



# Theorizing financialization

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## Abstract

The crisis of 2007–9 has cast fresh light on the ascendancy of finance in recent years, a process that is often described as financialization. The concept of financialisation has emerged within Marxist political economy in an effort to relate booming finance to poorly performing production. Yet, there is no general agreement on what it means, as is shown in this article through a selective review of economic and sociological literature. The article puts forth an analysis of financialization that draws on classical Marxism while remaining mindful of the recent crisis. Financialization represents a systemic transformation of mature capitalist economies with three interrelated features. First, large corporations rely less on banks and have acquired financial capacities; second, banks have shifted their activities toward mediating in open financial markets and transacting with households; third, households have become increasingly involved in the operations of finance. The sources of capitalist profit have also changed accordingly.

## Keywords

banking, financialization, heterodox economics, Marxism, rentiers

## Introduction

Financialization<sup>1</sup> is one of the more innovative ideas to come out of radical political economy in recent years, and has often been deployed in analysing the crisis of 2007–9. Its theoretical appeal lies in its ability to connect the current crisis to the secular growth of finance in recent years. More broadly, it can give insight into the structural transformation of capitalist economies during the last three decades, with its attendant social implications. To be sure the concept is still raw and undeveloped, but its power cannot be denied.

There is no generally agreed definition, or even understanding, of financialization. This article critically reviews some of the relevant literature in light of the current crisis. It subsequently puts forth a theoretical analysis of financialization that is situated within classical Marxist political economy. Financialization is posited as a systemic transformation of mature capitalist economies that comprises three fundamental elements: first,

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large non-financial corporations have reduced their reliance on bank loans and have acquired financial capacities; second, banks have expanded their mediating activities in financial markets as well as lending to households; third, households have become increasingly involved in the realm of finance both as debtors and as asset holders. The crisis of 2007–9 is directly related to these developments.

Section 2 discusses several approaches to financialization and the crisis, paying particular attention to Marxist, post-Keynesian and other heterodox treatments, which have significant overlaps with economic sociology. On this basis, Section 3 develops a theoretical view of financialization as systemic transformation of capitalism by drawing on the methodological approach of classical Marxism, especially that of Hilferding. It is shown that the main features of this systemic transformation are related to the current economic behaviour of productive capital, banks and workers, with important implications for capitalist profit making. Section 4 concludes.

## Radical approaches to financialization

### *Marxist political economy of financial expansion*

The Marxist current of *Monthly Review*, guided by Sweezy and Magdoff, put forth original insights on financialization already in the 1970s.<sup>2</sup> According to *Monthly Review*, capitalist accumulation in the 20th century was characterized by three trends: first, slowing down of the rate of growth; second, rise of monopolistic multinational corporations; third, financialization (Sweezy, 1997). These trends are associated with the fundamental problem of the ‘absorption of the surplus’ that presumably characterizes mature capitalism (Baran and Sweezy, 1966).

Specifically, in mature capitalism, monopolies generate an ever expanding surplus which cannot be absorbed by the sphere of production and thus results in stagnation. To relieve stagnation there is an inexorable rise in unproductive consumption (including pure waste). It is apparent that this argument is quite different from the analysis of accumulation and falling profit rates within classical Marxism. What matters here, however, is the use to which the argument was put by the *Monthly Review* current when economic turmoil took hold in the 1970s. Briefly, as production stagnated under the weight of the surplus, capital began to seek refuge in circulation, and above all in the speculative activities of finance. Financialization emerged as the sphere of production became inundated by the investible surplus.

It is a measure of Sweezy’s brilliance as a political economist that he surmised the future rise of finance so early, particularly in view of the relative neglect of finance in his work. But then Sweezy was one of the first Anglo-Saxon Marxist economists to become familiar with Hilferding’s writings in the original already in the inter-war years. Indeed, Sweezy was fully aware of the classical continental tradition on the role of finance in capitalist accumulation. The apprenticeship he had served as a student under Schumpeter probably stood him in good stead in this regard.

The gist of the *Monthly Review* argument on financialization has proven extremely influential, even when the rest of the current’s analysis has not been accepted. Political economy explanations of the crisis of 2007–9 have typically stressed the contrast between

stagnating or declining production and thriving finance. The unspoken assumption has often been that capital has attempted to deal with problematic profitability in production by seeking financial profits. But at some point the potency of the financial escape declined and crisis manifested itself.

