

Dynamics of Financialisation in Emerging Europe

Milka Kazandziska

Jacobs University Bremen

Abstract

This paper contributes to the financialisation literature exploring the dynamics of financialisation in eight emerging European economies (EEEs) compared to the Anglo-Saxon countries, both before, and after the financial crisis in 2008, including the Covid-pandemic. Our qualitative analysis focuses on the following aspects of financialisation: financial liberalisation, financial system depth, shift from bank-based towards market-based financial system, debt of the households, non-financial corporations (NFCs), and the government, and their external debt position. In this paper we identify ‘foreign-finance-led’ and ‘state-led’ financialisation, where ‘foreign-finance-led’ financialisation is characterised by increase in net capital inflows and subsequently, foreign indebtedness, whereas the government (the state) in the ‘state-led’ financialisation has a predominant role in the financialisation process. Most EEEs fit the ‘foreign-finance-led’ financialisation, but with a tendency of a significant state involvement during the Covid-pandemic. Foreign financial flows in Russia were not as significant for the process of financialisation, but rather the state itself. Overall, financialisation in the EEEs was less pronounced compared to United States and United Kingdom. Despite this, the dynamics of financialisation took a significant pace in the EEEs in the years following the financial crisis of 2008, with rising debt levels during the Covid-pandemic.

Keywords: financialisation, financial crises, deregulation, emerging countries, Central Eastern Europe

JEL classifications: E44, F34, F36, F65, G01, G20, P51, P52

Contact:

Prof. Dr. Milka Kazandziska, Jacobs University Bremen, Campus Ring 1, 28759 Bremen, Germany, email: m.kazandziska@jacobs-university.de

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1. Introduction

There are variances in the interpretations of the concept ‘financialisation.’ Mader, Mertenés, and van der Zwan (2020) provide an excellent overview of the definitions of financialisation existent in the literature. In this paper we will use the definition by Epstein who conceptualised financialisation within the framework of

‘(...) the increasing role of financial motives, financial markets, financial actors, and financial institutions in the operations of the domestic and international economies.’

Epstein (2005: 3)

Our focus in this paper is the literature on financialisation in emerging countries. Authors, like Bonizzi, Kaltenbrunner, and Powell (2020), used the term ‘subordinate’ financialisation to emphasize the emerging countries’ inferior position in the world production, trade, as well as international finance and capital movements. In this paper we will continue this debate, showing that financialisation in most countries in our sample has been highly impacted by foreign capital inflows. In Russia, however, the government itself, instead of foreign capital inflows had dominant role in the financialisation process.

We will analyse eight emerging countries in Europe: Poland, Czech Republic, Hungary, Bulgaria, Romania, Croatia, Russia, and Turkey. The abbreviation EEEs (Emerging European economies) will be applied for this group of countries. Moreover, for comparison, we will include United States and United Kingdom as two of the most financialised countries worldwide. Hopefully more data will become available for our future studies to include the countries in South-Eastern Europe or the CIS (Commonwealth of Independent States).

The period we will concentrate on is the decade before the financial crisis of 2008 and the years thereafter, including 2020, which was characterised by an exogenous shock – the spread of the Covid-pandemic. There are several elements or interpretations of financialisation that we will address: financial liberalisation; financial system depth; shift from bank-based towards market-based financial system; debt of the households, non-financial corporations (NFCs), and the government; and their external debt position.

The rest of the paper is organised as follows. The second section provides an overview of the existing literature of financialisation in emerging countries. The third section describes the different aspects of financialisation that will be covered in the analysis of EEEs in the section that will follow. The fifth section provides a discussion about the types of financialisation identified in EEEs. The last section offers concluding remarks.

2. Literature on financialisation in emerging countries

Financialisation has become a pivotal point of research among scholars in economics, political economy, sociology, and other disciplines especially in humanities particularly since the outbreak of the financial crisis in 2008.¹

This paper will necessarily focus on the financialisation literature with respect to emerging countries, which does not do justice to the complexity of the research done on financialisation

¹ For illustration, the number of journal articles that dealt with financialisation increased four times between 2018 and 2010 (see Figure 1.1 in Mader, Mertens, and van der Zwan 2020:4).

at large. The interest on financialisation in emerging countries gained momentum in the recent years. For instance, Bonizzi (2013) provided an extensive survey on the main theories used to explain financialisation and the characteristics of financialisation in emerging countries with particular focus on capital/financial account openness.

One nexus between financialisation and emerging countries is the Washington Consensus debate on capital/financial account deregulation as one of the recommendations by the International Monetary Fund (IMF) and the World Bank (Rodrik 1998, Priewe and Herr 2005, Stiglitz and Ocampo 2008).

Several authors emphasized the international aspect of financialisation and the dependency of emerging countries on foreign capital flows for development (Becker and Jäger [2010]; Bortz and Kaltenbrunner [2018]; Bonizzi, Kaltenbrunner and Powell [2020]; Datz [2008]; Kaltenbrunner and Paineira [2015]; Paineira [2012]; Tyson and McKinley [2014]). This strand emphasizes the necessity of maintaining relatively high interest rates and overvalued exchange rates that itself constrains the governments and central banks in the conduct of macroeconomic policies. Bonizzi, Kaltenbrunner, and Powell (2020) argue that emerging countries have a subordinate position in the international aspect of financialisation. They are subordinate in the global value chains, which means that they provide raw materials and low value-added intermediate products to the leading companies of the value-chain (Dünhaupt and Herr 2020).

Analysis of financialisation in the Minskian tradition of boom-bust cycles has been applied to developing/emerging countries by authors like Arestis and Glickman (2002), de Paula and Alves (2000), Kregel (1998) or Schroeder (2002). These authors argued that East-Asian countries went forth with capital account deregulation that spurred substantial amounts of capital flowing in these countries, increasing foreign indebtedness of the domestic private sector. Often these capital flows were directed towards the real-estate and the stock markets,

which created asset-price bubbles that were doomed to burst as soon as economic growth slowed down and the exchange rate depreciated.

Frenkel and Rapetti (2009) addressed the financial crisis of 2008/2009 and its effects on the developing/emerging countries. They argued that the conditions that were conducive for the financial crisis were different in developing compared to developed/advanced world. In developing countries, the specific set of macroeconomic policy interventions, including measures of capital market deregulation, encouraged higher risk-taking of the private sector.

From the Regulation school perspective, Becker (2009, 2011) and Becker and Jäger (2010) analysed the accumulation regimes in the Central Eastern European countries. They identified two accumulation regimes for these countries: 'dependent industrialisation' and 'dependent financialisation' regime. The former is characterised by strong growth of the manufacturing sector and exports, while the 'dependent financialisation' regime is characterised by a surge in capital flows in the financial sector that contributed to their de-industrialisation.

More often than not has financialisation in emerging countries been applied to individual countries (see for example, Ashman, Mohamed, and Newman [2013] for South Africa; Lapavitsas [2009a], and Gabor [2012] for individual countries in Central Eastern Europe; Kalinowski and Cho [2009] for South Korea; Rethel [2010] for Malaysia, Hong Kong, and Indonesia).

