Institutional Economics that is associated with the work of Douglas North (1981; 1990; 1994) and Oliver Williamson (Williamson, 2000), for discussion see (Gruchy, 1987), is a study of the implications of the economics as the study of human expectations in a world dominated by intangible value.

Commons' concept of futurity refers, therefore, simultaneously to latent tendency in any economic activity, but more specifically, to the re-orientation of an entire economy and

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property" in law that is, withholding rights from others or what they need but do not own. This distinction between the thing itself and ownership of the thing being exchanged is central to an institutional analysis of property. The thing itself may be scarce (have value) in a physical sense, but
It takes a property right to endow it with institutional scarcity. As Chamberlain (1963: 81) pointed out, "A stolen object or asset is no less scarce for being stolen rather than purchased, but in a going society it acquires institutional meaning only when a transfer of title has been legalized." Property rights are the social relations that the state vests in the owner or property. These rights are created by the imposition of duties upon other persons. To the extent that duties have been imposed upon other persons' (Van de Ven, 1993, 144).

[4] In the words of Jean-Phillipe Robé, they were value as 'dead enterprises' (private communication with the author).

society, as he saw it, towards the future. A slow and gradual process that became a dominant feature of capitalist economies only in late 19th century and which was captured perhaps best by his observation that 'man live in the future but acts in the present' (Commons, 1961, 58).

This article draws on Common's theory of futurity to present a theoretical interpretation of the causes of a long-known problem facing capitalist economies, namely, pro-cyclicality. Since Keynes, pro-cyclicality is typically viewed as endogenous to the financial system. It encompasses, according to Jean-Pierre Landau, Deputy Governor of the Bank of France, three components, which cannot easily be distinguished in real life: '(1) fluctuations around the trend (2) changes in the trend itself and (3) possible cumulative deviations from equilibrium value' (Landau, 2009). Such cumulative deviations are attributed to market sentiments of optimism and pessimism. Central bankers seek to intervene in the financial markets by introducing counter-cyclical policies. They have tended concern themselves with developing techniques of empirical and statistical identification of such deviations. I put forward an interpretation of OIE theories that suggests that pro-cyclicality tendencies are not only endogenous to the financial system, but are an organic dimension of the entire capitalist system. Counter-cyclical monetary or fiscal policies should have an impact, no doubt, but they are unable compensate sufficiently for the underlying pro-cyclical tendencies that are inherent to the system.

To keep the argument simple, I discuss here the dynamics of what can be called as first phase of futurity economics, a phase that began around the 1880s and ended more or less around the beginning of the first depression. The first phase centred on extraction of value against future earnings capacity per individual units. The second, post-war phase, saw the deepening and extension of futurity through a complete re-imagination of the role of debt in the economy. In the economy of accumulation, debt is generally seen as a burden. In the economy of futurity, debt is future income stream that can be leveraged at present time and hence seen as a tradable asset in and by itself (Nesvetailova, this issue). I acknowledge, therefore, that the dynamics of futurity and pro-cyclicality are far more complicated during the second phase than the relationship that I identify in this chapter.

Endogenous theory of money and OIE

The approach that has been focusing on issues of pro-cyclicality is broadly known as the endogenous theory of money and credit. It concerns the propensity of the financial system to develop changes due to its internal working as opposed to exogenous forces. Traditionally, pro-cyclicality had been of particular concern to an academic tradition known as Post-Keynesian or the heterodox tradition of economics.

Orthodox finance theory is an extension of Walras's theory of general equilibrium. The key assumption of this paradigm is that savings are brought into equilibrium with investment in the market for loanable funds. Capital market arbitrage is supposed to occur perfectly and instantaneously, rather than as a process evolving over time. In such a perfect market, problems arise out of temporary disequilibrium (Toporowski, 1999). According to the traditional model, banking serves as intermediary between savers and borrowers. The amounts of funds available for borrowing is ultimately restricted by savings. The theory is that one cannot borrow funds that are not saved. Hence, accumulation has its limits.

A basic premise of Keynes's theory of finance – also known as the theory of liquidity preference – is that contrary to the theory that savings determine the rate of investment, in reality, the opposite is true: investment determines savings (for discussion see Nesvetailova 2013). The primary function of financial markets is to provide liquidity for asset holders. But financial markets do not operate on supply and demand basis, but rather on expectations ((Keynes, 1936), 30.)

