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The Role of Financialization in Financial Instability:

A POST-KEYNESIAN INSTITUTIONALIST PERSPECTIVE

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Abstract: Financialization is certainly one of the most significant aspects of financial systems' evolution since the beginning of the post War period. Interestingly, while the start of the process can be identified as early as the 1980s, a majority of economists seemed to recognize its importance only after the onset of the 2007- 2008 financial crisis. The current and still unfolding crisis unveiled some of financialization's features (eg: securitization – CDO, CDS, shadow banking) and some of its related impacts on inequalities, instability and investments (Orhangazi 2008, Onaran, Stockhammer et al. 2011, Hein 2012, Palley 2013). The roles of securitization, shadow banking and financial complexity in the 2008 financial crisis are now common knowledge. A broader understanding of financialization and its socio-economic impact is, however, still under examination. While it may be argued that many economists have been at least „blind" to this phenomenon, post-Keynesian scholars have long discussed this issue and continue to largely contribute to the debate. Among them, Minsky argued in the early 1990s (Minsky 1990), (Minsky 1992) that capitalist economies evolve through various stages, the then stage (in the US) being that of „money manager capitalism", which corresponds to what we currently call „financialization". Minsky believed it had emerged in the early 1980s (Zalewski and Whalen 2010) and argued that it would increase the inherent instable nature of capitalist economies. On this point as on several others, history has shown that Minsky was rather prescient, and certainly ahead of his time with economic analysis. A closer look at his proposals remains crucial to understand today's situation. Reference is often made to Minsky's claim that financial systems are inherently unstable. To a lesser extent, and rather recently, defining financialization in reference to his capitalist stage approach has also developed. The link between these two components

of his analysis is, however, rarely presented. This is what we aim to do in this paper. We argue that understanding financialization and its relation to Minsky's financial instability hypothesis requires a closer look at Minsky's institutional approach. In addition, the recent path of capitalism has been associating financial liberalization and international financial integration to financialization. We believe that these three aspects are interrelated and need to be considered jointly, as the features of a „fifth" stage of capitalist economies, prone to crises and „sluggish" economic development.

Key words: financialization, Minsky, crisis, institutionalism

Introduction

FOR DECADES, DEVELOPED ECONOMIES HAVE faced decreases in growth and productive investment, and an intensification of revenue inequalities, on the one hand while on the other hand, financial activities have developed, the share of financial profits has increased, and financial innovation, securitization, and shadow banking have accelerated to end with severe financial and economic crisis like the one in 1929. The financialization process, which has been developing for about three decades now, certainly provides insight into these stylized facts.

Financialization finds its roots in financial liberalization, which states that financial development favors growth. While it is hardly worth discussing that better access to funds benefits investment, financial liberalization's impact on growth and macroeconomic volatility has long been disputed, both by liberalization defenders and detractors (Eichengreen, Mussa et al. 1999, Stiglitz 2000, Williamson 2000). Going a step further questions the role of financialization. Understood as the domination of finance and financial logics, financialization may be seen as an „inversion" of the logic underlying the financial liberalization initial postulate: finance is no longer primarily a means to feed investment and production, but production is dedicated to nourishing the financial system. Finance in itself is not debated, but its domination, outside any control or regulations, is to be questioned, as well as its consequences and impact on economic policy.

Since the late 1990s or 2000s, researchers from various disciplines have been addressing the issue of financialization. The term appears in economics, as well as in the fields of political science, sociology, geography and anthropology. In economics, although the topic is not new, it has only been broadly discussed since 2009. The importance of the debate, if estimated through its presence in academic journal publications, started to accelerate after 2009 and is still growing. More than 250 articles dedicated to financialization can be counted in peer review journals between 2000 and 2013[1]. In the period from 2000 to 2007, less than an average of 10 papers per year dealt with the subject. It reached an average of 25 articles per year from 2008 to 2010. In 2012 and 2013, more than 50 „financialization" papers were published ... The focus on „financialization" in economic literature is thus to some extent new, but also rich, large and in constant expansion. The debate is vast and still developing, as are the economic realities it encompasses.

Financialization is certainly one of the most significant aspects of financial systems' evolution since the beginning of the post-War period. Interestingly, while the start of the process can be identified as early as the 1980s, a majority of economists seemed to recognize its importance only after the onset of the 2007–2008 financial crisis. The current and still unfolding crisis has unveiled some of financialization's features (eg: securitization – CDO, CDS, shadow banking) and some of its related impacts on inequalities, instability and investment (Orhangazi 2008, Onaran, Stockhammer et al. 2011, Hein 2012, Palley 2013). The role of securitization, shadow banking and financial complexity in the 2008 financial crisis is now common knowledge. A broader understanding of financialization and its socio-economic impact is however still under examination.

