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DOI:

[10.1080/09692290.2019.1607770](https://doi.org/10.1080/09692290.2019.1607770)

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Document Version

Peer reviewed version

Citation for published version (Harvard):

Macartney, H & Calcagno, P 2019, 'All bark and no bite: the political economy of bank fines in Anglo-America', *Review of International Political Economy*, vol. 26, no. 4, pp. 630-665.
<https://doi.org/10.1080/09692290.2019.1607770>

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Huw Macartney & Paola Calcagno (2019) All bark and no bite: the political economy of bank fines in Anglo-America, *Review of International Political Economy*, DOI: 10.1080/09692290.2019.1607770

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ALL BARK AND NO BITE: THE POLITICAL ECONOMY OF BANK FINES IN ANGLO-AMERICA

Huw Macartney & Paola Calcagno

Review of International Political Economy
(forthcoming – please do not cite without permission)

Introduction

Following the global financial crisis, US and UK (henceforth Anglo-American) state managers (Burnham 2001:136) employed a wide range of measures to penalize misconduct and improve behavior within their respective banking sectors. Some of these measures involved big structural reforms – improving capital buffers, ring-fencing higher risk trading activity, remuneration reforms and reducing the likelihood of taxpayer bailouts by improving resolution measures (Hardie & Macartney 2016). One of the most high-profile strategies aimed at improving conduct – curbing excessive risk-taking, tackling unethical practices such as dealing with sanctioned countries, and reducing sales pressures that led to mis-selling – was to impose financial penalties (or fines) on banks. The discourse state managers attached to these financial penalties implied that the unprecedented size of the fines – totaling \$326bn by late 2016 – disincentivized misconduct by making bad behavior prohibitively costly. The main aim of this paper is to show that this was not the primary intention of the bank fines.

The main question we address is therefore, what was the real objective of state managers in their use of bank fines? The central question involves two puzzles. Firstly, the financial sums themselves and the rhetoric state managers attached to the penalties both give the impression that the political classes were getting tough on the banks. Indeed, this assertion would certainly fit with other areas of financial crime, including money laundering and terrorist financing, where some legal scholars argue that the UK and the US have been at the forefront of international efforts (Ryder 2011:6). Previously, legal critics had indicated that modest fines had little effect on the internal behaviour of a firm (Steinzor 2014:3); large fines might have therefore signalled more decisive action by the authorities. In contrast however, this article confirms what *other* legal experts have suggested: that behind the flurry of regulatory activity, the terms of the fines and their economic impact on the respective firms were relatively weak (Garrett 2014). This was, in large part, because the fines were significantly diluted and state managers were complicit in this weakening (Eissinger 2017). In answer to the first puzzle then, the article argues that the major objective of the fines was to send a political message to their electorates. This message had populist overtones – positioning the political classes as defenders of the general public against profligate financiers – and was a response to the legitimacy crisis state managers were themselves confronting (Streeck 2013).¹

¹ One reviewer of an earlier draft asked about the threshold for labeling something as a legitimacy “crisis”. We explain our use of the term more fully later in the paper. But our simple response is that – based on Habermas’ reading – we define a legitimacy crisis as – on the one hand – a dynamic process rather than having a static or fixed set of criteria

The first answer raises a second puzzle however, because if the aim was simply to send a strong populist message why did state managers not pursue an even tougher policy response? In the case of Iceland after the financial crisis; Enron in the early 2000s; or the US Savings and Loans Crisis of the 1980s, authorities decided to impose prison sentences on individuals to penalize misconduct. *Diluted* financial penalties levelled against multi-billion dollar corporations arguably send a *weak* political message. The answer the article provides lies in financialization, or the structural importance of financial activities within the Anglo-American economies (Krippner 2015). This financialization simultaneously strengthens the direct influence of the banks in lobbying against tougher penalties; but it also fuels a finance-led regime of accumulation within the US and UK economies that state managers are both complicit in constructing and yet find hard to dismantle. Put differently, the fines sent a populist political message whilst seeking to diffuse popular criticism of financialization in Anglo-America. The penalties are another example of state managers ‘walking a tightrope’ between the demands of the electorate and those of capital in the post-crisis period (Burnham 2011). Or, as Wolfgang Streeck has argued, the US and the UK authorities were forced to ‘manoeuvre between their two categories of stakeholders [the staatsvolk and the marktvolk], keeping them both at least sufficiently happy that they do not withdraw their loyalty or... their confidence’ (Streeck 2014: 83).

Together these two arguments point to the political constraints and contradictions associated with financialization. On the one hand state managers (or policymakers) contributed to the financialization of their economies; whilst on the other hand – even after a financial crisis that discredited the banks – state managers remain constrained by the structural changes that financialization has fuelled and the continued influence of financiers. Yet the economic inequality and financial instability derived from financialization mean that their electorates demand a political response. At face value the populist use of bank fines seemed to fit the bill. But populism lacks a substantive political program to deal with the contradictions of financialization. Thus, we argue in the conclusion, the uneasy relationship between financialization and democratic politics evidenced in the bank fines – as part of the wider political response to the financial crisis – is an important component of the anti-establishment voting that led to Brexit and Trump in our case study countries. The populist use of bank fines bought state managers a little time; but in so doing the political classes simply abdicated responsibility for dealing with the *real* causes of popular discontent.

Within the academic literature there is an established body of work on financial penalties, particularly within the legal and organizational studies corpus. In addition political economy has provided extensive research on financial crime and ethics. There is, to date, a relative lack of political economy analyses of bank fines however. Legal and organizational studies have highlighted the inefficacy of the penalties, both by unpicking the (legal) terms of the deals as well as examining the impact on (organizational) conduct itself. The legal literature in particular explains the weak penalties by reference to half-hearted efforts on the part of political authorities. This political failure stems from lack of resources and fear of the response from large corporations (Steinzor 2014: 6). We argue however, that the rationalist, descriptive account of legal scholars can be developed further by

attached to it; whilst on the other hand arguing that the concept captures a noticeable and analytically significant decline in public confidence in the institutions of government. On this basis, we argue that opinion polls – despite their limitations – are a suitable metric for measuring changes in levels of trust.

employing a critical political economy approach. Put differently, we argue that understanding the real objectives of state managers requires a critical political economy analysis operating at multiple levels of abstraction (Bruff 2011). Here, underlying processes and the disjuncture between discourse and intention can be more fully explored. Both processes of financialization and a crisis of legitimation (that precipitates populist discourses) are analytical abstractions – though we can of course measure and observe their symptoms *inter alia* in the shift in profits from productive to financial activities, or declining levels of public confidence respectively. Both phenomena nonetheless have real explanatory power in understanding the motivations behind these financial penalties that is not captured by existing legal accounts.

The paper unfolds as follows: following an overview of the academic literature that also sets out our critical political economy approach, the first part of the article dismantles the claim made by state managers that the fines were primarily aimed at penalizing misconduct and thereby improving bank behavior. We achieve this by firstly showing the questionable relationship between the fines and the economic performance of the banks; we start here because both the organizational studies literature and the state managers themselves delineated this economic performance pathway as the primary mechanism for inducing reform in the banks. Due to the complexity of the fines, the two parts of the article are not equally weighted though. The second, shorter part of the article then explains the rationale for the dilution of the fines that was witnessed in part one of the paper. Here we outline the populist narrative attached to the fines, and show how state managers were attempting to walk the tightrope – responding to popular demands whilst deflecting criticism away from their respective financialized economies.

In preparing this article we draw upon a wide range of statistical sources on bank profits and share prices; annual reports and statements by the banks; as well as legal and regulatory publications on, for example, conditions attached to the fines and the structure of the penalties. Further, we have also conducted semi-structured interviews with over 150 bankers, regulators, and policymakers across the UK and North America between 2014-2018, as part of the wider research project that informs this paper. For legal reasons – due to disclosure clauses – only a handful of these are referenced in this paper, though the findings heavily inform the argument.

The debate on bank fines

Fines and reputations

In relation to analysing bank fines and conduct, legal and organizational studies have led the way. Organizational studies, borrowing insights from behavioral economics, has focused on the intangible yet measurable impact that conduct has on the financial performance of a firm. The idea here – which speaks directly to our analysis of bank fines – is that reputational damage and financial penalties have a discernible impact and can therefore be influenced by regulatory actions. So-called “reputational capital” may not be readily apparent on a firm’s balance sheet, but there is abundant evidence that it is nonetheless significant. The obvious anecdotal example that sellers with higher reputational scores achieve higher prices has been supported by research findings (Resnick et al. 2006); Ebay is perhaps the most obvious example of this phenomenon. Similarly, other studies have confirmed that investment banks with strong reputations are able to charge higher fees.

More specifically though, announcements of regulatory investigations have been found to be associated with up to a 50% decline in the average share price of an IPO; and that daily stock returns can be significantly more volatile following these regulatory announcements (Beatty, Bunsis and Hand 1998). Similarly, another set of studies also concluded that it is logical for firms to act in socially responsible and lawful ways as a matter of enlightened self interest: that failure to do so has a statistically significant impact on shareholder wealth (Frooman 1997: 222, Ross, Westerfield and Jaffe 1996). In the case of banks more specifically, the predominant mechanism through which reputational loss can manifest is via a reduction in credit ratings and a lower share price (Karpoff 2012: 364). Share prices reflect the opinion of market participants regarding a firms' future cash flows: 'If participants believe that the future cash flows of a firm will decrease due to some behavior of the firm, demand for the stock will decrease, thus lowering the value of the stock' (Frooman 1997: 225).

