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There's Something Happening Here

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Abstract

“Financialization” is the latest, and probably most widely used term by analysts trying to “name” and understand the contemporary rise of finance and its powerful role. The term had been developed long before the crisis of 2008 but, understandably, since the crisis hit, it has become even more popular. This vast and rapidly expanding literature on financialization has a number of important strands. Some of the literature focuses on clarifying the definition of financialization, and assessing whether it is a dominant cause of the ills confronting capitalism or is just a symptom of other, deeper causes; some asks whether financialization is a new “phase” of capitalist development, perhaps a new “mode of accumulation”, or considers whether it is just one among a number of important developments along with “neo-liberalism”, “digitization” and “globalization” that are arising in the contemporary world; other literature is focused on less theoretical and more empirical matters, trying to measure the nature and extent of financialization, however defined, and to describe its institutional and economic dimensions; and still other work is focused on attempting to analyze theoretically and empirically the impact of financialization on important phenomena such as financial crises, productive investment, productivity growth, wages and income distribution; and finally, other parts of the literature are more policy-oriented, trying to grapple with policies and structural changes that can improve the role that finance plays in the economy. There are still many conundrums and open questions about “financialization” which means it will remain a fruitful area for multi-disciplinary research and an important arena for political battles and structural reform for the foreseeable future.

Keywords: financialization, short-termism, financial crisis, inequality

JEL Codes: B5, E320, G3

“There’s something happening here...But what it is ain’t exactly clear...”

--“For What It’s Worth,” Buffalo Springfield, 1966

I. Introduction

For anyone who didn’t know already, the Great Financial Crisis of 2008 made it completely obvious that finance has become a powerful force in our economy. Unfortunately, among those largely in the dark on the eve of the crisis were most of the mainstream macroeconomics profession as well as many regulators and practitioners operating in the financial market itself. This is because, in the post-war period, the thrust of the mainstream analysis was designed to demonstrate that financial markets were either irrelevant to macroeconomic outcomes, or, by facilitating the efficient allocation of resources, a potent force for efficiency and growth (Taylor, 2010; Crotty, 2009). The idea that finance could cause the virtual meltdown of the global economy was foreign to their theories and far from their minds.²

For heterodox economists, by contrast, at least since the work of the late Hyman Minsky, this fact had been well known. In the 1970’s, Hyman Minsky introduced the role of financial instability in the inherent dynamics of the economy and by 1992 had introduced the term “financial instability hypothesis” to refer to the inherently contradictory role of borrowing and lending in the course of the business cycle and on economic crises.³ Over the course of the next several decades, heterodox economists expanded their analyses of finance further. By the 1980’s and 1990’s, they were acutely aware that the size, nature and scope of finance had begun to grow enormously and that it was having much broader impacts on the economy than simply on the business cycle and economic crises: finance seemed to be changing the whole character of the economy and possibly even society itself. Minsky started writing about the rise of “money manager capitalism” suggesting a whole new phase of capitalism that was characterized, in particular, by the type of financial relationships that dominated the economy. Others also began to identify the very nature of the current form of capitalism with the type of financial relations that were dominant in them. Some went as so far as to argue that these financial relations not only structure our economy, but our very language and culture as well. Gerald F. Davis referred to a “portfolio society”, “in which the investment idiom becomes a dominant way of understanding the individual’s place in society. Personality and talent become “human capital”, homes, families and communities become “social capital” and the guiding principle of financial investment spread by analogy far beyond their original application.” (Davis, 2009, p. 6).

² Mainstream macroeconomics was not always so ignorant of the important role of finance. In the 1920’s and 1930’s, economists from many traditions, including Hayek, Fisher, and, of course Keynes, were trying to understand the role of financial institutions and markets in financial booms and busts; and others, including Joseph Schumpeter, were trying to analyze the role of finance in long-run economic growth.

³ Harry Magdoff and Paul Sweezy, sometimes called by short-hand, *The Monthly Review School*, in reference to the Marxist journal they founded and edited for many years, were among the first post-war scholars writing in depth about the important role of dominant finance in the structure of the macroeconomy.

