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The good, the bad or the ugly: financialization through heterodox and mainstream lenses

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Abstract

Since the late 1970s, heterodox economists have paid increasing attention to the phenomenon of financialization. However, the process, identified with the growing role of finance in the economy, as well as with its impact on the social, cultural and environmental aspects of society, was rather neglected in the mainstream economics. Despite its growing importance in the subsequent years – mainly due to the global financial crisis 2007–2009 – financialization still eludes unambiguous interpretation.

The aim of the article is to identify and explain the differences in the perception of financialization between heterodox and mainstream economics. We add to the existing literature by making a clear distinction between the ways in which heterodox and mainstream economists understand and interpret financialization. We find that the main source of the different approaches to financialization are oversimplifications in the understanding and modelling of monetary and financial spheres in the mainstream analyses.

Keywords: financialization, heterodox economics, mainstream economics, financial crises

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1. Introduction

Beginning in the late 1970s, heterodox economists paid increasing attention to the phenomenon of financialization. At this time, a fundamental change took place, which increased the proportional share of financial markets in the economies of individual countries. The United States was a pioneer of this change. As Bogle (2008) points out, over the past two centuries, the US has shifted from an economy based on agriculture to an economy based on industrial production, then to a service-based economy, and now to an economy based mainly on financial operations. This last transition, however, was the fastest. Similar tendencies have also occurred in other countries with developed financial markets, and this has stimulated the interest of researchers.

Nevertheless, the term 'financialization' has different meanings and definitions (see e.g. Brown, Spencer 2011; Epstein 2005; Freeman 2010; Krippner 2005; Ratajczak 2017; Sawyer 2013). Sometimes it is treated as a synonym of 'financialized capitalism' (Dumenil, Levy 2005), and is used to describe the growing role of finance in the economy, as well as its impact on the social, cultural and environmental aspects of society's functioning (Brown, Veronese Pasarella, Spencer 2016). In the simplest terms, financialization can be described as a process whereby financial motives, financial markets, financial actors and financial institutions come to have an increasingly important role in the operation of domestic and international economies (Epstein 2005), or whereby markets and financial elites gain increasing influence on economic policy and the effects of management (Ratajczak 2012). According to the latter author, financialization is considered to be a new stage of capitalism, referred to as rentier capitalism, or 'coupon capitalism', where financial investments are the main source of income in the modern economy.

Taking into consideration these definitions, the most characteristic feature of financialization becomes apparent. Namely, it is a kind of primacy of the financial sphere over the real sphere of the economy. The financial sphere becomes more important, generates more and more income, and determines the decisions of non-financial entities to an ever greater extent. Consequently, various types of financial institutions become increasingly important in the economy.

Moreover, financialization is a phenomenon that goes beyond purely economic processes. Its influence extends to the entirety of social life in individual countries and the global economy. Also, financialization creates specific attitudes that were previously only associated with the market economy in its particularly aggressive form. This rapid and intense growth of finance causes great controversy – not only of a purely economic nature, but also ideological. Two perspectives clearly come into conflict here. On the one hand, the supporters of liberal, free-market views basically consider financialization to be a phenomenon favourable and conducive to increasing the general welfare – or at least they were of this opinion until the outbreak of the global financial crisis. On the other hand, the opponents of the free-market philosophy are fervent critics of the process, linking it closely with 'neoliberalism'.[1]

This ideological dichotomy is also visible in the theoretical approaches to financialization. As a research problem, it is regarded differently by mainstream and heterodox economics.[2] Davis (2008) argues that what distinguishes these strains is that the former is built upon a "rationality–

[1] Interestingly, however, financialization is not seen as merely a derivative of neoliberalism. Dumenil and Levy (2005) state that it is rather neoliberalism that constitutes an ideological 'reflection' of the growing role of the financial world.

[2] The concepts of mainstream economics and heterodox economics are not clearly understood. There is no single, universally accepted assignment of individual schools of economic thought to mainstream or heterodox economics.

–individualism–equilibrium nexus", and the latter upon an "institutions–history–social structure nexus". These factors also have a crucial impact on the applied methods of research and the accepted assumptions, and subsequently on the different perceptions of the nature, sources and determinants of the crisis of 2007–2009.

With this in mind, the aim of this article is to identify and explain the differences between the perceptions of financialization in heterodox economics and the mainstream economics. This, in turn, could facilitate a better understanding of the determinants and consequences of the phenomenon itself. We employ a narrative approach to present and compare the views on financialization presented in heterodox and mainstream economics. First we describe financialization as a research project, with its origin and features. Subsequently, we discuss the sources of financialization and its effects – presenting both heterodox and mainstream approaches. Finally, we compare the main characteristics of this phenomenon as they are seen through the lenses of heterodox and mainstream economists.

2. Financialization as a research project

The growth of finance in relation to other sectors of the economy was observed at the end of 1970s,[3] and thus obviously was not an entirely new phenomenon. Yet, it is in this period that such a tendency ceased to be perceived only as a simple quantitative change and came to be identified as a sign of deep qualitative, institutional changes. With time, this gravitational shift toward finance in the economy started to be identified with a new stage or a model of capitalism itself.

However, for a long time this phenomenon was not even called financialization. The origins of the term are unclear, but it is reported that it began to appear with increasing frequency in the early 1990s. Foster (2007) argues that it was coined by either Arrighi (1994) or Phillips (1994). Since then, the popularity of the term has increased. According to Christophers (2015), if globalization was the new buzzword of the 1990s and neoliberalization (or neoliberalism) of the 2000s, then financialization became the buzzword of the 2010s.