One attempt to provide a more encompassing analysis of a group of emerging countries is provided by Akcay, Hein, and Jungman (2021). Using macroeconomic demand and growth regime analysis, they identify four regimes: debt-led private demand, export-led mercantilist, weakly-export-led, and domestic demand-led regimes, in which selected emerging countries are classified. China and Argentina are found to have export-led mercantilist regimes, Brazil, and Russia – weakly export-led regimes, India, Mexico, and Turkey - domestic demand-led regimes, and South Africa – debt-led private demand boom regime.

Karwowski and Stockhammer (2017) provided a systematic comparison across seventeen emerging countries in Asia, Africa, Central Eastern Europe, and Latin America using specific indicators of financialisation. The authors identified six interpretations in the literature explaining the financialisation development in emerging countries. These are: financial deregulation, foreign financial flows, asset price volatility, shift from bank-based to market-based finance, debt of businesses, and household debt. Our paper can be, to a certain extent, seen as continuation of the work by Karwowski and Stockhammer (2017).

3. Notes on the indicators

In the current paper we will analyse the dynamics of financialisation in the emerging countries in Europe. Through a descriptive analysis of several indicators, we want to find out the similarities/differences in financialisation between the selected countries in Emerging Europe. The following aspects of financialisation will be investigated: degree of financial liberalisation, financial system depth, shift from ‘bank-based’ towards ‘market-based’ financial system, debt of the households, the NFCs, and the government, and their external debt position.

a) Degree of financial liberalisation

Several authors have, in different contexts, emphasized the importance of these aspects of financialisation for understanding its dynamics. Lapavistas (2009b) and Correa, Vidal, and Marshall (2012) highlight the significance of financial account deregulation for the rise in financialisation. They see the origins of financialisation in the emerging/developing countries in the 1970s when these countries embarked on a journey of labour market and financial account liberalisation.

‘[F]inance has grown extraordinarily in terms of employment, profits, size of institutions and markets. There has been deregulation, technological and institutional change, innovation, and global expansion. Finance now penetrates every aspect of society in developed countries while its presence has grown strongly in the developing world.’ (Lapavitsas 2009b: 126).

Financial account deregulation especially in emerging countries has led to substantial increases in capital flows during the 1990s and even more strongly in the 2000s, leading to higher integration of these countries in the international financial structure (Aizenman, Jinjarak, and Park 2013). Financial inflows, particularly when dominated by portfolio flows, tend to increase the fragility of the financial systems in emerging countries. As an indicator for financial liberalisation, we will use the Chinn-Ito index. The higher the Chinn-Ito index is, the higher the level of financial account liberalisation.²

b) Financial system depth

Financial system deregulation in advanced countries has led to an emergence and growth of non-bank financial institutions, such as pension- and mutual-funds or insurance companies (Toporowski 2000). The assets of insurance companies, financial corporate investors, and pension funds have increased by around four times between the 1980s and 2000s in the UK and the US. We will use the ‘financial development index’ by the IMF as an indicator for the depth of the financial system (IMF 2015). This index shows three dimensions of development

² We use the Chinn-Ito index as an indicator for country’s financial account openness (see the database related to the paper Chinn/Ito, 2006). A country can obtain a score within the range of -1.9 and 2.4. Notes on the methodology of the calculation of the index can be found on the website: http://web.pdx.edu/~ito/Chinn-Ito_website.htm.

of financial institutions and financial markets: depth, access, and efficiency. The higher the value, the more developed the financial system is.³

c) Shift from ‘bank-based’ to ‘market-based’ financial system

The shift from a bank-based to a market-based financial system has been identified in the literature as another important indicator for financialisation. The study of Karwowski and Stockhammer (2017) reviewed the increasing importance of capital markets (relative to bank credit) as a source of funding for firms as one driving force behind financialisation. Whereas in the bank-based systems, bank credit is the most dominant source of finance for firms, in the market-based systems capital markets are the key source of funding for firms (Gerschenkron 1962). Beginning in the late 1970s when the process of financial market liberalisation in the advanced countries started to unravel, stock markets gained significance (Aglietta and Breton 2001). Lapavitsas (2009a) argued that in relation with the Washington Consensus ‘recommendations’ for capital market deregulation by the World Bank and the International Monetary Fund (IMF), the capital markets in emerging countries started gaining more significance than bank credit. The stock market value traded relative to bank credit will be used as an indicator for the shift towards ‘market-based’ finance. The higher the indicator, the bigger the tendency towards ‘market-based’ finance.

d) Debt of households, the government, and the corporate sector

Accumulation of debt among households and NFCs has been largely associated with financialisation in the emerging countries in Central Eastern Europe (Gabor 2012). The entry of foreign banks in these countries has created ample opportunities for favourable credit for

³ One can look separately at the development of the three dimensions (depth, access, and efficiency) for each country for both financial markets and financial institutions. However, this kind of analysis goes beyond the scope of our paper. For more information, visit the IMF website: <https://data.imf.org/?sk=F8032E80-B36C-43B1-AC26-493C5B1CD33B>

the households (Karwowski and Stockhammer 2017). NFCs, especially in advanced countries, have been put under pressure to make short-term investments in order to stay internationally competitive. Hence, there is a tendency of NFCs becoming quite active in the financial markets. Authors have pointed towards a shift of firms from stakeholder to shareholder corporate structure (see Lazonick and O'Sullivan [2000] for the US). Household debt and NFCs debt (both as a share of GDP) will be used as indicators for the exposure of households and NFCs to financial markets and their debt burden.

The government is an important actor in the process of financialisation as well. Karwowski (2019) explores the changing role of the government in the process of financialisation by focusing on monetary policy (central banks' pursuit of financial market deregulation and promotion of market-based liquidity management of the financial institutions) and fiscal policy (through creating secondary markets for public debt and through transformation of public services, like pensions and social provision). In order to have a more complete analysis of the government's involvement in the financialisation dynamics we need to also look at the structure of public revenues and expenditures. But, due to the limits of this paper, we will focus primarily on government debt as an aggregate.

e) External debt position of the households, the government, and the corporate sector

It is, however, even more important to look at the composition of debt of the economic sectors. Capital account liberalisation has made the financial markets of EEEs more vulnerable and exposed to capital fluctuations in and out of the countries. Accompanied by exchange rate fluctuations, capital account deregulation has impaired the domestic economic actors in servicing their external debt.⁴ Driven by the relatively low borrowing costs of credit

⁴ We apply here the definition of the World Bank with regards to external debt: 'Gross external debt, at any given time, is the outstanding amount of those actual current, and not contingent, liabilities that require payment(s) of interest and/or principal by the debtor at some point(s) in the future and that are owed to

denominated in euros, dollars, or Swiss franc, firms in EEEs preferred external finance to credit denominated in a domestic currency. If the domestic currency has lost one or more of its money functions, dollarisation and currency mismatch can occur. To address the external debt position of the economic actors, we will look at the external debt of the private sector (including the external debt of the households, financial and non-financial companies, and banks), and the external public debt (composed of the external debt of the government, and the central bank).⁵

