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What Is Financialisation?

Malcolm Sawyer[1]

Abstract: The paper seeks to distinguish between two broad perspectives on financialisation. The first, taking the view that financialisation relates to the growth of the financial sector in its operations, power etc.. On that basis, financialisation has been proceeding with ups and downs for possibly thousands of years. The specific forms which financialisation may have taken in the past few decades are outlined. The findings from mainstream economics literature on one aspect of financialisation (growth of bank deposits, growth of stock markets) and economic growth are reviewed. The second perspective views financialisation (financialised capitalism) as a stage or epoch of capitalism dating from circa 1980.

Keywords: financialisation, financial liberalisation, epochs of capitalism

Journal of Economic Literature classification G00, G01, G20, P10

Introduction

'The origins of the term "financialization" are obscure, although it began to appear with increasing frequency in the early 1990s. The fundamental issue of a gravitational shift toward finance in capitalism as a whole, however, has been around since the late 1960s. The earliest figures on the left (or perhaps anywhere) to explore this question systematically were Harry Magdoff and Paul Sweezy, writing for Monthly Review' (Foster, 2007) In the footnote to the first of those sentences, he writes that 'the current usage of the term "financialization" owes much to the work of Kevin Phillips, who employed it in his Boiling Point (New York: Random House, 1993) and a year later devoted a key chapter of his Arrogant Capital to the "Financialization of America," defining financialization as "a prolonged split between the divergent real and financial economies" (New York: Little, Brown, and Co., 1994). Correa, Vidal and Marshall

[1] Emeritus Professor of Economics, University of Leeds, UK. These notes are a write-up of remarks made at workshop on 'What is financialisation?' held at School of Oriental and African Studies, London, 23rd October 2013. The author is the Principal Investigator of the project Financialisation Economy Society and Sustainable Development (FESSUD), which is funded by the European Union under Framework Programme 7 contract number 266800. The views expressed here are my own and they should not be seen as the views of the partners in the FESSUD project.

(2012) cite de Bernis (1988) as the earliest author to draw attention to the rising dominance of finance.

The most widely cited definition of the term 'financialisation' is probably that given by Epstein (2005) in his introduction to his edited book Financialization and the World Economy [2]: ‘here we will cast the net widely and define financialization quite broadly: for us, financialization means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies’ (Epstein 2005: 3). This is a broad conception though underplaying influence on society of finance. This definition provides the object of study and in itself does not specify the time period or geographical space to which it applies; nor does it provide any analytical framework for its study. Krippner (2005) labels ‘the growing weight of finance in the American economy’ as ‘financialization’, and brings forward evidence to support the view that there has been financialization in the US post-war economy: this does not preclude that there has been financialization in other periods and in other countries. She also defines ‘financialization as a pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production’. (page 174)

Epstein (2005) prior to this quote indicates that there have been ‘profound transformations’ in the preceding thirty years (i.e. since circa 1975). Hence this could be taken to limit financialisation to the recent now near four decades. In these remarks, we adopt the broad definition of financialisation provided by Epstein, but do not limit it to the past three to four decades. Instead, we would view financialisation as sets of processes which have been on-going

[2] In our project title we use the UK English 's' spelling for financialisation, and follow that practice here -- but, of course, many including Epstein use the American English 'z' spelling: in quotations we follow the form used by the original author.

for many years -- perhaps following the title of Graeber (2011) for 5,000 years from his study of money, credit, interest rate and financial instruments emerging from that time on. This is not of course to say that financialisation has not taken many different forms and at times gone into reverse (the 1930s around the world would be the most well-known example).

We argue that definitions along these lines should be taken as indicating the general scope of the phenomenon under review. As such, the term 'financialisation' is not limited to a specific period or place, though it would be anticipated that the pace and form of financialisation varies across time and space, and indeed there are periods of de-financialisation as well as those of financialisation. The questions which could be seen as arising are (i) what are the features of financialisation over a particular period and space?; and (ii) is there analytical usefulness in distinguishing eras of financialisation between which there are substantial and economically and socially significant differences? From these questions would then arise such as the causes and consequences of the observed traits of financialisation.

