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Macroeconomic and financial sector policies to better serve the economy and society.

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Macroeconomic and financial sector policies to better serve the economy and society

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Abstract:

Financialisation processes have been generated by the widespread liberalization and de-regulation measures adopted in most developed and emerging economies. The result of these processes has been an unparalleled increase in the size of financial systems. Recent empirical research is showing that the relation between the size of financial system and economic activity is not a linear one and that in many countries we can talk of a an excessive size of financial systems as far as the current size of finances is well above the threshold that leads to a negative impact of finance on economic activity and growth and welfare.

On the other hand, financialisation has come in parallel, fuelling them and being fuelled by, a change in the macroeconomic policy strategy (with the dominance of a monetary policy focused on price stability), a re-distribution of income in favour of top incomes and capital incomes, and a de-regulation and liberalization of financial markets and institutions.

The paper argues that to promote a better financial system, economic authorities must adopt measures rationalizing (i.e., reducing) the size of financial markets at the same time that a more strict regulation of all financial markets and units be implemented. Moreover, the strategy of macroeconomic policy must be reformed, upgrading the current role given to fiscal policy and giving more relevance to real economic objectives, like economic growth

and full employment. Finally, there must be an income redistribution in favour of lowest incomes and labour incomes

Key words: Financialisation, macroeconomic policies, financial system, financial regulation, income distribution

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1. Introduction

The last decades have witnessed a fast growth of financial sectors in developed and emerging and developing economies. This expansion of financial sector, financial institutions and financial products, has given rise to what is labeled as 'financialisation' process. This concept encompasses not only the rising size of financial sectors, but, mainly, the rising influence of finances in non-financial agents' decision making: "financialisation means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies" (Epstein, 2005, p. 3)

However, although we are talking of a recent phenomenon typical of modern economies, "capitalist economies have always relied heavily on finance" (Brown, Passarella and Spencer, 2015, p. 6). Therefore, what actually defines, and is characteristic of, the current financialisation process is the fact that the influence of finances in the economic process, and in the political and social arenas, is significantly larger than in the past (Sawyer, 2015).

For this reason, most studies about the financialisation process begin with a definition of this process that is mainly focused in the description (and further explanation) of the consequences of financialisation instead of a precise definition of this process. Thus, for instance, for Hein and van Treeck (2010) the main consequences of financialisation would be their effects on the objectives and constraints of (financial and non-financial) corporations, mainly large corporations, with the consequent impact on corporate investment, the creation

of new opportunities and risks for families due to the larger influence of wealth and indebtedness on households' decisions about consumption; and, lastly, the impact generated in income distribution due to the change in the power relations among shareholders, managers and workers.

Fine (2013) emphasizes that the financialisation process has involved "the phenomenal expansion of financial assets relative to real activity (...); the proliferation of types of assets, from derivatives to future markets (...); the absolute and relative expansion of speculative as opposed to or at the expense of real investment; as shift in the balance of productive to financial imperatives within the private sector whether financial or not; increasing inequality in income arising out of weight of financial rewards; consumer-led booms based on credit; the penetration of finance into ever more areas of economic and social life such as pensions, education,, health, and provision of economic and social infrastructure; the emergence of a neo-liberal culture of reliance upon markets and private capital and corresponding anti-statism despite the extent to which the rewards to private finance have in part derived from state finance itself (...) the continued role of the US dollar as world economy (...) And however financialisation is defined, its consequences have been perceived to be: reductions in overall levels and efficacy of real investment (...); prioritizing shareholder value, or financial worth, over other economic and social values; pushing of policies towards conservatism and commercialization in all respects; extending influence of finance, more broadly, both directly and indirectly, over economic and social policy; placing more aspects of economics and social

life at the risk of volatility from financial instability and , conversely, places the economy and social life at risks of crisis from triggers within particular markets" (p. 6).

In a shorter, and more operative, way we can state that the main elements that define the financialisation process are: i) the rising weight and size of financial activities, sectors, institutions and products, in modern market economies, ii) the rising size of indebtedness of private agents (families and financial and non-financial corporations); and, iii) the rising influence of financial variables on the non-financial private agents' decisions on their resources allocation processes.

Having said that, it is evident that although financialisation is a common process to all developed economies, among them the European ones, and to many emerging and developing economies, and that the main reasons of this process have been the widespread policies of liberalization and de-regulation of the financial system (Sawyer, 2011; Stockhammer, 2011; Tyson and McKinley, 2014; Hein, 2015), it is true that the intensity, and the consequences, of this global process, differ markedly among countries, leading to a variegated process (Brown, Passarella and Spencer, 2015; Hein, Detzer and Dodig, 2016; Sawyer, 2015).

The existence of a variegated financialisation process is a key element to study and define, as it is stipulated at the Description of Work (DoW) of the FESSUD Project the "main policy

implications of the financial crisis of 2007/09 and the events leading to that crisis, and the policy recommendations coming from the work of FESSUD".

Throughout the research developed in the FESSUD project is clear that the origins of the current financial and economic crisis must be found in the financialisation process, and that, consequently, we cannot correctly understand the origins and the consequences of the current Great Recession if we do not pay the necessary attention to the huge development of finances that has taken place in the last decades and the consequent larger size of financial activities and the unparalleled larger size of the financial sector (Detzer and Herr, 2014; Hein, Detzer and Dodig, 2015; Hein and Dodig, 2014).

Although the elements that have triggered the financialisation of modern economies are common to all of them (the deregulation and liberalisation of financial sectors) and the consequences are similar (in terms of an unparalleled rising size of financial sectors and agents), however, in each case-country a number of different and specific elements converge that have contributed to define the particular model of development and working of the financial systems and the relations between the financial sector and the non-financial private agents, thus implying that the "processes of financialisation are not uniform across countries and time" (Sawyer, 2015, p. 4).

2. Economic impact of financialisation

Although the studies emphasize the existence of different, but simultaneous, transmission channels of financialisation (Hein, 2011), they all share the basic idea that the rising size and relevance of finances has given rise to a dramatic change in the decision making processes and the allocation resources of all agents and sectors, mainly in the case of non-financial agents, both in the case of households and non-financial corporations.

