Financialization and capital accumulation

Carlos Aguiar de Medeiros*

Fabian Amico**

Abstract

In the last decades, financial activities have grown disproportionately compared to other activities. This aroused a growing discussion in Keynesian and Marxian economists about the structures of modern capitalism and the role played by the dominance of finance on capital accumulation. After a brief review of the main issues, we discuss some mechanisms explored in this literature connecting financialization and aggregate investment.

JEL

E11, E12, E44

Key Words

Financialization- investment- income distribution

1. Introduction

In the last decades, financial activities have grown disproportionately compared to other activities. This increase in its weight does not seem to be justified by the importance of its contribution to economic growth (Barba and de Vivo, 2012) [(1)]. This structural change aroused a growing discussion particularly among Keynesian and Marxian economists about the structures of modern capitalism and the role played by

the “dominance of finance” on capital accumulation suggesting an antagonistic interest between finance and productive capital.

Although financialization process may describe some important features of modern capitalism we argue in this paper that the connections established with the rate of investment depends on particular hypothesis on investment decisions.

To address to this question we discuss in the following section some contributions on the financialization process and its effects on economic growth. The third section presents a critical appraisal; in the next section, we outline some concluding remarks and explore a hypothesis about financialization on the demand side and on the accumulation of capital.

2. Some background about "Financialization"

Marx considered the interest rate a magnitude determined by socioeconomic and institutional factors. The rate of profit constitutes the "upper limit" of the interest rate and appears as a subtraction from capitalist profit. In historical essays, Marx referred to the "financial aristocracy" whose action is governed by the "desire to enrich oneself, not through production, but through the stealing of the wealth of others already created".(2)

In *Financial Capital* [1910], Hilferding analyzes the transformation of 'liberal capitalism' into a monopolistic 'financial capital' that according to him led to a unification of instincts fractions of capital under bank control. Since then two main

critique emerged from this interpretation; one considers the predominance of finance a misleading argument, and the other holds that the institutional aspect of the financial dimension is inaccurate (See Hoca, 2012).

For Lapavitsas (2008), modern financialization is a new reality. Today rents take the form of salaries, bonuses and stock options. He observes that financialization has witnessed the ideological supremacy of shareholder value "as an appropriate principle of corporate governance" (p.25). The "shareholder value" leads companies to operate constantly with the stock market targeting short-term results instead of long-term returns. "It is possible that this has had an impact on the indifferent performance of real accumulation" (Lapavitsas, 2008, p.26).

For Dumenil and Levy (2004), there is a *negative* link between financialization and growth but such a relationship would be mediated by economic policy. Thus, "capitalism works well as long as private finance is not left in control of macroeconomic processes."(2004, p.197)[(3)].

In a later study (Dumenil and Levy, 2015),they highlight other mechanism in which the sudden increase in the weight of dividend payments occurred in recent decades benefiting shareholders, "profits paid out do not return to corporations, and accumulation is low. This is a crucial feature of the neoliberal decades, a major factor in the determination of the long-term trajectory of the U. S. economy" (p.63).

In this literature, financialization is a "new" stage of capitalism, characterized by the predominance of rentier interests (or financial capital) over productive or" real "capital and by the emergence of a new economic and political power in the hands of a financial aristocracy.

According to Foster (2010)since the 1980s, the slowdown in investment and growth went along with a rise in the interest and dividend payments and share buybacks of the Non-financial Corporation's (NFCs) (Duménil and Levy, 2004). Consequently, companies experienced a significant reduction in available funds for physical investments. The result of this process would be the so-called "neoliberal paradox" (Crotty, 2003): financial markets would require large corporations to attain increasing profits while product markets would make this outcome impossible to achieve. Foster and McChesney, (2012) argues that the connection between monopoly and financialization inevitably leads to a tendency towards economic stagnation and an "endless" crisis of capitalism.

Lazonick (2015)considered that in the 70s, the "retain and reinvest" strategy began to have problems due to the expansion of the corporations and the increase of the new international competition. In this context, in the late '80s and early' 90s in order to creating value for shareholders, there would have been a marked change in the strategic orientation of top corporate managers towards the idea of "downsize and distribute" rather than "retain and reinvest".