The most sophisticated and influential variant of this argument has been offered by Brenner (2002, 2006, 2009), who has linked stagnation in the sphere of production to Marx's theory of the tendency of the rate of profit to fall. Since the late 1960s sustained overcapacity in production has exacerbated competition, thus lowering profit rates. Incumbent enterprises have protected their positions, preventing a resurgence of profit rates and leading to permanent, if latent, crisis in the sphere of production. Actual crisis has been evaded by palliatives, such as boosting demand through exchange rate manipulation and encouraging cheap credit. When the credit creation that was spurred by the Federal Reserve in 2001 had run its course, the underlying reality of problematic production manifested itself and the world was plunged into crisis.

Brenner's account of the tendency of the rate of profit to fall is clearly different from Marx's, as was stated by several contributors to two special issues of the journal *Historical Materialism* (vol. 4 issue 1, 1999 and vol. 5 issue 1, 1999) that were dedicated to Brenner's argument. More important than this, however, has been Brenner's readiness to treat the economic upheavals of recent years as crises of long-term over-accumulation and falling profit rates. Writings by Harman (2009, and much more succinctly 2010) and Callinicos (2010) have shared this view, without necessarily accepting Brenner's core theoretical analysis. For both, financial expansion and credit provision were able to create prosperity, but as soon as credit growth had run its course, the underlying crisis burst out.

Harman and Callinicos are particularly keen to defend the explanatory power of Marx's tendency of the rate of profit to fall (or, rather, their interpretation of it) over the crisis of 2007–9. They share the strong underlying perception that unless the 'true' roots of the crisis were shown to lie in the sphere of production, the crisis would appear to be non-systemic, possibly the result of policy errors, or speculative excesses. Unlike Brenner, however, both openly accept that financialization is a notable trend of contemporary capitalism. They do not offer a systematic definition, but superimpose excessive financial expansion on the presumably fundamental process of over-accumulation. An unfortunate side-effect of this approach is to create the impression that the current crisis had been foreseen. In truth, those on the left who appreciated the importance of financial events in the summer of 2007 could probably be counted on the fingers of one hand, at least in the UK.

The strand of Marxist writing that aims to show the applicability of (some version of) over-accumulation theory to the current crisis has limited persuasiveness. The crisis of 2007–9 emanated in the sphere of finance and spread to production partly through financial mechanisms. Its global character was largely due to securitization which encouraged adoption of investment banking practices among commercial banks. Above all, its proximate causes lay in mortgage lending to the poorest sections of the US working class. None of these features fits with the theory of over-accumulation.

There is also some confusion with regard to financial theory among Marxist writings on the crisis that emphasize over-accumulation. It is notable, for instance, that such writings

are often laced with references to Marx's (1981 [1894]: 567) concept of fictitious capital. At core this is a technical idea amounting to net present value accounting, i.e. ideal sums of money that result from discounting streams of future payments attached to financial assets. These ideal sums correspond to financial prices which can fluctuate independently of what has happened to the money capital that was originally expended to purchase a financial asset. In that obvious sense, financial prices, particularly those on the stock-market, represent fictitious capital.<sup>3</sup>

Fictitious capital is capable of offering insight into the operations of finance, but it is also a widow's cruse of extraordinary arguments regarding financial activities. The huge nominal values associated with some financial markets, for instance, could give the false impression that the state lacks the resources for effective intervention in the realm of finance. Alternatively, and as is exemplified by Harman (2010), the bloated nominal values might lead to the false impression that the financial sector made 'fictional' profits during the bubble. The implication is that recorded profitability was exaggerated, and the 'true' profit rate was probably lower. The result of this argument is to divert attention from precisely the point that needs explaining, namely the existence and the source of enormous financial profits.

Confusion is also present in this strand of writing between fictitious capital and another of Marx's (1981 [1894]: part V) key ideas, namely interest bearing or loanable money capital. This is a special type of capital that is available for lending and is remunerated through the payment of interest. Trading loanable capital could certainly give rise to fictitious capital, but loanable capital itself is anything but fictitious. Rather, it emerges from investment and consumption processes attached to capitalist accumulation, and initially takes the form of idle money. Loanable capital is a hard reality of the capitalist economy and affords to its holders direct claims to the national product.