As a result of these changes, the economic growth of the countries where an intense process of financialisation has taken place would have been seriously damaged. On the one hand, corporate investment would have been negatively affected as a result of the decline in the own resources resulting of a corporate policy that favours, mainly in the case of larger corporations, the distribution of profits (dividends) instead of its allocation to increase productive investment. Moreover, productive investment would have also been damaged as a result of a generalized strategy, again mainly in the case of larger corporations, to allocate the rising resources obtained via external borrowing to the purchase of financial assets. All these mechanisms would have implied that non-financial corporations reduced their productive investments, abandoning the objectives of long-term growth of the activities of firms, thus negatively affecting the capital accumulation and the economic growth.

On the other hand, the rising household indebtedness would have led families to increase their levels of consumption and to shrink, in a parallel way, private savings (Hein, 2010 and 2011).

Therefore, the final result of the financialisation process would have been the break of the presumed positive nexus between economic growth and financialisation (or, to say in another way, financial depth, financial development, etc.); and, thus, nowadays, mainly in the case of developed countries, the economies with the largest size of finance, the excessive size (and growth) of financial sector would have a negative impact on economic activity and economic growth (Arestis, 2017).

However, we must also keep in mind that the economic consequences of the financialisation also differ among countries. In the last years, there has appeared a number of studies that argue that the relation between finance and the economic growth is not a linear-one, existing certain thresholds above which a higher size of finances would exert a negative impact on economic activity and growth (see, among others, Arcand, Berkes and Panizza, 2015; Bouis, Christensen and Cournède, 2013; Creel, Hubert and Labondance, 2014; Dabla-Norris and Srivisal, 2013; Law and Singh, 2014).

Although the estimation of the measure of the size of the financial sector that acts as a threshold regarding the impact on economic activity is debatable, the key lesson that we obtain from these studies is that the impact of financialisation on each country would depend on the respective size of the national financial systems. In this sense, the only general valid conclusions would be that the impact of a larger size of financial sector would be positive in

those economies with an intermediate size of finances, while the impact would be negative in those economies with a very large (excessive) size of finances.

The policy implications of these conclusions are clear. Countries with an intermediate size of financial sector should adopt measures to accelerate the financialisation process, thus increasing the size of financial sector (as a whole) and the size of financial balance sheets of financial and non-financial private sectors (i.e., non-financial corporations and households). Conversely, countries with large financial sectors, most of them developed economies, should adopt the opposite strategy, that is, to reduce the size of the financial sector, and, perhaps, the size of the largest financial institutions (in order to avoid systemic risks), and to reduce the size of financial assets and liabilities of financial and non-financial sectors.

However, we are aware that even in the group of developed countries with similar levels and forms of financialisation, the impact of financialisation on the economic activity and the financial behavior of financial and non-financial private agents is highly variegated. In this sense, focusing on the European Union and the Eurozone economies, Ferreiro and Gómez (2017) and Ferreiro, Gálvez, Gómez and González (2016) show the huge differences regarding the size, evolution and composition of sectoral financial balance sheets of euro countries, and the different impact of the financial and economic crisis among European Union economies.

The existence of these differences among similar and relatively homogeneous countries again reinforces the view that although the general guidelines of the policies that can contribute to a better working of financial systems in developed, in general, and European, in particular, economies must be based on the same principles, the translation to practice of these guidelines, that is the implementation of specific policies and measures in each country must be nation-based.

A lesson obtained at the studies related to the economic consequences of the financialisation processes and the economic impact of the financial and economic crisis is that the development of finances has favored the generation and growth of the size of macroeconomic imbalances, imbalances to which the classic macroeconomic (fiscal and monetary) policies have not been able to respond in an effective manner.

This phenomenon is important in the case of the European Union, in general, and, mainly, in the case of the Eurozone economies. Ferreiro, Gálvez, Gómez and González (2016) have shown that, since the creation of the European Monetary Union, the structural differences existing among the euro countries have not declined but they are even larger, a divergence process that has increased during the current Great Recession.

The existence of this process of rising divergence implies that the assumption that with the passage of time the nominal convergence that allowed the creation of the European Monetary Union would give rise to a real convergence process between the euro countries has not

fulfilled. Furthermore, the macroeconomic policies in the Euro area, both the single monetary policy and the national fiscal policies, have not been able the appearance of these imbalances, thus leading to the necessary reconsideration of these policies.

In this sense, the single monetary policy should abandon the principle of the price stability and the ECB's -main objective, adopting other real nature economic objectives related to the achievement and maintenance of a high level of economic activity that ensures a high level of employment or full employment, and the achievement of the financial stability.

Finally, regarding the fiscal policies, it would be necessary that, even in a framework of long-term sustainability of fiscal imbalances, national fiscal policies should enjoy a higher level of autonomy.

From the mentioned above, we can reach the conclusion that the financialisation process that has taken place in most developed and emerging economies, in general, and in the European Union countries, in particular, must be redefined. Abstracting form political considerations, and focusing only on economic arguments, we could accept that the changes associated to the financialisation process that have happened in the last decades, in the form of the liberalisation and de-regulation of financial systems, markets and institutions, of the change in the macroeconomic policy strategy in which monetary policy was focused on the (almost only) objective of price stability and where fiscal policy adopted a subordinated role, focused on the reduction of fiscal imbalances, and of the change in income (and wealth)

distribution in favour of top incomes and against labour incomes, had as ultimate objectives a higher welfare of the society and a higher and more sustainable economic growth.

However, these objectives have not fulfilled and, consequently, a change in these three vectors is urgently needed, re-orientating the strategy of macroeconomic policy, reverting the current pattern of personal and functional income distribution, and rationalizing (downsizing) and re-regulating the role and working of financial systems.