This statistically robust finding would lead to the conclusion that the mechanism by which bank fines influence conduct is via a negative impact on share prices and profits. Thus it would also be reasonable to assume that state managers might seek to exploit this mechanism to reform misconduct and corporate culture. For reasons we will explain however, this mechanism – fines impacting financial performance – was far less effective in post-crisis financial penalties than in earlier cases of firm misconduct. It appears that markets quickly adapted to a new normal, pricing in the likelihood of large penalties; and thus other factors – such as the structure of the bank bailouts and the recovery of the respect UK and US economies – provide a better explanation for the performance of the banks in question (***** 2019). But the fact that markets adapted to the large penalties was also a product of the weak terms attached to the fines themselves. Indeed, alternative organizational studies during the 1970s and 1980s seeking to establish a correlation between financial performance and corporate social responsibility found mixed evidence that effectively undermines some (reputational capital) conclusions outlined above (see Wood & Jones 1995 for an overview). That is, it was not clear whether firms that were less socially responsible performed worse, or that bad behavior hit profit margins. Thus we return full circle to our central puzzle: if the penalties *might* have promoted change by impacting the performance of the firm, but were structured in such a way as to reduce this impact, then what exactly were state managers seeking to achieve?

Fines as disincentives

To begin to answer this question we turn to the legal studies literature. This corpus provides some explanation of why the financial penalties' impact on corporate performance was diluted, by unpicking the terms attached to the penalties themselves. There has, for example, been an extensive focus on the American system and measures such as deferred prosecution agreements that are employed, oftentimes in place of criminal sanctions, to promote improved conduct (see Garrett 2014 for an overview). This literature is broadly sceptical of the efficacy of fines on improving corporate behavior (Shapiro 1984). A number of legal scholars have argued, for example, that 'the threat of fines has proved laughably inadequate at producing better behavior' (Karpoff 2012: 361). Indeed, US Securities Commissioners for New York and Colorado shared the view that 'regulatory slaps on the wrist and high-priced legal counsel become a cost of doing business for securities violators' (Stern & Schiffrin 1987). As Brandon Garrett, Professor of Corporate Crime, remarked, 'these billions of

dollars in fines imposed in recent years are not all that they appear' (Garrett 2016:39). Instead, civil society critics have also argued that if the pain of the financial penalty is diluted, 'future deterrence of corporate wrongdoing is weakened' (USPIRG 2015:6). Whilst the Washington-based activist group, Better Markets, concluded that 'these settlements... are more about headlines than accountability or deterrence' (2017: 82).

It is here that we begin to see the utility of a critical political economy account. For the conclusion of the above accounts – that the fines were weak – is well supported; but the explanation for why this was the case is typically underspecified. It rests – in the legal studies tradition – upon the fear of authorities to tackle large corporations (Eisinger 2017, see DoJ 2012); or on the type of prosecution pursued, where civil lawsuits generally result in modest fines and little retribution, whilst criminal prosecutions are watered down by plea bargaining (Shapiro 1984). As Rena Steinzor has argued, the main reason for the lack of corporate reform is 'the deeply ingrained tendency amongst investigators and prosecutors to take the route of least resistance' (2014: 6). For legal scholars though, this strategy is determined by the fact that proving corporate misconduct 'beyond reasonable doubt' is highly problematic; but also the fact that prosecutors are deterred by the risk of losing; limited resources; and 'apprehension about the intensity of the potential defence' (ibid.). Thus fines are ineffective because the balance of power between authority and firm is weighted heavily in favor of the latter and because of legal and institutional technicalities that constrain stronger political responses.

A critical re-reading

We argue however, that this is a relatively superficial explanatory account for three reasons: first, it is premised on the assumption of separately constituted and antagonistically interdependent authorities and firms, or states and markets (Underhill 2000). This reading understates the social and ideological relations between political authorities and capital that our critical political economy account foregrounds (Burnham 1994). Instead, our account begins with the understanding that the state fulfills two functions in capitalist society: to secure conditions for sustained accumulation and to maintain the legitimacy of the aforementioned mode of accumulation (Habermas 1973: 24-31, Offe 1975, Altvater 1973). In contrast to pluralist or elitist-inspired readings, the state is therefore neither simply a neutral, agnostic institution nor is it just captured by the elements of business class. Put differently, and at the risk of oversimplifying, the state itself is biased in favor of the interests of capital-in-general. This is because state managers operate under the belief that the genuine, long-term interests of subaltern groups can only be met through prioritizing sustained accumulation (Bonefeld 2010).

Secondly and relatedly, the fact that states appear deferential to the banks is highly contingent in the legal accounts. That is, the structural conditions (financialization) that empower the financiers are again underspecified (Bieler & Morton 2008). Instead our reading of financialization (see below) reveals how financialization has simultaneously created strong structural conditions whilst empowering particular agents. Yet it is inadequate to simply highlight the power of the financiers, because this is to revert to an instrumentalist reading of the state – or the concept of regulatory capture – that we reject. Instead, financialization has restructured financial and non-financial corporate strategies such that – in Anglo-America at least – maintaining conditions for sustained accumulation has become synonymous with maintaining financialization itself.

Thirdly, legal accounts struggle to conceptualize the power of ideas and rhetoric. They therefore limit our understanding of the real impact that populist narratives attached to the bank fines have on the crisis of legitimation (***** 2019). In its simplest form our argument is that the rhetoric attached to the fines does not accurately capture the actual intention of the fines. Nonetheless we do argue that the rhetoric sought to have a “real” impact – albeit limited and insufficient – on falling levels of public confidence. Populism, as a rhetorical device, is an alternative to democratic politics and a response to the contradictions of financialization; it is just not a very good one. We explain this third and final point more fully in the conclusion.

The political economy of post-crisis reform

Before we introduce a critical political economy account of legitimacy and financialization however, we must briefly outline the contribution this paper seeks to make to the existing *political economy* literature. There is, of course, a broader political economy debate on post-crisis reform in the banking sector that speaks to the themes of this paper (Epstein 2017). One simple way of categorizing this literature is to divide it between those accounts focused on regulatory reform; and those accounts focused on bank practices and models. The vast majority of the regulatory literature has targeted big structural reforms, from capital adequacy ratios, to resolution and ring-fencing measures (Moschella and Tsingou 2013). Accounts of changes in banking practices have suggested that despite a general shrinkage of investment banking operations in the largest banks, there has been a remarkable continuity in the business models of the largest banks (Bell & Hindmoor 2018). In particular, the heavy emphasis on shareholder metrics and non-interest income are seen as indicators of the continued financialization of Anglo-American banking systems, and market-based banking (Maxfield 2017, Froud et al 2017, Erturk 2016, ***** forthcoming, Mertens 2017).

In relation to corporate misconduct in the financial sector, political economists have drawn contradictory conclusions. In partial contrast to the findings of our article some scholars have argued that the strategic position of the US gives its enforcement agencies a structural power over international banks (see Emmenegger 2017 for an overview). Their claim is that international banks depend on access to US markets, allowing authorities to apply pressure during negotiations with firms. Instead, whilst we agree that economic nationalism has led US authorities to apply tough(er) sanctions to foreign banks in some instances, our study of financial penalties shows the limits to authorities’ power. In our case, at the risk of oversimplifying, the structural conditions are reversed; domestic authorities – in both the US and the UK – are limited to a degree by the embeddedness of a financialized regime of accumulation in their domestic economy. In that sense our argument confirms the findings of Malcolm Campbell-Verduyn, who describes the financial penalties as evidence of a shift from an ‘aggressive to a more lenient...market-based form of accountability’ (2017: 352).

From financialization to legitimacy

The last task of this section is therefore to briefly sketch out the theoretical framework that underpins our critical political economy of bank fines (Shields, Bruff, Macartney 2011). As stated, the point of departure for this framework is the claim that a critical political economy analysis operating at multiple levels of abstraction captures the causal influence of intangible processes (Bonefeld 2016).

This gives greater conceptual clarity to the concrete findings of the legal studies corpus; it also however, points to more disconcerting conclusions about the potential for democratic politics to overcome the pathologies of financialization. We will return to this claim in the conclusion. Put simply, we argue that the apparent weakness of state managers or the overweening influence of the bank lobby – which are really two sides of the same coin – must be embedded in the dynamics of financialization and capital accumulation. This process empowers the bankers to a point, even though the process did not originate with them; they are, in a sense, simply the bearers of the social power of money (Clark 1988). Likewise, a legitimacy crisis – though an abstraction – serves to explain the reason for the strategic use of populist discourses attached to the fines.

Financialization is a broad and oftentimes poorly defined concept. French, Leyshon and Wainwright (2011) divide this literature into two camps: one narrower set of accounts focuses on describing ‘the processes and effects of the growing power of financial values and technologies on corporations, individuals and households’ (emphasis added *ibid.*: 799); that is, these accounts take financialization as a given and focus primarily on how it manifests and the impact it is having via shareholder value and the diffusion of financial metrics. The second set of accounts adopts a broader lens, to consider both the causes of financialization in relation to changing patterns of accumulation and what this might mean for the health of an economic system (Foster 2007). The advantage of this second perspective is that the rising influence of financial actors and the intervention of the state, which fundamentally shaped the process of financialization, are embedded in the dynamics of capitalist accumulation. This helps avoid overemphasizing either structure or agents, determinism or contingency. As Krippner notes for example, though the turn towards financialization was oftentimes facilitated and actively encouraged by the state it was largely an attempt to ‘avoid a series of economic, social, and political dilemmas that confronted policymakers’ (Krippner 2011: 2). Thus financialization was not, by and large, a ‘deliberate outcome sought by policymakers but rather an inadvertent result of the state’s attempts to solve other problems’ (*ibid.*).

