

**The Colonisation of the Future:
An Alternative View of the Content and Cause of Financialisation**

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Abstract

Financialisation is generally interpreted by heterodox economists to be an outgrowth of contemporary capitalism that is at once dysfunctional and incompatible with this system's inner logic. This paper puts the contrary argument that financialisation is a functionally necessary development that is entirely in keeping with capitalism's logic as a commodity system. To be specific, it will be argued that financialisation represents the extension of the commodity principle along the axis of time just as globalisation represents its extension along the axis of geographical space. While this development is seen to be driven by constraints in the GDP realm, these are construed less as production and profit realisation constraints than as the constraints of time: the future is being colonised in order to escape the constraints of the present.

Key words: financialisation; spatialisation of time

JEL classification: G10; H10

1. Introduction

The neologism 'financialisation' is now generally accepted by heterodox economists to be that which best captures the fact that the financial markets now occupy a far more dominant position in domestic economies than was ever previously the case. This consensus on semantics extends to the deeper issues regarding the content and cause of financialisation. Taking as their cue the premise that the observed changes in the financial markets can only ultimately be explained in terms of the growth of short term speculation, heterodox economists broadly agree that financialisation is an outgrowth of contemporary capitalism that is at once dysfunctional and incompatible with this system's inner and that this outgrowth is the result of attempts to escape production constraints in the real sector.

This paper gives an alternative of view of financialisation and its portents by taking as its cue the observation that this phenomenon essentially represents the extension of the commodity

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principle along the axis of time just as globalisation represents its extension along the axis of geographical space. Given that financial securities, the stuff of the financial markets, are nothing other than tradable claims on the future income streams generated by corporations and governments, it follows that the systematic expansion of securities stocks can mean nothing other than the systematic occupation of the future, its annexation as an extra space of economic activity. This spatialisation of the future is certainly driven by constraints that exist in the GDP realm, but these constraints have less to do with those of production than with those of time: the future is being colonised so as to escape the constraints of the present. This line of argument does not preclude recognition of the fact that there are dysfunctional aspects of financialisation that accompany those that are functionally necessary to contemporary capitalism. The point, rather, is that these dysfunctional aspects should not be taken to be the defining content of financialisation.

The paper is structured as follows: Section two gives a brief overview of the heterodox position on financialisation. Section three gives an alternative view of the content of financialisation. Section four gives an alternative view of the cause of financialisation. Section five concludes.

2. An overview of the heterodox position on financialisation

Although scholars drawn from a variety of disciplines now use the term financialisation to describe the structural shift from industrial to finance capitalism, the primary concern here is with its use in the economics discipline. For the heterodox wing of this discipline, the term “summarises a broad set of changes in the relation between the ‘financial’ and ‘real’ sector, which give greater weight to financial actors or motives” (Stockhammer, 2012, p. 121) *. Of the changes that have given ‘greater weight’ to finance the three that stand out and have received most attention are (i) *size of the financial sector*: from being approximately equal in size with world GDP at that point in time, world financial stocks have grown at a much faster rate such that they now completely dominate annual output flows (see appendix, Figure 1A); (ii) *status of the financial sector*: from playing a largely peripheral role in domestic economies, the financial markets have moved to a more central position as attested by their

* There are several variations of this definition of financialisation, but the one that continues to be most frequently cited is that given by Epstein (2005, p.3): “financialization means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies”.

growing influence on the priorities of corporations and on the policy actions of governments and central banks; (iii) *character of the financial sector*: from being largely passive in character, the financial markets have become far more active as attested by the large increases in daily trading volumes in the capital, money and foreign exchange markets.

Many of the heterodox discussions of financialisation go on to focus on its wider economic and social implications such as those for the rates of industrial investment and output growth (e.g. Stockhammer, 2004; Orhangazi, 2008; Hein, 2009; 2010; Hein and Treeck, 2010), the sectoral distribution of income (e.g. Epstein and Jayadev, 2005; Epstein, 2013), the functional distribution of income (Stockhammer, 2009, 2010. Dunhaupt, 2012) and income inequality (e.g. Stockhammer, 2012). For the purposes of the present paper, we limit the discussion to the aforementioned changes in the size, status and character of the financial sector, concentrating attention on what heterodox economists have to say about what these changes amount to and about what is driving them.

