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# Financialisation, distribution, growth and crisis – long-run tendencies

**Eckhard Hein**

Conference 'Financialization and Labour'

WZB

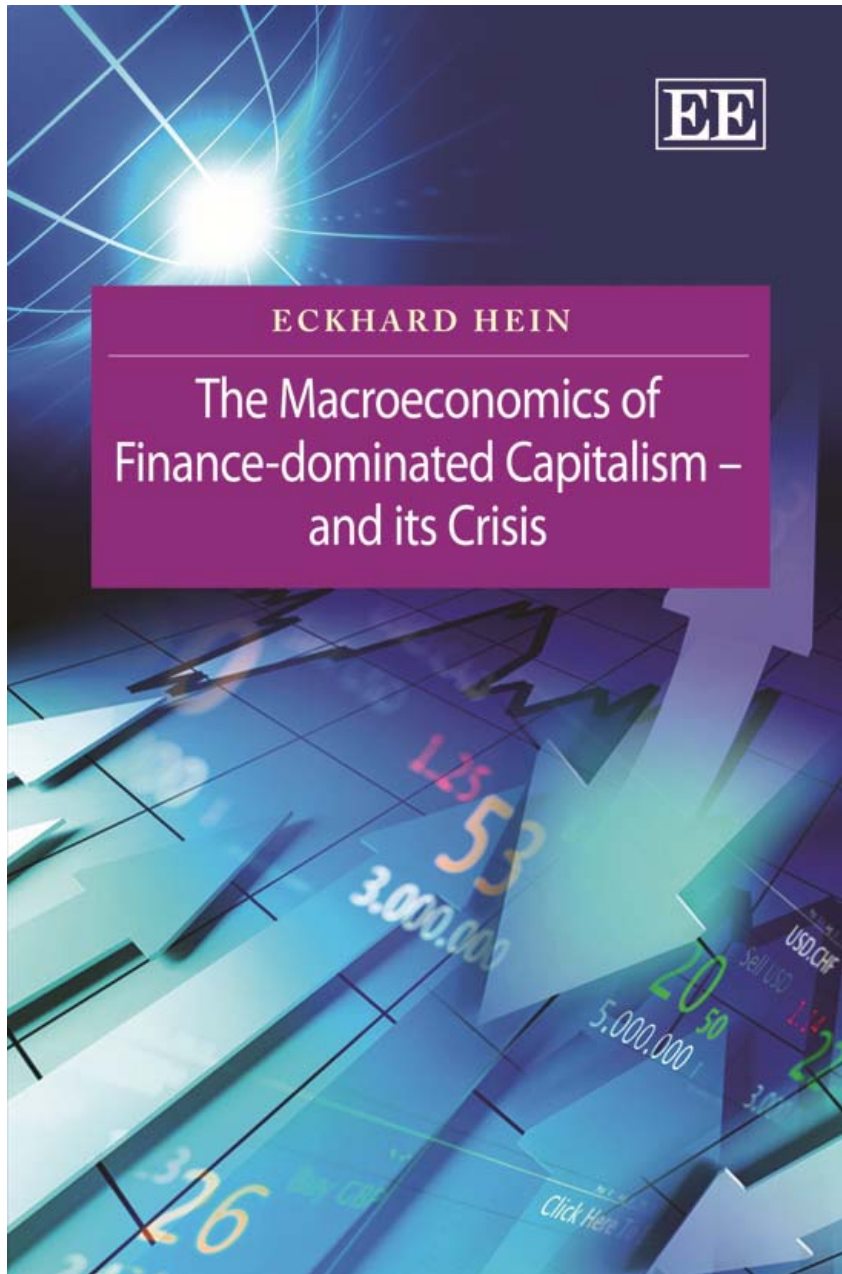
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## FESSUD