Accordingly, when a bullish sentiments abound, rising market prices do not encourage necessarily shift to other assets as predicted by standard economics (so that Pareto optimality is maintained), but may attract further funds in expectations of future gains. Excess demand results in capital asset inflation (Toporowski, 1999). Capital market inflation may, in turn, encourage further bidding on assets and hence further capital asset inflation. The problem with that scenario is that (i) exuberance may lead to the provision of funds far in excess of current incomes; and (ii) heavy investment induces further exuberant expectations of future returns. This can result in an investment (or credit) boom.

When at some point these euphoric expectations turn, and bearish sentiment comes to the fore, credit boom can turn to bust. Hence, the economy goes through such cycles. In Keynes words, '[b]y a cyclical movement we mean that as the system progresses in, e.g., the upward direction, the forces propelling it upwards at first gather force and have a cumulative effect on one another but gradually lose their strength until at a certain point they tend to be

replaced by forces operating in the opposite direction; which in turn gather force for a time and accentuate one another, until they too, having reached their maximum development, wane and give place to their opposite' (Keynes, 1936) chp.22, 189). Keynes presents a theory of sequential investment behaviour in which expectations are the driving force of pro-cyclical tendencies: 'expectation may lead to more employment and also to more current consumption than will occur when the long-period position has been reached. Thus the change in expectation may lead to a gradual crescendo in the level of employment, rising to a peak and then declining to the new long-period level' (Keynes, 1936), 31) and so on. 'Thus a mere change in expectation is capable of producing an oscillation of the same kind of shape as a cyclical movement, in the course of working itself out', (Keynes, 1936) 31).

It is well documented, for instances, that the rudimentary credit system that existed in the U.S. prior to the establishment of central banking was pro-cyclical, causing sharp fluctuations in the money supply. During period of rapid growth, banks resumed aggressive credit extension, which they financed by issuing new bank notes. This often encouraged speculative euphoria and accelerating inflation which enticed banks into excessive lending and issuing notes relative to their species reserves (Guttmann, 1994, 68). During bad times, the opposite took place. One solution to the volatility in the financial system in the late 19th century U.S. was to take issuing of promissory notes from banks and centralize the system.

Keynesian theory maintains that credit lines are generated against future interest payments, hence the financial system is pro-cyclical (Mehrling, 2011). Unregulated banks can extend in principle credit lines infinitely as they are not restricted by their liabilities. Why, then, do banks not generate endless credit lines? After all, interest payments on credit facilities are one of their main lines of business (of course, infinite credit lines will create zero income and infinite risk, but that is another matter). Banks do not extend credit lines infinitely for a number of reasons: first, they normally require collateral against lending – and these collaterals reflect market value of assets and hence by definition set a limit on credit lines. Second, banks assess the riskiness of default on credit lines and naturally, the higher the leverage the borrower seeks, the higher the risk. Third, banks are restricted by regulators who insist that they accounting for new risk on their balance sheet so that any increase in assets must be matched by increase liabilities. The method of accounting for risks may change, whether it is Basle 1, 2 or 3. One thing we have learned from the crisis is that regulations have created incentives to redistribute those risks to individual parties, so as that risks are lifted off the balance sheet of each individual banks, or that alternative formats of economic

agents have emerged emulating the functions of banks without the attendant regulatory burden (known as shadow banking (Pozsar, et al., 2010)Lysandrou and Nesvetailova 2014).

A key factor in all of the above is an assessment of future performance of asset or the asset holders and their ability to pay back loans. Keynesian theory factored in, in other words, expectations of future returns and shows that sentiments about the future determine the dynamics of the credit creation. Investment does not rely necessarily on savings rates, and hence, strictly speaking, wealth is not accumulating in the traditional sense of the word. Keynes warned that the financial markets do not have built-in countercyclical mechanisms. He famously believed that governments should intervene in the markets by adopting counter-cyclical stance vis-a-vis the economy. The so-called neoclassical synthesis essentially accepted those propositions.

Common's theory of futurity suggests that expectations affect not only investment behaviour but also asset value. It implies that just as investors seek to increase borrowing when an economy is on the upturn, their collateralised asset are likely to increase in value as well. Adversely when the market turns, collateralised assets whose value includes a futurity component are likely to decrease as well. Futurity therefore exacerbates the pro-cyclical tendencies in the market.

I now turn to the concept of futurity before I turn to its implications to a theory of pro-cyclicality.