This was in the aftermath of the global financial crisis. Since its outbreak and ongoing consequences, financialization, being perceived as one of the main causes of the crisis, has become much more popular in the critical scholarly vocabulary, political discussions and consciousness of societies. As Christophers (2015) notes, a Google Scholar search yields 170 hits for financialization (or financialisation) between 1996 and 2000, 1088 between 2001 and 2005, 5790 between 2006 and 2010, and 12,010 between 2011 and the midpoint of 2014 (Christophers 2015).[4] A new term was coined and introduced, namely 'finance dominated capitalism' (Hein 2012). For just a few years, a general (but

Moreover, one might argue that it would be more appropriate to consider the division into mainstream and alternative economy on the one hand, and economic orthodoxy and heterodoxy on the other. Taking all it into account, one might, however, assume that the mainstream schools include the schools of classical (and neoclassical) economics – monetarism, the new classical economics, and the real business cycle school – as well as Keynesianism and the new Keynesian school. The heterodox schools include post-Keynesians, the Austrian school, Marxists, the (old) institutional school, and feminist economics (for more, see Marszałek 2014).

[3] Or, according to Harry Magdoff and Paul Sweezy from *Monthly Review*, even from the 1960s. Both authors, as Pollin (2004, 2006) argues, were 'true pioneers in recognizing this trend', as they tracked and documented the emerging form of capitalism that has now become ascendant – the increasing role of finance in the operations of capitalism. This has been termed 'financialization'.

[4] Within last three years (2020–2022) it was already 17,000.

short-lived, as it turned out) consensus emerged between the mainstream and heterodox economists, who agreed that the role of finance had increased in contemporary capitalist societies and that its consequences could be disastrous (Sotiropoulos, Hallig 2020).

Of course, research on the growing importance of financial institutions, instruments and attitudes was visible before the 2010s. But then financialization as a research agenda was limited rather to the works of heterodox economists, who were the first to emphasize its importance and overwhelming influence on various aspects of economic and social life. What is characteristic is that there has been considerable diversity in the way financialization is studied and analysed in heterodox economics, implying a range of different analytical frameworks, methodological assumptions, research questions, and strategies.[5]

Regardless of some differences, within heterodox economics the core features of financialization were identified. Apart from the dominance of the financial sector in the economy, the following processes and phenomena can be indicated as more detailed distinguishing features (Brown, Spencer 2011; Hein 2012; Sawyer 2014): (1) the popularization and rapid expansion of financial markets; (2) the deregulation of financial systems and individual economies; (3) an ever-expanding range of financial instruments and institutions; (4) decisions in the field of economic and social policy favouring the development of financial markets; (5) an increase in credit sustained consumption; (6) the widespread and growing presence of institutions, instrument markets, and financial schemes in economic and social life, and (7) the development of a specific (individualistic, pro-market, utilitarian) financial culture.

Those features of financialization have subsequently been analysed by other heterodox economists. As an empirical substantiation of those features, four stylized facts are usually proposed (Mavroudeas, Papadatos 2018):

1. The increased weight of the financial sector in contemporary advanced capitalist economies, exhibited in the increased share of this sector in GDP and profits, along with the proliferation and widespread use of new complex financial instruments (e.g. derivatives);

2. Big firms finance themselves through retained earnings and capital markets (rather than through banks), and the emergence of 'shadow banking';

3. The widespread adoption by firms of policies of shareholder value maximization that focus on enriching shareholders rather than addressing the productive prospects of any given enterprise. This reflects the rise in the prominence of institutional investors;

4. The increased indebtedness of working- and middle-class households in several advanced capitalist economies.

Those stylized facts were developed and discussed along with formulated hypotheses, concerning, for example, the determinants and effects of financialization. Importantly, heterodox economics remains highly sceptical and wary of financialization and, as will be further elaborated, its consequences for society, political systems and domestic economies.

As mentioned previously, in contrast to heterodox economists, mainstream economists did not initially view financialization as an interesting research topic. They tended to label this new environment, in which financial markets predominate over the outcomes of goods and factor markets, as 'financial' or 'finance' capitalism (DeLong 1991; Neal 1990). At best, mainstream economics

[5] These issues are beyond the scope of the paper. One should mention only that different attitudes are presented by post--Keynesians, Marxists, and evolutionary economists, among others.

noticed the phenomenon, but treated it as a natural form of market adjustment, in principle beneficial to the economy. Surprisingly, as Mavroudeas and Papadatos (2018) point out, mainstream economists abruptly dropped the inhibition of general equilibrium theory concerning a large financial sector, arguing instead that such a phenomenon contributes to economic growth (e.g. King, Levine 1993). They also praised the expanded role of capital markets, arguing that market-based financial systems are more efficient and less risky than bank-based ones.

One might even say that mainstream economics, stuck in the assumptions of a new neoclassical synthesis, missed the systemic changes in the economy, brought about by a rapid development of the financial sector. A disregard for financialization was a part of the wider problem – the mainstream theories and models failed to keep up with the rapid and profound changes in the economy resulting from, among other things, technical progress. As Ratajczak (2012) emphasizes, the radical changes in the financial sphere and the entire economic world were not accompanied by adequate changes in the foundations of thinking about the functioning of the market economy. Thus, the main problem of mainstream economics was that it stayed in the circle of beliefs originating from neoclassical economics, which had been formulated in completely different institutional conditions, when society was very different.

3. General assumptions and research methods

Such a remarkable discrepancy between the two theoretical approaches to financialization, as signalled in the previous section was, to a large extent, the consequence of the accepted assumptions and the applied research methods. Different attitudes and methods for analysing financialization resulted in different conclusions and perceptions of finance growth.