Broadly, financialization describes the shift in emphasis towards financial activities in an economy, or the ‘shift in gravity of economic activity from production... to finance’ (Foster 2007:1). This shift however, is driven by a slowdown in profitability – a crisis of accumulation – in the non-financial sector. In its simplest form then, this accumulation crisis reflected declining opportunities for profitable investments in traditional, productive activity (Magdoff and Sweezy 1983). The process of financialization therefore occurred against the backdrop of economic stagnation in the early 1970s that was effectively global in scale. By the 1990s for example, the advanced capitalist economies displayed less dynamism and grew more slowly than they had during the 1980s, when they had expanded less rapidly than during the 1970s (Brenner 2003: 7). Given the potential for double-digit asset growth in capital markets, compared to the single-digit growth achievable in most real product markets, the shift towards financial activities is entirely understandable (Froud et al 2000, French et al 2011: 803). As we will explain in the final section of this paper, we can observe the prevalence of financialization in a number of ways: *inter alia*, via the finance sector (wage) premium; the dependence on non-interest income in banks; asset price inflation; and household indebtedness.

Yet our account of financialization needs to be unpacked still further. For the financialization of Anglo-America does not simply create a path dependency or stickiness which is hard to undo; it also

reflects a confluence of interests between financial and non-financial corporations that inhibits dramatic structural reform of the entire economy. Put differently, and at the risk of oversimplifying, part of the problem which confronts us in this paper is the risk of conflating state managers' desire to protect financialized accumulation with a sympathy towards the biggest banks (see Pirie 2007 for this critique). This is what we mean by the instrumentalist trap that also has echoes in the regulatory capture literature (see above, see also Campbell-Verduyn 2017). It is not simply that states weaken fines in deference to finance capital, but that a broader range of capitalist fractions – and the working class itself – have a vested interest in preserving the (albeit crisis-ridden) financialized regime of accumulation (Clarke 1978). To reiterate, part of the influence invoked by the biggest banks in watering down fines, and part of the inability of state managers to pursue a far-reaching structural reform of their economies, is that both financial and non-financial corporations have adapted to financialization; that is, an entire range of commercial activities in non-financial firms too – with share buybacks the obvious example – are deeply financialized (Froud et al 2008). This conditions Anglo-American state managers' attempts to protect their respective accumulation regimes.

Financialization also has implications for legitimacy however. To be clear, the legitimacy crisis Western state managers have been fighting is not solely the product of financialization. A legitimacy crisis refers to a decline in mass consent for the political strategies of the ruling classes (Streeck 2014). This has as much to do with ill-advised military campaigns, the long-term decline in welfare provision, and the failed promises of neoliberalism, as it does with financialization. Yet certain features of financialization have compounded the legitimacy crisis and limited the scope for democratic politics. One is that firms in financialized economies are increasingly myopic, as they jeopardize long-term integrity and the interests of wider societal stakeholders, in favor of short-term profits (Hardie and Howarth 2013, Zysman 1983, Albert 1991). A second is the finance sector premium – with wages and bonuses (on average) noticeably higher in the finance sector than in comparable roles in other parts of the economy (Lindley & McIntosh 2014, Philippon and Reshef 2012). And a third is the instability that accompanies market-based banking – the business model banks under financialized economies tend to employ (Maxfield et al 2017). This instability led to the bank bailouts, which were a major focus of protest movements following the financial crisis; thereby contributing to the legitimacy crisis (Ipsos MORI 2015). Thus financialization might realistically be considered the single most important driver of declining public confidence in Anglo-America.

The final piece of our puzzle is populism, which has become the dominant response of the political classes to the unfolding legitimacy crisis. Populism is often mistakenly conflated with its right-wing, nativist variant (Mudde 2017). Post-financial crisis however, a left-wing populism has been equally prevalent (Mounck 2014). Both left and right-wing versions share the fact that they are ideologically thin – insofar as they often attach to other existing ideologies and generally lack a specific policy program of their own (Mudde & Kaltwasser 2017). What they have in common however, is their depiction of a corrupt “elite” and a deprived “people” (Bale et al 2009). In this sense it has been argued that we should talk about populist narratives attaching to more traditional ideological positions, rather than simply analyzing populist “parties” in a narrower sense (Deegan-Krause & Haughton 2009). Populist discourses have thus permeated mainstream – Conservative and Labour, Democrat and Republican – narratives, with state managers presenting policies such as bank fines as a defense of the general will of the people (see Kriesi et al 2012 for an overview).

We argue though that in line with our critical political economy account, the work of Jürgen Habermas and Wolfgang Streeck on the crisis of legitimation provides the best explanation for why state managers of both left and right made this turn towards populist statecraft. As Ian Bruff and Magnus Ryner have argued, the answer lies in the so-called paradox of neoliberalism, whereby elites across the political spectrum – including social democratic parties – bought into the ideology of marketization and the limits of the welfare state (Bruff 2014, Ryner 2014). The immanence of neoliberalism therefore precipitated a crisis of legitimacy, signifying a growing divide between the (worsening) lived experiences of lower and middle income households and the promises of prosperity attached to the neoliberal project; this is the crisis of democratic capitalism (Streeck 2013: 6-9). The result was what Habermas defined as ‘unresolved steering problems’ (1973:2) or a crisis of crisis management (Clarke 1991:7).

The liberal capitalist state has a structural and ideological bias, for it operates under the belief that the resolution of class conflict can only lie in sustained progressive accumulation (Offe 1974: 36). Put differently, it suspends the democratic demands of the working classes for rising wages or welfare provision in favor of prioritizing capitalist accumulation. The state achieves this by ‘fixing in a system of observed norms the asymmetrical distribution of legitimate chances to satisfy needs’ (Habermas 1973: 96). During times of economic crisis this bias is particularly exposed. Indeed, as ‘belief in the legitimacy of the existing order vanishes the latent force embedded in the system of institutions is released’ (ibid.). This is simply another way of saying that the depth of the class antagonisms that had previously been vacuum-sealed in the container of extant institutional structures breaks loose; in such cases we would expect to see angry and often violent protests of the type experienced in Occupy movements in London and New York (***** 2019).

Put differently, the longer-term decline in public confidence in the ruling classes – which we will show briefly later in the paper – was exacerbated by the financial crisis and the subsequent austerity agenda. This is one way in which the financialization of Anglo-America contributed to the ‘steering problems’ experienced by the political classes (Habermas 1973: 4). The immanence of the neoliberal project however, and the demise of the democratic left, meant that there was little room to manoeuvre in the face of the unfolding legitimacy crisis. The turn towards populist statecraft was in some sense the logical response, in an attempt to regain popular confidence. It constitutes an attempt by the political classes to identify themselves with subaltern groups, and provide the appearance of relative autonomy from culpable institutions and individuals (the banks and bankers) (Macartney 2011). Bank fines were, we argue, one component of this populist turn.

How the fines were diluted

The main aim of this first section is to dismantle the claim that the bank fines were primarily aimed at penalizing misconduct and thereby improving behavior. This is a precursor to the second major claim of the paper – responding to the two puzzles outlined above – that state managers were walking a tightrope, using a populist strategy to respond to the legitimacy crisis whilst deflecting criticism of their financialized economies. As we noted though, the complexity of the first task is such that the two parts of the paper are not equally weighted. Before we examine several ways in

which the penalties were diluted, we begin by outlining the fines themselves and briefly showing that their effect on share prices and profits is very ambiguous.

Fines and profitability

Since the beginning of the financial crisis the banking sector has paid out over \$326bn in financial penalties. A quick overview of these fines is provided in Figures 1 + 2.

Figure 1: breakdown of US bank fines

Sources: data collected from regulatory authorities in US and UK

Figure 2: Total financial penalties paid by all banks (US\$ bn)

Source: Bloomberg 2017

The sub-claim of this first subsection can be framed as a hypothesis: if there were a direct, linear relationship between fines and financial performance – as the literature on corporation reputations suggested (Karpoff 2012) – we would expect the banks hit by the biggest fines to perform the worst financially. Our conclusion is that this is simply not the case. Over the past 2 years we have collected and analyzed data on *all* the fines imposed by UK and US regulatory authorities as part of a wider research project. We then examined the impacts of the fines on the share prices of all of the largest UK and US banks (Wells Fargo, Citibank, JPMorgan, Morgan Stanley, Bank of America, Goldman Sachs, Lloyds, Barclays, HSBC, and RBS). In the interest of space we limit our analysis here to the banks hit by the largest fines, to show the non-linear relationship between fines and performance. The aim of the first section is not to comprehensively refute the body of existing research on reputational capital. Instead we argue though that the financial penalties provide a very limited explanation for changes in share price and profitability. That is, a whole range of other factors, including the rate of recovery of their respective economies and the structure of the bank bailout packages themselves, provide a much more substantive explanation for the financial condition of the banks (Woll 2014, Bell and Hindmoor 2018).