Futurity

Late 19th century saw the birth of new form of capitalism, identified broadly with the rise of large corporations in the US. This form of capitalism was based on recruiting capital in stock exchanges, primarily in Britain, and later in the U.S, and on the rise of professional classes that perform different tasks vital to recruitment of capital: underwriting, valuation and so on. The consensus among economic historians is that the establishment of a continental size market economy in the US, combined with improvements in technology, and crucially, in methods of producing and distributing goods, inventions and engineering 'constituted a spiralling force continuously disturbing the economic equilibrium, destroying old industries and creating new ones, multiplying the production of goods and broadening national and

international market' (Corey, 1930, 245). In this context, the work of the economic historian, Alfred Chandler and colleagues has been highly influential. Chandler's analysis centres on the establishment of the internal market in the US and in particular the institutional and logistical transformation of American business enterprises, the emergence of what he calls M-form Corporation. It was this type of manufacturing enterprises, he wrote, that 'have provided a fundamental dynamic or force for change in capitalist economies" (Chandler, 1990, 4).

Conventional historiography tends to stress, therefore, technological, organisational and logistical advances made by corporate America. OIE scholars stress, in contrast, the evolution of property rights and specifically of intangibles in the development of American economy. Traditionally, as we saw, businesses were valued on the basis of their physical assets. The valuations best suited creditors' interests. The vast majority of sources of funds for the US economy as far as 1900 were foreign investors, whose knowledge of the US was limited. By 1860, the Secretary of the Treasury estimated that $400 million worth of American securities were held abroad, this rose to an estimate $1.4 billion in 1869 (Albion & Williamson, 1944, 666). These investors were interested in traditional valuations of assets.

In contrast to creditors, businessmen are interested in assets as living and growing entities that are likely to generate income in the future. As business culture spread in the advanced economies of the US and Britain, their preferred mode of evaluations of assets took hold as well. The 'future' added value to businesses, as future income could be factored in current value of assets. Value could be 'extracted' out of assets, and 'made to work,' with the help of financial expertise of the promoters in mergers and acquisition and in the creation of a special class of shares, called 'common shares', or through stock market re-valuation of corporate capitalisation that included now multiplication of current profits estimates.

The excess value generated in such proceedings appeared to be a class apart from the tangible assets that businesses owned. They were classed as 'intangibles'. This capitalised potential for profit making, or intangible value, was entered in the accounting books by reference to an archaic Common Law concept, the concept of 'goodwill.' It became an accepted wisdom, at the very least in the American corporate environment of late 19th century and ever since throughout the world, that businesses should be treated as 'going concerns.' As such, they were value at more than the sum of their parts, and the excess valuation could be attributed to goodwill. For instance, if customers were prepared to pay above

manufacturing costs in order to obtain a specific product from a specific company, say Heinz beans, then there is evidence that the company has established 'goodwill' among its customers, and that that goodwill has a market value. The Courts accepted the proposition that Heinz' goodwill should be protected by law. The excess value generated in such way was reflected in Heinz' market capitalisation – or so is the theory. The additional value could serve, then, as collateral either by Heinz or by its shareholders, as they sought additional credit. Although there is evidence that initially investors were cautious about such collaterals (Albion & Williamson, 1944). Crucially, once initial reluctance was overcome, the credit system could not distinguish goodwill collaterals from other forms of capital. Hence, the excess value generated by the new method of accounting joined the general pool of available capital that was used to bid for assets.

How then, did this system come about? As evolutionary thinkers, OIE scholars believed the system came about gradually and in an evolutionary manner of selection, adaptation and retention. Late 19th century and early 20th century US, described so well by Josephson as the age of the Robber Barons, saw the birth of a US-led corporate capitalism (Jospehson, 1962). The robber barons perfected the system of goodwill valuation.

The concept of goodwill has a long a venerable history in common law countries. It can be traced back to English Courts ruling of late 16th century England. For instance, in one of the first known cases in 1620, Broad y. Jollyfe, the court discussed the validity of a promise by a mercer not to keep a shop in Newport, in the Isle of Wight, in consideration of the plaintiff purchasing his old stock at prime cost. The Court held the promise to be good, accepting that promise not to compete with the seller had a legal value (Allen 1889, 8). The concept of goodwill has developed since along two tracts, one associated goodwill with a transaction, the other with the person. Modern economic historians have demonstrated that oddly, perhaps, in the English context a credit economy arose prior to a monetary economy (Muldrew 1998). British courts have recognised that access to credit is closely linked to person's 'good name' in society (Allen 1889). If a person tarnishes the good name of another person unjustifiably, then that person may be denied access to vital credit and hence may be economically inured. The courts accepted that the injured party may have monetary recourse to compensate for such damage. There was goodwill that was attached, therefore, to a person. Similarly, in early rulings it was not unusual for, say, for a pub owner who felt aggrieved if accused falsely for serving bad beer to use the courts to recover some of their losses.