In short, although the concept of financialization has strong roots in Marxist political economy, especially in the tradition of *Monthly Review*, the focus of Marxist theorists on the tendency of the rate of profit to fall during the last three decades has not facilitated its elaboration. The concept of financialization was developed by others – who were sometimes broadly related to Marxism – and only in recent years has it started to return to Marxist political economy.

### *Post-Keynesian analysis of financialization*

The analytical connection between stagnating or declining production and booming finance is also present in post-Keynesian analysis of financialization. Epstein (2005), for instance, has stressed the increasing weight of financial activities in the economy as capital favours investment in finance rather than production. Unlike the Marxist approaches reviewed above, however, post-Keynesians have focused on the deleterious impact of booming finance on production. In this vein, the poor performance of the real sector has been caused in large measure by the expansion of the financial sector.

It is important to stress that post-Keynesian analysis of financialization does not derive from Minsky, in whose work there is little mention of the long-term balance between finance and the rest of the economy, except brief references to 'money manager capitalism' in some very late output (Minsky, 1996; Minsky and Whalen, 1996). Rather,

post-Keynesian analysis is based on the concept of the rentier, and in particular on the money lender as rentier. This is clear in several influential works, such as Crotty (1990), Pollin (2007) and Epstein (2005). The re-emergence of the rentier – partly due to neoliberal economic policy – has fostered financial at the expense of industrial profits. Consequently, financialization has induced poor performance in investment, output and growth in developed countries. Policy intervention is required to regulate finance – for instance, liquidity reserves of banks, direction of credit, limits on investment banking activities and so on – resulting in improved output, employment and income (Crotty, 2008, 2009; Crotty and Epstein, 2008, 2009).

The rentier, as is well known, is important to Keynes' (1973 [1936]: chapter 24) analysis of mature capitalism. The rentier – a parasitical economic entity – extracts profits due to the scarcity of capital, and might thus depress investment and profitability. For Keynes, successful capitalism requires the 'euthanasia of the rentier' effected through low interest rates. In Marx's writings, on the other hand, the rentier makes only fleeting appearances, and there are no clear references to social strata of rentiers. But some of Marx's (1981 [1894]: chapters 21–4) analysis of 'monied' capitalists is certainly reminiscent of the rentier. 'Monied' capitalists are a section of the capitalist class that does not invest its capital in production but prefers to lend it to others. Thus, money capital available for loans is owned by the 'monied' section, but is put to use by the productive section, the latter paying a part of the resulting surplus value as interest to the former. Tension and opposition between the two are inevitable.

Consequently, the post-Keynesian stress on the rentier has found common ground with some strains of Marxist theory. This is clear in the work of Crotty (1990), but also in more recent publications, for instance, Stockhammer (2004) and Orhangazi (2008). Much of this output has a strong empirical dimension, seeking to show that the rentier has a depressing effect on the real sector, typically by constraining available investment funds and/or lowering the returns of industrial capitalists. Broad affinities between post-Keynesian and Marxist theory along similar lines are also apparent in the output of the 'finance-led capitalism' current (Evans, 2009; Hein et al., 2008).

However, in Marx's *Capital* there is a further and quite different approach to finance (Lapavitsas, 1997). Namely, capital for loan is seen as emerging spontaneously through the operations of industrial (and other) capital, by taking the form of idle money in the first instance. It does not belong to 'monied' capitalists; furthermore, receipt of interest does not define a distinct section within the capitalist class. Rather, the financial system is a set of markets and institutions (operating as separate capitalist concerns) that mobilize loanable capital and support capitalist accumulation. This approach is naturally averse to treating financialization as the triumph of the rentier over the productive capitalist. It also offers far richer insight into contemporary capitalism, as is shown below.

