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FINANCIALIZATION : THE LYNCHPIN OF THE SYSTEMIC CATASTROPHE

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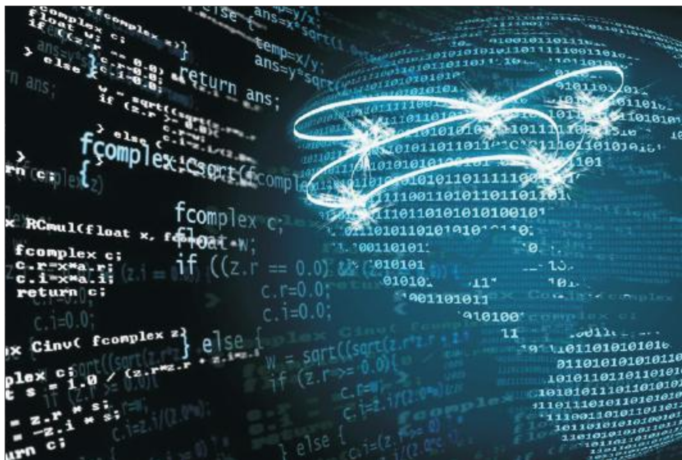

ABSTRACT

Progressive financialization taking over all economies

This paper attempts to present, through a theoretical framework, as to how the deepening process of finance is penetrating the whole realm of human life and social institutions in a catastrophic direction. It will portray the nature of omnipresent-expanding finance along with its soft bellies and the possible direction to limit its undesirable consequences.

The world for the past couple of years has seen the acme and also the nadir of the global socio-political, economic, and environmental phenomena. Since the apocalyptic 2008 crisis, people from all walks of life have seen the power of finance affecting their apparently "financially safe" lives.

Hyman Minsky, a renowned economist, popularized on his core model known as "Financial Instability Hypothesis" (FIH), which simply declares stability is inherently destabilizing .He opined "Unless we understand what it is that leads to economic and financial instability, we cannot prescribe -- make policy -- to modify or eliminate it. Identifying a phenomenon is not enough; we need a theory that makes instability a normal result in our economy and gives us handles to control it".

Financialization is not merely higher infusion of finance into the system; but is more of a qualitative change. Finance has not only changed the banking, stock and insurance business, but has affected every social institution. It is changing the way the prioritization is made in the society as every asset classification is evaluated in terms of its value as finance. Thus financialization is a qualitative process. But this qualitative change has emerged through the massive quantitative changes in the basic parameters of financial system.

EMPIRICAL EVIDENCE OF FINANCIALIZATION

In order to understand the process of financialization, it is essential to know its quantitative expansion in the economy; the following can be taken as the indicators to illustrate the expanding grip of finance in the economy:

Systemic quantitative indicators of financialization can be presented as follows -

1. A consistent higher growth of the finance sector and its share in the corporate profits than the other sectors of the economy. In 1950, financial-sector profits were about 8 percent of overall U.S. profits—meaning all the profit earned by any kind of business enterprise in the country. By the 2000s, they ranged between 20 and 40 percent. This isn't just the decline of profits in other industries, either. Between