In doing so, British courts accepted an important idea: that individuals possessed intangible qualities that they 'owned', and furthermore, that such qualities had monetary value. In Grismore words, 'The expectations of custom which one has acquired as the result of business endeavour -- is property, in the enjoyment of which the possessor is entitled to be protected and which he has the power to transfer to others, has been so long and so universally recognized that no citation of authority for the proposition is necessary' (Grismore 1932, 491). The courts described good name assets as 'good will' and placed monetary value on goodwill – although to the best of my knowledge, they never developed a systemic technique for evaluation of the monetary value of goodwill. The number of cases that involved goodwill rose steadily during the intervening centuries.

By the late 19th century, businessmen and the courts in the US and the UK increasingly recognised that companies may have created a reciprocal 'goodwill' value among prospective clients by impressing upon them the quality of their products. The law of trademarks and trade-names was developed initially by the Courts to protect the consumer against the "passing off" of inferior goods under misleading labels. It was also recognised that companies could signal quality to their clients and/or create 'attachment' to products and these attachments are worth something. The law of brand name recognition, trade mark and logos has developed as a result (Hopkins 1900). Goodwill in these cases are attached to the transaction, not to a person.

Intangible assets and goodwill were given monetary value, but there is a great confusion about the nature of goodwill. Chandler (1990) argues that not only did new corporate structures developed originally as ammunition manufacturers, but they borrowed the army's organizational and management methods to handle the logistical problems of sizeable workforce over great spaces and mobility. Like the army, the new corporations evolved to handle the logistical difficulties of an emerging continental-size economy. They also gave rise to the new giant banking organizations capable of mobilizing great financial resources.

Among the early innovators of these corporate forms were the great railway companies that were entrusted with the task of laying trans-continental railway lines. They innovated corporate structures capable of mobilizing huge resources and able to operate at great distances (Chandler 1990). The development of railway companies in the context of the US federal system (as opposed smaller countries such as the UK) raised important issues of

'goodwill.' Many railway franchises spanned a number of states, and held an effective monopolies over transport in these states. Hence their strategies for development and pricing would have had profound impact on the development of particularly land-locked states. States tried to impose their own ceilings on fares and commercial tariffs and impose other restrictions on the railways companies. In doing so, they would impact not only on the profitability of the companies at present, but also on anticipated future earnings which would then reflect in the share values of companies. In a number of trial cases, the Courts sought to calculate the impact of regulation on businesses on the railways as 'going concerns' and would count future profits in the equation (J. Commons 1961). In these cases the courts would place value on intangible assets.

The concept of goodwill and intangible value were introduced, in addition, in many mergers, trust and combinations that have proliferated in late 19th century US. It was recognised that the different parties to a merger (or in many early cases, 'trust') brought into the combined enterprises something more than the physical assets they owned: knowledge, organisation, contacts or 'goodwill.' The practice in the mergers that took place from the early 1880s to about the 1920s was to account for goodwill by differentiating between two classes of shares: preferred shares which would normally represent that replacement value (or tangible value) of the assets that were brought into the merged business. Typically, owners would sell their businesses to a newly created corporation, which would issue of 7% accumulative preferred stock and an issue of common stock (although, in the case of the United Tanners company it was 8% per annum) (Dewing 1930). The preferred stocks were supposed to bear some definite relation to the tangible assets. They represented in other words, more or less the assumed corporeal value of the enterprise and constituted, therefore, a definite class of financial instruments (Kemper 1921, 55). Preferred shares were seen (and were treated at the time) like bonds (See Dewing 1930 and Kemper 1921 for discussion).

Common shares in contrast, represented what was called at the time, the 'entrepreneurial value' of owner's contribution to the enterprise, or 'goodwill'. In the words of Kemper, '[b]ehind the common stock something known variously as 'goodwill' or earning power, was supposed to stand (Kemper 1921, 11). The idea was that owner's held greater part of the common stock and with it the control of the business. The banker, which was usually paid for his work by a common stock bonus, would sometimes sale his block of common shares, thereby 'creating an appetite for that particular kind of stock so that in the future the owner wanted to dispose of a part of this holdings there would be a ready market for it'

(Kemper 1921, 12). Of course, there were many exceptions to the rule, but on the whole the essential features of these industrials were the same. There were no clear guidelines or laws on such matters, so practices varied somewhat from one case to another and it was a matter of what 'the market will bear.'

A third venue for the generation of goodwill was the capitalisation of companies as 'on-going' concerns and places a value on future profits. Over time, that last component became the biggest (Kaner 1937). Hence, companies were traded at a P/E ratio of their current earnings capacity (Ellerman 2008).

