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Financialisation, or the Search for Profits in the Sphere of Circulation

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Abstract

Financialisation of advanced capitalist economies during the last three decades represents expansion of the sphere of circulation, while the sphere of production has continued to face difficulties of profitability and productivity growth. In the course of financialisation, relations between industrial/commercial capital, banks and workers have been put on a different footing. The financial sector has become capable of extracting profit directly out of wages and salaries, a process called financial expropriation. Financial institutions have also become adept at profit-making through mediating transactions in open financial markets, that is, investment banking. The combination of financial expropriation and investment banking catalysed the crisis that began in 2007.

1. Analysing financialisation: Approach and method

Financialisation has attracted much interest among political economists in recent years, and even more as the crisis of 2007-9 began to unfold. There is no commonly agreed use of the term, though it certainly refers to the extraordinary growth of finance during the last two to three decades. Several analytical approaches to financialisation can be found in the literature, some of which are selectively mentioned below. Despite their differences, these approaches have a common thread, namely to associate financialisation with a change in the balance between production and circulation. That is the point of departure for this article.

Much of the original insight into financialisation came from the Marxist work of the Monthly Review current, guided by Sweezy and Magdoff, who began to draw attention to the growth of finance already in the 1970s. [1] For Sweezy (1997), financialisation is due to the transformation of capitalist accumulation commencing at the end of the nineteenth century. Financialisation is one of three underlying trends of capitalist development in the twentieth century, together with the slowing down of the rate of growth and the rise of monopolistic multinationals. There is a clear rationale for financialisation within the framework developed by Baran and Sweezy in Monopoly Capital (1966). Namely, in mature capitalism, the sphere of production is incapable of absorbing as new investment the ever expanding surplus generated by monopolies. Production therefore stagnates and capital seeks refuge in circulation, particularly in the speculative activities of finance.

Sweezy and Magdoff's observation of the changing balance between production and circulation is particularly prescient in view of the relative neglect of finance in the corpus of the current's economic work, including in Monopoly Capital. The impact of their argument – direct or indirect – can be discerned among political economists, Marxist and other. For, the argument does not ultimately hinge on the theory of the ever-expanding surplus inundating production. Rather, it is consistent with several theories that identify persistent malfunctioning in the sphere of production. It is not surprising that the idea that capital has escaped in circulation as production stumbled in the mid-1970s has become common currency among heterodox economists.

This notion, for instance, is present - if at times tacitly - in the work of Crotty (1990), Pollin (2007), and Epstein (2005). Moreover, for these writers financialisation is also associated with the re-emergence of the rentier, which exacerbates the malaise of

[1] See Magdoff and Sweezy (1987). Bellamy Foster (2007, 2008) offers a clear account of the use and meaning of the term for Monthly Review. Pollin (2004) has lauded Sweezy's early awareness of financialisation, acknowledging his own debt to it.

production. Financial profits have grown at the expense of industrial profits and rentiers are a deadweight on industrial capitalists. Consequently, financialisation has induced poor performance in investment, output and growth in developed countries in recent years. Considerable empirical research in this vein has emerged recently. [2] This work overlaps with post-Keynesian analysis of the problematic macroeconomic implications of 'finance-led accumulation'. [3]

Yet, from a very different Marxist perspective, Brenner (2002) also shares the notion that capital has sought refuge in circulation as production stagnated. Brenner, whilst avoiding financialisation as an organising category, certainly suggests that financial activities in circulation have grown as a direct response to profitability problems in the sphere of production. The Marxist analysis of Dumenil and Levy (2004), on the other hand, also emphasises the intensified search for profits in the sphere of finance as profitability in production has remained problematic and neoliberalism took hold.

From a still different, and much broader, historical perspective, the same notion is the basis of Arrighi's (1994) analysis of financialisation. Ranging over centuries, Arrighi essentially argues that finance and circulation thrive when production stagnates. For him, financialisation represents autumn in the long-term, cyclical alternation of dominant capitalist formations. Arrighi's work is one of the motivations of Krippner's (2005) thorough empirical study of financialisation of the US economy. Krippner established the rising importance of financial profits for non-financial corporations during the last five decades.

In a related way the idea that circulation has expanded and thrived as production entered a period of trouble is also present in the recent work of the Regulation School. [4] In a nutshell, as Fordism disintegrated, the search for a new regime of regulation moved into the sphere of finance. The new regime has begun to emerge through financial markets, particularly the stock exchange. The regulationist approach chimes with the voluminous work on changes in corporate governance since the 1970s. 'Shareholder value' and the associated short-termism of corporate enterprises have been extensively analysed and documented by political economists, business school writers, and economic sociologists. [5]

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[2] Notably Stockhammer (2004) and Orhangazi (2008).

[3] See Hein, Niechoj, Spahn and Truger (2008).

[4] See Aglietta (2000), Boyer (2000) and Aglietta and Breton (2001). See also Grahl and Teague (2000).