The representatives of heterodoxy considered financial markets and capitalist societies to be inherently unstable. The acceleration and proliferation of financial institutions and instruments, along with financial engineering and changes in the money creation mechanisms available in the contemporary economy, were assumed to generate imbalances and lead to a deterioration in the structure of economic agents' incentives, thus hampering the functioning of the economy. Various strains of heterodoxy analysed different aspects of those issues. For instance, post-Keynesians (e.g. Minsky) stressed that the fundamental uncertainty of agents' decisions, financial investors' tendency towards speculation, the procyclicality of credit extension are sources of financial crises. Marxists introduced research on power and class relations, and considered their impact on economic interactions in the face of financialization. Institutionalists focused, in turn, on how institutions (organisations, conventions and, more generally, rules) influence economic interaction.

Taking those aspects into account, heterodox economists described financialization – its sources, nature, process, and consequences – in a rather narrative-oriented manner, without the use of formal models or advanced quantitative research. Above all, they tried to capture and understand the essence of this phenomenon in a broader economic and social context. They believed that mathematics – typical of mainstream economics – only simplified the real picture and led to false conclusions, especially with reference to such complex issues as financial and monetary areas. As a consequence, in heterodox works, issues connected with financialization have not been thoroughly operationalized and modelled econometrically. The narrative approach, which combines one's own narrative of historical events, tends to dominate (Shiller 2019), or only descriptive statistics of any given times series are presented, without any rigorous econometric analysis.

In contrast, mainstream economists present a rigorous mathematical and quantitative apparatus which in many cases demands adopting very strong (even counterfactual) assumptions on the market structure and behaviour of economic agents. Believing in the portfolio theory and the theory of efficient markets, they perceive markets and financial systems as always efficient and sustainable, and individual agents as rational. Therefore, the development of financial markets and the growing importance of the financial sphere are regarded as positive, in line with the needs of all market participants. Surprisingly, despite the dominance of monetary issues in mainstream macroeconomic theory, observable since the monetarist school, as well as the growing importance of monetary and financial problems, there was no serious attempt to include the institutional foundations of money creation and financial institutions in the mainstream macroeconomic models. The economists of the new neoclassical synthesis used and recommended DSGE modelling as the main macroeconomic method. However, its application did not allow for identifying the sources of monetary disorder or for proposing effective remedial actions. The social nature of money and the influence of sociological and psychological factors (including 'animal spirits') on its value were also ignored. As a result, those models presented the problem of money in an increasingly simplified manner and reduced the monetary system almost entirely to the monetary policy strategy of the central bank. Simultaneously, financial instruments, institutions and systems have only been analysed on a microeconomic scale, with only a few attempts to introduce them to macroeconomic models.

According to Spencer (2013), the methodological foundations of mainstream economics, such as methodological individualism, the rational expectations hypothesis and the assumption of the efficiency of financial markets, contributed to promoting excessive risk and disregarding the roots of the crisis (and later to primarily downplaying problems). Assuming that investors always maximize their total expected utility, the possibility of them making a wrong decision or being guided by other premises was eliminated.

These problems were also raised by Sławiński (2010a, 2010b). He emphasized that the belief in market discipline and the self-regulating economy is a result of the application of the efficient market hypothesis also to decisions made by households. It was assumed that they would not only have all the information at their disposal, but also be able to analyse it and use it appropriately in their decisions. This turned out to be quite dubious, especially with regard to the increasing complexity of the monetary and financial spheres. Investors – contrary to the efficient market hypothesis – had to deal not only with risk, but also with the uncertainty resulting from the inability to estimate the probability distributions of many variables. In this situation, their expectations were short-term and were only an extrapolation from the changing situation (see also Palley 2012; Vercelli 2019). In this context, Sławinski (2010b) drew attention to two other issues. First, he stressed that the efficient market hypothesis implied a certain attitude and behaviour of supervisory institutions over financial markets. For if it is assumed that the prices of financial assets (and the risk premiums included in them) correctly reflect the most likely course of events in the financial markets, then to ensure the stability of the banking system it is enough that banks maintain their capital at slightly higher levels than would be necessary for covering potential losses. In such a situation, supervisors should only focus on the loss calculation process and the amount of regulatory capital. Such action, however, in practice led the supervisors to disregard the erosion of prudent lending rules, which occurred when banking institutions focused on increasing the rate of return (Sławiński 2010a).

Secondly, adopting the efficient market hypothesis eliminates the need to include the financial sector in a model. If all the participants of economic life make rational decisions, then they make optimal decisions also with regard to the amount taken in loans – they never take them in an amount exceeding the possibility of their repayment. As Sławiński adds, in the world of the assumptions of general equilibrium models, the chances of households making optimal decisions are neither limited by any barriers to accessing sources of financing nor by the lack of futures markets that would allow them to hedge against risk. In such a situation, the financial system is so effective that it only plays the role of a neutral intermediary in the processes of production and exchange. Therefore, it is not necessary to include it in the formal analysis (Sławiński 2010b).

Moreover, according to Allington, McCombie and Pike (2001), within the framework of the new neoclassical synthesis, constituting the very core of mainstream economics, it is presumed that the market essentially regulates itself. This, in turn, prompted the poor regulation of the financial sector (so-called 'light regulation'). Meanwhile, according to these authors, the speculative bubble in the US mortgage market, which directly contributed to the crisis, was an endogenous factor, resulting from the development of financial innovations and their mass use. This allowed, along with the lack of regulation, a leap in moral hazard among subprime operators (see also, e.g. Rajan 2005).