Capitalised goodwill in late 19th century

Capitalised goodwill became significant in late 19th century U.S., and to a lesser extent in the UK. German and French accountants and lawyers were certainly aware of the concept of goodwill and value extraction that took place in the US, but the practice was heavily frowned upon and hardly began in these countries before the end of the Second World War (Allen 1889; Hopkins 1900). Due to the great volatility in valuation of common shares and diverging practices of valuations, it is not possible to provide an exact figure for the formation of goodwill 'stock' in late 19th century US, but the approximate figures appear to be in the range of 2 to 4% of the estimated GNP of the US each year.

The United States Leather Company is a case in point. The company was incorporated in February 25, 1893 in New Jersey. The certificate of incorporation was amended several times, so that the figures for the original incorporation are somewhat disputed. It appears that the authorized capital consisted of the merged company was $US 64 million of preferred shares and in the same amount of common stock of these amounts that were issued (Kemper, 1921, 19). The preferred stock carried 8%, cumulative preferential dividends, to be paid from the net earnings of the business. This was preferred both to dividends and to assets in case of liquidation.

Dewing reports that '[a]ll things considered, however, it seems fair to believe that the property acquired by the United States Leather Company had an actual market value of $60 million including the $6 million money obtained from the bankers. Against these assets the company issued $131,000,000 of securities, for nearly half of which the tanners admitted there was nothing tangible. The charges, including the cumulative dividends, required

$5,342,584 (19). How did a $ 60 million worth company become a $131 million company? Veblen's answer is that the value of companies or assets is a question of what the market will bear. As long as the market was prepared to accept the new valuation, the new valuation became the 'right' value of the company. But that also meant that at its formation in 1893, The United Leather Company had the largest stock capitalization of any American industrial Corporation. For instance, the component companies of Standard Oil Trust had at that time a little over $102 million (which refrained from dabbling too much in goodwill), while the American sugar refining Company had been authorized capital of $75 million; the National Lead company a little less than $30 million; and the American tobacco companies $35 million; and the United States Rubber company $50 million.

Estimated real U.S. GNP in 1883 $US12.79 billion, (Balke and Gordon 1986) suggesting that the United States Leather Company was capitalised at about 1% of US GNP, 1983, of which its common shares, or 'goodwill' component, stood at 0.5% of US GNP that year! Put differently, the United Leather Company was capitalised at nearly 30% of all issue greenbacks circulating in the US, and its 'goodwill' value amounted to nearly 15%. The value of these common shares diverged widely. During 1894, the market price of the preferred shares was about $60 a share. In 1986 the company was operating at a loss and the price of the preferred stock declined to about $40 dollars per share. During this period the common stock had been a mere nominal quotation of five dollars (Dewing 1930, 23). The company, in fact, failed to pay the 8% dividend in full, and as it was cumulative, led to much speculation. For a long time its common shares remained at 5$. Yet during the boom times of late 1899, there was flurry of speculation activity and the common shares reached in November $40.87, two days later fell back to$ 20, and by the end of November to $10. During the brief periods the original leather interests disposed of the greater part of their holdings of common stock, reserving for themselves and their families only that preferred stock (Dewing 1930, 24).

I am presenting the examples of the Unite Tanners Company, but all of the large mergers from 1880 onward in the US had a large goodwill component attached to them. An illustration of the economic significance of intangibles can be inferred from the way the trust was organized by J.P. Morgan and co. and one of the largest and least liked railways barons, James Hill, largely to prevent the ruinous competition that Andrew Carnegie was about to launch with his competitors in Pittsburgh.

The area around Pittsburgh contributed at the time to about 80 to 85% of all US steel production. Carnegie, who was by then the most successful Steel magnate, announced his intentions of building a larger plant with the latest improvements on the ores of the Lake Erie.

It became clear from past experience, that the new plant would drive many of his competitors out of the market. J. P. Morgan and Co. was called upon by some of Carnegie's competitors to construct, in response, a holding company which would take over all the plants and form an integrated into one large company to avoid this competition. The rest, as they say, is history (Ripley, 1905).