(i) **Financialisation as speculation**

The recent changes in the relation between the financial and real sectors have led some authors to assert that the former has in effect become “an increasingly autonomous realm” (van der Zandt, 2014). This assertion cannot of course be valid if autonomy is interpreted in the sense of *separate existences*: as financial securities are nothing other than claims on the future income streams generated by corporations and governments, it follows that the financial markets cannot exist independently of the product markets[†]. By contrast, the assertion does have validity if autonomy is interpreted in the sense of *separate motives*: the huge scale of activities taking place in today’s financial markets indicate that the majority of these activities are motivated by self-enclosed interests rather than by any underlying real sector interests. However, while this latter interpretation of financial sector autonomy may be correct its significance can be viewed in two very different ways. One position, which is that developed below, is to view the increase in self-motivated financial market activity as a trend that is functionally necessary to the operation of the capitalist system in the modern era while also remaining fundamentally compatible with this system’s underlying logic. The

[†] Treeck (2009) puts the same argument but from a different perspective. As he states: “the observation that financial profits have increased relative to non-financial profits has led many authors to conclude that there has been some sort of ‘decoupling’ of the financial sphere of the economy from the real sphere”, but as he also goes on to state, this decoupling is not possible because from a formal macroeconomic perspective “aggregate profits ultimately rely on the production and trade of real goods and services and firms in the aggregate can by no means autonomously choose either between real investment (production) and profits at large or even between non-financial profits and financial profits”.

diametrically opposite position, which is taken by just about every other heterodox economist, is to view the emergence of an autonomous financial realm as an historical aberration, a phenomenon that is not only totally superfluous to the continued development of the capitalist system but also totally opposed to the established norms of this system.

The immediate explanation for this latter position is that heterodox economists continue to hold to a fixed view as to what should be the proper role of the financial sector and as to the quantitative proportions that it needs to assume in order to carry out its role. As concerns finance's role, the heterodox position essentially coincides with that of mainstream finance theory, namely, that it is "to facilitate the allocation and deployment of economic resources across time and space in an uncertain environment" (Merton and Brodie, 1995, p 4).[‡] Where mainstream and heterodox theorists diverge is over the appropriate scale of finance. Where the former argue that the larger is the financial sector the more cost effectively can it carry out its functions in support of the real sector, the latter object to this argument on the grounds that while the financial sector has to reach a minimum scale to be able to operate effectively its current scale is far in excess of that minimum. "Overblown", "bloated" and "inflated" are some of the more colourful adjectives, and "ballooning", "booming" and "mushrooming" some of the more colourful verbs, used to characterise the financial sector's growing size and weight relative to that of the real sector.

Nowhere is this excess of scale more pronounced than in the trading sphere. As already noted, trading volumes in all of the major financial markets have exploded over the past three decades at rates far above those for material output or international trade. Some of this trading may be linked to real sector activities but the fact that such trading constitutes a vanishingly small fraction of total trading volumes coupled with the observation that the latter are overwhelmingly dominated by short horizon trades would appear to show that the key financial trading motive is speculation: trading solely in order to gain from trading. Mainstream theory generally takes a benign view of the unrestricted growth of financial speculation in that this is seen as something that generally adds to the liquidity and hence informational efficiency of the financial markets, outcomes which in turn can only add to the

[‡] According to Merton and Brodie, the financial system facilitates resource allocation by providing "(i) ways of clearing and settling payments to facilitate trades, (ii) a mechanism for pooling resources, (iii) a mechanism to transfer resources across time and across borders and amongst industries, (iv) a way of managing risk, (v) price information in decentralised decision making and (iv) a means of dealing with incentive problems that make financial contracts difficult and costly". Heterodox economists accept that the financial sector has to carry out each of these particular functions but, as we say, disagree over the quantitative proportions that the sector needs to acquire in order to execute these functions efficiently. Epstein, for example, presented just such a critique in a recent conference presentation (Epstein, 2013).

efficiency of production and resource allocation. However, the experience of recent decades, replete as they have been with price bubbles, currency crises and other severe financial disorders, all of which have had damaging repercussions on the real economy, has only served to confirm the negative opinion of speculative trading taken by heterodox theory. In this opinion, the growth of financial speculation has less to do with helping the allocation of resources in the real sector for society's benefit than with effecting the diversion of resources to the financial sector for its own benefit.

(ii) Speculation as the outcome of production constraints.

Just as financialisation tends to be identified with speculation because the scale of financial activity cannot be explained in terms of the needs of the production process, so does the root cause of financialisation tend to be located in the constraints on that process. Industrial profit is the key variable in this regard. Firms under capitalism generally produce in order to generate profit, an aim which in turn can only be fully realised if household wage incomes and hence money-backed demand for consumption goods are maintained at a certain commensurate level. On the contrary, if wage incomes and hence the aggregate level of effective demand consistently lag behind aggregate profits, thus placing constraints on the proportion of profits that can be realised in the normal way in the course of the production-consumption cycle, then it must follow that firms will need to seek supplementary outlets through which profits can be realised, outlets that can only be consistently provided by the financial sector. The recent evidence appears to corroborate this conclusion in that corporations appear to be able to continue to realise large profits even while profit levels have consistently outpaced wage levels on the one hand and levels of industrial investment on the other.