### *Other heterodox and sociological approaches to financialization*

Two other approaches to financialization, both broadly associated with Marxist theory and connected to economic sociology, also merit mention. The first relates to Arrighi (1994), who places financialization within an ambitious cyclical theory of the world economy starting with the early modern era. Hegemonic capitalist formations follow a

cyclical pattern of evolution, while succeeding each other. Financialization represents the autumn of the hegemon as productive power declines and the sphere of finance expands. Genoa, the Netherlands, Britain and the USA entered financialization when they lost their prowess in production and trade. In decline, they became lenders, particularly to younger powers that emerged to overtake them.

From this perspective the current crisis is another episode in the long-term decline of US hegemony. However, an intractable problem for Arrighi's theory in the current era is the absence of an obvious hegemonic replacement for the USA. Arrighi's own suggestion – made in the Epilogue of the first edition of his book on financialization – that Japan might play this role looks unfortunate with hindsight. China, incidentally, is not much better as a suggestion. Arrighi (2007) has examined the rise of China in detail making several penetrating observations, but the fundamental problem for his theory remains. Namely, and as Arrighi himself noted in the Postscript to the second edition of his book on financialization, the USA has been a massive net borrower for many years, not least from China (and Japan). If this is the autumn of US hegemony, it has not coincided with the US emerging as lender to the world, and certainly not to China. Indeed, there is no obvious way for Arrighi's theory to be made compatible with vast capital flows from China (and Japan) to the USA. Note that these flows have arisen because of state-to-state (not private capital) lending. They do not represent investment in productive or other capacity but result purely from the decision by China (and to a large extent Japan) to hold enormous reserves of dollars as world money.

Nonetheless Arrighi's work has been path-breaking in so far as it has placed financialization within a broad historical perspective. Furthermore, it has partly motivated Krippner's (2005) innovative empirical study of US financialization that has set the terms of the debate on financial profits within economic sociology. Krippner has established the rising importance of financial profits for non-financial corporations during the last five decades. Drawing attention to financial profits is a point of vital importance in analysing financialization.

The second approach was put forth by the *Régulation* School in the 1990s. The regulationist approach to financialization has resulted partly from the long-standing interest of this School in money and finance. Anglo-Saxon audiences were introduced to it through the journal *Economy and Society*; above all, by a seminal special issue on financialization in 2001 (number 30). The presumed disintegration of Fordism led regulation theorists to search for a new regime of regulation, including in the sphere of finance. For Boyer (2000), the new regime of regulation has begun to be formed around financial markets, mostly the stock exchange. However, regulation through finance can have problematic effects for the performance of accumulation, including rates of growth, output and so on (Aglietta, 2000; Aglietta and Breton, 2001). An early and balanced discussion of regulationist analysis of financialization was given by Grahl and Teague (2000).

The regulationist approach has affinities with the voluminous literature on changes in corporate governance since the 1970s. 'Shareholder value' and the associated short-termism of corporate enterprises have attracted the interest of political economists and business school writers. The widely quoted article by Lazonick and O'Sullivan (2000) has demonstrated the connections between shareholder value and company downsizing as neoliberalism rose to ascendancy.

This theoretical terrain clearly overlaps with economic sociology, particularly with regard to the problematic implications of financialization for work and employment. For Thompson (2003) the collapse of Fordism has led to various forms of a new ‘bargain’ between employers and workers, in which the latter might exhibit greater initiative as well as some ‘stakeholder mentality’ in exchange for greater job security. But financialization prevents employers from keeping their side of the bargain. Drawing on the literature on ‘shareholder value’, Thompson stresses that corporations that rely on the capital market are forced to shift the focus of managerial attention away from labour. Capital is ‘disconnected’ from established institutions and systems of business. In that context, work and employment tend to become short-term and precarious, and thus employers fail to meet their side of the bargain. Clark (2009) develops this approach further by arguing that the business model of private equity aggressively asserts the interests of equity owners over those of other stakeholders in the capitalist firm. Thus, the operations of capital are further disconnected from the practices of employment, particularly as the perception of firm efficiency might have little to do with the impact of company practices on workers.

Finally, it is worth noting that economic geographers and sociologists have traced the further social impact of financialization, including its implications for the spatial development of capitalism (Leysen and Thrift, 2007). Considerable work has been produced on the financialization of individual life (Langley, 2008a) as well as on the cultural aspects of finance in contemporary capitalism (Pryke and Du Gay, 2007).

