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Overview: Financialization as Financial Neoliberalism

This book is about financialization, a term that has become popular to describe developments over the past 30 years within the global economy, and particularly within developed industrialized economies. Seen in that light, financialization represents the most recent stage of capitalist economic development.

Krippner (2004) provides a history of the term “financialization,” and describes one definition as the dominance of the shareholder value model of corporate governance. Krippner (2005, p.174) also offers her own definition as “a pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production.” Epstein (2004, p.3) defines it as “the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies.”

A simple alternative definition is that financialization corresponds to financial neoliberalism which is characterized by domination of the macro economy and economic policy by financial sector interests. According to this definition, financialization is a particular form of neoliberalism. That means neoliberalism is the driving force behind financialization and the latter cannot be understood without an understanding of the former.

1.1 Neoliberalism

Neoliberalism is both a political and economic philosophy (Palley, 2012; Chapter 2). As a political philosophy, it maintains that a laissez-faire deregulated market economy is the best way to promote individual freedom; as an economic philosophy, it maintains that a laissez-faire
deregulated market economy is the best way to promote economic efficiency and economic well-being.

In the language of economists, such market arrangements promote Pareto optimal outcomes in which it is impossible to make someone better off without making someone else worse off. The claim is that resources are used in a productively efficient way (that is, production takes place at minimum cost so that it is impossible to produce the existing output at existing prices using less input), and that all opportunities for mutually beneficial exchange are used so that no gains from trade are missed. Consequently, it is impossible to either reorganize production or change the pattern of exchange so as to make people better off. Note, this does not mean outcomes are fair. The actual outcome will depend on the initial distribution of resources, and if the initial distribution is unfair the final outcome will be unfair. The important point is that the final outcome cannot be improved upon without making someone worse off.

1.2 The special standing of financial markets in modern neoliberal economics

Neoliberalism elevates the standing of markets which are argued to coordinate economic activity in an optimal fashion. Moreover, market behavior is deemed applicable to almost all walks of life. Where markets exist, the presumption is they should be deregulated, and where markets do not exist they should be created if possible. The market is viewed as the pre-eminent institution of social organization and coordination.

Financialization (financial neoliberalism) singles out financial markets and gives them special elevated standing. First, financial markets are held up as the ideal market. The claim is financial markets clear continuously via rapid price adjustment and are stable, and financial prices embody all economically relevant available information.

Second, financial markets are given a special economic role regarding the allocation of saving; the promotion of capital accumulation; the reallocation and spreading of risk; and as an instrument of corporate control. With regard to the allocation of saving, financial markets transfer saving from surplus economic units (savers) to deficit units (borrowers). This is the traditional microeconomic interpretation of financial intermediation. In neoclassical macroeconomics this role is played by the loanable funds market. The transfer of savings to deficit spending units supposedly counters the Keynesian problem of deficient aggregate demand. Financial intermediation, performed by banks and the loanable funds market, therefore ensures full employment. It also increases growth by allocating