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Financialisation, financial structures, economic
performance and employment

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Abstract: The first major theme is the trends in the processes of financialisation reviewing quantitative and qualitative features of those trends, covering both industrialised and emerging economies. The ways in which the processes of financialisation impact on and interacts with the real sector are discussed with particular reference to the empirical evidence. In this, the financial development—economic growth relations are explored, and whether positive relationship between the two has declined and perhaps reversed in recent decades. There are other ways through which financialisation (particularly in the guise of ownership by the financial sector of the corporate sector and the pursuit of shareholder value) sets the framework for a wide range of decisions taken by corporations including investment and employment. In section 4 the focus is on the ways in which the financial sector could be changed and developed which could be more conducive to supporting sustainable development and high levels of employment and human development. The thrust of the argument is the need to develop diverse financial institutions with a variety of ownership forms whose primary functions are the savings—investment linkages, and to enable funds to flow in a more socially beneficial manner not solely governed by profit calculations of the financial sector.

Key words: financialisation, economic development, human development, employment, financial structures

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1. Introduction

The growth and evolution of the nature of the financial system (which is labelled financialisation) has a multitude of effects for good or ill on the real economy, employment and human development. In this paper, we first set out what is to be understood by the term financialisation, and what have been the key developments in the growth and evolution of the financial system in industrialised, emerging and developing economies over the past three to four decades. In the subsequent section we seek to review the effects which financialisation has had on the performance of the real economy. The growth of the (formal) financial sector has often viewed as involving positive effects on economic growth – in effect through stimulating savings opportunities, allocating and monitoring the use of funds, and thereby stimulating investment and growth. The focus of attention has been on the growth of output, without much attention being paid to employment and to human development.

The processes of financialisation have generally involved the enhanced power of the financial sector at economic, political and social levels. Those processes have in the recent decades involved the growth of securitisation, derivatives, shadow banking, privatisation and de-mutualisation alongside the general growth of the financial sector. The increased stress on the pursuit of shareholder value and of the rise of household debt have also been seen as major features of the processes of financialisation. These developments can be seen as particularly significant in two major respects. First, the activities of the financial sector have shifted away from the linking of savings and investment and towards the financing of consumer debt, the expansion of financial assets and financial liabilities, and the trading of existing financial assets. But the financial sector is continuously making decisions on which types of investment are to be financed, who are receiving funds from the financial sector, and thereby strongly influencing and constraining the developments of the real economy. Second, the financial sector as owners (whether in their own right or as managers of personal wealth) of corporations with the emphasis on the pursuit of shareholder value has significant impacts on the production, employment and investment

decisions made by corporations. These trends in the processes of financialisation are the major theme of the first main section of the paper (Section 2).

The processes of financialisation have major impacts and interactions with the real sector, which leads into a review of the effects of financialisation on economic performance and employment. The general argument has previously been that financial development favours economic growth through the encouragement of savings, linking savings with investment and the monitoring functions of the financial sector. However, the ways in which the financial sector has grown in the past decades has shifted their activities (in relative terms) away from the savings—investment linkages and towards management of and trading in financial assets. Hence the question arises whether those changes have undermined the financial development—economic growth linkage, which is addressed. There are other ways through which financialisation (particularly in the guise of ownership by the financial sector of the corporate sector and the pursuit of shareholder value) sets the framework for a wide range of decisions taken by corporations including investment and employment. It is highly relevant to explore these influences and constraints imposed by financialisation. These themes are the focus of section 3.

In section 4 our attention turns to a discussion of ways in which the financial sector could be changed and developed which could be more conducive to supporting sustainable development and high levels of employment and human development. The thrust of the argument is the need to develop diverse financial institutions with a variety of ownership forms whose primary functions are the savings—investment linkages, and to enable funds to flow in a more socially beneficial manner not solely governed by profit calculations of the financial sector.

2. Trends in financialisation

A widely quoted definition of financialisation is that it 'means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies' (Epstein, 2005a, p.3). Financialisation in that broad

sense has been a long-ongoing process under capitalism though the word 'financialisation' itself is of recent origin. There have been previous periods of financialisation (see, for example, Vercelli, 2014) and periods of what may be termed de-financialisation (e.g. the 1930s in many countries). van der Zwan (2014) identifies three broad approaches within financialisation (which would be identified with the era since circa 1980, though some of the issues pre-date 1980) which go beyond the scale of the financial sector: these are 'financialisation as a regime of accumulation'¹, 'the financialisation of the modern corporation', and 'the financialisation of the everyday'.

The recent decades (often dated from circa 1980) have been ones of rather intensive financialisation. The focus of the study of financialisation has been on industrialised countries but it has spread through many emerging economies with global spread. The further growth of international financial markets, financial institutions and the greater flow of funds across national boundaries has also been pronounced. These processes of financialisation have been accompanied by the related trends of globalisation, neo-liberalism and increasing inequality within countries. In general here we do not enquire into the causal mechanisms involved, though financialisation has involved de-regulation and other hallmarks of neo-liberalism, and the relationship between financialisation and inequality is discussed below. The global spread of financial institutions has accompanied and fostered the globalisation of production and investment and increasing international trade. Neo-liberalism involves the growth of markets into realms of life hitherto outside of the market, trends to privatisation and de-regulation which have been features of financialisation. Inequality within countries has risen in most countries, and the financial sector itself displays high and rising degrees of inequality.²

¹ See Hein, Dodig and Budyldina (2014), for extensive discussion of three approaches to regimes of accumulation: they identify the French Regulation School, the Social Structures of Accumulation approach, and the contributions by several Post-Keynesian authors, with a focus on the work of Minsky.

² Publications such as OECD (2011), Piketty (2014) and the World Bank databank at <http://data.worldbank.org/indicator/SI.DST.10TH.10/countries> provide extensive data on inequality and the general rising trends in the past three decades.

The processes of financialisation are not uniform across countries and time. Within the broad definition given by Epstein, the recent decades can be viewed in terms of expansion of the banking sector and of equity markets, de-regulation and liberalisation of financial sector, growth of a range of financial instruments with securitization and derivatives, as well as growing social and political power of the financial sector, frequent occurrence of banking and financial crises and the rapid growth of financial flows especially on a global basis³. Others have placed the pursuit of 'shareholder value' as one of the hallmarks of the present era of financialisation. For example, 'scholars have attributed the financialisation of the corporation to the emergence of shareholder value as the main guiding principle of corporate behaviour (cf. Rappaport, 1986). Shareholder value refers to the idea that the primary purpose of the corporation is to make profit for its shareholders. According to Aglietta, shareholder value has become the 'norm of the transformation of capitalism' (2000, p. 149) and as such has provided the justification for the dissemination of new policies and practices favouring shareholders over other constituents of the firm' (van der Zwan, 2014, p.102).

Some illustrations of the growth of the financial sector are given in Figures 1 to 3. In Figure 1 the growth of employment in a broad measure of the financial sector (financial intermediation, real estate, rental and business activities) across a range of countries is illustrated. With the exception of Japan all the countries in that Figure show a substantial increase over the period 1995 to 2010, with a typical rise of 40 per cent. Figure 2 indicate the growth of value added in the financial sector relative to total value added over the 1990s and 2000s, with clear indications of the growth of the financial sector, and in general a substantial rise in measured productivity as value added grew much faster than employment. A further illustration of the growth of the financial sector is given by the growth of financial assets (and also liabilities) relative to GDP: see Figure 3

Figures 1, 2, and 3 near here

³ See Sawyer (2014a) following Fine (2011) for eight features viewed as central for the present era of financialisation.

One measure (relating to the scale of the formal banking system) frequently used is bank deposits to GDP. A measure such as bank deposits to GDP is also an indication of the cumulative level of household savings when bank deposits are the major outlet for savings. As such it would not be surprising if the ratio rose with the level of GDP. It is also a measure of the formal financial system, rather than the informal financial system such as the curb markets, and along with formality often goes licensing and regulation. The statistics in Table 1 indicate a substantial and general rise in the ratio of bank deposits to GDP.

Tables 1 and 2 near here

Another dimension of the size of the financial sector comes from measures of the size of the stock market in terms of stock market valuation to GDP. Table 2 provides information. The use of the ratio of stock market valuation to GDP is, of course, rather sensitive to the state of the stock market, which explains the fall in the average ratio between 2005 and 2010. The substantial rise in stock market valuation in the first half of the 2000s is clearly evident.

One trend which appears to have gone alongside financialisation in industrialised countries has been the reduced reliance on external funds, a tendency for lower investment and greater acquisition of financial assets by non-financial companies. 'The evidence indicated that, in all countries [USA, the UK, France, Germany and Japan], nonfinancial corporations have become less reliant on banks and have increased their acquisition of financial assets. ... For banks, the underlying tendency of financialisation is visible on the asset side of the balance sheet as lending has shifted toward other financial corporations, real estate and households. For households, finally, there is a trend to shift savings away from bank deposits and toward other financial assets that could be traded in open markets, including pension funds and equities. Also notable is the increase in household indebtedness, typically associated with housing.' (Lapavitsas and Powell, 2013, p.375). de Souza and Epstein (2014) observe 'that non-financial corporations have reduced their reliance on external finance for capital expenditures in the United States after 1980 and in the

European countries in the 2000s to the point that non-financial corporations became net lenders in the United Kingdom, Germany, and Switzerland during that period. The lower use of funds by non-financial corporations was, in almost all cases, associated with lower demand for productive investment as a share of GDP.' (p.1) Financial institutions shifted their lending policies. '[M]any of the big banks shifted their activities from traditional commercial banking towards investment banking and the German company network was increasingly dissolved. With those changes, a much more active market for corporate control emerged, along with the establishment of new financial actors, such as hedge funds and private equity funds. ... Against this background, significant changes in real GDP growth and its composition, as well as in the trends of the financial balances of the main macroeconomic sectors could be observed.' (Detzer and Hein, 2014).

Further, there appears to be a substantial increase in lending between financial institutions. Montecino, Epstein, and Levina (2014) report 'that intra-financial lending as a share of total financial sector lending [in the USA] appears to have grown nearly five-fold since the 1950s. After comprising a tenth of all lending throughout 1950-1980, by 2011 lending between financial institutions accounted for nearly half of all financial sector lending. The stock of intra-financial assets has followed a similar trend. These grew rapidly during the 1980s and 1990s and presently account for nearly 30 percent of all financial sector assets. Although the growth of intrafinancial assets accelerated after 1980, the fastest increase took place between 1991 and the bursting of the dotcom bubble in 2001, increasing from 15 to 25 percent of total financial sector assets. In the run up to the financial crisis of 2007-2008, the growth of intra-financial lending was concentrated in assets highly implicated in the genesis of the crisis, suggesting that this growth may have contributed to the crisis. This growth in intra-financial lending also raises questions about the contribution of the financial sector to the real economy: in the years before the financial crisis only 40 percent of financial lending was to the real economy. In recent years, we are witnessing similarly large shares of intra-financial lending.' (p.1).

A frequently noted feature of financialisation in the present era has been the growth of derivatives and securitization. This has often been seen as boosted by the Black-Scholes formula (Black and Scholes, 1973) for the pricing of derivatives is seen as a stimulus to the development of derivatives and their trading. The perceived roles of derivatives and securitization, notably mortgage backed securities, CDOs etc. in the generation and transmission of the global financial crisis are well-known.⁴ A remarkable feature of the past few decades has been the growth both of financial assets and of financial liabilities. 'Much of the growth of finance is associated with two activities: asset management and the provision of household credit. The value of financial assets under professional management grew dramatically, with the total fees charged to manage these assets growing at approximately the same pace.' Greenwood and Scharfstein (2013, p.4). The balance sheets of banks and other financial institutions have expanded in the sense that assets and liabilities relative to own capital and relative to GDP have grown, leaving banks more vulnerable to the effects of changing valuations of their assets, whether through default, through purchase of 'toxic assets' etc.. The extent of trading in financial assets whether through financial markets or through 'over the counter' has grown dramatically as derivatives, securitization developed.