Although these analysis develop some interesting features of modern corporate strategies it is not easy to see what has qualitatively changed. The separation of property from control in joint ventures and the dominance of finance capital (not confound with the dominance of financial institutions) was essentially observed by Marx, Hilferding, Veblen, Hobson, from the second half of the XIX century. The "regulated capitalism" as put by Kotz (2015) in his analysis of the Golden Age between 1950-1980 was an exception from the characteristics examined by these and others social critics of modern capitalism.

Blankenburg, Arena and Wilkinson (2012) examined Sraffas´s observations on the ‘governance ‘and change in modern corporation in the beginning of XX Century that ‘the mere supply of ‘business ability’, required in the partner-director or manager of an individually or family-owned firm, no longer suffices. Instead, modern manager directors now also need to be equipped with financial or even speculative knowledge, skills and connections[(4)].

The second difficulty that emerges from Lazonick´s insights is that some dimensions as the huge remuneration of CEO and the aggressive corporate strategy, are typically concerned to UK and US but not so common in Continental Europe and Japan.

3. A critical appraisal on the causality between "financialization" and accumulation of capital

The authors that consider "financialization" a new and differentiated stage follow some version of the neo-Kaleckian (or post-Keynesian) theory of investment, according to which capacity creating private investment is an *autonomous* variable and driving force for growth. However, if you start from an alternative approach, where the autonomous components of the effective demand (assuming that productive investment is an induced variable) prevail (Serrano, 1995), things change substantially.

In the first case, where productive investment is considered an essentially autonomous variable, the reduction of growth from the 1980s onwards could be the outcome of a "new growth regime", a "finance-dominated accumulation regime" (Stockhammer, 2004), or a "finance-dominated capitalism" (Hein, 2013).

As mentioned, a key point in this approach is the alleged conflict between shareholders and managers of large corporations. This conflict would seem to imply an inverse relationship between the growth rate of the firm and the rate of profit. They point to a number of microeconomic reasons why there is a "rising cost" of firm growth, which would reduce its profit as firms expand (increasing costs of advertising, product innovation and R & D, lack of knowledge of new markets and new products, among others).

However, even if this theory can explain CEOs speculative behaviors on financial investment at the level of microeconomic analysis, this view from inside the firms is manifested insufficient to explain aggregate investment involving the assumption of a "representative firm". It is not possible to obtain correct macroeconomic propositions based on what happens at the (micro) sectoral level of firms (see Serrano, 1995, p.13), Pasinetti (1981, p.35) calls the relationships that correspond to the system as a whole as "truly macro-economic" relations expressing essential structural features of the economic system viewed as a whole.

From this perspective, investment opportunities given by the expansion of the market induces the aggregate business investment. This stylized fact is independent of who holds the power, shareholders or managers. A typical manager of the old "managerial capitalism" would never invest in capital equipment in an economy trapped in stagnation.(5)

A microeconomic theory of investment may be useful in investigating which firms will gain market share, but not in explaining the *growth rate* of investment of the economy as a whole. The shift from "retain and invest" to "downsize and distribute",

emphasized by these authors, does not have the macroeconomic implications observed in the literature on financialization.

The contribution of Palley (2012) has a different meaning. Financial excesses played a central part but they were not the ultimate cause of the US crisis. Housing and financial bubble was necessary aspect to counteract the growing negative effects of the unequal growth model adopted. Barba and Pivetti (2009) followed the same interpretation.

As we will argue although there is not a direct connection from "financialization" to (macroeconomic) investment, there is an *indirect* connection that it is exerted through institutions (including ideologies) on economic policy (particularly fiscal policy) and income distribution.(6)

4. Financialization, Investment and Income Distribution

In this section, we discuss a set of *indirect* mechanisms that operate from the financialization towards the accumulation of capital. As ingrained in the so-called theory of Social Structures of Accumulation (SSA), a coherent and lasting institutional and ideological structure constitutes the base of support for different patterns of capital accumulation (Kotz , 2016).

In such a framework, financialization results from a drastic change in the system of power relations, shifting the focus of economic policy towards the exclusive objectives of price stability. Through this the main (indirect) mechanism

"financialization" introduces a contractionary bias in economic policy and adversely affects capital accumulation. As Steindl (1979) suggested long ago, and may be applied to the modern ‘expansionary fiscal consolidation’ policy, stagnation may result from a *policy* of stagnation rather than an (inherent) and systemic trend to stagnation.

