Financialisation and the economic stagnation of Europe

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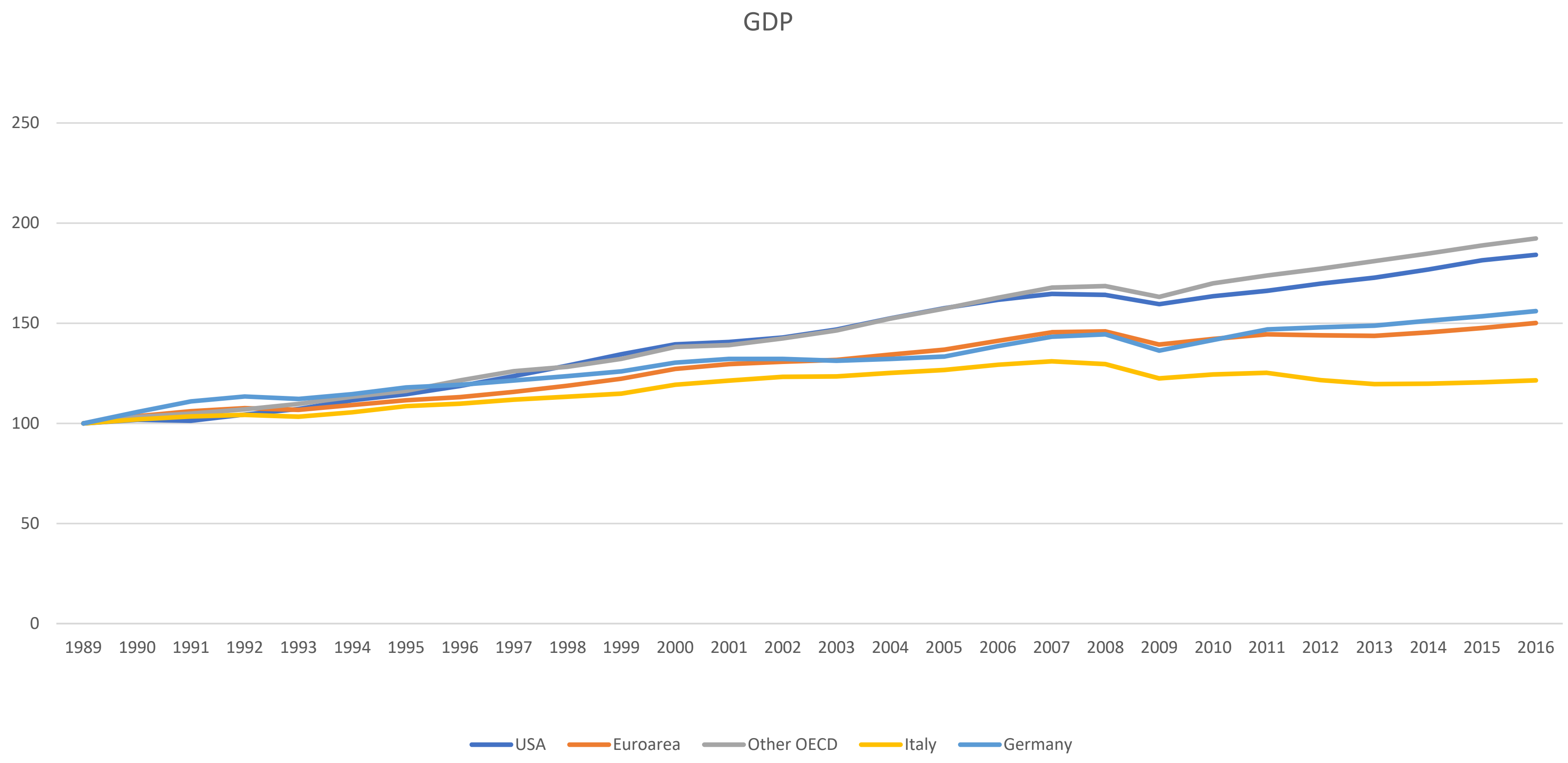
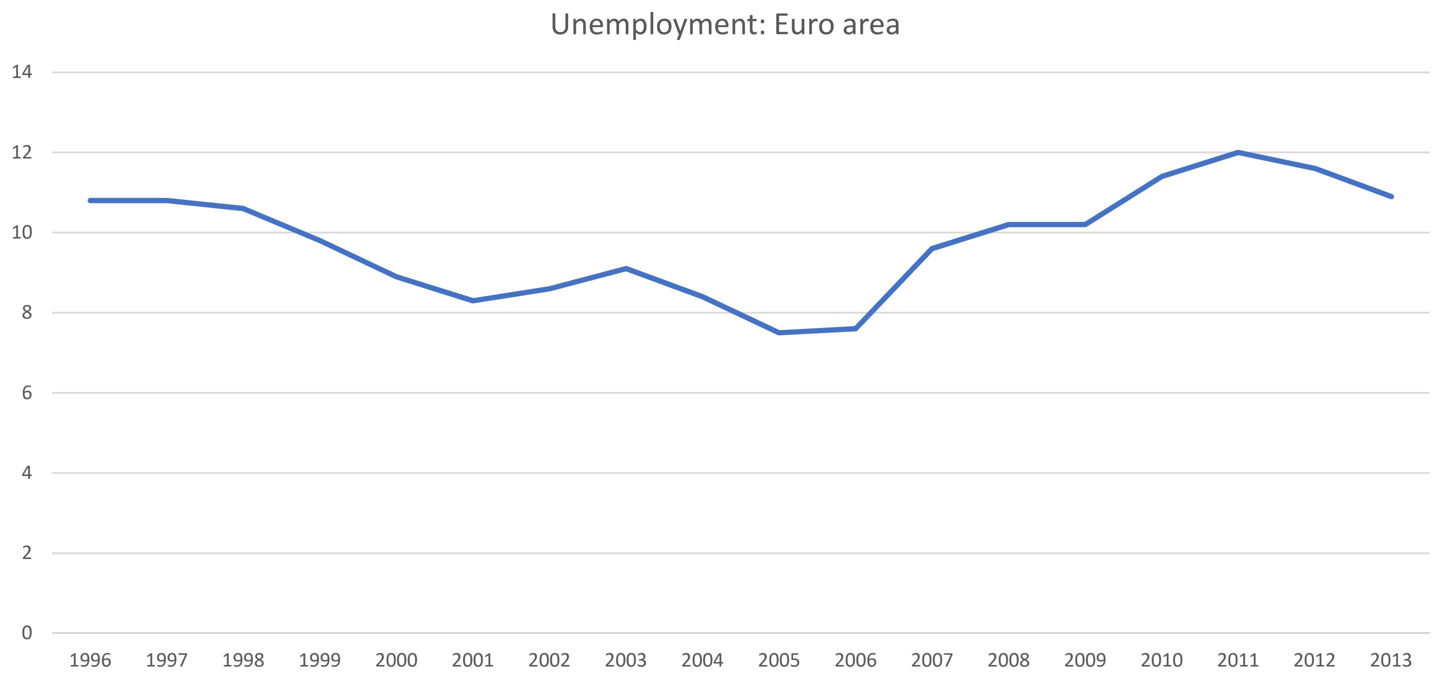
Outline