[5] Lazonick and O'Sullivan (2000) are particularly insightful. Shareholder value has been extremely prominent in the work of the CRESC group on financialisation, see Savage and Williams (2008) for recent work on financialisation and elites.

The crisis of 2007-9 has confirmed the emphasis laid by political economists on financialisation since it has emanated in the sphere of finance and spread to production partly through financial mechanisms. But the crisis has also presented unexpected developments shedding fresh light on financialisation and inviting a rethink of the relationship between production and circulation. Thus, its proximate causes are to be found in sub-prime lending in the USA which was exacerbated by financial engineering within the financial sector. It is unprecedented for a crisis of this magnitude to spring out of financial transactions involving the poorest sections of the working class. Moreover, its global spread is due, in the first instance, to securitisation associated with the adoption of investment banking functions by commercial banks. In short, financialisation in the 2000s has been closely related to the personal revenue of workers, while entailing a transformation of banking. The combination of the two has proven lethal for both finance and the productive sector.

A Marxist approach that is aware of these aspects of the current crisis can offer fresh insight into financialisation. As Sweezy and Magdoff noted, the balance between production and circulation has shifted in favour of the latter; however, the causes of the shift have to be reconsidered in terms of the fundamental relations of accumulation. It is shown below that the deeper roots of financialisation are to be found in the elemental relations among key economic entities of capitalist accumulation, namely industrial (and commercial) enterprises, workers, and financial institutions. In this light, and still more broadly, financialisation is due to changes in the forces and relations of production, combined with the transformation of the institutional and legal framework of capitalist accumulation in recent years.

The approach to financialisation proposed in this paper is explicitly informed by the classical Marxist debates on imperialism and finance capital at the turn of the twentieth century. At issue was the transformation of capitalism during the last quarter of the nineteenth century. Summarily put, giant monopolistic corporations had emerged, often organised as cartels that operated exclusive trading zones. Global finance, dominated by monopolistic banks, was on the ascendant. At the same time, British predominance in world markets was challenged by Germany and the USA. The political counterpart of these underlying trends was militarism and imperialism among the main powers.

Several Marxist theories contested the explanation of these phenomena, but Hilferding's (1981) analysis stood out. Hilferding, as is well known, argued that the transformation of capitalism was due to the rise of finance capital. This is an amalgam of industrial and banking capital created as monopolistic corporations come increasingly to rely on banks for investment finance. Finance capital is led by banks and 'organises' the economy to suit its interests, thus resulting in exclusive trading blocs and the export of money capital. Consequently, finance capital seeks to establish empire by mobilising political and military help from the state. Lenin (1964) took Hilferding's analysis, added 'parasitical rentiers' and greater emphasis on monopoly, and produced the definitive Marxist theory of imperialism in the twentieth century.

It is apparent that Hilferding's theory in its original form fits poorly the phenomena of contemporary capitalism. But for several reasons his theoretical thrust is sound, and can be a guide to analysis of financialisation.[6] First, Hilferding seeks the causes of the great transformation of his time in the fundamental relations of accumulation, rather than in policy or institutional change. Specifically, he claims that as the size of production grows, monopolies come to depend heavily on investment credit by banks. In his view this entails a closer relationship between banks and industry, and thus emergence of finance capital. Second, Hilferding is fully aware of the organisational implications of this development. Thus, finance capital rests on dense connections between finance and industry through interlocking appointments, exchange of information, and joint decision making.

Third, despite focusing on the rise of finance, Hilferding never opts for the opposition between 'active' industrialist and 'idle' financier. There is no suggestion in his theory of rentiers pressing on industrial capitalists and lowering investment rates, or rates of growth. Rather, finance capital is an amalgam, and hence industrial capital has a direct interest in the profitability of financial operations. Fourth, imperialism is not an arbitrary outcome of political choices but has roots in economic processes. By the same token, imperialism has a specific historical content and is not the result of, say, a human propensity toward aggrandisement and domination of others.

To be sure Hilferding also treats some economic phenomena perfunctorily, while overplaying his hand in other respects. Thus, his view that large monopolies increasingly depend on banks for investment finance is simply incorrect, and probably the result of focusing excessively on the German and Austrian economies of his time. Similarly, the notion that finance capital 'organises' the economy is far-fetched, and fits badly with the gigantic crises that took place in the 1920s and 1930s. Lenin was more careful on this score. Nonetheless, Hilferding's approach and results were path-breaking and a model for analysis of financialisation.

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[6] Bearing in mind that Hilferding's brief analysis of the sphere of production is grounded on inadequate empirical evidence.

For, financialisation has evident analogies with the transformation of capitalism at the turn of the twentieth century. Multinational corporations currently dominate the world economy; finance is again on the ascendant globally; capital export has grown substantially; a certain type of imperialism has reasserted itself. At the same time, there is no fusion of banks with industry; banks are certainly not dominant over industry; and there are no exclusive trading zones closely related to territorial empires. Nonetheless, the present period is characterised by the interpenetration of finance with industry and, more broadly, of finance with workers' activities, making Hilferding's work an indispensable analytical tool.