“Financialization” is the latest, and probably most widely used term by analysts trying to “name” and understand this contemporary rise of finance and its powerful role. The term had been developed long before the crisis of 2008 but, understandably, since the crisis hit, it has become even more popular. This vast and rapidly expanding literature on financialization has a number of important strands. Some of the literature focuses on clarifying the definition of financialization, and assessing whether it is a dominant cause of the ills confronting capitalism or is just a symptom of other, deeper causes; some asks whether financialization is a new “phase” of capitalist development, perhaps a new “mode of accumulation”, or considers whether it is just one among a number of important developments along with “neo-liberalism”, “digitization” and “globalization” that are arising in the contemporary world; other literature is focused on less theoretical and more empirical matters, trying to measure the nature and extent of financialization, however defined, and to describe its institutional and economic dimensions; and still other work is focused on attempting to analyze theoretically and empirically the impact of financialization on important phenomena such as financial crises, productive investment, productivity growth, wages and income distribution; and finally, other parts of the literature are more policy-oriented, trying to grapple with policies and structural changes than can improve the role that finance plays in the economy.

In the rest of this chapter I present the most widely used definitions of financialization and introduce the main ideas and debates associated with the concept. In section III, I discuss the dimensions of financialization with primary reference to the US but add occasional discussions of financialization in other countries. Section IV is devoted to discussing the impacts of financialization on various important aspects of the economy including investment, employment and income distribution. Section V concludes.

To anticipate our main conclusion, it is this: as the famous line from Buffalo Springfield says, with financialization we know that something important is happening here. We just don’t know yet exactly what it is.

II. Financialization: Definitions and Brief History of the Concept

As discussed by Malcolm Sawyer (2013), the term financialization goes back at least to the 1990’s and probably was originated by Republican political operative and iconoclastic writer Kevin Phillips, who first used the term in his book *Boiling Point* (New York: Random House, 1993) and, a year later, used the term extensively in his *Arrogant Capital* in a chapter entitled the “Financialization of America”. Phillips defined *financialization* as “a prolonged split between the divergent real and financial economies (New York: Little, Brown and Co., 1994). (Sawyer, 2013, pp. 5-6).

Scholars have adopted the term, but have proposed numerous other definitions. Sociologist, Greta Krippner, for one, gives an excellent discussion of the history of the term and the pros and cons of various definitions. (Krippner, 2005, 2012) As she summarizes the discussion, some writers use the term “financialization” to mean the ascendancy of “shareholder value” as a mode of corporate governance; some use it to refer to the growing dominance of capital market financial systems over bank-based financial systems; some follow Hilferding’s lead and use the term financialization to refer to the increasing political and economic power of a particular class

segment, the rentier class; for some financialization represents the explosion of financial trading with myriad new financial instruments; finally, for Krippner herself, the term refers to a “pattern of accumulation in which profit making occurs increasingly through financial channels rather than through trade and commodity production”. (Krippner, 2005, p. 14).⁴

I have defined the term quite broadly and generally as: “the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies.” (Epstein, 2005, Introduction). This definition focuses on financialization as a process, and is quite agnostic on the issue of whether it constitutes a new mode of accumulation or broadly characterizes an entire new phase of capitalism. Broad definitions like mine have the advantage of incorporating many features, but have the disadvantage, perhaps, of lacking specificity.

Other analysts have used variations on the term financialization to refer to more or less the same set of phenomena. Tom Palley has used the term “neo-liberal financialization” in his writings to emphasize the importance of neo-liberalism as part and parcel of the rise of financialization (Palley, 2013a, p. 8) Some have not referred to financialization but to “finance-dominated capitalism” (Hein, 2012; Sen, 2014; Palley, 2013a, chapter 1).

The use of the term “neo-liberalism” signals a topic of much discussion and debate in this literature: what is the relationship between financialization, globalization and neo-liberalism three forces that virtually all analysts in this area agree have had profound impacts on the evolution of our economy. (see Kotz, 2014, Dumenil and Levy, 2005, Lapavitsas, 2013)? The main issue is determining the key driving force in contemporary capitalism, and distinguishing it from the subsidiary, or less important, forces. This literature, though interesting, is ultimately unresolved: in fact, since these phenomena have all arisen more or less together since the 1980’s, it might be impossible, to settle this debate.

