Pandemic Paradox and Polanyi: Financial markets rise, economies crash, and regulators toss a coin.

Mark Findlay[1]

Abstract

In the pandemic, investors like all responsible citizens share an obligation to keep the community safe. This obligation extends to informed market decision-making which goes beyond self-interest. The current disconnect between financial markets and the economy is a story of two different realities – or perhaps one harsh reality and one expectant gamble. The disconnect cannot just be explained by the different purposes of economic and financial market analysis *but rather by the information indicators on which these rely*. To forewarn regulators concerned that these two worlds of global wealth generation and growth moving to polar opposite futures, this brief review has these aims:

- To reflect on a legal model for financial markets, their regulation and its limitations so that law and finance may be understood as positively relational when considering market sustainability; and then
- To suggest that the explanation for this dangerous disconnect can be found in Karl Polanyi's understanding of fictitious commodities in self-regulating markets, dis-embedding from the social and his propositions for market correction through the double movement.

Despite the neoliberal logic to the contrary (where financial markets are deemed only for maximising investor/shareholder profit) financial market regulation should prioritise market sustainability as part of pandemic control policy.

Key words

Financial markets; economy; disconnect; pandemic crisis; market sustainability and resilience; responsible market decision-making

Introduction – the Paradox:

> Is anything strange about the stock market behaviour in the time of COVID-19? As the world suffered from the worst economic crisis since the Great Depression (Baldwin and Weder di Mauro 2020a, 2020b, Bénassy-Quéré and Weder di Mauro 2020, Coibon et al. 2020)[2], the reaction of stock markets raises serious concerns. Since the beginning of the crisis, stock prices seem to be running wild. They first ignored the pandemic, then panicked when Europe became its epicentre. Now, they are behaving as if the millions of people infected,

[1] Professor, Director, Centre for AI and Data Governance, SMU. markfindlay@smu.edu.sg. Nydia Remolina Leon read the draft and offered very useful comments and additions. This research is supported by the National Research Foundation, Singapore under its Emerging Areas Research Projects (EARP) Funding Initiative. Any opinions, findings and conclusions or recommendations expressed in this material are those of the author(s) and do not reflect the views of National Research Foundation, Singapore.

[2] Baldwin, R and B Weder di Mauro (2020), 'Economics in the time of COVID-19', VoxEU eBook, CEPR Press; Baldwin, R and B Weder di Mauro (2020), 'Mitigating the COVID Economic Crisis: Act Fast and Do Whatever It Takes', VoxEU eBook, CEPR Press; Bénassy-Quéré, A and B Weder di Mauro (2020), Europe in the time of COVID-19, VoxEU eBook, CEPR Press; Coibion, O, Gorodnichenko Y, and M Weber (2020), 'The Cost of the COVID-19 Crisis: Lockdowns, Macroeconomic Expectations, and Consumer Spending', BFI Working Paper 2020-60.

This preprint research paper has not been peer reviewed. Electronic copy available at: https://ssrn.com/abstract=3671327

> the 400,000 deaths (as in June 2020), and the containment of half the world's population will have no economic impact after all.[3]

In Paul Krugman's view;

> Whenever you consider the economic implications of stock prices, you want to remember three rules. First, the stock market is not the economy. Second, the stock market is not the economy. Third, the stock market is not the economy (…). The relationship between stock performance – largely driven by the oscillation between greed and fear – and real economic growth has always been somewhere between loose and non-existent.[4]

Whether an explanation lies in that during the economic strains of the pandemic there are limited investment options, and as such stock trading is resorted to,[5] or that stock trading is more tied to stakeholder 'confidence' than to genuine facts, shareholders seem less troubled by the cataclysmic infection and death figures than they are impressed with the stimulus intervention of central banks.[6] It seems clear that many investors have not been seriously factoring into their trading decisions either the economic fragility of the jurisdictions in which they operate, or particular disease transmission vectors and measures of strategic social vulnerability.[7] On the other hand, government financial guarantees, social distancing lockdowns, lower policy interest rates and employment protection are approached as mitigating declines in stock prices, rather than essential health concerns.

Any fall in the financial market presently is not said to be a consequence of an asset bubble but rather of an interruption in economic activity to fight the disease. Factor in a reflection on profit returns as 'from now to infinity' rather than now till economic recovery out of the virus (if it comes) and financial markets adopt a more optimistic predictive tone than economic and social facts would justify. In addition, any suggested collapse in the financial sector is not now, like there was in 2008-9, the evil consequences of risky bank speculation, and as such governments are more willing to assist the financial industry with credit support and relief, and the voting public is more prepared to accept this approach. And on firm valuation, earlier company buy-back schemes have comforted the market that valuations during the crisis and beyond are realistic. Ultimately there may be a sense that panic and the fire-sale buying which attends it is not the best approach for medium term financial gains.[8]

However one reads the tea leaves, if the wild fluctuations in the stock markets worldwide during the progress of the pandemic are any indication, and stock markets can be said to represent financial markets in all there forms which is contestable, there is no doubt a huge disconnect between financial market progressions and radical declines in all major economic pointers. In his article 'The US is in a recession, but the stock market marches higher: Here's why there is a disconnect', Greg