- There has long been recognition that the ‘old’ EU member countries (EU15) have faced rather slow growth and high levels of unemployment for two decades or more.
- Numerous policy initiatives which were forecast to improve economic performance (e.g. internal market, Economic and Monetary Union, de-regulation, Lisbon Strategy, services directive) with a notable lack of success.
- Slower growth would be welcomed if it were combined with trends towards greater equality and environmental sustainability.

Growth in Europe



Unemployment in Euro area



Remarks on possible contributory factors

- Financialisation
- Structural reforms
- Economic and Monetary Union and its policies

Financialisation

- Financialisation is a broad and contest concept
- Our working view rests on
- ‘financialization means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies’ (Epstein, 2005).
- To which is to be added the impacts and effects of the financial sector on society, polity and environment

Financialisation in the present era

- Financialisation has been a general feature of capitalism – which cannot be conceived without finance as a central feature.
- The pace of financialisation varies over time, sometimes going into reverse, and takes different forms. Focus here is on the period since circa 1980 (‘the present era’); financialisation has gone alongside and been part of globalisation and neo-liberalism.

Financialisation in the present era

- Rapid expansion of financial institutions and financial markets; blurring of the distinction between banks and markets
- Evolving financial institutions including shadow banking, changing structures and privatisation/de-mutualisation
- De-regulation, financial liberalisation

Financialisation in the present era

- Financial crises (especially as compared with ‘golden age’)
- Household debt: causes of tendency to rise?
- Relationships between financial sector and real sector including ownership by financial sector of corporations, pursuit of shareholder value, and fusion between financial and non-financial corporations

Financialisation and growth performance

- The growth of the scale of the financial sector (bank deposits to GDP; stock market valuation to GDP, for example): financial deepening/development