The new trust had to buy all of Carnegie's interests. The value of Carnegie's holdings on traditional valuation of reconstruction cost was estimated at 75 million dollars at the time. Carnegie, however, demanded and received 300 million dollars in gold bonds as his share value in the new trust. Carnegie's explanation for the not inconsiderable difference of $225 million, recalls Ida Tarbell, was that '[b]usiness on a grand scale required special talent for organization and management, and that talent was rare…. If the right men were obtained, they soon created capital; otherwise capital soon took wings' (Tarbell, 1936, 9). This 'talent' was described in business lingua as 'goodwill. The difference in valuation, writes John Commons, could not have been ascribed "on the traditional theory of economics, as the value of the corporeal property. Nor was it incorporeal property since it was not a debt owed to Carnegie. The only other name that could be given to it was "intangible property" the name given by the financial magnates themselves' (Commons 1990, 649-50). Carnegie charged, in effect, $225 million dollars for his personal goodwill (Tarbell, 1904).

Commons takes a slightly less favourable view of Carnegie's talent. What was the $225 million exactly all about? Or what was exactly, the goodwill that Carnegie brought to the enterprise, considering that he withdrew from steel making henceforth? What Carnegie described as his good-will, 'arose solely from the need of all competitors to remove Carnegie from the price-cutting competition which it was known he would initiate' (Commons 1959, 650). The value of his good-will was the potential or anticipated future earnings that accrue to the new enterprise on the basis that Carnegie was removed from competition. The valuation of Carnegie's holdings was therefore, in effect, an estimate of his aggressiveness and his contacts, which gave him the capacity to sabotage his competitors and reduce their profit margins– the removal of such an aggressive saboteur was worth something. Carnegie's intangible 'value' measured, in other words, his talent as a businessman—a talent to bargain and sabotage, which obtained pecuniary value far in excess of 'real' or tangible property.

Carnegie was not alone in obtaining 'goodwill' money during the creation of US. Steel Trust. The establishment of US Steel was such an audacious act that overnight, 700 million of 'corporeal' property held by the different steel barons that made up U.S Steel became $US1600 million (Albion & Williamson, 1944). Or to put it in other terms, the new

company was capitalized at an equivalent of one fourth of U.S. GNP at the time! J.P. Morgan and Co.' commission alone was 150 million dollars, or nearly 2% of U.S. GNP. This amounted to a huge injection of capital into the economy. So much so that Carnegie refused to accept shares in the new trust, which he considered 'water', and demanded gold bonds. The creation of so much new capital under the banner of 'goodwill', in and by itself, it sparked the 1903 financial crisis (Jospehson, 1962). But despite being 'water', US steel survived and flourished.

Today according to some estimates, the goodwill value of the Standard & Poor's 500 amounts to about 80 per cent of their value. The consulting firm, Ocean Tomo, estimates that for the year 2009 for the EU were 70 per cent, 35.8 per cent for Japan, and 73.5 per cent for China (Ocean Tomo 2009). Wealth in modern economies is largely a denomination, therefore, of goodwill.

Intangibles and pro-cyclicality

The vast expansion in capitalised goodwill was viewed initially as inflating value (or 'watering' of stock value). Perhaps the key to the successful capitalization of goodwill was the fact that the markets traded only a small fraction of stocks and shares at any given moment. As stocks can serve as collateral, inflated stock prices raised the overall stock of collateralized assets in the economy and the potential credit lines, which in turn, inflate stock value and so on. The paradoxical result was that despite the huge injection of 'watered' stocks into the market, stock prices kept rising. The market endogenously took care of itself (Kelso & Dunam, 1992).

The results of these processes were that soon enough all assets, including labour, were denominated effectively on the basis of an estimation of their future earning capacity. Equities are valued against future earnings and factor in the specific circumstances of a business asset, but also the general mood of optimism or pessimism in the markets about the future. As equities rise in value during 'good times', they can be used as collaterals say, for credit lines that are used for bidding, say, on real-estate purchases. The result is that real estate value increases, but their rising value represents partly and indirectly, the bidding by the excess capital generated on the basis of optimism about the future (or directly estimation of future rents or anticipated capital gain). As real-estate assets rise in value, they can be used

as collaterals as well to bid on other real estate assets or equities. The rise in real estate or equity can be used further as collateral for further credit lines and so on and so forth. The sense of wealth that is generated and optimism about the future also affects the labour market. Since a good, but crucially, unstable portion of all values assigned to different assets represents estimations of future earning capacity, the value of these assets is by and large subjective and represents the different factors, and including nothing more than the market sentiments of optimism and pessimism about the future.

When the mood changes for one reason or another, the same pro-cyclical dynamics that have contributed to an apparent inexorable rise in asset value turn in the opposite direction and wealth literally vanishes. Capitalist system that is founded on principle of futurity is pro-cyclical and hence highly volatile, it faces constant hurdles it must negotiate: current payments (of interest, for instance) to sustain the fiction of future earnings.