3. Re-regulating and rationalizing the financial system

A good (optimal) financial sector would be that better fulfils the functions that financial sector-institutions perform. Tomidajewicz (2014) points out that, acting as an intermediary, the main functions of financial sector are:

1. the function of meeting financial needs of non-financial entities,
2. a deposit function performed for entities that have financial surpluses, and
3. to provide protection against risks involved in business and other human activities

Moreover, there would be a second role played by financial institutions, being the creation of additional funds through the creation of credit money and the creation of autonomous financial deposits that enable the use of these funds

From a macroeconomic point of view, an efficient financial system must contribute to generate a high and sustained level of economic activity that ensures a high and stable economic growth. To reach this objective, financial institutions must provide an adequate, and at the lowest possible cost, amount of funding to those agents that perform high productivity real activities. The roles of intermediation and creation of credit-money must be developed in a context of financial stability, ensuring the liquidity of savings entrusted to financial institutions, reducing the risks associated to the transfers of financial surpluses to the financial system (Tomidakjewicz, 2014). Therefore, the objective of the financial stability implies, first, that problems generated in the financial system must not affect real-sector agents and, second, that problems arisen in individual financial entities must not affect the whole financial sector.

We are conscious of that view implies that the functions to be developed by the financial system are mainly of a (macro)economic nature, helping to make an effective allocation (and even generation) of resources that guarantee a stable and sustained economic growth that in turn ensure a full employment economic activity.

It is obvious that the financial system and the financial activities have an impact on income and resources allocation (among individuals, kinds of incomes, firms, industries, regions, etc.). Many of these effects can be undesirable from different perspectives (social, political, economic...), and therefore public authorities have the duty and obligation of implementing the required offsetting mechanism.

In our opinion, we cannot trust that the financial system carry out some functions that do not belong them, mainly those related to distributive elements whose responsibility belongs to public sector. In other words, financial system must not be responsible of achieving an egalitarian distribution of income, wealth or opportunities.

As mentioned above, Tomidajewicz argues that one of the main functions of financial sector is that of meeting financial needs of non-financial entities. However, as proven in a high number of studies about the evolution of global and sectoral financial balance sheets carried out along the FESSUD project, in the last decades financial sector has focused on meeting financial needs of financial entities and not only those of non-financial entities (non-financial corporations and households). Moreover, the purpose of the financial behavior of non-financial agents clearly shows that to a great extent the financial needs of non-financial agents were not based on real operations, that is, related to consumption and real investment decisions, but on the need to fund the purchase of financial assets, operations that do not have by themselves a positive direct impact on real economic activity.

In this sense, Hein (2015) points out that the re-regulation of the financial system requires of a set of measures aimed at guiding the financial sector to the real economic activity (real investment and growth of real GDP). Thus, measures are required which increase transparency in financial markets in order to reduce the problems of uncertainty, asymmetric information, moral hazard and fraud. Moreover, re-regulation should generate

incentives for economic actors in the financial and non-financial sectors to focus on long-run growth rather than short-run profits (thus involving the reduction of securitization). Finally, measures directed at containing systemic instability, like credit controls, asset-based reserve requirements and counter-cyclical capital requirements for all financial intermediaries should be introduced, and a general financial transactions tax in order to slow down activity in the financial sector should be implemented.

A key argument spreading out most work carried out along the FESSUD Project is that the normal working of financial markets and institutions does not ensure an efficient use of the financial resources leading to a high and sustainable level of economic growth. In this sense, Kregel (2015) argues that there is a substantial difference between the working of the goods and services markets and the working of the financial markets.

The recent decades have witnessed the existence of an intense (domestic and external) liberalization and de-regulation process of the financial markets. These processes were justified with the implicit assumption that a more intense liberalization of financial markets would generate not only a higher available volume of financial resources, but also a more efficient use of these resources, giving rise to higher productivity and to a higher rate of economic growth.

Contrary to this assumption, Kregel argues that in financial markets a higher competence among markets and financial intermediaries is not directly associated to a more efficient

resource allocation, in contrast with what happens in the good and services markets, where higher competence is associated to productivity gains and higher economic growth. On the contrary, in financial markets higher competence leads to lower profit margins for financial institutions. The lower profits makes that financial institutions seek business opportunities that allow them to get higher profit margins, what typically involves to assuming higher risks. This practice can have negative consequences not only on the financial entities but also on the overall economic activity and the welfare of the whole society.

As far as competition and innovation in financial markets and between financial agents is a continuous process, Kregel argues that financial regulation must be dynamic and constant, and, if possible, it should try to anticipate the changes resulting from competition (Kregel, 2016). However, regulation (no matter how effective and well-designed is) cannot prevent financial crises. Innovation in the financial system make these agents avoid, evade and adapt to the structure of regulation and intervention put in place to constrain the incoherence resulting of the 'normal' working of financial agents and markets. In this sense, the development of a shadow financial system can be understood as a "rational" response of financial institutions to avoid tighter regulations, leading to the growth of a sub-sector of the financial system, with one of its main characteristics is the lower regulation in comparison to that of the "normal" banking entities, hence the need of a tighter regulation of these

shadows entities, given the size of them (similar to those of the commercial banking system) (Herr, 2016) and the potential (individual and systemic) risks coming from these entities[1].

The argument that a higher competition does not necessarily results in a more efficient and solid financial system also pervades the analysis carried out by Elisabetta Montanaro (2015). Focusing on the European case, Montanaro argues that, with the approval in the year 1986 of the Single European Act, it was expected that the opening to international competence of the domestic financial markets would imply a stimulus to the economic activity and a consequent larger welfare. The reason behind these presumed positive consequences was that a higher competence would allow a more efficient allocation of financial resources thanks to the lower capital costs, a better access to credit and lower charges for the use of financial services. However, the resulting rising financialisation, the cross-border expansion of banks and the process of financial innovation has given rise to very fragile financial structures, mainly due to the lack of two stabilizing mechanisms: an European-level lender of last resort and a common European fiscal policy. Thus, for Montanaro, "the inconsistency between structural heterogeneities across member states and international capital mobility through cross-border banking were destined to give rise to an uneven distribution of costs and advantages of the European project of financial integration" (Montanaro, op.cit., p 10).

[1] In a Delphi study about the future of finance, a high share of the experts that participated at the study (84 percent of experts) thought that the size of non-bank financial institutions would keep on increasing in the near future, and, being more relevant and worrying, 88 percent of experts thought that shadow banking system will generate a new financial crisis in the next five to ten years (Ferreiro, Gómez and Landeta, 2016).