In the Financialisation Economy Society and Sustainable Development (FESSUD) Description of Work, we spoke of the era of financialisation and implied that the present forms of financialisation started to emerge around 1980 (or a little earlier), a dating which broadly coincides with the dating often applied to the neo-liberal era and globalisation. It should be made clear that this should not be seen as the start of financialisation but rather the start of an era in which the processes of financialisation had some continuing aspects of previous processes (e.g. the growth in volume of financial transactions), some acceleration of previous processes (e.g. perhaps de-regulation), and some novel aspects (e.g. securitization). Thus it is helpful to think in terms of different eras of financialisation, different intensities and different forms of financialisation. Vercelli (2014), for example, speaks of the present period as neo-liberal financialisation in the context of financialisation as one episode of financialisation amongst a number where episodes 'have specific characteristics that have to be thoroughly analyzed to understand their specific causes and implications'. (p.3 of typescript). His Figure 1 also illustrates the rise of the financial sector in the USA since the end of World War II, and on the crude measure used there financialisation has been continuing throughout that period. This is not to say that there were significant changes in the financialisation processes during that period.

The FESSUD description of work, following Fine (2011), discussed financialisation in the present period (since circa 1980) in terms of eight features: these could be seen as empirical observations on the particular forms which financialisation is taking in the present era, which are now summarised.

'First, it refers to the large –scale expansion and proliferation of financial markets over the past thirty years. ..

Second, the process has been closely interwoven with de-regulation of the financial system itself and the economy more generally….

Third, financialisation, understood as both the expansion and the proliferation of financial instruments and services, has been associated with the birth of a whole range of financial institutions and markets, and corresponding acronyms, that are bewilderingly complex, quite apart from futures markets for trading in commodities yet to be produced (for which futures carbon trading is the most striking) and, infamously, subprime mortgages….

Fourth, at a systemic level, financialisation has been located in terms of the dominance of finance over industry. …

Fifth, financialisation is strongly associated with market mechanisms, complemented or even reinforced by policies that have underpinned rising inequality of incomes and of inequality more generally….

Sixth, though, consumption has often been sustained by the extension of credit, not least through the use of capital gains in housing as collateral….

Seventh, it is not merely the expansion and proliferation of financial instruments and markets that are striking but also the penetration of such financing into a widening range of both economic and social reproduction – housing, pensions, health, and so on. …

Finally, financialisation is associated with a particular culture which is to be interpreted broadly. ..

In short, financialisation is a complex term, containing several different dimensions and aspects.' (from FESSUD Description of Work, Part B, p.3)

These features should be viewed as subject to refinement as our studies and those of others proceed, deepening our understanding of those features, and discovering others to add to the list. Further it should be acknowledged that while these features are intended to relate to the Western industrialised countries, the nature and speed of them varies between countries. These features should then be viewed as characterising financialisation in this period and in a range of industrialised countries, without viewing them as Pasarella Veronese (2014) draws on the national financial system reports which have been undertaken within the FESSUD project to elaborate on these features across 15 or more countries showing the differences and similarities.[3] One aspect of the FESSUD work is that a number of former COMECON countries are included, and hence some judgement may be made as to the nature of financialisation in those countries

[3] The national financial system reports are available as Studies in Financial Systems from the web site fessud.eu

since circa 1990. The features listed are also subject to scrutiny as to how far they developed after circa 1975-1980 and how far they were continuation of previous trends.

One question to be settled as to whether there has been a ‘gear shift’ spread around the late 1970s/early 1980s, though much of the literature assumes that there has been. On some of the crude measures of the size and scale of the financial system, there would seem to be some degree of continuity (see for example Figure 1 of Vercelli, 2014), and the processes of de-regulation were in evidence prior to 1980. But there are other discontinuities – amongst which we would put securitization which went alongside banks and other financial institutions shifting from an ‘originate and retain’ model to an ‘originate and distribute’ model with implications for the operations of monetary policy and its objective and related with the rapid growth of ‘fictional finance’ as assets and liabilities grew rapidly relative to GDP and measures of productive capital and the fragility of the financial system. The pace of de-regulation speeded up, and there were major shifts from public and mutual ownership to private ownership. In previous eras, financialisation (though that term was not used) was seen in terms of growth of the stock market relative to GDP and of bank deposits and loans also relative to GDP. In a simpler era, the growth of bank deposits was closely associated with growth of savings with bank deposits being the major way within the formal sector in which savings were held. The growth of the financial sector was then associated with growth of savings and of private (household) wealth; thus financial development would be positively related with economic development, even if the causal mechanisms were matters of intense debate. A marked feature of the recent era of financialisation has been the growth of assets and liabilities in ways that are not related to economic growth. The rise of household debt is also seen as a further key feature of the present era of financialisation.

