



# New corporate elites and the erosion of the Keynesian social compact

Work, employment and society

2014, Vol. 28(2) 323–334

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DOI: 10.1177/0950017013496303

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## Abstract

The role of corporate elites – notably financial elites – has been at the forefront of political debates in Western capitalist societies since the start of the Great Recession in 2008. The major structural unbalances that had accumulated in Anglo-American economies over the last quarter of the 20th century played a key role in the build up to the financial crisis. Taking advantage of the mobility of capital, business elites promoted a model of shareholder capitalism actively backed up by the state. A process of elite competition took place: financial intermediaries acting on behalf of institutional investors marginalized the alliance between traditional managerial elites and workers that had been at the heart of the Keynesian compromise. This contribution outlines the consequences of the unravelling of the 20th century social pact for workers and their families. It concludes by outlining ‘what is to be done’ to forge a 21st century social pact.

## Keywords

Anglo-American capitalism, corporate elites, financial intermediaries, Keynesian compromise, social pact

## Introduction

The accumulation of major structural imbalances in the Anglo-American model of financial capitalism over the last quarter of the 20th century and the early 21st century has been at the heart of the Great Recession of post-2008. By the late 1970s, the deregulation and the globalization of financial markets, actively backed up by the state, had led to the spread of shareholder capitalism in the governance of the firm. As a result, financial intermediaries acting on behalf of institutional investors marginalized the alliance between traditional managerial elites and workers at the heart of the post-war Keynesian social compromise. Financial elites or, to use Pareto’s (2008) term, ‘speculators’, started

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to rise to elite positions thanks to the apparent success of a model of short-term profitability, displacing traditional managerial elites associated with the post-war Keynesian social pact. Based on real wage increases, a stable employment contract and mass consumption, this social pact provided the economic security that had eluded capitalist societies for most of the first half of the 20th century. This era ended in the 1980s, when the deregulation of financial and labour markets led to the rise of 'disconnected capitalism' where employers could no longer keep their side of the bargain (Thompson, 2003).

This article argues that the process of elite competition – especially the rise of finance-oriented elites from the late 1970s onwards, first in the USA with the UK rapidly following suit in the early 1980s – is crucial for understanding the demise of the Keynesian social pact. This erosion must be understood as a cumulative process, with each wave of de-industrialization in the mid-1970s, early 1980s, early 1990s and 2000s corresponding to a strategy of maximizing shareholder value. While new forms of workers' protection have emerged (health and safety, anti-discrimination, etc.) the employment relationship has become increasingly individualized, fragmented, de-localized and de-materialized, opening up new forms of vulnerability for workers (Martínez Lucio and MacKenzie, 2004).

It is clear that the financial crisis has accentuated pre-existing trends towards the casualization of work and the recommodification of labour, with a new management-led offensive (Taylor, 2012). The financial crisis has also laid bare a crisis in the circulation of elites: in Pareto's terms, class I or fox-like residues (based on deceit, fraud and manipulation) accumulated too heavily in economic elites in the 1980s. Recurrent corporate scandals and fraud from the late 1990s onwards can be seen as evidence of the decay of the reign of the foxes in the quest for rent-extraction that characterizes highly innovative and volatile financial markets.

This article is divided into three sections. First, the article reviews the debates on corporate elites in historical perspective, with a particular focus on Pareto's concept of elites' circulation and conflict. The article explores the process of accommodation of workers' interests that took place in both the USA and the UK, resulting in the post-1945 social settlement. The industrial working class became the main 'bearer' of the Keynesian compromise, together with the 'managerial class' – itself a consequence of the separation of management and ownership in advanced capitalist societies (Berle and Means, 1932). Second, the article examines the changing world of corporate elites associated with the spread of shareholder capitalism. The 'managerial class' (Burnham, 1960, originally published in 1941), or the power elite (Mills, 1956), which had replaced the old entrepreneurial, property-based elite, faced increased competition from financial elites, which included financial intermediaries. Financial intermediaries are fundamentally different from corporate managers who 'have needed to build minimum levels of trust among stakeholders to ensure on-going production and productivity growth' (Appelbaum et al., 2012: 4). Appelbaum et al. suggest that the intellectual paradigm of employment relations research based on the need for managers to accommodate different stakeholders' interests no longer captures the reality of financial capitalism, when renegeing on employee-managers' contracts can be a source of shareholder value. This assumption does not necessarily hold true for all sectors of the economy; for instance knowledge-based activities typically require the implementation of high-road practice to ensure a

high level of employee productivity. However, the partial displacement of traditional managerial elites by financial intermediaries with no connection with the world of employees helps to understand the mechanisms underlying the spread of management by fear and the erosion of socio-economic rights. Third, the conclusion outlines ‘what is to be done’ to forge a 21st-century social pact.