Heterodox theorists point to two major ways in which many of the large non-financial corporations have come to rely on the financial sector for profit generating and profit realisation purposes. One is through their diversification into financial service provision. Indeed, some industrial corporations now generate more revenues from their provision of various financial services and products than through their traditional lines of production (see e.g. Krippner, 2005; Epstein, 2005; and Crotty, 2005). The other, more direct way, is through their provision of financial securities. Corporations have always been the chief providers of financial securities but what is different today is that the top corporate managers now appear to have joined the ranks of rentiers and speculators in being as active on the demand side of

the securities markets as on the supply side (see e.g. Seccareccia, 2013). The fact that the remuneration packages of most of these managers are now dominated by stock options, thus giving the latter a huge incentive to find ways of boosting share prices, is generally taken to be the main explanation as to why an increasing proportion of profits are being diverted away from industrial investment and used instead to finance dividend payments, which have a direct positive impact on share prices, or share buy backs, which indirectly impact on share prices by restricting the quantities of shares in circulation. Finally, this same fact concerning equity-based managerial pay is also used to help explain why, in addition to un-invested profits, corporate managers are increasingly resorting to bond issuance as another means of raising cash to be returned to shareholders.

In making the firm sector, through its attempts to escape the production constraints on profit realisation, the main driver of financialisation, heterodox economists do not by any means ignore the part played by the other major economic sectors. Rather, all of these are shown as playing a significant role in one way or other. Thus banks, also eager to maintain the profits made out of their links with the large corporations, are increasingly moving away from their traditional, interest charging corporate loan business towards fee-based sales of financial products and services. Households are similarly key to the financialisation process because their need to increasingly rely on bank credit to make good the income shortfalls caused by stagnant wage growth has furnished the banks with much of the raw material necessary for creating increasing amounts of asset backed securities. Finally, if banks are the main conduit through which securitisation links in with financialisation, governments are the main conduit through which neoliberalism and globalisation link in with this same phenomenon. At the domestic level the acceptance by governments of the neo-liberal dogma that market efficiency is maximised when government intervention is minimised has helped spur the deregulation of financial markets thus enabling them to grow to proportions that were previously impossible (see e.g. Kotz, 2010) while a more direct boost to their growth has also come from the rise in real interest rates that has accompanied the increasing prioritisation of inflation targeting in macroeconomic policy (see e.g. Dumesnil and Levy, 2005). At the international level, the lifting of trade and capital controls has helped to promote the closer integrations of the world's product and financial markets, the former process contributing to financialisation by helping to keep average wage levels low thus enabling more profits to be diverted to the financial sector and the latter process contributing to financialisation by

adding to the competitive pressures forcing corporations to distribute any increased profits to the financial sector (see e.g. Crotty, 2005).

(ii) **Anti-reductionism**

Given the massive contradiction at the heart of financialisation as theorised by heterodox economists – namely, that its continued development depends on the repression of wages and rates of industrial investment that, by lowering growth and employment, have the converse effect of undermining the material foundations of its continued development – one sees why few if any of these economists are prepared to bet on its survival prospects over the longer term. Indeed, some of them go so far as to predict that just as the previous era of financialisation came to an abrupt end with the stock market crash of 1929 and the ensuing Great Depression so the current era of financialisation will most likely suffer a similar fate due to the huge damage done to the global real economy by the financial crisis of 2007-8. Lavoie (2012, p232), for example, states that: “Just as the Great Depression called an end to finance capitalism, the current financial crisis should bring about the end of financialisation”. Other heterodox theorists, while not so ready to boldly predict the imminent demise of financialisation, nevertheless leave the door open to this possibility. Thus Palley (2007) states that “there are serious reservations about the sustainability of the financialisation process”, while Stockhammer (2012) ends his recent review of the literature on financialisation with a flurry of questions, the last of which is this: “ And, finally, will it (i.e. financialisation) last or will it go down in the thunder of further financial crises?”

The very fact that heterodox theorists can entertain the possibility that the financialisation process will collapse at some point in the not too distant future indicates a belief that this process is not only not functionally necessary to the contemporary capitalist system but also that it is not fundamentally compatible with the inner logic of that system. This belief comes down to the underlying methodological feature that unites all heterodox discussions of financialisation, namely, the resistance to any form of methodological reductionism. In the abiding concern to maintain the realism of their theories or models, heterodox economists generally take the ‘sector’ rather than the ‘individual’ as their key analytical unit[§]. What

[§] As orthodox Marxists similarly adhere to anti-reductionism, albeit that ‘class’ rather than ‘sector’ is their basic analytical unit, their analysis of financialisation does not fundamentally differ from that of other heterodox theorists. Strip aside terms such as ‘monopoly capitalism’, ‘exploitation’, or ‘surplus value’ and one finds the same basic take on financialisation as a dysfunctional outgrowth of contemporary capitalism, a symptom of its current stagnation. This point is well illustrated by Lapavistas who basically sides with other heterodox theorists in linking financialisation, defined as a “booming financial sector”, to production constraints in the real sector