With regard to the post 1980 era of financialisation, there has been much work on the effects of those financialisation processes on economic and social performance. In the FESSUD Description of Work these were summarised in the following terms: Financialisation may:

‘(i) Reduce overall levels and efficacy of real investment as financial instruments and activities expand at its expense.

(ii) Prioritise shareholder value, or financial worth, over other economic, social, and environmental values and goals.

(iii) Push policies towards acceptance of the operation of market forces and commercialisation in all areas of economic and social life.

(iv) Extend influence more broadly, both directly and indirectly, over economic and social policy.

(v) Place more aspects of economic and social life at the risk of volatility from financial instability and, conversely, places the economy and social life at risk of crisis from triggers within particular markets (as with the food and energy crises that preceded the financial crisis, for example).

(vi) Encourage particular forms of culture and corresponding governance that shapes what policies can be formulated and implemented.’ FESSUD Description of Work, Part B, page 11)

Many of these effects would often been regarded in a negative light. As Epstein (2005) remarks with regard to his edited book: ‘the authors [in the volume] share at least two common convictions: First, financial phenomena have become increasingly important in much of the world economy. And, second, that some of the effects of financialization – in concert with neo-liberalism and globalization—have been highly detrimental to significant numbers of people around the globe’ (Epstein 2005: 5)

The study of financialisation is undertaken across a range of disciplines, notably (heterodox) economics and political economy, geography, political science -- or at least the term is used by researchers from those disciplines. Whilst the term financialisation rarely, if ever, makes an appearance in the mainstream economics literature (or the mainstream finance literature), there is, of course, discussion of the growth of finance, financial development and financial deepening. Within that literature, there has been a favourable view taken of the growth of finance and the financial sector (which would be seen as coming within the Epstein definition of financialisation). There are two particular aspects of this to mention here. First, the empirical work on financial development and economic development[4] has often found a positive relationship between the two. 'Theory illuminates many of the channels through which the emergence of financial instruments, markets and institutions affect –and are affected by— economic development. A growing body of empirical analyses, including firm-level studies, industry-level studies, individual country-studies, time-series studies, panel-investigations, and broad cross-country comparisons, demonstrate a strong positive link between the functioning of the financial system and long-run economic growth. While subject to ample qualifications and countervailing views noted throughout this article, the preponderance of evidence suggests that both financial intermediaries and markets matter for growth even when controlling for potential simultaneity bias. Furthermore, microeconomic-based evidence is consistent with the view that better developed financial systems ease external financing constraints facing firms, which illuminates one mechanism through which financial development influences economic growth. Theory and empirical evidence make it difficult to conclude that the financial system merely—and automatically—responds to economic activity, or that financial development is an

[4] This is the terminology often used: the term 'development' here should not be interpreted as necessarily involving social development etc.

inconsequential addendum to the process of economic growth.' (Levine, 2005: 921)[5]. Within that and related literatures, debates have focused on the causal interpretation of the positive relationship (does financial development precede and led to economic development, or economic development generates demands for financial services, or bi-causal). A further debate has concerned the relative roles of banks and financial markets (where there is something of a 'score draw' – see Levine, 2005). But some recent work has cast doubt on the positive relationship invoking an inverted U-shaped relationship suggesting that after some point further growth of the financial sector has a negative effect on growth. For example, 'We document that the size of the financial sector has increased dramatically in both the developed and developing world in combination with a high volatility of the financial sector relative to the economy as a whole. In line with previous research we find that in the long run financial intermediation increases growth and reduces growth volatility. Both effects have, however, become weaker over time. The size of the financial sector while controlling for the level of intermediation in an economy does not seem to affect long-run growth or volatility. Our analysis also shows that neither the size of the financial sector nor intermediation is associated with higher growth in the medium run. This result obtains despite a positive growth effect of the size of the financial sector and the non-intermediation component in the subsample of high-income countries. Critically, financial system size, especially non-intermediation services, has a positive relationship with volatility in high-income countries over the medium-term.' (Beck et al., 2014: page 55)

'Based on a sample of developed and emerging economies, we first show that the level of financial development is good only up to a point, after which it becomes a drag on growth. Second, focusing on advanced economies, we show that a fast-growing financial sector is

[5] This and related literature is reviewed and critically assessed in Sawyer (2014).

detrimental to aggregate productivity growth.' (Cecchetti and Kharroubi, 2012 Abstract: page iii)[6].