1980 and 2006, while GDP increased five times, financial-sector profits increased sixteen times over.
2. While financial and nonfinancial profits in the US grew at roughly the same rate before 1980, between 1980 and 2006 nonfinancial profits grew seven times while financial profits grew sixteen times. The corporate profits in India have a volatile position, from 2001 at 2% of GDP, rising up to peak at 7.8% of the GDP in 2008, currently at 3.9%.
3. According to the Prowess data sources(Mumbai-based Centre for Monitoring Indian Economy (CMIE).) asset growth rates for corporate have sharply fallen, from 32.8 percent in 2008 to zero percent in 2012, and falling further to (-)6 percent in 2013.In contrast, the profit rate have sharply fallen, from 36 percent in 2007 to 16% in 2009, plunging to 25% percent in 2011, and falling further to 10 percent in 2013. The mismatch between the 10% profit rate and the -6% asset rate, clearly represent the existence of financialization.
4. Corporate investments in equities, including derivatives, were primarily transacted in the secondary market for stocks. The sharp increase in transactions of derivatives in the latter has overshadowed the role of the primary market in equities in India's capital market. Rise in resource mobilization in the derivative markets as compared to negligible growth in the primary markets. In India, ,as per SEBI Reports, in 2001-02 ,both the sections had equal resource allocation of Rs 100 trillion, which contrasted when in 13 year time gap, the primary markets resource mobilization remained almost constant and the derivative markets acquired tremendous turnover peaking at 400 trillion.
5. The percentage share of Financial, real estate & professional services in the GDP stands at 20.51 % (2015) , growing at 8.5% annually.
6. Alarmingly rising Debt to GDP ratio. And debt burden of various sectors such as domestic, corporate, Government etc. The domestic credit to private sector as percentage of GDP has plummeted from 7.7%(1960 to 52.6%(2015).The external debt-to-GDP ratio in India has risen from 17% in 2005 to 23% in 2015 as compared to US 63.9% (2006) TO 104% IN 2015. Overall the world debt to GDP ratio was recorded at 89.5%(2013) as compared to 78.7% in 2011.
7. As per Reassessing the impact of finance on growth by Stephen G Cecchetti and Enisse Kharroubi in July 2012, An alternative gauge of financial sector size and financial development, one based on inputs, the effect on productivity growth turns negative when that proportion passes 3.9%. The maximum employees were in the financial intermediaries segment in India, that is, between 65-70% of total industry employment. The shares of the insurance segment was about 5% while that of the non-banking and mutual funds segments were less than 1% of the total industry employment.
8. The speculative transactions making deals in commodity markets, stock markets, forex markets any market where future-forward contracts or derivatives based upon the same are possible .E.g. out of the transfer of international funds transferred globally in any 24 hours (equivalent to $ 5.3 trillion) 98 percent are not related to payments of goods and services. And majority of them can be categorized as speculative. Speculative transaction is one where there is no intention to make or to take delivery of what is bought and sold.
9. A rising and decisive role of the financial indicators in macro and micro economic decision making.
10. Alarmingly growing disconnect between the growth of real economy than the speculative- derivative markets
11. Alarmingly growing disconnect between the prices on one hand and the actual quantities of production and consumption of the given commodities on the other. For instance, the crude oil market has 60% of its prices valuation in terms of price speculation. With the development of unregulated international derivatives trading in oil futures over the past decade or more, the way has opened for the present speculative bubble in oil prices. A June 2006 US Senate Permanent Subcommittee on Investigations report on "The Role of Market Speculation in rising oil and gas prices," noted, "…there is substantial evidence supporting the conclusion that the large amount of speculation in the current market has significantly

increased prices."This has lead to a haphazard price fluctuation, which are not under the control of the traditional economics anymore.

12. The report pointed out that The US Commodity Exchange Act (CEA) states, "Excessive speculation in any commodity under contracts of sale of such commodity for future delivery . . . causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity, is an undue and unnecessary burden on interstate commerce in such commodity."

13. Considering the commodity future market of agro products, guar- a crop used as a thickening agent and additive in food products such as soups and ice-creams. India is the largest producer of guar seed in the world and accounts for 80 percent of the world's total guar seed production. Guar seed and guar gum prices rose at an extraordinary rate during the six months period between October 2011 and March 2012.A strong export demand for guar products pushed up prices in the first four weeks but a 900 percent price increase cannot be attributed solely to this factor. The key factor behind the massive increase in guar prices was the excessive speculation.

14. Increasing proportion of Bank Credit Creation in proportion to GDP. Bank assets as a percentage of gross domestic product (GDP) rose from more than doubled from 24 per cent (2010) to 53 percent in 2014.