Another important debate is on the periodization of “financialization”. Is it only a recent phenomenon, say, important since the 1980’s? Or does it go back at least 5000 years, as Malcolm Sawyer has suggested? (Sawyer, 2013, p. 6).⁵ If it goes back a long time, does it come in waves, perhaps linked with broader waves of production, commerce and technology or is it a relatively independent process driven by government policy such as the degree of financial regulation or liberalization (see Vercelli, 2013, Arrighi, 1994, Krippner, 2012, and Orhangazi, 2008a, 2008b). Arrighi famously argued that over the course of capitalist history, financialization tends to become a dominant force when the productive economy is in decline, and when the dominant global power (or “hegemon”) is in retreat. Think, for example the early 20th century when Great Britain was losing power relative to Germany and the US, and the UK economy was stagnating. This was a period also of a great increase in financial speculation and instability. (See also Orhangazi, 2008a and Pollin, 1996).

This historical discussion has also melded into a more contemporary discussion of the causes of financialization. There is a big debate about whether the current wave of financialization is due

⁴ See also Costas Lapavitsas (2013) and Ozghur Orhangazi (2008) for important contributions.

⁵ Sawyer was apparently inspired in this statement by David Graeber’s monumental book, *Debt: The First 5000 Years*. London: Melville Press, 2011.

to the liberalization of financial markets starting in the 1980s, or whether it reflects the reduced profitability and stagnation in the non-financial (the so-called “real”) economy. In latter case, it is argued, financiers are forced to find other ways to make profits, and they turn primarily to dangerous speculation in the financial sphere. In short, the question is whether financialization is due to changes in the nature and regulation of the financial sphere or is it primarily due to profound structural problems in the non-financial economy, including foreign trade and relative global power.⁶

A related argument is whether the current phase of financialization is due to the massive increases in income and wealth inequality which has led to the need for massive household borrowing and provided the wealth for rich people to invest.

One policy implication of this debate is that if financialization is a purely financial problem, it might be easier to “fix” “simply” through financial regulation and financial restructuring; if the problems stem from the “real” economy, wealth distribution and the global distribution of power, then “fixes” might not be so easy, and in particular, might require dramatic changes in the very structure of contemporary capitalism and global political economy.

The final set of debates mentioned here concern the impact of “financialization” on the economy and on those who inhabit it. Those heterodox economists and sociologists who have analyzed “financialization” have generally taken a quite critical view of the impact of financialization on the economy. Prior to the GFC, some suggested that financialization might provide a viable system of regulation and growth (Boyer, 2000). But most analysts identified a number of key problems associated with financialization: among these problems cited by these analysts are increases in economic instability, increased short term orientation, reduced long-term investment in equipment, innovation, infrastructure and human capital and an increase in income and wealth inequality. Still, there is no consensus on the precise dimensions of these problems and to what extent they should be attributed to financialization or other factors such as neo-liberalism, digitization or globalization.

These broad issues and debates are fascinating and provide frameworks and agendas for investigating key questions with respect to the dynamics and impacts of financialization. But, in my view, among the most important contributions made in this literature are in the empirical realm, that is, empirical and historical studies that have looked at the dimensions of financialization, its key institutional embodiments and dynamics, and at its impacts on key economic, political and social outcomes.

III. Dimensions of Financialization

If one takes a broad perspective on financialization, then one can identify many dimensions of it. One is the sheer size and scale of financial markets and can be seen quite clearly in the large growth in the size of the financial sector relative to the rest of the economy over the last several decades. This growth in finance has been a quite general phenomenon in many parts of the world. For the most part, we will focus here on data from the US.

⁶ Paul Sweezy and Harry Magdoff and the so-called Monthly Review School, were important contributors to this perspective on financialization.

The growth of finance relative to the size of the economy since 1980 or so has been nothing short of spectacular. A few pieces of data illustrate this point well. Start with profits of financial institutions. In the United States, financial profits as a share of GDP was around 10% in the 1950's. By the early 2000's, financial profits constituted about 40% of total profits in the US, a historical high. After a sharp decline during the Great Financial Crisis of 2008, financial profits have recovered to above 30% of profits, well above the average for the post-war period.

Naturally, with profits having grown so significantly, the size of the financial sector is likely to have been growing as well. Financial sector assets relative to GDP was less than 200% from 1950 to 1985. By 2008, they had more than doubled to well over 4 times the size of the economy. After a short dip following the GFC, financial sector assets had grown to be almost 500% of GDP by 2015 (Epstein and Montecino, 2015).

Trends in the UK are similar to those in the US, with both the size and the profitability of the financial sector and its profitability growing substantially in the post-war period until the great financial crisis, and resumed growth since that time. Indeed, since the crisis, growth of financial assets in the UK have outpaced those in the US, Germany and Japan, relative to GDP (Lapavitsas, 2013, pp. 205 – 2011).