4. Dynamics of financialisation in EEEs

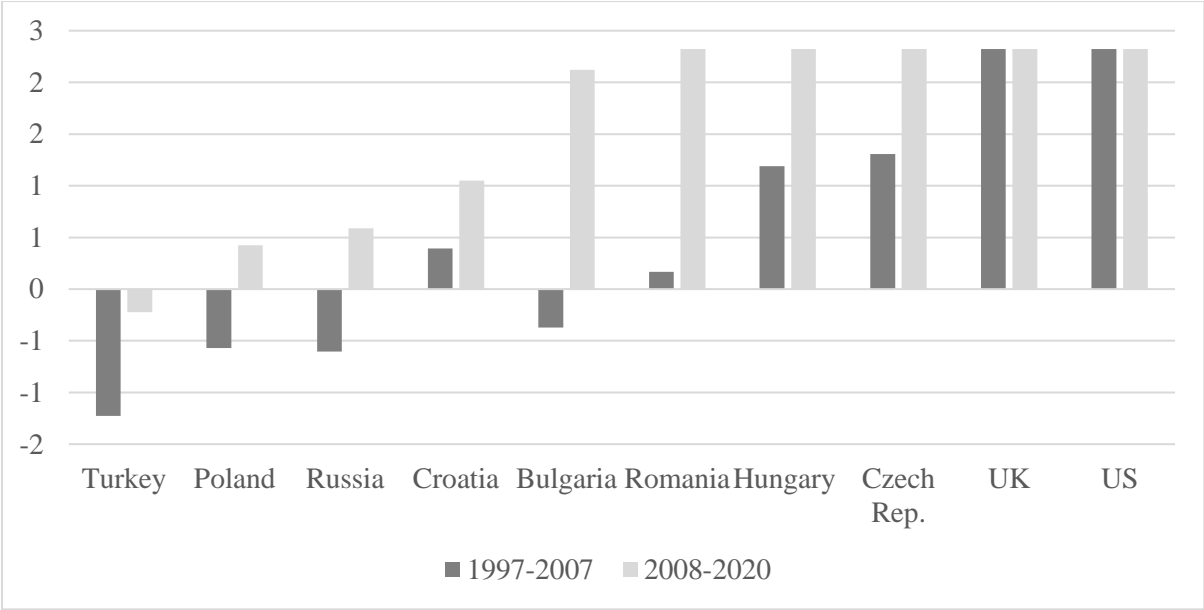
In this section we will analyse the aforementioned aspects of financialisation in the EEEs. One of the most important drivers of financialisation particularly in emerging countries as elaborated earlier is the growth of capital inflows. The first indicator we will look at is the Chinn-Ito index as a proxy for the level of capital account liberalisation. Figure 1 shows the capital account openness among the EEEs. Vis-à-vis the Anglo-Saxon countries that already liberalised their capital account to the fullest extent in the 1990s, the EEEs in our sample maintained some capital controls as a remnant of the transition period. The EEEs can be classified in two groups depending on the level of capital account openness. On the one hand, there is a group of EEEs that did not fully deregulate their capital account. Turkey, Poland, and Russia are the least financially liberalised countries in our sample. In the late 1990s Turkey experienced boom-bust cycles and high volatility of capital flows, with episodes of high capital inflows that increased the vulnerability of its financial system, caused an appreciation of the currency, and resulted in financial crisis. On the other side, Romania, Czech Republic, and Hungary went for (at least ‘de-jure’) full capital account liberalisation in

nonresidents by residents of an economy.’ See the website of the World Bank for more information: <https://datahelpdesk.worldbank.org/knowledgebase/articles/474124-what-is-external-debt>

⁵ Owing to unavailability of comparable data for the external debt of the individual economic sectors for the EEEs, we focus on the two composite indicators: external private debt and external public debt.

the decade after the financial crisis (Kazandziska 2019). But all in all, one can spot a tendency towards capital account liberalisation among all EEEs.

Figure 1: Capital account liberalisation in the EEEs, (average values of the Chinn-Ito index) 1997-2020¹



Note: ¹ Data are only available until 2019.

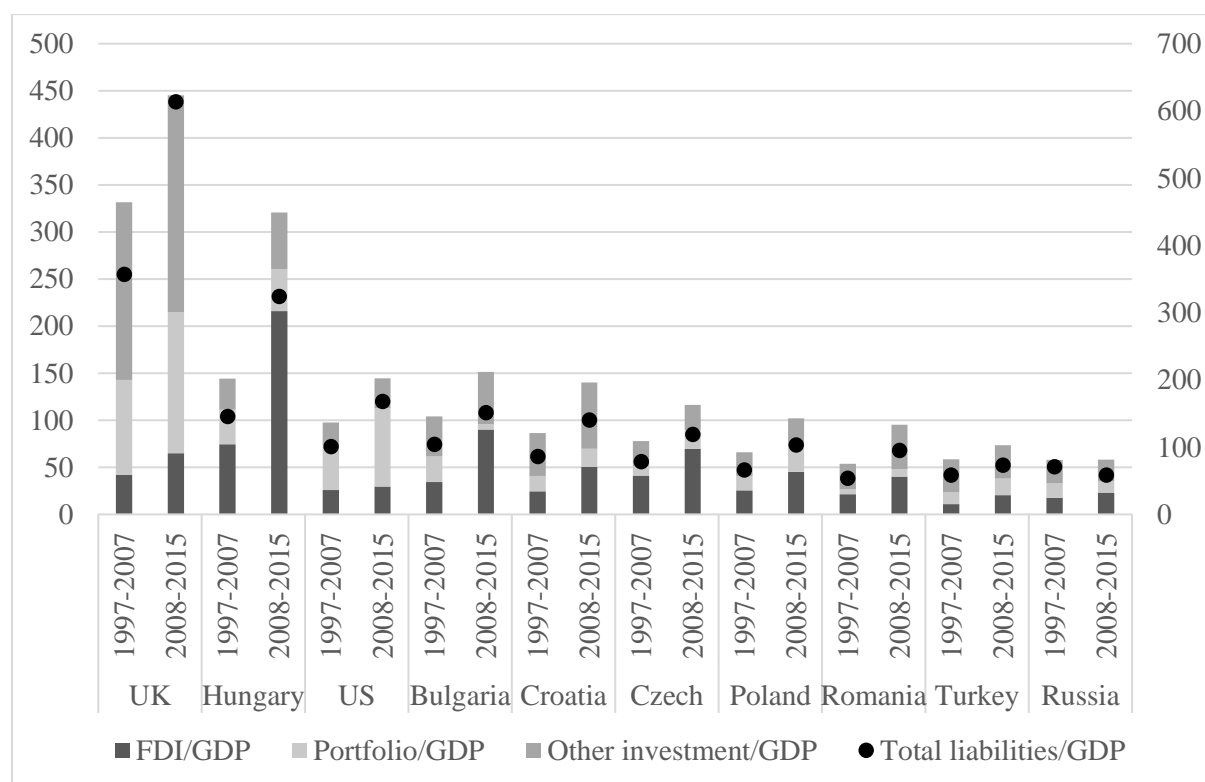
Source: Chinn/Ito 2021.