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The fragility generated by the liberalization and cross-border financial integration in Europe was, furthermore, exacerbated by the existence of significant differences in the national frameworks and mechanisms of domestic regulation and supervision. As a consequence, there was an increase in the possibility that shocks affecting certain national financial systems or entities, regardless the domestic or external origin of these shocks, become systemic for the whole European economy.

Therefore, the financialisation process has come in parallel with a rising financial instability. It is important to note that, as Creel, Hubert and Labondance (2014 and 2015) have shown, there is a negative relation between financial stability and economic performance, and thus financial instability would be an element exerting a negative impact on economic activity and growth.

As far as financial stability has the nature of a public good there is the need that public authorities adopt measures to preserve and maintain it. In this sense, it is necessary that these authorities adopt a combination of microprudential and macroprudential policies. The microprudential policies try to reduce the probability of bankruptcies and idiosyncratic shocks. The objective of these policies would be the protection of the consumer of financial services (investors, depositors. On the contrary, macroprudential policies try to avoid the burst of financial crises, avoiding the negative macroeconomic impact resulting of the financial stability. Thus, if in microprudential policies risks are managed at an individual level, in macroprudential policies risks are managed at an aggregate level.

Macroprudential policies are based on the acceptance of the assumption that financial system is subject to potential systemic shocks, which not only affect to financial units but also to non-financial agents (households, non-financial corporations, and even government). Therefore, is the total risk assumed by the whole financial system what matters and must be object of control and supervision by public authorities. As we will see later, this implies that the management of monetary policy be modified, because the total amount of credit and liabilities of the financial and non-financial agents must be supervised and controlled, thus assuming another objective additional to the usual macroeconomic objectives (price stability, economic activity, employment, etc.).

It is therefore evident that to ensure a higher stability in the national and European financial and banking markets, and also a more efficient allocation of the resources intermediated by these institutions, it is necessary the existence of a single regulatory and supervision mechanism, with similar rules for all the European Union members states, something that is even more necessary in the case of the euro countries. This point makes a clear connection to the needed change in the current strategy and framework of macroeconomic policies.

Nevertheless, a correct regulation of the financial systems would not be enough for guaranteeing an efficient working of them, fulfilling the objectives pointed out at the beginning of this section. As mentioned in precedent sections, the economic problems resulting of an inefficient financial system have a twofold root: on the one hand, the problems

resulting of an inefficient regulation, and, on the other, the problems resulting of an excessive size of the financial systems.

As we have mentioned before, the relation between the size of the financial system and the impact on the macroeconomic performance is not a linear one. Therefore, we need to know whether the size of the financial system has exceeded the threshold from that point on a larger size of finances exerts a negative impact on economic activity and growth (and, obviously, welfare). If we focus on the case of the European Union countries, the answer would be that such a threshold has been exceeded in most of these economies. Thus, in the year 2012, the (unweighted) mean of financial liabilities in the EMU-11 countries reached 1,088 percent of the GDP, 672 percent of the GDP in the EMU-6 countries, and 1,421 percent of the GDP in the EU-10 countries. Moreover, this size of financial liabilities had increased during the Great Recession, and thus, since the year 2008, the size of financial liabilities had increased in 114 percentage points of the GDP in the EMU-11 countries, in 111 percentage points of the GDP in EMU-6 countries, and had only declined in the case of the EU-10 countries where the size of financial liabilities had fallen in 70 percentage points of the GDP (Carrasco et al., 2016)

Creel Hubert and Labondance (2015) have concluded that the financialisation process (identified with the financial depth) has not had a positive impact on the economic growth in EU economies. For the authors, this result is explained by the fact that the level of financial

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depth in the European Union is so high that it has stopped generating positive effects on economic growth.

Accepting this conclusion implies that the economic growth in the European Union would rise if the size of finances in the EU shrinks. In the short run, a widespread de-leveraging process and reduction of the size of financial balance sheets of households and financial and non-financial corporations can negatively affect the economic activity, mainly if no offsetting measures are adopted. This impact is highly probable in the current situation. Thus, as Hein argues "stagnation after big financial crises becomes likely when the balance sheets of economic units are not quickly cleaned, when the nominal wage anchor breaks, and when there is no big and longer stimulus by the government" (Hein, 2015, p. 9).

From the above conclusion it cannot be automatically inferred that a de-financialisation process implies a stimulus to economic growth. In other words, we are not defending the hypothesis of an expansionary de-leveraging or de-financialisation process. On the contrary, as Hein argued, unless it comes with the proper off-setting measures, this process will unavoidable have a negative impact on economic activity in the short- and perhaps medium-term, and event it is doubtful the size of this offsetting impact.

What we are actually arguing is that the de-leveraging process is a necessary condition to recover path of high and sustained economic growth that allows to reaching and maintaining a level of economic activity compatible with the full employment.

To summarize, and following Herr (2016), any financial market reform aimed to reduce the inherent instability of financial system, to foster economic growth and development and to provide safe assets that allow households and firms to transfer wealth from the present to the future must include the following elements: a clear separation between commercial banks and investment banks, a tighter regulation of shadow financial system, a reduction of the leverage and the size of shadow banking, a regulation of the financing of the real estate sector, higher transparence in all financial institutions, a reduction of the size of biggest financial units that avoid the too-big-to-fail problem, the development of macro-prudential supervision, less securitization practices, allowing the trade of derivatives only in regulated and controlled markets, a decline in the role of credit agencies, and the use of tax policy to reduce asset price bubbles by strictly taxing speculative gains (Herr, 2016, pp. 22-26).

4. Redistributing income

An extended argument developed throughout the research carried out in the FESSUD project is the key role played by income distribution in the rising size and relevance of finances and as a key determinant of the negative consequences generated by the Great Recession. Thus, for some authors the financialisation process was associated to the deregulation of the financial system and to the massive redistribution of income at the expense of labour and low income households.

In this sense, Santos, Lopes and Costa (2016) in survey inquired about household socio-demographic characteristics, household income, household debt, household possessions of financial assets, perceived impact of household financial engagements, welfare provision, and perceived impact of the financial crisis and subjective well-being in five countries (Germany, Poland, Portugal, Sweden and the UK) show that the financialisation process affecting European households has increased income inequality, where the lower-income households have been the units more negatively affected by this process of rising financialisation and inequality.