- ‘Financial development’ (e.g. size of banking system, stock market) and economic growth have generally been viewed, theoretically and empirically, as positively related; the debates have been on the direction of causation.
- ‘A growing body of empirical analyses, including firm-level studies, industry-level studies, individual country-studies, time-series studies, panel-investigations, and broad cross-country comparisons, **demonstrate a strong positive link between the functioning of the financial system and long-run economic growth**.’ (Levine, 2004)

Financialisation and growth performance

- The recent evidence reversing the relationship
- Authors have reported on at least some weakening of the links between financial deepening and economic growth.
- Rousseau and Wachtel (2011) argue that ‘we show that it [the finance-growth link] is not as strong in more recent data as it was in the original studies with data for the period from 1960 to 1989.’
- A study of ‘the complex real effects of financial development and come to two important conclusions. First, financial sector size has an inverted U-shaped effect on productivity growth. That is, there comes a point where further enlargement of the financial system can reduce real growth. Second, financial sector growth is found to be a drag on productivity growth.’ (Cecchetti and Kharroubi, 2012, p.14).

Financialisation and growth performance

- Sahay et alia (2015) use a broad measure of financial development and find that 'the effect of financial development on growth is bell-shaped; it weakens at higher levels of financial development. This weakening effect stems from financial deepening, rather than from greater accessor higher efficiency. The empirical evidence also suggests that this weakening effect reflects primarily the impact of financial deepening on total factor productivity growth, rather than on capital accumulation. [Further] the pace of financial development matters. When it proceeds too fast, deepening financial institutions can lead to economic and financial instability'.

Financialisation and growth performance

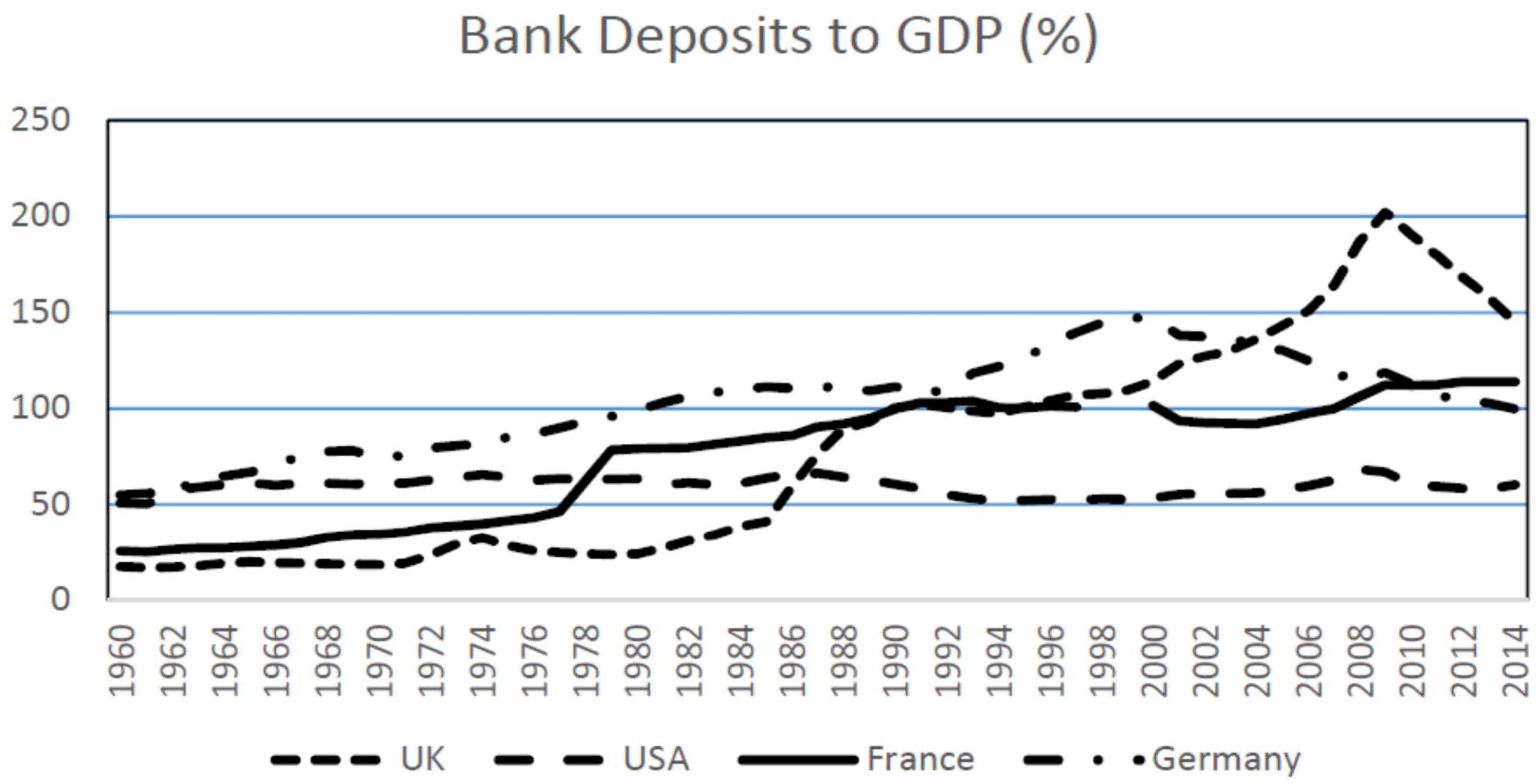
- Financialisation has also involved the rise of financial institutions as shareholders and the emphasis on the pursuit of shareholder value
- Empirical work suggesting the depressing effects of the pursuit of shareholder value on investment and innovation