One can look at the composition of the financial liabilities to understand the source of financial inflows and the accumulation of liabilities in the EEEs. Figure 2 shows that few EEEs (Hungary, Czech Republic, and Poland) received capital flows primarily in the form of FDI. The latter was an important driver for economic growth in these countries. In the run up to the financial crisis of 2008, the stock of foreign liabilities in Croatia, Romania, Turkey, Russia, and Bulgaria increased predominantly due to other investment inflows.⁶ These countries received a significant part of their capital inflows in the form of interbank loans and

⁶ US and UK saw their foreign liabilities increase owing to portfolio investment and other investment inflows.

trade credit (Bogumil 2014: 2). Russia is the only net creditor country in our sample. It invests heavily in foreign assets, primarily in foreign exchange reserves (BIS 2013: 295).

Figure 2: Composition of foreign liabilities in EEEs (share of GDP, per cent), average values, 1997-2020¹



Note: ¹ Data are available until 2015. Data on total liabilities-to-GDP are given on the right y-axis.

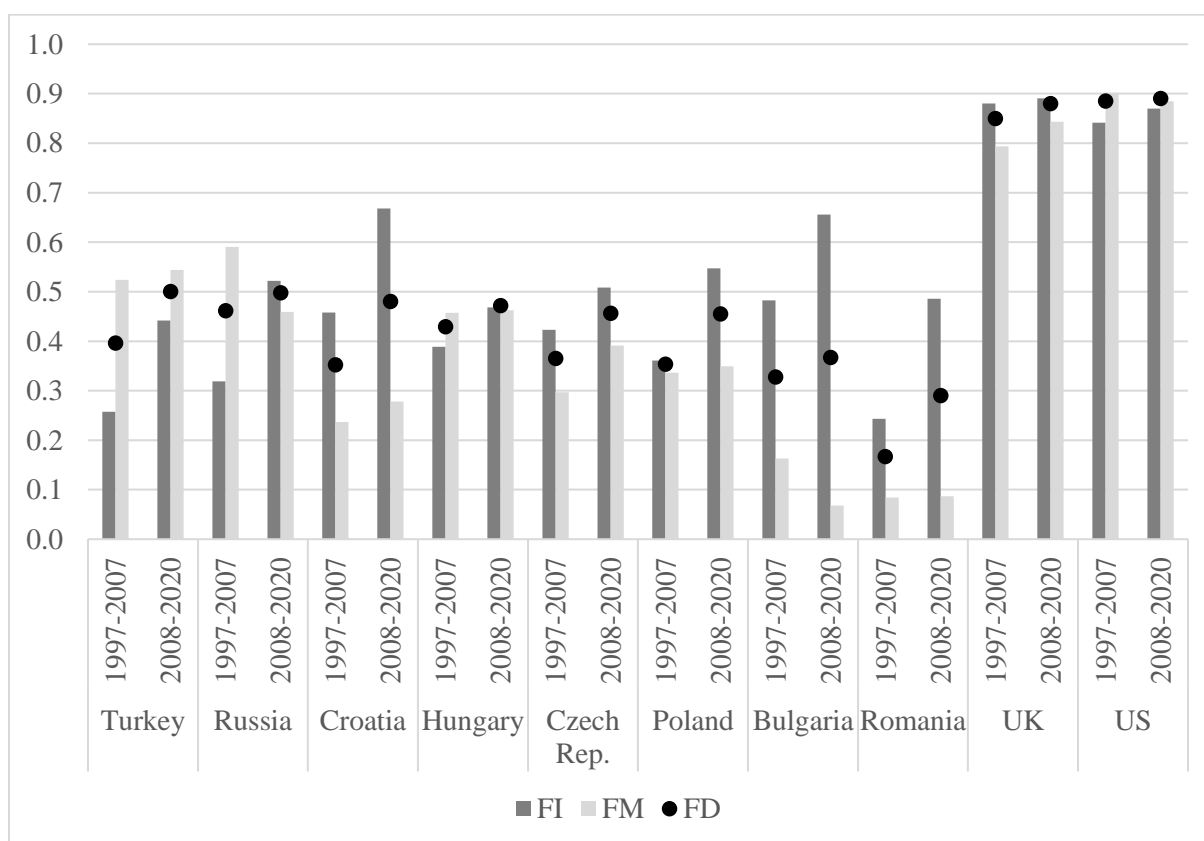
Source: Lane/Milesi-Ferretti 2018.

We will use the indicator ‘financial development index’ from the IMF (2021) as a proxy for the level of financial development of a country. This indicator consists of two elements: financial institutions and financial markets.⁷ The highest value of the financial development

⁷ Visit the website of the Financial Development Index Database of the IMF (2021) for more information on the construction of the index and its components (Financial Development - Story - IMF Data). Financial markets compose predominantly of stock and bond markets, while financial institutions include banks, mutual funds, pension funds, insurance companies, and other non-bank financial institutions.

index (as well as its two components – financial institutions and markets), is one, and the lowest is zero. Figure 3 shows that in the aftermath of the financial crisis of 2008 the overall financial system depth in the EEEs increased compared to the period before. Yet, relative to the UK and the US, the EEEs reached a much lower level of financial system development. It is also noteworthy to mention that using this indicator, Russia and Turkey are some of the countries that had a relatively high level of financial development. They had strong development of their financial markets in the late 1990s/early 2000s, but the level of financial market development in Russia dropped at the onset of the Great Recession. Turkey's financial markets continued to grow when the government actively supported the process of securitisation and the deepening of the bond markets in 2009. Before the financial crisis of 2008, Turkey's financial institutions were relatively poorly developed, but they caught up in the aftermath of the financial crisis. Romania shows the lowest degree of financial development throughout the whole period of observation.