In the rest of this article financialisation is discussed on this basis, while drawing on recent theoretical and empirical work. [7] It is shown that financialisation is rooted in changes in the molecular relations between industrial and financial capitals in the first instance. To be specific, large industrial and commercial corporations have become less reliant on banks for finance. Open financial markets have grown and corporations have become 'financialised' in the sense of acquiring financial assets as well as issuing traded financial liabilities.

Consequently, financial institutions have been forced to change in profound ways during the last three decades. Two among these changes stand out: first, banks have turned toward individual income as source of profits and, second, banks have adopted investment banking methods generating profits through fees, commissions and trading on own account. The former is based on the financialisation of workers' revenue in general. Workers have become heavily implicated in the activities of the formal financial system both in terms of borrowing (mortgages and consumption) but also in terms of assets (pensions and insurance). These developments owe much to the withdrawal of public provision across goods and services comprising the real wage: housing, health, education, pensions, and so on. Financial institutions, consequently, have been able to extract profits directly and systematically out of wages and salaries. This process is called financial expropriation.

Financialisation has certainly involved a search for profits in the sphere of circulation. However, this has been a structural and deeply-rooted process, as is shown in the rest of this article. It should finally be noted here that financialisation has also witnessed changes in the institutions and mechanisms of economic policy-making, including the central bank. Moreover, financialisation has entailed a transformation of international finance - typically

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[7] See, above all, the special issue of Historical Materialism on financialisation, namely Lapavitsas (2009), Dymski (2009) and Dos Santos (2009).

related to the role of the dollar as world money - which has affected power and surplus transfer relations globally. These developments are beyond the scope of this article, which focuses on the underlying domestic aspects of financialisation.

Section 2 below considers financialisation in terms of the balance between production and circulation. Particular attention is paid to technological change and its impact on productivity. Section 3 then turns to the economic content of financialisation and considers, first, relations between financial institutions and industrial/commercial corporations, second, the turn of financial institutions toward workers' revenue and, third, the turn of financial institutions toward mediating activities in open financial markets. Section 4 concludes.

2. Financialisation and the changing balance between production and circulation

2.1 Asymmetry in the development of production and circulation

In some respects the financialisation of major developed countries during the last three decades is apparent to the point of triviality. The financial sector has grown relative to the rest of the economy, including with regard to labour employed; financial assets have become a large part of the assets of non-financial corporations; individual borrowing for housing, consumption, education, and health has grown substantially, as have individual assets held for pensions, insurance and so on; global financial markets have become increasingly integrated; international money and capital flows have reached unprecedented levels. The list could be easily extended.

Simply and summarily put, the sphere of circulation (particularly the financial sector) has exhibited more dynamism than the sphere of production since the 1970s. There is little doubt that the productive sector of developed countries has performed indifferently during this period, as is manifested in consistently lower rates of growth compared to the pre-1973 period. An asymmetry appears to have developed within developed capitalist economies between sluggish production and vigorous circulation, particularly booming finance. While the particular characteristics of the asymmetry vary across developed countries (as well as across developed and developing countries) its presence is not in doubt.

This asymmetry is fundamental to financialisation and forms a natural starting point for its analysis. What are the reasons of its emergence? From a Marxist perspective, if the balance between the constituent spheres of the capitalist economy has altered significantly, the deeper causes must be sought in developments in the forces and relations of production.

These would account for differential growth patterns in production and circulation, including the appearance of new fields of profitability.

In this light, the roots of financialisation during the last three decades are to be found, on the one hand, in the technological revolution in information and telecommunications and, on the other, in the deregulation of labour and financial markets, with the attendant intensification of labour. These underlying material factors appear to have impacted on the sphere of circulation, including finance, with particular force. Establishing and analysing their workings in historical detail is, of course, a gigantic task, far beyond the scope of this article. But some insight on the impact of technological change can be gleaned from the trajectory of the growth of the productivity of labour during this period. This is discussed in section 2.2, while the impact of deregulation is briefly considered in section 2.3.

2.2 Technological change and productivity growth

Productivity has continued to rise in the USA, Japan and the other developed countries since the mid-1970s. However, the dynamism of capitalist expansion depends on the rate of growth of productivity. In this respect, the asymmetry between production and circulation in recent decades has to do with the unstable rate of growth of productivity, and therefore with the nature of the underlying technological change.

But before discussing this point, there are conceptual problems to confront. Productivity in the sphere of production is a straightforward concept (physical output per worker) and depends on technological progress, labour skills, the organisation of production, and so on. Productivity in the sphere of circulation, on the other hand, is far more problematic. Enterprises that specialise in circulation are often intermediaries (for instance, financial institutions) and hence do not produce output. Furthermore, from a Marxist perspective, they typically do not produce value.