In relation to share prices, consider the examples of Barclays and Bank of America. As Tables 1 and 2 show, these two banks were hit by severe financial penalties from both US and UK authorities. Figures 3 and 4 track the share price of these two banks. The date of the fines being announced has been marked, and the largest fines have been labeled on both graphs. An important methodological note should also be added. In most cases we would not expect to see a significant fall in the share

price on the day of the regulatory announcement itself. This is because, of course, the announcement follows months or even years of investigations by regulatory authorities; and the exact starting point for these investigations is often hard to discern. In most instances markets are aware of these pending settlements. This conclusion is confirmed by existing research, where identifying the precise ‘event’ we would expect markets to be responding to has proven extremely problematic (Karpoff et al 2013). Thus, if anything, we might expect to see a slight rise in the share price immediately after the announcement, as uncertainty about the size of the penalty is resolved.

However, as per the existing literature above, over a given period – if our hypothesis that banks hit by the largest fines might also suffer the biggest decline in share price – we would still expect to notice a relationship. Instead, if anything, the data suggests that after the initial crisis period (2007-2009), markets became progressively less responsive to announcements of further penalties. As we will explain in due course, it appears that markets rapidly priced in the likelihood of fines – thereby reducing their pain and effectiveness. In this sense, the case of the bank fines following the financial crisis perhaps challenges the findings of earlier research in one important respect: the volume of fines, the size of each penalty, and the vast range of financial institutions to be hit, is unprecedented. Thus the data suggests a case of overload; the extent of the fines may actually have worked to undermine their effectiveness, by inadvertently desensitizing markets to their impact. In due course we will also show however, that the deliberately diluted terms attached to the fines by the political classes contributed to market assessments of the impact of the fines on corporate performance.

Table 1: Barclays

	Date	Amount	Description
1	2007-05-30	\$10.9m	US – charges for insider trading.
2	2009-08-19	£2.45m	UK – fined Barclays Capital for transaction reporting failures.
3	2010-08-18	\$298m	US – sanctions violations charges for dealings with Cuba, Iran, Sudan.
4	2011-01-18	£7.7m	UK – failure to provide adequate information in relation to the sale of two major funds.
5	2011-01-26	£1.13m	UK – fined Barclays Capital for failure in protecting customers' money.
6	2012-06-27	£59.5m	UK – for LIBOR and Euribor manipulation.
7	2012-06-27	\$360m	US – for LIBOR manipulation.
8	2012-08-18	\$176m	US – settled sanctions violations for dealings with Cuba, Iran, Burma, Sudan.
9	2013-07-16	\$435m	US – charges for energy market manipulation.
10	2013-09-10	\$36m	US – settlement over mortgage-backed securities.
11	2014-04-24	\$280m	US – misleading investors over mortgage-backed

			securities.
12	2014-05-23	£26m	UK – mis-selling and conflicts of interest.
13	2014-09-23	£38m	UK – failure to protect customer’s assets.
14	2015-05-20	\$992m	US – price-fixing in Forex markets.
15	2015-05-20	£284	UK – price-fixing in Forex markets.
16	2015-05-20	\$60m	US – additional fine for Libor manipulation.
17	2015-11-26	£72m	UK – failure to minimise risk in transactions open to financial crime.

Source: various UK & US regulatory agencies, media, press releases

Table 2: Bank of America

	Date	Amount	Description
1	2008-10-08	\$50m	US – manipulation of securities auction rate.
2	2010-02-04	\$150m	US – failure to disclose bonuses and losses before merger.
3	2010-12-07	\$137m	US – bid rigging in derivatives markets.
4	2010-12-31	\$1350m	US – sale of faulty mortgages.
5	2011-01-03	\$1520m	US – sale of faulty mortgages.
6	2011-05-26	\$20m	US – foreclosure relief to military borrowers.
7	2011-11-10	\$20m	US – foreclosure relief to military borrowers
8	2011-12-21	\$335	US – discrimination claims against minority borrowers.
9	2012-02-01	\$200m	US – Libor rate-rigging.
10	2012-02-09	\$11820	US – National Mortgage Settlement charges.
11	2012-09-13	\$370m	US – discrimination against disability recipients.
12	2013-01-07	\$2886	US – Independent Foreclosure Review settlement.
13	2013-01-07	\$11600	US – settlement over faulty mortgage sales.
14	2013-03-29	\$165m	US – sales of poor MBS securities to credit unions.
15	2013-12-12	\$131m	US – fine for insider dealing.
16	2014-03-26	\$9330m	US – misleading investors over mortgage backed securities.
17	2014-04-09	\$772m	US – misleading customers on credit card protection.
18	2014-08-06	\$16650m	US – mis-selling mortgage backed securities.
19	2014-11-12	\$250m	US – unsound practices on foreign exchange trading business.
20	2015-05-20	\$205m	US – rigging foreign exchange markets and Libor manipulation.
21	2016-03-23	\$430m	US – misusing client funds to finance trading activity.
22	2016-09-16	\$15.5m	US – risk control failures on trading activities.

Source: various UK & US regulatory agencies, media, press releases

Figure 3: Barclays share price (GBP £'s)

Source: Datastream

Figure 4: Bank of America share price (US \$'s)

Source: Datastream

Three points should be noted: first, it was not unusual for share prices to be inflated in the 2005-07 period, which distorts the subsequent fall as the financial crisis hits. Secondly then, both banks experienced a fall in their share price since 2009; this is true for all banks in our survey sample. Thirdly though, the changes in share prices appear to bear little relationship to the fines themselves. This is particularly evident in the case of all the US banks. Though the size of their fines were in orders of magnitude greater than their UK counterparts, US bank share prices recovered significantly more.

The argument that neither the fines nor the associated increase in compliance costs – part of the reform measures accompanying the fines – are an accurate indicator of the financial performance of the banks can also be demonstrated in another way though. Compliance laws, rules and standards generally cover issues ranging from correct market conduct, managing conflicts of interests, and ensuring that clients and customers are treated fairly (BIS 2005: 7, Interview 20170627). Compliance is aimed at regulating banks' behavior towards their shareholders, customers, employees and the markets (International Compliance Association, 2017). The banks unequivocally highlighted the rise in compliance costs in the post-crisis regulatory environment. According to the Global Accenture Survey of Executives for example, approximately 89 per cent of financial services industry executives expected continued cost increases in compliance due to 'an explosion in digital data, a finite talent pool of compliance professionals to draw from and a more-complex risk ecosystem' (Accenture, 2017), with costs rising anywhere between 20-59% for the largest US and UK banks alike, since the financial crisis (Thomson Reuters 2016: 23). Figure 5 shows the financial performance of the largest British and American banks however and helps to capture the secondary effect – after the initial financial penalty – by showing that despite the increased compliance spending, profits for US banks recovered dramatically and even for UK banks improved from their 2008 low. A graph of this type cannot explain the content or impact of the compliance reforms brought into being as a result of the fines; we will discuss this in due course. What the graph does do however, is to begin to problematize the view that either in the immediate or medium-term the fines imposed the economic imperative to reform conduct that state managers had claimed. In other words, it begins to highlight the disjuncture between the rhetoric attached to the fines (their stated objective), and the reality (or real objective).

Figure 5: Average operating profits of US and UK banks (US \$millions)

Source: authors calculations from Fitch Connect data²

In relation to our tentative hypothesis, the message is clear: though the American banks were hit by larger fines, they continued to experience a growth in profitability far in excess of their UK counterparts. Put differently, the largest US banks experienced fines in orders of magnitude greater than those of UK banks, but UK banks experienced more prolonged stagnation in their share price and profits whereas US banks show marked improvement by the tail-end of 2016. This is not, of course, to suggest that reputational damage to the bank has no influence on financial performance. In fact countless studies have shown that it does. But before we can address the legitimacy and financialization argument toward the end of this paper, our aim here is to problematize the simplistic notion that “big fines = big financial impact on the banks = big incentive to address conduct”. This leads towards our central claim that the bank fines were motivated by another concern: they were (primarily) part of a populist strategy by UK and US state managers.

The remainder of this first part of the article is now devoted to explaining four factors that helped to diminish the pain of the financial penalties: their tax deductibility; that the fines were a surcharge on an otherwise lucrative business; that the terms of the fines actually allowed banks to earn further profits; and that the compliance reforms attached to the fines were weak and poorly enforced. Not only do these factors help to explain how banks increasingly incorporated fines into their existing business models, but they also explain why markets were increasingly desensitized. As one industry insider contended, the fines have ‘gone from being unthinkable, to being a grave existential threat, to being a cost of doing business.’ (Levine 2017a). Indeed, another account suggested ‘the threat of

² The banks included here are Bank of America, Merrill Lynch, Goldman Sachs, JP Morgan, Morgan Stanley, Wells Fargo, Lloyds, Royal Bank of Scotland, Barclays.

finer is seen as a footling expense, just another cost of doing business, no different from paying the quarterly phone bill' (The Times, 2009). Or as one senior Wall Street lawyer put it, 'I look at the major banks in the world who've paid humongous fines and they just continue as usual...it's just a matter of business and if you're lucky you get that deducted as an expense for taxes...It's an expense of doing business' (Interview 20160416). Indeed, though the data sets and interview material that inform this analysis are original, both the legal studies literature and the trade press drew similar conclusions about the inefficacy of the fines. The political economy approach we employ however, provides a more comprehensive explanation of the motivations of state managers; and – as we will see in the conclusion – of the challenges in overcoming the pathologies of the Anglo-American economies (Hay 2011).