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No 23

Financialisation, distribution, growth and crises –  
long-run tendencies

Eckhard Hein and Nina Dodig

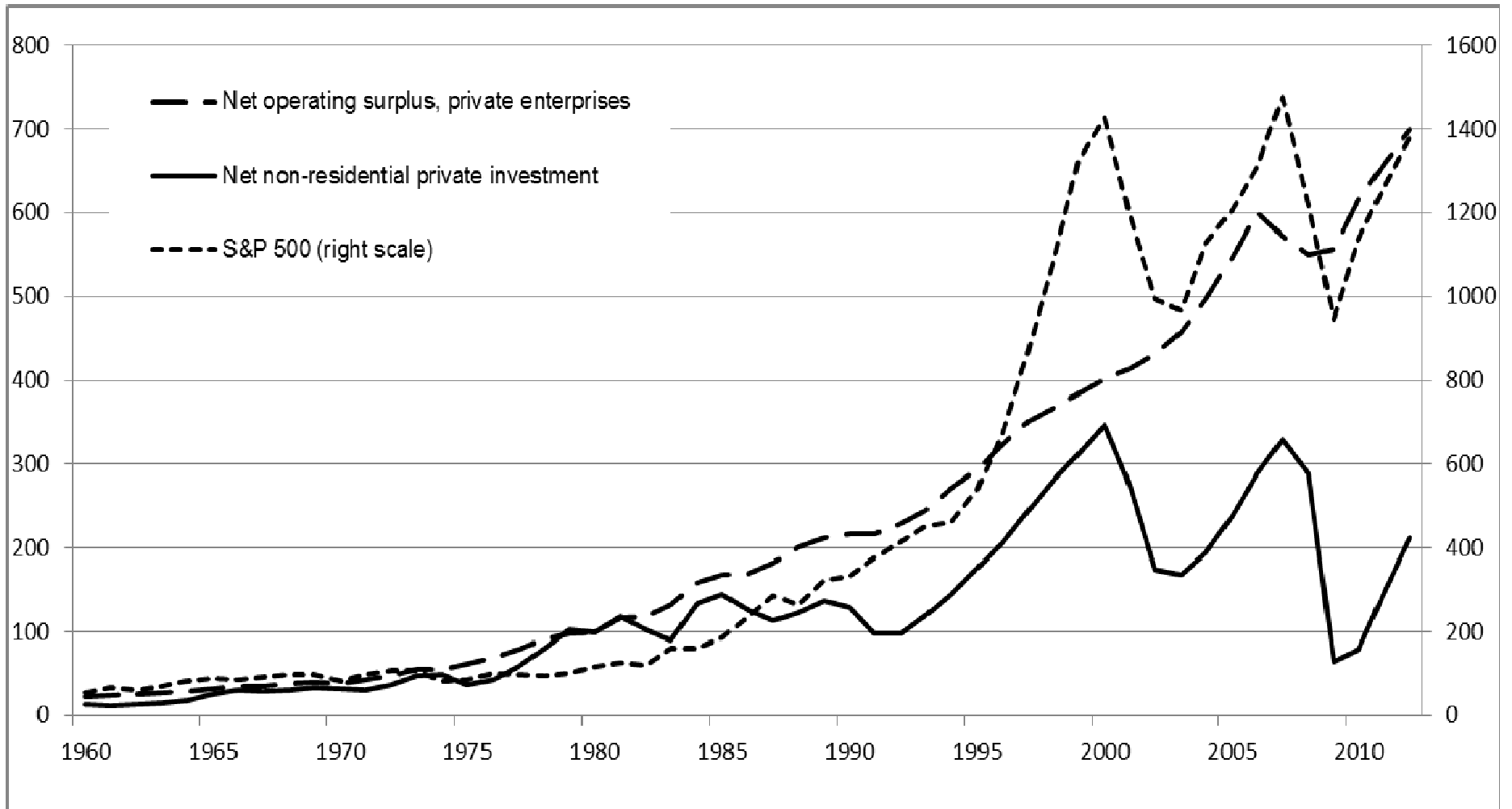
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## Macroeconomics of financialisation and crisis:

1. Re-distribution of income in favour of **shareholders (rentiers) vs. firms, firms vs. workers, managers vs. workers** (distribution channel)
2. Rising shareholder power, dividend payments and share buybacks affect **objectives and constraints of firms and hence real investment** in the negative (preference channel and internal means of finance channel)
3. Financial asset price booms, house price booms, and financial market liberalisation allow for **wealth-based and debt-financed consumption boom** → compensating for the contractive effects of financialisation → risk: financial fragility and over-indebtedness of private households
4. Deregulation and liberalisation of international capital markets and capital accounts, has created the potential to run and finance persistent current account deficits, and for counterpart **mercantilist export-led strategies** as alternative to generate demand for some countries → risk: global imbalances and over-indebtedness of current account deficit countries

**Figure 1**

**Investment, profits (index 1980 = 100), and share prices (index), USA, 1960-2012**

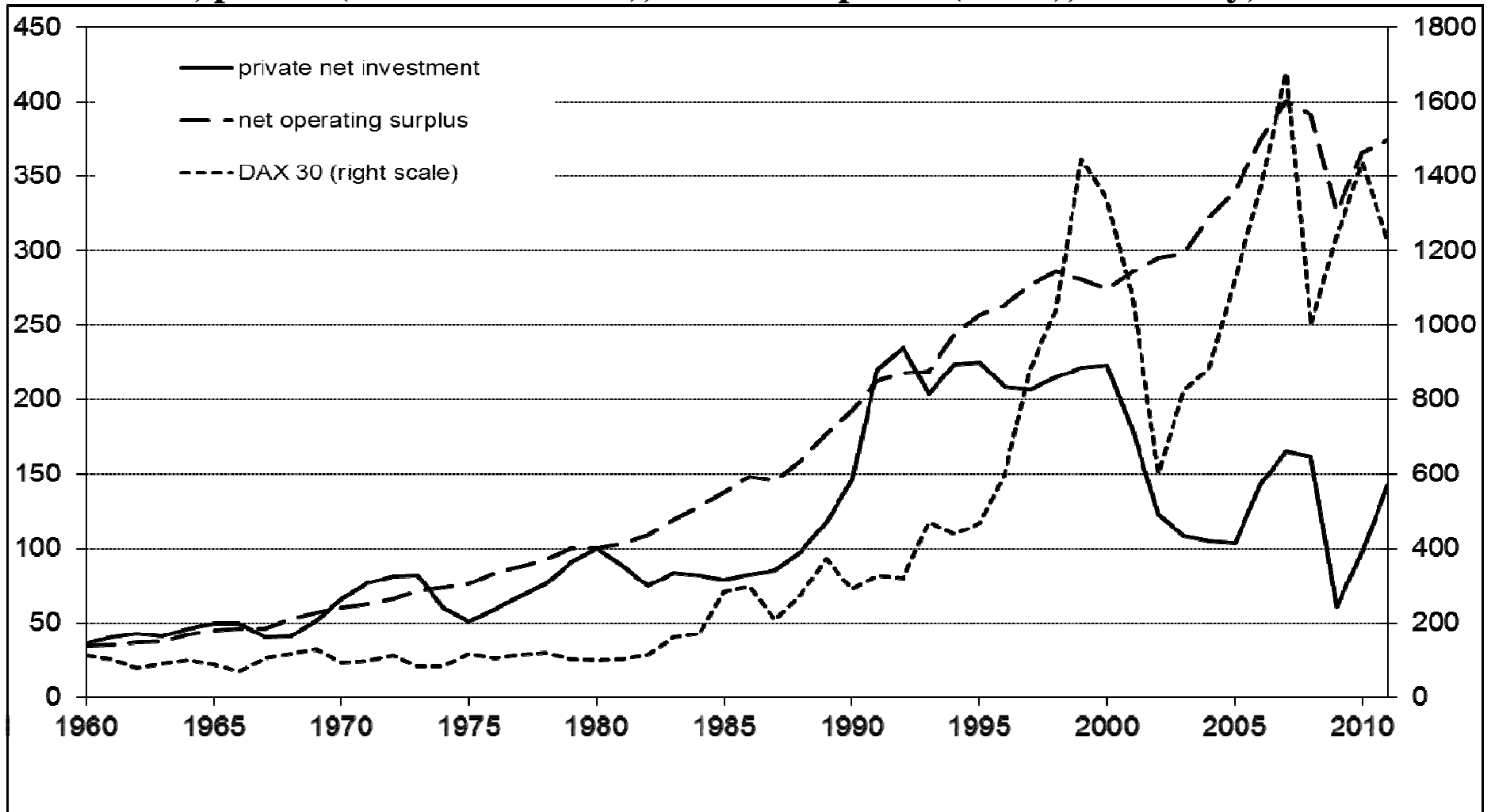


Data sources: Bureau of Economic Analysis (2013), Federal Reserve Bank of St. Louis (2013), authors' calculations.