While it may be argued that many economists have been at least „blind" to this phenomenon, post-Keynesian scholars have long discussed this issue and continue to largely contribute to the debate. Among them, Minsky argued in the early 1990s (Minsky 1990), (Minsky 1992)that capitalist economies evolve through various stages, the then stage (in the US) being that of „money manager capitalism", which corresponds to what we currently call „financialization". Minsky believed it had emerged in the early 1980s (Zalewski and Whalen 2010) and argued that it would increase the inherent instable nature of capitalist economies. On this point as well as on several others, history has shown that Minsky was rather prescient, and certainly ahead of his time concerning economic analysis. A closer look at his proposals remains of interest today.

Reference is often made to Minsky's prediction that financial systems are inherently unstable (the financial instability hypothesis – FIH). To a lesser extent, and rather recently, financialization has been defined in reference to his capitalist stage approach (Wray 2009, Zalewski and Whalen 2010, Wray 2012, Palley 2013). The link between these two components of his analysis is yet rarely presented. We aim, in this paper, to develop this link. We argue that understanding financializa-

1 Estimates based on EBSCO academic journal data base.

tion and its relation to Minsky's financial instability hypothesis requires a closer look at Minsky's institutional approach. In addition, the recent path of capitalism has been associating financial liberalization and international financial integration to financialization. We believe that these three aspects are interrelated and need to be considered jointly, as the features of a „fifth" stage of capitalist economies, prone to crises and, to quote Minsky, to

„*a continuation of the current miasma: a sluggish stagnant performance*" (Minsky 1992, p. 20).

To develop these arguments, in the first section, we define the concept of financialization and discuss its main expected economic impacts. In the second section, we discuss the role of financialization and its place in Minsky's approach of financial instability. We argue that the institutional post-Keynesian approach he developed is key not only to Minsky's FIH but also to understand current economics. In the last section, we discuss the implications in terms of economic theory and political economic perspectives.

Financialization: Definition, key features, consequences

Ethnographic studies of Wall Street, discourse analyses of investment manuals, historical narratives of the Great Recession ... from ethnography to geography, sociology and economics, studies of financialization share the common feature of interrogating finance beyond its traditional role as provider of funds to production. They question the increasing dominion of finance, its interrelation with altering industrial economic logics and the inner workings of society (Van Der Zwan 2014). In 2007, Palley was asked the following question: „Financialization: What it is and Why it matters" (Palley 2007). Seven years and many papers later, the question is still worth addressing.

Financialization: definition(s)

The term „financialization" was presumably first used in economics by (De Bernis 1988), at a conference in Mexico. It actually refers to various realities and phenomena. Its designation is in itself variable. (Krippner 2004) discussed the history of the term and its different definitions. For some authors, financialization refers to the primacy of 'shareholder value' in corporate governance models. For others, the focus is placed on the dominance of market-based versus bank-based financial systems. Some authors such as Hilferding discuss the increase of the political and economic power of the „rentier class". Financialization eventually also calls for the explosion of innovative and complex financial instruments such as securitization. Krippner herself defines financialization as a

„pattern of accumulation in which profit making occurs increasingly through financial channels rather than through trade commodity production" (p. 14).

Epstein (2005, p. 3) proposes a broader definition, encompassing the different patterns of financialization. He refers to

„the increasing importance of financial markets, financial motives and financial institutions in the operation of the domestic and international economies",

He relates this to complementary profound transformations of the economic world:

„In the last thirty years, the economies of the world have undergone profound transformations. [...] [T]his changing landscape has been characterized by the rise of neoliberalism, globalization and financialization" (Epstein, 2005, p. 3).

Following Epstein, (Palley 2013) emphasizes the ideological aspect of financialization, both as a political economy and as an economic philosophy:

„financialization is a particular form of neoliberalism", characterized by the *„domination of the macro economy and economic policy by the financial sector interest*" (Palley, 2013, p. 1).

(Rochon 2012) expresses this in more specific terms:

„Financialization involves the replacement of industrial or production capitalism by a more predatory form of financial capitalism" (Rochon, 2012, p. 168)

He argues that the post-Keynesian view identifies there a

„new form of capitalism which has not only transformed the way markets work, but carries with it important political, cultural and economic consequences" (*ibid.*).

We refer in this paper to Epstein's definition, which we view as both descriptive and factual. We also follow him in focusing on two major complementary changes in the economic landscape: neoliberalism and globalization, which we associate to financialization. We eventually clearly anchor the discussion in the post-Keynesian theoretical perspective, as bordered by Palley and Rochon.