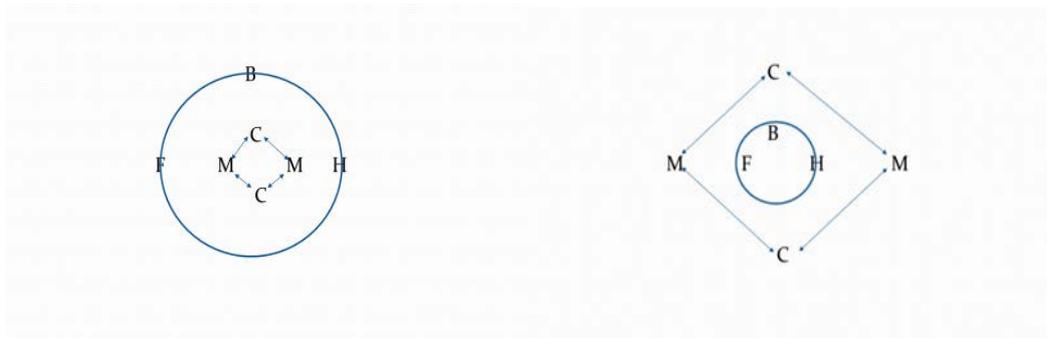
results from this highly aggregative approach is the assumption, illustrated in figure 1a, that it is the associative principle (the personal, one to one relation between counterparties) that is the dominant economic principle under capitalism while the arms-length principle (the impersonal exchange relation) has a subordinate role. This ordering of economic principles is exemplified in the heterodox interpretation of the income-expenditure relation: while it is recognised that household expenditures on consumption goods conform to the arms-length exchange principle, what comes first in the minds of heterodox economists is the fact that incomes are financed by the wages that are paid to households by firms on an associative basis. From this position, it follows that the bank-based form of finance is that which is most ideally suited to maintaining the stability and continuity of macroeconomic relations. The crux of the matter is the quantitative relation between finance and material output. The quantity of bank credit money can never deviate significantly from the quantity of material output over any significant length of time because this form of finance represents exactly the same type of one to one relation in the financial sphere as exists in the production sphere (indeed, the whole point of classifying bank credit as endogenous money is to bring out this fact that its quantity is always ultimately determined by the needs of firms and households engaged in production and consumption respectively). By contrast, the quantity of capital market instruments can deviate significantly and for significant lengths of time from underlying output quantities because, once issued, the subsequent trading of these instruments need have no connection with the initial conditions of issuance. In other words, capital market forms of finance can pose a potential threat to macroeconomic stability and continuity because these forms are representative of the impersonal exchange principle. If this potential threat is to be nullified, the capital markets have to be constrained in ways such as can maintain the impersonal principle in a subordinate position relative to the associative principle; on the contrary, if the capital markets are allowed to grow to a size such that the impersonal exchange relation becomes the dominant economic relation that subsumes all other personal relations as is illustrated in figure 1b, the potential threat to macroeconomic stability can become a very real one.

Figure 1

i.e to “poorly performing real accumulation”. Where Lapavitsas differs from other heterodox theorists is in his specification of the “mediations through which the malaise in production has been associated with booming finance”.

(a) Domination of personal principle

(b) Domination of impersonal principle



Key: M=Money; C=Commodity; F=Firms; B=Banks; H=Households

Impersonal exchange relation= \longleftrightarrow

Personal associative relation = ———

The fundamental question that falls out of the above discussion is whether the ordering of economic principles as illustrated in figure 1a is indeed an accurate description of the fundamental logic of capitalism. If it is, then financialisation can only be construed as a deviant phenomenon in which case predictions of its imminent demise make sense. However, if it is the opposite ordering of economic principles as illustrated in figure 1b that is the more accurate description of capitalism's inner logic then it must follow that financialisation is a phenomenon that is entirely in keeping with capitalism's contemporary phase of development in which case predictions of its demise as are wide of the mark. In what follows we shall put this latter line of argument taking as our starting point Marx's own point of departure in his analysis of capitalism.

3. An alternative view of the content of financialisation

Contrary to the widely held assumption that Marx takes 'class' to be his basic analytical unit, the opening part of Capital begins with a disaggregated category, a single element taken as the unit of analysis, the 'commodity'. In beginning with the commodity Marx begins with the individual, but the individual viewed not subjectively but objectively, not as a preference maximiser but as a commodity seller. As individuals operate in a division of labour system, their commodities have to conform to social standards of provision – unlike 'products' that need only conform to privately established criteria – a constraint that immediately presupposes an essential role for money. In a neoclassical world populated by rational agents

there is no need for money because the subjective preferences and choices of agents can be reconciled both with each other and with technological and resource constraints by some central market force or authority (e.g. Walras' 'auctioneer') that sets exchange ratios accordingly. In Marx's commodity world where there is no central price setting and market clearing authority, money is the medium through which social standards of pricing are set and enforced: it is through money's function as measure of value that each individual can assign a price to the commodity put on offer, while it is through money's function as medium of exchange that privately assigned prices are either sanctioned (offers of money by buyers informs the seller that the commodity conforms to social standards of provision and pricing) or falsified (the non-offer of money by prospective buyers informs the seller that the entity put on offer does not conform to social standards and thus does not qualify as a commodity).

