Catherine Sifakis

University of Grenoble (UPMF), France - Centre de Recherches d'Economie de Grenoble (CREG)

Catherine.Sifakis@upmf-grenoble.fr

1/ How to explain financialization as a systemic transformation of the capitalist way of production and life?

The increasingly financial nature of capitalism is reflected in the growing importance of financial markets, motives, institutions and elites in the workings of the economy and in national and international centres of power.

This is the end result of a process of financial deregulation, which started in the 1970s, when the Bretton Woods system collapsed, and gathered momentum in the 1980s when all controls on movements of capital were lifted. Deregulation of financial systems and free movement of assets has brought about a new form of financial capital which has gradually achieved a predominant position in the global economy. It may be referred to as global finance. The aim of financial deregulation is to strengthen the position of financial markets – in which global-finance agents enjoy a dominant position – for collecting savings and funding investment. The decision by European Union authorities to fund public borrowing almost exclusively on the money and capital markets (aka securitization) has played a particular part in the rise of financial markets in Europe.

The agents of global finance may be divided into three categories: multinational banks and investment banks; institutional investors, such as pension funds, insurance companies, undertakings for collective investment in transferable securities (Ucits); and finally, the 1980-2000s saw the emergence of various other types of investment funds – hedge funds, equity funds, vulture funds and such.

Between these agents runs a very dense network of capitalistic connections. They are the material expression of the most complete merger ever achieved between banking and industrial capital. These agents also own the largest share of the debts contracted by European states and control almost all the stock markets.

They have brought about new forms of articulation between financial and productive capital, in particular with equity funds. When these funds take a share in a company, the purchase is almost entirely funded by bank loans paid back not by the contracting fund but by the company which has been taken over. Soon afterwards, after being restructured at a high cost in job losses, the company is sold off. In its quest for added value, productive capital increasingly takes the form of equity funds, due to the greater ease with which assets can be committed and then withdrawn. The legal status of equity funds leverages the advantage derived from the high mobility enjoyed by capital under the current rules on free movement of assets.

The setting up of this deregulated global financial order is largely the result of a series of initiatives and decisions taken by the American administration when it broke away from the world financial organization based on the Bretton Woods agreement. These initiatives were primarily the result of pressure exerted by US capital – first by banks, then multinational corporations. Until the 1970s the US banking sector was highly segmented geographically and under tight government control, in the latter case due to the crisis of the late-1920s which had made financial stability a government priority. As their profits dwindled in the 1960s US banks stepped up pressure on the administration – exerted since the end of the war – to remove controls on their business.

Financial deregulation also catered for the interests of monopolistic US capital, with its growing international reach. Efforts to relocate production reflect capital's essential tendency to extend the space from which it derives added value. This process began to gather speed in the 1960s, and then the crisis in the 1970s hit profit margins, providing a further stimulus for the international redeployment of capital.

The increasingly international character of production affected the attitude of industrial capital in the US to the regulation of financial activities, in particular the movement of assets. Leading US corporations originally endorsed the post-war financial order, but they gradually changed their minds due to the negative effects of such controls, in particular with regard to their increasingly international business.

Growing disillusion as to the capacity of Keynesian economic policies to overcome stagflation also explains the feeble resistance to deregulation of the economy and the triumph of free market ideals.

Last but not least financial deregulation, particularly the end to any controls on the movement of assets, played into the hands of US global economic interests. It encouraged international savings to flow into US financial markets, the most highly developed in the world. Demand for financial assets denominated in US dollars increased substantially. The great drawing power of its financial markets enabled the US to avoid the necessary efforts – higher taxes, lower public spending (particularly military spending) – to cope with its twin (budget and current account) deficits. Free movement of assets also made it possible to shift the burden of US monetary policy onto the rest of the world, witness the sudden increase in US interest rates implemented by Paul Volcker in the 1980s. This move encouraged higher interest rates all over the world, triggered the debt crisis in the developing world and raised the value of certain currencies, notably the Deutschmark, a trend which the Federal Republic had actively opposed. This significantly boosted the ability of the US to shape the economic conditions and policies of other countries. Finally the coming of the financial world order consolidated the position of the dollar as the prime international currency.