Rising share of financial profit and decreasing wage share

A series of statistical reports describes the features of financialization among developed economies, since the 1980s; we synthesize here the main stylized facts.

Firstly, we want to point out two related observations: on the one hand, the share of financial profits rises; and on the other hand, the share of wages in the national income decreases. After 1984, the part of financial institutions' profits compared to non-financial corporations' profits increased in countries like the

United States and France and, more generally, among OECD countries (Epstein, 2005).The „rentier share" of the national income, which is the share of national income that is attributed to financial institutions or holders of financial assets, also increased after the 1980s in OECD countries (id.).This seems to be exacerbated in the US: in recent years, the financial sector has contributed to 20% of the GDP, but obtained 40 percent of corporate profits (Nersisyan and Wray 2010).

Hein (2013) associates these observations with the fall in the labor share. He observes that the part of labor income in national income decreases in OECD countries over the long run. This is particularly noticeable in southern European countries and, to a lesser extent, but nonetheless a constantly decreasing trend, in European countries, the US, and Japan (cf. figures 1a to 1d below). Heinargues that the sectorial composition of the economy has been modified, with an increase in management salaries and in profit claims of the „rentiers", to the detriment of the labor share.

Figures 1a to 1d: Labor income shares as % of GDP in selected OECD Countries (1960-2012)

Figure 1a: UK, US, Japan, Sweden

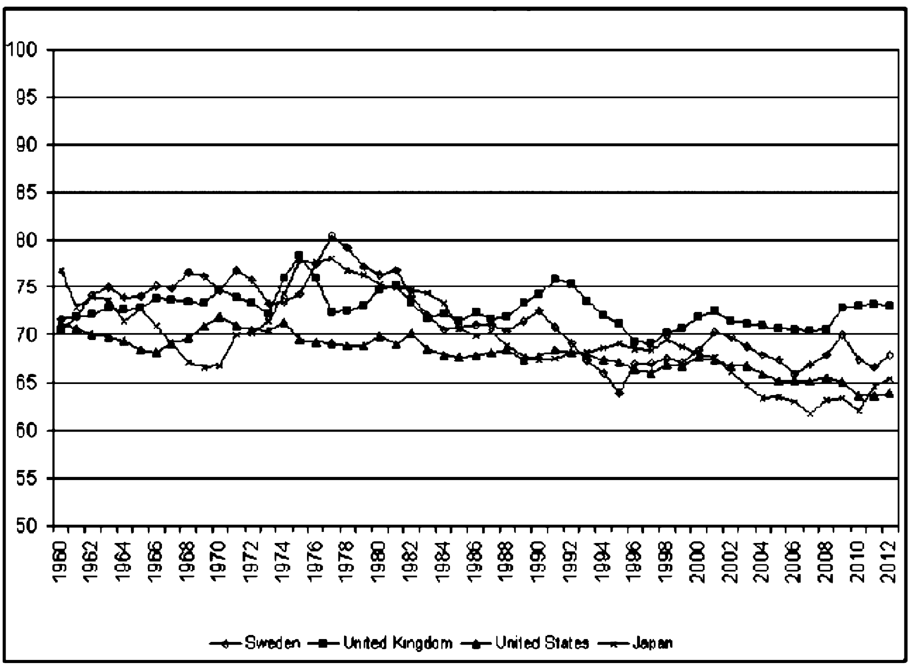


Figure 1b: Selected European countries (France, Italy, Portugal)