As a result of these different attitudes to research and neglect of the issue in the mainstream approach, only heterodox economists undertook macroeconomic studies on the functioning and instability of financial systems and the consequences of these phenomena. Surprisingly, the Global Financial Crisis 2007–2009 allowed the agenda of these heterodox economists to enter into wider awareness, introducing financialization as a source of the fragility and instability of individual economies, thus contributing to the outbreak of the crisis and its contagion between countries.

As Spencer (2013) points out, the critique of economics – as in other crisis periods – came not only from the outside, but also from within. According to Palley (2012), it was the lack of pluralism within mainstream economics, and the neoclassical dominance within it, that caused such misdiagnosis and the inability to correctly assess the increasing threats stemming from financialization. In this context, it is above all the neoclassical core of mainstream economics that was criticized.

But even after the crisis, only a few adjustments were made to the mainstream methodology and research agenda. Furthermore, they were rather modest and did not go beyond its core paradigm (Allington, McCombie, Pike 2011; Dembiński 2009; Palley 2012; Mehrling 2000). Mainstream economists still fail to incorporate the imperfections of financial markets into their macroeconometric models.

Admittedly, after the crisis mainstream economists agreed in principle that financial markets could generate inefficient outcomes, but these critiques have had little impact on either the broad thinking about financial markets or the direction of economic policy. They have remained driven by the belief that deregulation and the expansion of financial markets is good for the general welfare. Moreover, the critique of financial markets was generated within mainstream grounded theoretical foundations, hence it remained structured by them. This means that the assessment of financial markets continues to be made in terms of the neoclassical hypotheses of market efficiency and rationality. They have not been seen as a part of an overall economic system that distributes power and affects the character of production and the distribution of income (Palley 2007).

During this theoretical *interregnum*, heterodox economists were unable to propose a coherent, precise methodological framework for research on financialization, focusing rather on a narrative--approach. The acceptance by heterodoxy of the social nature of financialization without more quantitative research on its determinants (taking into account all the shortcomings of the overly formalized approach) makes it difficult to fully understand this phenomenon and its evolution over time. The counterattack of mainstream economics contributed to a relative (unjustified) weakening of interest in financialization at the end of the previous decade.

4. The causes of financialization

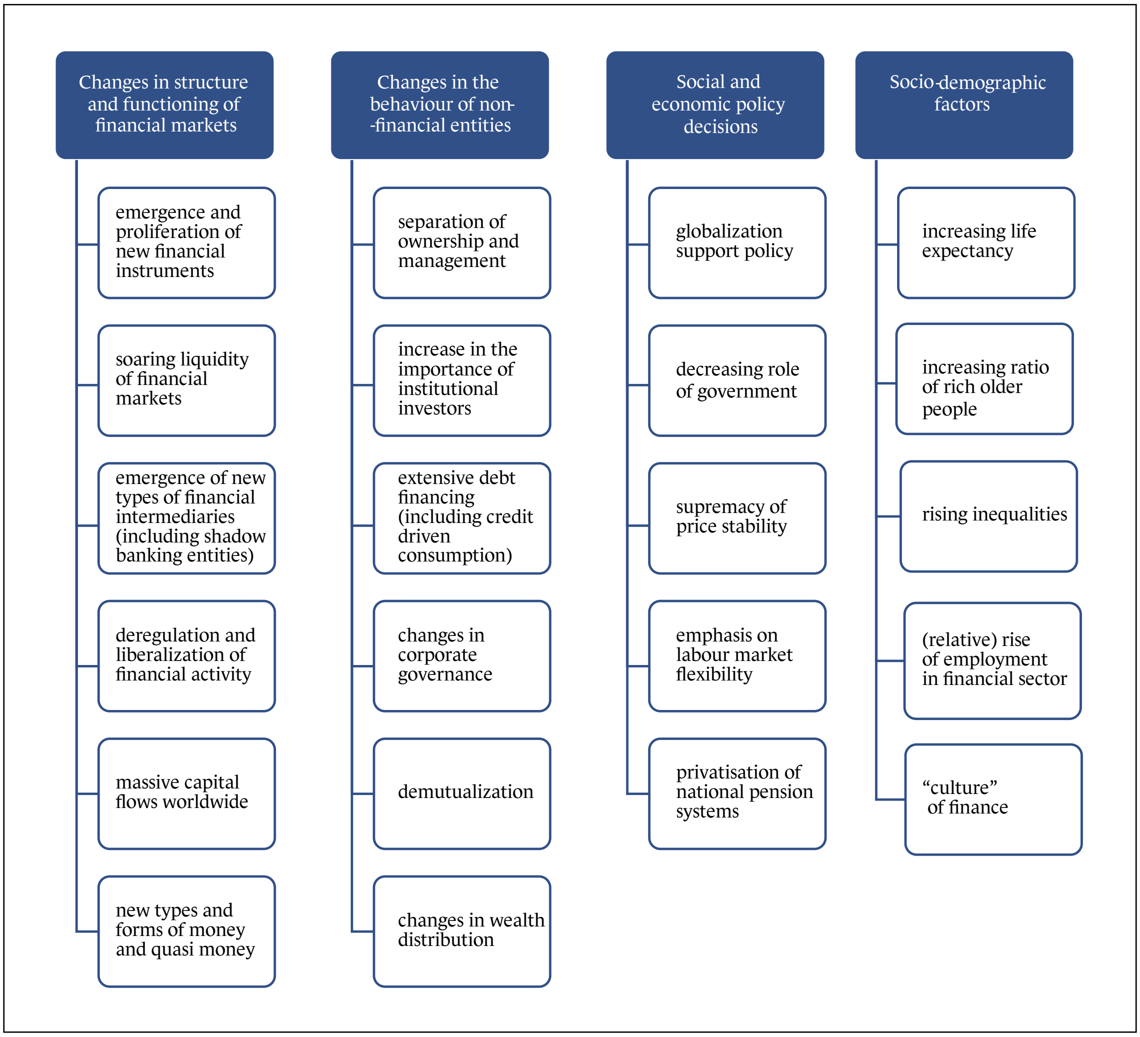
Bearing in mind this polarization of research methods and approaches, it is not surprising that no single determinant of financialization was identified and accepted as being the most important. Nor is it surprising that heterodox economists were those who paid more attention to financialization issues. They argued that when analysing the determinants of financialization it is necessary to consider a combination of many, mutually stimulating factors, both at the microeconomic and macroeconomic levels. The former refers to enterprises, households and specific markets, while the latter refers to the state's decisions (i.e. those of governments and central banks) made in the area of social and economic policy, and regulations.