Figure 3: Financial development index in EEEs, average values, 1997-2020¹²



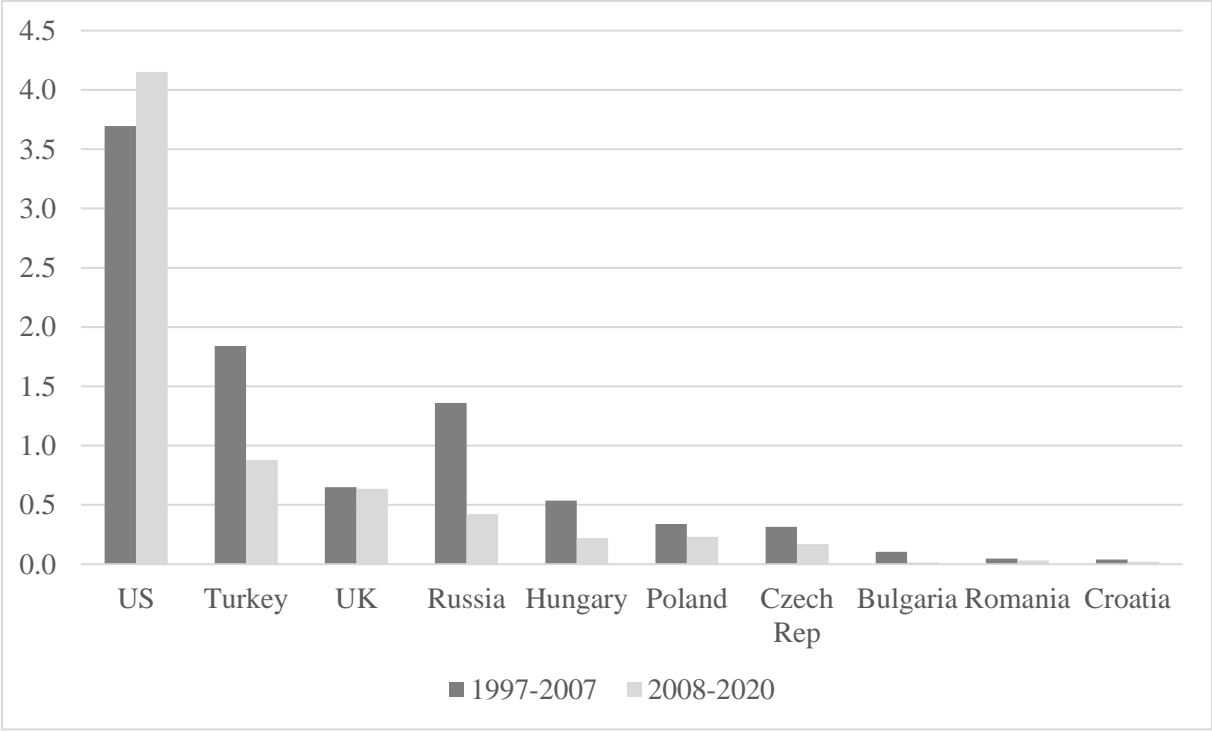
Note: ¹ FD stands for financial development index, FM – financial markets, and FI – financial institutions. ² Data are only available until 2019.

Source: IMF Financial Development Index Database 2021, author's calculations.

Figure 4 shows the development of market-based in relation to bank-based financial systems. Following Karwowski and Stockhammer (2017), we use the ratio of stock market value traded divided by bank credit (both as a share of GDP) to show the increased role of the capital-markets vs. bank-dominated financial systems. A value above one indicates a more dominant position of capital markets relative to banks in their financial systems, and a value below one implies that bank lending is stronger than capital markets activity. Turkey and Russia show the most prominent shift from the bank-based towards the market-based financial system in the decade prior to the financial crisis in 2008. Using this indicator, these two countries had a stronger shift towards market-based finance than the UK. In the other

EEEs the ratio of stock market value traded relative to bank credit was lower than one, which means that bank credit remained the most important source of external funds for firms. The stock market in relation to bank credit was the lowest in Croatia and Romania. It is noteworthy to mention that in all the EEEs, bank credit regained its importance in the years following the Great Recession.

Figure 4: 'Market-based vs. bank-based' indicator (share of GDP, per cent), average values, 1997-2020



Source: World Bank 2021, authors calculations.

The fall in nominal and real interest rates in the early-2000s encouraged borrowing of the private sector in the emerging countries of our sample. Figure 5 shows the level of debt of non-financial corporations. Non-financial corporations (NFCs) debt-to-GDP ratio will be used

as a proxy of financial distress of firms. The data for the levels of debt to GDP for all economic sectors are retrieved from the Bank for International Settlements (BIS).⁸

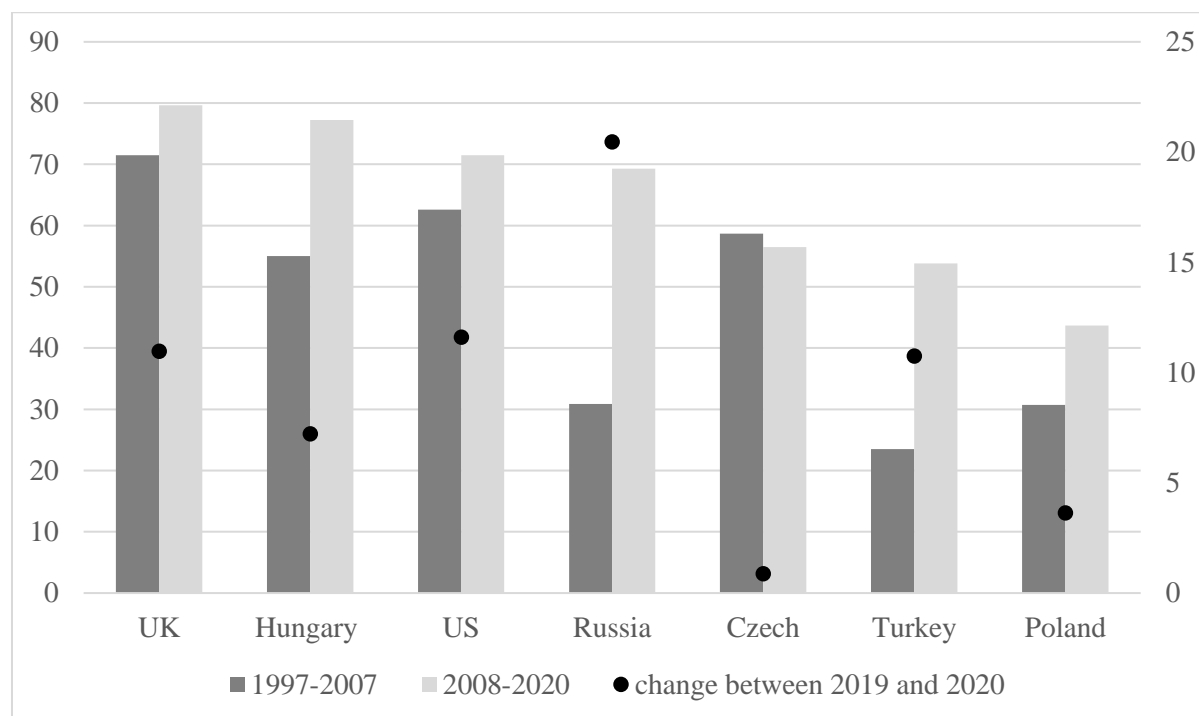
Before the Great Recession, Czech Republic had the highest level of NFCs debt with an average value of slightly less than 60 per cent, followed by Hungary with an average value of 55 per cent. During the same period, the NFCs in Russia were the least indebted according to this indicator. After the outbreak of the financial crisis in 2008, the NFCs in EEEs increased their debt relative to GDP. In Czech Republic, contrary to Hungary, NFCs switched towards deleveraging. Compared to the two Anglo-Saxon countries, we can argue that the NFCs in EEEs had lower debt as a share of GDP.

However, looking more closely one can observe that EEEs marked a strong increase of their NFCs debt-to-GDP ratios relative to the Anglo-Saxon countries. For example, the NFCs in Russia had initially a low level of debt of about 30 per cent on average between 1997 and 2007. However, the NFCs debt rose by more than 120 per cent in the second period of analysis (2008-2020). Similar dynamics of growth could be identified for Turkey.

