



EUROPEAN POLICY BRIEF



FINANCIALISATION ECONOMY SOCIETY AND SUSTAINABLE DEVELOPMENT

The processes of financialisation

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INTRODUCTION

Financialisation

Financialisation involves the growth of the financial sector in the economic, the social and the political spheres. The processes of financialisation have major consequences for economic performance, social well-being and the environment. This policy brief focuses on the forms which the processes of financialisation have taken over the past three and a half decades in a wide range of European economies (and USA and South Africa). It discusses the ways in which the financial sector has grown in importance and its institutions evolved. It is argued that the processes of financialisation have been universal in the countries examined (and more generally) but the pace and forms of financialisation have differed – this leads us to coin the term ‘variegated financialisation’.

The processes of financialisation in the recent era

The term ‘financialisation’ is designed to refer to the roles of finance in and of itself and also the economic, social and environmental embedding of finance in the system as a whole. The term also relates to the growth of finance and of the financial sector (relative to the economy). Financialisation has long been a central feature of capitalist economies. In our studies the focus is on the present era of financialisation which many would date from circa 1980. Each period of financialisation has had its own characteristics and effects. There are several features which are often seen as distinguishing the present era of financialisation since circa 1980. In our work a starting list of features has been used to enable further work and investigations to be undertaken.

The first feature identified is the rapid expansion of financial institutions and financial markets. This feature has been shared with earlier periods of financialisation. It has, however, been particularly noted that financial markets have grown in relative importance as the range of financial assets being traded expands. The development and growth of derivatives and of securitisation are specific ways in which the range of financial assets has grown. The volumes of trading and the turnover of financial assets have also grown rapidly. There have been dramatic rises in the ratio of financial assets to GDP and also of financial liabilities to GDP, at the national and global levels.

The second feature has been the general de-regulation and liberalisation of the financial system. This has gone alongside the general trends towards de-regulation of the economy. Financial liberalisation has involved de-regulation of domestic financial systems and liberalisation of capital movements between countries. Pressures from the financial sector to throw off the restrictions of its operations have played a major role in the de-regulation policies. Mainstream economics and finance theories have helped the promotion of financial liberalisation through theories which viewed regulation as ‘financial repression’ constraining savings and investment. De-regulation is viewed by mainstream theories as promoting innovation and efficiency. Other scholars have though pointed to the

de-stabilising effects particularly in the form of unsustainable credit booms. This era of financialisation has involved a

Thirdly, the present era of financialisation has involved the expansion and the proliferation of financial instruments and services. It has been associated with the birth of a whole range of financial institutions and markets, developing and trading a spectrum of new financial instruments with corresponding acronyms, and which are bewilderingly complex. The complexity of the financial instruments has meant that the risk evaluation of the financial instruments becomes virtually impossible. The development and growth of financial derivatives and securitization (such as mortgage backed securities) has been particularly significant in their consequences for risk and financial crisis.

At a systemic level, financialisation has been located in terms of the dominance of the financial sector over industry which is the fourth feature. Non-financial corporations have necessarily been caught up in the process of financialisation as they have increasingly derived profitability from their financial as opposed to their productive activities. Financial institutions increasingly become owners of equity. The pursuit of shareholder value has been widely adopted through the interests of financial institutions. There are implications, generally adverse, for the levels of investment and innovation by corporations from the pressures for the pursuit of short-term profits and dividends.

Fifth, the present era of financialisation is strongly associated with market mechanisms, neo-liberalism and globalisation. Globalisation and financialisation have seen much greater capital flows between countries and gross flows on a much greater scale than net flows. The period of financialisation has also been associated with generally rising inequality over the past three decades. This has been well documented, in for example, OECD, *Growing Income Inequality in OECD Countries: What Drives it and How Can Policy Tackle it?*, Paris: Organization for Economic Co-operation and Development. The financial sector itself contributes to inequality through, for example, payment of large bonuses. In many countries the wage share has declined substantially, with consequent effects on the level of aggregate demand. Rising income inequality has been seen adding to pressures for consumer credit to maintain consumption levels.

Sixth, there has been substantial rises (relative to income) of household borrowing and the extension of credit. Household debt to income ratios have generally rise. Rising property prices, particularly in the years preceding the global financial crisis, enabled the use of housing as collateral for borrowing.

Seventh, there is the penetration of finance into a widening range of both economic and social reproduction – housing, pensions, health, and so on, has been a continuing feature of financialisation, leading to societal transformation. For example, a trend away from social provision of pensions to private provision through funded schemes draws people into complex financial decisions and expands the scale of the financial sector.