While Marx's 'commodity' reductionism distinguishes itself from methodological individualism in that it can provide a realistic insight into the workings of decentralised, money-using economies, it distinguishes itself from standard heterodox macroeconomics in that it can provide this realistic insight in a way that respects the principle of logical generality on the one hand and the principle of historical evolution on the other. Take the first of these two distinctions. In focussing from the outset on the relations linking together the firm, household and bank sectors, heterodox theorists in effect begin, not with what all these sectors have in common, but with what differentiates them, namely, the fact that they all fulfil different economic functions: firms a production function, households a consumption role and banks a financing function. This opening focus on functional differences inevitably leads to a preoccupation with the associative relations that are necessary to the performance of the different functions – the wage relation in production, the credit relation in finance – a preoccupation that then reinforces the assumption that the associative relation is the dominant economic relation in the capitalist system. With Marx's commodity reductionism it is different. The whole point of this reductionism is to establish not only a realistic but also a generalising insight into the economic system: to reduce the system to a single representative unit is to allow one to see across the system and identify what all its constituent parts have in common. What is general to a modern economy is not the production relation or the credit relation, or indeed any other type of associative relation, but the impersonal commodity exchange relation. Only having first established this generality of commodity exchange relations, does Marx then proceed to discuss particular types of associative relations, beginning with the production or wage relation and subsequently the credit relation.

Now take the second distinction regarding historical evolution. An aggregative methodological approach that takes the sector as the analytical unit hinders the analysis of change in the capitalist system. The point is that the distinguishing characteristics of households, firms and banks in the 19th or 20th centuries are not all that different from the characteristics that these sectors have in the present, which means that to keep attention constantly focussed on these sectors and on the distinct functions that they perform runs the risk of missing out on the emergence of any new economic phenomena. It is different with commodity reductionism because another of its advantages is that it enables one not only to see across space (to identify the generality of the commodity principle) but also across time (to track the unfolding development of the commodity principle). The crux of the matter is that the 'commodity' form is a historically-conditioned category: any entity that has a use value has the potential to be commoditised, that is, to have its exchange value determined against socially established standards rather than determined by private negotiation, but it is only under certain historical circumstances that that potential is realised. This is the case for example with material products. Elements of commodity exchange exist in most pre-capitalist economic formations, but it is only under capitalism that the commodity principle is stretched to the point where it covers most products traded within a given locality or region for it is only then that the labour power capacity itself becomes a commodity as large numbers of individuals are transformed into property-less workers who are forced to rely on the market for their subsistence needs.

The contention here is that what happened to material products in capitalism's early development is now happening to financial securities in its current stage of development. In fact, we go so far as to contend that the recent structural changes in the financial sector that go under the collective label of financialisation are really nothing other than different manifestations of the commoditisation of securities, a development powered above all by the recent changes in institutional asset management. As can be seen from figure 2A in the appendix the largest source of demand for financial securities are the institutional investors, the pension and mutual funds and insurance companies. For long a small cottage industry catering for a few wealthy clients, institutional asset management has become a mass industry catering for the retirement and other welfare needs of large sections of the population. With this growth in the scale of asset management has come a corresponding growth in the scale of demand for 'investables', that is, assets whose use values are to serve as stores of value into which clients' money can be poured and from which money can be withdrawn to repay

clients. In principle, other assets such as real estate, gold and other natural commodities can also be used as value containers. However, the physical constraints on the supplies of these assets, combined with certain disadvantageous attributes most notably a lack of liquidity, mean that institutional investors have to depend on financial securities as the major type of investable asset. It is this dependence that separates the institutional investors who dominate the demand side of the securities markets today from the household investors who were dominant in the past. Households can choose to put their savings into securities but as they do not have to market wealth portfolios to the public there is nothing to stop them from putting all of their savings into other assets. The large institutional investors of today have no such option but must instead rely on the ability of governments and corporations to supply the debt and equity securities they need to fulfil their asset management needs just as other agents rely on these organisations to supply the material goods and services they need for their consumption or production needs.

If the growth in the scale of professional asset management has led to the increased demand for securities to serve as portable stores of value, it is the accompanying shift towards the standardisation of the asset management function that explains the emergence of common standards for the pricing of securities. The central issue here concerns risk. Investors in all periods need to monitor the behaviour of security issuing organisations so as to compute the amount of risk that needs to be factored into the prices of the latter's securities. However, what separates the different periods are the benchmarks against which the behaviour of security issuers is compared. In the past there was no single, universally acceptable benchmark because none of the investor types then dominating the demand side of the securities markets had need to make systematic cross comparisons of the different security issuing organisations. All this has changed with the transformation of institutional asset management into a mass industry and its corresponding shift towards more standardised forms of provision so as to accommodate the increased demands made upon it. In place of the broad based, discretionally managed portfolio that was previously typical what is typical today is the standardised portfolio managed to a specific mix of risk and return as advertised in a fund prospectus or as laid down in an investment mandate. Given that the overall risk profile of a portfolio depends on the risk characteristics of the individual constituent securities, one can see why institutional investors need to make systematic comparisons of securities to determine their respective suitability for inclusion in a particular portfolio. In light of this need, one can see why it is these investors more than any others who have pushed

not only for the imposition of tighter transparency and information disclosure rules on security issuing organisations but also for the establishment of uniform governance standards against which the behaviour of these organisations can be measured and the corresponding risk quantified and priced.