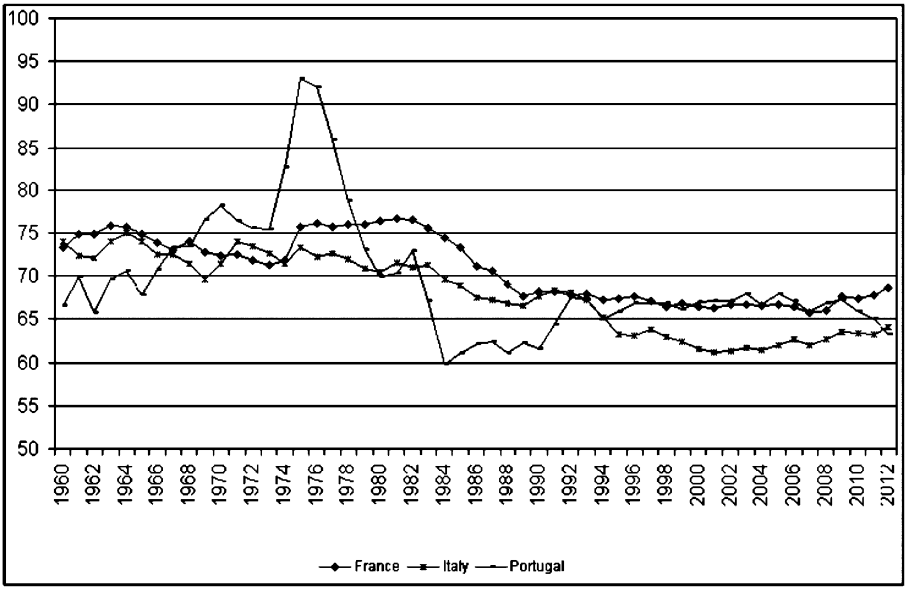


Figure 1c: Selected northern European countries

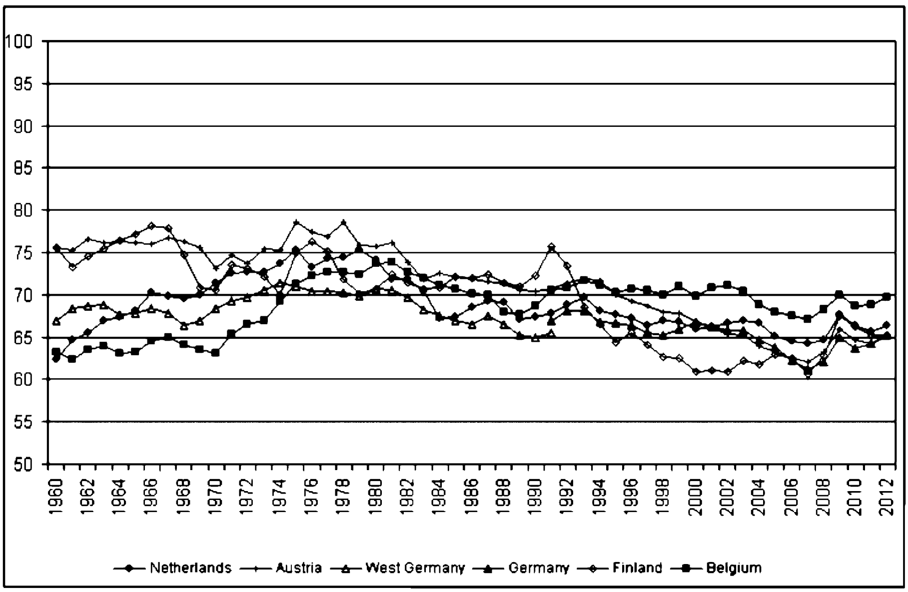
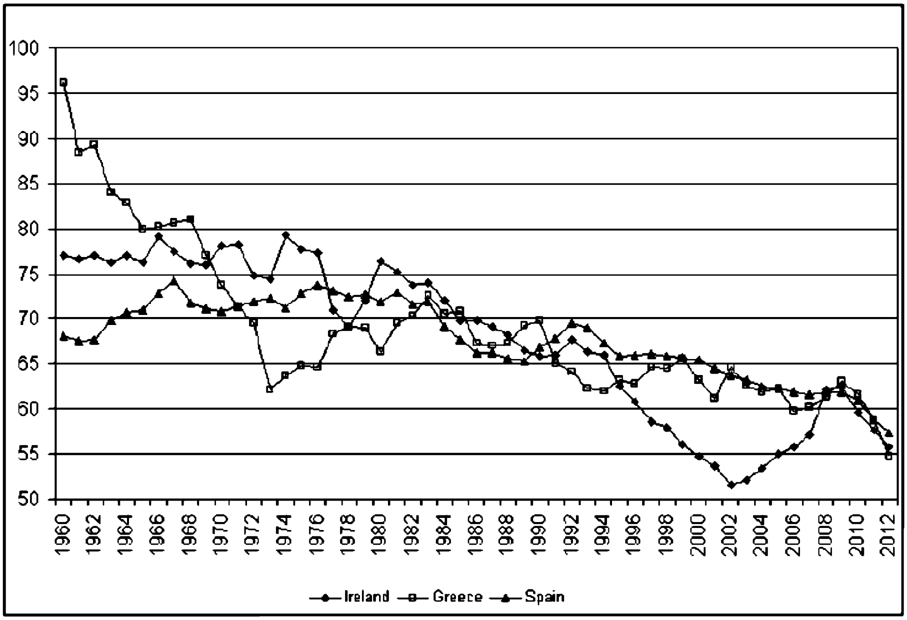


Figure 1d: Selected southern European countries (Netherland, Austria, Germany, Finland, Belgium) (Ireland, Greece, Spain)