Fully reviewing this literature is beyond the confines of this article. It should be mentioned, however, that the literature is (often consciously) eclectic in its theoretical approach. Emphasis is placed on revealing key features of contemporary capitalism almost as ‘thick description’ rather than advancing theoretical explanations. This is clearly demonstrated by the substantial and illuminating output on financialization generated by the UK Centre for Research on Socio-Cultural Change in recent years. From early analyses of financialization, researchers at CRESC have proceeded to discuss ‘coupon pool’ capitalism, the transformation of banking and the emergence of new elites (Savage and Williams, 2008). These insights are important to developing a coherent Marxist analysis of financialization, as is briefly shown in the following section.

## **Financialization as systemic transformation of mature capitalist economies: an approach that draws on classical Marxism**

### *Finance and real accumulation*

For Marxist political economy, real accumulation sets the parameters for the functioning of finance, although the direction of causation can run in both directions (Itoh and Lapavitsas, 1999: chapter 4). Even more important, however, is that causation between the two is never direct but always mediated, and heavily so. A complex set of structures, often reflecting historical, institutional, political, customary and even cultural factors, mediate the interaction between finance and real accumulation (Lapavitsas, 2003: chapter 4).

The difficulty in analysing financialization, therefore, lies in specifying the mediations through which malaise in production has been related to booming finance. This involves establishing changes in the behaviour of industrial capitals, the operations of banks, the practices of workers, the articulation of financial markets with each other and with the rest of the economy, the interventions of the state and so on. The issue, in other words, is to show how industry, banks, workers, financial markets and so on have become 'financialized', individually as well as jointly. Causation between poorly performing real accumulation and a booming financial system would then emerge in its several dimensions.

A distinct social layer of rentiers, for instance, is far from evident in contemporary capitalism. It is erroneous to conflate the financial system with a rentier section of the capitalist class, i.e. with owners of money capital available for lending. Financial institutions are intermediaries that mobilize idle money across social classes, not a rentier social layer. Furthermore, the presumed social tension between ('bad') rentier and ('good') industrialist has been far from visible in the course of the recent crisis. Indeed, there has been remarkable commonality of response to the crisis by corporate and financial interests.

Similarly, the view that stagnating real accumulation has led to booming finance, or financialization, contradicts the inherent drive of capitalist production to restructure itself. Production has been transformed since the 1970s drawing on new technologies in information and telecommunications, as well as on deregulated labour. There has been significant economic growth, even if lower on average than in the 1950s and 1960s, and capitalist production has made enormous strides in poorer countries.

Things are not much better for the 'crisis-in-suspension' view of contemporary capitalism – such as Brenner's – according to which crises are due to underlying over-accumulation, but are postponed or delayed through financial expansion. This is, indeed, a reversal of classical Marxism, for which restructuring is an inevitable response to over-accumulation, while crises are temporary and sharp upheavals that prepare the ground for the restoration of profitability. Even worse, it is not at all evident that over-accumulation has taken place in the USA, Japan or across Europe in the 2000s. There has not been a decline in profit rates that is remotely commensurate with the gigantic magnitude of the crisis commencing in 2007. To be sure, average profitability in developed countries has been variable and consistently below the levels of the 1960s, despite recovering from the trough of the early 1980s.<sup>4</sup> But the crisis of 2007–9 has little in common with a crisis of profitability, such as that of 1973–5.

To recap, there is no doubt that the rise of finance in recent decades has been accompanied by indifferent performance of real accumulation, as was shown by Glyn (2006) succinctly and concisely. But in order to construct a theory of financialization it is necessary to have a view of changes in the behaviour of industrial enterprises, banks and workers, while being aware of transformation in the structures of the international financial system. Theoretical guidance in this respect can be found in contemporary Marxist political economy, broadly understood. There is, for instance, path-breaking work on derivative markets by Bryan and Rafferty (2007), even though they misleadingly interpret derivatives as a new type of money. There is also recent writing on the international political economy of the current crisis undertaken from a variety of standpoints, for instance, Gowan (2009), Panitch and Gindin (2009) and Wade (2008). Such

writing stresses the political dimension of financial phenomena and remains mostly at the international level, but nonetheless sheds light on fundamental changes in contemporary finance.