The absence of value creation in circulation is not directly relevant to measuring productivity, since the latter is about physical output per worker. However, lack of value creation limits the economic impact of productivity growth within the sphere of circulation. Productivity growth is ultimately important because it changes the value of output per unit, and therefore affects costs and profitability across the economy. Nonetheless, intermediaries that engage in circulation have a measurable volume of activities, both on and off the balance sheet. They also employ large numbers of staff that take up the bulk of costs. Hence a measure of the volume of activities relative to workers employed would still be a valuable indication of how intermediaries mobilise resources.

These conceptual problems are compounded by intractable difficulties of measurement, since productivity refers to quantitative aggregates of use values. But these well-known problems are not a direct concern of this paper. It suffices for our purposes to refer to mainstream productivity measures, irrespective of the methodology used. In this respect, even Total Factor Productivity, a notoriously problematic, residual measure of productivity, can be of use. If it was systematically applied over time, even Total Factor Productivity would still give a sense of the dynamism of change of productivity. [8]

In this vein, mainstream literature has shown that productivity growth for the economy as a whole has been deficient since the late 1970s across developed countries. Manufacturing productivity growth has been weak but productivity in services has been even weaker. The USA during the short period from the late 1990s to the early 2000s is a partial exception. [9] However, in the course of the bubble of 2001-7 labour productivity growth appears to have declined again in the USA. [10] It is important to note that productivity growth has also been problematic in finance. Poor productivity growth in finance fits well with the literature that directly examines the costs of banks, which has shown that financial intermediaries have been inefficient in recent years. [11] In short, new technologies and associated labour practices have failed to set the capitalist economy on a path of systematic and rapid productivity growth, including in finance, during the last three decades.

Quite why this should be is unclear but it evidently has to do with the nature of information and telecommunication technologies as well as the work practices that they enforce and encourage. Irrespective of the reasons for it, hesitant productivity growth does not make for dynamic expansion in the sphere of production. In the long term, productivity gains drive down costs, leading to increases in (relative) surplus value and thus expanded capitalist accumulation. Mediocre productivity growth in recent decades is associated with

[8] The methodology of measuring productivity has changed significantly in the USA during the last two decades with the adoption of 'hedonic indices', which are deeply unsatisfactory. But that again does not matter for the purposes of this article.

[9] The literature is extensive. See, very selectively, Gordon (1999), Jorgenson and Stiroh (2000), Oliner and Sichel (2000), Triplett and Bosworth (2003).

[10] The US Bureau of Labor Statistics (various) has reported a consistently declining rate of growth of labour productivity since 2002.

[11] See Berger and Mester (1997), (2003).

the indifferent performance of the productive sector, including weak profitability. Strengthening profitability in the sphere of production during the last three decades appears to have relied heavily on keeping real wages stagnant while intensifying labour, thus allowing capitalists to reap the benefits of whatever increases in productivity have taken place. Restored profitability has not resulted from dynamic improvements in productivity through technological progress.

At the same time, the impact of new technologies on the sphere of finance has been dramatic. Finance might have become neither more efficient nor more productive in terms of intermediation per worker, but it has become capable of operations that were previously completely impossible. The changes are apparent in terms of the internal organisation of financial institutions, the speed of transactions, the feasibility of financial engineering, the links between financial markets, the techniques of pricing and risk management, and so on. [12] Not least, finance has become technically capable of dealing with huge numbers of individual borrowers.

These changes lie at the core of the asymmetry between production and circulation. Against a background of hesitant productivity growth, and spurred by new technology and associated labour practices and skills, the sphere of finance has been able to expand faster than production. In doing so, finance has generated new sources of profitability for the capitalist class as a whole. These new avenues of profit-making are a vital feature of financialisation, and are particularly important in the context of sluggish productivity growth.

2.3 Deregulation

The forces and relations of production do not operate in a vacuum but rather within complex institutional, political, customary and other mechanisms. These are 'external conditions through whose channel capitalist development flows', to use Trotsky's (1923) pithy phrase. [13] For financialisation this 'channel' was set by the profound institutional and legal transformations associated with neo-liberalism since the late 1970s. Two among these stand out.

The first is the deregulation of labour markets, with an associated shift in the balance of power against organised labour. Deregulation of labour includes reduced protection of

[12] Discussed in Lapavitsas and Dos Santos (2008).

[13] While briefly criticising Kondratieff's long wave theory.

employment with parallel use of unemployment as disciplining device. The composition of the labour force has also changed through entry of part-time workers and women, the two often being the same. Flexible employment, invasion of private time by work, unpaid labour, and intensified labour have characterised the period. Real wages, meanwhile, have been relatively stagnant in all advanced capitalist countries. Changes in the labour process and in the institutional and legal framework of employment, together with stagnant real wages, have contributed to a partial recovery of profitability after 1982. [14]

The second is the deregulation of financial markets, a process that commenced in the late 1960s. Financial liberalisation initially involved measures to remove controls on interest rates and quantities of credit advanced by financial institutions, mostly banks in developed countries. Deregulation of the price and quantity of credit still remains the core of financial liberalisation. However, in the early 1970s the liberalisation trend also spread to developing countries, where it gradually assumed the character of a new development paradigm.