When current payments fail on mass, the whole system of evaluation based on future earnings fails with it. This is a point of crisis that expressed itself in large downward evaluations of all assets, including labour costs, that pervades the entire system. A financial crisis takes place and central banks are placed in a difficult position of serving not simply as lenders of last resort, but as Mehrling notes, had to learn fast to play the role of dealers of last resort. They must clear the market in real time so that the future does not collapse completely. In doing so, central banks form the necessary bridge between exuberant forecasts of future earnings and current income streams.

This implies that in good times, the following pro-cyclical patterns tend to develop the following scenario:

Scenario 1: Positive pro-cyclicality

Optimism about the future → Rising value of intangible property → larger credit lines → larger leverage ratios → growth and prosperity → Rising value of intangible property ...

In other words, optimism encourages inflationary pressures in intangible value of assets, which in turn, releases additional credit lines, raising leverage rations, which in turns, further inflates the value of intangibles and so on. The systemic effect of extended 'good times' is what Nesvetailova (2010) calls 'liquidity illusion', the market for financial products in particular appear to be highly liquid.

The markets can, and will, eventually turn sour and could generate two paths towards wealth 'destruction.'

Scenario 2: pessimism about the future

Pessimism about the future → Intangible value declines → credit lines close down → lower leverage ratios → share value declines → less growth and prosperity → intangible value decline...

= Destruction of wealth

In the event, the current crisis took followed a different scenario, scenario 3.

Scenario 3: Credit failure

Income streams fail to materialized, business failure → Intangible value proved inflated (delusionary) → shares value decline → credit line closed down (liquidity meltdown) → leverage values decline → intangible value decline → less growth and prosperity

= Destruction of Wealth

Scenario 3 is a well-known and well-rehearsed crisis point. It is exactly what had happened in the current crisis. A Federal Reserve study estimates that U.S. households' net worth tumbled by $11.2 trillion in 2008 alone, a figure that compares to about 70% of US GPD that year (Kalita, 2008). A U.S. Treasury report estimates that by the full cost to the US amounted to $19.2 trillion of lost household wealth by 2011 dollar (Treasury, 2012). A

Roosevelt Institute report written by Henry Liu calculates that the financial crisis 'had destroyed $34.4 trillion of wealth globally by March 2009, when the equity markets hit their lowest points. The lost wealth, $34.4 trillion, is more than the 2008 annual gross domestic product (GDP) of the US, the European Union and Japan combined.' (Liu, 2010). Liu goes on to say: 'This wealth deficit effect would take at least a decade to replenish even if these advanced economies were to grow at mid-single digit rate after inflation and only if no double dip materializes in the markets.' Surprisingly, although growth remained barely above inflation rate in the U.S, while EU economies have stagnated, the aggregated household wealth in the world not only recovered by 2013, but has surpassed its pre-2007 level. What has changed? The mood has changed, and the pro-cyclical tendencies of a future oriented economy does the rest.

It could be argued that OIE theory unnecessarily complicates the issue. In a series of publications John Geanakoplos developed an original take on pro-cyclicality in the financial markets. Geanakoplos differentiates between consumers and investors, the former seek to maximize utility, he argues, the latter 'trade assets primarily to bet or to hedge' (Geanakoplos, 1997, 293). Geanakoplos identifies a similar pro-cyclical trends in the economy described as the leverage cycle (Geanakoplos, 2010). He notes that 'in the absence of intervention, leverage becomes too high in boom times and too low in bad times. As a result, in boom times asset prices are too high, and in crisis times they are too low. This is the leverage cycle' (Geanakoplos, 2010, 2). Geanakoplos calculates that leverage increased dramatically in the US and globally from 1999 to 2006 to reach about 1:60 and fallen after the onslaught of the crisis to a low 1.2 (Geanakoplos, 2010, 3). The theory reaches more or less the same conclusions that I reach above. The theory lacks, however, an historical dimension, the notion that current trends have transient value. In addition, Geanakoplos' theory is firmly wedded to the law of supply and demand. OIE, as we saw is concerned primarily in supply and demand curves as seen from the perspective of human expectations.