For Kotz financialization was largely a consequence and not the cause of neoliberal restructuring (Kotz , 2015, p.13-14). According to him, growing inequality, large asset bubbles, and a speculative and risk-seeking financial sector that took place since the nineties in US explain the prolonged economic expansions. These factors led to increasing household and financial sector indebtedness, the spread of new toxic financial instruments and the increase in the excess of productive capacity. These trends explained the crisis that emerged in 2008 (p.128).

In his analysis, Kalecki [1944](1990) outlined three potential ways to achieve full employment: incentives to private investment; redistribution of income from the richest to the poor; and public spending financed with debt. He anticipated that the path of encouraging private investment without increasing direct government spending would not work. Even if the government managed to increase production capacity faster than the product (thanks for example to the granting of investment subsidies), the consequence would be a reduction in the level of capacity utilization (an increase in excess capacity) and a drop in the (effective) rate of benefits. This fall in the rate of profit would then tend to *depress* the level of investment. If the government insisted on this path, a greater amount of subsidies would be necessary and even if the investment would go back up, there would be an additional excess of capacity followed by a drop in profitability and so on.

In terms of the general argument of this paper, it could be said that the reduction of autonomous spending only depress induced productive investment, even when incentives improve profitability. Incentives do not translate into higher investment but as, as Patnaik (2017) suggests, on the formation of "bubbles" in the prices of assets.(7)

Barba and De Vivo (2012), highlight this transmission channel from financialization to growth. According to them, much of the services provided by the financial sector are non-basic (or luxury) final consumption goods. Nevertheless, the expansion of the financial sector facilitates the solution of problems on the demand side through "bubbles". The link between the mechanism of bubbles, and the growth and subsequent crisis is suggested in recent contributions (Barba and Pivetti, 2009; Mian and Sufi, 2015). A combination of excessive indebtedness (an increase in the household debt-to-income ratio) with an accelerated decline in consumer net worth, which serves as collateral (due to falling real estate value) in a context of stagnant or declining real wages, can greatly boost private consumption to later affect it negatively in a very drastic way.(8)

The question of the long-term sustainability of this substitution of loan for wages emerges as the main problem. As is argued by Barba and Pivetti (2009: 127), while in the case of public debt the growth rate of total income is not exogenous with respect to the dynamics of debt (and therefore of public expenditure), in the households case the evolution of their income (wages) is clearly independent of the evolution of their debt. In short, different from public debt that influences the output and Government revenues household spending alone does not necessarily affect the individual worker's wage levels. Additionally, as Pariboni (2016) points out, with credit-financed workers' consumption as *the only autonomous component of demand*, the debt-to-income ratio will be stable to the extent that the wage share in income is constant. With this

hypothesis, the economy will grow at the same rate as household consumption (which is equivalent to the growth of household debt). Thus, the numerator and the denominator of the available debt-to-income ratio will grow at the same rate.

However, another dimension is relevant to the analysis of sustainability. Assuming that autonomous expenditures now consist of public spending plus the consumption of debt-financed workers, the economy's rate of growth will be led by the rate of growth of the autonomous spending. This implies that if public spending grows more slowly than debt-financed consumption (as appears to be the case), even with a constant share of wages, the debt-to-income ratio will no longer be stable (because debt accumulation will occur at a rate faster than GDP). The conclusion of the analysis is that the growth of public spending is vital for the stability of the private sector debt-income ratio.

Thus, if government does not play its role as a fundamental driver of growth, while maintaining the conditions of financial deregulation, economic opening and increasing inequality in distribution, growth is forced to be erratic, highly volatile and socially impoverishing experience. In this sense, certainly, not everything results from "financialization".

A last question remains. In relation to the conflict of interests in finance capitalism, as Clarke (1988, p.5) points out the very distinction between financial and industrial capital " is becoming increasingly anachronistic as accumulation on a world scale is dominated by multinational corporations, which take the form of financial holding companies, closely integrated with multinational banks and financial institutions".

As observed, for Hilferding, Keynes and even Sraffa finance speculation was a persistent dimension of modern capitalism and formation of a new financial aristocracy.

[9] Thus, when the economy goes into recession, the diversion of capital into speculative channels is the normal consequence [10]. The increasing shift from surplus to speculation is not the cause of the decline in productive investment, but rather its *consequence* (reverse causality).