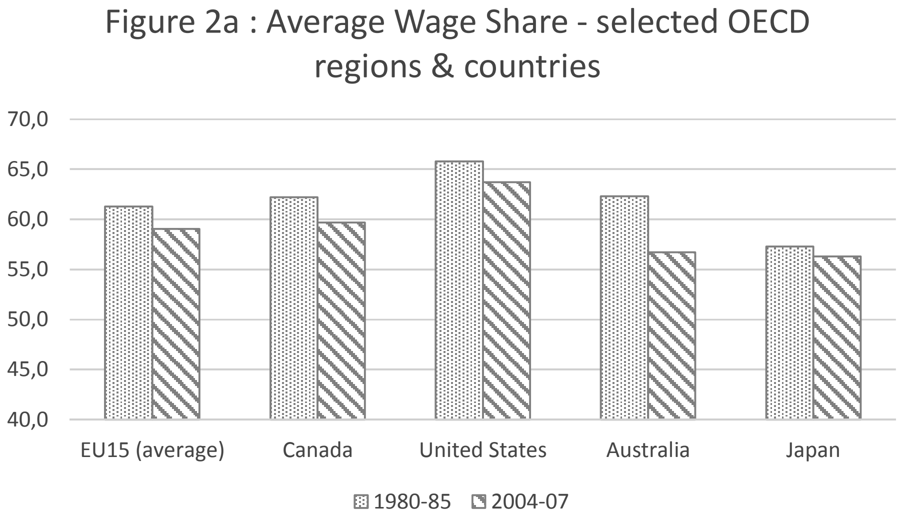


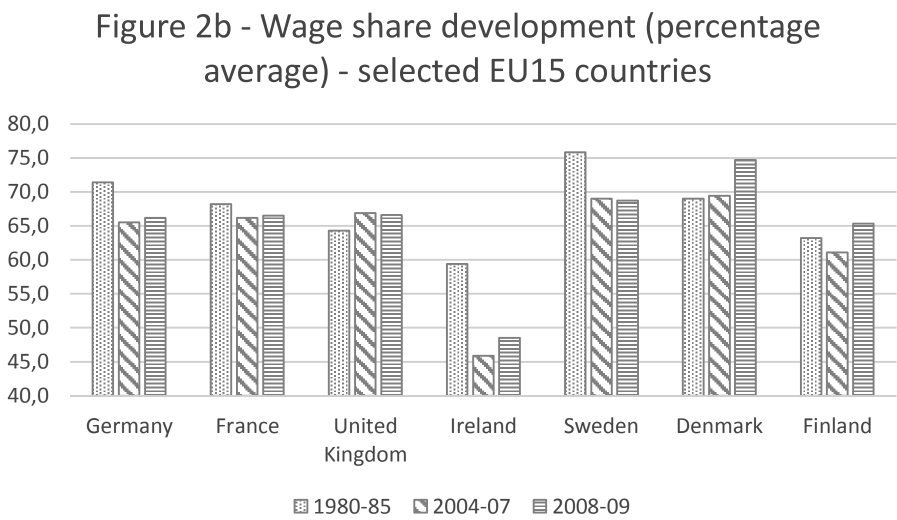
Source: (Hein 2013), p. 5-6.

More recent observations confirm that the wage share[2] has been globally decreasing in OECD countries since the 1980s (International Labour Organization 2010). Only a few OECD countries are exception to this, such as Finland and the UK (see figures 2a and 2b below). The 1980s and early 2000s were particularly marked by this trend, while the first crisis years after 2007 were more erratic. On average, the last thirty years have seen a negative trend. Besides, the International Labor Organization (ILO, *ibid.*) shows that long term factors dominate short term or crisis-related explanatory factors (*ibid.*), which is coherent with the financialization hypothesis. Obviously, financialization cannot be considered the single explanatory factor of wage share decrease. Technological progress, globalization, and sectorial composition of the economy play significant roles, the latter appearing as the most significant in quantitative terms (*ibid.*). Bargaining power between capital and labor, institutional framework developments, and „rents" existence are also proved significant explanatory factors by the ILO. This, in our view, supports the financialization approach.

2 Unadjusted wage share as defined by the International Labour Office. Wage share is defined as the ratio of compensation of employees to gross value added, both measures in nominal terms.