Whilst it can be said that there has been a general move towards de-regulation, this has often involved re-regulation etc.. Another aspect has been the rigour with which regulation has been carried out -- an illustration of this being the widespread view that regulators were 'asleep on the job' in many countries (notably USA and UK) in the build-up to the 'great financial crisis' of 2007/09.

Financial liberalisation and de-regulation of financial institutions⁵ has gone alongside the processes of financialisation in the past half-century or so. Financial liberalisation has had internal and external aspects – for example, internally the slackening of regulation and controls over interest rates and credit allocation, and externally the reduction and removal

⁴ See, for example, Gabbi, Kalbaska, and Vercelli (2014) for the development of securitization and discussion of its contribution to the 2007/09 financial crisis.

⁵ De-regulation and liberalisation is clearly in matters such as lifting of limits on interest rates, removal of capital controls. In other ways though there has been de-regulation and re-regulation.

of capital controls. The questions which arise here include (i) what have been the effects of lower barriers to capital movements, and specifically the direction, magnitude and volatility of the capital flows; (ii) the effects of (net) capital inflows on the exchange rate, and the possibility that trade is affected by the resulting exchange rate; (iii) the constraints on monetary and other policies for carry trade etc..

The processes of financialisation are not limited to industrialised economies, and some aspects of financialisation for emerging markets can be briefly illustrated. The Tables above have illustrated the general expansion of the financial sector in a wide range of economies. We can now make reference to qualitative aspects of financialisation in developing and emerging markets for which Bonizzi (2014) provides an extensive review. He draws a first theme as the implication of 'financialisation for non-financial firms' investment. A common observation is that firms increasingly engage in financial rather than productive investment.' He draws on the work of Demir 2009a, 2009b), who found that 'policies of financial liberalization do not significantly contribute to reduce capital market imperfections, while the availability of financial investment and the differential return between financial and non-financial investment have a negative effect on productive investment and a positive effect on financial investment.' Other studies quoted by Bonizzi finding the increasing importance of financial activities, including derivatives speculation, for non-financial corporations are Correa, Vidal, and Marshall 2012; Farhi and Borghi 2009; Rossi 2013). 'Moreover, there is evidence that shareholder orientation in South Korea has decreased not only productive investment but also investment in research and development, with potentially more damaging long-term effects (Seo, Kim, and Kim 2012). 'Karwowski (2012) presents evidence that South African firms are overcapitalized," that is, they hold financial assets substantially in excess of what they need for their productive activities, becoming the largest holders of bank deposits.' Araújo, Bruno, and Pimentel argue that 'financialisation becomes an even bigger structural obstacle, since it causes functional re-concentration of incomes in favour of the holders of capital without necessarily inducing them to raise the level of productive investment, a basic factor in the

generation of employment and income.’ (2012: 23)⁶ Bonizzi reports from a range of studies that banks allocate an increasing proportion of credit to households, with a growing proportion of household income paying interest on loans. As observed in many countries, emerging markets have seen the expansion of foreign banks into previously protected domestic markets. ‘Finally, financialisation has affected developing countries indirectly through its impact on commodities. Commodity prices have exhibited a typical boom-bust trajectory over the 2002–2007 period (Akyüz 2012)’.

Correa, Vidal, and Marshall (2012) also emphasise in the context of Mexico ‘the growing divergence between the financial needs of an economy and the profit-generation requisites of the global (and Mexican) economy’s largest banks and nonfinancial corporations. In cases such as those of Mexico and other developing countries, the profit-generating space of global corporations have come to encompass all the strategic areas of the economy, including ones previously dominated by the state, creating dynamics of ever greater profitability for these corporations, but at the cost of a constant deterioration of public-sector institutions and ever increasing capital outflows and a sharp polarization of wealth’ (pp.271–2).

Panizza (2008) ‘suggests that the traditional dichotomy between external and domestic debt does not make much sense in a world characterized by open capital accounts’ (p.14)

Financialisation has important global dimensions with the growth of cross-border flows of short-term and long-term capital. An illustration of the effects comes from Brazil, with qualitative as well as quantitative changes in cross-border flows. ‘In addition to a substantial increase in magnitude, capital flows to Brazil have seen qualitative changes: firstly, from foreign currency to domestic currency denominated assets; and secondly from standard DEC [developing and emerging countries] instruments, such as bond and banking flows, to an increasingly complex set of (very short-term) alternative portfolio assets. ... the paper has argued that this changing financial integration has created NFEV [new forms of external vulnerability] for Brazil, which caused the large and sudden exchange rate

⁶ Quote taken from Bonizzi (2014).

movements observed over recent years.' The implications of this comes DEC's through (a) pointing to the need to analyse the changing nature of their integration into international financial markets, and (b) acting as an example for those countries considering further opening up of their domestic financial markets to foreign financial investors' (Kaltenbrunner and Paineira, 2014, pp.20-1).

In this section we have sought to give a brief overview of the processes of financialisation in the past few decades with the growth of the financial sector, its changing structures and evolving relationship with the real sector. In the next section the question is addressed as to the impacts of financialisation on economic performance.

3.Financialisation, financial development and economic performance

The processes of financialisation are intimately wrapped up with the operations of capitalist economies, and the recent decades of financialisation have been accompanied by globalisation and neo-liberalism. Disentangling the effects of financialisation on the economy from the broader operations of capitalism is particularly difficult, if not impossible. However, in this section we attempt some partial answers to the question of the effects of financialisation on economic performance. In this regard, economic performance is broadly interpreted, and it is specific aspects of financialisation such as the growth of the financial sector and the rise of the pursuit of shareholder value which can be examined.

There has been a substantial literature on the relationship between what is termed financial development and economic development where the latter is generally viewed in terms of level and growth of GDP (whether in total or per capita). Financial development, often measured by variables such as bank deposits to GDP, focuses on the growth of the formal financial sectors and does not reflect the role of informal financial sectors and 'curb markets'. In a similar vein, economic growth (and development) often relates to the formal sector and (implicitly) industrialisation. The link between financial development and the quantity and quality of employment does not follow in a straightforward from the literature on financial development and economic growth. Insofar as a higher level of investment

comes from financial development the impacts on employment are ambiguous – a short-term boost to demand, and higher capital stock

The relationship between finance and the real sector has often been presented in terms that while finance may facilitate real sector activity it has no fundamental impact on the scale and nature of real sector activity. In its simplest form, money is viewed to arise to facilitate trade and the 'classical dichotomy' viewed the level and composition of economic activity as set by demand and supply, and the price level determined by the stock of money (and hence the rate of inflation by the rate of increase of the stock of money). When savings and investment are introduced into the picture, there is a market for loanable funds with the 'natural rate of interest' providing a (full employment) equilibrium between savings and investment. This could be described in terms of the financial sector and markets as providing a conduit through which funds flow from savers to investors. In the debates over the relationships between financial development and economic development debates, the story is further developed, and can be represented in terms of the role of the banking sector particularly (and the financial sector more generally) as encouraging savings through providing liquid assets and thereby investment, with the presumed causation running from savings to investment.

The banking and financial sectors clearly set the terms on which funds, loans and credit are supplied not only in terms of the interest rate and other charges but also in terms of who are the recipients of those funds and loans. The ways in which the price of loans and the allocation of funds are set obviously impact on investment, inequality etc..

Corporate governance and related issues also arise. The financial sector becomes an important owner of equity on its own account and on behalf of its customers. Pension funds, insurance companies, mutual funds etc. Financial institutions have become important owners of equity. This immediately raises issues of corporate governance through how those financial institutions exercise their shareholder role, and below this comes through under the pursuit of shareholder value. The provision of loans often involves the monitoring of the use of those loans.

Much of the literature has tended to focus on GDP and its growth as the measure of economic performance, and here that will be extended as far as possible to include employment and jobs, and poverty.

Financial deepening and economic growth⁷

Under the heading of financial development and deepening rather than financialisation, there has been a large literature extending back many decades on the relationship between finance and economic growth, notably using measures such as bank deposits to GDP, stock market value to GDP as measures of financial development. This literature has generally found a positive relationship between financial development and economic growth, though the causal relationships involved are matters of debate. A more recent literature which has tended to find a much weaker relationship. Whether there is a sense in which the financial sector has become too large is also considered, and particularly in terms of the scale of financial asset transactions (relative to the levels of savings and investment).

Financial deepening is often measured in terms of the ratio of broad money (M2 or similar) to GDP, and much of the content of broad money is deposits in the banking system. The justification for that would come from a bank-dominated financial system in which savings are predominantly held as bank deposits, and correspondingly, the bulk of external funding for investment comes from banks (usually in the form of loans).

Levine (2005) in his extensive review of the empirical literature concluded that 'a growing body of empirical analyses, including firm-level studies, industry-level studies, individual country-studies, time-series studies, panel-investigations, and broad cross-country comparisons, demonstrate a strong positive link between the functioning of the financial system and long-run economic growth. While subject to ample qualifications and countervailing views noted throughout this article, the preponderance of evidence suggests that both financial intermediaries and markets matter for growth even when controlling for potential simultaneity bias. Furthermore, microeconomic-based evidence is consistent with the view that better developed financial systems ease external financing constraints facing

⁷ This section draws heavily on Sawyer (2014c) for which see for further references.

firms, which illuminates one mechanism through which financial development influences economic growth. Theory and empirical evidence make it difficult to conclude that the financial system merely—and automatically—responds to economic activity, or that financial development is an inconsequential addendum to the process of economic growth.’ (p. 921)

Arestis, Chortareas, and Magkonis (2014) conduct a meta-analysis of the existing empirical evidence on the effects of financial development on growth. They conclude that ‘our meta-regression analysis shows that the type of data employed, and the different variables used to measure financial development in the literature can constitute sources of heterogeneity. Specifically, the usage of market-based proxies of financial development seems to result in lower correlations than the usage of either liquid liabilities or market-based variables. On the other hand, the estimated coefficients of bank-based measures and complex indices are found statistically insignificant in all specifications. Additionally, panel data, which are frequently used from the late 1990s onwards, produce smaller correlations. The same seems to hold for time series. ... [H]owever, the results suggest the existence of a statistically significant and economically meaningful positive genuine effect from financial development to economic growth’ (pp. 10-12).

The relationship between financial development and economic growth in the past three decades or so in the industrialised world is of particular interest. Casual observation may suggest that the general growth of the financial sector and the enhanced size of that sector have not obviously been associated with any faster economic growth. Indeed it is often argued that growth in the Western industrialised economies has been somewhat slower over the past three decades of financialisation. Further, the literature on financialisation has indeed suggested a variety of ways in which the processes of financialisation may have diminished investment, as further discussed below.

Authors have reported on at least some weakening of the links between financial deepening and economic growth. Rousseau and Wachtel (2011) argue that ‘we show that it [the finance-growth link] is not as strong in more recent data as it was in the original studies

with data for the period from 1960 to 1989.' Another study documents 'that the size of the financial sector has increased dramatically in both the developed and developing world in combination with a high volatility of the financial sector relative to the economy as a whole. In line with previous research we find that in the long run financial intermediation increases growth and reduces growth volatility. Both effects have, however, become weaker over time.' (Beck, Degryse, Kneer, 2013, p. 13). A study of 'the complex real effects of financial development and come to two important conclusions. First, financial sector size has an inverted U-shaped effect on productivity growth. That is, there comes a point where further enlargement of the financial system can reduce real growth. Second, financial sector growth is found to be a drag on productivity growth. Our interpretation is that because the financial sector competes with the rest of the economy for scarce resources, financial booms are not, in general, growth enhancing. This evidence, together with recent *experience* during the financial crisis, leads us to conclude that there is a pressing need to reassess the relationship of finance and real growth in modern economic systems. More finance is definitely not always better' (Cecchetti and Kharroubi, 2012, p.14)⁸.

Overall, it could be concluded that a positive relationship between of the financial sector and economic growth has generally been found though issues of causation have not been resolved. The positive relationship has weakened and indeed may have been reversed in recent years. The empirical work has focused on measures of the financial sector such as bank deposits, size of the stock market, and has not in general reflected the expansion of the financial sector in recent decades in terms of derivatives, securitisation and volume of trade in assets and liabilities.