The determinants of financialization identified by heterodox economists have often been divided into micro and macroeconomic ones (see e.g. Bhaduri 2011; Palley 2007). The micro causes of financialization can be further divided into changes in the structure and functioning of financial markets and changes in the behaviour of non-financial entities. Among the macro causes one might identify social and economic policy and socio-demographic factors. All the determinants are presented in Diagram 1, and the most important of them are briefly described below.

At the very core of financialization stand financial innovations and technological changes that made it possible to trade money very quickly (Fiasanos, Guevarra, Pierros 2016). Technological factors (mainly IT technologies), leading to the so-called economy 4.0., were particularly eagerly used by financial institutions in projecting and distributing brand new types of financial instruments. Financial innovations (e.g. securitization and structured financial products like ABS, CDO's or CDS), in turn, have played a key role in the development of recent financial practices. As Lapavitsas (2013) argues, innovations, financial liberalization, increasing pace and magnitude of financial transaction, speculative trading, asset securitization, shadow banking, internet finance, etc., have been shifting economic activities to financial markets (which has led to the gradual separation of finance from the real economy). All these factors have allowed the financial sector to overcome regulatory barriers and contributed significantly to the fast progress of financialization, both in individual countries and globally (Davis, Kim 2015; Pozsar, Singh 2011; Jurek, Marszałek 2014).

Another boost to the creation of financial innovations was given by the liberalization of economies, which enabled massive capital flows. This process became visible in the US economy in the 1980s, and subsequently accelerated, with the Glass-Steagall Act being gradually relaxed by the Fed and eventually repealed in 1996. At the same time, US financial institutions, becoming increasingly active and aggressive in the global markets, lobbied for loose regulations (Komai, Richardson 2011). Finally, the reform of FDIC (The Federal Deposit Insurance Corporation) into FDICIA (Federal Deposit Insurance Corporation Improvement Act) in 1991 institutionalized the 'too big to fail' doctrine (Komai, Richardson 2011) and increased incentives for moral hazard on the part of banks (see also Kregel, Tonvenarochi 2014; Orhangazi 2008; Toporowski 2010).

Diagram 1
The causes of financialization



Source: the authors.

The specific manifestations of financialization and, at the same time, its determinants, are also the aftermath of the following factors: the increase of the financial sector's share in GDP (including banks and other financial institutions) as well as the increase of its share in total employment (Krippner 2005; Sawyer 2017). At the same time, it is also manifested in the high global penetration of financial institutions' transactions among countries, the substantial financial penetration of developed countries into developing countries, and the faster growth rate of the total amount of international capital flows over the growth of world output (Bonizzi 2013).

Among the microeconomic determinants of financialization connected with the activity of non-financial agents, representatives of heterodoxy pointed to the increasingly important position of financial operations in the overall activity of non-financial enterprises. This means that financial products have become an element of the offer of these entities (Milberg 2008). Moreover, non-financial enterprises have started acting according to the ‘risk and return’ paradigm. Such phenomena as pharmacy financialization, commodity financialization, water financialization, financial talents, and financial investment funds controlling the scale of industrial capital, have gradually become more common (Basak, Pavlova 2016). As a result, a larger proportion of non-financial corporate profits was generated from financial channels (Krippner 2005). This was connected with another factor: the increased role of financial activities as a determinant of the pay packages of the top management of non-financial corporations. In particular this includes corporate CEOs, whose incentives shifted towards more risky decisions and financial investments (Lazonick 2013).

When it comes to the macro determinants of financialization, the economic and social policies introduced in developed countries since the 1990s are indicated. They were a projection of the predominant neoliberalist worldview that contributed to market liberalization and subsequently to the acceleration of the supremacy of finance. Two terms – neoliberalism and financialization – became closely related in the political and economic debates.

In particular, one should mention here the actions of policymakers being made in accordance with the principle of the limited role of the state in economic life[6] (e.g. by departing from the welfare state doctrine and economic interventionism, to liberalization, privatization, and changes in pension systems). Those actions resulted in making the labour market more flexible (e.g. by weakening the role of trade unions, limiting the level of the minimum wage and unemployment benefits), rigorous price stability, and promoting globalization by the liberalization of capital flows and macroprudential policy (Palley 2012; Hein 2012; Toporowski 2010).

Some of the macro determinants are connected with institutional changes, such as the collapse of the Bretton Woods system and the expansion of flexible exchange rates, the full dominance of fiat money within monetary regimes, the new political agendas set forth by Thatcher and Reagan in the 1980s, as well as the creation of the ECB (gradually) leading to central bank independence, zero inflation targeting, and the abandonment of the goal of full employment in favour of the so-called New Consensus Monetary Policy (Arestis, Sawyer 2005). These processes brought about a clear deflationary policy bias in central banks (Palley 1996). At the same time, the tendency towards free market orientation was succeeded by a policy regime in which fiscal instruments played a critical role in economic activity, which additionally created demand for financial instruments.