15. One study which looked at the distribution of the growing profit share among different parts of the economy (financial corporations including banks and investment funds, non-financial corporations, government, and finally households and non-profit organisations) revealed the financial sector as the prime beneficiary .The Sensex is a benchmark index of the Bombay Stock Exchange (BSE). It is composed of 30 of the largest and most actively-traded stocks on the BSE has historically increased 1.25 times as compared to the BSE S&P Finance which is designed to provide investors with a benchmark reflecting members of finance sector which has increased to 3.13 times from 2010 to 2015.

16. The Proportion of market capitalization to GDP (Buffett indicator) increased by 175 times from 2002-03 with an increase from 52 to 143. The BSE market capitalization raised from Rs 16,98,428 to Rs 94,75,328 in 2015-16

17. Financial instruments are growing exponentially faster than the investments in real asset.

18. Debt to the finance sector as been growing much faster than the non finance sector

19. The market price of shares on stock market are have overtaken their book values 2-3 times over

20. The size of the derivative market in national as well as international financial flows is 99 times more . According to the Bank for International Settlements, foreign-exchange trading increased to an average of $5.3 trillion a day. To put this into perspective, this averages out to be $220 billion per hour. The foreign exchange market is largely made up of institutional investors, corporations, governments, banks, as well as currency speculators. Roughly 90% of this volume is generated by currency speculators capitalizing on intraday price movements.

Historically, money and finance have always played a role of facilitation of transactional exchange and therefore realized the potential for division of labor. With the introduction of money, division of labor became possible as the barter exchange became redundant. With the rise of banks and financial instruments, more and more purchasing power could be infused into the economic system.

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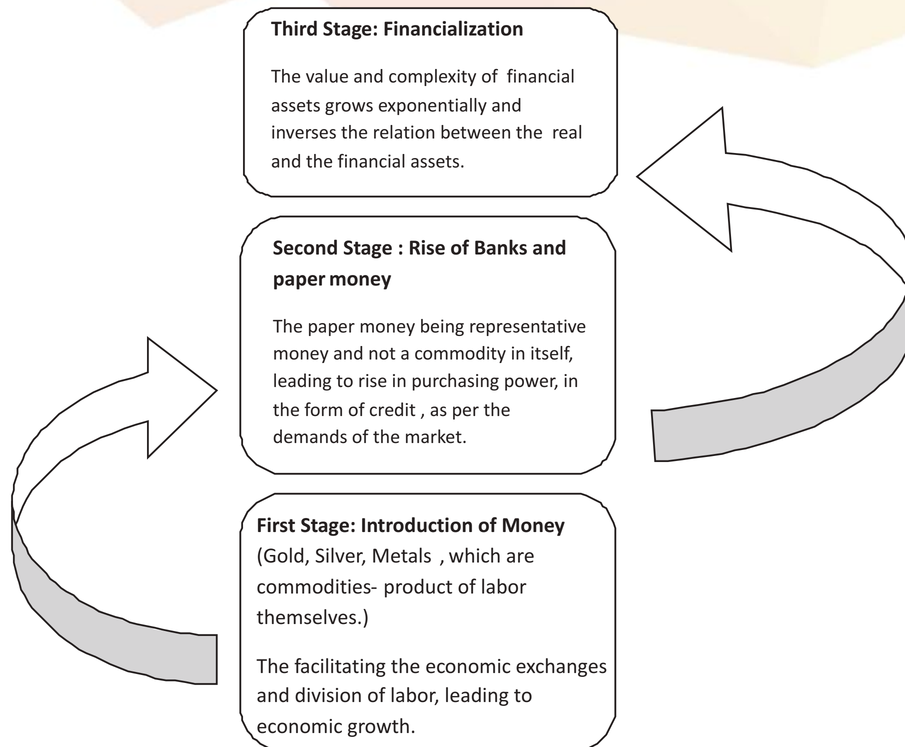
THE SPIRAL EVOLUTION OF FINANCIALIZATION



FROM QUANTITY TO QUALITY

Such massive changes in indicators have influenced not only finance; but have now been redefining the whole economic system, with long lasting impact upon society and polity.