Financial liberalization and growth

McKinnon (1973) and Shaw (1973) propounded the 'financial liberalisation' thesis arguing that government restrictions on the banking system restrain the quantity and quality of investment. Financial liberalisation was to remove 'financial repression' which referred to a

⁸ For other studies see, for example, Barajas et alia (2012, 2013), Rioja and Valev (2004, 2005), Aghion et al. (2005), Dabla-Norris and Srivisal 2013.

high degree of regulation of the banking and financial system in many countries, and specifically control by Central Bank and government of the level of interest rates and the allocation of credit. McKinnon (1973) and Shaw (1973) stressed two other issues: first, financial repression affects negatively the efficient allocation of savings to investment; and second, through its effect on the return to savings, it has a restraining influence on the equilibrium level of savings and investment. The financial liberalization thesis argues for the removal of interest rate ceilings, reduction of reserve requirements and abolition of directed credit programmes. In short, liberalise financial markets and let the free market determine the allocation of credit. With the real rate of interest adjusting to its equilibrium level, low yielding investment projects would be eliminated, so that the overall efficiency of investment would be enhanced. Further, as the real rate of interest increases, saving and the total real supply of credit increase, which induce a higher volume of investment. Economic growth would, therefore, be stimulated not only through the increased investment but also due to an increase in the average productivity of capital. Moreover, the effects of lower reserve requirements reinforce the effects of higher saving on the supply of bank lending, whilst the abolition of directed credit programmes would lead to an even more efficient allocation of credit thereby stimulating further the average productivity of capital.

Bumann, Hermes, and Lensink (2012) summarise the position with regard to the 'hotly debated' relationship between financial liberalisation and economic growth' in the following terms: 'whereas some have claimed that liberalisation of financial markets contributes to the efficiency with which these markets can transform saving into investment, which ultimately fosters economic growth, others have pointed out that these liberalisations have contributed to various financial and economic crises in the past. ... The evidence that emerges from these studies [of the relationship] remains inconclusive.' (p.41)

They undertake a meta-analysis based on 60 empirical studies. Their 'meta-regression analysis provided the following main results. First, the unconditional mean of the t-statistic of the financial liberalisation variable equals 1.42, which is highly significant. Using a chi-

squared test we also have to reject the null hypothesis that the average t-statistic equals 1.96. Hence, we conclude that although our results indicate that, on average, there is a positive effect of financial liberalisation on growth, the significance of this effect is only weak. Second, for most of the variables that may help explaining the heterogeneity of results about the relationship between financial liberalisation and economic growth we do not find any significant results. There are two exceptions. Our analysis suggests that data from the 1970s generate more negative financial liberalisation coefficients which suggests that financial liberalisation policies carried out during the 1970s seem to have a stronger negative relationship with growth. Moreover, our results show that studies that take into account a measure of the level of development of the financial system report lower t-statistics for the relationship between liberalisation and growth' (pp.43-5).

A conclusion which can be drawn from this is that growth of the financial sector particularly in terms of the banking sector has generally gone alongside growth of the real economy. The causal relationships have been much discussed without a clear settlement. In more recent times, the generally positive relationship between growth of financial sector and growth of the real economy appears to have weakened. Further, the ways in which the financial sector has grown, specifically the growth of shadow banking, securitization and trading in financial assets, may not be conducive to economic growth.

Financial crises

The history of capitalist economies is littered with financial crises of which the 2007-09 financial crises were amongst the more global and extensive; but it should not be overlooked that there were other major crises (notably the East Asian 1997). Laeven and Valencia (2012) (from their Figure 4) record 346 financial crises in the period 1970 to 2011, of which 99 were banking crises, 18 sovereign debt crises and 153 currency crises, 11 banking and debt, 28 banking and currency, 29 debt and currency, and 8 combined all three elements. After a lull in the early 2000s, a total of 25 banking crises are recorded for the 2007 to 2011. Their paper also gives estimates of the large scale costs of financial crises.

The period of financial liberalisation since circa 1970 appears to have exacerbated the extent of financial crises, though, of course there are many examples of pre-1970 crisis. There appear to be inherent features of the banking and financial system which tend to generate financial instability, credit booms and busts etc., and that whilst measures of regulation and structure of the financial system can be adopted which reduces those tendencies, nevertheless they remain.

The IMF in 2009 summarised their findings on the effects of financial crisis on output, growth and employment as follows:

'The path of output tends to be depressed substantially and persistently following banking crises, with no rebound on average to the precrisis trend over the medium term. Growth does, however, eventually return to its precrisis rate for most economies.

- The depressed output path tends to result from long-lasting reductions of roughly equal proportion in the employment rate, the capital-to-labor ratio, and total factor productivity. In the short term, the output loss is mainly accounted for by total factor productivity, but, unlike the employment rate and capital-to-labor ratio, the level of total factor productivity recovers somewhat to its precrisis trend over the medium term. In contrast, capital and employment suffer enduring losses relative to trend.

- Initial conditions have a strong influence on the size of the output loss. What happens to short-term output is also a good predictor of the medium-term outcome, as is the joint occurrence of a currency and a banking crisis. This is consistent with the notion that the output drop is especially persistent following large shocks, carrying over into the medium term. A high precrisis investment share of GDP is a reliable predictor of high medium-term output losses, because of its correlation with the dynamics of capital after the crisis. There is also evidence suggesting that limited precrisis policy room tends to be associated with more muted medium-term recoveries. Interestingly, postcrisis output losses are not significantly correlated with the level of income.

- The medium-term output loss is not inevitable. Some economies succeed in avoiding it, ultimately exceeding the precrisis trajectory. Although postcrisis output dynamics are hard

to predict, the evidence suggests that economies that apply countercyclical fiscal and monetary stimulus in the short run to cushion the downturn after a crisis tend to have smaller output losses over the medium run. There is also some evidence that structural reform efforts are associated with better medium-term outcomes. In addition, a favourable external environment is generally associated with smaller medium-term output losses.' (IMF World Economic Outlook 2009, pp. 122-3).

Their findings are summarised in Figure 4

Figure 4 near here

A significant caveat to these results can be that they are relating to the 'bust' phase of a 'boom and bust' cycle, and do not consider whether the boom period was stronger and/or lasted longer through the rapid expansion of credit, which in the end was unsustainable leading into the financial crisis. A capitalist economy is inherently cyclical, and the expansion and contraction of loans and credit are key elements in the cycles. Sharp reversals from 'boom' to 'bust' are often associated with financial crises. Focusing on the downswing without allowing for the upswing may overstate the impact of financial crisis; a debt-fuelled expansion prior to the crisis will have lifted output and employment.

It is an unsurprising conclusion that financial crises in general and banking crises in particular can impose substantial costs in terms of lost output and unemployment. Of particular relevance are whether such crises are a virtually inevitable feature of a financial system, and whether financialisation and financial liberalisation have increased the frequency of financial crises and the attendant costs. The evidence in Laeven and Valencia (2012) support the view that financial crises have become rather frequent, and often associated with substantial costs.

Shareholder value, Investment and Industrial Re-structuring

Financialisation has been associated for many with the rise of the push for the maximisation of shareholder value, as for example in the formulation of van der Zwan (2014) noted above. Financialisation often involves the growth of the financial sector's

ownership and dealings in equity, and the growth of financial markets. There has been the speed-up in the trading of equity (as with other financial assets), and emphasis on short-term share-price performance rather than on longer-term growth prospects. The particular significance of these developments here comes from the impact on decisions on investment, employment, output etc., as made by corporations. Do these developments foster more or less investment, more or less research and innovation? – questions often summarised under issues of short-termism. Further, do these developments favour some sectors over others? What would impact be on the quality and quantity of jobs?

The relationship between owners and managers in corporations has been subject to long debates from at least Berle and Means (1932), and the ways in which managers were pursuing their own objectives and the incentives which they face. Financial institutions, notably in the form of pension funds, insurance companies, investment banks, whether trading on their own account or on behalf of others become owners of equity and have interests in the price of equity. The financial institutions and their managers have material interests in the corporate performance, at least as reflected in the equity price. At the same time, and in some ways paradoxically, the frequency of trading has speeded up and hence the average length of time for which an equity is held is reduced. The exercise of ownership interest in the performance of a corporation can be enhanced with the growth of financial institutions in so far as a large number of small individual shareholders is replaced by a small number of financial institutions with a sizeable interest. The higher frequency trading though means that a financial institution's portfolio is continuously changing, and reliance on price changes for profits.

The advocacy of the pursuit of 'shareholder value' is a route through which shareholder interests are imposed on managerial interests. It also acts in the interests of the financial sector who gain from increasing stock market valuations. It is interesting to note that the 'managerial theories' of the firm would 'predict' that growth would be slower under 'shareholder value' maximisation than previously. The re-alignment of management interests with shareholder value was advocated through the use of share options, profit-

related bonuses etc.. The growth of inequality resulting from the high pay of 'top' managers is one result of that attempted re-alignment.

'The decade-long boom in the US stock market and the more recent boom in the US economy have fostered widespread belief in the economic benefits of the maximization of shareholder value as a principle of corporate governance. In this paper, we provide an historical analysis of the rise of shareholder value as a principle of corporate governance in the United States, tracing the transformation of US corporate strategy from an orientation towards retention of corporate earnings and reinvestment in corporate growth through the 1970s to one of downsizing of corporate labour forces and distribution of corporate earnings to shareholders over the past two decades. We then consider the recent performance of the US economy, and raise questions about the relation between the maximization of shareholder value and the sustainability of economic prosperity.' (Lazonick and O'Sullivan, 2000).

Hein summarises a range of arguments on the generally adverse effects of 'shareholder value' under financialisation on investment:

'1. Shareholders impose higher distribution of profits on firms, i.e. a higher dividend payout ratio and hence a lower retention ratio and/or a lower contribution of new equity issues to the financing of investment, or even share buybacks. Therefore, internal means of finance for real investment are reduced, and the ability to invest hence suffers ('internal means of finance channel').

2. Managers' (firms') preference for growth is weakened as a result of remuneration schemes based on short-term profitability and financial market results. The preference for growth, and hence the willingness to invest in capital stock, therefore suffers, too ('preference channel').' (Hein, 2012)

'Regarding investment in capital stock, financialisation has been associated with increasing shareholder power vis-à-vis management and labourers, an increasing rate of return on equity and bonds held by rentiers, and decreasing managements' animal spirits with

respect to real investment, which each have partially negative effects on firms real investment.' (Hein, 2012)

The often rise in profit rates and shares in industrialised countries over the past three or more decades can be compared with a tendency for investment to slow. 'A remarkable macroeconomic phenomenon that has been recognized by various political economists is that profit rates have developed very favorably in many advanced economies over the past 20 or 30 years, while physical investment dynamics have tended to slow down One popular (microeconomic) explanation of this macroeconomic phenomenon is that increased shareholder value orientation, as an important constituent of financialisation, has induced firms to develop a larger preference for profitability at the expense of investment (and potentially jobs and growth). Indeed, such a conclusion appears logical from the point of view of a firm-centered political economy where firms are seen as 'the key agents of adjustment . . . whose activities aggregate into overall levels of economic performance' (Hall and Soskice, 2001: 6). Similarly, the observation that financial profits have increased relative to non-financial profits has led many authors to conclude that there has been some sort of 'decoupling' of the financial sphere of the economy from the real sphere in the sense that, with financialisation, 'profits accrue primarily through financial channels rather than through trade and commodity production' (Krippner, 2005: 174). Apparently, many firms have decided to abandon the real sector and 'moved into financial operations to increase profits' (Epstein, 2005: 7;).' (van Treeck, 2009, p. 908)

A rather similar view comes from Dallery (2009). 'whether a firm's orientation is decided by managers under shareholders' pressure or by shareholders themselves, financialisation effectively leads to a decreasing tendency to accumulate. ... On the one hand, managers do not blindly pursue growth, and they also care about target utilization rates and the indebtedness threshold. On the other hand, shareholders are not only motivated by profit rate; they are also concerned with debt-leverage and growth. ... What I have shown is that financialisation taken as a constraint for managers entails a relatively small drop in accumulation, and it could even lead to a constant accumulation through increased

pressure on workers and/or increased real fragility. Considering the opposite case where shareholders preside over firms' fates, I find that the decrease in accumulation is far greater, but the scale of this reduction is dependent on what is assumed to be shareholders' objectives and time horizons (the longer it is, the more need for growth). The way financialisation has been presented here offers a theoretical representation of the historical change in corporate governance, "from an orientation towards retention of corporate earnings and reinvestment in corporate growth through the 1970s to one of downsizing of corporate labor forces and distribution of corporate earnings to shareholders over the past two decades" (Lazonick and O'Sullivan 2000: 13).⁹ (Dallery, 2009).