The NFCs became strongly affected by the Covid-pandemic, particularly in the tourism, travel, accommodation, and retail sectors. The debt of the NFCs in 2020 rose to the largest extent in Russia and to the smallest extent in the Czech Republic (Figure 5).

⁸ The Eurostat database could be also used to obtain data for NFCs debt. However, this database lacks data on the UK and the US. Furthermore, data on NFCs' debt diverge (for some countries of our sample) significantly from the BIS database, which is more commonly used in the financialisation literature. Therefore, we decided to use the BIS database instead, for the debt of NFCs, governments, and households. This database unfortunately does not contain data on NFC debt for Croatia, Bulgaria, and Romania; therefore, Figure 5 does not include these countries.

Figure 5: Level of debt of non-financial corporations (NFCs) (as a share of GDP, in per cent), and the growth of the NFCs debt in the pandemic

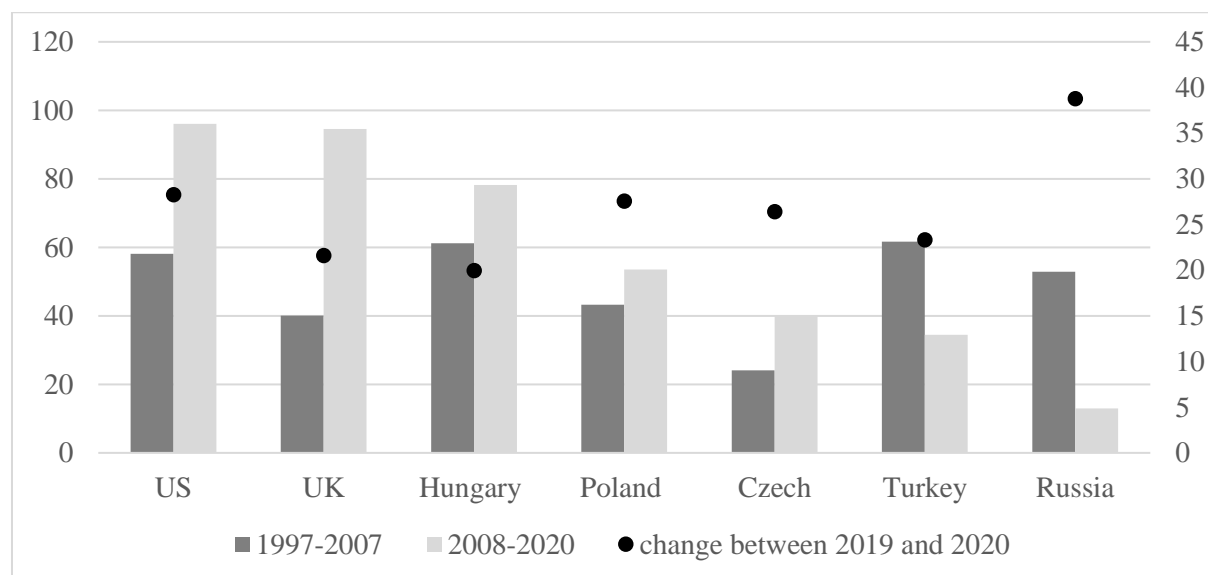


Note: The averages (1997-2007 and 2008-2020) for the NFCs debt-to-GDP ratio are indicated on the left y-axis, while the percentage change in the indicator between 2020 and 2019 is shown on the right y-axis.

Source: BIS 2021, author's calculations.

Public debt-to-GDP is the next indicator we will analyse. In the decade succeeding the financial crisis in 2008 the governments in Turkey and Russia managed to reduce their public debts relative to GDP, whereas public debt continued to rise in Poland, Czech Republic, and Hungary (Figure 6). The Covid-pandemic led to serious collapses of the economies in emerging countries in Europe. The governments in EEEs increased their borrowing leading to rising public debt-to-GDP ratios. For instance, in Russia the public debt-to-GDP ratio rose by almost 40 per cent between 2019 and 2020. Relative to UK, government debt-to-GDP in EEEs increased at a larger pace during the Covid-pandemic.

Figure 6: Level of public debt (as a share of GDP, in per cent), and the growth of public debt in the pandemic



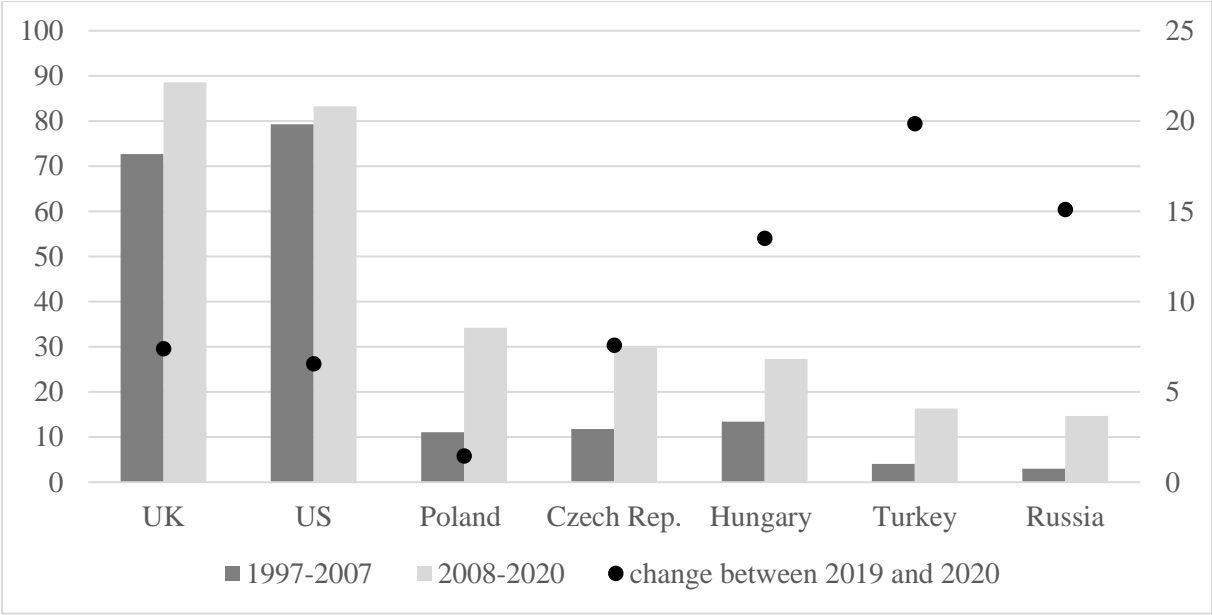
Note: The averages (1997-2007 and 2008-2020) for the public debt-to-GDP ratio are indicated on the left y-axis, while the percentage change in the indicator between 2020 and 2019 is shown on the right y-axis.

Source: BIS 2021, author's calculations.