Others have observed a decline over time in the strength of the relationship (in terms of the size of the coefficient on financial development in a regression analysis with growth or economic development as the dependent variable). A literature is emerging on the financial sector being 'too large' (Epstein and Crotty, 2013), with some straddling of mainstream and heterodox literatures.

The second is that mainstream economics and finance literatures to a greater or lesser extent are associated with highly favourable views of the workings of markets and market mechanisms. This is reflected in the 'efficient markets' view (though efficiency here is the incorporation of information into price). It is also reflected in the promotion of liberalisation and de-regulation to allow market forces to prevail, and to bring Pareto improvements if not Pareto optimal outcome. Innovations, if successful in profit terms, are interpreted as beneficial.

It could then be argued that mainstream economics has studied some aspects of financialisation, though without using that terminology (and without considering the broader aspects of financialisation such as the power of the financial sector). It has generally taken in both empirical and theoretical work a positive view of financialisation though we have noted the emerging empirical work which has a less favourable view of financialisation.

Financialisation, Neo-Liberalism and Stages of Capitalism

We argue that a distinction with regard to the concept of financialisation should be drawn between a definition of financialisation along the lines of those of Epstein and Krippner above, and those which are now discussed here which view financialisation in terms of an epoch of

[6] For further examples of the critical views within mainstream economics of the growth of the financial sector, see Sawyer (2014).

capitalism in which the relationships between the financial sector and the real sector have changed in major ways (as compared with previous epochs). The first is a definition indicating the scope of study whereas the second relates to stages or epochs of capitalism.

Many aspects of the empirical material and analysis of the causes and consequences of financialisation under the first type of definition can be brought forward in support of the second conceptualisation. We would, however, suggest that there are some significant differences. The first type of definition of financialisation is not limited to a specific time period or geographical space, though the focus of attention has been on the era since 1980 or thereabouts; the second form is specific to the past three or four decades and to some groups of industrialised countries. The first type of definition permits the application of many different types of analysis, and indeed many different portrayals of the features of financialisation in any specific period and geographical space. The second type of concept has generally arisen within or from a particular analytical framework.

We have indicated above that the pace and nature of financialisation varies over time and place, and that since circa 1980 for the North American and European economies[7] there has been an era of financialisation which has seen further growth in the financial sector and major shifts in its nature (securitization, profitability, privatisation being amongst them). In the FESSUD project our attention is focused on those changes and their impacts on economy, society and development, and also including 'changing the financial sector to better serve the economy, society and the environment'[8]. There is a widespread view that there was an emergence of an era of neo-liberalism (informally viewed in terms of the coming into office of Reagan in the USA

[7] A different start point is often appropriate, mostly notably for obvious reasons in the case of Central and Eastern Europe where 1990 (or later) would be relevant.

[8] The title of the bid call (SSH.2010.1.2-1 in FP7 Cooperation Work Programme: Socio-Economic Sciences and the Humanities European Commission C(2009) 5893 of 29 July 2009, p.10

and Thatcher in the UK) and of globalisation, which coincides with the dating of the present era of financialisation from circa 1980 (in the dominant capitalist economies). ‘In the last thirty years, the economies of the world have undergone profound transformations. Some of the dimensions of this altered reality are clear: the role of government has diminished while that of markets has increased: economic transactions between countries have substantially risen; domestic and international financial transactions have grown by leaps and bounds…. In short, this changing landscape has been characterized by the rise of neoliberalism, globalization and financialization.’ (Epstein, 2005: 3). This raises the obvious question of the relationship between neoliberalism and financialisation (and a similar question for globalisation and financialisation), and we can here only offer a few remarks on that.

Within the Monthly Review monopoly capitalism school, John Bellamy Foster argues that ‘Changes in capitalism over the last three decades have been commonly characterized using a trio of terms: neoliberalism, globalization, and financialization. Although a lot has been written on the first two of these, much less attention has been given to the third. Yet, financialization is now increasingly seen as the dominant force in this triad. The financialization of capitalism—the shift in gravity of economic activity from production (and even from much of the growing service sector) to finance—is thus one of the key issues of our time. More than any other phenomenon it raises the question: has capitalism entered a new stage?