## **Managerial corporate elites and the Keynesian social compact**

At the turn of the 19th century, the Italian School of Elitists (Michels, 1927; Mosca, 1939; Pareto, 1963 [1916], 2008) theorized the division between the elite (the ruling class for Mosca, the technocratic oligarchs for Michels) and the rest of society. Elite theorists developed their ideas, especially Pareto, as a political challenge to Marxist theories of class struggle. A neo-Machiavellian, Pareto argued that societies – ‘social organisms’ – were characterized by a need to reconcile preservation and combination, i.e. innovation. Economic elites were made of two types: rentiers (consolidation or conservation) and speculators (innovation). Economic elites lost their legitimacy precisely because they became increasingly self-reproducing, complacent and mediocre as they no longer recruited talented members from the working class. Elites had to remain flexible and open in order to maintain their supremacy. Typically new elites remain open for a while, but quickly become complacent again; while, ‘for the time being the new elite is flexible and open to all, after victory [...] the elite becomes more rigid and more exclusive’ (Pareto, 2008: 86). Another cycle of decline and fall of elites can start again.

The interwar period was a crucial test of legitimacy for ruling elites. Although Anglo-American democratic capitalism was spared the descent into authoritarianism that characterized Spain, Italy and Germany, British and American elites remained opposed to forging a compromise with the working class, at least until the early 1930s (Higley and Pakulski, 2012).

### *Challenges to ruling elites and the advent of Keynesianism*

The incapacity to prevent the Great Depression precipitated the decline of ruling British and American elites in the interwar period. In particular, financial and political elites excluded the working class from the economic policy framework, leading to a chronic lack of demand due to stagnating wages and workers’ insecurity. In contrast to mainstream economist thinking at the time, Keynes understood the need to accommodate working class interests in order to maintain aggregate economic demand (Crouch, 2009; Duménil and Lévy, 2001; Tomlinson, 1993, 1994). Although in time economic and political elites came to accept his policy prescriptions as the best remedy to safeguard the lifestyles and institutions of the ‘educated bourgeoisie’ (Denis, 2002), this remained a contested process.

In Britain, the City/Bank of England and the Treasury formed an autonomous system capable of formulating a hegemonic project – free trade, balanced budgets and adherence to the gold standard – that was detrimental to both industrial and working class interests. When the second minority Labour government led by Ramsay MacDonald increased public spending in order to respond to mass unemployment, London bankers called for

drastic economies, especially on social benefits (Williamson, 1984). In August 1931, confronted with a speculative attack on the pound, MacDonald asked his Cabinet to implement cuts in order to restore markets' confidence in the pound. MacDonald argued that cuts would help secure the financial support of American banks to rescue the pound. This led both Labour and the Trade Union Congress to protest against the 'bankers' ramp'. In 1945, when Labour won its first clear election victory, the commitment to full employment, the partial de-commodification of labour through the Social Insurance Act (1943), the repeal of the 1927 Trade Union Act (which had placed restrictions on the ability of trade unions to strike and picket) and the nationalization of the rail, coal and steel industries, were all measures that reflected the political interests of the labour movement. However, the financial community managed to preserve its core interests. The City maintained its self-regulating doctrine: the nationalization of the Bank was largely symbolic (Tomlinson, 1994).

In the USA, the era of corporate political hegemony was brought to an end with the financial crisis of 1929 and the spread of the Great Depression, when unemployment rose from over 3 per cent in 1929 to a peak of 25 per cent in 1933 (Jenkins and Brent, 1989: 895–7). The image of financiers was greatly tarnished by the revelations of the Pecora investigation into the causes of the Wall Street Crash of 1929. The investigation uncovered a wide range of abusive practices on the part of banks and bank affiliates (Blyth, 2002; Weinberg, 2002).

Throughout the New Deal, a split between rival capitalist blocs became apparent. While a moderate business community (retail, commercial banks) accepted the need to guarantee some degree of labour de-commodification and collective bargaining (Blyth, 2002; Domhoff, 1970), these measures were opposed by a conservative anti-New Deal coalition representing heavy industries led by the National Association of Manufacturers and the American Chamber of Commerce. Finally, the moderate wing of the business community, led by the Committee for Economic Development, adopted the ideas of automatic stabilizers and negotiation with trade unions (Blyth, 2002; Mizuchi, 2010). The compromise between business and employees was at the core of the American version of Keynesianism, consolidating capitalist expansion domestically and internationally, while providing workers with economic security and increased real wages (Blyth, 2002; Reich, 2009). This compromise was strengthened during World War Two, when union leaders agreed not to strike in exchange for rising wages and low unemployment.