This impact is more marked in poorest countries which have less developed Welfare States and social protection systems, hence the need to build up these social protection schemes for low-income people to face the risks and problems generated by the financialisation processes.

Therefore, the correction of the negative consequences resulting of the financialisation processes requires not only the necessary re-regulation of the financial system but also a change in the income distribution. A more resilient (economic and) financial system "requires the re-regulation and downsizing of the financial sector, the redistribution of income (and wealth) from top to bottom and from capital to labor, the re-orientation of macroeconomic policies towards stabilising domestic demand at non-inflationary full employment levels, and the re-creation of international and economic coordination" (Hein, 2015, p. 2).

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The change in the income distribution can be done at the primary income distribution or at the secondary income distribution. The first option implies to rise the total amount of wages paid at the economy, more specifically, that labour incomes grow faster than capital incomes, and a higher growth of lower wages.

A change at functional distribution of incomes implies a wage growth above productivity growth. This can be done with an incomes-wages policy that favours the growth of real wages. However, in the current scene in many European countries of mass unemployment this possibility is difficult to take place at least in the short-term. However, we cannot forget that income distribution and inequality is strongly related to the labour market performance, where employment destruction processes and mass unemployment are associated to more inegalitarian income distribution. Therefore, in the short and medium-term the implementation of policies to increase employment levels and to reduce the current unemployment rates to rates close to full employment would be the more effective tools to improve income distribution and a necessary condition to allow in the medium and long-term a real wage growth compatible a higher share of labour incomes in the GDP. Obviously, to reach this objective the current strategy of macroeconomic policy must be redefined and monetary and fiscal policy must adopt a high level of economic activity compatible with full employment as the main objective of economic policy.

In the case of lower wages, a possible intervention would be related to the increase (and setting them where they do not exist) of minimum legal wages, approving rates of growth of these wages above average wage increases. Although in the current scenario, there would be room for a real growth of minimum wages, we are aware that in many cases these wages are linked to low-productivity and low-skilled jobs. An excessive growth of minimum wages could lead to a strong decline in the supply of these jobs by firms. In a situation of high and sustained employment creation this would not be a problem for skilled workers, who could find a job with higher productivity (and wages). However, it could be a problem for low-productivity and low-skilled workers that could not apply and get a high productivity job. This measure could lead to create a structural unemployment process for low-skilled unemployed. For these people, it should be necessary the implementation of active labour policies that upgrade their skills and raise their probability to find a job.

A complementary approach implies the use of redistributive policies, altering primary distribution of incomes as arisen of market exchanges. For this purpose, it is necessary a more intense use of fiscal measures, based on the combined use of tax and expenditure measures.

In recent decades most developed countries, the European ones, among them, have changed the composition of public revenues reducing the size of direct taxes in favour of indirect (VAT, consumption, excises, etc.) taxes. In parallel, they have adopted measures to reduce the size of those items of public spending that are usually included in the label of Welfare State or

social expenditures. All in all, these changes in the size and composition of public budget have reduced the redistributive capacity of states in European economies and can be considered as one of the main explanations of the rising inequality in (personal) income distribution. Therefore, to revert the tendency to a higher income inequality it is necessary to redefine the size and composition of public budget. It seems obvious that a larger size of public budget (i.e., public revenues and expenditures) is a necessary condition to improve the current income distribution, mainly in those countries with a (relative) small size of public sectors. In those countries with large public sector, at least it would be necessary to alter the composition of public budgets, increasing the shares of direct taxes and social expenditures.

It is also important to notice that in many countries one of the main consequences of the financialisation process has been that the States have distanced itself of the direct provision of services that in the past were considered as a direct responsibility of public sector, like water, housing, etc. (Bayliss, Fine and Robertson, 2016a, 2016b), focusing, instead, to develop incentives for a private provision of these services. These incentives were considered as necessary to guarantee that market provision of these services generated socially desirable outcomes.

The analysis of the consequences of the privatization of public services shows that in many cases the performance of these now private services neither more efficient neither more socially inclusive (on this respect, see the different studies about the privatization of formerly

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public services carried out in the context of Work Package 8 at the FESSUD project[2]). Therefore, in many cases, States must recover the responsibility of directly providing some basic services.

5. Changing macroeconomic policies

The analyses made in previous sections implies the need to make a deep reform in the strategies of macroeconomic policies, both as regards the definition of the objectives of macroeconomic policy and the implementation of the main instruments of macroeconomic policy, i..e, monetary policy, fiscal policy and incomes-wages policies.

Regarding monetary policy, the European Central Bank, with the other national central banks, should abandon the strategy of having price stability as the main, if not only, objective of its working, playing a key role in the design of the common regulation and supervision framework. Besides the traditional objectives of macroeconomic regulation, central banks should have a larger prominence in the regulation and supervision of, at least, banking institutions, both from the perspective of the micro-prudential regulation and the macro-prudential regulation.

[2] Available at: http://fessud.eu/working-papers

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In this sense, Montanaro (2016) argues that central banks, by having focused their actions on the achievement of the objective of price stability, leaving aside the consequences of their actions on the price of financial assets or on the financial balance sheets of financial and non-financial (households and non-financial corporations), would have contributed to the surge of financialisation processes.

Behind this working of central banks, one can find the "prevailing belief that financial markets were naturally efficient and resilient, the pre-crisis consensus was that a low and stable inflation, together with "light touch" micro-prudential supervision, was also the best way to deliver financial stability" (Montanaro, 2016, p. 4). Accordingly to this view, "monetary policy should not react to asset prices bubbles, except to the extent that they affect price stability, and should only intervene after the bubble had burst" touch" micro-prudential supervision, was also the best way to deliver financial stability" (Montanaro, 2016, p. 4).