Figures2 a & 2b: Decrease in the wage share in selected OECD countries (1980s – 2000s)





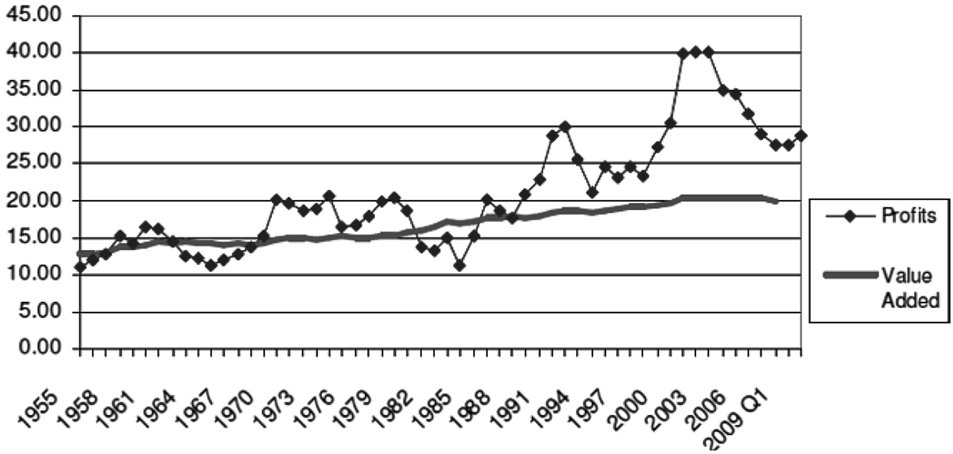
Source: International Labour Organization (2010), author's calculations

Financialization process in non-financial sectors

The domination of financial activities is not limited to the financial sector. **Financial activities within large non-financial corporations** also develop, amplifying the scope of financialization. This has been particularly observable in the automotive sector (Sinapi and Jacquin 2010). In the manufacturing and retail sectors, major corporations, such as General Motors and General Electrics, have developed financial companies far more profitable at times than their manufacturing units. As a result, the distinction between „finance" and „industry" tends to disappear (Nersisyan and Wray 2010).

Statistics show that the share of financial activities in the non-financial sector's corporate profits has been rising since the 1980s. Recently, the trend has accelerated (see figure 3 below).As a direct consequence, industrial activity is threatened by the instability of the financial sector. A financial crisis adds to the bankruptcy risk of manufacturers via direct financial channels, in addition to the traditionally expected economic effects of a crisis on demand and investment.

Figure 3: Share of financial sector in Corporate Profits



Source: (Nersisyan and Wray 2010), p.6.

Securitization and shadow banking

The development of securitization is the last – but not the least! –financialization feature we want to emphasize. in the last twenty years, the financial industry has experienced rapid innovation and complexity. It has taken the form of securitization and shadow banking development. Sub-prime credits, securitization of counterparty risk via SPE and SPVs, collateralized debt obligations (CDO's) and credit default swaps (CDs) emerge and multiply. They expand in the form of „remics" or „squared", meaning securitization of securitized instruments, and the repetition of the operation.

Initially dedicated to risk reduction, for banks in particular, securitization took on a new role after the 1980s (Lavoie 2012), fueling financial investment (*ie*: transaction for speculative motives). In its new „clothes", securitization fuels leverage, risk spreading, and no-limit expansion of the financial sphere. In August 2007, banks ended up holding billions of securitized products, including MBS's, CDO's and CDS's. The share of derivatives in large banking institutions balance sheets literally exploded in the 2000s.The importance of the derivative notional value as a percentage of the US's largest banks' assets was marginal or null in the 1990s; it was higher than 1000% at the end of the 1990s; and it reached an amazing level of 2000% to 6000% on the eve of the crisis in 2007(Nersisyan and Wray 2010).

A majority of these structured products are dealt with Over The Counter (OTC), via dedicated structures such as SPE (Special Purpose Entities) and SPV's (Special Purpose Vehicles). They are disseminated through financial institutions such as hedge funds, which are opaque by construction. As a result, the securitized global positions are largely „hidden", invisible or very difficult to assess, and unregulated. The development of the so-called „shadow banking" thus significantly contributed to the expansion and dissemination of the risk and, later, of the crisis.

Structured contracts have enabled potentially infinite leverage, as Minsky had already pointed out in 1987:

„Securitization implies that there is no limit to bank initiative in creating credits for there is no recourse to bank capital" (Minsky 1987, p. 3*).*

In practice, securitization expanded leverage in both a somewhat hidden pattern and in extraordinary volumes as in its 2000s. It also increased balance sheet interdependence, thus risk dissemination and crisis spill-over effects. In addition it included powered margin-call mechanisms of the debt deflation type. In short, securitizations largely contributed to the development of financial fragility as defined by Minsky, in a renewed meaning (Desmedt, Piegay et al. 2010).