Inequality and poverty

The relationships between financialisation and inequality and poverty are not straightforward, and since financial development and growth can take many forms and working through a variety of institutional arrangements the relationships will vary over time and space. It is easy to point to features of the financial system and institutions which are intended to aid the poor – micro-finance institutions, credit unions being notable examples. At the other end of the spectrum private equity companies operate to make high returns for the already rich. As Piketty (2014) argues that the rich receive higher returns on their wealth than the poor.

It is possible that there is some form of Kuznet's curve type relationship⁹ involved – initially financial development favours the wealthy but as banking spreads to the less well-off it can favour the less wealthy. It can be remarked that over the past three to four decades the growth of the financial sector and rising inequality have gone together.

The majority of theoretical studies on the relationship between income inequality and financial development argue that financial deepening might be a feasible instrument for improving income distribution. This paper finds that the prediction crucially depends on the

⁹ Kuznet's curve expressed the idea that economic development and industrialisation would at first associated with rising inequality, and then with falling inequality generating (over time) an inverted U-shaped relationship between level of GDP per capita (or similar) and inequality. The evidence of the past thirty years with rising inequality and higher levels of GDP per capita has severely undermined the Kuznet's curve.

stages of financial development that the country is undergoing. The benefits of financial depth only occur if the country has reached a threshold level of financial development. Below this critical value, financial development counteracts income inequality. Our policy implication is that a minimum level of financial development is a necessary precondition for achieving reduction in income inequality through financial development' (Kim and Lin, 2011, Abstract).

Beck, Levine, and Demirguc-Kunt (2007) 'found that financial development disproportionately helps the poor. Greater financial development induces the incomes of the poor to grow faster than average per capita GDP growth, which lowers income inequality. ... Although the results show that financial development is particularly beneficial to the poor, this research is silent on how to foster poverty-reducing financial development.' (p.46)

Some argue that 'theory provides sound reasons for believing that the poor disproportionately benefit from financial development. Financial developments that lower the fixed costs of accessing financial services are especially useful to low-income individuals, helping them to pay for education and health care. Financial development that operates on the extensive margin facilitates entrepreneurship by people with promising ideas, but little collateral and income. This both reduces inequality of opportunity and enhances aggregate efficiency... [However], theory is not unambiguous, however. In particular, financial development that operates on the intensive margin and improves the financial services available to rich individuals and well-established firms can reduce the equality of opportunity, perpetuate cross-dynasty relative income differences, and widen the distribution of income. While theory provides guidance on the potential mechanisms linking inequality and the operation of the financial system, many of the core questions about the nature of the relationship between inequality and finance are empirical.

Although far from conclusive, an accumulating body of empirical evidence supports this view. The results of cross-country, firm-level, and industry-level studies, policy experiments, as well as general equilibrium model estimations all suggest that there is a

strong beneficial effect of financial development on the poor and that poor households and smaller firms benefit more from this development compared with rich individuals and larger firms. Empirical research suggests that an improvement in financial development expands economic opportunities, particularly for those whose opportunities had previously been tightly curtailed.' (Demirguc-Kunt and Levine, 2009, Pp.45-7)

'Using data restricted only to African countries for the period of 1980-2004 and applying the generalized method of moment (GMM) techniques, this study test the alternative hypotheses by investigating the impact of financial development on the distribution of income in African countries. Our empirical result show that the alternative financial development variables and the composite index predict a negative and linear relationship between finance and Gini Coefficients while the inverted U-shaped relationship is not established.'

'Two phenomena can be observed over the last five decades around the world – increasing financial development and increasing gross income inequality in many countries, especially in the developed world. ... Earlier empirical research focusing on this financial development versus income inequality nexus has broadly confirmed the decreasing effect of financial development. ...Using a broader data set and time-invariant country specifics in our panel estimation, we reach a different conclusion in the analysis of this nexus and reject these earlier theories and previous empirical research. Integrating time-invariant country characteristics, we find a positive relationship between financial development and income inequality within countries. Better-developed financial markets lead to higher gross income inequality. This finding holds for several robustness checks, e.g., for subsamples by different income groups, neglecting country characteristics and including further control variables, as well as bank deposits as an alternative measure for financial development. The positive relationship is highly significant but is only of a small magnitude. An increase in the provision of credit by ten percent leads to an increase in the Gini coefficient by 0.23 for the within estimation.

We do not exclude the possibility that all income groups within a country benefit from more financial development, but we do find that those who are already better off benefit more because income inequality is increasing. Our results should, at the very least, allow researchers to remain somewhat skeptical when confronted with the supposedly beneficial effects of financial development. It appears instead to be very important to target financial development towards the poorest in society. Only then can we hope for inefficient and excessive inequality to reduce. Nonetheless, the relationship between finance, financial development and income inequality offers more research opportunities and merits more resources and effort.' (Jauch and Watzka, 2012)

For the USA Onaran et al (2011) 'find that the primary redistribution of income in favour of the rentier income as well as the non-rentier profits at the expense of wages suppresses consumption; however, the secondary redistribution of profits in favour of rentier income has a positive effect on consumption. The wealth effects of rising housing and financial asset prices on consumption also lead to an increase in consumption. A higher rentier income suppresses investment through both lower investable funds available to the firm and shareholder value orientation, and an increase in non-rentier profits has a positive effect on investment. However, the overall effect of a pro-capital redistribution on investment is modest. As a result the US economy is moderately wage led, however the lower bound of the estimate is almost zero, indicating little effect of distribution on private excess demand; thus, the positive and negative effects of a pro-capital income distribution almost cancel each other out.

The results suggest that the changes in functional income distribution and wealth effects in the era of financialisation have had an overall neutral effect on aggregate demand. But without the wealth effects, the overall effect on consumption and investment would have been negative. Thus, the macro economy is not finance led (in the sense of Boyer, 2000) while still being shaped by changes in the financial sector. The effects of financialisation regarding income distribution at the expense of wage earners, the consequent reliance on debt fuelled by the housing bubble to maintain consumption and growth based on low

physical investment has led to a risky and fragile economy. This is exactly the mechanism that underlies the financial crisis of 2007–09. The coming years will show the negative consequences of debt repayments and the bust of the housing bubble on consumption. Indeed, over the longer term, if the negative wealth effects of the bust phase are also incorporated, the overall consequences of financialisation for growth may prove to be significantly negative. An alternative scenario with an improving wage share and declining rentier income share would provide a sounder and more sustainable basis for growth.’ (p.657)

A more direct linkage with financialisation comes from the following: ‘Using time series cross-section data at the industry level, we find that increasing dependence on financial income, in the long run, is associated with reducing labor’s share of income, increasing top executives’ share of compensation, and increasing earnings dispersion among workers. Net of conventional explanations such as deunionization, globalization, technological change, and capital investment, the effects of financialisation on all three dimensions of income inequality are substantial. Our counterfactual analysis suggests that financialisation could account for more than half of the decline in labor’s share of income, 9.6% of the growth in officers’ share of compensation, and 10.2% of the growth in earnings dispersion between 1970 and 2008.’ (Lin and Tomaskovic-Devey, 2013, p.1284).

Das and Mohapatra, (2003) present ‘evidence of a strong statistical association between the event of liberalization and income shares. The data strongly support a positive coefficient between liberalization and the highest income quintile’s share of mean income, and a negative coefficient between liberalization and the middle class income share.... We find no evidence of any statistical association between liberalization and the lowest income quintile. Although the middle class “suffers” in the wake of a liberalizing reform while the upper quintile gains, this statement is true for income shares. We find that income levels in liberalizing nations almost universally rise after liberalization. ... However, it is important to note that there are mechanisms which should relate capital market liberalizations to income shares under a wide variety of hypotheses that are true in emerging markets (e.g.,

differential access to credit markets, limited stock market participation, and the tight links between upper quintiles and policy makers).’ (p.245).

Employment and Work

The discussion above does not speak directly of the effects of financialisation and financial development on the quantity and quality of employment. Financialisation has been accompanied by increased incidence of financial crisis, and crises, particularly banking crises, have a devastating effect on output and on employment. The longer term effects of financialisation on employment are not at all clear-cut. In so far as financial development fosters growth and higher output, then it could be thought favourable for employment. But the causal links between financial development and economic growth are not well-established, and higher output does not necessarily translate into higher employment depending on productivity trends and capital formation. Some other trends, which may be associated with financialisation, which have been discussed in the preceding section would operate to constrain employment.

Slater and Spencer (2014) have highlighted four routes through which the processes of financialisation have consequences for work and work relations. The first is that ‘financialisation has impacted directly on the employment relationship. Specifically, it has enabled employers to increase their power over workers. As workers have accumulated financial assets and taken on greater amounts of debt, they have become less able and willing to push for higher wages and better working conditions. To the contrary, their weakened economic position has made them more vulnerable to real wage cuts, longer work hours and more precarious forms of employment (Glyn 2006)’.

The second echoes the shareholder value route with ‘the interests of shareholders have been elevated above those of other stakeholders, including workers. Pressurized by financial markets to maximize short-term profits and to raise dividends for shareholders, managers have looked to reduce wages, lay off workers, and downsize production (Lazonick and O’Sullivan 2000; Froud et al. 2006; Thompson 2011).’ ... The simultaneous

growth of private equity investors that have bought and sold productive assets, in addition, has resulted in poorer employment outcomes for workers (Clark 2009)'.

The third issue which is discussed is the impact of the financial crisis of 2007/09 which 'has its origins in the financialisation process and among its outcomes has been a decline in employment, job security, wages and working conditions', to which could be added that financial crises have become more frequent under financialisation.

The fourth impacts on the organisation of work where it is argued that 'financialisation impedes the adoption and sustainability of forms of participatory work practices that rely on the elicitation of commitment and flexibility from workers. Despite their perceived economic benefits ... these practices have not been adopted to any great extent (Godard 2004), in part because they represent too high a cost for firms, but also because they pose a challenge to employers' 'right to manage'..... Managers demand commitment and flexibility from workers but their drive to maximize shareholder value means that they cannot maintain the conditions required to secure the continued cooperation of workers.' (Slater and Spencer, 2014, pp.142-3).

Cushen (2013) speaks of 'startling trends concerning employment outcomes under financialisation which indicate the hegemonic force of financialized interests within organizations' (pp.317-8). Lazonik (2014) speaks of an organizational failure in which 'U.S. business corporations have failed to use their substantial profits to invest in new rounds of innovation that can create new high value-added jobs to replace those that have been lost' to the financialisation of the U.S. corporation. U.S. corporations are pursuing 'employment strategies purely for financial gain' which includes manufacturing plant closure, off-shoring production to low wage areas. But 'business corporations failed to invest in new, higher value-added job creation on a sufficient scale to provide a foundation for equitable and stable growth in the U.S. economy.

On the contrary, with superior corporate performance defined as meeting Wall Street's expectations for quarterly earnings per share, companies turned to massive stock repurchases to "manage" their own corporations' stock prices. Trillions of dollars that

could have been spent on innovation and job creation in the U.S. economy over the past three decades have instead been used to buy back stock for the purpose of manipulating the company's stock price. This financialized mode of corporate resource allocation has been legitimized by the ideology, itself a product of the 1980s and 1990s, that a business corporation should be run to "maximize shareholder value." Through their stock-based compensation, corporate executives who make these decisions are themselves prime beneficiaries of this focus on rising stock prices as the measure of corporate performance. Assa (2012) argues that the 'strengthening of finance vis-à-vis the rest of the economy did not come without a price. The empirical evidence clearly confirms the relationships discussed in the literature on financialisation, and in particular its negative effects on equality, growth and employment. Each percentage increase in financialisation is associated with between 0.49% and 0.81% more inequality (depending on which indicator of financialisation is used). A similar increase in financialisation is related to a 0.2% slower growth of GDP, and between 0.12% and 0.74% higher unemployment' (p.39)¹⁰.