This general pattern of behavior of the monetary policy can also be found in the case of the Eurozone. With the creation of the single currency, the main objective of the European banking policy was not financial stability but freedom of competition. It was believed that the opening of national markets to foreign banks would help to complete the financial integration process, rising by itself the efficiency of the least developed national financial systems, mainly in the case of the South and Central European countries. Therefore, it was implicitly assumed that the higher competition in euro banking and financial systems, generated by the domestic and cross-border financial liberalization, and the price stability, generated by

the ECB's monetary policy, would be sufficient to generate highly efficient and resilient financial sector in the euro area. In other words, central banks, the European Central Bank among them, were working on the assumption that price stability was a necessary and sufficient condition to generate price stability.

In this sense, a vicious circle was generated between monetary policy and financial markets. Monetary policy, by focusing on price stability, would have contributed to the build-up of large financial imbalances and to an excessive size of financial sector and financial balance sheets, thus leading to a more fragile financial system. On its behalf, the changes in the size and operation of the financial markets and institutions would have contributed to reduce the effectiveness of the conventional transmission channels (among others, interest rate and credit channels) of monetary policy.

Therefore, it is clear that central banks, in European Central Bank, in particular, must include financial stability as a key objective of their monetary strategies. Before the financial crisis, central banks, as mentioned assumed that price stability would lead to financial stability. This strategy implicitly assumed either that financial systems were inherently stable, or that the causation relationship was from the real sector to the financial sector. That is, shocks originated at the real sector (regardless they had its origin at the supply side or the demand side) would negatively affect the stability of financial units. In other words, financial crises were the consequence, and not the cause, of real crises. Consequently, guaranteeing the real economy stability would lead to financial stability. As far as price

stability, by avoiding the mistakes at inflation expectations, lead to the removal of business cycle fluctuations (zero output gaps), central banks only had to focus on price stability, and the two other objectives (financial and real stability) would automatically be achieved.

However, the financial crisis that burst in 2007 has proved that price stability if not a guarantee for financial stability and that (Blot et al., 2014) there is a twofold causation relationship, and, thus, the shocks arisen at the financial sector can have an impact on real economic activity. Hence, the need for central banks to supervise the normal working of financial markets, as this a necessary condition for the real stability and include financial stability as a key objective of any strategy of monetary policy.

An essential component of the new regulatory framework is the regulation of the governance of financial corporations, setting strict limits and constraints to (at least) some financial activities and products. The development of the financial system was based on the naïve view that the market generated by itself the disciplinary mechanism needed to avoid inefficient and irresponsible behaviours. This view is in contradiction with the fact that the financial institutions were the market itself, thus questioning the possibility that a self-regulation or a self-limitation could avoid those harmful behaviours.

Indeed, the assumption of the efficiency and ultra-rationality of financial markets and institutions extended the view that financial systems could effectively discipline to non-financial private and public agents. By rising the cost of borrowing (interest rates), reducing

the amount of funds available or setting stricter conditions (in terms of collaterals, for instance) to the access of external funding, financial system would discipline non-financial agents, avoiding the generation of unsustainable financial positions, thus setting limits to the size and growth of non-financial operations.

However, the financialisation process, and the onset of the financial crisis has demonstrated that it has been the financial system itself which has grown out of control, leading to unsustainable positions and financial balance sheets, and that, consequently, self-disciplinary mechanisms, presuming that they have existed, have plainly not worked at all, hence the need of a regulatory framework originated outside the financial system.

The inclusion of regulation and supervision of banking/financial system, or, in other words, financial stability, should not be the only change in the catalogue of objectives of monetary policy. Contrary to expected, a low inflation rate is not a sufficient condition to achieve a level of economic activity compatible with full employment or to reduce in a significant way the depth and length of economic fluctuations and business cycles. Therefore, monetary policies must adopt objectives related to the achieving of high levels of economic activity and (full) employment. This could imply the setting of targets for these objectives based on ranges, in a similar way to what most central banks use for their inflation rates targets.

This new strategy of monetary policy implies that central banks should adopt a triple mandate: price stability, financial stability and real economy stability.

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But the monetary policy strategy must be amended at the level of the tools used by central banks. Since the onset of the financial crisis, and with the burst of the Great Recession, most central banks have abandoned the common practices based on the setting of official short-term policy interest rates and the provision of very short-term liquidity to banks embarking on the implementation of unconventional monetary policy measures[3] (see on this respect, Creel, Hubert and Viennot, 2014; Rodriguez and Carrasco, 2014; Serrano and Altuzarra, 2015).

The implementation of these measures, based on the provision of (very) long-term liquidity to bank units and the direct acquisition of assets issued by financial and non-financial corporations and also governments, although radically different from the usual practices of those central banks that have implemented inflation targeting (or similar) strategies since the decade of the 1990s, were part, however, of the common practices of central banks in the management of the monetary policy in earlier decades. They were abandoned due to the belief that the management of nominal short-term interest rates sufficed to stabilize inflation expectations and, consequently, economic activity. Behind this belief, there was the implicit assumption that financial markets were stable-neutral and that, consequently, the usual transmission channels of monetary policy (basically, the interest rate channel and the credit channel) worked smoothly.

[3] Bowdler and Radia (2012) even talk of "conventional unconventional monetary policy" and "unconventional unconventional monetary policy".

On the contrary, accepting that financial markets are not efficient and that they can be subject to intrinsic shocks and that these shocks can have deep consequences on real economic activity implies that "unconventional" monetary policy measures must be part of the catalogue of instruments that must be available for the normal use of central banks. As far as a stable financial markets are a necessary condition for the efficient working of monetary policy, central banks must assume the role of lenders of last resort, mainly, in periods of liquidity crises, not only for the banking sector but also for the government, thus avoiding the existence of episodes of big financial crises with a deep impact on economic activity.

Just like monetary policy strategies must be reformed, the role to be played by fiscal policies must also be revised. Before the onset of the Great Recession, the role of fiscal policies was downgraded being subordinated to that of monetary policy. This implied that, from the perspective of aggregate demand, fiscal policies should avoid the generation of fiscal imbalances in order to ensure a smooth and efficient working of monetary policy. From the point of view of aggregate supply, it was though that to achieve a high and sustainable growth of potential output it was necessary to reduce the size of the public budget (size and expenditures) and to reduce the size and shares of those items of revenues (direct taxes, mainly) and expenditures (basically, social expenditures) that were considered as non-productive and that, consequently, did not contribute to rise the productivity of capital and labour. Finally, from the perspective of income distribution, given that it was thought that redistribution from top incomes to bottom incomes could generate disincentives to the

generation and use of productive factors (i.e., labour and capital-savings), and that to foster long-term economic growth the share of capital income had to be higher, the redistributive capacity of fiscal instruments was significantly reduced, opting for kinds of public revenues and expenditures that had a low or neutral impact on redistribution.