More generally, the size of the financial sector and financial profits relative to the size of the economy has grown substantially in most European countries over this period. (FESSUD, various).

Another dimension that characterizes financialization in many countries has been an increase in the financial activities and financial orientation of non-financial corporations. De Souza and Epstein (2014) present data on the financial activities of non-financial corporations in six financial centers, the US, UK, France, the Netherlands Germany and Switzerland. They show that in all the six countries – with the possible exception of France – non-financial corporations significantly reduced their dependence of external borrowing for capital investment. And, indeed, in three of the countries – the UK, Germany and Switzerland – non-financial corporations became net lenders, rather than net borrowers, indicating an increasing role for financial lending as a profit center for non-financial corporations in these countries. Lapavitsas (2013) showed similar trends for the US, UK, Germany and Japan.

A key aspect of financialization that analysts agree has been particularly pernicious has been the vast increase of debt levels in many countries and many sectors (Admati and Hellwig, 2013; Taylor, 2012; Turner, 2013). Debt, or leverage, is an accelerator that enables the financial system to generate a credit bubble, that allows some actors, such as private equity and hedge funds to extract wealth from companies, and that can quicken the pace of economic activity more generally, and it is the accelerator on the way down after the bubble bursts, leading to distress, deflation and bankruptcy. (Minsky, 2008; Fisher, 1933 ; Jarsulic, 2013)

Playing a key role in the development of financialization is the role of financial innovation; in fact some authors argue that financial innovation itself *is* financialization (Vercelli, 2013). To be sure, financial innovation has played a key role in the development of recent financial practices

that contributed significantly to the massive growth in financial activities and that ultimately contributed to the financial crisis (Vercelli, 2013; Jarsulic, 2013; Greenberger, 2013; Stout, 2011; FCIC, 2011). Among these key financial innovations have been securitization and structured financial products such as Asset Backed Securities (ABS); Collateralized Debt Obligations (CD's); the growth of credit derivatives, such as Credit Default Swaps (CDS) that both facilitated and then became embedded in these structured products themselves; and innovation in wholesale funding such as REPO's and REVERSE REPO's all facilitated by complex utilization of collateral that greased the wheels of the whole system. These financial innovations have implications that are global in scope. The Bank for International Settlements in Basel Switzerland reports that the global use and level of trading in these instruments has grown spectacularly over the last several decades (BIS, 2013). This process of financial innovation has clearly helped to drive financialization, both within countries and globally as well.

Financialization and Non-Financial Corporations

There are other important dimensions of the increased financial activities related to non-financial corporations. Among the most important are the increased role of financial activities as a determinant of the pay packages of top management of non-financial corporations, including, most importantly, the corporate CEO. Perhaps most important are stock options and other stock related pay for non-financial corporate management. In the US, where this is especially prevalent, CEO's on average receive 72 % of their compensation in the form of stock options and other stock related pay (Galston and Kamarck, 2015; Lazonick, 2015a, 2015b).

This focus on stock price leads non-financial corporations to use their revenue to buy back stocks in order to raise the stock prices and increase their compensation (Cheng, et. al., 2015). This use of funds Lazonick refers to this pressure as leading to management policies of "downsize and distribute" a dramatic shift from an earlier strategy or retain and reinvest, by which management would retain profits and re-invest back into the human and technological capital of the firm. (see, eg., Lazonick 2012, 2015a; Almeida, et. al., 2014). The numbers in the case of the US are staggering. Using a sample of 248 companies that have been listed on the S&P 500 since 1981, Lazonick reports that: in 1981, firms use 2 percent of net income for stock buybacks. Between 1984 and 1993, such purchases averaged 25 percent of net income, from 1994-2003, 37%; from 2004 – 2013, they used a full 47% of net income for stock buybacks. (Lazonick, 2015a, 2015b). Particular large, well-known corporations used even a higher percent of their income for buybacks.