During World War Two, new elite constellations emerged, based on an alliance between the military, managers of large corporations, public bureaucracies and trade unionists: these actors were the main beneficiaries of the institutions of war management (Higley and Pakulski, 2012). These elites promoted a Keynesian/Fordist compromise that guaranteed economic stability and secured workers' participation in exchange for increased wages and social protection in the form of the modern welfare state. It was after World War Two that American power elite theorists (Domhoff, 1970; Hunter, 1953; Mills, 1956) identified a coherent corporate community forming an inner circle (Useem, 1984), organized on a national basis, with banks being core institutions connecting disparate directors. The corporate community possessed tremendous economic resources which gave it 'structural economic power', enabling business leaders to dominate government policy through lobbying, campaign finance, appointments to key government

positions and a policy-planning network made up of foundations, think tanks and policy discussion groups (Scott, 2008: 37). According to Domhoff (2010), American business elites constituted highly integrated social groups whose members used to be able to transcend their own individual interests to promote and safeguard the interests of capitalism at a systemic level. Useem (1980, 1984) also found that corporate elites socialized in exclusive schools, social clubs, formal associations such as boards of trustees and in universities, thus allowing for the formation of class cohesion. In sum, elite theorists assumed that there existed a symbiosis of interests between industrial and financial capital through interlocking directorates, which enabled the business community to act with a single voice (Carroll, 2008: 44–65). Such assumptions, however, understated the ongoing competition between rival elite blocks (Poulantzas, 1978).

### *Shifts in elites' allegiance: the erosion of the Keynesian compromise*

By the end of the 1960s, several economic and sociological factors made the Keynesian compromise unsustainable. First, in both the USA and the UK, the industrial proletariat was in decline, being increasingly replaced by the 'white-collar' class. This posed a serious problem for the labour movement as the white-collar class was more politically 'passive' and more culturally tied to capital than blue-collar workers (Crouch, 2009; Mills, 1951). By the 1980s, public sector employees had replaced industrial workers as leaders of the union movement in both countries (Crouch, 2009). Second, British and American industries were facing increasing foreign competition from emerging economies such as Japan in the 1970s and China from the 1980s onwards (Mizruchi, 2010). In a dramatic reversal of the Fordist compromise, managers used the argument of foreign competition to rewrite labour contracts, downsize and restructure (Boyer, 2005; Reich, 2009). Third, as inflationary tensions built up following the rise in commodity prices in 1973 and 1978, Keynesian full employment policies were abandoned in favour of monetary policies based on inflation control. Fourth, the collapse of the Bretton Woods system in 1973 and the return to floating currencies accentuated the mobility of financial capital, thus strengthening the 'privileged position of business' (Lindblom, 1977). Fifth, the fraction of the elites who had never accepted the Fordist-Keynesian compromise seized the historical moment of the 1970s to accelerate the process of ideological, political and intellectual counter-mobilization (Canova, 2009; Crouch, 2009; Duménil and Lévy, 2001). The election of Margaret Thatcher in 1979 and Ronald Reagan in 1980 heralded the political hegemony of neo-liberalism. Sixth, the gradual deregulation of financial markets – which started with the development of Euromarkets in the 1960s and the abandonment of selective credit controls in the 1970s – accentuated pressure from financiers for high short-term performance, driving downward pressure on top executive tenure (Gospel and Pendleton, 2003). Seventh, the growth of credit markets for low and middle-income people starting in the 1980s and accelerating in the 1990s sustained aggregate economic demand, while a separate market of derivatives catered for the very wealthy (Canova, 2009). 'Privatized Keynesianism' represented a new social bargain based on consumer confidence in spite of real falling wages. Crucial to this model was the expansion of in-work tax credits for low waged workers, which sustained the purchasing power of low skilled occupational groups without affecting core business interests, i.e. without

employers having to substantially increase wages (Crouch, 2009, 2011; Hay, 2010). This era of 'Great Moderation' came to a halt when the Great Recession in 2007–8 laid bare the structural flaws of speculative Anglo-American capitalism.

This series of institutional, economic and ideological changes has had a profound impact on the nature of corporate elites, with huge implications for working people. In particular, the financialization of the economy encouraged the ascent of new financial elites that sought to obtain distributional advantages from the ruling of private market organizations. In so doing elites shifted the burden of insuring against a rapid decline in income from employers to workers and households, inducing rising income insecurity for the vast majority in both countries (Hacker, 2006; Milberg and Winkler, 2010).