---

[3] Capelle-Blancard G & Desroziers A. (2020) 'Stockmarkets and the Economy: Insights from the COVID-19 crisis', VoxEU CEPR Press (19 June 2020).
[4] Krugman, P (2020), 'Crashing Economy, Rising Stocks: What's Going On?', *New York Times*, 30 April.
[5] Malkiel, B and R Shiller (2020) 'Does Covid-19 Prove the Stock Market Is Inefficient?', *Pairagraph*, 04 May 4.
[6] Capelle-Blancard & Desroziers (2020).
[7] Ibid.
[8] The points in this paragraph are raised by Vermaelen T. (2020) 'COVID-19: Four reasons to be optimistic about the stack market', INSEAD Knowledge (23 April 2020) https://knowledge.insead.edu/blog/insead-blog/covid-19-four-reasons-for-optimism-about-the-stock-market-13896

This preprint research paper has not been peer reviewed. Electronic copy available at: https://ssrn.com/abstract=3671327

Iacurci, while reiterating that the stock market is not the economy, explains it as a mix of internalised market confidence and hopeful prediction[9]:

> The Covid-19 public health crisis pushed states to shutter broad swaths of their economies…
>
> Nearly 43 million Americans have since filed for unemployment benefits, shattering prior records.
>
> The country's 14.7% official unemployment rate in April was its highest level since the Great Depression, when it peaked above 25%. The rate rebounded to 13.3% in May after the economy added 2.5 million jobs during the month, but some economists are sceptical that trend will continue. (However)
>
> Stock investors are looking beyond present conditions toward what they believe will happen in the future — which they're currently viewing with optimism, experts said… A 34% decline in the S&P 500 wasn't reflective of the pandemic's likely effect on the long-term U.S. economy, said Preston Caldwell, senior equity analyst at Morningstar. (Caldwell observed)
>
> "I would say the economic data is old news for the market's purposes," Caldwell said. "Right now, most market participants are looking beyond the [second quarter] to try to understand the second half of 2020 and beyond."

Absent the recognition of a rich mine of contrary data on which financial advisers can qualify their rosy predictions this is a story of two different realities – or perhaps one harsh reality and one expectant gamble. The resultant disconnect cannot just be explained by the different purposes of economic and financial market analysis *but rather by the information indicators on which these rely*. Financial markets manipulate internally generated information (about things like financial product) to calibrate and monetise risk. Economic forecasting is more likely to rely on external variables that reveal the state of essential economic relationships (such as employment figures and job vacancies). In an effort to forewarn regulators concerned that these two worlds of global wealth generation and growth moving to polar opposite futures, this brief review has these aims:

- To reflect on a legal model for financial markets, their regulation and its limitations so that law and finance may be understood as positively relational when considering market sustainability; and then
- To suggest that the explanation for this dangerous disconnect can be found in Karl Polanyi's understanding of fictitious commodities in self-regulating markets, dis-embedding from the social and his propositions for market correction through the double movement.

Polanyi's theoretical frame offers a clearer understanding of how, when markets move further away from genuine social utility, they represent threats to social stability which short-term wealth generation does not counterbalance. Further, as is the case with stock market activity during the pandemic crisis, if particular markets operate beyond the economy in ways which reflect no economic reason, they represent a pressing challenge for regulators to employ devices such as law as counter-movements against collapse which specious market information bases risk. Giving substance to this concern the paper reflects on Defoe's critique of speculative stock trading at the time of the Southsea bubble.

---

[9] https://www.cnbc.com/2020/06/03/understanding-the-huge-disconnect-between-the-stock-market-and-economy.html

This preprint research paper has not been peer reviewed. Electronic copy available at: https://ssrn.com/abstract=3671327

In crafting this theoretical analysis to the present disconnect between financial markets and the economy, it is hoped that regulators may have a better chance of risk prediction through targeting the dynamics of the current financial market most in need of correction and control. Despite the now discredited suggestion that legal intervention into market dynamics will dampen profitability unduly the legal theory of finance offers possibilities and limitations when considering law as an effective tool for market sustainability.

Prior to exploring our theoretical facilitators, it is worthwhile reflecting on not dissimilar concerns centuries past when the speculation of traders in *exchange alley,* leveraged the autonomy of the market to create wealth at times of economic uncertainty, and fuel market collapse that threatened the general economy and the body politic.

As a point of explanation, some might argue that speculation itself is not a problem, provided it does not degenerate into market manipulation. Therefore, short-selling could represent nothing more than a valid market strategy within the permits of legitimate trading. Here I do not advance a critique of speculation in general. However, attitudes to the information on which speculation is based have shifted radically in times of crisis. For instance, as a consequence of financial turmoil in the 1980's most jurisdictions moved to criminalise insider trading. In the spirit of regulating out of crisis to ensure market sustainability, the argument here is that regulators are well advised to focus on the nature and impact of information stimulating speculation and determine if and how such information needs to be viewed as a risk factor working against sustainability and resilience.

Distracted Markets – A historical vignette[10]

In 1719, when Robinson Crusoe was first read, Daniel Defoe published a pamphlet *The Anatomy of Exchange Alley: or a System of Stock-Jobbing.* Using satire as his weapon Defoe exposed what he viewed as nothing short of embezzlement on the London exchange market. His critical ire was specifically against the risky speculative activities of the day, when the reign of Queen Anne was in decline and the national economy was in a parlous state. Like how the cannibals Robinson Crusoe pounce on their poor and unsuspecting victims, Defoe portrayed the stock-jobbers[11] devastating the market, through what he saw as manipulative trading like short-selling[12] (not uncommon today), and, thereby endangering the stock market as a gambling device rather than any fair reflection of stock market values. Defoe extended the attack by self-interested and manipulative traders, to the national economy, the Parliament, the Crown, and all the citizens of the Kingdom (where, for instance, public debt depended on a secondary market in manipulated securities). The result is an apocalyptic vision of what, in the future would become the most important financial market in Europe and that, in 1719, was emerging as a profitable financial platform. The text in its grievances against the vibrant speculations on the securities market, at the time allegedly perpetrated by the jobbers, was preceded in 1709 from his pen, by *The Villainy of Stock Jobbers Detected and the*