This focus on stock price is often seen as a prime example of "share-holder value" ideology, a perspective seen by some as the very essence of "financialization". (Froud, et. al., 2006; Aglietta and Bretton, 2001). Share-holder value ideology, promoted in the mainstream of the economics profession by Michael Jensen, among others, argues that since shareholders own the corporations (are the risk-bearing residual claimants"), that the goal of the corporation management should be to maximize the corporate value for shareholders. Since, they argue, shareholders bear all the risk in the corporation, then this maximization is the most efficient corporate outcome. Lazonick shows that other stakeholders, like workers and taxpayers, bear as much if not more risk than shareholders (Lazonick, 2013). And Stout shows that shareholders do not really own the corporations, nor do they all share the same values as embodied in the Jensen ideal. (Stout,

2012). Hence, “maximizing share holder value” does not mean maximizing share price. But it does often lead to short-term, destructive orientation by management.

This is one of the most discussed examples of the role of modern financial markets in creating more “short-termism”, as a major component of “financialization”. By ‘short-termism’ is meant a short time horizon by economic leaders in making production, investment and financing decisions. This short-termism might lead to under-investment in long gestation but highly productive and profitable (in the long-run) investments, under-investment in labor development, under-investment in research and development activities, and over-investment in activities that generate short run profits but that might generate long-run risks and/or losses. (Graham, et. al., 2005; Dallas, 2011). The same kinds of pressures face portfolio managers for pension funds and other institutional investors, leading to a similar focus on short-term returns, sometimes at the risk of longer term investments (Parenteau, 2005)

Evidence of short-termism include the reduced holding period of equities in financial markets, survey evidence that managers will cut profitable long-term investments to reach short-term profit goals, and that investors have higher rates of required returns for longer term investments than is necessary (see Haldane and Davis, 2011).

This short – term oriented behavior is alleged to affect non-financial corporation management not simply because of the direct incentives facing corporate CEO’s, but also because of the pressure from outside investors and financial institutions. These include pension funds and related institutional investors (Parenteau, 2005) and also private equity firms (Appelbaum and Batt, 2014) and hedge funds (Dallas, 2012). These financial institutions use access to debt and financial engineering to extract value in the short run from non-financial corporations, possibly at the expense of investment, tax payers and labor.

In short, this strand of literature suggests that “financialization” not only affects behavior in the financial sector itself, but also has profound effects on non-financial corporations as well.

Financialization and Households

As the Great Financial Crisis of 2008 clearly demonstrated, the process of financialization has not only caught financial and non-financial institutions into its orbit, but also households as well. After all, the epi-center of the financial crisis in the United States was in the home mortgage market and to some extent one segment of that market, the so-called “sub-prime mortgage market”. Costas Lapavistas (2013) and others have argued that process of financial incorporation of households led to the “financial expropriation” of these households by financial businesses, and expropriation most clearly and obviously expressed by the massive loss in housing wealth experienced by poor people and minorities in the US as a result of the crisis. (See Taub, 2013 and Engel and McCoy, 2011).

The incorporation of households into the “circuits” of financialization goes beyond the intensive use of mortgages to buy homes, sometimes, as we saw in 2008, with catastrophic consequences. The use of credit cards and other forms of consumer credit, and the widespread indebtedness of

students through student loans, also comprise the webs of connections that households have come to have with the financial markets (Kuttner, 2013; Warren, 2014).

Conclusion

As this section has shown, financialization has numerous dimensions, and has moved in some countries way beyond the “financial sector” itself. Financial returns, financial motives, widespread use of debt and short-termism, among other aspects, have become crucial, if not dominant, for financial firms, non-financial firms, and households. This growth in finance, which accelerated around 1980 in a number of countries, has taken on significant global dimensions as well.

The question naturally arises, what is the impact of financialization on the economy and on society?

IV. Impacts of Financialization

Much of the macroeconomic literature on financialization concerns, of course, the impact of financialization on crucial macroeconomic outcomes such as economic growth, investment, productivity growth, employment, stability and income distribution. The massive literature on the great financial crisis has made it pretty clear, that aspects of financialization, including the huge increase in private debt, the use of securitization and complex financial products, the widespread use of complex over the counter (OTC) derivatives, and the pernicious fraud and corruption, all contributed to the financial crisis and therefore, quite obviously, undermined stability.

But the impacts of financialization on other macro-outcomes are less obvious, and less studied. Before discussing particular impacts, it will be helpful to present some broad frameworks that have been proposed to understand the impact of financialization on macroeconomics. (see Palley, 2013a, 2013b; Hein and Van Treeck 2010, Skott and Ryoo (2009)).