Once set in motion, financial liberalisation acquired a host of further characteristics, such as establishing and promoting capital markets, removing non-competitive practices among market brokers, channeling private savings to capital markets as pension and insurance funds, removing controls on international flows of loanable capital, promoting cross-border operations of financial institution, and so on. In these complex ways financial deregulation became an integral element of the Washington Consensus that has dominated development thinking and macroeconomic policy since the late 1980s.

In short, and speaking broadly, financialisation is the outcome of developments in the forces and relations of production coupled with changes in the institutional and legal framework of accumulation. It represents a systemic transformation of the capitalist economy and as such it has had profound implications on social life. The full import of this transformation has emerged gradually, partly because the rhetoric and practice of neo-liberalism have directed attention to the general freeing of markets. But neo-liberalism has acted as midwife of financialised capitalism.

3. Financialisation as economic process

Financialisation, then, represents a shift in the balance between production and circulation that derives from changes in the forces and relations of production as well as in the institutional and legal context of accumulation. This section probes more deeply into

[14] For the path of profitability and the factors affecting it, see Dumenil and Levy (2005).

the specific economic roots of financialisation, locating them in economic relations between industrial/commercial enterprises, financial institutions, and workers. As was discussed in section 1, the analytical approach adopted here derives from the classical Marxist debates on finance capital and imperialism. In the spirit of Hilferding's analysis, the roots of financialisation are sought in the molecular relations between industry, banks and workers.

3.1 Industrial capital and finance

The development of the world market during the last three decades presents two significant trends, which appear contradictory at first sight. On the one hand, competition has intensified across deregulated global markets; on the other, the world economy has come to be dominated by multinational corporations (MNC). Thus, the period of financialisation represents an extremely high concentration of power in the hands of MNC in terms of world trade and foreign direct investment. [15] However, the rise of MNC has not led to emergence of exclusive trading blocs, even though protectionism exists and is often directed against developing countries.

Rather, competition in the world market appears to have intensified without monopolistic control over prices and quantities. New MNC have also emerged in developing countries, including Brazil, China, Korea, Malaysia, India. They have challenged established MNC from developed countries, often in the very markets of the latter, but also in new markets among developing countries. [16] This phenomenon is symptomatic of the gradual shift of productive capacity away from the established centres of industrial accumulation in the West and mostly toward Asia.

Financialisation has drawn on the changed financial requirements and practices of the dominant corporate enterprises, including MNC. Contrary to what Hilferding had postulated, large industrial corporations have become adept at financing their investment needs while relying less on banks. The primary mechanism is retention of own profits, as Sweezy (1942: p. 267) observed already in the early post-war decades. Several empirical studies bear this out at the aggregate level. [17] The reasons for this phenomenon are not entirely clear, but it probably has to do with the internal organisational structure of MNC as well as the types of technology that have prevailed in the post-war period.

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[15] See Morera and Rojas (2009).

[16] Recent trends are summarized in UNCTAD (2006).

[17] See, for instance, Corbett and Jenkinson (1997).

For external finance, on the other hand, MNC have increasingly turned to open financial markets in bonds, stocks, and related instruments. The evidence of the last four or five decades leaves no room for doubt regarding secular trends across the main developed countries. [18] The most striking example is provided by Japanese corporations, which used to rely heavily on bank finance during the years of the post-war boom but have increasingly diversified their financing toward open markets. The deeper reasons for this shift are again obscure, but they probably have to do with corporations finding themselves in command of temporarily idle funds as their retained earnings have become significant. Inevitably corporations have sought flexible and profitable ways of lending these funds while by-passing financial intermediaries.

The changes in the financing requirements of large corporations have favoured the growth of markets in loanable capital in which corporations could enter as both lenders and borrowers. Flexibility and low cost make such markets attractive relative to banks, thus encouraging corporations to diversify their sources of funding toward markets. As the shift toward open markets has become better established, corporations have been able to develop skills in independent financial trading. Such skills typically include trade credit – in which corporations have always been heavily entangled – but also securities and foreign exchange trading.

Corporate financial skills have been important in the course of the successive waves of mergers and acquisitions during the last three decades. Despite obtaining small amounts of net investment finance from open markets, corporations have become heavily engaged in stock markets, issuing and acquiring equities. [19] Financial assets held by the corporate sector have increased substantially across developed countries. The importance of this phenomenon for financialisation cannot be overemphasised. In spite of greater independence from banks, industrial corporations have become more heavily implicated in financial activities. The modern MNC is 'financialised' in the sense that financial transactions are a substantial part of its activities and profit making. [20]

Finally, the spur given to financial markets by corporate participation has undermined financial regulations. 'Regulatory arbitrage' was prominent already in the 1960s and 1970s as US and other corporations began to hold and trade loanable funds in 'Euromarkets', that is, off-shore markets beyond the controls on price and quantity that

[18] For some relevant data see Lapavitsas (2009).