Tax deductibility

Arguably the most important component – in relation to incorporating fines into existing business models – was the tax deductibility of the fines. As a report by the US Public Interest Research Group noted, when large companies cause harm they rarely pay a financial penalty as other citizens might. Instead, 'these companies negotiate out-of-court settlements that resolve the charges in return for stipulated payments or promised remedies' (USPIRSG 2015: 1). At stake is the fact that 'the pain of penalties from improper activities can be significantly reduced when the penalties are tax deductible' (Forbes 2016). In the UK, tax deductibility was highly controversial. In fact, by 2016, a highly publicized political debate was unfolding over whether the costs of fines incurred as a result of misconduct would be able to be offset against corporation tax bills. In February 2016, the Treasury Committee Chairman Andrew Tyrie wrote to the then Chancellor of the Exchequer asking for clarification on this issue. In the letter, which he published in the press, he contended that 'it is important to ensure that, when a UK bank reaches a settlement with a foreign regulator, any fines cannot be structured to permit UK tax deductibility' (Treasury Select Committee 2016a). A similar clause had been introduced into the Finance Act 2015 to ensure that banks would not be entitled to any tax relief for compensation payments made to customers. According to Tyrie, the idea that the costs for misconduct could be covered as 'legitimate business costs' under the HMRC's Business Income code was unacceptable, as it would mean that taxpayers were 'required to be a part of the burden of any payment imposed by the FCA or overseas regulators' (ibid.).

The Conservative Chancellor, George Osborne, replied confirming that 'fines imposed as a punishment by regulators are non-deductible for UK corporation tax purposes' (HM Treasury 2016). Andrew Tyrie subsequently responded though that certain payments to regulators might be considered to be general compensation - to people other than customers - then they might be considered deductible, which was again 'unacceptable' (Treasury Select Committee 2016b). As we shall see below, this was a not insignificant technical point. In almost all cases, the financial penalties comprised of different segments: in both the UK and the US a relatively limited amount would return to the central budget (the Treasury in the UK; the respective regulators; or federal or state budgets in the US); other elements of the fine comprised commitments to increase lending to particular communities; or charitable donations. In Tyrie's view this created a grey area whereby compensatory payments to customers were not tax-deductible and neither were fines; but compensation payments to the regulator could still be offset against the tax bill of a firm (Treasury Select Committee 2016b). Tyrie therefore urged that 'any payments required from banks for misconduct are either

compensation to customers ... or are clearly set out as fines' (ibid.). Yet the Chancellor failed to respond to the final line of criticism and the issue slowly faded from view.

In reality then, it remained largely unclear in the case of the UK the extent to which the largest banks were able to offset portions of the penalties against their tax bill. Moreover, these tax data are obviously not publicly accessible. Yet, as some commentators have argued, the fact that finance ministry officials in the US and the UK did not make every effort to promote transparency in this area is suggestive of a desire to depoliticize the tax issue and to conceal it from public scrutiny. Moreover, if developments in the US are indicative of the tax loopholes the largest banks have been able to exploit in relation to the fines, they raise significant concerns about the UK case.

In the US a similar political struggle was taking place. In September 2015 Senator Elizabeth Warren had sponsored the Truth in Settlements Act, making it a requirement for regulatory authorities to publicly disclose the 'amount the settling party is obligated to pay that has been expressly specified as a civil or criminal penalty or fine and any amount expressly specified as not deductible for tax purposes' (US Congress 2015). As with the UK case, the US tax code prohibited 'any fine or similar penalty paid to the government for the violation of any law' from being tax deductible (Tax Code Section 162f). But, on the other hand, civil settlements may be tax deductible (USPIRG 2015). This led the Internal Revenue Service to conclude that unless enforcement agencies explicitly forbid a corporation from doing so 'almost every defendant deducts the entire amount' of the settlement as a business expense (emphasis added IRS 2013).

Because of the opacity of the issue almost no systematic studies have been conducted. The United States Public Interest Group, a non-profit advocacy group, did however conduct a study examining the 10 largest settlements by five government regulators since 2012: the Department of Justice, the Securities and Exchange Commission, the Environmental Protection Agency, the Department of Health and Human Services, and the Consumer Financial Protection Bureau. Admittedly, the study was not limited to financial penalties paid by banks themselves but the conclusions were nonetheless illuminating. In that time, the firms in question were required to pay nearly \$80 billion in fines, but the analysis found that they had been able to write off at least \$48 billion. As noted above, the study found that this stemmed from a 'grey area' in the tax code. Whilst corporations were not permitted to deduct penalties or fines, many of the largest settlements were structured in such a way as to address some form of liability connected to alleged misconduct. In relation to banks more specifically though, Frontline noted that the civil penalty imposed by the Department of Justice on JP Morgan in 2013 for its mis-selling of mortgages totaled \$13 billion. Yet, of that amount, \$11 billion was eligible for tax deduction. Similarly, in 2012 the Department of Justice reached a \$25 billion mortgage settlement with Ally Financial, Bank of America, JPMorgan and Wells Fargo. Yet \$20 billion of that amount was eligible for tax deduction (PBS 2015). In other words, state managers were complicit in the dilution of the fines, in part because the structural importance of the largest banks limited the scope for a more robust, and more democratic, response by state managers.

Surcharge

The second factor diluting the impact of the fines was that they were, essentially, a surcharge on otherwise highly profitable business ventures. Determining precisely how much banks profited from

illegal or unethical activity is an impossible task, not least because this data is also not publicly accessible. As the Better Markets Group noted however, if a prosecution is concluded with a \$10 billion settlement, but consumer/investor losses (that is, bank gains) total \$100 billion, then the fine is simply a small percentage of the profit. The National Mortgage Settlement leveled by the 49 state attorneys general, the District of Columbia, and the federal government, against the five largest mortgage providers (GMAC, Bank of America, Citibank, JP Morgan, and Wells Fargo) in February 2012 is a prime example. The \$50 billion settlement involved relief to distressed borrowers and direct payments to the relevant states and Federal government. The Department of Justice emphasized that this was the ‘largest consumer financial protection settlement in US history’ (NMSS 2018).

Yet one central claim of this paper is that this type of rhetoric should not simply be accepted at face value. Put differently, despite the rhetoric the fines were neither a substantive nor a genuinely democratic response; they were infused with populism. Why? Because state managers were constrained by the structures of financialization and the empowered financiers. Of the lenders involved in the aforementioned National Mortgage Settlement, the largest portion of the penalty was paid by Bank of America (\$16.65bn). In response to the settlement however, BoA chief executive Brian Moynihan simply stated that ‘We believe this settlement, which resolves significant remaining mortgage-related exposures, is in the best interests of our shareholders, and allows us to continue to focus on the future’ (BoA 2014). There were two reasons for this conclusion: firstly, the \$16.65bn settlement was estimated to reduce pre-tax earnings for 2014 by only \$5.3 billion, due largely to the structure of the penalty which will be examined below; and secondly, and much more importantly, Bank of America had made significantly more than \$16.65 billion from its original investment. In fact, BoA made approximately \$57.5bn on the bonds it sold to Fannie Mae and Freddie Mac alone (ibid.).

The settlement was therefore only – effectively – an 8.5% surcharge on a very lucrative business deal. State managers issued fines which were not (primarily) intended to disincentivize misconduct, but to send a political message to their electorates whilst diffusing criticism of financialization. The two functions of the capitalist state outlined earlier in this paper were readily apparent in this instance.

Profiting from “troubled assets”

The third factor diluting the pain of the fines was that as a result of the terms of the deals, banks actually profited. Returning to Bank of America and the National Mortgage Settlement, as with many other parts of the mortgage mis-selling penalties, approximately one third of the settlement involved repurchasing troubled mortgage bonds that BoA sold to Fannie Mae and Freddie Mac. The catch was that the regulatory agency – the Federal Housing Finance Authority – did not force BoA to repay the original sums Fannie and Freddie had paid for the defective bonds. Instead BoA were allowed to purchase them at the current market price, which was approximately 20% of their original value. The point was that as the economy and housing market recovered, these distressed mortgage bonds became a hot investment. As a result it was estimated that the group of bonds BoA had bought in the settlement had already earned the bank \$138 million in only two months (Fortune 2014). Again and again, multiple state agencies either turned a blind eye to grey areas in the tax code or

actually inserted clauses that undermined the costs – and therefore the effectiveness – of the financial penalties.

Another related issue was that the terms of the fines demanded that significant portions would adopt the form of consumer relief. This too was a deliberately ambiguous feature of the penalties that authorities were aware of but allowed to pass. Consumer relief was construed in the broadest possible terms, including additional lending to poorer communities – which itself was somewhat ironic given the origins of sub-prime lending – and ‘donations’ to approved groups. What was important for our argument was that most of the deals with the banks gave ‘double credit or more against the settlement amount for every dollar in [these] donations’ (WSJ 2016a). In the case of a Goldman Sachs settlement, for example, the bank was called to spend \$240million on affordable housing. But an appendix to the deal explained that the bank would have to pay - at most - only 30% of that total to actually fulfil the terms of the deal (DoJ 2016:4). A conservative estimate was that this could save the bank as much as \$1bn from the total of the overall fine (NY Times 2016). Whilst in terms of donating to approved organizations, an analysis of the Bank of America’s donation list showed that \$1.15million ‘donated’ to the National Urban League – an African-American civil rights group – counted as if it were \$2.6 million against the banks’ settlement; and \$1.5million to La Raza – the United States’s largest Latino non-profit advocacy organization – took \$3.5 million off the total amount of consumer relief owed by the bank. As one Justice Department official argued, banks were given extra credit for activities that the government wanted to encourage (cited in NY Times 2016). We will return to this point in the final part of this article.