Households have become involved in the financialisation process of EEEs through the privatisation of the health-insurance system, as well as the (at least partial) privatisation of the pension systems, and increasingly through real-estate and stock purchases (Lapavitsas 2009b). Figure 7 shows the level of households' debt measured as a ratio of household debt-to-GDP. Relative to the households in the Anglo-Saxon countries, their counterparts in the EEEs were less indebted. Russia, followed by Turkey, had the lowest household debt-to-GDP ratio. Using this indicator, we can argue that the households in EEEs were less exposed to financialisation than the Anglo-Saxon countries, whose household debt-to-GDP ratio ranged between 70 and 80 per cent on average before the financial crisis. However, we can also spot

a tendency of a rise of households' indebtedness in the years following the Great Recession. The household-to-GDP ratio in Poland reached the highest level of around 34 per cent.

Figure 7: Level of household debt (as a share of GDP, in per cent) and the growth of the household debt in the pandemic



Note: The averages (1997-2007 and 2008-2020) for the household debt-to-GDP ratio are indicated on the left y-axis, while the percentage change in the indicator between 2020 and 2019 is shown on the right y-axis.

Source: BIS 2021, author's calculations.

EEEs started off from rather low levels of household debt. The household debt-to-GDP ratio in Russia was less than 1 per cent in 1998 and increased to 10 per cent in 2007 (BIS 2021). Hence, even though the level of household debt relative to GDP in the EEEs was lower than in the UK and the US, the increase of household debt as a share of GDP in EEEs was much stronger than in the Anglo-Saxon countries.

During the Covid-pandemic, all the EEEs experienced rise of the household debt-GDP ratio. In the first half of 2020 households were hesitant to consume as many countries were in a lockdown; hence, the household debt-to-GDP increased only slightly in the first quarter of 2020 (BIS 2021). However, in the second half of 2020, household debt started picking up. Low-income households were severely affected by the Covid-pandemic because they saw their incomes being reduced. They had to accept reduction of their working hours, were put on furlough, or lost their jobs. The borrowing of the low-income households picked up in the Covid-pandemic to cover the costs of food and/or rent because these households did not have sufficient savings to weather even temporary losses of their income (Francis-Devine 2021: 13).⁹

Albeit the level of indebtedness of households in EEEs is relatively low (compared to the UK and the US), the risk of over-indebtedness is quite substantial. For illustration, 36 per cent of the households in Croatia in 2016 were at risk of over-indebtedness, followed by Bulgaria (31 per cent).¹⁰ According to Eurofound (2020), households are considered at risk of over-indebtedness, if in the past 12 months they were not able to make scheduled payments for rent, utility or telephone/internet bills, mortgage payments, payments for consumer loans, or informal loans (taken from friends). Hence, even though financialisation in EEEs is at a lower level compared to the UK, the risk of over-indebtedness in the former is significantly higher compared to the latter.

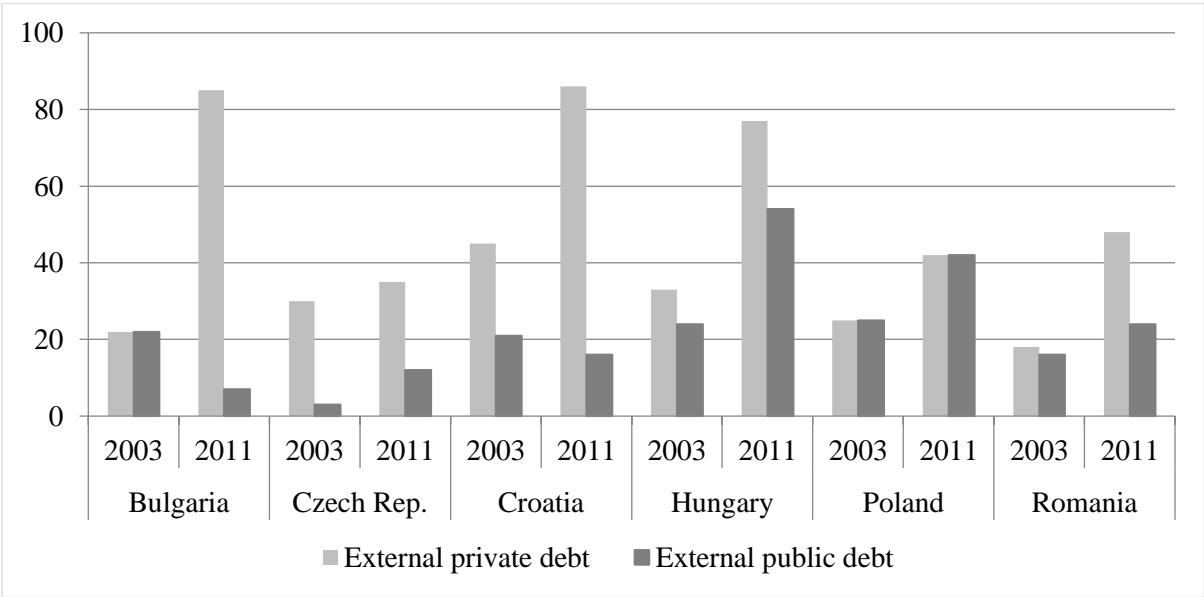
The last aspect that we will analyse is external debt. Against the background of relatively weak or unstable domestic financial systems, firms in EEEs relied on external funds to finance investment and production. In the cases where the external finance predominantly finances the export sector, the danger of a currency mismatch can be minimised. However, if

⁹ Poland did not see its household debt-to-GDP ratio rise in 2020. This is due to the fact that Poles are rather conservative towards consumption even during economic boom; hence, they largely resorted to depleting their savings in 2020 and 2021 (Szustak, Gradon, and Szewczyk 2021: 12).

¹⁰ For comparison, in the UK 12 per cent of the households was at a risk of over-indebtedness.

the domestic financial system does not properly function, and the domestic currency cannot fulfil all the functions of money, then the problem of a currency mismatch elevates. When capital inflows are suddenly reversed, the whole financial system can collapse. To address these concerns, we will explore the external private, and the external public debt. External debt of the private sector rose in all EEEs in the decade after the Great Recession (Figure 8). Overall, Croatia and Bulgaria, followed by Hungary had the highest external private debt as a share of GDP. In the years following the financial crisis of 2008, external debt of the public sector rose in the majority of the countries, and it declined in Bulgaria and Croatia.

Figure 8: External debt in the EEEs in 2003 and 2011 (as a share of GDP, in per cent) ¹



Note: External private debt includes debt of the households, financial and non-financial companies, banks, as well as inter-company loans. External public debt includes the debt of the government, and the central bank. Data for Russia, Turkey, UK, and US are not available.

Source: Giday 2013, Tables 7, 10.

In juxtaposition with external debt ratios, it is of key importance to analyse the currency denomination of external debt to capture more closely the potential risk of dollarisation and currency mismatch. In the EEEs foreign-currency-denominated debt constitutes the bulk of the gross external debt. In 2021 between 60 and 96 percent of the total gross external debt was denominated in a foreign currency in these countries (World Bank, 2022). The only exception is Czech Republic, where 52 percent of the external debt had domestic currency denomination. In contrast, 92 per cent of the external debt in the US was denominated in a domestic currency.