Macroeconomic Models and Financialization

Space prevents me from giving a thorough over-view of the rapidly expanding heterodox literature on models of financialization, so I will very briefly discuss one framework here, that of Eckhard Hein. Hein utilizes a Kaleckian model, in which aggregate demand plays a key role in determining investment and output and income distribution of income between profits, wages and “rentier” or “financial incomes” have a big impact on aggregate demand. Eckhard and van Treeck, for example, identify three key channels through which financialization can affect macro variables and outcomes: 1) The objectives of firms and the restrictions that finance places on firm behavior 2) New opportunities for households’ wealth-based and debt-financed consumption, and 3) The distribution of income and wealth between capital and labour, on the one hand, and between management and workers on the other hand.

Hein and van Treeck show that within the Kaleckian framework, that expansive effects may arise under certain conditions, in particular when there are strong wealth effects in firms' investment decisions and in households' consumption decisions. However, they show that even an expansive finance-led economy may build up major financial imbalances, i.e. increasing debt-capital or debt-income ratios, which make such economies prone to financial instability.

Financialization and Investment

Stockhammer (2004) pioneered the theoretical analysis of the impact of financialized manager motives on investment. He showed that finance oriented management might choose to undertake lower investment levels than managers with less financialized orientations. He presented macro-level econometric investment equations that were consistent with this impact in several OECD countries.

Orhangazi (2008b) uses firm level data to study the impact of financialisation on real capital accumulation in the United States. He used data from a sample of non-financial corporations from 1973 to 2003, and finds a negative relationship between real investment and financialisation. Orhangazi explained his results by exploring two channels of influence of financialization on real investment: first, increased financial investment and increased financial profit opportunities may have crowded out real investment by changing the incentives of firm managers and directing funds away from real investment. Second, increased payments to the financial markets may have impeded real investment by decreasing available internal funds, shortening the planning horizons of the firm management and increasing uncertainty.

Davis (2013) provided further evidence of negative impact of financialization on real investment. She also studied a sample of non-financial firms, showing a significant difference between large and smaller firms in the degree to which they receive financial income as a share of total income. Larger firms appear to be more financialized in this sense. Using a firm-level panel, she investigated econometrically the relationship between financialization and investment, exploring focusing on the implications of changes in financing behavior, increasingly entrenched shareholder value norms, and rising firm-level demand volatility for investment by NFCs in the U.S. between 1971 and 2011. Importantly, Davis found that shareholder value norms were associated with lower investment, though this relationship tended to be true primarily of larger firms.

This results are consistent with the concerns expressed by heterodox analysts and others that financialization will tend to reduce real investment.

Employment, human capital, R&D and Wages

An increasing chorus of analysts among heterodox economists including William Lazonick (2009, 2013, 2014), Eileen Appelbaum and Rosemary Batt (2014) and iconoclast Andrew Haldane (2011), as well as more mainstream economists (eg. Galston and Kamarck, 2015) and even political figures such as Hillary Clinton have expressed concerns that "short-termism" associated with financialization may be coming at the expense of investments in human capital,

research and development, employment and productivity growth. There is some empirical work that is supportive of these fears. In a set of surveys of corporate managers, Graham, et. al (2005) show that many chief financial officers are willing to sacrifice longer term investments in research and development and hold on to value employees in order to meet short-term earnings per share targets. In a panel econometric study, Almeida, et. al. (2014) similarly find using firm level data that managers are willing to trade-off investments and employment for stock repurchases that allow them to meet earnings per share forecasts. Appelbaum and Batt (2014) in a survey of econometric studies of private equity firms find that especially large firms that use financial engineering to extract value from target companies, have a negative impact on investment, employment and research and development in these companies. In short, there is significant empirical evidence that “short-termism” and other aspects of financial orientation have negative impacts on workers well-being, productivity and longer-term growth.

And, as many of these studies emphasize, these activities do NOT maximize share-holder value, but often increase incomes for some managers and shareholders, partly at the expense of other shareholders of the firms not to mention stakeholders, such as workers and taxpayers.

Income Distribution

This raises the issue of the over-all impact of financialization on income distribution. A key issue in this area is where do financial profits come from? (Pollin, 1996). Are they the result of provision of services by finance to the rest of the economy, as is asserted by most mainstream economic theory? Or does much of it come in this era of financialization from the extraction of income and wealth by finance from workers, tax-payers, debtors and other creditors? Iren Levina proposes that much of financial income comes from access to capital gains in financialized markets and therefore does not necessarily reflect a zero-sum game, as is implied by some who argue that financial returns are extracted rather than result from increased wealth. (Levina, 2014). This issue of the source of financial income is extremely difficult to sort out theoretically and there is no consensus on this topic (see Lapavitsas, 2013).

