The Cambridge Trust for New Thinking in Economics

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Financialisation of the global economic system, past, present and future: its relevance to austerity economics

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Outline

- “Financialisation” and the literature explaining the phenomenon
- Internal and external expansion as financialisation spread over institutions, countries and sectors since the 1980s
- Prospects for ending financialisation as a burden on the economy
- Policies for crisis management and for revering and ending financialisation

Introduction

- Global financialisation: the gradual spread of the power and influence of the financial sector and financial thinking throughout the global economy
- The financial sector: banking, including shadow banking, savings and loans, mortgaging, currency exchange and commodity financial markets, insurance, financial services
- Austerity, post-2007, is the result of a “bankers’ ramp”, the outcome of 30 years of creeping financialisation of the system, including economic policy
- The approach is to explore how financialisation has spread from it’s core in London and New York in the early 1980s, both in relation to the rest of the economy (internal growth) and affecting other countries and sectors (external growth) and how it will end

The Literature on Financialisation

- The theory of financialisation in the literature can be divided into
  - a Marxist form of capitalist dynamics
  - the Neo-liberal outcome of free market operations
  - an example of Post Keynesian institutional capture
- Each explanation is valid in some respects, but the "capture" theory is the best: the sector has flourished through deregulation and globalisation, spreading into the unregulated areas of the global market and eventually becoming above and beyond the law
- The ability of banks to create money has been exploited by the banking system to take resources away from other sectors to such an increasing extent that collapse eventually becomes inevitable

Why the Marxian Analysis is wrong

- Financialisation is not a result of class conflict or the capitalists exploiting the workers
  - the bankers are speculating with other people's money
- The endgame is not collapse of the system: governments have a choice in confronting the banks
- The problem is not teleological, but system loss of control of money creation by governments to the international banking system

Why the Neo-liberal Analysis is Wrong

- Financialisation is not the result of unrestrained free market activity
- Instead the banking system has found a way to create money independently of Central Banks and regulators
- Bankers have exhibited greed that is unrestrained by ethics or national or international law, but their behaviour does not necessarily lead to financialisation
- The failures are those of

1. ineffective and inadequate regulation by governments and
2. corruption of the power structure by the bankers

Financialisation of the economic system: internal to the financial sector

- The sector spread out from London and NY into other regions and countries and became larger in nearly all countries
- Growth of intra-industry trade in financial services (sales from one firm to another within the sector)
- Growth of employment and productivity, growth of number of traders, numbers of financial companies
- Growth of the scale of financial operations as more activities are out-sourced to customers via ATMs and on-line automatic services
- This growth is poorly measured in the SNA 1993 onwards because the difference between interest paid by the sector and interest received is treated as productive, when it is not necessary so (Assa, 2015)

Financialisation of the economic system: external to the financial sector

- The sector also spread its influence to other sectors of the economy
- Growth of inter-industry trade of financial services (excluding own sector)
- Purchases of legal services, IT services, land and buildings
- Sales to other industries, government and personal consumers
- % graduates recruited to the financial sector
- Increasing specialisation in companies in finance: Financial Directors and Departments

Prospects for ending financialisation: Internal – a succession of crises

- The dynamics are such that financialisation will proceed apace until it collapses in a crisis of confidence
- The system becomes more unstable as the burden of debt grows in relation to the underlying securities
- Any weakness or failure in an individual bank is liable to bring down the whole system because of the increased interconnectedness of the banks

Policies for the Crisis

Three Phases of Crisis Management

1. Short-term: Immediate Damage Containment
2. Medium-term: Restructuring Insolvent Banks
3. Long-term: Systemic Restructuring

Traits of good strategies (Ergungor, 2007)

1. Transparent, early recognition preserves trust
2. Politically and financially independent agencies
3. Maintain market discipline (e.g. Enron)
4. Repair the real economy especially creditworthiness

None of these strategies have been fully followed in the current crisis through lack of international agreement

Prospects for ending financialisation: external – policies to balance the economy

- Financial transactions tax and other taxes on turnover may begin a gradual reduction in unproductive activities
- Radical changes in the regulations leading to separation of routine domestic consumer banking from investment banking would reduce speculation
- The break-up and de-merging of the global banks into smaller banks, specialised by function, industry, or region would allow for bank failures
- Strengthening of the global interbank payments system as an independent intergovernmental agency

A return to normal?

- very unlikely - shadow banking continues to grow
- "the new normal" is a series of crises and stagnation with banks "too big to fail"
- the system is now more fragile than in 2009
  - increasing shadow banking
  - fluttering prices and threat of deflation
  - failure of monetary policy and QE
  - weak fiscal policy and increasing inequality