Analytically speaking financialization is essentially the channelization of Economic Transactions and Relations through a set of tradable financial assets. Economic relations are relations between the parties arising out of their respective roles in the social process of production, distribution and exchange of goods, resources and services. Therefore economic relation necessarily involves a component of social function. Market or exchange in money form becomes only a universalized expression of the same.

But with financialization, economic relations start transforming into the financial relations between the parties. It dissolves the actuality of the respective economic variables such as production-consumption of commodities into an illusory finance form. With financialization the fundamental economic institutions such as market, business firms as well as social sectors lose their socio-political roots, legitimacy and even the connection with the given polities. The national identification such as American company, Indian Company loses its meaning altogether .It grips not only the economic processes but spreads over to engulf the entire realm of human life and its connection with the nature. As financialization attempts to fill all the gaps, interconnection, relations between and amongst economic institutions, it converts all objects and entities into a common denominator of finance. When taken to its logical end, it inevitably challenges the very logic and fundamentals of the market as an institution

Sno	Institutions		Traditional Relationship (Economic Relations)	Financialized Relationship	Social Implication
1.	Corporate Firm	Shareholder	Owner • Dependent on Dividend income • Stable relationship with the corporate body • Controlling the management by the appointment of directors • Concrete nature of economic relationship	Investor • Primarily motivated by the capital gains • Unstable and hovering relationship with the corporate body • No involvement in management whatsoever • Amorphous nature of financialized relationship	• `The roles of the institutions have Reversed such that the more often the decisions affect the market price of the shares, but the prices manipulate the decisions. • Effective control of the faceless investors(shareholders) upon the management is lost and consequently , there is total separation between share-holding and management, making the management less accountable, self rewarding and self- fulfilling. As was evidence during the 2008 Financial crisis.
2.	Banking or any lending Institution	Borrower	Customer • Personal knowledge qualifies depositor to be a borrower • Personal bond and sense of belonging • Banker's involvement in the region and the social segment	Realizable Asset • After the lending process, the borrower becomes a mere faceless "realizable" account • Such accounts can be sold to other financial instruments in packages for debt servicing and recovery. • Personal, social or regional bonds are lost due to bundling, packaging and transferring of debt accounts to series of institutions	• Banks lose connection with the recovery process on one hand, while the financial intermediaries ,managing the recovery process have no knowledge of the credit worthiness of the borrowers. As evidenced in 2008 crisis. • The relationship between the quantum of bank finance and collateral prices, form a self feeding loop, substantiating each other in a spiral up gradation, leading to bubbled prices and its eventual tragic collapse. • Interlocking of financial institutions with leverages leads to a total financial collapse with serious social implications.
	Social Security Institution (Pension fund, provident funds, etc)	Social Security Holder	Employee/Contributor • Social welfare project emerging with joint contribution of employees and employers. • Employees having stakes and representation in the management and functioning of the social security organization. • Commitment to a social segment.	Beneficiary • Social security funds become merely the fountain heads of finance having highest exposure to speculative markets. • Employees becoming merely the passive beneficiaries of the vagaries of the market. • Commitment to social segment is irrelevant.	• The ownership of the social security funds changes from public to private and accordingly the orientation and focus deviates . • Even the publically managed funds,in order to compete with private players have to submit to norms set in the market by the private players.

Financialization is not just an exclusive independent issue affecting the global economy; failing all traditional understandings of Economics, it is the lynchpin which holds the following dominos, claiming itself of utmost importance, yet being the cause of the chaos.