It is worth noticing that many of the described micro and macroeconomic causes of financialization were a consequence of applying the principles and recommendations (and ideological optics) of mainstream economics in practice. Thus, one might say that mainstream ideas contributed in a way to spreading and fostering financialization. For mainstream economists, the growth of the financial sector is a natural process of market development and tends to bring benefits for the economic system as a whole. They were aware of financialization but did not perceive the phenomenon as a problem in any way. Quite the contrary, they supported the development of finance as being consistent with the mainstream theories and their policy recommendations (based on the New Neoclassical Synthesis).

It would be an oversimplification to state that mainstream economists did not devote much attention to the causes of financialization. It would be rather more accurate to say that they perceived those causes from a completely different perspective than did heterodox economics. They regarded them not as factors contributing to the harmful and disastrous phenomenon of financialization,

[6] Yet, the role of the state (government) in financialization is rather ambiguous and very complex (see Ratajczak 2020).

but rather as factors allowing for the introduction of a desirable mainstream political agenda. Thus, somewhat surprisingly, one might state that both theoretical strains of theories agree on the causes of financialization. The difference lies in their perceptions of financialization and its consequences: mainstream economists treat it and its effects as a natural economic phenomenon,[7] while heterodox economists focus on its harmful nature and negative effects.

5. The effects of financialization

It should come as no surprise that the effects of financialization are multifaceted and complex. The main effect is the importance of financial institutions and markets, and their growing autonomy in relation to the rest of the economy (including supervisory and monetary authorities).

Among heterodox economists it is believed that the effects of financialization are purely negative. According to them, it generates serious problems that are economic and social in nature. In the first case, the process has: complicated business activities outside the financial sector and contributed to a greater dependence of economic entities on what happens on volatile financial markets; shortened the time horizon of economic decisions; created the pressure to undertake risky ventures; and accelerated the pace of economic life. Under such circumstances, enterprises (especially small and medium-sized ones) and households depend to a large extent on the financial system, and modify their activities according to the requirements of financial institutions that provide them with financial services.[8] Those entities also embody a specific "financial culture" and behaviour.

Financialization also involves the complicated activities of policy makers and financial supervision institutions. It became increasingly difficult to enforce the prudential compliance of financial institutions due to the blurring of differences between types of financial institutions, the emergence of large financial holdings, the use of various "creative" accounting techniques, and the extensive use of financial engineering. Moreover, the growing burden of public debt has also made many governments dependent on funds raised in financial markets. Governments have, in a way, become "hostages" to financial institutions. Implementing monetary policy has also become more complicated, as financialization has changed the institutional foundations of money creation, the form and nature of money, and the relationship between a central bank and commercial banks.

All these economic consequences of financialization were reflected in the following three processes: the weakening of economic growth (Assa 2012; Jayadev, Epstein 2005), the changing shape of the business cycle (Palley 2007), and the growing vulnerability of economies to financial crises, with the most expressive manifestation of this being the Global Financial Crisis 2007–2009 (Hein, Detzer, Dodig 2016; Toporowski 2010).

[7] Some changes in the perceptions of the causes of financialization by mainstream economists and policymakers were visible after the outbreak of the Global Financial Crisis. Mainstream economists argued then that the scale of deregulation and liberalization had gone too far and the faith in the self-regulating free market mechanism was too optimistic. As Greenspan (2008) admitted "the immense and largely unregulated business of spreading financial risk widely, through the use of exotic financial instruments called derivatives, had gotten out of control and had added to the havoc of the crisis" (NYT, 28 October 2008). These problems, however, were treated rather as effects of the process of financialization, not as its causes.

[8] In the heterodox approach, the potential benefits from a larger financial system (for example in the form of more productive investment) are also noted, yet they are also contrasted with the problems of intensifying speculation and problems with systemic instability.

Financialization also generates serious problems of a social nature. It creates specific attitudes, previously inherent only in the market economy, particularly in its aggressive variant. This in turn, contributes to social exclusion (Lavoie 2013), increases inequalities in society (Kedrosky, Stangler 2011; Sawyer 2017), causes unfavourable tendencies in the structure of wages and their amount (Orhangazi 2008; Palley 2012) and promotes egoistic, extremely utilitarian attitudes (Fine 2013).

While heterodox economists are very critical of financialization, the mainstream, as was already mentioned, usually praised financialization, suggesting it contributed to increasing the overall prosperity through so-called 'financial deepening' (development of financial markets and instruments). For them, financialization is a manifestation of market efficiency and the effective allocation of resources.[9]

Financialization was also praised as a factor conducive to globalization – which for mainstream economists is clearly a positive process – and a remedy for the so-called 'financial repression' hypothesis (Shaw 1973). The deregulated and liberalised financial markets following (but also accompanying) financialization were greeted with the approval of mainstream economists, the World Bank and the IMF, becoming a key part of the Washington Consensus (Williamson 1990). Those institutional solutions were recommended for implementation as a part of the financial systems reforms package for developing countries, aiming at getting 'interest rates right' (World Bank 1989).

Deeper and liberalized financial markets, larger financial institutions operating on the supranational level, and the intense financial activity of non-financial entities, were welcomed as a new, successful stage of the capitalist economy. With the so-called Great Moderation (Bernanke 2004) in the global (and especially the US) economy since the mid-1980s and the triumph of free market liberal democracy, this finance-led capitalism, approved in a way by mainstream economists, appeared to be good for the whole economy as well as for individual agents.