[19] The trend is particularly clear in the USA, see Dos Santos (2009).

[20] As was established for US corporations in the previously mentioned work by Krippner (2005).

existed at the time. This development prepared the ground for financial deregulation to proceed apace in the 1970s and 1980s. Thus, financial deregulation found ready-made terrain in spontaneous developments among industrial corporations and financial institutions.

To recap, using Hilferding's and Lenin's terminology, during the last three decades monopolistic capitals have become relatively more independent of banks, but also more heavily involved in financial transactions. They have become 'financialised' insofar as they have acquired functions that previously belonged to financial institutions. But they have also become more autonomous relative to the sphere of finance. Monopolistic capital in the era of financialisation is not dominated by banks.

3.2 Financial institutions and workers' revenue

These developments have had complex implications for commercial banks in the major developed countries, leading to their gradual transformation. For one thing, profit-making opportunities for banks from lending to large corporations have shrunk as open markets grew. This lies at the core of 'financial disintermediation' that emerged as a major problem for banks in the 1980s and 1990s. Financial deregulation exacerbated pressure on banks by removing controls on interest rates. Bank deposits became more costly and, as open financial markets grew, ceased being a captive source of liquidity. Individual savings found several other outlets, for reasons discussed below. The end result was the end of traditional post-war financial intermediation in developed countries, that is, collecting secure deposits to make loans to industry and elsewhere.

Commercial banks have consequently sought other avenues of profit making, and in the process re-invented themselves. A variety of activities have been pursued, including mass lending to developing countries in the late 1970s and early 1980s, foreign exchange dealing, money-dealing transactions across the world market, including remittances, and so on. However, two developments stand out and characterise the era of financialisation: first, lending to individuals for mortgages and consumption; second, engaging in financial market mediation to earn fees and commissions as well as on own account (investment banking). Both have been instrumental to the bubble of 2001-7 and the subsequent crash. The former is briefly considered in this section, the latter in the next.

Credit for individual workers and others is not a new phenomenon, indeed pawnshops (and even formal institutions that lend to individuals) predate industrial capitalism. But in the course of the twentieth century consumer lending and more complex financial operations involving personal income became a permanent fixture of formal finance. Financialisation since the late 1970s has witnessed a profound deepening of these phenomena. The personal revenue of workers and others has been 'financialised'. This refers to borrowing, including loans for housing, general consumption, education, health, and so on. It also refers to financial assets, including (again) housing, pensions, insurance, money market funds, and so on. [21]

The prominence of individual borrowing is due to developments that connect financialisation to changes in production and the economy more generally. Above all, real wages have been effectively stagnant from the late 1970s onwards in several advanced capitalist countries. In that context, consumption has become increasingly mediated through finance. This phenomenon has turned postponement of payment for wage goods into an accepted social practice in several advanced countries. In effect, commodities in the wage basket have been increasingly consumed by discounting future wage earnings. The financial system has inserted itself in this process, extracting profits directly out of wages and salaries.

There is, however, an evident contradiction at the core of this phenomenon: individual debt has been rising while real wages have been stagnant, making the wherewithal to validate expanding personal credit ever more scarce. The implications are also clear. Given that the bulk of such borrowing has been for housing, ideal conditions have been created for real estate bubbles across the developed (and sometimes the developing) world. Mortgage loans seem validated for short periods of time by rising house prices, but that is mostly due to easy provision of housing loans. The crash inevitably comes when real wages prove incapable of sustaining interest and repayments of rising loans. This is in a nutshell what took place in the USA in 2001-7, but also in several other countries during the last three decades.

At the same time, and as part of the neo-liberal agenda, there has been gradual withdrawal of public provision from several fields that relate directly to the circulation of the income of workers and others. Retreat of public provision has been vital in housing, which forms the large bulk of consumer debt. Meanwhile, private homeownership – as opposed to public housing or renting – has been promoted as a mechanism of social binding in the USA, the UK and elsewhere. But public provision has also retreated in health, education, transport, and so on. Private arrangements have been put in place to deal with these social needs. Hence, private finance has found new scope to engage in lending. In

[21] Relevant evidence for these trends can be found in the above-mentioned special issue of Historical Materialism.

effect, the circulation of workers' revenue has become more strongly privatised, while being increasingly mediated by private finance. Withdrawal of public provision has fostered the 'financialisation' of the individual, encouraging the emergence of private finance as a mechanism dealing with a range of social needs.

However, worker revenues have also been financialised with regard to assets. To an extent, the growth of individual financial assets is merely an automatic result of turning housing into a financial asset – by far the largest asset possessed by workers. Nonetheless, the financialisation of housing has had deleterious effects on the expenditure of worker income. As liability, housing creates fixed obligations through mortgage debt, but as asset its value varies according to the vagaries of the housing market. This has been a significant aspect of the bubbles characteristic of financialisation. In the course of a housing boom, the net financial wealth of household appears to rise, further boosting consumption; when a housing bubble burst, the reverse occurs, limiting consumption.

