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The Macroeconomics of Financialization: Stages of Development Approach

Chapter 2 provided an empirical characterization of financialization. This chapter examines the macroeconomics of financialization using a stages of development approach that captures the evolving nature of financialization. This stages of development approach is suggested by Chick’s (1986) treatment of the evolution of banking systems.

A stages approach is very consistent with the notion of financialization as a long-running evolving process. It also links with two other strains of economic thought. The first is the French regulationist (Boyer, 1990, 2000) and American social structures of accumulation (Tabb, 2010) approach which sees economies in terms of regulatory, political, and institutional arrangements that shape the process of capital accumulation. The second is Minsky’s (Ferri and Minsky, 1992; Palley, 2009a) financial instability hypothesis that represents the economy as a financially driven long-running non-equilibrium process marked by changes in economic institutions, beliefs, and behaviors.

The chapter presents a series of simple models that describe a stylized history of financialization. This stylized history highlights both the economic impacts and the dynamic nature of financialization. The chapter focuses on the US economy, in which financialization is the most evolved and which therefore provides a longer, more extended, view that may be helpful for anticipating developments in other economies.

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The process governing the evolution of financialization is long, and the duration of individual stages may be of unequal length. Moreover, some stages may be expansionary, while others may be contractionary. The beginning and middle stages of the process tend to be marked by expansionary forces, but the mature, later stage is likely marked by stagnation. The extended duration of the process means it can look stable yet ultimately prove unstable; formal discussion of the issue of stability is reserved for Chapters 4, 8, and 9 dealing with the business cycle, Minsky’s financial instability hypothesis, and growth.

The fact that financialization is an extended process poses deep political and policy challenges. The process of financialization develops over a long time period and looks good for much of the time, yet the crisis of 2008 has confirmed that it ultimately hits the economic rocks. That raises profound political problems of how to initiate policy change that alters the direction of the process. Who is going to believe the case for change, and who will be willing to bear the political cost of implementing change if current economic conditions look good? Politicians are not rewarded for imposing pain now even if doing so prevents far greater future pain. Instead, they are rewarded for good times now.

Analytically, the chapter changes the focus of existing enquiry on financialization. The existing conversation (see for example Hein, 2008a, 2008b; Hein and van Treeck, 2007) focuses on the effect of financialization on the goods market price markup, income distribution and stock market valuations. This interest in the markup comes from the traditional Kaleckian model, as the markup is critical for determination of the functional distribution of income between wages and profits. The impact of financialization on the functional distribution of income is a valid question, and the model that is developed is capable of addressing it. However, the wage share has been relatively stable, which suggests the markup is not the key issue for understanding financialization. Instead, the chapter directs attention to the role of debt and the changing financing behavior of corporations and households.

The chapter examines changes in the way that firms have financed investment combined with changing patterns of dividend payouts. In this regard, no distinction is drawn between stock buy-backs and dividends, which are treated as macroeconomically equivalent – though in practice there is a difference, owing to the tax benefit from distributing profits via buy-backs rather than dividends. Additionally, the chapter introduces consumer debt, which was of critical significance in the last US business cycle expansion that ended in December 2007.