Macro-economic impacts

We already argued, in the above section, that financialization contributed to the increased weakness of the financial system by increasing leverage, opacity, complexity, spillover effects within and outside financial institutions, and by accelerating the debt deflation mechanisms. The finance domination over the economy also fueled a „capital-asset price inflation" (Bellofiore 2013). Financialization is thus expected to have played a significant role in the development of the current crisis' causes and mechanisms, whose impacts, as are well known, are not limited to the financial sphere. We highlighted some of these socio-economic impacts in the preceding paragraphs, in particular the decrease of the wage share. Pushing the analysis further, the debate states that financialization may have negative impacts on growth and inequality, via its effects on wages, aggregate demand and investment, which we will discuss now.

Firstly, financialization may have a **depressive effect on productive investment**. Orhangazi (2008) argues that financial investment by manufacturing companies may reduce firm managers' incentives to direct funds to productive investments. Thus increased payments to financial markets reduce available internal funds. His empirical findings support this hypothesis. He finds a negative correlation between real investment and financialization on US non-financial corporations from 1973 to 2003. He relates this negative correlation to the increase of financial assets in non-financial corporation balance sheets. This is financialization.

Second, financialization is expected to **negatively impact consumption and demand**. The redistribution of income in favor of profits, the increase in the so-called „*rentier*" income, and the wealth effect from the asset price inflation (housing and financial) are expected to negatively impact consumption. Increase in profits relative to wages negatively affects consumption (propensity to consume out of profits supposedly lower than out of wages), while wealth effects (stock market boom and housing price boom in the US in the 1990s and 2000s) supports it. Empirical findings support a globally negative impact of financialization on aggregate demand(Onaran, Stockhammer et al. 2011).Onaran *et al.*observe a sharp decline in the ratio of gross private investment compared to gross operating profit surplus in the US since the 1980s. They show that distribution effects related to financialization have globally had a negative impact on the aggregate demand in the US over the last decades, partly offset by wealth effects. They eventually measure a slightly negative effect on growth.

In the US, (Lavoie 2012) associates financialization to the development of a new consumption-led accumulation regime fueled by increasing household debt: households go into debt to compensate for their stagnating purchasing power (a situation which obviously cannot last forever).In countries where growth is less moderately wage-led than the US, the distribution-related impacts of financialization on aggregate demand and growth are expected to be even stronger. This is all the more important for consumption-led growth countries like France, for example.

Thirdly, distributional effects fuel the widening of **inequality** in the United States and elsewhere. Between 1975 and 2005, the income level of the top fifth of US households rose at about 6%. The gain was about 80% in recent years. The top 1% of US families earn 22.9% of national pre-tax income, more than doubling their share compared to 1967(Piketty and Saez 2008).OECD (2008)observes similar patterns in diverse countries such as Germany, Norway and Canada, although at less pronounced levels than in the US. Zalewski and Whalen (2010) argue that the development of inequalities is rooted in aspects of institutional financialization.

Financialization, defined as the domination of the financial sector, of financial institutions and financial logics upon the rest of the economy, is thus primarily marked by the massive development, innovation and complexity of the financial sector. Securitization and shadow banking have undoubtedly contributed to the financial crisis: by increasing financial fragility and thus to the causes of the crisis, to the size of the crisis, its spill-over effects, and its massive and lasting macro-economic impacts. Financialization has also created a major shift in the non-financial sector, dominated by shareholder value governance models and financial logics. Productive investment, wage share, inequalities, and presumably growth rate, have deteriorated in its wake. Minsky began drawing attention to the structural changes in financial systems as early as the mid 1980s. The main interest of his approach lies, in our view, in its institutional perspective. We view this perspective as crucial to understanding the profound roots of current economic development. This perspective will be developed in the next section.

The development of financial economies: A Minskyan institutional approach

Financialization, as characterized in the above section, appears in Minsky's proposals in the form of a long term approach to the history of capitalism. Minsky refers to the „stages of development" of capitalist economics. He develops this proposal in his last contributions, later formalized by Whalen(Minsky 1992, Whalen 1999, Whalen 2001). We argue here that this part of his work, although late and somewhat incomplete, is not anecdotal but is, key to really understanding Minsky's theoretical prospects. This perspective places economic analysis in a historic institutional approach, encompassed in the long theoretical tradition of American Institutionalism. It completes and somewhat justifies the Financial Instability Hypothesis.

Minsky's Financial Instability Hypothesis: What can we (still) learn from it?

Minsky's work is usually referred to for its approach to crisis, known as the 'Financial Instability Hypothesis' (FIH), which predicts that financial systems are inherently instable. Economic literature as well as the press, have since largely echoed the onset of the crisis as a „Minsky moment"(Whalen 2007)[3]. Whether this is appropriate or not would be another debate. It is however worth recalling briefly what Minsky meant in the FIH, before showing its applicability to the current financial crisis.