The growth of individual financial assets is also due to developments associated with the retreat of public provision and neo-liberal policy in general. Pension provision is the main element of saving for workers and others, particularly as lifespan has lengthened in developed countries. The withdrawal of the state from pension provision has created room for private mediation, primarily through pension funds. Neo-liberal policy, furthermore, has actively encouraged the flow of personal savings into pension funds, but also insurance companies and a host of other intermediaries operating in open financial markets. Thus, regulation 401K in the USA and a range of similar measures in the UK has actively diverted personal savings into the realm of private financial capital. For commercial and investment banks, this presented further opportunities for profit making through mediating open market transactions. In short, investment banking functions were encouraged, as is shown in more detail below.

The rising importance of worker revenue in the operations of banks signifies major changes in profit making that are characteristic of financialisation. In line with classical political economy, Marxist theory analyses bank profits as deriving typically from handling the monetary transactions of enterprises (earning the average rate of profit) as well as from lending to enterprises (earning interest, a part of surplus value). Bank profits that derive from mediating the circuits of worker revenues (whether as liabilities or assets) constitute a new source of profits. Such financial profits are rooted in the sphere of circulation and derive directly from wages and salaries. This process has elsewhere been called financial expropriation. [22]

Financial expropriation has exploitative aspects deriving from systematic differences between financial institutions and workers in terms of information availability, economic and social power, and alternatives in undertaking transactions. On the one hand, workers have been increasingly forced into the arms of private finance as public provision of key wage goods has retreated. Financial profits have been generated out of wage income in ways reminiscent of the practice of trucking, except that this now happens on a social scale and the profits accrue to financial institutions, not to the providers of wage goods. On the other hand, financial profits have also been generated out of wage income through predatory lending and other forms of over-charging through fees and commissions. These practices are reminiscent of the age-old tradition of usury, but they are now performed by the formal financial system.

Financial expropriation represents the generalisation on a social scale of financial practices that resemble trucking and usury. It has allowed financial institutions to boost their profits independently of surplus value generated by the indifferently performing sphere of production. This is a constituent element of financialisation.

3.3 Financial market mediation and the growth of investment banking

The second trend characteristic of the transformation of banks in the course of financialisation is the turn toward financial market mediation. Banks have aimed at earning fees and commissions but also at making profits through trading on own account. These are essentially investment banking functions. Combined with the turn of banks toward workers' revenue, they have been a prime cause of the crisis of 2007-9. Lending to individuals, even for housing, could never have generated a global capitalist crisis by itself, as is apparent from the relatively small size of the US subprime market compared to the mortgage market as a whole, and even more compared to the US financial system. But when lending to individuals was combined with the growth of investment banking, it proved capable of triggering a major recession.

The acquisition of investment banking practices is partly a reaction of banks to the growth of open financial markets. Such markets are the natural terrain of investment

[22] See Lapavitsas (2009). See also Dymski (2009) and Dos Santos (2009) for further analysis of the exploitative content of individual lending.

banking, i.e., banking that borrows short in wholesale money markets to invest in securities, thus earning profits through fees, commissions and proprietary trading. [23] Profits from these sources, above all, proprietary trading, were instrumental to bank profitability during the bubble of 2001-7. The rise of these banking activities has been notable since the late 1970s; it accelerated in the 1980s; and it was given formal status with the abolition of the Glass-Steagall Act in the USA in 1999 and similar legislation elsewhere.

The turn of banks toward financial market mediation is related to broader developments, discussed above. First, the rise of monopolistic capitals in the form of MNC has encouraged repeated bouts of mergers and acquisitions. Monopoly capital might not have sought significant finance for investment in capital markets, but it has certainly turned to them to foster the centralisation of capital. The ideology of 'shareholder value' also seems to have affected the behavior of industrial/commercial corporations, forcing them to organise activities with an eye of stock market returns. The proliferation of leveraged buy-outs, takeovers, share buy-backs and the like has provided natural terrain for growth of investment banking. Second, the channeling of personal savings toward capital markets (as public provision has retreated) created scope for investment banks to intervene in transactions associated with pension funds, insurance companies, and so on. Third, floating exchange rates and volatile interest rates have contributed to expansion of derivative markets. Investment banking has found room for proprietary trading in these markets, including financial engineering.

Securitisation of mortages and other assets represents a combination of commercial with investment banking. In a nutshell, long-term assets are transformed into (presumably) liquid securities that are then taken off the balance sheet. Meanwhile, liabilities are shifted toward borrowing in wholesale money markets, diluting the importance of deposits. Capital adequacy is effectively reduced – despite regulations – through 'churning' capital to create off-balance sheet items, the final responsibility for which still lies with the bank. US and UK banks took the lead in expanding this process, while continuing to engage in standard commercial banking activities of deposit collection and lending to a variety of borrowers. Thus, commercial banks have continued to acts as financial intermediaries but acquired a strong admixture of the investment banker. The combination eventually resulted in the effective bankruptcy of a broad swathe of commercial banks across developed countries.