Finally, financialisation is associated with a particular culture which is to be interpreted broadly. It ranges, for example, from the shifting from admiration and envy to antipathy to those who work in finance, but equally is attached to an ethos of reliance upon the market and the use of the state merely as an agent of last resort. The material culture of financialisation is much more than a set of ideas or images, or an ethos of being for or against the market, but is closely integrated with the public and private institutions that have evolved during the course of the rise of finance itself.

In the FESSUD project, up to 20 large studies on the financial systems of a wide range of EU and others countries (USA, South Africa and Turkey) were undertaken (and published as [FESSUD Studies in Financial Systems](#)). These studies track the ways in which the financial systems in these countries have evolved since circa 1980 (for obvious reasons since 1990 for central and Eastern European countries). In addition, these countries have been studied on the ways in which the financial system was related to the financial crises of 2007-09. The studies provide a wealth of information which enable us to track the processes of financialisation in the countries concerned to discern common trends and country differences.

There has been, as would be anticipated, growth of the financial sector as measured by value added. In Table 1 below, our classification is that in none of the countries observed did the financial sector decline relative to the economy as a whole. In five countries,

the growth of value added in the financial sector relative to the non-financial sector grew on average by less than 2 per cent per annum and was judged as 'stable or variable'. In three countries, the growth of the financial sector relative to the non-financial was judged as 'moderate' at between 2 per cent per annum to 4 per cent. Faster growth ('boom conditions') applies in the Central and Eastern European countries included and six others.

With a broad definition of the financial sector (FIRE finance, insurance and real estate), the share of employment in the financial sector has grown in all the selected countries since the early-1990s, the only exception being Japan. Benelux countries and the UK are the economies with the highest employment share in finance (all above 20% since the mid-2000s), followed by France and the US. Germany's share of employees in the financial sector is rather high too. Italy represents a sort of middle-ground (around 15% in 2010), whereas the other Mediterranean countries and the Central and Eastern European countries (CEECs hereafter) still show a lower share of employment in the broadly-defined financial sector. In recent years Hungary, Estonia, Slovenia, Poland, and Slovakia, are the countries in which employment in the financial sector has been growing rapidly since 1995. By contrast, early-financialized European economies (along with Portugal) are those in which that the employment share of finance has been growing slowly.

With a narrower definition of 'financial sector', no clear trend in the employment share shows up. For instance, the broadly-defined financial sector is one of the largest employers in the French private sector. But if one excludes the real estate, rental and business activity, the share of finance in total employment turns out to be rather low and stable (in the range of 1.6-1.8%) since the mid-1990s. Similarly, in Germany the share of employment in the narrowly-defined financial sector fluctuates in a range of 1.5%-2.2% since the 1990s and is even decreasing. In Italy, the maximum percentage of employees in the monetary and financial services sector reaches 2.78% in 1994 and decreases to 2.57% in 2010. In Spain, the share of employment in the financial sector is rather stable (around the figure of 2.5% of total employment in the last decade). In Portugal, financial activities register a marginal decrease in importance in terms of employment (from 3.1% in 1995 to 3.0% in 2011), even though the employment share of the financial sector in the broad sense is relatively stable. In Greece, the total number of employees in the financial sector increases until

2009 and then reverses, whereas the share of total employment starts to decline earlier (from 2.29% in 1995 to 2.53% in 2000 and then to 2.35% in 2009)

There is no clear dynamic in the profitability of the banking sector. Instead, there is a high degree of volatility in the measures considered. This reflects the effects of the dot.com crisis of the early 2000s and, above all, the recent global financial crisis, which have heavily affected rates of return of both equity and total assets of the banking sector.

The size of the banking sector, measured in terms such as the ratio of bank deposits to GDP, has generally also risen. There has also been (particularly prior to the financial crisis of the market valuation of financial assets relative to GDP). Within the general increase of the banking sector and of the stock market, the growth of the stock market has tended to be faster than of the banking sector. The commercial banks provide a payments clearing system and serve to link enable savings to be linked with investment requirements. In contrast, the fast growth of financial markets, involves the development of and extensive trading in financial assets, which does little to facilitate savings and investment. The activities of the financial sector have shifted in a way which does not encourage savings and investment, and thereby growth.

The rising indebtedness of households is common across all the countries examined. The composition of the indebtedness in terms of the roles of mortgages and housing loans and consumer debt does vary substantially between countries. By 2008, the median ratio of household debt to disposable income was close to 100 per cent (across OECD countries). In all that ratio had risen. Since the financial crisis that ratio had flattened off with a mixture of rises and falls across countries.

In summary, based on the measures used, there is evidence that EU member-States and the other economies considered have gone through a process of financialisation in the last three decades, and this process has affected their economic and social structures, materialising in a variety of different historically- and geographically-related forms.

Table 1. Relative trends in a number of financial dimensions since the early 1990s.