I will argue that, although the system has changed as a result of financialization, this falls short of a whole new stage of capitalism, since the basic problem of accumulation within production remains the same. Instead, financialization has resulted in a new hybrid phase of the monopoly stage of capitalism that might be termed “monopoly-finance capital.’ (Foster, 2007, p.1)

In the Social Structure of Accumulation (SSA) analysis, it is argued that the neo-liberal SSA ‘represented a sharp break from the previous one. Its main features are the removal of barriers to free movement of goods, services, and especially capital, throughout the global economy; a withdrawal by the state from the role of guiding and regulating economic activity; privatization of state enterprises and public services; the slashing of state social programs; a shift to regressive forms of taxation; a shift from cooperation between capital and labor to a drive by capital, with aid from the state, to fully dominate labor; and the replacement of co-respective behavior among large corporations by unrestrained competition. Neoliberalism has an associated ideology of worship of the so-called "free market" along with a denial of any positive role for the state apart from its coercive functions.’ (Kotz, 2008: 3) However, within that SSA, ‘the changing role of finance in the economy in recent decades can, in our view, best be captured, not by the idea of dominance by the financial sector, but by the concept of "financialization," which suggests an expanding role for finance in economic activity. It will be argued here that the immediate cause of the financialization process of recent decades is found in neoliberal restructuring, rather than financialization explaining the rise of neoliberalism. However, financialization also has deeper roots that are unrelated to neoliberalism. This interpretation of the relation between financialization and neoliberalism clarifies what would otherwise be puzzling differences between the form of financial dominance that arose in the late nineteenth/early twentieth centuries and the financialization of the current neoliberal period.’ (Kotz, 2008: 2)

Dumenil and Levy argue that all the features of capitalism which they list ‘point to the crucial position of finance at the centre of the new neoliberal setting.’ (Dumenil and Levy, 2005: 17). For these authors, ‘it is finance that dictates the forms and contexts in the new stage of internationalization, it is not internationalization or globalization that creates the insuperable necessity for the present evolution of capitalism. Once the leadership of finance has been identified at the root of neoliberalism and the internationalization of capital, one is very close to an interpretation of recent trends in class patterns.' (Dumenil and Levy, 2005: 17).

These selective quotes are intended to illustrate some of the varying views on the causal relationships between financialisation (in the sense of Epstein) and neo-liberalism. The quote from Kotz above suggests a new epoch (SSA) with financialisation as an element, while that from Foster has doubts as to whether what has been constituted represents a new stage of capitalism.

Boyer (2001) postulates 'a financialized growth regime as the latest candidate for replacing Fordism', in which 'the hierarchy among institutional forms … is drastically shifted: the financial regime plays the central role that used to be attributed to the wage-labour nexus under Fordism'. He presents a theoretical (and steady state) model of such a financialized growth model. This could be viewed as something of an ideal type (in the sense of Weber) and Boyer focuses attention on the United States for such a regime, and indeed Boyer (2013), indicates that finance-led growth may apply in USA and UK but not elsewhere.

Lapavitas views financialisation 'as a systemic transformation of mature capitalist economies that comprises three fundamental elements: first, 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' (Lapavitas, 2011: 611-2).

These quotes are intended to illustrate that the concept of financialisation can be viewed in terms of a new epoch of capitalism, whether in terms of the defining characteristics or as a significant dimension[9]. In that vein, 'financialisation' would relate to the post-1980 era and to a range of industrialised countries. That clearly does not preclude that financialisation has been spreading nor that it contains significantly variations between countries (and as it is evolving over time).

Concluding Remarks

In this brief paper, we have not sought to give a definitive answer to the question of what is financialisation. Instead we have argued for the separation of two types of way of answering that question. The first is to view financialisation in terms of the object of study in the broad terms of the quantitative and qualitative evolution of the financial sector and the role of finance. The forms which financialisation (and sometimes de-financialisation, sometimes with little change) take vary over time and space, and care must be taken to specify to which time and space any particular analysis refers. The forms of financialisation and its effects and consequences have to be established for each time and each space. There is no single answer: for the period since circa 1980 and for industrialised countries, a provisional answer has been quoted above, and a range of possible consequences outlined.

The second type of answer has been to view the present era (since circa 1980) as a new epoch or stage of capitalism in which finance has become more dominant than hitherto, and that whilst the economic system remains capitalist a different form of capitalism has emerged (which at some stage will evolve into some other form).

We would not wish to advocate that every paper on financialisation includes a statement of what is meant there by financialisation, nevertheless the debates and analyses on

[9] See Hein, Dodig and Budyldina (2014) for a review of a range of these approaches.

financialisation would be greatly aided by clarity over the general approach being adopted and the time period and space to which the analysis applies.

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