[10] In this short digression I have drawn heavily from the informative and entertaining article, Annunziata F. (2020) 'At the Early Dawn of the Modern Regulation of Financial Markets. The Villainy of Stock-Jobbers (1701) and The Anatomy of Exchange Alley (1719) by Daniel Defoe'. (June 22, 2020). Bocconi Legal Studies Research Paper, Available at SSRN: https://ssrn.com/abstract=3633103 or http://dx.doi.org/10.2139/ssrn.3633103

[11] Stock-jobbers acted as market makers. They held **shares** on their own books and created market liquidity by buying and selling securities, and matching investors' buy and sell orders through their brokers, who were not allowed to make markets.

[12] There can be a counter-argument put that short sellers provide a perverse insurance by offering pressure valves to sell off stocks in decline before their lowest point is reached.

This preprint research paper has not been peer reviewed. Electronic copy available at: https://ssrn.com/abstract=3671327

Causes of the Late Run after the Bank and the Bankers Discovered and Considered in which he condemned the conduct of London jobbers (speculators) from the position of his literary prominence.

Filippo Annunziata asserts many of the questions that Defoe raised remain significant for financial markets today, underpinning many of the policy choices that govern the regulation of stock exchanges, and, generally, of markets for financial instruments, addressing market abuse. He suggests that the situations Defoe described are prophetic of the issues which modern market regulatory legislation confronts, such as insider trading, market manipulation and appropriate disclosure of price-sensitive information. Market efficiency, if Defoe is to be believed, relative to economic sustainability, was problematic even in the earliest operations of the London stock exchange.

> Three hundred years separate us from the cannibals and speculators mentioned by Daniel Defoe… (cannibalism has been outlawed in all civilised jurisdictions) but the abusive conduct of those operating on the markets represents current risks where…Defoe compares manipulators to the worst kind of criminals.

For the purposes of my analysis, Annunciata chronicles how disruptions in the body politic were turned by stock traders to their advantage, contrary to the economic tide that was running against national stability. Specifically, he notes how Defoe refers to the circulation of untrue news to affect the price of securities such as the rumor that the Pretender to the throne had been captured, creating a Jacobean frenzy that rocked market values

> …the merit of Defoe lies, therefore, in having *grasped the relevance of information on the proper functioning of the market, and, above all in having shown how the correct or distorted use of information can determine the fate of markets* (emphasis added); information is, in fact at the root of grave distortions in the price formulation mechanism if it is not properly disseminated and disclosed (hence the disassociation Defoe sees between the price of the securities and their 'intrinsick value').

The resonance with contemporary concerns about fake news (surrounding such issues as effective COVID-19 drugs) and its impact on stock trading is uncanny, as are the calls for legal regulatory intervention.

If the nature and riskiness of information on which market decisions are made is a factor in the disconnect so far identified, and therefore it is argued a focus for regulatory attention, can law play a part in achieving objectives for market sustainability and resilience? In answering this question, it is useful to explore a legal theory of finance.

A Legal Model for the Financial Market

The neoliberal Washington Consensus desiderata is for a deregulated financial market, without which wealth maximisation cannot be realised. Joh Braithwaite in his compelling analysis of mega multi-national capitalism dispelled this fiction, by establishing that it was an explosion in regulation in all its forms which enabled the massive market surges of recent times.[13] Accepting for the sake of argument that regulation is not the antithesis of a healthy financial market, the next question is,

[13] Braithwaite J. (2008) *Regulatory Capitalism: How it works, ideas for making it work better,* Cheltenham: Edward Elgar.

This preprint research paper has not been peer reviewed. Electronic copy available at: https://ssrn.com/abstract=3671327

what model might best ensure market profitability and sustainability, rather than fiddling with some crude regulatory pressure valves. To make an informed determination it is necessary first to settle on a theory of the market which anticipates and encapsulates legal regulation.

In her paper 'A Legal Theory of Finance' Katharina Pistor[14] argues that financial markets are legally constructed and as such occupy a hybrid (regulatory) space between the state and the market, the public and the private. Now this makes sense because the institutional core of financial markets which is the corporation, is a legal fiction, without form or substance but for law. Even so, as Pistor observes, financial markets exhibit dynamics that frequently put them at odds with commitments in both public and private law. She asserts that the law/finance tension tends to be resolved in times of crisis by suspending the full enforcement of the law where market survival is at stake. Once this occurs, she reverts to a power analysis.

Useful as is her endeavour to establish a legal model for the financial market, and necessary as this would be if law is to play a role in effective market regulation to return the financial market to the social (which will be discussed in the next section), there are two obvious flaws in Pistor's compromise. First, a power analysis of any market is not simply the product of law's recession. Markets are structured around power dynamics inherently. The basic concept of the exchange market is that someone has surplus that they wish to commodify, and this is a power relationship between buyer and seller, depending on the externalities governing supply and demand. Therefore, a legal model for the financial market necessarily operates within and beyond prevailing market forces and dispersals. The second misconception, perhaps based on the earlier mentioned myth that market profitability and regulation are antithetical, enforcing law, and thereby creating certainty, which is essential for market predictability, will not lead to market meltdown, no matter how powerful market players argue to the contrary.