A concluding remark

The impacts of financialisation on the performance of the real economy are clearly far from agreed upon. However, we would hazard the following remarks. The financial sector has grown rapidly in the past three decades, and it can be doubted that this has aided growth. In earlier periods a positive relationship between financial deepening and economic growth was generally accepted, even if the direct of causation remained disputed. The relationship has become much weaker, and the larger scale of the financial sector has been associated with somewhat slower growth in industrialised countries. Financialisation has been associated with a greater frequency of financial crises, which are often associated with substantial unemployment and loss of output. Inequality has in general risen (at least as far as industrialised countries are concerned) in recent decades. Some authors have viewed

¹⁰ His measures of financialisation are: Value added in finance as a percentage of total value added and Employment in finance as a percentage of total employment, where finance sector is the broadly defined FIRE. The estimation is panel for OECD countries, and for the years 1970 to 2008 for growth and unemployment, and six period observations for inequality (Gini coefficient).

the growth of the financial sector as tending to reduce inequality, while others have seen financialisation as encouraging inequality. Financialisation has been associated with the pursuit of 'shareholder value', and many authors have postulated to negative effects on corporate performance coming from that pursuit in the form of discouragement of long-term investment and innovation, and the impact on employment conditions.

The major questions to which we now turn concern the policies towards and the structures of the financial sector which would be more conducive to employment, quality jobs and human development within a more sustainable path of economic development.

4. Alternative financial structures and scenarios

The creation of higher levels of employment, good quality jobs and the enhancement of human development require a wide gamut of policies which could be placed under the heading of 'real side' of the economy (or industrial policies, supply-side policies). The ILO(2014), for example, argues that 'to meet these challenges [of lack of quality jobs], it is essential, first and foremost, to boost a diversified productive capacity rather than just liberalizing trade ... ;... second, strengthen labour market institutions rather than neglecting labour standards ...; ... third, extend well-designed social protection floors as drivers of inclusive development, not just as a narrowly targeted safety net for the poor (ILO, 2014, pp.xxi-xxii). Heintz (2009) points to 'targeted policies to facilitate the structural transformations associated with their varied processes of industrialization. The precise policy mix differs from one case study to the next, but they shared a number of common areas of intervention – government-directed investment in infrastructure, development finance to channel credit to specific productive activities, targeted industrial policies such as subsidies and tax credits, financial institutions that extended long-run credit for productive investment, and the pursuit of dynamic competitive advantage by nurturing the development of strategic industries and activities. ... Nevertheless, similar kinds of interventions can be used to transform the structure of employment and encourage the development, in the longer term, of a solid foundation of decent work opportunities' (Heintz,

2009, p. 53). Many similar and dissimilar policy interventions could be mentioned which are intended to achieve sustainable development, high levels of employment and decent work opportunities. These policy interventions could be described as industrial, employment and supply-side policies. The obvious question which then arises is what is the relevance of the workings of the financial sector for the successful implementation of such policies?¹¹

One focus here is on the direction (what could be termed the 'quality') of funds rather than the total ('quantity'). This may not seem the obvious place to start. But at the global level there has often been talk of a 'savings glut', as for example, a cause of the financial crisis; others have spoken of asset price inflation (Toporowski, 2000, for example) arising from savings seeking outlets which are not directly associated with productive investment. The general levels of unemployment and underemployment comes from many factors including lack of capacity in the relevant places, but it is also a sign of potential excessive savings. Some of those excessive savings are exhibited in budget deficits; but to the extent to which appropriate budget deficits are not in place the potential savings cannot be realised. The processes of financialisation with the shifts in the distribution of income from those with low propensity to save to those with a high propensity to save, and the effects of financialisation on investment (in industrialised countries as discussed above) have exacerbated the situation.

The banks as providers of loans which are translated into money play a crucial role in the ability of investment to expand ahead of savings. It is essential that those loans are provided in the relevant quantities but also allocated in socially desirable ways. Banks and other financial institutions have the crucial roles of the allocation of the savings which have been generated.

We address the question on the role of the financial sector under two heads. The first is that the financial system is the conduit through which funds flow and finance provided, and as such the financial system is continuously making decisions on the allocation of funds and credit, and in doing so implicitly (or explicitly) favours some sectors of the economy

¹¹ This is a general question whatever is the nature of the supply-side policies which are being advocated.

over others, some groups over others, some activities over others. The financial sector would be allocating funds on the basis of perceived credit worthiness and anticipated profitability. The perceptions of credit worthiness often incorporated forms of discriminatory behaviour, for example on grounds of ethnicity and gender, scale of the firm (favouring large over small firms) etc.. The decisions on grounds of private profitability would not in general accord with social benefits. This would include, though be much broader than, the divergences between private costs and benefits and social costs and benefits. The approach adopted here is to think in terms of the development, support and promotion of financial institutions which are more conducive for investment in human development, good quality jobs etc.. The general policies towards financial institutions have to be set in the context of overall strategies on human development, good quality jobs etc., and to seek to ensure that the financial institutions operate in ways which are supportive of those strategies. There are no 'magic bullets' but rather seeking ways of shifting the financial sector in ways by which that sector would better serve the economy and society than it presently does.

The second head comes from consideration of the interests of the financial sector. The processes of financialisation, the growth of the financial sector as owners of equity with the pursuit of 'shareholder value'. The relationships between the financial sector and the real sector in terms of ownership, corporate governance and pursuit of 'shareholder value' have impacts on investment and employment. In this regard we echo the argument of Stockhammer (2012) when he argues for 'two central demands for economic policy: a de-financialisation of the economy and a pro-labour shift in the distribution of income. ... We go beyond the familiar call for more and better regulation and advocate de-financialisation. This would imply a shrinking of the financial sector, a stronger voice of stakeholders; it would also aim at replacing the logic of profit (or shareholder value maximization in many social areas by a democratically determined policy priorities and principles of solidarity' (p.64). In a somewhat similar vein, Lawrence (2014) speaks of de-financialisation through

measures such as targeting credit at the productive economy and a reassertion of the public interest in the financial system.

In considering alternative financial structures and scenarios, it has to be recognized that whilst policies can mould and influence the scale and forms of the financial sector, but (as part of financialisation) the social and political power of the financial sector heavily constrains the social and political actions. The evolution of the financial system is not given by nature nor solely by the desires and demands of the financial system. There are, of course, many examples from recent history of how government policies have facilitated the growth and development of the financial section- notably in so-called financial liberalisation and de-regulation and promotion of stock markets. However, the growth of the financial sector has not raised the levels of savings and investment (at least in the industrialised countries), and that growth of the financial sector has been centred on the development and trading in financial assets through securitization, derivatives etc. The profitability of trading in such assets is linked with rising asset prices, and as such is not sustainable. It is investments (in terms of quality and quantity, and including research and development) which are relevant for the evolution of the real sector and job creation. Savings are generated as a result of investment (and other expenditures notably budget deficits) and those savings have to be allocated to match the funding of investment.

The social and political power of the financial sector raises question of who forms of economic policies which it promote and what interests does it pursue. This is not to argue that the financial sector has a coherent set of interests and objectives which are collectively pursued. The ways in which credit-rating agencies (viewed as part of the financial sector) operate clearly have strong implications for the pursuit of fiscal policies: the threat of credit-ratings is used as a potent argument for balanced budgets rather than the use of deficits for reflationary purposes. The credit-rating agencies do not merely respond to macroeconomic 'fundamentals' (even if such exist) but rather to their perceptions of the world.

Employment generation and the growth of output in the future cannot be discussed independently of ecological considerations. Thinking about future prospects for employment cannot take place without a deep consideration of the growth possibilities for the future – technological opportunities and ecological considerations. The relationship between the growth rate and employment is complex, but working time is an issue. The quantity and quality of jobs depend on decisions on investment, output, employment which lie in the hands of corporations and businesses – that is in the non-financial sector. With regard to economic activity, employment and growth, the financial sector considered in its entirety can promote or limit the quantity of investment through the willingness of banks to provide loans, and can through decisions made on loans and on the allocation of funds have a major influence on the direction of investment, the sectors for investment and the nature of jobs created. Banks (as financial institutions) and stock markets have been viewed (as briefly mentioned above) as alternative mechanisms by which funds are allocated and monitored. However, banks and financial institutions take many forms, and our first task in this section is to explore the features of the different types of financial institutions. The approach here is to put on to the agenda the diversity of banking and other financial institutions, and the potential differences in their behaviour and performance. A relatively brief discussion of the roles of taxation, notably on financial transactions taxes, financial activity taxes etc., viewed in terms of seeking to influence the scale and nature of the operations of the financial sector follows.

Alternative forms of banking

Financial institutions provide credit and finance to non-financial institutions and households (and also government). The relationships between financial institutions and non-financial institutions may be viewed in terms of market relationships in a perfectly competitive market where there is trade under conditions of anonymity and tendency to uniformity of price. But 'interest rates are not like conventional prices and the capital market is not like an auction market' (Stiglitz and Greenwald, 2003, p. 26). Indeed 'a central

feature of the Arrow-Debreu model is the anonymous nature of markets ...However credit is totally different. ... The terms on which credit will be supplied will depend on judgements about the likelihood that the loan will be repaid' (Stiglitz and Greenwald, 2003, p.30). Thus the relationship of banks with customers involves aspects of a market relationship, but also significant departures from the anonymous relationship portrayed in a perfectly competitive market. From this perspective, the nature of the relationships between financial institutions and customers becomes highly relevant for the ways in which finance and credit are provided, on what terms and to whom, and the monitoring and other efforts of financial institutions to ensure the repayment of loans. It is then in the nature of credit that there will be what may be termed credit rating and pricing of credit which reflects assessment of likelihood of default (partial or total).

The financial sector operates in the provision of funds to industry to favour some types of firms over others. It is a frequently expressed argument that there is, in some sense, a lack of funding for small and medium sized enterprises. In a similar vein, research and development activities may not secure sufficient funding from external sources. A major and obvious difficulty here is the finding of the appropriate benchmark against which to judge whether there is the right level of funding for say small and medium sized enterprises and at the 'right price'. In a world of risk where the probability of default by a given category of borrowers is well-established, it would be rather straightforward to assess whether banks were using the correct information, though asymmetric and moral hazard problems would blur the picture. In a world of fundamental uncertainty there is not a firmly established benchmark of the likelihood of default by a borrower¹². The likelihood of default has to be assessed by the borrower without a clear benchmark of what that likelihood is.

Credit rationing immediately gives rise to a range of questions. Information has to be obtained, collected, assessed and analysed, and what is regarded as information? The

¹² Risk is taken as the situation where the outcome of a decision or action can be represented in terms of a probability distribution; uncertainty as a situation in which the individual does not know of any such probabilities and/or such probabilities do not exist as the future is inherently unknowable and will differ from the past.

manner in which information is assembled and assessed (particularly where information is necessarily asymmetric and in a world of uncertainty information is more perception than confirmed knowledge) is significant for how credit is rationed – how is it determined who receives and does not receive credit (and in a loan driven banking system how much credit is generated)?

The providers of loans (and funds more generally) will for rather obvious reasons have concerns over the credit worthiness of the borrower and the perceived likelihood of repayment of loan and interest. The availability of loans as far as an economic agent is concerned will be subject to the 'principle of increasing risk' (Kalecki, 1937) which applies to all forms of lending. In his words, the cost of finance facing the individual firm where 'the entrepreneur is not cautious enough in his investment activity, the creditor who imposes on his calculation the burden of increasing risk, charging the successive portions of credits above a certain amount with a rising rate of interest' (Kalecki, 1990, p.288).