The financial deregulation initiated in the US gradually spread to the rest of the world, to the United Kingdom, then Japan and subsequently Europe. The global spread of financial deregulation was the result of the asymmetric ability of the US to impose economic policy options on the rest of the planet, and of the drive to achieve competitive deregulation of other capital markets set in motion by liberalization of US finance. In 1986 the Single European Act gave fresh impetus to the process of European integration, but also played a key role in lifting controls on the movement of assets worldwide. The last two factors contributing to this process were the determination of rising economic powers with plenty of financial clout (Japan) to open their markets, and the pressure exerted by Europe's multinational capital, particularly in finance, then undergoing large-scale consolidation.

Internationalization, then globalization, of production had a huge impact, a trend reflected in the relocation of industry to peripheral countries, particularly recently industrialized countries. Relocation, initially under tight control of multinational firms – actively incited by European capital – ultimately encouraged the emergence of national industrial firms in these countries. The overall effect of this process was to weaken – with some exceptions – industry in the US and Europe. The threat of relocation increased the bargaining power of multinational capital in its dealings with individual states and its ability to bend public policy to suit its interests. Lastly the decline in the west's industrial base increased the influence of global finance in capital and largely speculative financial dealings in the stock of US and European multinationals. A 1994 study by the Bank for International Settlements of swap markets, then enjoying massive growth, showed that non-financial firms were behind almost half of all currency-swap operations and more than a third of interest-rate swaps. A survey carried out by Fortune magazine indicated that the overwhelming majority of the executive teams of the top 200 US firms had no intention of pulling out of the derivatives market, explaining that these instruments were now part of their overall strategy.

The rise of global finance, which has brought about its unprecedented growth and global involvement in corporate funding, has wrought systemic changes in capitalism. A global capitalistic class is coalescing. The first key characteristic of this social caste – and the basis of its power – is the extreme mobility of assets, which means that workers the world over are in competition with one another. This is driving a radical shift in the balance of power between capital and labour, to the advantage of capital. It enables the agents of global finance and international firms to impose on companies in which they hold a share profit margins at least equivalent to those they could obtain from any other market, with the constant threat of withdrawing their backing and investing elsewhere.

The growing stranglehold of global finance results in the increasingly financial concerns of industry, which profoundly alters its principles and goals (*financialization of firm's strategies*). The sole objective of large capitalist enterprises is to maximize short-term shareholder value, setting very high targets.

The power of finance and the consolidation of management principles obsessed with creating shareholder value have major macroeconomic consequences, borne out by the concept of *financialization of economies*. The main negative impact of this process is on productive investment: paying high dividends to shareholders reduces the self-financing capacity of investment; companies have less scope for raising capital by issuing shares because in so doing they run the risk of undermining share prices and hence the potential value for existing shareholders. The increasingly financial focus of our economies and its counterpart, globalization, also encourages external rather than internal growth, and consequently relocation of production and productive investment in low-wage countries. The threat of relocation has prompted 'core' countries to introduce 'flexibility' policies in the labour market and to reduce payroll costs, with a corresponding knock-on effect on demand and hence productive investment. Inadequate investment in production is a factor in poor growth.

The financialization of capitalist economies and the corresponding financial deregulation have increased the debt burden of households and fuelled rising inequality of earnings.

Lastly, the interests of finance, backed by business in general, have reversed the direction of economic policies in order to boost profits. Economic policies in Europe exacerbate the negative effects of financialization for European workers. As a result workers are locked in a sort of box, its four walls formed by globalization, the end of full employment as a political priority, weak government, and a flexible job market. The pressure exerted by these walls, and the policies on which they rest, explains why wages are increasingly disconnected from productivity gains and why inequality is on the rise: private-sector workers are the victims of globalization; their public-sector fellows suffer from powerless government; all wage-earners are threatened by greater workplace flexibility and the end of full employment as a political priority.

2/ What role does the European Union and especially European Monetary Union play in financialization? In this context, European directives, treaties and funding mechanisms are of particular interest.

There are very close, indeed organic links between the process of European monetary union and financial globalization which led to the financialization the European economies.