Starting from the principle that in each society the size and composition of public budgets are the result of the preferences of their constituencies, and that therefore, there can be (marked) differences among national public sectors, fiscal policies can and must play a more active role in the achievement of economic (and social) objectives, contributing to generate a stable level of economic activity (aggregate supply and demand) compatible with full employment, real stabilization and a more egalitarian distribution of disposable income at the same time that contributes to generate a state of confidence and expectations that ensures the achievement and maintenance of these objectives in the long-term (Ferreiro, García del Valle, Gómez and Serrano, 2011).

From a long-term perspective, governments should rise the size and shares of those items of spending that have a positive impact on economic activity and growth, like can be the cases of spending on education, health, public infrastructures; R&D activities, etc.

From a short-term perspective, focusing on the capacity of fiscal policy to management economic fluctuations, fiscal policies should adopt larger responsibility in the management of business cycles, both using the existing built-in stabilizers and using discretionary

measures from the revenues and spending sides. In other words, fiscal policies must adopt a countercyclical stance in order to correct economic fluctuations arisen from supply and demand sides. Fiscal rules limiting the adoption of countercyclical stances, either limiting the size of the required fiscal deficits or surpluses or the length of these disequilibria should be removed.

The use of fiscal policies as a countercyclical tool must be, however, compatible with the long-term sustainability of public finances (Ferreiro, Gómez and Serrano, 2014a and 2014b; Ferreiro and Gómez, 2015). In this sense, it is important to ensure that counter-cyclical (expansionary) fiscal policies are implemented during recessions but also that restrictive fiscal policies be applied during booms.

Moreover, it must be ensured that public revenues ensure the sustainability of public expenditures. An extended practice among developed and developing economies, including European countries, has been the implementation of fiscal cuts (in order to stimulate the aggregate demand in the short-term, or to stimulate the aggregate supply in the long-term, or even to force a cut in public expenditures that reduces fiscal deficits). Experience has shown that this practice, first, does not lead to the expected results, and, second, that it is difficult to revert in good times, when a tax hike is justified. Given that, furthermore, fiscal multipliers of taxes are below those of public expenditures, discretionary stabilization fiscal policies should be mainly based on changes in expenditures rather than on changes in taxes, in order to ensure a sustainable path of public finances in the long-term.

As we mentioned above, the neoclassical-mainstream view of macroeconomic policy was really simplistic. The achievement of price stability was enough to achieve the objectives of real stability and financial stability, and to succeed in the objective of price stability (a low and stable inflation rate) economies only need an independent central bank with the main (if not single) objective of price stability. Reality, however, does not conform this theoretical reasoning, and, consequently, a new strategy of active monetary and fiscal policies is required to achieve a stable path of economic growth that allows the joint outcome of price, real and financial stability.

The pursue of the three objectives can, nonetheless, put an overburden on fiscal and monetary policies, as far than these two instruments must try to achieve three objectives. The problem is higher in a framework of open economies with capital mobility, where external equilibrium joins the objectives of domestic stability.

This problem is exacerbated in economies with fixed exchange rates and in monetary unions. In the former economies, monetary policy must focus on the stability of the exchange rate of the national currency. In the case of monetary unions, like the Eurozone, there is a single monetary policy for all member states, and national fiscal policies must respect some rules that ensure the needed coordination of these policies. All in all, these elements imply the existence of constraints to the capacity of economic authorities to use monetary and fiscal policies to eliminate or reduce domestics and external imbalances.

As far as wage growth is a determinant of the inflation rates and the performance of labour market, some form of controlling wage dynamics can be necessary for the achievement of the objectives of domestic and external imbalances. As Hein argues, "Incomes and wage policies should take over responsibility for nominal stabilisation, i.e. stabilising inflation at some target rate which contributes to maintaining a balanced current account, to the extent that exports and imports are sufficiently price-elastic. In order to contribute to rebalancing the current accounts, nominal wage growth in the current account surplus countries will have to exceed the benchmark of national long-run productivity growth plus the inflation target for an interim period, whereas nominal wage growth in the deficit countries will have to fall short of this benchmark during the adjustment process, however, without driving the economy towards deflation" (Hein, 2015, p. 27).

We must keep in mind that in pegged exchange rates regimes and in monetary unions, like the Eurozone, wage growths above productivity growths lead to higher unit labour costs and to a potential loss of competitiveness against partner countries where unit labour costs remain constant or where their increase is smaller. Therefore, some control of wage dynamics is required in order to avoid or correct internal (inflation, unemployment) and external (current account) imbalances.

An effective and durable wage or incomes policy must have the agreement and support of social agents (workers and trade unions in the case of a wage policy). However, the

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acceptance of such voluntary wage moderation can be a net cost for unions and workers, making difficult for these agents to offer a long-term and constant support to voluntary wage policies, making necessary the existence of some kind of economic and/or political compensation and exchange (Ferreiro and Gómez, 2014).

It must be emphasized that in monetary unions, these wages policies should be implemented symmetrically. In countries with high current account surpluses, low inflation and low unemployment rates[4], wages policies should set targets for wage growth above the productivity growth (that is, wage policies would imply higher real unit labour costs), whilst in countries with high current account deficits, high inflation and high unemployment rates, wages policies should set targets for wage growth below the productivity growth (that is, wage policies would imply lower real unit labour costs).

6. Coordination of national economic policies

Previous analysis brings to light that in an environment of intense internationalization and globalization an appropriate coordination of national economic policies is essential to guarantee a harmonious and sustained global economic growth. This coordination is even

[4] In this context, "low" means a value lower than the average for the monetary union, and "high" means a value higher than the average for the monetary union.

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more necessary in those economies where interactions are so large that put limits to the effectiveness of economic policy measures unilaterally implemented.