The legal theory of the financial market is based on two premises, fundamental uncertainty and liquidity volatility, reinforced by law:

> The two go together: If the future were known we could take precaution to deal with future liquidity scarcity; if liquidity were always available on demand, i.e. a free good, we could refinance commitments as needed when the future arrives…LTF's critical contribution is to emphasize that the legal structure of finance is of first order importance for explaining and predicting the behaviour of market participants as well as market-wide outcomes.

Such an elaboration well represents the dynamics of financial markets in the current pandemic context when uncertainty and liquidity volatility are devoid of even much private law constraint. Hence, while wealth creation may be short term, peaks and troughs in market flow are inevitable in the short to medium terms. He solution to volatility may not rest in refining predictability. In fact, certain unpredictability and volatility situations may lead to short term profit taking. However, if the objective of regulation is to preserve financial stability, this may differ from predictability. Financial stability is achieved in large measure by risk-based regulation, which is supposed to incentivize players in a financial market to being capable to absorb losses depending on the risks they take – this is applicable particularly to banks. That is why designated financial institutions with fiduciary obligations to a broad client base cannot engage in certain speculative activities. They have to be capitalised depending on the risks they take, they have to be stress tested on the basis of

[14] https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=3286&context=faculty_scholarship

This preprint research paper has not been peer reviewed. Electronic copy available at: https://ssrn.com/abstract=3671327

SMU Classification: Restricted

hypothetical stressed macroeconomic scenarios, etc. Additionally, in the world of capital markets – not so much in the banking sector, even though both worlds collide – it may be more important for regulators to address asymmetries of information, rather than how predictable markets are. Even so if unpredictability in markets is to be tolerated so that some investors enjoy profit through associated speculation and risk taking, that does not deny regulators the opportunity employ law to achieve a more certain understanding of the consequences of risk and speculation. As will be posited in the final section, greater certainty in appreciating the consequences of market choice will enhance sustainability while not requiring that every risk be predictable. In some styles of risk analysis, while a particular dangerous consequence is not possible to predict in terms of temporal and spatial accuracy, if the negative outcome is certain at some time or place then regulators have the challenge to avoid that eventuality.

Noting what she refers to as contemporary facts about finance Pistor suggests financial assets are legally constructed, law contributes to financial instability, finance is inherently hierarchical, and the binding nature of legal and contractual commitments tends to be inversely proportional to finance's hierarchy (that is law has a more productive regulatory influence on the periphery of a financial system).

Interestingly, by focusing on what the theory sees as law's elasticity, the regulatory vision is one where law is not performing command and control functions but is more likely to assume negotiable private law arrangements which become more flexible as the market hierarchy is scaled. Again, this presents a limitation in applying law as a more stringent enforcement mechanisms, in market settings that have thrived through risk-taking an irresponsibility.

Moving on from the theory's interest in what it refers to as the law/finance paradox (which again can be criticised as a duality based on contestable neoliberal assumptions regarding market dynamics – such as profit over sustainability) attention is drawn to 'power as the differential relation to law'. In explaining this connection Pistor argues:

> Power is exercised throughout the financial system. It is exercised by those who have the resources to extend support to others without being legally obliged to do so. Those who have access to unlimited resources have the most power: Sovereigns with control over their own currency and debt. Their access to unlimited resources derives from their power to issue the legal tender, to use their means of coercion to levy taxes on their subjects and to coordinate political and economic resources to make credible their commitments (Kapadia 2013). The absence of any of these three conditions can undermine the credibility of a sovereign as effective lender of last resort. By the same token it positions the sovereign towards the periphery of the global hierarchy of finance.

As a consequence of this reasoning positioning in the financial hierarchy is a matter of power and not simply of law. So, where does this locate law in its regulatory role over finance?

> Taken together, the elements of LTF suggest that law is central to finance in at least three respects: Law lends authority to the means of payment; it spurs regulatory pluralism by delegating rulemaking to different stakeholders and in doing so helps draw boundaries between different markets; and it vindicates financial instruments and other financial contracts. State authorized and backed money serves as the backbone of modern financial systems. It is the common reference price for all other assets; it is also the asset of last

This preprint research paper has not been peer reviewed. Electronic copy available at: https://ssrn.com/abstract=3671327

> resort when others no longer find takers. Further, law sets the stage for legal pluralism by determining which actors, activities and instruments to regulate and which to leave to private regulation. The greater the tolerance for competing regulatory regimes, the greater the probability that competition will increasingly take the form of regulatory arbitrage, i.e. the gaming of the very system that makes and shapes finance. Last but not least, law recognizes contracts and defines the contours of their enforceability. This enhances their credibility, but to the extent that financial instruments are designed to weaken regulatory costs it effectively sanctions regulatory arbitrage and the erosion of formal law.

Despite my reservations about how Pistor seems to collapse discretion to enforce into her rather broad notions of elasticity and power, the recognition in a legal theory for finance of the instability of finance and the elasticity of law towards the apex of financial markets are useful impressions when addressing the central paradox of this paper. Financial instability, rather than representing a common scourge, could be seen as the lifeblood of the stock market gymnastics during the pandemic crisis. At the same time governments and central banks have been expending urgent energies to stabalise central economic indicators such as employment and credit liquidity. Bizarre as it might seem these economic buffers have further stimulated stock markets when viewed by investors as having spill-over effects to shore up stock losses. Law can play a role in market certainty and predictability, regulatory functions that may dull the profit possibilities in market speculation. However, due to the manner in which financial markets represent complex power dynamics, it is no revelation that full enforcement will not decimate financial relationships at the apex, but rather re-align profit advantages which will be powerfully resisted through pressure for legal flexibility.