Arguably even more perplexing though is that some of the banks that incurred consumer relief as part of their US mortgage settlement packages never had a consumer mortgage business. As with the Bank of America distressed assets example above, this was a case of banks profiting from the spillover of the sub-prime mortgage lending crisis. Goldman Sachs Group for example, earmarked \$1.8bn for consumer relief even though it had no consumer mortgages to speak of; it bought up other firms’ mortgages, repackaged them as securities and then sold them on to investors. As part of the mortgage relief settlement then it opted to buy up other banks’ mortgages at a discount, and then modify them. But the stock of busted subprime loans a decade after the crisis was minimal. So some of the larger banks developed an alternative strategy: indirectly funding new loans to subprime borrowers. Deutsche Bank, which had a small US mortgage business, agreed to provide \$4.1bn in relief to borrowers. The bank would lend to companies offering government-backed mortgages to persons with weaker credit scores. These included Federal Housing Administration mortgages which allow for a downpayment as low as 3.5% (Bloomberg 2017). Put differently, it is ironic that the deals – approved by state managers – that were ostensibly intended to penalize banks for sub-prime mis-selling, actually encouraged banks to profit from increasing their investment in poorer, deprived communities (again).

Similarly, in October 2017 it was reported that JPMorgan had been engaged in equally unscrupulous practices. As part of the \$25bn National Mortgage Settlement, the bank was fined \$5.3 billion, but only \$1.1 billion had to be paid in cash. The other \$4.2 billion came in the form of financial relief for homeowners in danger of losing their homes to foreclosure. In reality though, JP Morgan set about forgiving loans on properties it no longer owned. Several years earlier it had sold the outstanding

mortgages to 21 third-party investors when these loan portfolios were virtually valueless. And then, at a later date when it was required to provide consumer relief under the settlements, the bank fraudulently created paperwork indicating that it still owned the properties (The Nation 2017). Not only was the bank therefore attempting to deceive investors and Federal authorities, but it also defrauded homeowners, who were informed that their mortgages had been forgiven only to receive subsequent notification that this was not the case because JP Morgan did not own their mortgages to be able to forgive them (Levine 2017b). It was yet another example however, of the ability of banks to exploit the weak and poorly structured technical details for writing off large portions of their financial penalties.

The conclusion of a number of commentators was that the government agencies ‘appear to have grossly inflated the settlement amount for P.R. purposes to mislead the public, while in the fine print, enabling [the banks] to pay 50 to 75 percent less’ (Dennis Kelleher, founder of Better Markets, cited in NY Times 2016). On this reading, the bank settlements were ‘carefully crafted to conceal more than reveal to the...public’ (ibid.). As a senior lawyer involved in negotiating one major US misconduct case phrased it, ‘we used the banking system as a political tool’ (Interview 20170416). Or as the aforementioned Fortune article concluded, ‘The way post-financial crisis justice is doled out for Wall Street banks is a head-scratcher’ (Fortune 2014).

What conclusion should we draw? We have shown clear evidence of the weak and flexible conditions attached to the fines, and that many of these conditions were only apparent in the appendices. We should therefore assume that state managers hoped that the fineprint would pass unnoticed. By implication, the *content* of the penalties served a different purpose to the *message* that state managers attached to them. In fact, the *content* and the *message* contradicted each other: the headlines claimed that the fines were a form of public justice for banker misconduct; whilst the content of the fines told banks that their financialized business strategies had been vindicated.

Compliance

A fourth and final reason for thinking that the impact of the financial penalties on corporate conduct was diluted, is the *legal* terms attached to the penalties themselves. This is not the place for a lengthy discussion about whether or not prosecutions of specific individuals ought to have been pursued. Certainly there has been an extensive body of the legal studies literature arguing that only individual prosecutions can effectively remedy culture and conduct (see Rakoff 2014 for an overview). Other accounts have pointed to the historical parallels between corporate misconduct during the savings and loans crisis of the 1980s and the financial crisis 2007-09, highlighting the conspicuous absence of individual prosecutions in the most recent period compared to the 1980s (Better Markets 2017). In a similar vein, other academic accounts have contended that the explanation for the lack of prosecutions lies in the weakness of, in particular, the US Department of Justice in the face of the overweening power of the largest banks. Certainly there is evidence that the UK is moving towards a type of individual accountability with the Senior Managers Regime though (Cullen 2016).

Instead, setting aside the individual accountability question, in this brief final subsection, we will present the evidence that the legal terms attached to the financial penalties were weak at best. This

was not simply a product of effective bank lobbying, but also the result of state managers' reluctance to tackle more deeply rooted structural problems derived from financialization. Institutional arguments – made by legal scholars – about types of prosecution and attaching terms to penalties are important. But, set within the context of the broader account of politics and statecraft outlined here, a deeper set of underlying structural pressures and incentives also shaped the political response in a way that is not captured by the narrower, institutionalist reading. Instead, our account seeks to show how the political classes consistently sought to navigate between the competing demands of subaltern groups – for a (so-called) bonfire of the bankers – and those of capital – for renewed, financialized accumulation.

The UK case can be dealt with swiftly, for the British legal system does not have a mechanism for attaching (conduct-related reform) conditions to financial penalties. Tellingly though, authorities made almost no efforts to circumvent this legal barrier or were blocked by a combination of industry-lobbying and direct intervention by the Chancellor when they sought to (Interview 20170511)³. In sharp contrast, the US legal system has an extensive history of applying Non-Prosecution Agreements (NPAs) and Deferred Prosecution Agreements (DPAs) to fines. Essentially, NPA and DPA's 'trade criminal charges for promised reforms and criminal fines' (Garrett 2015). The terms of non-prosecution deals usually specify that banks must not engage in additional criminal activity for two or three years; but the caveat is that the subsequent wrongdoing must not be a similar offence. As we shall see below, this important caveat has contributed to the inability and unwillingness of prosecutors to follow through on the punitive action specified in the terms of an original penalty in cases where banks (and indeed other large corporations) have failed to abide by the original terms. The point is that although the US legal system does have a mechanism for promoting cultural reform attached to financial penalties, it has been highly ineffective due to the weakness of political authorities and banks' propensity to push at the limits imposed by prosecution agreements.

One of the most telling features of the Forex manipulation penalties when considering the use of fines and compliance conditions, was that the involvement of a number of banks breached the terms of earlier non-prosecution agreements. In fact there is a pattern of repeat offending or recidivism following compliance monitoring attached to prosecution agreements: Credit Suisse entered a deferred prosecution agreement in 2009 only to re-offend and sign a plea agreement in 2014; HSBC faced a non-prosecution agreement from 2001 and then a deferred prosecution agreement in 2012; JP Morgan faced a non-prosecution agreement in 2011, a deferred prosecution agreement in 2014 and a further plea agreement in 2017; Lloyds faced a deferred prosecution agreement in 2009 and another deferred prosecution agreement in 2014; RBS a deferred prosecution agreement in 2013, a guilty plea in 2013, and another guilty plea in 2017; and there are numerous other examples (see Garrett 2014: 42). This prompted legal scholar Brendan Garrett to conclude that the largest banks had 'almost without exception avoided convictions and sentences entirely' (Garrett 2015).

³ The removal of the reverse burden of responsibility from the Senior Managers Regime at the last minute – as a result of lobbying and the intervention of George Osborne – might be considered one such attempt to push for tougher sanctions on individuals.

Barclays is arguably one of the best examples, because its series of misconduct-related charges happened in a particularly short span of time and highlight the unwillingness of US authorities to take a stronger stance, preferring instead the populist use of big fines. In 2010 the bank entered a DPA for violations of economic sanctions against Burma, Cuba, and Iran. The bank avoided conviction but paid a \$300million fine. It was warned not to violate any Federal laws for two years. Two years later though Barclays was being prosecuted over the Libor rate, but received a more lenient NPA for its ‘extraordinary cooperation’. Then in 2015 however, the bank admitted that its FX trading and sales practices and its collusive conduct violated a principal term of the June 2012 NPA following the Libor manipulation (DoJ 2015b). The Justice Department specifically explained that ‘some of that [Forex] conduct occurred during the pendency of the [Libor] NPA’, which had ‘prohibited the defendant from committing any United States crime during that term’ (DoJ 2015c: 9). The result of this criminal activity though was only a \$60million fine. The fine was minimal because, once again, Barclays had agreed to plead guilty to the Forex allegations and had again agreed to ‘specific remediation with respect to the conduct’ that lead to Forex (ibid.: 10). This involved strengthening its compliance and internal controls, including ‘thorough reviews of the activities and decision-making by employees of the defendant’s legal and compliance functions’ (ibid.:12). Our interview evidence indicates however, that these remedial measures did relatively little to change the overall strategy of the banks – which, as we will argue subsequently, derives from the pressures and incentives of financialization. As one senior compliance manager argued, ‘the regulators keep pushing the same types of thing; you need to do more of this, more of that. But in reality, the effectiveness of some of this stuff is pretty minimal’ (Interview 20170627).

