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Academic Foresights

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Financialization

How do you analyze the present status of financialization?

The Western economies are deeply affected by financialization, understood as a process that has evolved over the last four decades and that has, inter alia, paved the way for the financial crisis. Financialization characterizes a situation where capitalism is affected by a dominance of the financial sector (financial elites, income, institutions and motivations) relative to the productive sector. This dominance may be detected in various observations, such as neo-liberal economic policy, the ascendancy of shareholder value, rising levels of corporate and household debt, wage stagnation and income polarization, the erosion of coordinated models of capitalism, rising global imbalances (e.g., between China and the US), and increasingly volatile and fragile financial markets (Epstein 2005, Palley 2007, Nölke and Perry 2007). More operationally, Greta Krippner defines as “financial” portfolio incomes, which are all those activities that serve the “provision (or transfer) of capital in the expectation of future interests, dividends, or capital gains”, as opposed to those activities that serve the “production and trade of commodities” (Krippner 2011: 4). As a key indicator of financialization she compares portfolio income to corporate cash flow. She finds that in US non-financial firms the share of portfolio income has risen more than five-fold from the 1950s to the 2000s (Krippner 2011: 35).

First signs of financialization go back to the evolution of the Euro-Dollar market in the 1960s and the (related) break-down of the Bretton Woods-System in the early 1970s, but the main thrust of its development coincides with the rise of the Thatcher and Reagan governments around 1980 (Krippner 2011). Since then, financialization has become the pre-dominant feature of the Western economies, first in the Anglo-Saxon heartland, but later also in the Continental economies and, to a more limited extent, also outside of the Transatlantic. The sub-prime economic crisis at first appeared to indicate the end of this phase of the historical development of capitalism, given that a high degree of financialization was the (structural) root of the crisis (Heires and Nölke 2011). Developments since 2007, however, indicate that the age of financialization may not be over yet.

In your analysis, how will the situation likely evolve over the next five years?

Recent measures for financial market regulation did not affect financialization in any substantial way. Policies regarding increased transparency for rating agencies, the registration of hedge fund managers and increased capital requirements for banks do not really reduce the degree of financialization. Measures that would have affected financialization in any meaningful way, in contrast, have not been chosen. Given the deep, structural character of financialization, it would require activities such as the imposition of a broad-based financial transaction tax, cross-border capital controls, strong curbs on hedge funds and shadow banks, the de-concentration of systemic banks as well as the separation of investment banking and retail banking to substantially decrease the degree of financialization.

In addition to the seemingly utopian character of the measures that would be necessary to decrease financialization, the latter has also become deeply engrained in the social and political structures of Western societies, inter alia based on a mass investor culture and a (house) ownership society. Thus, broad strata of the middle classes have developed a strong interest into the well-being of the financial markets. Moreover, the system of revolving doors between financial regulators and major financial institutions inhibits fundamental reforms. Finally, financialization has become a central discursive practice in economy and society (Froud et al. 2008). Correspondingly, it is highly likely that financialization will stay around for the next years, unless another economic crisis deeply affects the political support for this capitalist formation.

What are the structural long-term perspectives?

Given that highly financialized economies are inherently crisis-prone, it is quite likely that we will witness another major economic crisis in the long term. This crisis probably will be more severe than the 2007/2008 one, given that the public budgets of most Western economies have been depleted during the latter and will be unable to come up with comparable rescue operations or stimulus programmes for the foreseeable future. Under these circumstances, it may well be possible that the broad support for financialization will dwindle, paving the way to a different economic formation, similar to the world economic crisis of 1929 that has opened the way to New Deal and Fordism. It is difficult to foresee the exact outline of this long-term developments, but it could well be that we will witness the emergence of some kind of state capitalism, given that the latter is quite typical for the large emerging markets that have grown so strongly over the last decade. Moreover, a break-down of the current global economic order will likely further advantage the latter, given the lower degree of financialization in these economies.

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