In the following section of the paper Polanyi's concepts of fictitious commodities, market dis-embedding, and the correctional double movements are introduced to reinforce law's role in assisting the return of particularly risky markets back to the social.

Polanyi's Answer to the Paradox

Karl Polanyi published, 'The Great Transformation: the political and economic origins of our time'[15] in the final year of World War II, about the same time as Hayek's 'The Road to Serfdom' appeared, which was the driving force behind the free-market revolution in the final quarter of the 20th century. Polanyi, on the other hand, using the transformation from the industrial revolution as his backdrop, explained the deficiencies of the self-regulating market[16] (writ so large in the 2008-9 global financial crisis), and the potentially dire social consequences of un-tempered market capitalism. The importance of his thinking in an era of globalisation under challenge, free trade in retreat and the dislocation of financial markets from the economy, cannot be underestimated.[17]

Instead of positioning the social and the economic as two polar opposites, compelling a choice of one over the other, Polanyi's theory focuses on the interconnectedness between the two and the

---

[15] Polanyi K. (2001) *The Great Transformation: The political and economic origins of our time,* Boston: Beacon Press.

[16] Explaining self-regulating markets, when some might respond that financial markets are already significantly regulated, much of the regulatory 'back-bone' in financial markets as I see it still reverts back to the exercise of investor discretion even where that discretion may be confined. It is what Julia Black refers to as constitutionalising self-regulation. Black J. (1996) 'Constitutionalising Self-regulation', *Modern Law Review* 59/1: 24-55.

[17] Discussed at length in Findlay M. (2017) *Law's Regulatory Relevance: Property, power and market economies, Cheltenham: Edward Elgar.*

This preprint research paper has not been peer reviewed. Electronic copy available at: https://ssrn.com/abstract=3671327

manner in which this has been strained. For Polanyi, the economic system was never entirely separated from the social.[18] Polanyi recognized the importance of both the social and economic spheres and their duality manifested in various stages of embeddedness, a concept we recognize is not free of criticism to which we will return subsequently.

When addressing the failings of neo-liberal market economies, and the disconnect between financial markets and the economy at large Polanyi's interest in economic anthropology is useful on at least two levels.[19] The first is to explain the dis-embedding of property and its markets in which fictitious commodities such as land, labour and money are cultivated. The second is to determine whether a modern critique of property and its markets can be removed from a capitalist market environment. At the centre of such an exploration is his concern about how property, as the product of labour becomes disconnected from society. The relevance of Polanyi's theory lies in how it maps out the shift from a state of embeddedness to one of dis-embeddedness (as characterized by financial markets and the more general the market economy), prompting resistance by society as it seeks to re-embed the market back into the social.

Rather than dismiss Polanyi's interest in the dis-embedding/re-embedding pendulum for its ill-defined edges and slippery generalization, I am attracted by the openness of Polanyi's theory, not limited by some static or time-bound notion of the social or consequently, a contextually constrained concept of embeddedness. This openness is necessary if law is to be considered as a viable regulatory agent for returning financial markets closer to the general market economy. I assert that this transition is one way of dealing with the speculative volatility of stock markets that risk a *second wave* of economic collapse if one of the reason for the disconnect of finance from economy is a bubble in the former created by a reliance on information that had little reality when measured against economic predictors. In addition, the flexibility of the embeddedness/dis-embeddedness continuum resonates with Pistor' legal theory of finance, where law is portrayed as at the same time elastic and restraining.

Dis-embedding and re-embedding are more a dynamic than a simple binary – leaving and returning to the social. Gemici argues, that a central fracture in Polanyi's thought concerning the embedding dynamic creates an ostensible contradiction:

- Economies are embedded and enmeshed in institutions.
- Market exchange and market economy are self-regulating and dis-embedded.

Gemici approaches this contradiction by declaring that Polanyi uses embeddedness as an analytical construct to discern the changing place of economy in society throughout human history. In so doing he employs embeddedness to specify the degree to which economy is 'separated' from the rest of society. In such a way, the embeddedness concept represents a mirror for understanding how economy becomes dislocated from its organic social bonds. As an example, market economy is regarded by Polanyi as the first *dis-embedded* economic system in history. Accepting this analysis as restricted to the institutional comparison of market systems to other economic systems then embeddedness is just a methodological principle positing that economy and society can only be analysed through a holistic approach, that being to understand the divergence/convergence of economy in society under any historical market conditions. The current historical market conditions

[18] Polanyi (2001); p70.
[19] Polanyi (2001). See also, Bell D. (2002) 'Polanyi and the Definition of Capitalism', in J. Ensminger (ed) *Theory in Economic Anthropology*, New York: AltaMira Press.

This preprint research paper has not been peer reviewed. Electronic copy available at: https://ssrn.com/abstract=3671327

which focus paper not only represent economy dis-embedded from the social, but due to the largely self-regulating financial market, finance is dis-embedding from economy, Both financial markets and the wider market economy are enmeshed in institutions, the financial market significantly determined by stock exchanges. It is within these institutions that regulatory intervention to encourage re-embedding should well be directed.