One of the greatest transformations of the last 40 years has been the financialization of the economy. In the USA and the UK, deregulatory reforms enabled the growth in the liquidity of capital markets. Financialization refers to a 'pattern of accumulation in which profit-making occurs increasingly through financial channels rather than through trade and commodity production' (Krippner, 2005: 181). As firms, especially multinationals, became involved in independent financial trading, the frontiers between industrial and money capital became blurred (Lapavitsas, 2011). The ascendancy of finance in corporate governance (Jensen and Meckling, 1976) was justified by principal agent theories according to which the interests of principals (shareholders) and agents (managers) are structurally divergent as each party seeks to maximize its utility. The need to align the interests of shareholders and managers justified the explosion of top executive compensation (bonuses linked to individual financial performance) as well as the distribution of stock options to managers.

## **Changes in the world of corporate elites**

The globalization and deregulation of capital markets resulted in a change in the nature of share ownership. In Britain, in the 1980s, share ownership was still dominated by domestic institutional shareholders but more recently there has been a relative decline in the share of British institutions and a corresponding rise in the share of non-British ownership, such as overseas pension funds and sovereign wealth funds (BIS, 2010: 17).

The rise of institutional investors has also been a prominent feature of American capitalism (Useem, 1996). As financial markets became more complex thanks to the range of new financial products and instruments (securitization, private equity, structured finance, credit default swaps, etc.), institutional investors, who have neither the time nor the capacity to keep up with these constant changes, tended to delegate investment decisions to financial intermediaries such as fund managers.

From the early to the mid-1980s this coincided with a reconfiguration in the traditional inner circle of large corporations in the UK and the USA. Traditionally production-oriented corporate elites (Useem, 1984) were increasingly replaced by senior corporate managers with strong financial backgrounds (Mayer and Whittington, 1999; see also Maclean et al., 2010) and links to financial intermediaries (Folkman et al., 2007). In keeping with Pareto's circulation of elites theory, this new business elite was more open and thus more diverse; the rise of financial intermediaries was associated with the

entrance of ethnic minority groups and women in limited, but still unprecedented, numbers compared to the previous business elites (Domhoff, 2010).

Financial intermediaries are paid on the basis of fees and commissions, and are more interested in deal-making than in long-term investment. Fund managers generate income for themselves through fees related to the number of portfolio changes, without any long-term value for their clients (Wooley, 2010: 121–44). As corporate performance becomes measured by share value, senior partners in the firm, consultants on executive pay, investment bankers, corporate lawyers, hedge fund managers, traders and dealers and financial analysts all have a stake in the ‘economy of permanent restructuring’; deals (takeovers, mergers and acquisitions, securitization) are the source of fees, and senior partners are able to ‘capture substantial shares of turnover and profits’ (Folkman et al., 2007: 561–2; Mizruchi, 2010). In the USA, following the relaxation of antitrust legislation, raiders (outsiders to the world of traditional elites) bought diversified industries in order to split them up and sell off the parts upon completion of the deal. These takeovers ultimately ‘punished’ existing managerial elites for underperformance in terms of share prices (Davis and Stout, 1992; see also Reich, 2009). In the City and Wall Street, financiers expect to maximise their earnings during a relatively short period of time (10–15 years), especially as cyclical lay-offs are the norm in investment banking (Folkman et al., 2007: 564). Because the stock market reacts negatively when a firm fails to meet securities analysts’ quarterly earnings forecast, workforce downsizing has become an accepted managerial strategy to meet analyst forecasts, either as a way of boosting profits or maintaining investor confidence (Jung, 2011; Taylor, 2012). As the actors who monitor share prices are fund managers under intense pressure to maximize current performance, the shareholder value paradigm is played out at all levels of the investment chain.

The focus on share prices has encouraged the development of modular production networks, where firms focus on brand names and intellectual property, leaving contractors to do the actual manufacturing and assembling. As a result, ‘corporations have grown less numerous, less integrated, less concentrated, more ephemeral and more constrained by their shareholders’ (Davis, 2011: 1335). The vertically integrated corporation of the past has been replaced by a horizontal network based on a myriad of contractors. This has led to a disaggregation of employment in which attachment of workers to particular firms is more tenuous, tenures are shorter and opportunity for career mobility through clear job ladders is becoming the exception rather than the norm (Davis, 2009).

### *Implications for work and employment*

In the 1980s and 1990s, as the result of financialization and globalization in corporate strategies, senior executives made an alliance with financial intermediaries, breaking up the traditional Fordist alliance with employees inside the firm (Palpacuer et al., 2011: 564). This has had three main implications for work and employment.