Full deregulation of capital movements, key to financial globalization, forms the central plank of the Single European Act of 1986 which opened the way for European monetary union. The liberalization of capital flows concerned not only the residents of the European Union but also non-European capital - reciprocity non being required - whereas the liberalization of European capital movements was the only requirement for setting up the European financial area stipulated by the Single European Act. Free movement of assets is also recognized by all the subsequent European treaties, on which the running of the European Union is based.

The following factors influenced the decision to remove controls on the movement of assets:

- The crisis in the process of capital accumulation (see previous question) which caused stagflation and a drop in the rate of profit on capital.
- Growing pressure by the United States to remove all controls on capital movements. An additional factor was the Europeans' determination to reassure the US that the future European monetary zone would continue to be fully integrated in the US zone of influence.
- Lastly an end to controls on capital movements in Europe was a key argument in the strategy deployed to convince public opinion that the single currency was not only necessary, but inevitable. According to the Monnet 'method' – which underpinned and even directed the relaunching of European integration in the 1980s – free movement of capital, by spilling over onto economic policy (triangle of incompatibilities) would render the European Monetary System inoperative and make the single currency necessary.

The economic governance of the EU also depends on global finance. European institutions rely of the financialization of European economies and by the same token encourage this process.

The stranglehold of financial markets over the economic governance of the EU is a consequence of the shortcomings of the institutional structure of the EU.

The first source of problems is the way economic policy is organized, binding together the monetary and exchange rate policies of a set of countries with different characteristics and levels of development, with no active coordination of budgetary policies in the context of free trade and unrestricted movement of capital. The institutional setup of the EU aggravates the differences in competitiveness inside the EU, which are reflected in the amplification of real and financial imbalances, at the expense of peripheral EU countries. In the context of an economic recession the growing financial imbalances lead to a crisis in the solvability of banks, which in turn require rescue plans which undermine public finances. Private debt thus turns into public debt. As a result peripheral states are increasingly dependent on financial markets to cover their borrowing requirements. In this respect it should be borne in mind that since public debt has been securitized the financial markets have become the almost exclusive source of funding for states (financialization of public debt). This reform was carried out as part of setting up the European Financial Area provided for by the Single European Act.

A second source of problems derives from the powers allocated to the European Central Bank. Unlike all other central banks, it is not authorized to fund states directly. Obviously a change in the ECB statutes opening the way for direct funding of individual states would not solve the structural problems of the euro zone – far from it. But current ECB practice plays into the hands of global finance: financial institutions owning government bonds can be funded by the ECB in exchange for the relevant bonds while paying a very low rate of interest. On the strength of their improved liquidity they may then purchase more government bonds on the primary market, rewarded with very high interest rates.

A third shortcoming of EU economic governance relates to the importance of economic policy guidelines for the conduct of economic and particularly budgetary policies. The Maastricht and Amsterdam treaties (respectively 1992 and 1997) launched the trend towards economic 'constitutionalism'. The 'six-pack' and 'two-pack' directives, coupled with the Treaty on Stability, Coordination and Governance substantially tightened up the rules on budgetary policy. Application of the Budgetary Pact will plunge the euro zone into recession. Such is the conclusion of three independent economic institutes: Germany's Institut für Makroökonomie und Konjunkturforschung, the Observatoire Français des Conjonctures Economiques in France and the Österreichisches Institut für Wirtschaftsforschung. These organizations forecast that between 2010 and 2013 negative fiscal impulses in the euro zone would impact budgets, entailing a 6.7% drop in GDP for the zone as a whole. In crisis-racked countries such as Ireland, Spain, Portugal and Greece, the austerity measures would be even more severe, dragging GDP down by as much as 12 to 24%. Such measures would lead to aggregate growth losses ranging from 10% of GDP in Ireland to 25.3% in Greece, where they would lead to a total collapse of the economy.

It would be a mistake to imagine that the economic constitutionalism, reflected in the framing of cross-the-board economic policy guidelines, with which for the least developed EU countries have increasingly difficulty complying, could possibly go on working without the disciplinary power of global finance. Its attacks on sovereign debt are not just punishment inflicted on states for laxist management of their public finances. They are actually becoming an integral part of European governance, with the aim of bringing about far-reaching changes in the social model and the balance of power in the workplace.