The credit allocation processes depend on risk assessments which in an uncertain world can only be perceptions of frequency of default etc., rather than based on well-established probability distributions. There have been many large literatures on how banks and other financial institutions approach lending to different social, ethnic groups and gender and in effect discriminate against some and practice financial exclusion. There are other literatures on lending to SMEs (small and medium size enterprises), lending for innovation, research etc., which have tended to express concerns over the lack of finance for those type of firms and activities.

The financial sector can involve a wide range of institutions (even when limited to banks – that is institutions who are licensed to accept deposits) with different forms of ownership (private, public, mutual), different objectives and 'market niches'. There are different types of financial institutions and the allocation of credit: included here are credit unions, micro-financial institutions; mutual organisations and public banks. These different forms of financial institutions can be judged in many different dimensions – their relative efficiency, their objectives, their relationships with their customers etc..

The term banks covers a range of different types of institutions -- clearing or commercial banks, savings banks, investment banks and universal banks. Banks differ substantially in terms of their ownership structures – private, public (State), mutual and co-operative. Depending on ownership structures, the objectives of banks differ. The objectives of privately owned banks would generally be that of profits – though a range of objectives may be stated ('providing employment', for example), and the effective decision-makers in a bank may pursue other objectives such as growth and size (as postulated in the managerial theories of the firm). The objectives of public and mutual ownership are often more difficult to state (at least on any universal principles) but would often include the provision of finance for stated aims – e.g. to support industrial development, to provide housing finance etc.. As the question arises for privately owned banks and whether their managers will seek to maximise profits, so the question arises for public and mutual organisations as to whether their managers will maintain the objectives which are set for them, or whether their interests will lie elsewhere.

The mainstream perspective here would be that privately owned banks themselves seeking to maximise profits will seek to allocate funds and loans to the more profitable investment opportunities. There may be a (expected) returns—risk trade-off¹³ which has to be taken into account. There are informational issues and the much analysed problems of moral hazard and asymmetric information. But, overall, there would be relatively efficient allocation of funds.

The pervasiveness of credit rationing extends across all types of financial systems. Financial systems and sub-systems will differ in how credit rationing is dealt with, how it impacts on who receives credit and at what price. Two broad comments may be made. The first is that financial systems develop what appear to be discriminatory practices through

¹³ That is investment projects with the higher expected returns would also be those with the higher risk (variance of outcomes).

favouring some groups over others in their credit rating assessments. The discrimination can be along ethnic lines, gender, area of residence etc..¹⁴

Block (2014) argues that 'if a financial system needs gatekeepers, everything hangs on the decision rules that those gatekeepers employ to evaluate creditworthiness. In the past, gatekeeping positions in the United States were filled largely with upper-class individuals who had gone to the right schools and knew all the right people. It was simply common sense for these gatekeepers to define creditworthiness in class terms; the closer an individual came to the manners and styles of upper-class men, the more creditworthy they were seen to be. If they were female, from a minority group, or working class in origin, then they were obviously less creditworthy.

Potential entrepreneurs from disfavored groups were then forced to find other ways to borrow the capital they needed. Certain ethnic groups developed parallel financial institutions or used informal mechanisms, such as rotating credit associations, to finance business efforts. In the worst case, they might resort to desperate exchanges with predatory lenders whose terms would significantly reduce the probability of business success.' (p.15).

The second is that relational banking and similar arrangements develop to aid credit assessment and to ease monitoring issues. Causal observation suggests that the nature of the relationship, e.g. short-term vs. long-term, spot market vs. contractual, between banks and (potential) borrowers differ substantially between countries. The ways in which the monitoring and assessment issues are addressed clearly differ substantially between financial systems.

The contrast is often drawn between bank-based financial systems and market-based financial systems (as discussed above). We have argued in Sawyer (2014b) that the dichotomy is too sharply drawn, that all financial systems require banks and almost all operate with stock markets. Further, banks engage in what may be termed market activities. Banks and asset markets can be compared (as indicated above) in terms of the

¹⁴ Dymski (2006) for a review: he concludes that 'the literatures on discrimination in the credit and housing markets are compelling, incomplete, contradictory and controversial'.

ways in which funds are allocated and monitored. There are, though, two important differences which do not often feature in discussions. The first is that the stock market often has a limited role to play in the allocation and re-allocation of funds. The scale of the stock market is often measured in terms of stock market valuation relative to GDP, but the inflows of funds to companies through the equity markets is rather small and sometimes negative. The figures in Table 2 illustrate another scale of the stock market, namely the turnover in existing stocks, but obviously that is an exchange of the ownership of existing financial assets. Corporations retain profits, out of which investment is funded (along with depreciation allowances), though a feature of financialisation has been the use of retained profits for financial assets purchase as well as real investment. This leads us to focus on banks and other financial institutions as the main route through which funds are allocated and re-allocated.

The second is that banks are institutions which make decisions on the allocation of funds and the conditions attached to loans. It is then highly relevant as to the nature of banks and their relationships with borrowers. Further, who makes the decisions, what influences those decisions etc. become important issues for the ways in which funds are allocated (and more generally financial services provided).

An illustration of the latter comes in the following observation: 'banks should be part of local communities. They should not be permitted to up sticks and leave local communities in the lurch. Maintaining a socially desirable network of branches should be a necessary quid pro quo for a deposit-taking licence and the state's deposit protection guarantee. Each branch closure must be sanctioned by the regulator, and banks must be required to demonstrate that after closure, the local community's access to banking services will not suffer' (Sikka, 2014. p.24). Further, 'it is clear that capital markets do not function in a perfect, neutral way; rather, they are inherently imperfect and non-neutral. Funds do not necessarily flow to potentially profitable projects irrespective of where the latter are located. Our concern in this paper has been whether and to what extent the spatial structure of capital markets—for both public and private equity—interacts with monetary

non-neutrality to exacerbate the funding problems of SMEs' (Klagge and Martin, 2005, p. 414).

The nature of financial institutions and their history and traditions vary widely across countries, and the purpose here is not to propose some universal solution which would often be inappropriate for the circumstances of a particular country. It is rather to comment on the potential for different forms of financial institutions and banks for the provision of finance and funds in ways which met social objectives rather than profit objectives. In doing so it particularly focuses on the roles of the State and of mutual and co-operative organisations, which historically have played major roles in the operations of the financial sector, albeit ones which have tended to diminish in the past few decades as privatisation has proceeded. It is particularly relevant to note that different forms of financial institutions serve different groups – some may be appropriate for small local firms, others to facilitate larger firms.

Micro finance institutions

The objectives for micro finance institutions are often portrayed in terms of the 'double bottom line' – that is both profitability (or at least break even) and poverty reduction¹⁵. The poverty reduction aspect is intended to come from the provision of credit to those previously excluded from credit which enables them to establish a business (even if a one person business). Micro finance could also be seen as using peer pressure within local groups of borrowers as a means of reducing default rates. It has often been promoted as promoting financial inclusion and addressing gender inequalities through a focus on female participation.

However, the successes or otherwise of MFIs in poverty reduction and (self) employment creation have hotly disputed. By way of examples, consider the following. On the one side: 'The emerging microfinance revolution—the large-scale provision of small loans and deposit services to low-income people by secure, conveniently located, competing

¹⁵ See, Lagoa (2014) and Lagoa and Suleman (2014) for a review of the role of microfinance in the European context.

commercial financial institutions—has generated the processes needed to democratize capital.... Appropriately designed financial products and services enable many poor people to expand and diversify their economic activities, increase their incomes, and improve their self-confidence. Financial institutions knowledgeable about microfinance can become profitable and self-sustaining while achieving wide client outreach. Governments and donors no longer need to provide ongoing credit subsidies; they also need not cover the losses of state banks providing credit subsidies. Over the past 20 years these characteristics of the microfinance revolution have been demonstrated in widely differing country environments.’ (Robinson, 2001, p. xxx). On the other, ‘By the early 1990s, however, it was becoming clear that the original Grameen concept – microcredit provided to establish or expand income-generating projects – was transmuting into the much wider concept of microfinance, meaning the supply of a whole range of financial services to the poor, including microcredit, micro-insurance, micro-savings, and so on In particular ... it was becoming quite clear that most microcredit is actually used not so much for income-generating projects, but mainly to facilitate consumption spending.’ (Bateman and Chang, 2014, p. 4). They organise their doubts on micro-finance under three headings: the construction of ‘hugely optimistic narrative constructed around the microfinance model [which] is actually rather seriously flawed’; that the dominant microfinance model ‘has not unambiguously resulted in a sustainable poverty reduction and economic development episode anywhere’; and the ‘intimate relationship [of microfinance] with neoliberalism and the globalisation project.’ (pp.4-5)

Many would argue that MFIs suffered from ‘mission creep’ and became more focused on profit than on poverty relief. Micro finance institutions have suffered from financialisation in being sucked into operating as profit-seeking financial institutions, and from the financing of consumer debt rather than provision of investment.

The ‘development model’ which lay behind micro-finance could be seen as groups (whether because poor, on grounds of gender etc.) could not otherwise secure credit, and this acts as a constraint on their economic activities. The reasons why they could not otherwise secure

credit would include transactions costs for small loans, discrimination etc.. Providing those groups with credit would then enable investment to be undertaken. But there is the need for support (education, management skills, infrastructure) and the need for demand for what they produce. Further, MFI represents the allocation of existing funds which detract from their use elsewhere: that may of course be socially preferred.

State development and investment banks

State development banks have often viewed in terms of their role in economic development, notably industrialisation. Epstein (2013) contrasts the prevailing neo-liberal inflation targeting independent central bank approach with 'the historically dominant theory and practice of central banking, not only in the developing world, but, notably, in central banking in the US, UK, Europe, and elsewhere, financing governments, managing exchange rates, and supporting economic sectors by using 'direct methods' of intervention have been among the most important tasks of central banking and, indeed, in many cases, were among the reasons for central banks' existence.' (p.276). Epstein provides some case studies of developmental central banking (the title of his paper). He includes under that heading the pursuit of economic activity and growth oriented objectives (in place of the single one of inflation targeting), the promotion of lending (directly or by other banks) to specific sectors or groups (e.g. agriculture, SMEs) and guidelines for industrial development and green investment.

There are a range of State development and investment banks around the world; some notably examples are the German KfW, Brazilian development bank, and European Investment Bank (EIB); and recently proposals such as the BRICs Development Bank (Griffiths-Jones 2014), and relatively small scale ones such as the UK Green Investment Bank. State development banks and the like again offer the possibilities of social influence on the allocation of funds through the setting of objectives for such banks.

Ethical banking

A range of banks and financial institutions are seeking to operate on different bases to that of solely profit maximization. One example is those linked with the Global Alliance for Banking on Values (GABV) which 'is a foundation with an established charter, made up of the world's leading sustainable banks, from Asia, Africa, Australia, Latin America to North America and Europe. Members include microfinance banks in emerging markets, credit unions, community banks and sustainable banks financing social, environmental and cultural enterprise.' (<http://www.gabv.org/>). Another of growing significance would be Islamic banks and finance which confines its financial activities to those which are Sharia compliant with respect to the payment of financial rewards (notably the prohibition on interest), the financial products which can be offered and the activities of businesses such as the production of alcohol, pornography or weapons.

Financial institutions operating along these lines at least offer the potential that savers can express their social values through the provision of funds to such institutions. They also offer possibilities for the channeling of funds in specific directions in line with the social objectives of the institution. The specific issues which arise are (as with micro finance) whether such institutions suffer from 'mission creep', and whether the pressures push them towards profits. Much may then depend on whether the activities into which these alternative financial institutions put funds are ones which yield an acceptable rate of profit – and hence that while the social returns to such investments may be high, are the private returns similarly so. But, if the private returns are indeed relatively high, then profit seeking financial institutions would themselves be willing to lend. Thus it can be argued that alternative financial institutions would in effect require subsidies which can come in the form of direct government subsidy or through savers willingness to accept a lower rate of interest.