Financialisation and growth performance

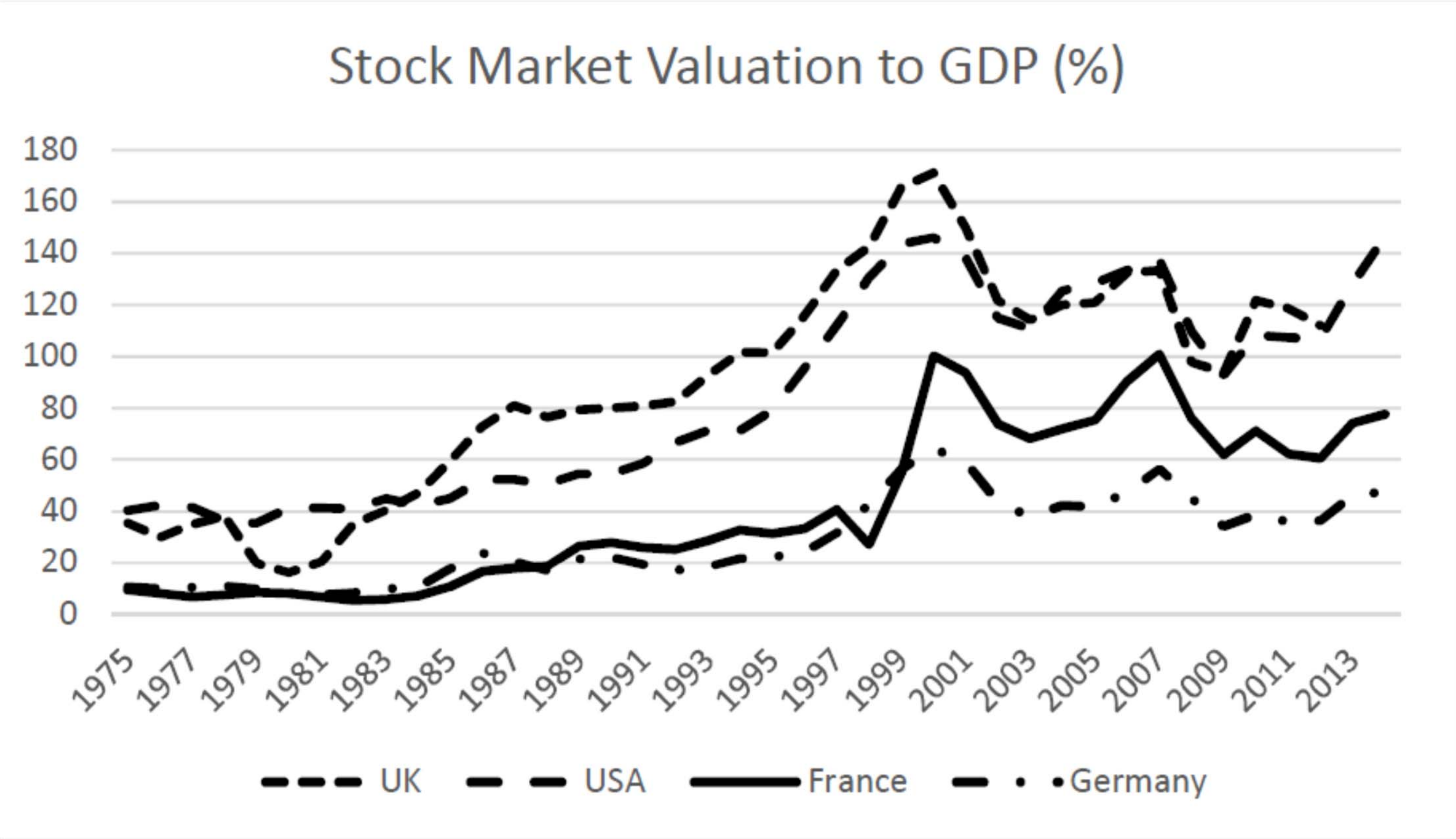
- Why the reversal?
- Issues of causality arise
- Growth of household borrowing and consumer debt – financial sector activity rises but no additional investment;
- Development of complex financial assets and growth of trading in financial assets: no provision of funds for investment or encouragement of savings;
- Use of resources in the financial sector