Gemici argues that embeddedness is not necessarily a variable or a characteristic of economic systems. Polanyi viewed markets and economies as both capable of social location and thereby be socially beneficial. Therefore, embeddedness requires that whether it is markets or economies that we are reviewing against this measure (or any other frame of social bonding) the evaluation must be holistic against a range of forces, which work towards or against bonding.[20] Consistent with this position Polanyi proposes the impossibility of separating economy from society because all economic systems are initially and essentially embedded in social relations and institutions. Dramatic deteriorations in economic indicators during the pandemic indicate massive social hardship no matter what the wealth creating alternatives in the financial markets demonstrate for some.[21] While the economy inhabits a separate and autonomous sphere under capitalism, it is enmeshed in society under pre-modern economies in such a manner that studying the economy apart from 'the tissue of relationships' that constitutes 'the reality of society' would be erroneous.[22]

That Polanyi envisions the market economy as separate from social institutions, functioning according to its own rules, (being more mechanical social arrangements) only goes further to confirm that dis-embedding social processes from their social bonds tends to create in these processes a dependency on externalities such as an artificial division of labour for their essential functioning. If financial markets are what Polanyi would have determined to be self-regulating markets then their dis-embedding from the economy, and thereby from the social are a function of the fictitious commodities they trade, and the risks they take in so doing to maximise profit. This understanding favours Gemici's interpretation of embeddedness arising as a *gradational concept*; and that the totally dis-embedded economy is not possible, but some economic arrangements are more absorbed in social institutions and relations than others. In Polanyi's arguments, there exists an almost unidirectional and relentless assumption of the market moving away from the social. Again, while recognising that such a dynamic at least is likely to be affected by push/pull factors which influence market development and transformation, it is enough to observe stages and states at which market societies and social dis-embedding are empirically undeniable. Relative to particular market form and social needs the drift to dis-embedding will have differing rates and even peaks and troughs. As Ebner identifies, Polanyi advanced a twofold consideration of embeddedness; as a representation of the connection of markets to the moral fabric of society, and as a political term that refers to social reform and the regulation of

[20] As economic actions within the market are just one category of a wide range of social interactions; see Perry-Kessaris A. (2011) 'Reading the Story of Law and Embeddedness through a Community Lens: A Polanyi-meets-Cotterrell Economic Sociology of Law?', *Northern Ireland Legal Quarterly* 62/4, pp. 401-413.

[21] https://www.nytimes.com/live/2020/07/30/business/stock-market-today-coronavirus/the-us-economys-contraction-in-the-second-quarter-was-the-worst-on-record?campaign_id=60&emc=edit_na_20200730&instance_id=0&nl=breaking-news&ref=cta®i_id=129870407&segment_id=34753&user_id=7abf8ef3da6fcf5f1151612878bdffdd#apple-blows-past-expectations-with-surging-sales-and-profits

[22] Gemici K. (2008) 'Karl Polanyi and the Antimonies of Embeddedness', *Socio-Economic Review* 6, 5-33, p. 8.

This preprint research paper has not been peer reviewed. Electronic copy available at: https://ssrn.com/abstract=3671327

markets (in particular regarding fictitious commodities).[23] As was observed following the near collapse of the global financial industry in 2008-9, the reform process as a move toward market re-moralising through closer social governance cannot be left to the vagaries, even treacheries of self-interested self-regulation.

Despite prevailing free market ideologies, dis-embedding exchange markets, as seen by Polanyi, are frameworks of power asymmetry. This interpretation is compatible with Pistor's view that at the apex of financial hierarchies, market movements are more about power than law. Re-embedding markets is a dispersal of power from the economic to the social. Returning commodities from the fictitious to the actual is a dispersal of power from the economic to the social. If power can motivate markets to embed and to dis-embed, then it is necessary for the regulator to examine constraints on power which will preference social empowering.

Adopting Polanyi's explanation that the movement in market economies away from the social requires and results in fictitious commodification, then the binary fictitious/real (actual) will necessitate the real as the social and the fictitious as self-regulating markets cut free from fundamental social bonding.

What is meant by fictitious can be seen in Jessop's interpretation of Polanyi:

> …a fictitious commodity has the form of a commodity (can be bought and sold) but is not actually produced to be sold. It exists already before it acquires the form of an exchange value (eg. raw nature) or it is produced as a use value before being appropriated and offered for sale…a fictitious commodity is not created in a profit-oriented labour process subject to competitive pressures of market forces to rationalise its production and reduce the turnover time of invested capital…[24]

Therefore, fictitious commodities and their markets do not obey rules such as that of pure competition, normatively declared by capitalism. In terms of, for instance the information economy, we can see the influence of social scarcity in an artificial rather than a real vein. Law at present is actively involved in the enclosure of collectively produced knowledge (and does so in exchange market regulation through limiting some forms of privileged information from trading decisions). As a result, knowledge is:

> …codified, detached from manual labour and disentangled from material products to acquire independent form in expert systems, intelligent machines, or immaterial products and services.

From this characterization, Jessop returns to the dis-embedding of commodities if knowledge in certain market contexts can be seen as fictitious:

> …knowledge is dis-embedded from its social roots and integrated into extra-economic institutional orders, functional systems, and the lifeworld and made subject to creeping

[23] Ebner A. (2010) 'Transnational Markets and the Polanyi Problem' in Joerges C. and Falke J. (eds) *Karl Polanyi, Globalisation and the Potential of Law in Transnational Markets* Oxford, UK: Hart Publishing; pp. 19-41.