The root cause of the explosion of trading volumes in the major financial markets also ties in with the emergence of institutional asset management as a mass industry. In the case of the capital markets, a large part of the increase in trading comes down to the fact that the standardisation of asset management has brought about a change in the status of trading. Where trading was previously an exogenous activity in that while needed to set up a portfolio it was not subsequently essential to its maintenance, it has now become an endogenous activity in that daily trading is vital to keeping a portfolio to its pre-specified risk-return target. As for the growth of trading in the money and forex markets, a large part of this growth can be attributed to the widening disparity between the size of securities stocks on the one hand and the size of bank deposits, the major component of the money supply, on the other. Securities, as with material commodities, need money to serve as a medium of exchange to facilitate their circulation and they need money as a store of value to temporarily bridge the gaps and discontinuities in their circulation. Faced with this increasing demand for liquidity from institutional investors, but at the same time constrained by various factors including government monetary policy and by regulatory rules from creating deposits above certain limits, banks resolve the dilemma by passing around any spare liquidity among themselves. These cash recycling operations take various forms, but it is generally the case that unsecured trades dominate the overnight markets where credit risk is negligible while the preference at longer maturities is for collateralised transactions that, because they minimise credit risk, lower the cost of obtaining liquidity. This same point also helps to explain the growth in daily FX turnover. Half of these observed volumes comprise FX swaps, transactions that combine a spot transaction between two currencies and a forward reverse transactions between the same two currencies. While some FX swaps are indeed motivated by currency demand and exchange rate considerations, the majority proportion of these instruments are in fact motivated by money market type borrowing considerations in that they represent an alternative type of repo, the difference merely being that in place of government bonds it is a key currency such as the dollar that serves as the collateral.

Although the trades described above typically have short time horizons they are not speculative trades. In fact, they are the antithesis of speculation for where speculators trade to

exploit any price movements asset managers who trade for portfolio rebalancing purposes or banks who trade for cash borrowing or lending purposes try to do so in ways that avoid causing price movements. This is why institutional asset managers tend to deploy trading methods and to use trading venues such as ensure that their large orders cause minimal price changes and thereby reducing the potential costs of trading. This also is why banks who engage in repo and FX swap trades tend to execute these trades in the deepest and most liquid money and FX markets and thus where their price impact is minimised. However, while speculative trading is antithetical to portfolio rebalancing trading or to cash recycling trading between banks, it is also parasitic on the latter. The highly concentrated nature of trading in all of the major financial markets gives clear proof of this parasitism. If speculative trading was indeed an independent, self-enclosed activity, we should to find a much wider dispersion of trades across different securities or currencies where there is scope for more differences of opinion or information. However, the opposite is case as most trading is concentrated on a very few securities or currencies, those with the most liquid markets and hence those most used by institutional asset managers and banks. Try as they might to avoid causing price disturbances through their trade orders, institutional investors and commercial banks will always cause such disturbances that will in turn always give hedge funds and other speculators the opportunity to profit from them. Such disturbances are likely to be very small because of the measures taken to minimise them, but it is precisely for this reason that the institutions engaging in speculation have to trade the same securities or the same currencies many times over, sometimes as much as forty or fifty times a day, in order to extract profit from these trades.

Thus it is that the present day scale of non-speculative and functionally necessary short term trading in the major financial markets begets an even greater scale of speculative and potentially dysfunctional short term trading in the same markets. This said, there is no reason to take the speculative component of short term financial trading to be the defining content of financialisation. That content rather, is the commoditisation of financial securities as institutional investors are required not only to hold increasing volumes of securities to meet their asset management needs but also to price and trade securities against social standards to meet these same needs. Strip out financial market trading that is connected in one way or another with institutional asset management, and speculative trading collapses to a fraction of its current scale. However, strip out speculative trading and you would still find an enormous amount of short term trading that is necessary for asset management and consequently for

much of the money market operations that support the liquidity needs of asset managers. Only if the growth of institutional asset management was considered to be an inessential feature of modern day capitalism could the volumes of trading triggered by that growth also be considered to be inessential, in which case the identification of financialisation with speculation would still be plausible.