Finally, there is Marxist work that has stressed the importance of financialization, while examining several of its specific dimensions. Blackburn (2006) has revealed several penetrating insights regarding the operations of financial markets and associated financial institutions. Above all, Chesnais (1997) has long studied financialization, although little of his work has been translated into English. Chesnais has stressed the role of the rentier, but is also fully aware of the international aspect of financial flows.

### *Following Hilferding's path*

The analysis of financialization proposed in this article was originally developed after the emergence of crisis in 2007.<sup>5</sup> It is acutely aware of the theories mentioned above, but also draws heavily on classical Marxist debates on imperialism and finance capital, particularly from the methodological approach of Hilferding (1981 [1910]) and Lenin (1964 [1916]). In this light, it treats financialization as a systemic transformation of the capitalist economy.

Summarizing ruthlessly, Hilferding argued that capitalism was transformed through the rise of finance capital at the end of the 19th century. Finance capital was created as monopolistic corporations increasingly relied on banks to obtain investment finance. Industrial and banking capitals were amalgamated, with banks in a dominant position. The rise of finance capital led to erection of trade barriers, export of capital, militarism and imperialism. Lenin took the core of Hilferding's analysis, added 'parasitical rentiers' as well as greater emphasis on monopoly, and produced the definitive Marxist theory of imperialism.

Note also that Hilferding identified a new form of profit for the capitalist class as finance capital took hold. In stock markets future profits are discounted at the rate of interest, but the capital that is actually invested generates the rate of profit. Since the rate of interest tends to be below the rate of profit, the price paid for shares exceeds the capital actually invested. The difference is 'founder's profit', and accrues in a lump sum to those who issue share. Banks also obtain parts of 'founder's profit' as payment for investment banking.

The era of financialization has evident analogies with Hilferding's and Lenin's time: multinational corporations dominate the world economy; finance is on the ascendant; capital export has grown substantially; a certain type of imperialism has reasserted itself. But it is also apparent that the original theory does not fully fit present conditions: there is no fusion of banks with industrial capital; banks are not dominant over industry; there are no trade barriers corresponding to territorial empires.

Nonetheless, the methodological approach of Hilferding and Lenin remains sound since both sought the deeper causes of the phenomena of their time in fundamental relations of accumulation, including credit relations among monopolistic enterprises and banks. The rise of finance capital had organizational implications, such as dense connections between finance and industry through interlocking appointments, exchange of information and joint decision making. Trade barriers, capital export and imperialism flowed naturally from these developments. Imperialism was not an arbitrary political strategy but a phenomenon with specific historical content rooted in economic processes.

### *The characteristic features of financialization in the light of the crisis of 2007–9*

In this light, the point of departure for a systemic approach to financialization is provided by the molecular relations between contemporary industrial and financial capitals. The world economy has been dominated by large monopoly capitals (multinational corporations) in terms of both trade and foreign direct investment (Morera and Rojas, 2009). However, contrary to Hilferding, large corporations have been able to finance investment without relying heavily on banks. The primary mechanism has been retention of own profits, as was observed by Sweezy (1942: 267) decades ago.

External finance for large corporations, meanwhile, has been raised increasingly in open financial markets due to flexibility and low cost. Even the wage bill is frequently financed through the issuing of commercial paper. Consequently, corporations have developed skills in independent financial trading, including trade credit but also securities and foreign exchange trading. Successive waves of takeovers, furthermore, have led to corporations becoming heavily involved in bond and equity trading in stock markets. In short, monopoly capitals have become ‘financialized’, i.e. they are at once more independent from banks and more heavily involved in financial activities on their own account.

Consequently, banks have restructured themselves since the 1970s in several ways, two of which stand out. First, banks have turned toward households and individuals as sources of profit; second, banks have turned to financial market mediation to earn fees, commissions and profits from trading, i.e. toward investment banking, broadly understood. This fits the stylized facts of the crisis of 2007–9: the enormous expansion of bank assets in the 2000s had little to do with lending to corporations for investment, and involved lending to individuals and to other banks.