[24] Jessop B. (2007) 'Knowledge as a Fictitious Commodity: Insights and limits of a Polanyian perspective,' in A. Bugra and K Agartan (eds.) *Reading Karl Polanyi for the Twenty-First Century: Market economy as a political project,* New York: Palgrave Macmillan pp.115-134; p118.

This preprint research paper has not been peer reviewed. Electronic copy available at: https://ssrn.com/abstract=3671327

> commodification so that the primary code governing its use is profitable/unprofitable rather than true/false, sacred/profane, health/disease et cetera.[25]

Along with law's responsibility in this age of change there will be an adjunct necessity for an extension of market organization to work in favour of what Jessop refers to as genuine rather than fictitious commodities. Discussions for achieving this in terms of requiring risky financial product to be explained to potential investment intensified after the 2009-9 financial collapse. This process, therefore, is more than an ideological intent.

> This self-regulating market of economic liberalism is opposed by social protection intended to preserve man and nature. This is Polanyi's famous double movement.[26]

Polanyi singled out the essential elements of the market, namely, labour, land and money as fictitious commodities,[27] elements that are not produced for sale yet playing a pivotal role in the market. *Money*, for instance, is merely a token of purchasing power which, as a rule, is not produced at all, but comes into being through the mechanism of banking or state finance".[28]

Polanyi analysts such as Jessop have recently proposed a reconsideration of commodities which might be deemed fictitious, as well as for a more nuanced reflection on the processes of market dis-embedding through fictitious commodification.[29] In relation to the latter, Jessop advances, on the way to evaluating whether *knowledge* might now be seen as a fictitious commodity, a five-stage commodification format: pre-commodification, fictitious commodification, quasi-commodification, real commodification and fictive capital. These different commodification forms are said to better cover fictitious market transformation in a globalised economy.

Bringing Polanyi back to considering the disconnect between the financial markets and the economy in this time of pandemic the following observations follow:

- The economy has dis-embedded from the social so that disease mass infection translates into economic collapse, due in part to the impact of revaluing fictitious commodities in exchange markets;
- The financial markets have dis-embedded from the economy because financial markets transact quasi commodities which are income generating instruments and relationships not requiring any connection to social reality;
- The financial market generates wealth through trading fictive capital which is an imaginary creation of the market. As such there is less need for the financial market to reflect the trends in an economy which ultimately returns to the means of production;
- If knowledge/information can be viewed as a fictitious commodity then it can service any market if the primary code governing its use is profitable/unprofitable rather than true/false (sacred/profane, health/disease);

[25] Jessop (2007); p.120.
[26] Jessop (2007); p. 117.
[27] Polanyi (2001); at p75.
[28] Polanyi (2001).
[29] Jessop B. (2007) 'Knowledge as a fictitious commodity: Insights and limits of a Polanyian perspective' in A. Buğra and K. Ağartan (eds.) *Reading Karl Polanyi for the 21st century: Market Economy as a Political Project* Basingstoke: Palgrave Macmillan, 115-134.

This preprint research paper has not been peer reviewed. Electronic copy available at: https://ssrn.com/abstract=3671327

SMU Classification: Restricted

- Knowledge/information can dis-embed further from the social and service fictitious commodities more detached from the social, when markets are more self-regulated.

As such the disconnect between the financial market and the economy in times of pandemic is not so much a paradox but a product of different degrees of dis-embedding and fictitious commodification. However, as the double movement asserts, no exchange market will ever absolutely dis-embed from the social and therefore counter-movements such as a pandemic disease can reign in even the most self-regulated markets if those social essentials for the market re-assert themselves (such as a sustainable human/natural environment within which market trading can occur).

South Sea Bubble – Preserving man and nature

Returning to the era of Defoe, in 1720 there was an incredible boom in South Sea Company stock, as a result of the company's proposal, accepted by Parliament, to take over the national war debt. The company expected in part to recoup its outlay by expanding trade into promised concessions, but chiefly from the foreseen growth in the company's share value. Indeed shares rose dramatically, from 128 $^{1}/_{2}$ pounds sterling in January 1720 to more than 1,000 pounds in August. Those unable to buy South Sea stock were inveigled by overly optimistic company promoters or downright swindlers into unwise ancillary investments. The Bubble Act was passed in June, requiring all joint-stock companies to receive a royal charter. The legislation had been promoted by the South Sea Company, presumably as a means of controlling competition in the burgeoning market. The South Sea Company received its charter, perceived as a vote of confidence in the company, and by the end of June its share price had spiked to a peak of £1050.

Through widespread rumours, which came about from within the company, the stock price inflated to surreal levels leading to a value £200 million, $4 trillion US in today's money. Investor confidence began to wane, however. The sell-off commenced in early July and the collapse occurred quickly. By the end of August stock was down-graded at less than £800. By September the share price had plummeted to £175, devastating institutions and individual investors alike, and dragging other, including government, stock with them. In 1721 formal investigations exposed a web of deceit, corruption and bribery surrounding the stock pricing and supporting information, that led to the prosecution of many major players in the crisis, including both company and government officials. The scandal brought Robert Walpole, generally considered to be the first British prime minister, to power.

The South Sea Bubble was not an isolated bubble event in 1720. It was the product of intersecting financial, legal political and cultural factors. The company was promised the monopoly over trade with the Spanish colonies so long as it financed the British role in the Spanish War of Succession. As such company valuation was tied to something as unpredictable as the fortunes of war. Speculators not only needed to predict the outcome of hostilities, but also a range of uncertain market consequences if the outcome went either way. Most investors were privy only to information which at best was rumour.   Around the time of the South Sea Bubble a general interest in joint-stock investment opportunities was developing which no doubt stimulated unsound financial decision-making in the panic to be part of the action. By the middle of 1720 the market was flooded with a remarkable range of new ventures, each creating smaller bubbles as the speculative frenzy mounted.