1. Delegitimization of Market as the most 'rational' resource allocating institution

Market had been considered to be the institution which synthesizes the needs and desires of the society and potential of the society, in terms of all it's resources, in a given political system. It was considered to be an institution in capitalism which allocates the resources to their best possible and most economizing use. In spite of frequent systemic failures of markets in terms of social justice, its fundamental legitimacy as a functioning economic system has not made it redundant altogether.

The reliance on market as the resource allocating mechanism in the society has been based on the assumptions of free and perfect market conditions, in product as well as factor markets.

It presumes that the demand side represents the use (consumption) and supply side by the (production).Today most of the commodity and manufactured goods and services operate in monopolistic

and/or monopsonic market conditions. This can be evidenced by the respective market shares of various producers/ buyers in various markets

The presumption of free self regulating markets has always been subject to theoretical challenge and question A self-regulating market demands nothing less than the institutional separation of society into an economic and a political sphere. Such a dichotomy is, in effect, merely the restatement, from the point of view of society as a whole, of the existence of a self-regulating market. As Karl Polayni has been quoted, it might be argued that the separateness of the two spheres obtains in every type of society at all times. Such an inference, however, would be based on a fallacy. True, no society can exist without a system of some kind which ensures order in the production and distribution of goods. But that does not imply the existence of separate economic institutions; normally, the economic order is merely a function of the social order. Neither under tribal nor under feudal nor under mercantile conditions was there, as we saw, a separate economic system in society. Nineteenth-century society, in which economic activity was isolated and imputed to a distinctive economic motive, was a singular departure.

Moreover, in the financialized world today, the market as legitimate resource allocating institution is facing a serious challenge in view of the following:

1) The monopolization in the production and distribution of goods and services all over the globe is a matter of separate consideration and exposition. Additionally consequent market manipulation, through marketing techniques, media and advertizing, has further degraded the rationality of markets as a reliable institution. The process of globalization of trade has emerged on the backdrop of such erosions into the foundations of self regulating markets. The rational economic man as the protagonist of the market system has become invisible. The process of financialization has further taken the invisibility and residual rationality to its destruction.

The study of global commodity markets reveal that the buying and selling contracts no more represent the production and users (consumption) in a system.It is more than evident from the data pertaining to these market above vindicate the conclusion that the surges and plunges in the demand and supply forces influenced by speculative perceptions and interventions than to actual production and consumption of various commodities. The price level and fluctuations in the financial markets are difficult to be rationalized on the basis of the book values. Refer section empirical evidence.

Hence the legitimacy of the market allegedly the most 'rational and beneficial institution for the best possible resource allocation' has been lost, even if we decide to ignore the other socio-economic evils of market such as allowing inequalities to deepen and trade cycles resulting in recession and depressions etc.

2) Criminalization of global finance

For instance, the menace international tax evasion and mushrooming tax havens have been draining the legitimate state revenues globally. It had reached a level that United Nations had to adopt an anti-corruption convention, followed by adoption of GAAR. The nations of the world were seen united in forming various forums on Tax transparency and exchange information, StAR, BEPS, TIEAs. Free flow of finance and international investments all over the globe is a reality today. The investors have to face the taxation as per the local taxation laws. Thus investments are global; but the taxation is local. Taxation being a burden eroding the share of returns to the investors, investments are attracted to the centres where there is highest ease of taxation in terms of rates and enforcement. Keeping this in mind many nation- states in the world have been offering tax incentives or tax holidays to attracting global flow of investments or even bank deposits to their locations. Switzerland, Singapore, Luxemberg, Cayman Ilands, Panama, etc. have been such tax havens specially created with very low or zero tax rates on the profits earned on the investments coming in or out from their country. There are such minimum 69 indentified tax havens in the world. With deepening financial liberalization after 1990s , the MNCs as well as other high net-worth individuals (many

with shady sources of income and huge black income even) have relocated their corporate head offices in the tax havens, so as to reap the full advantage of tax holidays. This is done by complex routing layering , camouflaging , and money laundering arranged by creating paper entities, shelf companies, fictitious identities, fictitious transactions, anonymous investments etc. This has opened the flood gates to the tax evaded money, corruption money , crime money and even terrorist money from all over the globe to be safely stashed into the tax havens and moved all round the world in search of quick capital gains in the speculative markets. This process has brought an increasing tinge of criminality to global capital and finance. Capital and finance has almost acquired global sovereignty superseding the sovereignty of the nation states . Finance has lost not only its local national moorings; but even the connectivity to the any accountability to any political authority whatsoever.