Mainstream economists also praise and support the impressive increase in private households' stock market participation – even through institutional investors rather than direct ownership. They described it as the 'democratization of ownership', and as 'shareholder' capitalism. Therefore, all the arguments in favour of allegedly negative financial attitudes and behaviour were rejected. Instead, they argued that greater involvement in financial investments and operation might rather be interpreted as a manifestation of rationality and seeking the best investment decision.

Such an optimistic perception of financialization and its effects, presented by mainstream economists, was undermined by the outbreak of the global financial crisis. It brought about profound changes in the financial systems and the real economy in many countries, changes in the hierarchy of financial institutions, and decreased trust in banks and other financial institutions. These shed new light on the conditions necessary to ensure economic stability. Importantly, mainstream economists finally admitted that it was financialization and the processes and phenomena connected with it, identified and described by heterodox economists, which were the cause of the crisis.

According to Vercelli (2019), the consensus point of view of mainstream economics on the causes of the crisis was that:

[9] It might be said that financialization and its effects were considered as an opportunity. For example, in 2014 the accounting firm PwC announced financialization to be a USD 9 trillion opportunity for China and six other emerging market economies (EMEs) because this is the sum it would take in loan extension to match the credit-to-GDP ratios in the rich G7 countries (Karwowski, Stockhammer 2017).

– the subprime crisis triggered a “bank run” in the shadow banking system;

– the effects of this bank run were rapidly transmitted and amplified by the new “originate and distribute” model of banking, which created incentive problems;

– the excessive risk generated by the two abovementioned factors contributed to the collapse of the world financial system.

These problems, however, have not been treated as contrary to the mainstream agenda. As Mishkin (2010) pointed out, “none of the lessons from the financial crisis in any way undermines or invalidates the [...] basic principles of the science of monetary policy developed before the crisis.”

Yet, as Vercelli (2019) stresses, after the initial critical self-evaluation of mainstream economics, the criticism started to fade rather fast in favour of a re-assertion of its validity, and since 2010 the financial system has been progressively discharged of its responsibilities. The crisis came to be explained as an aftermath of some mistakes in economic and social policy, and the result of some factors deviating from mainstream recommendations on organization and functioning of the financial and economic system, not as the consequence of the flaws in the overall mainstream programme. Heterodox economists, on the other hand, for several reasons, were not able to impose their narrative and convincingly express and explain the problems brought about by financialization.

6. Conclusion

The aim of the paper was to identify and explain differences between the ways in which heterodox and mainstream economics perceive financialization. Reviewing some crucial aspects of the phenomenon and identifying features of the approaches and attitudes towards financialization presented by the two discussed theoretical perspectives, a clear distinction between the understanding and interpretation of financialization by heterodox and mainstream economists has been presented.

The considerations make it possible to compare synthetically various aspects of financialization viewed through the lenses of heterodoxy and mainstream economics. The most important or/and most characteristic features of the phenomenon were used as the basis for a comparative analysis. The results are presented in Table 1.

The first thing that comes to mind when analysing the contents of the table is that financialization is a phenomenon that is much more important for heterodox economics. For them it constitutes an independent, important research subject, around which the entire research programme was created and conducted very thoroughly. For mainstream economics, financialization is rather a side-effect, in essence, being an offshoot of natural market processes resulting in the (beneficial) development of financial sectors and economic development. Until the global financial crisis of 2007–2009 it was rather neglected or downplayed in the studies, and was regarded as an object of ideological rather than substantive debates.

Table 1

A comparative analysis of the approaches of heterodox and mainstream economics to financialization

Criteria	Heterodox economics	Mainstream economics
Definition	Increasing role of financial motives, financial markets, and financial institutions in the functioning of domestic and international economies	'Financial deepening'
General perception of financialization	A phenomenon fundamentally changing the functioning of national and global economies; regarded as a transition to a brand new stage of capitalism, unfavourable and harmful; a concept closely linked to neoliberalism	A natural phase in the development of financial markets, beneficial for national and global economies
Main research topics	A focus on the identification of mechanisms, causes and effects of financialization	Not focused on financialization *per se*, but researching various aspects of financial activities and their impact on the economy
Methods of analysis	Narrative, descriptive approach; basic statistical analysis; rare application of formal models and advanced econometrics	Rigorous formal modelling; econometric techniques; DSGE modelling; macroeconometric models in which financial aspects are included in a very limited way
Causes of financialization	A combination of numerous, interlinked and reinforcing micro- (on the side of financial institutions and non-financial entities) and macroeconomic (social and economic policy, socio-demographic factors) factors	In principle the same determinants as identified by heterodox economics, but interpreted as clearly beneficial to the economy and leading to the realization of a desirable mainstream political agenda
Positive effects of financialization	Sparse, overcome by negative effects	Numerous positive effects, e.g. deeper and more effective financial markets, improving the efficiency of the market mechanism, better allocation of funds, overcoming of 'financial repression', more liberalized and deregulated economies, open to globalization
Negative effects of financialization	Severe problems of economic (weakening of economic growth, changing the shape of the business cycle, growing vulnerability of economies to financial crises) and social (social exclusion, rising inequalities, unfavourable tendencies in the structure of wages, promotion of egoistic, extremely utilitarian attitudes) nature	Some problems connected with too far-reaching deregulation, the functioning of shadow banking

Table 1, cont'd

Criteria	Heterodox economics	Mainstream economics
The role of money in financialization	A very important factor; endogenous and non-neutral; a blurred distinction between "normal" money and the proliferation of quasi money instruments	Surprisingly, rather neglected, under effective financial market conditions, the monetary system reduced in principle to the strategy of monetary policy of a central bank
Ideological perception of financialization	A process closely connected with neoliberalism and an aggressive free market worldview, negatively assessed by left-oriented researchers and authors	A manifestation of free market orientation and processes, typical for 1980s, perceived as the best solution for economic problems
Impact on economic and social development	Clearly negative	Positive

Source: the authors.