5. Types of financialisation in the EEEs

Financialisation in the EEEs has been largely encouraged by foreign capital inflows (Figure 3). Foreign ownership among banks in the EEEs increased substantially between the late 1990s and 2000s. Through the process of privatisation, foreign banks (mainly Western European) increased their presence in Central Eastern Europe both through their subsidiaries and by cross-border loans (Bubbico et al. 2017). The share of foreign-owned banks in the total number of banks ranged between 49 per cent in Turkey and over 60 per cent in Hungary, Bulgaria, Poland, and Romania in 2008 (EBRD 2009). In the EEEs, except Russia and Turkey, foreign banks have also owned the majority of assets in the banking sector (over 70 per cent in 2008).

As Berglöf and Bolton (2001) argue, by the end-1990s the financial systems were characterised by primarily foreign-owned commercial banks, which gave credit predominantly to the government. Companies at the time, received the bulk of the finance from their retained earnings. From 2000s on there has been strong credit creation towards the private sector, whereby the borrowing dynamics of households in the EEEs seems to have been particularly pronounced. Foreign banks in Poland, as well as the other EEEs of our sample (excluding Russia) were the main providers of credit to the private sector. We can call

this type of financialisation ‘foreign-finance-led’. To a large extent denominated in a foreign currency (the Euro or the Swiss franc), the increase in debt led to financial distress of the households that had to take over the exchange rate risk of the foreign-currency debt (Bohle 2014). Mortgages denominated in a foreign currency were particularly attractive because they offered lower interest rates, less stringent assessment criteria, and had longer duration than mortgages in a domestic currency (Büdenbender and Lagna 2019).

Financialisation in Russia, however, was not primarily driven by foreign capital inflows. Big role in the process of financialisation was given to the government. We can call this type of financialisation ‘state-led’ financialisation, which means a financial system that is:

‘(...) largely controlled by the state as most key financial firms, including banks, securities firms, insurance companies are state-owned.’ Pan, Zhang, and Wu (2021: 750)

In the state-led financialisation the government plays a predominantly important role in encouraging and promoting financialisation using various tools. Pan, Zhang, and Wu (2021) explore the financialisation dynamics in China and identify two characteristics of this type of financialisation. On the one hand, the government promoted market-based reforms to open up financial markets, but on the other, supported by state-owned banks and state-owned financial institutions, the government set the main directions for the development of financialisation in this country.¹¹ According to the authors, the combination of the government and state-owned companies on the one hand, and the market-orientation on the other, is the key to understanding state-led financialisation in China.¹²

¹¹ The Chinese government is interested in promoting financialisation, for instance, via encouraging an entry of state-owned enterprises in the stock exchange (Pan and Xia 2014).

¹² Pan, Zhang, and Wu (2021) argue that the forms and characteristics of state-led financialisation can vary between countries.

Let us elaborate on the Russian state-led financialisation in more details. Already in the mid-1990s there were recommendations by the IMF and the World Bank within the Washington Consensus policy package for Russia to follow the path of deregulation (Gilman 2010: 262–3). In 1997 and 1998 Russia started liberalising capital account, but only partially and primarily in the sphere of short-term government bonds, which was transitory because of the financial crisis that hit Russia in 1998. In the 2000s and especially between 2006 and 2008 Russia experienced strong increase in securitisation. Nevertheless, as the global financial crisis of 2008/09 started spreading over the Russian territory, the government turned towards a policy of re-nationalisation of banks (Viktorov and Abramov 2015). The process of re-nationalisation of banks was accelerated in 2014 as a result of the conflict that arose between Russia and Ukraine, when the former annexed Crimea.

The financial sector in Russia is highly dominated by the government and the Central Bank of the Russian Federation (CBR). Hence, CBR has a dual role of a regulator and a partial owner of shares in the banking system in Russia (BER 2021). Commercial banks play an important role of accumulators of foreign currency through export revenues of their corporate clients, which the central bank needs for its foreign exchange reserves. Through commercial banks, the central bank and the government participate in the allocation of credit, which can be politically motivated (Büdenbender and Lagna 2019).

Between the central bank and commercial banks there is one more important pillar in the banking system, which are the state-owned banks. Similar to China, state-owned banks make the bulk of the Russian banking system (Sutela 2012: 168–77). Assets of the state-owned banks in total made up over 65 per cent of the total banking sector assets, primarily in the hands of the four largest state-owned banks (Sberbank, Gazprombank, VTB, and Rosselkhozbank) (Bofit 2019). The largest state-owned banks are also the first ones that receive financial assistance from the government in times of crisis.

‘They act as agents of the monetary authorities in supplying credit, channelling liquidity into the system, bailing out weaker institutions, setting a politically desirable price level for loans and deposits, and supporting the money exchange and even the stock market.’ (Vernikov 2012: 257).

Overall, in the years of economic expansion, which are strongly correlated to oil price increases and rise in export surpluses, the government accumulates substantial foreign exchange reserves that are then used to bail out large private companies via state-owned banks (Viktorov and Abramov 2015).

Another important mechanism through which the government is involved in the process of financialisation is through the state-owned Agency for Housing Mortgage Lending (AHML). In times of crisis AHML bought mortgage-backed securities and covered banks from commercial banks to ‘free up their accounts’ (Büdenbender and Lagna 2019: 112). Moreover, AHML has served as a vehicle for social policy for the government through which it gave preferential housing loans to socially vulnerable groups.

Other agents through which the government is involved in the process of financialisation in Russia are Vneshekonombank (the state development bank), ASV (the deposit insurance agency) and various state-owned companies that were in charge of rescuing failed private banks after 2008 and 2014, using government funds (Vernikov 2012).

6. Conclusions

In this paper we analysed the dynamics of financialisation in selected countries in emerging Europe and compared them with the developments in the Anglo-Saxon countries as some of the most financialised countries worldwide. The focus of this paper was on the decade before and the years after the financial crisis of 2008, including the latest course of events caused by the Corona-pandemic.

After providing an overview of the financialisation literature related to emerging countries, the paper analysed the process of financialisation in the EEEs looking into the development of specific elements/interpretations of financialisation. It was found that EEEs experienced strong financial inflows and an accumulation of foreign liabilities. Russia was relatively less exposed to foreign finance. In Russia, the government is an important factor for the development of financialisation either in a direct (as a majority shareholder) or in an indirect way (banks controlled by state-owned companies and banks).

One can say that financialisation in EEEs developed in a heterogenous way. There is a difference between countries in terms of the intensity of financialisation dynamics portrayed through the financialisation indicators. As a whole, the financialisation in the EEEs was less intensive than in the Anglo-Saxon countries. However, the debt dynamics of the EEEs were more pronounced than in the latter, which raise concern about the fragility of their financial systems, particularly amidst the Covid-pandemic, when the households, the NFCs, and the governments saw their debt-to-GDP ratios rise. Hence, even though the level of debt relative to GDP has been low compared with the UK or the US, the debt dynamics over time need to be carefully approached and monitored. The level of external debt of the EEEs is important to be considered as well. Their external debt is increasing and is primarily denominated in a foreign currency, which increases the danger of currency mismatch and financial crises.

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