Thus, with the market institution being de-rationalized, the explosion of finance knows no boundaries; finance becomes not only global but almost autonomous, attempting to escape not only the limits of local Governments but even the idea of governance. Financialization becomes such an order that no law of any Government what so ever remains applicable to it. The ideas of right and wrong, crime and punishment, just and unjust get dissolved in the autonomous finance. Resultantly, finance becomes a indiscriminate means and destination for legal-illegal and social-anti social enterprises all over the world.

3) De-socialization of the state

With globalization of capital and finance, the States all over the world have been reduced to becoming the competitors for attracting investments, rather than the being controllers and regulators of capital. The capital in the form of finance, having acquired a supranatural national identity, has now acquired a decisive power to choose its destination of investment or disinvestment. The States' inward looking welfare vision has shifted towards outward looking political entities competing with each other for investments.

During the post world war period, 1948 till 1980s, the role of the state was transformed from a mere passive policeman to a participating regulator and even to a leader in the developing countries such as India.

The states all over the world, in this period, acquired almost a social role to promote a pattern of economic development, protect the poorer sections, and preserve the resources from being wasted or misused by the private sector.

Since the liberalization and globalization of finance, the State is being made to collapse into its original role of a policeman. The enterprises owned by the State in the vital sectors such as energy, finance, telecommunications, are being replaced by private monopolies. Thus the choice is being made in favour of uncontrolled private monopoly in place of a public monopoly. The state has shed away its social role. It has been planned to make the state withdraw from education, health agriculture, finance . This has even gone to the extent of state leaving the ownership of the natural resources of the nation. The power to make economic regulation for the welfare of the people is also being surrendered to the pressures of international corporate finance.

This has led to alienation of State from the aspirations of the people. Political process is either sinking into communalization, identity wars or creation of non state actors creating parallel power centres and laws causing tremendous hatred, strife and violence all over the world.

4. Conclusive commoditization of all biological processes leading to destruction of bio-sphere

The advent of the above processes allowing the "free" play of finance and unaccountable corporate investments has not only affected the general world economics; but has led to the creation of the new era – The Anthropocene. Humans far from being mere nomads on the planet Earth's surface, are now

fundamentally affecting the way the earth looks and works The process of commodification of natural resources such as crude, minerals and even the natural systems such as forests, rivers, ocean tracts, biological reproduction, genetic modifications, to name a few, is being taken to its logical end. Under capitalism, there is progressive commercialization of investments in commodities into the financial assets. Once a resource becomes a commodity, it needs investments to be extracted and marketed. Such investments, being too centralized, tend to get the form of global corporate entities. Finally, the investments and capital of such global bodies tend to become tradable financial assets with a progressive grip of financalization over the natural systems and resources. Although, such a financialization is evident only in limited spheres in crude oil, agriculture and minerals, it is likely to widen its grip over the other natural systems and even the environmental solutions such has carbon credit. "The objective is to transform environmental legislation into tradable instruments.

Nature is destroyed because its economic value is not visible enough to corporations and politicians. Much of 'nature' will continue to remain outside the economic calculus, so the claim that ecosystem service valuation will show the 'true cost 'of destruction of nature is false. For example, the social, cultural and spiritual values and functions that are also part of 'nature' remain 'externalities'. Ecosystem service valuation will not halt this destruction of the social, cultural and spiritual functions and values of nature.

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