This preprint research paper has not been peer reviewed. Electronic copy available at: https://ssrn.com/abstract=3671327

Why this return to historical diversion? For these reasons which are true then and now[30] in the current disconnect between financial markets and the economy:

- This spectacular bubble could not have occurred without the reliance on internally generated and validated misinformation.
- The value of the company never bore any resemblance to a reasonably determined economic value.
- Self-regulating markets for fictive capital and quasi-fictitious commodities operate in risk-laden elasticity.
- Self-regulating markets reject external governance in the good times but rely on external guarantees in collapse.
- Power dispersal in self-regulating markets for fictive capital and quasi-fictious commodities does not depend on the same rules and information as govern the economy or the social.
- Wealth creation in fictive capital and quasi-fictitious commodity markets does not essentially benefit an economy in decline.
- Self-regulating markets for fictive capital and quasi-fictious commodities will experience forces for re-embedding consistent with Polanyi's double movement.
- A burst bubble hurts economies and the social.

Many of these conditions require market regulation if the disconnect between the finance market, the economy, and the social is not to be narrowed through disruptive and painful re-embedding. This brief paper explains the nature of the disconnect and its possible outcomes. Employing a modified legal theory of finance and reflecting on Polanyi's double movement, regulators are well advised to direct an initial regulatory focus on developing more uniform information 'commodities' that make sense of the financial market **and** the economy in decline. If this is achieved, then the risks associated with self-regulating markets could be more commonly surveyed.

There are several assumptions on which this paper's regulatory invocations rely

1. That in times of economic crisis such as this pandemic, and situations where the financial market and the economy significantly diverge, the objective for regulating financial markets (particularly self-regulating markets) is market sustainability and resilience.
2. A disconnect between financial markets and the economy in terms of risk evaluation and market activity can endanger market sustainability and resilience if a counter movement in the economy and the social is not managed effectively. The consequences of market bubbles need to be avoided proactively.
3. The law can be employed to create greater levels certainty in the market in order to minimise or avoid catastrophic risk outcomes.
4. Law's elasticity (rather than its mandatory enforcement capacity) makes it compatible with market fluidity, even in times of crisis.
5. In crisis regulation, the law is not necessarily employed to improve risk predictability for investor benefit or otherwise.
6. Nominating sustainability and resilience as regulatory priorities for market regulation may mean a reduction in short-term investor profit, in times of crisis and post crisis recovery.

[30] Gayed M (2020) 'The Summer Crash of 2020:Or the great readjustment', *Seeking Alpha* https://seekingalpha.com/article/4360320-summer-crash-of-2020-great-re-adjustment

This preprint research paper has not been peer reviewed. Electronic copy available at: https://ssrn.com/abstract=3671327

7. A practical target for legal regulation is the reduction in information asymmetries between the financial market and the economy.
8. Targeting information asymmetries should not be restricted to instances of conscious market manipulation but regulators should concentrate on enhancing information accuracy to facilitate market choices based on a more certain understanding of consequences for sustainability and resilience.

In the pandemic, investors like all responsible citizens share an obligation to keep the community safe. This obligation extends to informed market decision-making which goes beyond self-interest. More than being a 'call to arms' for regulators who should be concerned about the possible negative consequences of the disconnect between financial markets and the economy, the paper's argument has endeavoured to establish that the disconnect is evidence of extreme social dis-embedding and as such represents a danger to political and general economic recovery policy.

Consistent with directing regulatory energy to information essential for market dynamics and decision-making consequences, regulation to shield the financial market, the economy and their sustainability will need to responsibilise the protection of investor profit, recognising the two objectives are not mutually exclusive. The inherent problem with the prevailing financial market wisdom that the *riskier product* the greater the profit and therefore 'let the buyer beware' is the reality in times of crisis that such approaches jeopardise much more than individual investor wealth creation. Polanyi would agree, the more fictitious the commodity the more the risk its transaction represents, but in there lies a fundamental question of how law should structure a sustainable market which thrives on internally generated information and speculative profit prediction.

With pandemic control having wider economic ramifications for the safety of society, I am not arguing for law as an agent of market certainty/predictability and acting as risk management variable primarily protecting investor profit. This analysis is more interested in law addressing fundamental information asymmetries at the heart of the disconnect so that certain risk taking, with adequate information is no longer an indicator of speculative and sometimes irresponsible market choice. Despite the neoliberal logic to the contrary (where financial markets are deemed only for maximising investor/shareholder profit) regulation should prioritise market sustainability as part of pandemic control policy. The clear regulatory objective when markets are radically dis-embedding, should be not only making risk more predictable but instead making the foundations and consequences of risk more certain and as such to introduce measures of responsible market behaviour.[31]

[31] The discussion of the importance of introducing measures of responsible market behaviour is a timely debate because of the clash between hedge funds (acting as shadow banks) and some regulators. Regulators are calling for tougher oversight since the global financial crisis, but little has been done in that space. See https://www.bloomberg.com/news/articles/2020-08-03/fed-is-headed-for-a-clash-with-hedge-funds-other-shadow-banks?utm_source=url_link

This preprint research paper has not been peer reviewed. Electronic copy available at: https://ssrn.com/abstract=3671327