6. Final remarks

Most of explanations that connects financialization with economic growth have, in general, two characteristics in common. First, a theory of investment based on a level of individual firm from which are derived propositions about essentially macroeconomic phenomena. Second, and in many cases this is complementary to the previous argument, many of these authors use some version of the neo-Kaleckian (or post-Keynesian) theory where capacity creating private investment is an *autonomous* variable with respect to income levels. Thus, they emphasize the role of investment as the fundamental driver of growth.

The transmission mechanisms considered within the financialization approach assumes that if a corporation has governance structure that privileges shareholder value, it will be inclined to seek short-term gains and will be less inclined to invest in fixed capital over a longer-term horizon. This idea makes sense if the firm´s decision investment is *independent* of the market dynamics and effective demand. Only then could the volume of investment respond to the "biases" related to "conflicting interests" within the corporation.

Nevertheless, this channel linking financialization and investment loses explaining power when one assumes investment in productive capacity as a *derived* or *induced*

demand, following and not driving the rate of growth. A basic feature of any capitalist economy is that aggregate investment has to go along with the expansion of the market. Therefore, the shift from "retain and invest" to "downsize and distribute", emphasized by these authors, does not have the macroeconomic implications observed in the literature on financialization. From this perspective, financialization does not suppose that aggregate investment today is determined in a different way from the phase of postwar capitalism.

Changes in corporate governance are not the starting point for explaining the current stagnation, but rather a *result* of the whole process (distributive changes and low growth of global demand). The principle of "retain and reinvest" cannot be applied (even with increased profits) in an environment of low dynamism of the effective demand.

Notes

*Carlos Aguiar de Medeiros is profesor in the Economics Institute at the Federal University of Rio de Janeiro (Brazil) The autor thanks the National Council for technological Development (CNPQ) for financial support

** Fabian Amico is profesor in UMET (Universidad Metropolitana para la Educación y el Trabajo) and in UNSAM (Universidad Nacional de San Martín), Buenos Aires.

(1) Although discussions on the scope and effects of the so-called financialization are long-standing, the debate gained momentum after the great crisis of 2008.

(2) See Karl Marx, [1895] (1969)

(3) In the course of the 1980s, "finance decided to stop inflation in order to protect its revenues and its investments, whatever the cost might be for others, and to restore the claims of stockholders to profits. The rate of accumulation declined accordingly, and the crisis and unemployment found themselves extended" (Dumenil and Levy, 2004, p.77).

(4) Sraffa's following observation surely has an almost eerily modern ring to it: "To-day control of the great industrial organizations has drifted from the hands of those who know the technique of industry into the hands of those who know the technique of company finance and who have the connections that qualify for membership of the controlling groups. Skill in stock manipulation has become more important than efficiency in production" (Blankenburg, Arena and Wilkinson (2012).

(5) In this context, it will suffice that the expected rate of profit on the new capital equipment is higher or at least equal to the minimum or "normal" profit rate.

(6) Hossein-Zadeh emphasizes that neoliberal austerity policies are class policies, and not just "bad" policies. He shows that public policies are more than simply an administrative or technical issue of choice, but rather "it is a deeply socio-political issue that is organically intertwined with the class nature of the state and the policy-making apparatus." (Hossein-Zadeh, 2014: 4).

(7) Patnaik (2017) underlines this indirect relationship (which goes from financial capital to economic policy). State efforts to increase employment and economic activity should take the form of "incentives" to capital instead of direct spending.

(8) , as observed by Mian& Sufi (2015: 31-45) consumption became the driver of the recession in the United States in 2008. Investment declined as a reaction to the collapse of spending on consumption of durable goods (cars, household appliances and housing).

(9) ‘ a new financial aristocracy, a new kind of parasite in the guise of company promoters, speculators and merely nominal directors; an entire system of swindling and cheating with respect to the promotion of companies, …’ (Hoca, 2012, p 427)

(10) "is not the cause of the scarcity of funds for productive investment, but the consequence of the lack of profitable opportunities" (Clarke, 1988, p.5).

References

Barba, Aldo, Giancarlo de Vivo. "An ‘unproductive labour’ view of finance", *Cambridge Journal of Economics*, Volume 36, Issue 6, 1 November 2012, Pages 1479–1496.

Barba, Aldo, Massimo Pivetti. “Rising household debt: Its causes and macroeconomic implications. A long-period analysis”, *Cambridge Journal of Economics* 2009, 33, 113–137.