First, there has been a development of insecure employment. The rationale for maintaining long-term employment relations has been severely undermined, making redundancy as ‘a critical life event’ a common experience for both manual and white-collar workers (see: Gabriel et al., 2013 for middle managers in the Great Recession; Gardiner

et al., 2009 for steel workers in the 1990s). Arbitrary changes to employment contracts have also become more common (Clark, 2009). In the UK, as shown by Armour et al. (2003) it is clear that despite the incorporation of EU law (the Collective Redundancy Directive or CRD and the Acquired Rights Directive or ARD) into the domestic legal framework, corporate law and regulations are tilted in favour of shareholders and managers acting on their behalf.

Second, as the modern corporation relies on a network of subcontractors, we have witnessed both a demise of internal labour markets (Capelli, 1999) and the development of a temporary agency workforce (Forde and Slater, 2006; MacKenzie et al., 2010).

Third, there has been an acceleration of work intensification, where multi-skilling has been associated with multi-tasking (Lloyd and Payne, 2006). This trend has been particularly acute for middle managers as corporations have adopted increasingly horizontal and lean operational structures (McCann, 2010).

What is worth emphasizing is that the Great Recession accentuated the erosion of the social compact, as firms responded to the crisis by massive lay-offs, pay cuts and under-employment (Appelbaum, 2011; Lallement, 2011). Hopes that the financial crisis would spark a counter-mobilization of labour interests have not yet materialized, especially in the UK.

## Conclusion

It has been argued that as a consequence of globalization and financialization of Anglo-American capitalism in the late 20th century, new business elites specializing in constant deal-making replaced the traditionally nation-based, production-oriented managerial elites of the post-war era, destroying the alliance between capital and labour that had been at the heart of the Keynesian compromise.

These new elites are dominated by a relatively heterogeneous set of financial intermediaries who follow a logic of short-term rent extraction. This crisis in the circulation of elites has stark implications for the world of work and employment, as a purely finance-driven model of corporate governance has destroyed collective values in the workplace, despite the rhetoric of team-working and corporate social responsibility.

### *So, to paraphrase Lenin, what is to be done?*

What is required is a 21st century social contract that would both re-engineer a form of elite circulation and promote fairness inside and outside the workplace. This can be referred to as 'good capitalism' (Hutton, 2012). If we are to admit that lifelong employment belongs to the bygone era of a society of organizations (Davis, 2009, 2012), then part of a 'new' New Deal would entail provision of generous unemployment benefits to ensure that laid off workers are not starved back into low-paid jobs (the opposite of the Anglo-American workfare model), the obligation for large-scale employers to provide training guarantees and health benefits, the reintroduction of internal labour markets with clear career ladders and finally a system of government work as guarantee of last resort. Although flexicurity reforms are not a panacea for employees, they do represent an alternative to the generalization of contingent employment, intensification of work



through automated surveillance and the development of workfare policies that have spread like a policy virus (Richardson, 2000) across much of the OECD over the past 30 years, including in coordinated market economies (McCann et al., 2010; Palpacuer et al., 2011).

For such a new social contract to be negotiated, there may be a need for another circulation of elites. The 'educated bourgeoisie' has to come forward and convince recalcitrant, finance-oriented elites. In the USA, the 'enlightened bourgeoisie' has finally understood that self-preservation entails accepting higher taxes if they want to overcome the sense of disenfranchisement expressed by the Occupy Wall Street movement (*New York Times*, 2012). In this respect Mr. Obama, in standing up to House Republicans in the fiscal cliff stand-off (in the winter of 2012–13), is an ally of the moderate wing of corporate America, just like President Roosevelt once was.

The words of Keynes spoken in 1923 echo in the 21st century:

I would like to warn the gentlemen of the City and High Finance, that if they do not listen in time to the voice of reason their days may be numbered ... I prophesy that unless they embrace wisdom in good time, the system on which they live will work so very ill that they will be overwhelmed by irresistible things that they hate much more than the mild and limited remedies offered them now. (Keynes, 1971 [1923]: 152)

## Acknowledgements

For valuable comments on earlier versions of this article the author is grateful to *Work, Employment and Society's* three anonymous referees. The author would also like to thank *Work, Employment and Society's* editor Professor Robert MacKenzie for his exceptionally helpful and encouraging suggestions.

## Funding

This research received no specific grant from any funding agency in the public, commercial or not-for-profit sectors.

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**Date submitted** October 2012

**Date accepted** March 2013