Mutual and local financial institutions

Klagge and Martin (2005) 'argue that the regional structure of the financial system in general, and of the capital market more specifically, is potentially of some significance. A geographically decentralized financial system with sizable and well-embedded regional clusters of institutions, networks, agents, and markets can be advantageous in at least three ways. First, the presence of a local critical mass of financial institutions and agents—that is of a regionally identifiable, coherent and functioning market—enables local institutions, SMEs, and local investors to exploit the benefits of being in close spatial proximity. ... Second, the existence of regional capital markets specialising in local firms may help to keep capital within the regions, as local investors direct their funds into local companies— and hence into local economic development—rather than investing on the central market. ...Third, in a nationally integrated financial system, the case can be made for a regionally decentralized structure on the grounds that it increases the efficiency of allocation of investment between the centre and the regions'. (p. 414). However, 'this is not to ignore the fact that regional capital markets face a number of major challenges and problems. If regional stock exchanges are to be considered a realistic option they must bring clear benefits to both the businesses involved and to the local economies within which they function. Their success will depend on the extent to which they succeed in mobilizing local investor funds, that is provide liquidity. This in turn will depend on the economic performance and wealth of the region: economically depressed and low wealth regions may face difficulties in attracting a large enough local investor base or an adequate demand for liquidity from local businesses. In other words, regional capital markets might be a necessary feature for regional economic prosperity, but they are certainly not sufficient. Indeed, while one of the key arguments for local and regional capital markets is that potentially they offer a means of mobilizing local liquidity. But this is also likely to be their primary challenge. Here then is central dilemma; while a case can be made that regional capital markets can help boost and sustain regional economic development, they in turn depend on a prosperous and thriving local business and investor base. ... From a

policy point of view the creation of regional capital markets needs to be accompanied and underpinned by other measures aimed at promoting and supporting local economic growth, innovation and business development.’ (p.415)

‘This kind of automation is a particular problem with small-business lending. Since failure rates of small business loans are high, the computerized algorithms tend to limit credit to firms that have already proven themselves or to firms that have collateral in the form of real property. This tends to bias credit availability toward real estate development and away from other endeavors. The best way to overcome this dynamic is to introduce significant competition from financial intermediaries who are not seeking to generate profits. These could take the form of credit unions, community banks, nonprofit loan funds, or banks that are owned by government entities; but the key is that their mission is defined as facilitating economic development in a particular geographical area. With this mission, they have a reason to employ loan officers who develop the skill set needed to provide credit to individuals and firms who fall outside the parameters of the standard lending algorithms.’ (Block, 2014, p. 16)

The local aspects of this is stressed by Sikka when he writes that ‘banks should be part of local communities. They should not be permitted to up sticks and leave local communities in the lurch. Maintaining a socially desirable network of branches should be a necessary quid pro quo for a deposit-taking licence and the state’s deposit protection guarantee. Each branch closure must be sanctioned by the regulator, and banks must be required to demonstrate that after closure, the local community’s access to banking services will not suffer’ (p.24).

Credit allocation policies

An alternative is that ‘government has an active role to play in allocating credit to finance productive economic activity, and it should use a full range of policy tools including interest rate subsidies, loan guarantee programs, and tax incentives to assure that capital flows in the most productive directions.’ (Block, 2014, p.13).

An important element of an industrial strategy is to seek to ensure that funds flow in the direction which is compatible with that strategy. This can involve some degree of guided lending for banks – that is requirements that a specified proportion of their lending are to those sectors identified for development and growth. In the current circumstances, we would advocate that the key focus here should be on green and environmentally friendly investment. This could draw on the US experience of the Community Reinvestment Act (CRA), introduced in 1977 and revised in 1995, whereby banks and other financial institutions are legally required to direct a portion of funds to lending to the local community. ‘The Community Reinvestment Act is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound operations. The CRA requires that each depository institution's record in helping meet the credit needs of its entire community be evaluated by the appropriate Federal financial supervisory agency periodically. Members of the public may submit comments on a bank's performance. Comments will be taken into consideration during the next CRA examination. A bank's CRA performance record is taken into account in considering an institution's application for deposit facilities’.¹⁶

Dayson, Vik, Rand and Smith (2013) explore the use of a Banking Disclosure Act as ‘it is believed that disclosure could support research into the determinants of underinvestment and lending, which in turn would aid by enhancing our understanding of financial exclusion and underinvestment. In particular, it would help identify groups and areas less likely to access financial services’.

A specific policy is the use of reserve requirements against specified types of assets. In the context of macro-economic policy there has been advocacy of variable reserve requirements on mortgages during house price booms. Campiglio (2015) has, for example, has proposed green reserve requirements. It is usual for reserve requirements to differ between asset risk classes. The suggestion here would be an extension to asset classes

¹⁶ http://www.federalreserve.gov/communitydev/cra_about.htm; accessed March 2014.

based on the sector to which loans are made. This is not to underestimate the difficulties of specifying and monitoring which asset classes would be eligible for lower reserve requirements. And some (such as 'green investment') would face less difficulties than others (e.g. specifying whether the loan had been used for 'good quality' jobs).

Financial transactions taxes

The era of financialisation has been one of expansion of the financial system (as evidenced above), and future scenarios have to involve some thoughts on whether that expansion will continue and indeed whether such an expansion would be sustainable. Much of the growth of the financial system involved unsustainable processes relying on rising asset prices. It also needs consideration of the ways in which the financial systems grew. Earlier discussions of financial development had focused on growth of the banking system in terms of deposits and loans, and expansion of stock markets. These were related to the functions of the financing and funding of investment, and the facilitation of savings. As such, there would likely be some linkages between growth of the financial system and economic growth, whatever ones views on the causal mechanisms involved. The era of financialisation has rather seen the growth of trading in financial assets. In terms of future scenarios there may be doubts as to whether there will be further expansion, and whether such expansion would be desirable. Although such trading is not a large employment generator, it nevertheless absorbs resources which could be deployed elsewhere. The case for financial transactions taxes comes in part from the discouragement of such transactions¹⁷.

Keynes (1936) advocated what would now be termed a financial transactions tax which 'might prove the most serviceable reform available, with a view to mitigating the predominance of speculation over enterprise in the United States' (p.102). He saw the changing balance between what he termed enterprise and speculation as disadvantageous. 'When the capital development of a country becomes a by-product of the activities of a

¹⁷ See, for example, Arestis and Sawyer (2013) for recent discussion on financial transactions taxes, and the references cited there.

casino, the job is likely to be ill-done. The measure of success attained by Wall Street, regarded as an institution of which the proper social purpose is to direct new investment into the most profitable channels in terms of future yield, cannot be claimed as one of the outstanding triumphs of laissez-faire capitalism—which is not surprising, if I am right in thinking that the best brains of Wall Street have been in fact directed towards a different object' (Keynes, 1936, p.101).

The over-all impact on employment resulting from a financial transactions tax would depend on the uses to which the additional tax revenue is put as the FTT would somewhat reduce employment in financial asset trading. It could have further indirect effects depending on the alternative employment of those traders, on corporate governance arising from longer holding of financial assets (equity), and on financial stability. These could not be expected to be major impacts but would generally be favourable to the quantity of jobs.

5. Concluding remarks

This paper has begun by outlining the processes of financialisation around the globe, though recognizing that financialisation has been concentrated in industrial countries and spreading to emerging markets and the international economy.

The effects of financialisation on economic performance, broadly here taken to include economic growth, inequality and employment. Whilst still an area of much contention, we have argued that the beneficial effects of financial development have been much reduced in recent years, and there are adverse effects notably on inequality and the quality of employment which can be associated with financialisation.

The creation of employment, improvement of job quality and human development come for decisions and policies put in train on what may be termed the real side of the economy. However those decisions and policies have to be financed and funded, and policies will be constrained in their adoption and implementation by the interests of the financial sector.

Alternative forms of financial institutions with a diversity of ownership forms including mutual and public, operating with different objectives including social and environmental, and often organised at local and regional levels have to be evaluated for their contributions in being supportive of employment and job creation.

Table 1: Ratio of bank deposits to GDP (%)

| | 1995 | 2000 | 2005 | 2010 | 2011 |
|---------------------------------|------|-------|-------|-------|-------|
| High income OECD countries (26) | 92.1 | 106.1 | 118.5 | 151.2 | 151.5 |
| Middle income countries (75) | 35.0 | 39.5 | 41.3 | 48.1 | 47.3 |
| Low income countries (12) | 30.9 | 40.9 | 43.3 | 55.2 | 58.4 |

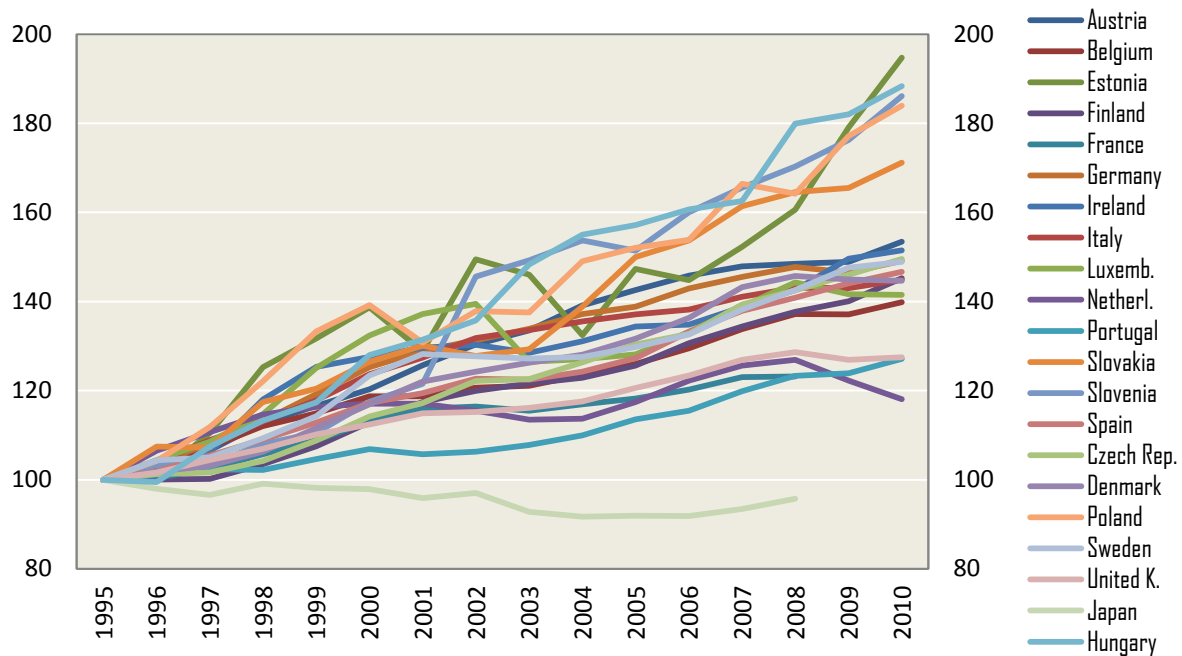
Source: Calculated from Financial Development and Structure dataset

Table 2: Stock market measures (72 countries)

| | 1995 | 2000 | 2005 | 2010 | 2011 |
|-----------------------------------|------|------|------|------|------|
| Stock market valuation to GDP (%) | 39.5 | 61.3 | 71.1 | 65.6 | 60.0 |
| Stock Market Turnover Ratio (%) | 35.5 | 65.5 | 60.7 | 52.2 | 53.0 |