Blankenburg, Stephanie, Richard Arena and Frank Wilkinson.“Piero Sraffa and ‘the true object of economics’: the role of the unpublished manuscripts” *Cambridge Journal of Economics* 2012, 36, 1267–1290

Clarke, Simon. *Keynesianism, Monetarism and the Crisis of the State*, Edward Elgar, England, 1988.

Crotty, James R. "The Neoliberal Paradox: The Impact of Destructive Product Market Competition and Impatient Finance on Nonfinancial Corporations in the Neoliberal Era", *Review of Radical Political Economics*, September 1, 2003, Vol 35, Issue 3.

Duménil, Gerard, Dominique Lévy. “Neoliberal Managerial Capitalism Another Reading of the Piketty, Saez, and Zucman Data”, *International Journal of Political Economy*, 44 (2015) 71–89.

Duménil, Gerard, Dominique Lévy. Capital Resurgent: Roots of the Neoliberal Revolution, Cambridge, MA: Harvard University Press(2004)

Foster, John B. "The Financialization of Accumulation", *Monthly Review*, Volume 62, Issue 05 (2010).

Foster, John B. and Robert McChesney. *The Endless Crisis: How Monopoly-Finance Capital Produces Stagnation and Upheaval from the USA to China*, Monthly Review Press (2012).

Hein, Eckhard. "Finance-dominated Capitalism and Redistribution of Income: A Kaleckian Perspective", Berlin School of Economics and Law and Institute for International Political Economy, Berlin, *The Levy Economics Institute Working Paper* No. 746, January 2013.

Hilferding, Rudolf. [(1910) 1981]. *Finance Capital – A study of the latest phase of capitalist development*. Routledge, 1981.

Hoca, Bulent.“A suggestion for a new definition of the concept of finance capital using Marx’s notion of capital as commodity”, *Cambridge Journal of Economics*, 2012, 36, 419-434.

Hossein-zadeh, Ismael. *Beyond Mainstream Explanations of the Financial Crisis: Parasitic finance capital, R*outledge. (2014)

Kalecki, Michael. “Three ways to full employment” , Collected works of Michal Kalecki, Vol. I, Edited by J. Osiatynsky, Oxford University Press [1944](1990)

Koo, Richard. *The Escape from Balance Sheet Recession and the QE Trap: A Hazardous Road for the World Economy*, John Wiley. (2015)

Kotz, David. "Social Structure of Accumulation Theory, Marxist Theory, and System Transformation", Department of Economics, University of Massachusetts Amherst and School of Economics, Shanghai University of Finance and Economics, *ASSA Convention* (2017).

Kotz, David. *The Rise and Fall of Neoliberal Capitalism,* Harvard University Press. (2015)

Lapavitsas, Costas. *Financialised Capitalism: direct exploitation and periodic bubbles,* Department of Economics, School of Oriental and African Studies, University of London, May (mimeo)(2008).

Lazonick, William. "When Managerial Capitalism Embraced Shareholder-Value Ideology", *International Journal of Political Economy,* 44:2, (2015) 90-99.

Marx, Karl. *Class Struggle in France: 1848- 1850* in Karl Marx and Frederich Engels, Selected Works, volume 1, Moscow, Progress Publishers [1895](1969)

Mian, Atif, Amir Sufi, A. (2014). *House of debt: how they (and you) caused the Great Recession, and how we can prevent it from happening again,* The University of Chicago Press, Ltd., London. (2014)

Palley, Thomas. *From Financial Crisis to Stagnation: The Destruction of Shared Prosperity and the Role of Economics*, Cambridge University Press. (2012)

Pariboni, Riccardo. "Household consumer debt, endogenous money and growth: A supermultiplier-based analysis", *PSL Quarterly Review,* vol. 69 n. 278 (2016), 211-233.

Pasinetti, Luigi. *Structural Change and Economic Growth,*Cambridge University Press, Cambridge. (1981)

Patnaik, Prahbat. "Neo-Liberal Capitalism and its Crisis", International Development Economics Associates, *IDEAs*, October 24, 2017.

Serrano, Franklin.“Long period effective demand and the Sraffian supermultiplier”, *Contributions to Political Economy*, 14, (1995) pp. 67–90.

Steindl, Joseph.“Stagnation theory and stagnation policy”, *Cambridge Journal of Economics,* 3, 1-14 (1979)

Stockhammer, Engelbert. “Financialisation and the slowdown of accumulation”, *Cambridge Journal of Economics*, 28, (2004) 719–741.