Source: Hein/Dodig (2014, p.3)

**Figure 2**

**Investment, profits (index 1980 = 100), and share prices (index), Germany, 1960 – 2012**



Data sources: European Commission (2012), Börse.de (2012), authors' calculations.

Source: Hein/Dodig (2014, p.3)

Gross profits net of taxes =  
Gross investment  
+ Capitalists' consumption  
+ Government budget deficit  
+ Export surplus  
– Workers' saving

(Kalecki 1971, p. 82)

- 1. Introduction**
- 2. Financialisation and redistribution of income since the early 1980s**
- 3. Financialisation, distribution, investment and consumption – macroeconomic effects**
  - 3.1 Financialisation, shareholder value orientation, and investment – macroeconomic effects**
  - 3.2 Financialisation, household debt and consumption – macroeconomic effects**
- 4. Financialisation, open economy effects and current account imbalances**
- 5. Summary and conclusions**

## 2. Financialisation and redistribution of income since the early 1980s

Table 1

<b>Labour income share as percentage of GDP at current factor costs, average values over the trade cycle, early 1980s – 2008</b>				
	1. Early 1980s – early 1990s	2. Early 1990s – early 2000s	3. Early 2000s – 2008	Change (3. – 1.), percentage points
Austria	75.66	70.74	65.20	-10.46
Belgium	70.63	70.74	69.16	-1.47
France	71.44	66.88	65.91	-5.53
Germany	67.11	66.04	63.34	-3.77
Greece <sup>a)</sup>	67.26	62.00	60.60	-6.66
Ireland	70.34	60.90	55.72	-14.61
Italy	68.31	63.25	62.37	-5.95
Netherlands	68.74	67.21	65.57	-3.17
Portugal	65.73	70.60	71.10	5.37
Spain	68.32	66.13	62.41	-5.91
Sweden	71.65	67.04	69.16	-2.48
UK	72.79	71.99	70.67	-2.12
US	68.20	67.12	65.79	-2.41
Japan <sup>a)</sup>	72.38	70.47	65.75	-6.64

*Notes: The labour income share is given by the compensation per employee divided by GDP at factor costs per person employed. The beginning of a trade cycle is given by a local minimum of annual real GDP growth in the respective country.*

*a) adjusted to fit in 3 cycle pattern*

*Data source: European Commission (2010), author's calculations*

*Source: Hein (2012, p. 13)*



**Table 3**

<b>Financialisation and the gross profit share – a Kaleckian perspective</b>					
	<b>Determinants of the gross profit share (including (top) management salaries)</b>				
	1) Mark-up			2) Price of imported raw materials and semi-finished products	3) Sectoral composition of the domestic economy
Stylized facts of financialisation (1.-7.) and neo-liberalism (8.-9.)	1.a) Degree of price competition in the goods market	1.b) Bargaining power and activity of trade union	1.c) Overhead costs and gross profit targets		
1. Increasing shareholder value orientation and short-termism of management	...	+	+	...	...
2. Rising dividend payments	...	...	+	...	...
3. Increasing interest rates or interest payments	...	...	+	...	...
4. Increasing top management salaries	...	...	+	...	...
5. Increasing relevance of financial to non-financial sector (investment)	...	+	...	...	+
6. Mergers and acquisitions	+	...	...	...	...
7. Liberalisation and globalisation of international finance and trade	-	+	...	+/-	+/-
8. Deregulation of the labour market	...	+	...	...	...
9. Downsizing of government	...	+	...	...	+

Notes: + positive effect on the gross profit share, – negative effect on the gross profit share, ... no direct effect on the gross profit share