The importance given to such guidelines in the conduct of European economic policies is an expression of the incomplete integration of the policy mix and of the European integration itself. The shortcomings of Europe's institutional structure are the result of disagreement between states on the modalities of integration, perhaps even on the principle of integration itself: disagreement on whether political union should come before or after, on how it should be achieved and who should foot the bill for the current running of the EU.

Far from liberating the EU from all-powerful global finance, the various 'solidarity' bodies or mechanisms set up since the start of the sovereign debt crisis – the European Financial Stability Facility and European Financial Stabilization Mechanism (EFSM) (2010), the European Stability Mechanism (ESM) (2012) – have in fact strengthened its grip. The role of these bodies is to loan funds to states which have difficulty borrowing on the financial markets. More specifically regarding the ESM, states must start by borrowing €80bn to endow the mechanism, with scope for its capital to be raised to €700bn. Its real capacity for intervention – and consequently the amount it will raise on the financial markets – will be much larger, its statutes allowing it to borrow three to four times its capital. The ESM, much as the EFSF and the EFSM, do not qualify for ECB funding. Banks, which can borrow at a very lower interest rate from the ECB, will loan funds to the ESM at a substantially higher rate. In turn the ESM will make loans to states at even higher rates and the relevant funds will be used to service the debt, paying off the holders of government bonds, in other words banks.

However, for the ESM to be able to borrow at low interest rates, it must maintain a good image with the rating agencies. Yet the mechanism's rating depends in turn on how highly the countries contributing its capital are rated – and most of them are out of favour with the agencies. The EFSF lost its triple-A when most European countries were downgraded. It is also open to question how the ESM will pay off what it borrows if the predicament of contributing countries, also in its debt, deteriorates or if interest rates rise. Furthermore the ESM has made it quite clear that EU countries will have to go on raising funds on the financial markets.

Lastly the Treaty on Stability, Coordination and Governance stipulates that the ratification of the Treaty is *a sine qua non* condition for countries in difficulties being able to resort to the ESM. Under the terms of the ESM treaty, in order to benefit from its funding, conditions such as macro-economic adjustment programmes will be imposed. We are all too familiar with the consequences of those already imposed on Greece.

3/ Why and how does the EU/euro crisis promote financialisation?

The euro zone crisis - mainly taking the form of sovereign debt crisis - is a direct and indirect consequence of the banking crisis which was fostered by financial deregulation. The euro zone crisis can be considered a direct result from the banking crisis, since the multiplication of bailouts of troubled banks led to unbalances in public finances, in particular in the least developed European countries. Indirect effects of the banking crisis have also contributed to worsen sovereign debt crisis insofar as the banking crisis, which turned into financial crisis, ended to widespread austerity policies leading to further deterioration of public finances. It should be recalled in this regard that the Spanish public debt - that was about 36% of GDP in 2007 before the outbreak of the "subprime" crisis - rose to 68.5% in 2011, the public debt of Ireland increased from 25 to 108%; while Portuguese debt rose from 62.7 to 107.8% during the same period.

The sovereign debt crisis in the euro zone promotes financialization:

- Firstly it worsens the dependance of states victims of sovereign debt crises from the financial markets for covering their funding needs.
- The sovereign debt crisis and the hardening of European economic policy rules it induces weaken the position of employees. They also lead to salaries reductions, favouring increasing shareholder value, which is the fundamental objective of the actors of global finance and multinational groups. The crisis that hits particularly Southern European countries, leads to definitive loss of competitiveness in these countries thus transforming them - and the evolution of semantics is revealing in this respect - in the immediate periphery of the dominant European countries.
- The sovereign debt crisis reinforces the influence of multinational capital through the development of a movement of large-scale privatizations in favor of foreign companies, mostly from creditor countries.
- The risk of explosion of the euro zone associated with the sovereign debt crisis, leads - by implementing recovery plans to states in difficulty – to the gradual transfer of the cost of the insolvency crisis from financial institutions to states and ultimately to taxpayers. This aggravates opposition, resentment and grudges between European countries and peoples.