There has been some empirical work to look at the impact of financialization on income and wealth distribution. Descriptive analysis in the U.S. indicates that the top earners, the 1% or even .01% of the income distribution get the bulk of their incomes from CEO pay or from finance (Bakija, et. al. 2012). Econometric work looking at the relationship between financialization and inequality is also growing. Tomaskovic-Devey and Lin (2011) present an econometric model indicating that since the 1970's, between 5.8 and 6.6 trillion dollars were transferred to the finance sector from other sectors in the economy, including labor and taxpayers.

Lin and Tomaskovic-Devey (2013), using a sectoral econometric analysis for the US, find that in time-series cross-section data at the industry level, an increasing dependence on financial income, in the long run, is associated with reducing labor's share of income, increasing top executives' share of compensation, and increasing earnings dispersion among workers. They do a counterfactual analysis that suggests that financialization could account for more than half of the decline in labor's share of income, 9.6% of the growth in officers' share of compensation, and 10.2% of the hgrowth in earnings dispersion between 1970 and 2008.

Dunhaupt (2013) finds a negative relationship between financialization and labor share in a larger set of countries. She uses a time-series cross-section data set of 13 countries over the time period from 1986 until 2007. The results suggest that there is indeed a relationship between increasing dividend and interest payments of non-financial corporations and the decline of the share of wages in national income. Other factors that can be accounted for the decline relate to globalization and a decrease in the bargaining power of labor.

Financialization and Economic Growth

As the massive recession stemming from the great financial crisis makes clear, there is no linear relationship between the size and complexity of financial markets and economic growth. Several econometric studies have suggested an inverted U shaped relationship between the size of the financial sector and economic growth. A larger financial sector raises the rate of economic growth up to a point, but when the financial sector gets too large relative to the size of the economy, economic growth begins to decline (see for example, Checchetti, et. al, 2012; Tomaskovic-Devey, 2015). To the extent that this relationship is true, economists are still searching for the explanation. One argument is that as the financial sector increases in size, because of its relatively high pay levels, it pulls talented and highly educated employees away from other sectors that might contribute more to economic growth and productivity. As a University Professor teaching economics since the 1980's, I can verify that many of my undergraduate students had the dream of going to work on Wall Street. Perhaps some of them could have contributed more elsewhere.

V. Conclusion

There is little doubt that the size and reach of financial activities, markets, motives and institutions has grown enormously in the last thirty years, relative to other aspects of the economy. There is a great deal of historical and empirical evidence that, at least to a some extent, this growth has contributed to economic instability, an increase in inequality, and in some cases, to a decline in productive investment and employment relative to what might have occurred otherwise. There is less consensus on whether this constitutes a new epoch, phase, or mode of accumulation or what exactly is causing this shift: is it underlying problems in the “productive core” of the economy, a reaction to broader shifts in the global economy associated with globalization, technological changes associated with digitization, or primarily due to financial de-regulation as being part and parcel of neo-liberalism?

To some extent, policies or programs aimed at reducing the deleterious consequences of financialization depend, to some extent at least, on the underlying causes of the negative aspects of financialization. If the problem primarily stems from issues of financial regulation, then adopting strict financial regulations as suggested by many (see, for example, some of the chapters in Wolfson and Epstein, 2013; or Epstein and Crotty, 2009), imposing a financial transactions tax to reduce short term trading, prohibiting destructive stock buy-backs (Lazonick, 2015a), breaking up the large banks (Johnson and Kwack, 2010), change corporate governance so that corporations take into account the preferences of stake holders, and a host of other reforms could well go a long way to taming financialization.

If, the problems stem largely from the vast and growing inequality of income and wealth and the political power that this inequality buys, then deeper reforms of taxation, wages, and ownership as well as money in politics must be implemented.

If the problem goes deeper to the underlying capitalist dynamics that lead to financialization, then we are looking at even more fundamental reforms.

The state of our knowledge does not allow us to clearly sort out these issues. But, it wouldn't hurt to start someplace, start anyplace. Because, we do know: there is something happening here.

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