Source: based on Hein (2013, p. 15)

### 3. Financialisation, distribution, investment and consumption – macroeconomic effects

#### 3.1 Financialisation, shareholder value orientation, and investment – macroeconomic effects

$$h = \frac{\Pi}{pY} = 1 - \frac{1}{1 + m(\rho)}, \quad \frac{\partial h}{\partial \rho} \geq 0, \quad (2)$$

$$\sigma = \frac{S}{pK} = \frac{\Pi - R + s_R R}{pK} = r - (1 - s_R)\rho\gamma, \quad 0 < s_R \leq 1, \quad (9)$$

$$g = \frac{I}{pK} = \alpha + \beta u + \tau h - \theta\rho\gamma, \quad \beta, \tau, \theta \geq 0, \quad (10)$$

**Table 4**

<b>Short-run cases for a change in the rentiers' rate of return</b>			
	<i>'Normal' case</i>	<i>'Intermediate' case</i>	<i>'Puzzling' case</i>
	$1 - s_R < \theta$	$\theta < 1 - s_R < \frac{\theta h}{v\beta}$	$\frac{\theta h}{v\beta} < 1 - s_R$
$\frac{\partial u}{\partial \rho}$	-	+	+
$\frac{\partial r}{\partial \rho}$	-	+	+
$\frac{\partial g}{\partial \rho}$	-	-	+

Source: Hein (2013, p. 52)

**Table 5**

<b>Short-run accumulation regimes under the conditions of financialisation and rising shareholder power</b>			
	<i>'Contractive' regime</i>	<i>'Profits without investment' regime</i>	<i>'Finance-led growth' regime</i>
Effect via management's animal spirits	weak/strong	weak	weak
Effect via rentiers' rate of return	'normal' case	'intermediate' case	'puzzling' case

Source: Hein (2013, p. 53)

Long-run analysis: only 'finance-led growth' regime generates a stable financial structure of the corporate sector

### 3.2 Financialisation, household debt and consumption – macroeconomic effects

$$h = h(m) . \quad (21)$$

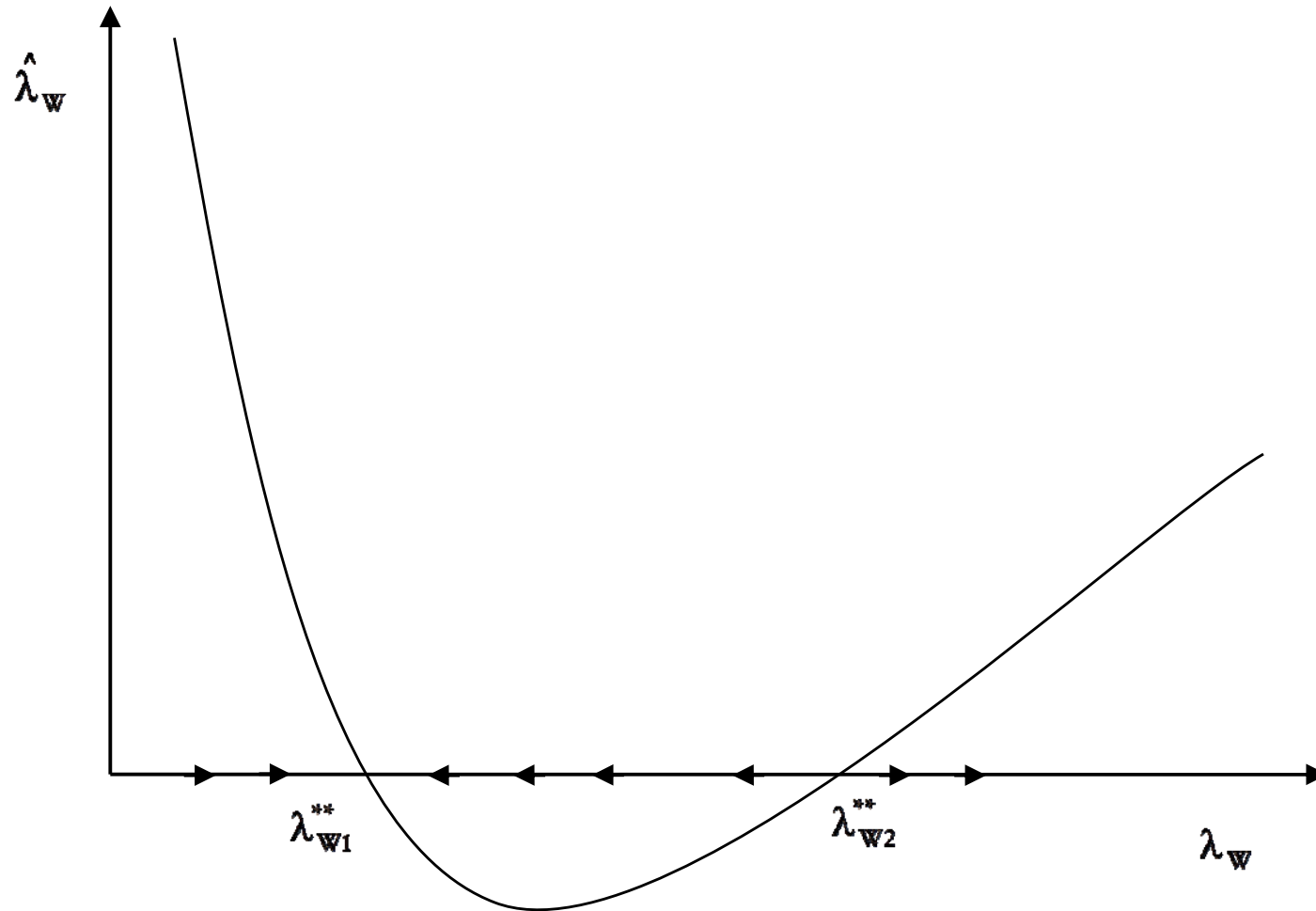
$$C_W = W + \Delta B_W - iB_W = (1 - h)Y + \Delta B_W - iB_W . \quad (24)$$