Variable	Trends			
	Decrease	Stable or variable	Moderate increase	Boom
Employment in Financial Sector to Total	Germany, Romania	Greece*, Portugal*, Spain, Italy, France	Turkey, UK, USA, Sweden, South Africa	Central and Eastern European countries (except Romania)
Value Added of Financial Sector to Total		Germany, Italy, Spain, Finland, France	Spain, Portugal, Greece	UK, Netherlands, Ireland; Central and Eastern European countries; South Africa, Turkey
Value of Financial Assets to GDP			Germany, Italy, France, USA, Greece, Central and Eastern European countries	Luxembourg, Netherlands, Ireland, UK, Portugal
Bank profitability (ROE and ROA)*	Netherlands, Spain, Ireland, Greece, Hungary, Denmark	Rest of countries		
Household debt (consumer credit & house mortgages)		France, Germany, Italy	Portugal, Spain, Greece	UK, USA, Central and Eastern European countries

Source: OECD, Eurostat and FESSUD country reports (2013). Notes: * data start from 1997.

ROE: rate of return on equity

ROA: rate of return on assets

Financialisation is particularly evident across countries and time in the measure of household debt and consumer credit. Rises in household debt (relative to GDP and household income) have been widely observed over the past three decades. Household mortgage loans showed increasing trends in Europe over the two decades before the financial crisis, though with varying speeds depending on the structures of the housing finance markets. In many cases, growth of mortgage loans was associated with a construction boom and/or rising property prices which proved unsustainable. Consumer credit also showed increasing trends. The rising household debt has helped to support the level of aggregate demand but at the expense of instabilities when debt bubbles burst.

A surprising finding in Table 1 relates to profitability where the trends of bank profitability are broadly constant or decreasing. It has often been a perceived feature of financialisation that financial sector profits have risen at the expense of non-financial sector profits. These statistics do though refer to banks and do not encompass the broader financial sector and the degree to which the profits of the financial sector were dependent on rising asset prices.

These findings confirm many of the broad trends which have been linked with the notions of financialisation. There are other trends such as the pursuit of shareholder value in situations where financial institutions are the shareholders and

The countries examined have all been moving in the direction of financialisation with no evidence of de-financialisation. But Table 1 illustrates the difference speeds of elements of financialisation between countries. There are a great deal more information and analyses available in the individual country reports, and these are complemented by the studies on the financial crisis in individual countries. We interpret our findings alongside the idea of **variegated financialisation**. There is increasing dominance and influence of finance across the globe and financialisation has been (and continues to be) a general phenomenon. It is though not a homogenised set of processes – similar forces can be at work but national institutions, governments. Yet, figures and analyses provided by FESSUD country

reports seem to suggest that in most of the economies considered there has been a deep penetration of finance into a wide range of both economic and social reproduction spheres. The increasing dominance of finance over industry (in terms of both value added share and dominant culture – here the dominance of the shareholder value maximisation model is key), the booming value of financial assets, the multiplication of financial instruments and financial operators, the increasing weight of credit- and asset-led consumption, and the growing reliance of real economies on the growth of financial market, are clear signs of this process. On the whole, the quantitative indexes considered confirm the growing weight of the financial sector in the nation considered since the 1980s, even though the recent global financial crisis has heavily affected financial profitability. In the aftermath of crisis, there is no sign that the importance of finance has been diminished – indeed recovery in many countries has relied on some form of finance-led growth.

RESEARCH PARAMETERS

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?

PROJECT IDENTITY

PROJECT NAME	Financialisation Economy Society and Sustainable Development (FESSUD)
COORDINATOR	Professor Malcolm Sawyer. University of Leeds, UK. Email: fessud@leeds.ac.uk
CONSORTIUM	University of Siena, Italy School of Oriental and African Studies, UK Fondation Nationale des Sciences Politiques, France Pour la Solidarité, Brussels, Belgium Poznan University of Economics, Poland Tallin University of Technology, Estonia Berlin School of Economics and Law, Germany Centre for Social Studies, University of Coimbra, Portugal University of Pannonia, Veszprem, Hungary National and Kapodistrian University of Athens, Greece Middle East Technical University, Ankara, Turkey Lund University, Sweden University of Witwatersrand, South Africa University of the Basque Country, Bilbao, Spain
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WEBSITE	fessud.eu
FOR MORE INFORMATION	Helen Evans: fessud@leeds.ac.uk
FURTHER READING	Andrew Brown, Marco Veronese Passarella, and David Spencer, <u>The nature and variegation of financialisation: across-country comparison</u> , FESSUD Working Paper Series No 127 FESSUD Studies on Financial Systems available at http://fessud.eu/studies-in-financial-systems/