This proposition of course raises the question as to whether the continued growth of asset management is in fact an essential feature of contemporary capitalism. The commoditisation of securities that has been triggered by the transformation of institutional asset management into a mass industry may be entirely compatible with the inner logic of capitalism as a commodity system but a demonstration of logical compatibility is not enough. What is also required is a demonstration of functional necessity. Such a demonstration is possible if we draw on Marx's distinction between labour power as 'capacity' and labour as 'activity' and make that same distinction between governments and corporations' capacities for production and service provision and the goods and services that flow from the use of these capacities. The financial sector has no good reason to grow beyond a certain threshold level in order to help the production or service provision activities of governments and corporations in a way that facilitates the efficiency of these activities or the efficiency of their coordination. On the contrary, the financial sector has every reason to keep growing in scale in order to help organisations' capacities for activity in a way that facilitates their continued deployment. The next section expands on this argument.

4. An alternative view of the cause of financialisation

If financialisation in its most basic sense denotes the growing weight of the financial sector relative to the real sector then 1980 must mark its approximate starting point for that is when (as shown in figure 1A) the rate of growth of global securities stocks began to significantly outstrip the rate of growth of global material output. This fact would indicate that the government sector played the decisive role in providing financialisation its initial impetus for 1980 also roughly marks the point when Western governments, led by those of the US and UK, decisively abandoned Keynesian style growth and employment oriented macroeconomic policies in favour of monetarist policies that had inflation targeting as their overriding priority. While several other commentators have also linked the emergence of financialisation with the U turn in macroeconomic policies, the tendency has been to attribute this U turn to

the resurgence of neo-liberal ideology. Without discounting the influence of this ideology on Western governments, it is likely that factors of a more material nature played the more decisive role in forcing the abrupt turnaround in policy. While the government expenditure to GDP ratio averaged 10% all through the 19th century and into the early 20th century, that ratio began to rise during the Great Depression and even more significantly after WW2 so that by 1980 it averaged 50% where it has more or less stubbornly remained despite all the neo-liberal talk of downsizing the economic role of the state. Faced with increasing demands on their capacity to govern on the one hand, and faced with limits on the amounts of tax revenues that can be generated on the other, governments have increasingly resorted to bond issuance as the means of bridging the gap. If inflation targeting became the overriding macroeconomic priority after 1980, where it remained at least until the outbreak of the Great Financial Crisis of 2007-8, it was largely because of governments' concern to contain borrowing costs in the face of expanding borrowing volumes.

While the control of inflation and hence of borrowing costs is a necessary condition enabling governments to increase their borrowing levels, it is not a sufficient condition. On the demand side of the government bond market there has to exist an investor body large enough to accommodate the increased scale of government borrowing. The reality is that such a body does now exist courtesy of the very same pressures that have forced governments to increase their supply of bonds in ever increasing amounts. While other factors have played a role in the transformation of asset management into a mass industry, by far the most important is the move away from universal government provision of social and welfare services towards more selective forms of provision that give priority to the needs of the poorest and most vulnerable sections of the population. As mid to high income households have been made to take more responsibility for retirement arrangements so have they had to take a keener interest in the returns on their assets, a development that helps to explain the shift in the composition of household assets away from bank deposits towards capital market securities. At the same time, the fact that most individuals continue to have a limited appetite for risk even while they become more yield oriented helps to explain the trend towards delegating asset management to professional investors. As already noted, with the growth of asset management comes a corresponding growth in the scale of demand for investable securities, including government bonds. In addition to the increase in the issuance of bonds of given maturities, another important element in the expansion of the government bond markets is the lengthening of maturities. Bonds with a 10, 20, 30, and even maturity, are now being issued

alongside shorter dated bonds as governments take advantage of a low inflation environment to spread out their debt repayments. Only institutional investors, and particularly insurance companies and pension funds, have liabilities on a scale and of a maturity structure such as make their demand for bonds dovetail with the interests of their issuers.

The fact that the overwhelming bulk of household demand for investable assets is channelled through institutional investors rather than exercised directly has a crucial bearing on the depth and liquidity not only of the government bond markets but also of the markets for bank and non-bank corporate securities. Commercial banks have always tapped the capital markets for extra funding resources, but as their core lending business has grown so also has the importance of their contribution to the supply of securities. Increased lending to small businesses and households by banks explains the increase in their need to bridge financing gaps with the issuance of bonds and short term paper; it explains the increase in their issuance of equity as a means of keeping to solvency requirements; finally, it explains their pivotal role in the securitisation process as they attempt to accommodate the expanding demands for credit while at the same containing the costs of this accommodation by off-loading loans in the form of asset backed securities. Large corporations in the US and UK have always relied on the capital markets to supplement their longer term external funding requirements and, when doing so, have always tended to issue a mix of debt and equity securities in order to avoid an excessive concentration of risk on one hand and an excessive dilution of the benefits of ownership and control on the other. What has happened in these countries in recent decades is that while the ratio of debt to equity forms of external funds raised by corporations has remained fairly stable the ratio of bank borrowing to capital market forms of funding has not. As the costs of the latter have fallen in line with the deepening and closer integration of the capital markets, so have American and British corporations increasingly come to rely on these markets for all but very short period borrowing requirements.