The turn of banks toward households is related to the financialization of workers’ revenue, a striking aspect of the last three decades. It includes increased borrowing (mortgages, general consumption, education, health and so on) but also expanding financial assets (housing, pensions, insurance, money market funds and so on). Financialization of workers’ revenue is associated with real wages remaining stagnant, or rising very slowly, since the late 1970s. It is also related to public provision retreating across a range of services: housing, pensions, education, health, transport and so on. In that context, workers’ consumption has become increasingly privatized and mediated by the financial system. Banks and other financial institutions have been able to extract profit directly out of wages and salaries, rather than surplus value. They have also been able to make profits out of workers’ assets, particularly as public provision of pensions has retreated, encouraging the channelling of workers’ savings to pension funds, insurance companies, money funds and thus to the stock market.

The ‘financialization’ of workers’ income, savings, consumption and assets characterizes the current period, and has also stamped the crisis of 2007–9. But relations between banks and households are qualitatively different from relations between banks and industrial capitalists. The former involve finance that is not directly involved in generating surplus value in accumulation. Furthermore, the aim of workers, generally speaking, is to acquire use values, while financial institutions and industrial capitalists share a similar

aim, i.e. profit extraction. By the same token, there are systematic differences in information as well as economic and social power between banks and workers.

The emergence of financial profits out of wages and salaries as a systematic social phenomenon has been called financial expropriation (Lapavitsas, 2009). Given the specific features of relations between workers and financial institutions, it is not surprising that predatory and usurious practices have proliferated, both in lending and in handling workers' assets. In the USA predatory lending in the years leading to the crisis of 2007 has even had a racial dimension (Dymski, 2009). In these respects financialization represents the revival of the ancient predatory outlook of the financial system toward both economy and society.

Financialization, furthermore, has implications for employment, work and the conditions of life of workers, though research in these areas is still scanty.<sup>6</sup> Financialization by definition represents a shift of the economy in the direction of the financial sector. However, the capacity of the financial sector to generate employment appears to be limited. There is no doubt that financialization has not generated a significant expansion of employment in the financial sector, something which was already noted by Krippner (2005). Employment in the financial sector did not significantly increase in the course of the bubble of 2001–7. More broadly, financialization appears to have rebounded against employed labour with regard to inequality and the distribution of skill across industries, as Dore (2008) has observed. It is not entirely clear why financialization should have this impact on employment, but one reason is probably the use of information technology and the dramatic change in the mix of labour skills deployed by financial intermediaries (Lapavitsas and Dos Santos, 2008).

Still on the subject of labour, it is probable that the increasing exposure of workers to the imperatives, motives and incentives of private finance has had an impact on decision making by workers, both in everyday life and work. The accumulation of financial assets and liabilities has perhaps affected attitudes to work and readiness to confront employer pressure. The nature of this effect, however, is far from clear and more research is needed. Perhaps financialization has resulted in greater docility of workers, allowing for intensification of work but, equally, it might encourage new forms of opposition between capital and labour.

The implications of financialization for consumption and other worker expenditures, on the other hand, seem clearer, though they are far from fully established in the literature. Workers' spending has been partly turned into a financial decision conditioned by unsecured loans but also by the ability to borrow against assets, typically homes. Consequently, consumption might suffer when workers attempt to reduce their debts, thus generating recessionary pressures. Credit decisions by workers are qualitatively different from those by capitalist enterprises, as was mentioned above. Thus, 'deleveraging' by workers is subject to non-economic conditions that include moral commitments, familial obligations, personal aspirations and so on. There is no simple analogy with 'deleveraging' by capitalist enterprises when faced with a crisis: reducing worker debt could well turn out to be a protracted and unpredictable process. The implications for the performance of financialized economies remain to be seen, but they are likely to be negative.

The turn of banks toward investment banking, on the other hand, has been fostered by the growth of open financial markets. Investment banks typically borrow in wholesale

money markets to invest in securities, thus earning profits through fees, commissions and proprietary trading. The rise of these banking activities was given formal status with the abolition of the Glass-Steagall Act in the USA in 1999, and similar legislation elsewhere. Investment banking has been fuelled by successive waves of mergers and acquisitions among monopoly capitals during the last three decades. It has also benefited from the channelling of personal savings to stock markets at the behest of the state. Finally, it has found room for growth in the new markets that have emerged in derivatives, particularly as exchange rate instability set in.