Limits on Futurity

Are there any barriers to exuberant sentiments about the future? Is there any logic, then, to asset prices? The standard view is that there is (Davidson 1996, 479). But the concepts of reality as known and ergodic is rejected by Keynesian theory. In my interpretation, OIE has

gone further. The implication of OIE theory is that the factors that determine future earning capacity of assets are just too complex and numerous. There are just too many factors that shape the future, many of which are under control of nobody, and hence any sampling from past and present market data tells us precious little about the future. Furthermore, there is no consistency (as far as we know) in the relationships between different sectors' evaluations of futures. In fact, future forecasting is not an exact science. Far from it, evaluations would differ tremendously from one sector to another over time, from one asset class to another. Different assets can enter into a whirlpool of asset bubble inflation, or deflation, and at least in theory, the process can go on forever. The result is that in the society dominated by futurity, it is no longer possible to have any clear indications of 'real' value of any asset. The theory of futurity implies that ultimately every class of assets are subjectively valued in relation to one another. The only general rule of future forecasting in the world of futurity that Veblen could identity was captured by the adage: 'whatever the market will bear'. Businesses would 'test the market' and would adjust their prices accordingly to whatever level the market will bear. Any system, theory and ideology, however absurd it may be would sustain itself and be sustained, Veblen believed, 'as long as it works.'

The principle of 'as long as it works' that Veblen refers to often appears as a mere sarcastic remark. I believe the principle goes deeper, and presents the OIE's notion of market behaviour and market discipline. This is another area of contention, in my view, between Keynesians and OIE theory. Critiques of market liberalism from Keynesian perspective were concerned that liberalized financial markets are generating the euphoric sentiments that Keynes and Minsky talked about. The financial markets were increasingly speculative and Ponzi-like. However, the weakness of the Keynesian and post-Keynesian critique was that the relies on a concept of some real valuation or real economy, which implied that the speculative dimension could somehow be disentangled from objective valuations. In reality it proved very difficult to describe or model the dividing line between good financial practices and speculative finance. Hence, Keynesians could not provide quantitative assessment of the speculative portion of finance. Lacking alternative quantitative models, concern about liberalized financial system remained, therefore, limited to the naysayers or born pessimists. The only way of assessing disequilibrium conditions was by comparing current state of affairs with some arbitrarily chosen historical benchmarks, such as historical P/E ratios and the like. But there was never a guarantee that any of these historical ratios would be valid in the present.

OIE theory eschews philosophical reference or anchoring, whether implicit or explicit, to hypothetical 'real' economy that inhabits a world free of speculation. It suggests that all economic systems are evolutionary in nature and hence transient, and are heavily reliant on the prevalent 'habits of thought' of the day. But a capitalist system that is based on principles of futurity faces one clear barrier against which exuberant projections of future earnings capacity is measured constantly: the present. In other words, credit lines generated against collateralized assets whose value lie in future estimation must generate income at present in the form of interest payments. It is that quotidian payments that are of great significance, because when those fail on mass, there is a problem. Equally, stock valuations which are based on future earning capacity must be backed by income at present. When those fail on mass, than the stock valuations are in danger. Financial crisis phase results, therefore, in the words of Kelso and Dunam, 'in a liquidation of nominal values of existing capital (physical and financial) and a cessation of extension of credit. Lines of credit vanish, bring an end to investment spending and create difficulty in securing the operating credit necessary to maintain the current level of production' (Kelso & Dunam, 1992, 225).

Veblen's principle of 'as long as it works' can be interpreted to mean that irrespective of the dominant theory of the day, or the common 'habit of thought' of the day, the ultimate barrier to various valuations of future profit capacity, and the only true link between estimations of futures against some 'hard' reality, is the ability of borrowers to pay back interests at the present time. The system is constantly challenged.

Conclusion

The implication of OIE theory is that not only financial products are subject to exuberant volatility and pro-cyclicality as Keynes argue, but in conditions of pervasive futurity all assets, goods, services, labour, real estate and the like are denominated against some estimation of future. I would interpret the theory to suggest that the kind of pro-cyclicality identified by Keynes in the financial system was in fact built into the very nature of concept of property that evolves from late 19th century. Sentiments about the future influence not only the credit system, but influence asset prices in the entire economy. That means that not only financial assets, but all assets are caught up indirectly by sentiment of exuberant expectations.

In other words, asset price volatility is much larger than expected even by Keynesian thinking.

The theory of futurity implies that not only financial system is vulnerable to sentiments about the future: the entire economy in the age of futurity has lost its anchoring in any objective measures of value as such (if there ever were any in the first place). The system works in a world of nominal value. The economy is a self-referential system that ultimately is held back by the principle of 'as long as it works' – and that principle are very vague indeed. This leads to the disturbing conclusion, in the words of Kelso and Dunam, that 'A Vebleian depression is essentially "a psychological fact", and "readjustment of values rather than a destruction of wealth or a serious reduction of aggregate productiveness of business'((Kelso & Dunman, 1992, 225)

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