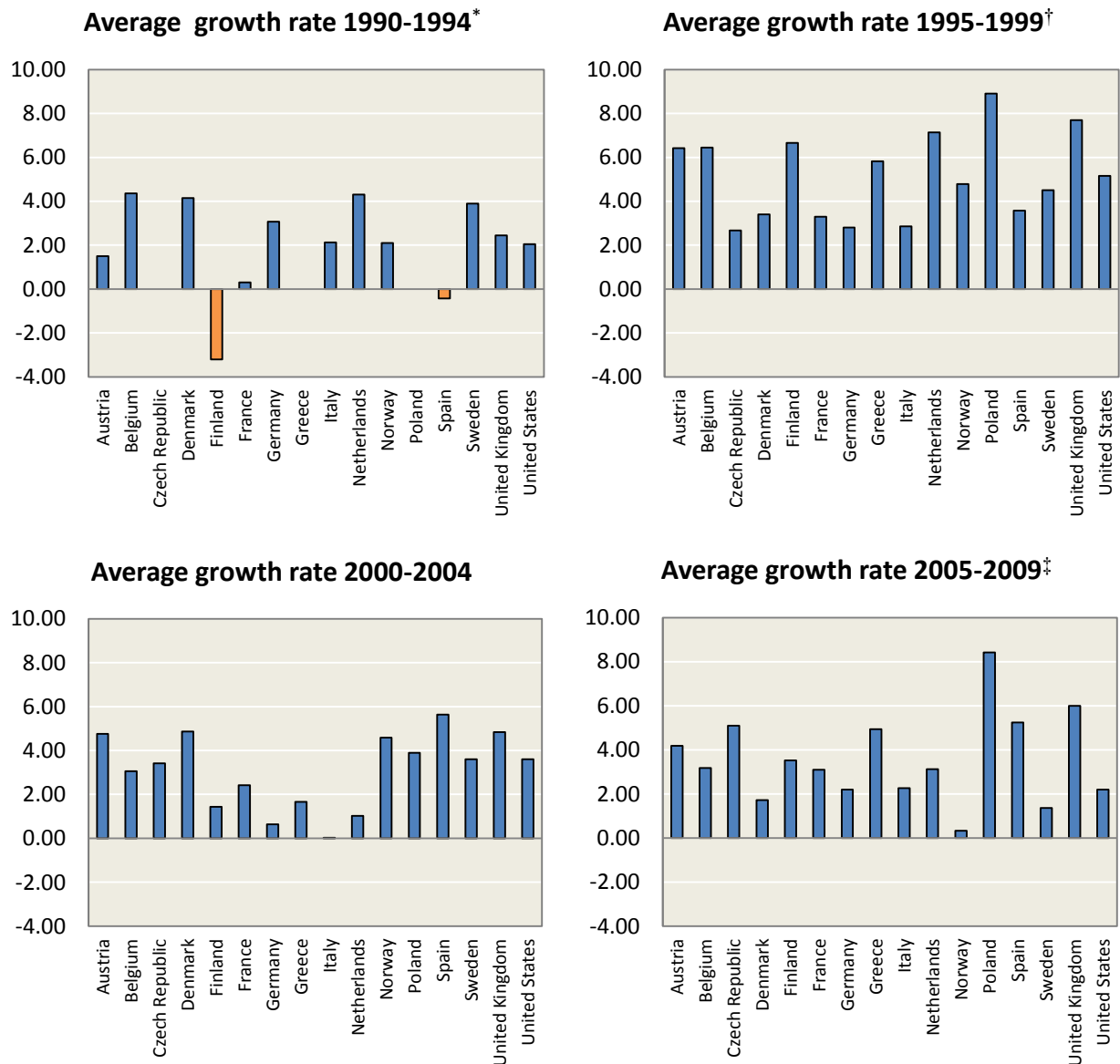
Source: Calculated from Financial Development and Structure dataset

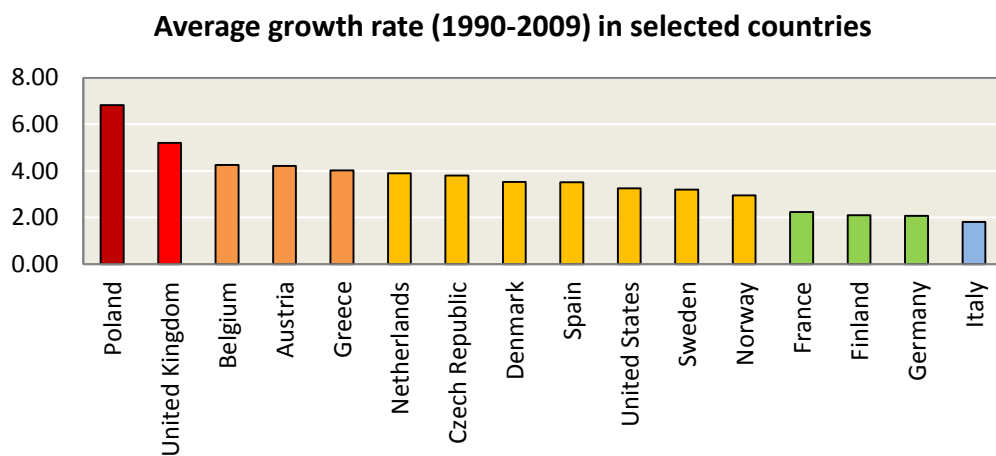
Figure 1 Employment in financial intermediation, real estate, rental and business activities (Index 1995=100).



Source: Brown, Passarella and Spencer (2015) based on OECD statistics

Figure 2 Growth rate in value added of financial sector (finance, insurance and business services) to total value added in a number of selected countries.

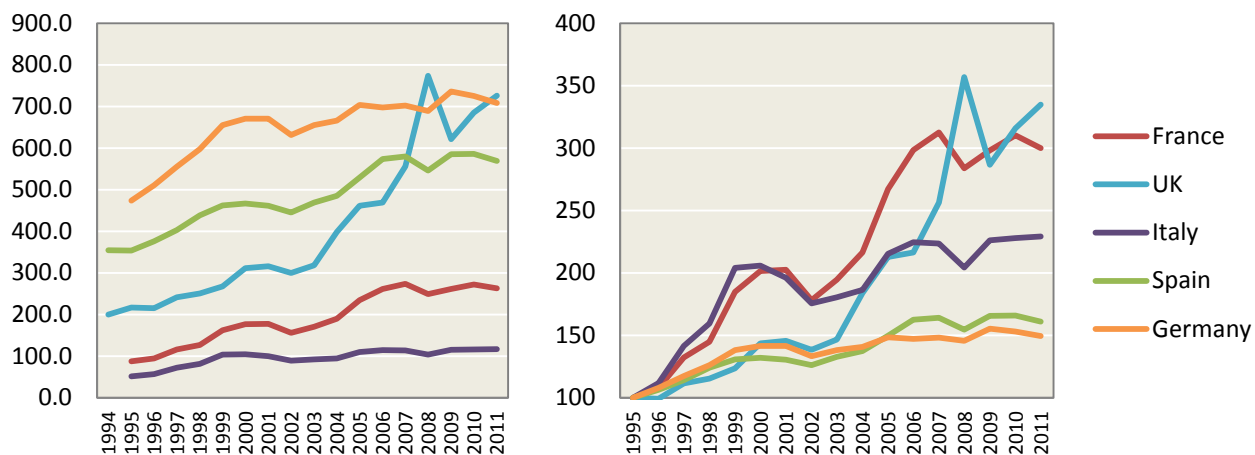




Source: Passarella (2014) based on OECD statistics (September 2013).

Notes: * Germany from 1992; Sweden only 1994; † Czech Republic, Greece and Poland from 1996; ‡ France, Poland and the UK until 2009.

Figure 3 Financial assets to GDP ratios in top-5 European economies (left-hand chart) and its trend since 1995 (right-hand chart, Index 1995 = 100).

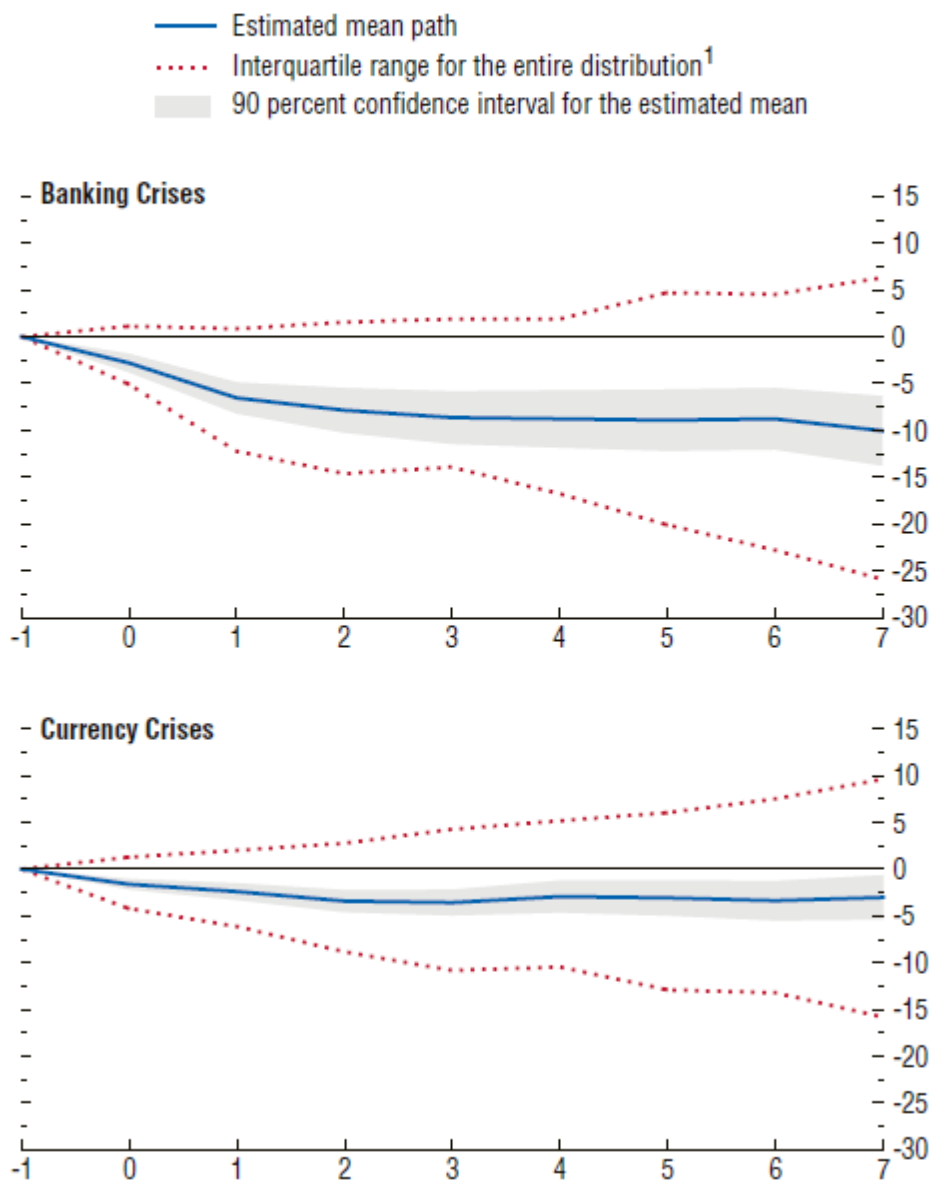


Source: Brown, Passarella and Spencer (2015) based on OECD statistics (September 2013).

Figure 4

Figure 4.4. Output Evolution after Banking and Currency Crises

(Percent of precrisis trend; mean difference from year $t = -1$; first year of crisis at $t = 0$; years on x-axis)



Sources: World Bank, *World Development Indicators*; and IMF staff calculations.

¹The interquartile range indicates the middle 50 percent of all crises.

Source: World Bank (2009)

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THE ABSTRACT OF THE PROJECT IS:

The research programme will integrate diverse levels, methods and disciplinary traditions with the aim of developing a comprehensive policy agenda for changing the role of the financial system to help achieve a future which is sustainable in environmental, social and economic terms. The programme involves an integrated and balanced consortium involving partners from 14 countries that has unsurpassed experience of deploying diverse perspectives both within economics and across disciplines inclusive of economics. The programme is distinctively pluralistic, and aims to forge alliances across the social sciences, so as to understand how finance can better serve economic, social and environmental needs. The central issues addressed are the ways in which the growth and performance of economies in the last 30 years have been dependent on the characteristics of the processes of financialisation; how has financialisation impacted on the achievement of specific economic, social, and environmental objectives?; the nature of the relationship between financialisation and the sustainability of the financial system, economic development and the environment?; the lessons to be drawn from the crisis about the nature and impacts of financialisation? ; what are the requisites of a financial system able to support a process of sustainable development, broadly conceived?

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