The crisis of 2007–9 represents a particularly acute combination of bank lending to individuals with investment banking. Large commercial banks borrowed in the money markets, used the funds to finance lending to workers for mortgages, and made profits out of trading mortgage-based securities. In effect banks ‘churned’ their capital to create off-balance sheet items, drawing profits from fees or capital gains. By implication banks came to rely on money markets to obtain liquidity, while weakening their solvency. These two effects combined to produce the most acute phenomena of the crisis (Lapavitsas, 2009).

The transformation of commercial banks has been inevitably accompanied by profound changes in information gathering and risk management. Dealing with individuals normally has prohibitive informational costs for banks due to large numbers and small size of transactions. But the technological revolution in information and telecommunications in recent decades has allowed banks to adopt ‘credit scoring’ and associated statistical manipulation of risk. Similarly, banks have adopted essentially investment banking techniques to manage the risk attached to their balance sheets in general. The dominant practices of Value at Risk rely on computationally intensive statistically based techniques, which rest on mark-to-market accounting (Lapavitsas and Dos Santos, 2008).

In short, ‘relational’ have been replaced by ‘hard’ methods of ascertaining creditworthiness. Banks rely less on personal visits, the placement of bank employees within corporation structures, and the management of corporate accounts and monetary transactions, and more on computationally intensive statistical methods. Furthermore, due diligence on marketed loans has often been subcontracted to other institutions, such as credit rating agencies. The net result appears to have been a net loss of the ability of banks to judge creditworthiness. This, again, was a notable feature of the crisis of 2007–9, marked by the explosive growth of problematic subprime loans.

## **Conclusion**

The crisis of 2007–9 is a systemic upheaval that reflects the rise of finance relative to production in recent years, a trend that has been increasingly captured by the term financialization. The origins of this concept lie within Marxist political economy, but it has been deployed in complex ways by other social scientists, including sociologists. The literature on financialization reviewed in this article – Marxist, post-Keynesian, radical sociological and other – has put forth arguments that relate expanding finance to poorly performing production. However, the relationship between finance and production is more complex than is often assumed. There are mediating processes between the two that have to be analysed in their own right, if the concept of financialization is to have explanatory power.

In this light, this article drew on Marxist political economy to argue that financialization is a systemic transformation of mature capitalist economies with three distinguishing features. First, relations between large non-financial corporations and banks have been altered as the former have come to rely heavily on internal finance, while seeking external finance in open markets. Large corporations have acquired independent financial skills – they have become financialized.

Second, banks have consequently transformed themselves. Specifically, banks have turned toward mediating transactions in open markets, thus earning fees, commissions and trading profits. They have also turned toward individuals in terms of lending and handling financial assets. The transformation of banks has relied on technological development, which has encouraged ‘hard’ as opposed to ‘soft’ practices of risk management.

Third, workers have become increasingly involved with the financial system both with regard to borrowing and to holding financial assets. The retreat of public provision in housing, health, education, pensions and so on has facilitated the financialization of individual income, as have stagnant real wages. The result has been the extraction of bank profits through direct transfers of personal revenue, a process called financial expropriation.

## Notes

- 1 This article draws on the work of the network Research on Money and Finance (RMF), see <http://www.researchonmoneyandfinance.org> (consulted 25 July 2011). All errors and omissions are the author’s fault.
- 2 See Magdoff and Sweezy (1987). Bellamy Foster (2007, 2008) offers a clear account of the use and meaning of the term for *Monthly Review*. The recently published book by Bellamy Foster and Magdoff (2009) places the crisis of 2007–9 in the context of the current’s approach. Note that Pollin (2004) has lauded Sweezy’s early awareness of financialization, acknowledging his own debt to it.
- 3 Marx actually used the term to denote several distinct cases of financial price or traded value. But no generality is lost by considering fictitious capital as simply net present value.
- 4 See Dumenil and Levy (2004, 2005). Dumenil has stated categorically at two RMF conferences (May 2008 and November 2009) that the crisis of 2007–9 is not due to falling profitability.
- 5 See, above all, the special issue of *Historical Materialism* on financialization, particularly Lapavistas (2009) and Dos Santos (2009).
- 6 Some of these implications have been discussed in the work of Langley, for instance (2008a) and (2008b).

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