In the case of monetary integration processes, like the Eurozone for instance, this coordination is more necessary because, along with the freedom of capital and goods-services movements, joins the disappearance of the exchange rates and the existence of a single monetary policy for all the member states of the monetary union.

Furthermore, the experience of the Eurozone shows, first, that a monetary union alone does not lead to a real convergence process among member states, and second, that member economies can suffer asymmetric shocks, with the result that individual economies can be at the same time in different phases of the business cycle and/or, second, that the intensity (depth and duration) of national shocks may significantly be different.

Therefore, the adjustment of domestic imbalances must be addressed in a coordinated way among all member states of a monetary union. This coordination implies that economic imbalances must be symmetrically defined, thus leading to the adjustment of those imbalances in which the value of a variable is below the target value but also to the correction of those imbalances in which the value of the objective is above that target. Thus, for instance, countries with, for instance, high inflation rates (see footnote 4) of current account deficits must implements fiscal or wage policy measures to adjust these imbalances, at the same time that countries with lower inflation rates or current account surpluses must also adopt

measures to correct them (for instance, implementing an expansionary fiscal policy or setting a wage growth guideline above productivity growth). In other words, in monetary unions there must be rules and norms that ensure a symmetric burden of the adjustment of macroeconomic imbalances.

Monetary unions, and the European Monetary Union is a good example, are an evident case that the free international movement of capital is an element that contributes to generate unsustainable growth strategies and to increase the size of economic imbalances. Furthermore, we cannot forget that the expansion of national financial systems is directly related to the existence of international capital movements that allow the acquisition of financial assets but also the higher indebtedness of national financial and non-financial agents.

Lastly, we cannot either forget that international capital flows are a powerful transmission mechanism of economic shocks, making that real and/or financial crisis episodes arisen in certain countries become systemic. To ensure national and global financial and economic stability it is necessary to adopt measures to reduce the size and volatility of international capital flows, like the setting up of capital controls, tighter regulations of capital movements, or the taxation of international capital transactions. However, this can only be made under the umbrella of a coordinated international strategy that encompasses the most significant economies

7. Conclusions

Existing studies about the consequences of financialisation on economic activity point out that the relation between the size of financial system and the economic activity and growth is not a linear one, existing a threshold above which the potential positive effects of financial development would blur and, consequently, the economic activity would be negatively affected by a larger size of finances.

Furthermore, financialisation processes come with a rising financial instability, financial instability that also generates a negative impact on the economic activity and resulting in a rising economic instability.

Therefore, it is peremptory to reform the current financial systems with the objective that they have an efficient working, that is, that they effectively contribute to the achievement of a productive use and generation of financial resources and to the achievement of a high level of economic activity that ensures a full employment of all (capital and labour) productive resources subject to the smallest possible economic fluctuations. In other words, financial systems must be reformed to achieve the simultaneous objectives of price stability, economic stability and financial stability.

The different studies carried out along the whole FESSUD project share the view that the current size of the financial systems, at least in the more developed economies, which also have the largest financial systems, like it is the case of the European economies, is excessive. Therefore, measures must be implemented to reduce in the medium and long-term the size of financial systems. However, as far as the problems resulting of the financial systems come from their excessive size and their incorrect regulation, this process of shrinking financial systems must come with a more strict regulation of financial markets and entities, mainly, with a more restrictive supervision and regulation of shadow banking system

We must also keep in mind that financialisation processes have come with, and have been fuelled by, an intense income distribution in favour of top incomes and capital incomes. To guarantee a high and sustained economic growth it is necessary to revert this tendency. With this aim, macroeconomic policies must focus on the objectives of employment creation and full employment. Nonetheless, to correct the inequalities generated at the primary income distribution redistributive fiscal policy measures are also required through those revenues and public spending items with most intense redistributive impact.

The current framework of macroeconomic policy must also be reformed. On the one hand, monetary policies must reformulate their objectives including besides the objective f a low and stable inflation rate objectives related to the economic growth and full employment, but also objectives of financial stability in order to guarantee a correct working of the financial system and an appropriate transmission of monetary policy measures.

Fiscal policy must also regain a higher prominence both as a tool to manage short-term economic fluctuations and to achieve in the long-run a full employment level of economic activity. In some cases, this will involve to increase the size of public revenues and expenditures, mainly in the items with the largest redistributive impact. But, it will also imply to set up rules and norms ensuring that fiscal policy adopt a counter-cyclical stance both in recessions and in expansion phases, thus helping to achieve that fiscal imbalances be sustainable.

Incomes and wages policies must also be more intensively used in order to get a low and stable inflation rate and to adjust domestic and external imbalances. Wages policies are especially relevant in those economies with fixed exchange rate regimes and in monetary unions, like Eurozone. In the case of the latter economies, wage guidelines should be implemented linking wage growth and productivity growth.

Finally, we cannot omit the fact that in a context of rising economic globalization, national economic policies must be coordinated. This coordination implies that economic imbalances be symmetrically defined, making that countries implement the needed measures to adjust their (domestic and/or external) imbalances, regardless the sign of these imbalances

We must also keep in mind that financialisation has been fuelled by a liberalization and de-regulation of international capital movements. The reversion of financialisation processes

needs the re-structuring of international capital flows, something that will only be achieved in a context of international co-operation and coordination.

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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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THE PARTNERS IN THE CONSORTIUM ARE:

Participant Number	Participant organisation name	Country
1 (Coordinator)	University of Leeds	UK
2	University of Siena	Italy
3	School of Oriental and African Studies	UK
4	Fondation Nationale des Sciences Politiques	France
5	Pour la Solidarite, Brussels	Belgium
6	Poznan University of Economics	Poland
7	Tallin University of Technology	Estonia
8	Berlin School of Economics and Law	Germany
9	Centre for Social Studies, University of Coimbra	Portugal
10	University of Pannonia, Veszprem	Hungary
11	National and Kapodistrian University of Athens	Greece
12	Middle East Technical University, Ankara	Turkey
13	Lund University	Sweden
14	University of Witwatersrand	South Africa
15	University of the Basque Country, Bilbao	Spain

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