This final subsection has therefore argued that although authorities in some cases sought to attach compliance reform conditions to the fines in order to promote culture reform these conditions were either weak or poorly enforced. As a result, despite the increased compliance spending highlighted earlier in the paper, the largest banks have repeatedly breached the terms of earlier legal agreements. Indeed, academic studies support the view that increased compliance spending has negligible impact, and may even normalize socially or financially irresponsible conduct. A study conducted in 2017 found for example, that the appointment of chief risk officers in the mid 2000s actually led many banks to adopt more high-risk activity. Contrary to expectation, these risk officers found themselves needing to justify their commercial existence, which led to a more complacent attitude within the firm. Similarly, a 2011 study found that there was almost no correlation between increased compliance with Basel Core Principles and measures of bank risk-taking (Demirguc-Kunt and Detragiach 2011). In other words, state managers continued – after the global financial crisis – to pursue compliance reform strategies that they knew had only limited impact.

The legitimacy crisis and financialization

The first (and longer) part of this paper problematized the claim that large financial penalties were primarily intended to have an impact on conduct and culture in the banks. This second, albeit shorter section, now briefly explains what state managers were actually trying to achieve. It does this in two ways: firstly, we begin by providing an overview of the legitimacy crisis Anglo-American state managers were experiencing. Then, by examining both the rhetoric and details of the financial penalties we make the claim that the fines were part of a populist response. Secondly, we then also argue that the populist response was an attempt to avoid more fundamental structural reforms to both

economies. Understanding motives beyond actors' discourses is clearly challenging. In the limited space here however, we show the ongoing financialization of Anglo-America as a means of arguing that despite the heavy penalties and tough-talking rhetoric, little substantive effort was made to tackle the underlying structural conditions. This claim is more fully developed in the wider research project we have undertaken in recent years. In this light, bank fines were an attempt to deflect criticism away from the financialized accumulation regime. As we indicate in the conclusion, if we are right, and state managers have used populism to fight the legitimacy crisis rather than actually tackling financialization; and if financialization does indeed have stability and legitimacy threatening effects; then state managers have only exacerbated the problems that arose post-financial crisis.

Populism & legitimacy

Firstly, we will briefly outline the legitimacy crisis and how it was aggravated by the financial crisis. Countless opinion poll surveys confirm the fact that public confidence in both the banks and elected politicians fell to a historic low following the global financial crisis. Figure 6 shows IPSOS Mori 2015 Veracity Index data from the UK, or the % of the survey population that trusted the respective professions to 'tell the truth'. Politicians and bankers are amongst the least trusted professions. Similar longitudinal trends – of falling trust – are evident in both the US and the UK (see Edelmann 2016).

Figure 6: Veracity Index 2015: % trust to tell the truth

Source: IPSOS Mori 2015

More importantly though, the instability and inequality of financialized capitalism was a major threat to legitimacy. One simple way of showing this is to highlight the pronounced drop in confidence associated with the banking crisis of 2007-09. Figure 7 shows, for example, that according to US Gallup poll data respondents registering ‘very little’ confidence in the banking system rose to the highest level (33 per cent) since the polls began in 1983; and those registering a ‘great deal’ of confidence also fell (between 2009-2012) to the lowest level on record (8-9 per cent).

Figure 7: Levels of confidence in the banking system

Source: Gallup polls

Likewise, in the UK, Figure 8 shows results of a study by the Institute for Business Ethics and Centrica in 2009. Participants were asked whether ‘the conduct of banks linked to the financial crisis has damaged my trust in all businesses’? The results show that 74% of the participants answered either ‘strongly agree’ or ‘tend to agree’. The point here is not to provide an exhaustive overview of the decline in public confidence in the banking sector. Instead, as other commentators have already noted, state managers – who were also struggling with their own legitimacy crisis – saw an opportunity to restore their own credibility by championing the interests of “the people” against the “profligate banks” (Sinclair 2009, Thirkwell-White 2009). From an early stage after the financial crisis both US and UK state managers therefore mounted a comprehensive, yet populist attack on the banks (Macartney 2011). As we explain in the second subsection below however, this populist statecraft was tempered by the desire to deflect criticism away from the financialized accumulation regime.

Figure 8: Conduct of the banks damaged my trust in all businesses? (%)

Source: Institute for Business Ethics and Centrica (2009)

Two details surrounding the financial penalties confirm that they fit within this wider populist strategy: one is the rhetoric attached to them; and the other is the recipients of funds raised through the fines. One reason for believing that the fines were part of a wider *populist-in-discourse* yet *light-touch-in-substance* strategy was the discourse state managers attached to the penalties. In the UK, in 2008 the director of enforcement at the UK Financial Services Authority stated, ‘it’s great to see the FSA hitting companies where it hurts. This record PPI fine should send out a clear message to other companies that mis-selling will be severely punished’ (The Guardian 2008). In 2010, concerning JP Morgan the FSA again stated ‘This penalty sends out a strong message to firms of all sizes...Firms need to sit up and take notice of this action - we have several more cases in the pipeline’ (The Guardian 2010). Then in 2013, speaking about the fines against RBS, George Osborne stated, ‘What happened at RBS and other banks is totally unacceptable. At my insistence, the bankers, not the taxpayers, will pick up the bill’ (The Guardian 2013). Whilst in 2014, concerning the fines for the Forex scandal, the head of the Financial Conduct Authority (FCA) noted ‘The FCA does not tolerate conduct which imperils market integrity or the wider UK financial system. Today’s record fines mark the gravity of the failings we found, and firms need to take responsibility for putting it right’ (cited in CityAM 2014). In 2015, Tracy McDermott - then head of FCA enforcement explained ‘We don’t set ourselves targets for the number of fines we will issue in a given period – what we look at is whether the sanctions we do impose are having an impact on behaviour.’ (The Guardian 2015a). Whilst again in 2017, the new director of enforcement at the FCA stated ‘The size of the fine reflects the seriousness of [the bank’s] failings’ (Financial Planning Today 2017).

Similarly in the US, in 2009 the Justice Department noted ‘Today's agreement is but one milestone in an ongoing law enforcement effort to reassure hard-working and law-abiding taxpayers who pay their fair share of taxes that those who don't will pay a heavy price’ (Finextra 2009). In 2012, the SEC contended that ‘Today's actions involving RMBS securities are a continuation of the SEC's strong efforts to pursue wrongdoing committed in connection with the financial crisis’ (SEC 2012). Concerning another JPMorgan fine, attorney general Eric Holder stated in 2013, ‘The size and scope of this resolution should send a clear signal that the Justice Department’s financial fraud investigations are far from over. No firm, no matter how profitable, is above the law, and the passage of time is no shield from accountability’ (DoJ 2013). Whilst in 2014, Holder again emphasized that ‘The significant financial penalties...send a powerful deterrent message to any company that places its profits ahead of its adherence to the law’ (DoJ 2014). Then in 2015, the head of the New York Department of Financial Services stated ‘Financial institutions must heed this message: banks that operate in the United States must comply with our laws, and banks that ignore the warnings of those charged with compliance will pay a very steep price’ (NY Post 2015). Whilst Attorney General Loretta Lynch concluded that the sizeable penalties over Libor allegations ‘should deter competitors in the future from chasing profits without regard to fairness, to the law, or to the public welfare’ (DoJ 2015a). And again in 2016, the DFS emphasized ‘Today’s settlement is another example of the department’s resolve to hold accountable those whose illegal conduct resulted in the financial crisis of 2008’ (DoJ 2016). Then in 2017, Christy Goldsmith Romero, the inspector General of Sigtarp, the federal agency overseeing government bailout funds, contended that ‘our nation cannot afford to take our eye off the ball when it comes to crime or other legal practices inside banks... they should not be able to buy themselves out of accountability. The [fines] are important because there must be a cost’ (cited in FT 2017).

In short, the message both US and UK state managers attached to the financial penalties was that the fines imposed a significant cost on the banks. The accompanying message was that authorities would no longer tolerate misconduct of this type and scale. Yet as we have seen in the first part of this paper, these messages were at odds with the terms of the financial penalties themselves. Instead, the penalties served a different objective. Bank bailouts, the bonus culture, and the austerity drive had further undermined ‘belief in the legitimacy of the existing order’ (Habermas 1973: 96). According to the 2017 Edelman Trust Barometer for example, 57% of the US survey population agreed that “The system is failing them” – characterized by (i) a sense of injustice (ii) lack of hope (iii) lack of confidence and (iv) a desire for change (Edelman 2017). The discourse attached to the fines was therefore part of a populist narrative designed to re-assert the autonomy of state managers from their embattled banks, presenting themselves as ‘understand[ing] directly and embody[ing] the will of the people’ (Crick 2005: 626). Yet the fines were neither substantive nor democratic because, in large part, financialization had constrained the options available to state managers.

One other feature of the fines however, supports the claim that they were intended to serve a legitimacy-enhancing goal: namely the groups and charitable causes that benefited from the fines. We have already mentioned the fact that donations to approved groups resulted in significant write-downs for the banks. Here we can look a little more closely. In the US, with data taken from 2015 when the size of the penalties paid by all US banks totaled \$110bn: \$44.68bn went to consumer relief; \$5.35bn went to states; \$14.49bn to the Treasury; and \$38.99bn to Fannie Mae and Freddie

Mac for housing provision (WSJ 2016b). Of the settlements with (only) the three largest banks, over 35% went to consumer relief, 29% to the Treasury, 20% to other agencies, 5% to states, and 0.3% to harmed investors and whistleblowers (Authors' own calculations from data collected). As we have already argued though, labeling these donations as consumer relief is disingenuous. As the Wall Street Journal proclaimed: 'Imagine if the president of the United States forced America's biggest banks to funnel hundreds of millions -- and potentially billions -- of dollars to the corporations and lobbyists who supported his agenda, all while calling it "Main Street Relief." The public outcry would rightly be deafening. Yet the Obama administration has used a similar strategy to enrich its political allies, advance leftist pet projects, and protect its legacy -- and hardly anyone has noticed.' (WSJ 2016a). The agency responsible for collecting these particular penalties has been the Residential Mortgage-Backed Securities Working Group, a coalition of federal and state regulators and prosecutors established in 2012 and working alongside the Justice Department. Ostensibly, this consumer relief portion of the penalties is supposed to benefit homeowners harmed after the financial crisis. Yet, in reality, large portions are allocated to organizations on a federally approved list.