Financialisation and growth

- Financialisation can help understand the general slow-down in growth and through effects on economic activity on employment and unemployment: it may not though help explain EU slower growth and higher unemployment relative to US as all have gone through the processes of financialisation.
- However, there has been variegated financialisation.
- UK, USA have higher stock market value/GDP ratios than France and Germany: but ratio for latter two countries rose faster prior to financial crisis
- USA has lower bank deposits to GDP ratio than UK, Germany, France.



Bank Deposits to GDP (%)
250
200
150
100
50
0
1960
1962
1964
1966
1968
1970
1972
1974
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008
2010
2012
2014
UK
USA
France
Germany



Stock Market Valuation to GDP (%)
180
160
140
120
100
80
60
40
20
0
1975
1977
1979
1981
1983
1985
1987
1989
1991
1993
1995
1997
1999
2001
2003
2005
2007
2009
2011
2013
UK
USA
France
Germany

Features of present era of financialisation

- Inequality and financialisation: what contribution of financialisation?
- Effects on demand and on savings propensity
- Rents and rent extraction by the financial sector

Financialisation and the single currency

- Financialisation has also involved a range of financial liberalisation; removal of capital controls within EU an element of that.
- Capital mobility to play stabilising role?
- Absence of fiscal transfers
- Current account imbalances enabled by capital flows

The failures of ‘structural reforms’

- A persistent, if underplayed, theme at EMU/EU has been the ‘need’ for ‘structural reforms’, and particularly with reference to labour markets
- ‘Europe has a clear challenge. It has far too few jobs and a sustainable growth rate that is just too slow. Product and labour markets do not seem to be flexible enough. Too much regulation seems to be tying the hands of Europe’s businesses. Investment in knowledge creation and its further use in production are insufficient. Nevertheless, there is broad agreement about the way to meet Europe’s challenge. Comprehensive structural reforms that tackle the frictions braking Member States’ economies need to be implemented’. (European Economy Economic Papers no. 282, June 2007)

The failures of ‘structural reforms’

- ‘Structural reforms’ – a euphemism for de-regulation, lowering of employment protection; part of a broadly neo-liberal agenda
- The EC claim that the decline in unemployment in EU through to 2007 from ‘structural reforms’ soon blown away by ‘great recession’

The failures of ‘structural reforms’

- ‘Structural reforms’ were claimed to address ‘structural unemployment’: but no general decline in the non-accelerating inflation rate of unemployment
- The lack of evidence that neo-liberal structural reforms improve economic performance.
- One example: ‘it cannot be argued that more rigid labour markets have led to larger declines in employment and increases in unemployment rates, and that more flexible labour markets have contributed to a more rapid recovery of labour markets’ (Ferreiro and Gomez, 2017).
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The euro effects on stagnation

- The formation of EMU was intended to be one of the major policy moves which would stimulate economic activity – perhaps relatively small but some promotion of trade
- There has always been an austerity side to EMU through the nature of the macroeconomic policies adopted including the position and policies of the ECB.
- Fiscal policies particularly problematic with drive to balanced structural budget and the ‘one size fiscal policy fits all’.

The euro effects on stagnation

- These problems have been exacerbated by the ‘fiscal compact’; the ‘excessive deficit procedure’.
- The endogeneity of ‘potential output’/NAIRU for the calculation of structural balanced budget.
- The current account imbalances and the misalignment of the exchange rate between euro area member countries.

A concluding comment

- The processes of financialisation have not been conducive for sustainable growth and high levels of employment
- The policy agenda needs to accommodate the effects of financialisation on demand through appropriate fiscal policies and development of policies to restructure the financial sector.