$$C_R = c_R (hpY + iB_W), \quad 0 < c_R < 1 . \quad (25)$$

$$g = \frac{I}{pK} = \alpha + \beta u, \quad 0 < \beta , \quad (31)$$

$$\sigma = \frac{S}{pK} = s_R \left( h \frac{u}{v} + i\lambda_W \right), \quad 0 < s_R < 1 , \quad (32)$$

Figure 9: Medium-run equilibrium values for workers' debt-capital ratio and their stability with positive stable goods market equilibrium at  $\lambda_{W1}^{**}$



**Table 6**

Short-run and medium-run effects of changes in exogenous model variables, assuming $\alpha > \delta s_R i$						
	$\alpha$	$h$	$\delta$	$i$	$s_R$	$\lambda_W$
<i>Short run</i>						
$u^*$ (stable)	+	- (wage-led)	+ (debt-led)	-	-	-
$g^*$ (stable)	+	- (wage-led)	+ (debt-led)	-	-	-
<i>Medium run</i>						
$\lambda_{W1}^{**}$ (stable)	0	0	+	0	0	...
$\lambda_{W2}^{**}$ (unstable)	+	+	0	-	0	...
$u_1^{**}$ (stable)	+	- (wage-led)	+ for $r_1^{**} = d_1^{**} > i$ (debt-led) - for $r_1^{**} = d_1^{**} < i$ (debt-burdened)	-	-	...
$g_1^{**}$ (stable)	+	- (wage-led)	+ for $r_1^{**} = d_1^{**} > i$ (debt-led) - for $r_1^{**} = d_1^{**} < i$ (debt-burdened)	-	-	...

#### 4. Financialisation, open economy effects and current account imbalances

$$\sigma = g + b. \quad (50)$$

$$\sigma = \frac{S_{\Pi}}{pK} = \frac{s_{\Pi}\Pi}{pK} = s_{\Pi}h \frac{u}{v}, \quad 0 < s_{\Pi} \leq 1. \quad (51)$$

$$g = \alpha + \beta u, \quad \alpha, \beta > 0. \quad (52)$$

$$b = \psi e_r(h) - \phi u + \varepsilon u_f, \quad \psi, \phi, \varepsilon > 0. \quad (53)$$

Increasing financialisation ( $\Omega$ ):

1. Declining animal spirits of firms with respect to investment in capital stock:  $\frac{\partial \alpha}{\partial \Omega} < 0$ .