Simply, large portions of the funds raised via bank fines have been used to serve the political agenda of federal or state authorities. Many of the groups benefitting from so-called Main Street Relief are overtly political, liberal allies of the Obama administration. As noted, these groups include La Raza, the National Urban League, and the National Community Reinvestment Coalition. Further, members of the RMBS Working Group have also directed money to their supporters and states. Beyond that, other state officials have used bank fines to raise funds for their respective constituencies. Lisa Madigan, the Democrat attorney general for Illinois, announced that she had negotiated \$422.5million of a Morgan Stanley settlement to channel to Illinois pension schemes (Illinois Attorney General 2016). In New York, Governor Cuomo used the proceeds to replace the Tappan Zee Bridge and renovate the Port of Albany, as well as providing horse stables for the annual state fair (WSJ 2016c).

The claim that the financial penalties leveled against the banks had a populist function is equally evident in the UK. In particular, from 2012 the Chancellor George Osborne committed to allocate a portion of the fines to military charities. This process began with an amendment to the Financial Services Bill on 2nd July 2012. The amendment meant that fines would go to the Exchequer, rather than remaining in the hands of the regulator (Osborne 2012). Up until that point, funds retrieved through fines allowed the FCA to keep membership fees for financial institutions artificially low. As Osborne argued, this created the situation where fines actually served to benefit other banks (ibid.); and so the political classes saw this legislative change as another opportunity to champion the will of "the people". In October 2013 then, the Treasury announced it would allocate £35m to the armed forces community, including Help for Heroes, Royal Marines Families, and Veterans Centres (BBC 2013). In 2014 that figure rose to £45m (Osborne 2014); and in the 2015 Budget a further £75m was committed to these charitable causes (The Guardian 2015b). Indeed, George Osborne framed the financial penalties in Robin Hood (rob from the rich to give to the poor) language: 'We're using the money raised from fines on those who demonstrated the very worst values in our society to support those who demonstrate the very best' he repeatedly emphasized (Osborne 2013, 2014, 2015). With

the new Conservative leadership in place in 2016, the charitable donations continued, with Phillip Hammond - the new Chancellor - committing £102m in donations.

In closing though, and as a precursor to the conclusion, we return to the other central claim of this paper: that state managers used populism as opposed to engaging in a more fundamental restructuring of their financialized economies.⁴ Put differently, though the fines were part of a populist statecraft, their impact was deliberately weak not simply because of the lack of resources implied by the legal studies corpus, but because of the underlying structural conditions of the financialized regime of accumulation in Anglo-America – that both empowered the banks and created a regime of accumulation that was hard to dismantle. It is beyond the scope of this paper to fully elaborate this claim, but there is strong evidence that four insidious features of the financialized accumulation regime have worsened in recent years (***** 2019): disproportionately high wages in the financial sector; the dependence on non-interest income within the largest banks; asset price inflation; and consumption-led growth accompanied by consumer indebtedness. The worsening of these facets is a means of showing the lack of political success in tackling the problems of financialization.

Firstly, there is clear evidence in both economies that the finance sector premium – or disproportionately high wages in the finance sector compared to comparable roles in most other sectors of the economy – has only continued after the financial crisis. Figure 9 shows this for the UK. Not only were wages in the finance sector disproportionately high at the start of the 2000s, but they have risen at a faster pace since that time as well.

Figure 9: UK Average Weekly Wages for Whole Economy (not excluding Finance) & Finance sector (2000-2017) (£ sterling)

⁴ Of course, we are not able to fully develop this claim in the context of this short article. But we have undertaken this task in the larger research project which this article builds upon (***** 2019).

Source: ONS 2018

Secondly, the traditional model of banking relied upon interest earned on the spread between interest paid to depositors and the interest charged to borrowers (Engelen 2011:115). One major feature of the crisis of profitability from the 1970s that fuelled financialization was the rise of non-interest income, and the shift towards retail banking fees and commissions from selling financial products such as mortgages, and wholesale banking earnings from various kinds of trading activity (Uppal 2011). Our wider research project (***** 2019) shows the continued dependence of most major Anglo-American banks on non-interest income as a sizeable revenue stream (see Figure 10 for an example). This has been shown to contribute to declining investment in the non-financial sector (Erturk & Salori 2007).

Figure 10: Bank of America income streams (US \$ millions)

Source: Fitch Connect

On the third issue, quantitative easing that accompanied the politics of fiscal stringency (austerity) in most western economies has been the main driver of asset price inflation, or ‘an increase in the value of wealth that is unaccompanied by any increase in the flow of goods and services’ (Stiglitz 2012: 9). The result is that despite the growth in financial activity there are limited benefits of this distributive activity for society as a whole (Bootle 2012). Whilst fourthly, against the backdrop of relatively stagnant wages in most sectors of both economies and the dependence on consumption-led growth, household indebtedness in both economies has skyrocketed since the financial crisis. In the US, household debt reached a new peak in the fourth quarter of 2017, rising \$193bn to \$13.15trillion (New York Fed 2018). By Q2 of 2017 the total stockpile of UK household debt was £1.6trillion, with the Financial Policy Committee (FPC) estimating that 8.3 million people in the UK were experiencing debt problems (FPC 2017:13).

In short, these are some of the structural features of financialization in Anglo-America, which state managers sought to obfuscate via the populist use of bank fines. The terms of the debate about reform in the financial sector were reduced to a debate about culture and conduct; and, on this new (but ultimately superficial) terrain, bank fines became a populist instrument for state managers to deflect criticism away from financialization.

CONCLUSION

From the outset we have argued that the critical political economy approach employed in this paper provides a more comprehensive and sophisticated understanding of the objectives and motivations of state managers in the use of bank fines than the legal studies literature. That legal literature rightly points to the inefficacy of the fines. But it tends to imply that the weakness of the fines was largely a product of effective bank lobbying and weakness on the part of the political classes. We do not reject this conclusion. We argue however that both of these elements – lobbying and political weakness – need to be understood in their proper material and ideological context. Financialization, stemming from a longer-term crisis of accumulation, empowers the financiers and constrains state managers, even though state managers themselves were active agents of the process itself (Brenner 2003). Likewise the turn towards populism evidenced in the use of bank fines reflects an ideological (and material) struggle over legitimacy, which is also imbricated in the long-term decline of social democratic alternatives to neoliberalism (Ryner 2014).

At the heart of the matter then, is a deeply disconcerting conclusion. Because it is not simply that the critical political economy account provides a more comprehensive explanation of motives and objectives. Ultimately, the conclusion points to the severe challenges in addressing the pathologies of Anglo-American capitalism (Hay 2011). Inequality and instability are the obvious manifestations of these pathologies. But the conclusion of our analysis is that state managers used the bank fines as a populist strategy because of the deep material and ideological constraints confronting them. In this sense, our critical political economy account here is actually an account of the political constraints of financialization. To reiterate, it is not that state managers were passive bystanders to the processes of financialization that restructured their political economies in recent decades; we explained at the start of the paper why this was not the case. But neither was financialization always a conscious, deliberate strategy. Instead it was ‘an inadvertent result of the state’s attempts to solve other problems’ (Krippner 2011:2). The irony though is that these earlier political efforts simultaneously locked the Anglo-American economies into a particular course that constrained options to tackle the very problems – of inequality and instability – that financialization itself created.

Put differently, financialization – though by no means the only causal factor – is nonetheless arguably the single most important driver of the decline in democratic politics witnessed in – inter alia – Anglo-America. Relatedly, populism is not solely an Anglo-American phenomenon in the 2010s of course (Mudde & Kaltwasser 2017). But our argument is suggestive of the *decisive* role played by financialization in the turn towards populism in the US and the UK. We do not claim that financialization does all the explaining. But we argue that if inequality – both as a measure of income distribution and as a descriptor for the overbearing influence of the finance sector – and financial instability – that led to the financial crisis and subsequent bailouts – are key drivers of the legitimacy crisis – because they engender problems and constrain responses – then financialization is perhaps the single most important cause of the turn to populism. This claim is beyond the immediate scope of this paper. But the connection between financialization and populism in other Western countries is surely an area for further research.

In closing though, our study of bank fines suggests that the turn towards populism has only limited potential to resolve the legitimacy crisis itself. This is simply because populism lacks substance; it works as a rhetorical device, but not as a political program. It is great for winning votes; it is

tragically incapable of reducing inequality and financial instability. At the time of writing this is the bleak reality becoming increasingly apparent to those disillusioned voters who pinned their hopes to Trump and Brexit. And if we are indeed correct, the response to the failure of democratic politics will be more anti-democratic forms of resistance (Bailey 2014). If financialization has contributed to the slow death of democracy, and populism makes promises it cannot deliver on, then traditional forms of political expression – through parties and democratic institutions – may give way to a more radical politics. Just as Anglo-America has led the way in financialization and – to a degree – in the turn to populism, then Anglo-America may also have the unfortunate privilege of being test cases for these more radical forms of resistance.

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