The final assessment of financialization by mainstream and heterodox economists is completely different. The former consider it as a quite positive phenomenon, while according to the latter it has a clearly negative character, as it interferes with various aspects of social and economic life, devastating individual areas of the economy and relations within society. We find that the main source of differences are oversimplifications in the understanding of monetary and financial spheres in the mainstream analyses, as well as differences in applied research methods.

Only after the financial crisis of 2007–2009 did mainstream economists acknowledge that a downplaying of the financial sector in their models had led to many oversimplifications and inadequate policy recommendations. Admittedly, there have been some areas of consensus, such as policy recommendations to limit shadow banking or to introduce better procedures of risk management in financial institutions. However, the actions proposed by heterodox economists are to a large extent perceived by mainstream economists as exaggerated, not conducive to economic development and limiting economic freedom. Thus, formulating universal policy recommendations is not an easy task.

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Dobra, zła czy brzydka: finansjalizacja według ekonomii heterodoksyjnej i ekonomii głównego nurtu

Streszczenie

Od późnych lat 70. ubiegłego wieku ekonomiści heterodoksyjni zwracają coraz większą uwagę na zjawisko finansjalizacji, czyli wzrostu znaczenia i roli motywów finansowych, rynków finansowych, podmiotów finansowych i instytucji finansowych w gospodarce, a także ich rosnący wpływ na społeczne, kulturowe i środowiskowe aspekty gospodarki oraz funkcjonowania społeczeństwa. Zjawisko to wystąpiło przede wszystkim w Stanach Zjednoczonych, ale podobne tendencje pojawiły się także w innych krajach o rozwiniętych rynkach finansowych.

Finansjalizacja dalece wykracza poza procesy czysto ekonomiczne. Jej wpływ obejmuje całokształt życia społecznego w poszczególnych krajach oraz gospodarkę światową. Co ciekawe, szybki i intensywny rozwój sfery finansowej (podsycany w ostatnich latach przez głębokie i szybkie zmiany technologiczne) jest jako problem badawczy różnie traktowany przez ekonomię głównego nurtu i heterodoksyjną. Rzutuje to na zrozumienie finansjalizacji, jak też na określenie jej przyczyn, następstw oraz sformułowanie określonych rekomendacji pod adresem polityki gospodarczej.

Z powyższych względów celem artykułu było zidentyfikowanie i wyjaśnienie różnic między postrzeganiem finansjalizacji w ekonomii heterodoksyjnej i ekonomii głównego nurtu. Może to ułatwić zrozumienie uwarunkowań i konsekwencji tego zjawiska. W artykule przyjęto podejście narracyjne, aby przedstawić i porównać poglądy na temat finansjalizacji prezentowane w ekonomii heterodoksyjnej i ekonomii głównego nurtu. Tego typu podejście jest zasadne, gdyż finansjalizacja stosunkowo rzadko jest przedmiotem formalnych analiz wykorzystujących skomplikowane modele matematyczne.

W pierwszej kolejności opisano finansjalizację jako projekt badawczy, z jego genezą i cechami. Następnie przedstawiono źródła finansjalizacji i jej skutki – prezentując ponownie zarówno podejście heterodoksyjne, jak i mainstreamowe. Na koniec porównano główne cechy tego zjawiska wskazywane przez ekonomistów heterodoksyjnych i ekonomistów głównego nurtu.

Po pierwsze, po przeprowadzeniu badań nasuwa się wniosek, że finansjalizacja jest zjawiskiem znacznie ważniejszym dla ekonomii heterodoksyjnej. Stanowi dla nich samodzielny, ważny przedmiot badań, wokół którego stworzono i bardzo skrupulatnie przeprowadzono cały program badawczy. Dla ekonomii głównego nurtu finansjalizacja jest raczej problemem ubocznym, będącym w istocie pochodną naturalnych procesów rynkowych, których skutkiem jest (korzystny) rozwój sektorów finansowych. Do czasu światowego kryzysu finansowego z lat 2007–2009 była raczej bagatelizowana lub wręcz pomijana w badaniach; traktowano ją głównie jako przedmiot debat ideologicznych, a nie merytorycznych.

Po drugie, można uznać, że głównym źródłem różnic są nadmierne uproszczenia w rozumieniu sfery monetarnej i finansowej w analizach głównego nurtu. Znaczenie mają także różnice między stosowanymi metodami badawczymi.

Po trzecie, różnice w postrzeganiu rzutują na odmienną ocenę finansjalizacji przez ekonomistów głównego nurtu i heterodoksję. Ci pierwsi uznają ją za zjawisko dość pozytywne, drudzy natomiast akcentują wyraźnie negatywny charakter finansjalizacji jako czynnika wpływającego na różne aspekty życia społecznego i gospodarczego, wręcz dewastującego poszczególne dziedziny gospodarki i relacje społeczne. Dopiero po kryzysie finansowym z lat 2007–2009 ekonomiści głównego nurtu przyznali, że bagatelizowanie sektora finansowego w ich modelach doprowadziło do wielu uproszczeń i nieodpowiednich rekomendacji politycznych.

Słowa kluczowe: finansjalizacja, ekonomia heterodoksyjna, mainstream, kryzysy finansowe