2. Redistribution at the expense of the wage share:  $\frac{\partial h}{\partial \Omega} > 0$ .

3. Acceleration of foreign demand:  $\frac{\partial u_f}{\partial \Omega} > 0$ .

$$\frac{\partial u^*}{\partial \Omega} > 0, \text{ if : } \quad \frac{\partial \alpha}{\partial \Omega} + \frac{\partial h}{\partial \Omega} \left( \psi \frac{\partial e_r}{\partial h} - s_{\Pi} \frac{u}{v} \right) + \frac{\partial u_f}{\partial \Omega} \varepsilon > 0, \quad (55b')$$

$$\frac{\partial g^*}{\partial \Omega} < 0, \text{ if : } \quad \frac{\partial \alpha}{\partial \Omega} \left( s_{\Pi} \frac{h}{v} + \phi \right) + \beta \left[ \frac{\partial h}{\partial \Omega} \left( \psi \frac{\partial e_r}{\partial h} - s_{\Pi} \frac{u}{v} \right) + \frac{\partial u_f}{\partial \Omega} \varepsilon \right] < 0, \quad (56b')$$

$$\frac{\partial b^*}{\partial \Omega} > 0, \text{ if : } \quad -\frac{\partial \alpha}{\partial \Omega} \phi + \frac{\partial h}{\partial \Omega} \left[ \left( s_{\Pi} \frac{h}{v} - \beta \right) \psi \frac{\partial e_r}{\partial h} + s_{\Pi} \frac{u}{v} \phi \right] + \frac{\partial u_f}{\partial \Omega} \varepsilon \left( s_{\Pi} \frac{h}{v} - \beta \right) > 0. \quad (57b')$$

,Profits without investment'/export-led mercantilist regime requires:

- Weak effects of financialisation on ,animal spirits'
- Weak redistribution in favour of profits
- High price elasticities of demand for exports and imports
- Dynamic effects of financialisation on foreign demand (debt-led consumption boom)
- High income elasticities of demand for exports and imports



## In a 2-countries model

$$\hat{A}_d = \frac{\Delta A_d}{A_d} = \hat{L}_f = \frac{\Delta L_f}{L_f}. \quad (60)$$

$$\frac{A_d}{Y_d^n} \text{ and } \frac{L_f}{Y_f^n} \text{ constant, if } \hat{A}_d = \hat{Y}_d^n = \hat{L}_f = \hat{Y}_f^n. \quad (63)$$

$$\text{I) } \hat{Y}_d^n < \hat{Y}_f^n \rightarrow \frac{A_d}{Y_d^n} \text{ constant and } \frac{L_f}{Y_f^n} \text{ falling or } \frac{A_d}{Y_d^n} \text{ rising and } \frac{L_f}{Y_f^n} \text{ falling}$$

→ no over-indebtedness problem due to upwards instability of foreign debt of deficit country, but potential internal household debt problems in foreign economy

$$\text{II) } \hat{Y}_d^n > \hat{Y}_f^n \rightarrow \frac{A_d}{Y_d^n} \text{ constant and } \frac{L_f}{Y_f^n} \text{ rising or } \frac{A_d}{Y_d^n} \text{ falling and } \frac{L_f}{Y_f^n} \text{ constant}$$

→ over-indebtedness problem due to upwards instability of foreign debt of deficit country

## 5. Summary and conclusions

- Financialisation, redistribution of income and depressed investment in capital stock, allows for short- to medium-run dynamic ‘profits without investment’ regimes.
- However, ‘debt-led consumption boom’ and ‘export-led mercantilist’ type contains internal contradictions, with respect to household debt and with respect to foreign debt of the counterpart current account deficit countries, which finally undermine the sustainability of these regimes and lead to financial and economic crises.
- Wage- or mass income-led regime as only sustainable alternative – feasibility??