While governments and corporations have reaped benefits from the dominating presence of large institutional investors in the securities markets, these benefits have come accompanied with constraints. All security issuing organisations now face tighter demands for transparency and information disclosure as institutional investors require this information if they are to compare different organisations' behaviour against prevailing governance norms so as to quantify the amount of risk to be factored into prices of their securities.

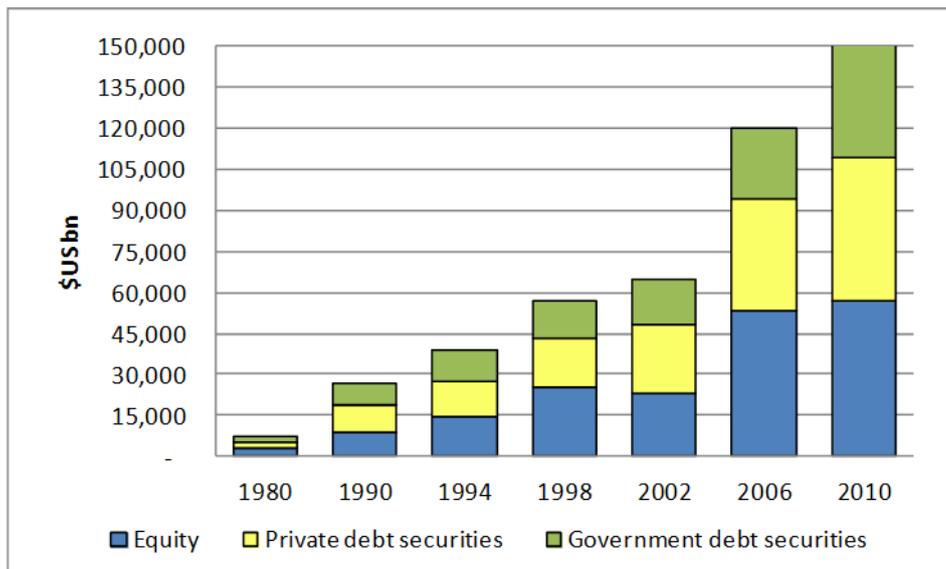
The new tight constraints imposed on government and private corporations when accessing the capital markets has drawn huge criticisms on the grounds that they interfere with the efficiency which organisations can carry out their production or service provision function. The problem with this criticism is that it fails to distinguish the capacity to perform a certain function from the actual performance itself: investor constraints may well make little contribution to the efficiency of performance, and may even hamper this efficiency, but they certainly make a contribution to the capacity for performance. All capacities require financing for their upkeep and reproduction and in most cases this financing takes two forms: financing out of current income streams and financing from claims on future income streams. Where the claims on individuals' labour power capacity can only take a non-tradable form, typically that of a bank loan, claims on organisations' capacities can take a variety of forms including the issuance of tradable securities. Governments and private corporations have always depended on the capital markets for extra funding but where in the past they would typically issue small amounts of securities or, if issuing large amounts would only do so as a temporary measure to confront a particular emergency or fund a particular project, today they issue large amounts and for long periods. It is this difference in the scale and duration of dependence on the capital markets that explains the corresponding difference in the range and intensity of the constraints and conditions attaching to this dependence. When in the past governments and corporations has either a small or temporary need of capital market forms of financing, it was enough for them to have households as the dominant type of investor on the demand side of these markets, a type that had no need to enforce strict conditions on security issuers given that the holding of securities was not indispensable to their function as households. Today when governments and corporations have a large and permanent need of capital market forms of funding, they require a very different type of investor to be dominant on the demand side of these markets, namely, institutional investors who have liabilities on a scale and of a maturity that match the assets issued by the borrowing organisations. But this type of investor, precisely because the holding of securities is indispensable to their asset management function, do have need to enforce strict conditions on security issuers. Thus governments and corporations in effect face a difficult choice: they can either retain a certain freedom of action when issuing securities but then accept tight limits on the amounts of securities that can be issued, or they can seek to lift the limits on the amounts of securities issued but then accept tight constraints on their freedom of action. What security issuing organisations cannot do is to have it both ways: retain complete freedom of action while continually increasing the amounts of securities issued. To be continued.

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Appendix Figure 1

Financial Deepening of the Global Economy



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|-----------------|------|------|------|------|------|------|------|
| Deposits | 5,00 | 16,0 | 18,0 | 22,0 | 29,0 | 45,0 | 59,0 |
| | 0 | 00 | 00 | 00 | 00 | 00 | 00 |
| GDP | 11,0 | 22,0 | 26,0 | 30,0 | 33,0 | 49,0 | 63,0 |
| | 00 | 00 | 00 | 00 | 00 | 00 | 00 |