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[23] Investment banking profits are a theoretical problem for Marxist political economy. Hilferding (1981) argued that they originate in 'founder's profit', which is future profit of enterprise accruing as lump sum. This is not persuasive and it is better to treat 'founder's profit' as a share of the loanable capital traded.

One reason for the eventual disaster was that, as commercial and investment banking functions were combined, tensions were generated between solvency and liquidity. All banks are obliged to walk a tightrope between liquidity and solvency, since they borrow short to lend long. However, things differ significantly between commercial and investment banks. Commercial bank liquidity typically originates in deposits, and is held as secure, tradable assets to meet withdrawal pressure on money-like deposits. In contrast, investment bank liquidity originates in wholesale markets, and is not subject to demands from money-like deposits. Solvency, on the other hand, requires all banks to hold sufficient own capital. This is typically lower for investment banks, partly because they act as brokers, and partly because commercial bank capital adequacy is closely regulated to protect their monetary functions.

When commercial banks engage in securities trading – be that to earn fees or on own account – they typically seek wholesale liquidity to finance their operations. If the securities acquired prove problematic (as was the case with mortgage-backed securities) wholesale liquidity could dry up, potentially creating shortages in meeting deposit withdrawal requirements. The spectre of a bank run is always present. If, at the same time, banks have effectively reduced capital adequacy along investment banking lines (by moving assets off-balance sheet but still having ultimate responsibility for them) liquidity shortages due to poor securities could become a solvency problem. For those commercial banks that cannot easily recapitalise and obtain fresh liquidity the outcome is bankruptcy. This was, in short, the predicament of a host of large commercial banks across developed countries in 2008-9.

A further reason why combining commercial and investment functions has proven so damaging in the current crisis is the impact of the information-gathering practices of commercial banks, leading to changes in risk management. The information costs of lending to large numbers of individuals are of a different order to magnitude to those of lending to enterprises. Consequently, the turn toward personal income on a mass scale would have been impossible without the technological revolution in information and telecommunications. Thus, banks have acquired ways of managing the risks attached to housing and consumer loan through 'credit scoring' and the associated statistical manipulation of its results. [24] This is a clear instance of the development of the forces of production favouring the asymmetric growth of finance in recent years.

[24] See Lapavitsas and Dos Santos (2008).

But technological change has had further profound effects as investment banking activities spread. For, commercial banks have gradually adopted essentially investment banking techniques in managing credit risk as well as their balance sheets in general. Computationally-intensive statistically-based techniques have come to dominate the management of Value at Risk. These are necessarily related to mark-to-market accounting. And they have been fostered through the global imposition of BIS requirements on capital adequacy.

The overall outcome has been that commercial banks have become even more 'arms-length' from corporations and borrowers in general. Banks appear to have lost some ability to collect information through personal visits, by placing bank employees within corporation structures, by managing corporate accounts and monetary transactions, and so on. These 'relational' methods have traditionally been fundamental to banks' ability to assess borrower risk. But banks have gradually replaced them with 'hard' techniques of information collection and risk management that draw on computationally intensive statistical methods.

The result has been far from happy, as the current crisis testifies. As 'relational' risk management declined, the banking system as a whole seems to have experienced a net loss of capacity to assess risk altogether. This has been exacerbated by the subcontracting of due diligence on loans to other institutions within the financial system, with the final result that mortgage-backed securities were not properly assessed by anyone. These developments pose profound questions regarding the future of banking in financialised capitalist economies. If commercial banks are less important to large corporations as providers of funds, if they grossly mishandle and exploit lending to individuals, and if they are bad at managing risk, what is their future role?

4.Conclusion

Financialisation is a complex social and economic process that has emerged gradually in the course of the last three decades. The sphere of circulation has shown considerably more dynamism than the sphere of production. At one remove, this reflects the continuing difficulties that production has faced during the period, resulting in uncertain productivity growth and problematic profitability. At a further remove, it is the outcome of deregulation across the financial sector and the labour market. Consequently, new sources of profitability have been sought in the sphere of circulation, above all, in finance. This is a distinguishing feature of financialisation as a period of capitalist development.

Using a political economy framework based on Hilferding's Marxist analysis, this paper has further shown that financialisation has originated in changing relations between industrial/commercial capital, banks and workers. Specifically, industrial and commercial corporate enterprises have become less reliant on banks for loans, while engaging in independent financial transactions in open markets. As a result, banks were forced to alter their operations, above all, by turning toward individual income as a source of profits, and by adopting investment banking practices in open markets. Meanwhile, workers have been forced into the arms of the financial system through withdrawal of public provision across a range of wage goods as well as through legislative change over pensions and other forms of saving. The result has been financial expropriation, that is, the extraction of financial profit directly out of wages and salaries. The combination of financial expropriation and investment banking has led to the current crisis.

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