According to the FIH, financial fragility increases within business cycles. Two „theorems" constitute the FIH. The first characterizes the financial fragility, in reference to the well-known „hedge", „speculative" or „Ponzi" criteria. Over periods of economic expansion, financial risk increases: balance sheets evolve from „hedge" to „speculative" and eventually to „Ponzi". The fragility is assessed via cash

3 *"Mr. Minsky long argued markets were crisis prone. His "moment" has arrived"*. – The Wall Street Journal.

flow criteria, which measures the ability of future profits to service the financial commitments. Risk arises thus from both the financial structure (liability side) and from the quality of investment (assets side).

Financial fragility in Minsky's view first arises from the liabilities structure: it increases with debt, but, in an open economy, it also results from maturity mismatch and currency mismatch (Arestis and Glickman 2002). The analysis is set in a temporal dynamic: current profits depend on past investments; the quality of current assets (ie: past investments), in terms of profitability, thus directly impacts financial fragility. Eventually, because entity balance sheets are inter-related (the liabilities of A are the assets of B), „*balance sheets are interdependent*". In modern terms, risk taking is pro-cyclical, both on the financing and the investment sides and spill-over effects are inherent to financial systems and capitalist economies. When the business cycles start inversing (which is in itself endogenous for Minsky[4]), Ponzi and speculative entities go bankrupt, driving in their wake the rest of the economy (balance sheet interdependence). This leads, in the absence of accurate public intervention, to debt deflation mechanisms and to the auto-cumulative crisis.

The 2007–2009 financial crisis may be looked at as a case study regarding these predictions. Financial fragility increased in the 2000s following Minsky's criteria, which are revisited to adapt to the contemporary financial context. The process of indebtedness is easily observed in the US household debt associated with the real estate and sub-prime bubble; it is also present though hidden in the burst of structured products (derivatives), which include enormous leverage. We may recall here that a derivative consists, in technical terms, of a structured financial product, involving a combination of spot transactions and debt contracts. As long as the contract is held, the leverage may remain hidden, as it is not registered in the balance sheets. However, if contracts are exercised or if investors take short positions on derivatives, the enormous size of the included leverage is revealed. The collapse of Lehman Brothers and of AIG, and the panic concerning CDOs and CDSs demonstrate the power of such „hidden" leverage. The spill-over effects of balance sheet interdependence are also clearly illustrated by the systemic risk represented by large financial institutions, banks, and also insurance, hedge funds, and other unregulated structures known as the „shadow banking" system. It may be more difficult to argue that investment quality has deteriorated over the period.

4 On this point see Nasica, E. (1997). "Comportements bancaires et fluctuations économiques: l'apport fondamental d'H.P. Minsky à la théorie des cycles endogènes et financiers." Revue d'économie politique107: 853-873, Nasica, E. (2010). Rationale and innovative behaviors at the core of the financial crises: banking in Minsky's theory. The Elgar Companion to Hyman Minsky. D. B. Papadimitriou and L. R. Wray. Cheltenham (UK), Eward Elgar Publishing Limited: 100-116.

The decreasing trend in investment and corporate profits described in the previous section may suggest this. We also believe that the increase in financial and speculative assets share in the non-financial corporation's investment contributions to fragility in the Minskyan way.

In short, the FIH states that financial systems are prone to instability, that crises are endogenously generated by capitalist economies, via a dynamic approach of business cycles:

„over protracted period of good times, capitalist economies tend to move from a financial structure dominated by hedge finance units to a structure in which there is large weight to units engaged in speculative and Ponzi finance" (Minsky 1992, p. 9).

'The financial instability hypothesis is a model of a capitalist economy which does not rely upon exogenous shocks to generate business cycles of varying severity. (ibid.)

This short term – cyclical dynamic of financial fragility finds its origin in institutional mechanisms. Agents' behaviors towards risk are pro-cyclical and institutionally driven(Minsky 1991, DelliGatti, Gallegati et al. 1994, Sinapi 2011, Palley 2013). Along with this short term cyclical dynamic of the FIH, a long term perspective has to be taken into consideration, grounded in the history of capitalism and an institutional perspective.

Financialization in Minsky's stage of development of capitalism

Minsky considers that economic theory must be built in history: Economic theory has to explain the development of cumulative capitalist economies through history (Minsky 1986). However, this prospect is developed by Minsky rather late in the 1990s in response to the then political context of deregulation, which we may today qualify of financialization process. As recalled by Charles Whalen:

„Minsky saw the need for nothing less than a thorough re-examination of 'our current model of capitalism,' he found the most effective way to obtain this 'deeper look' was to focus on long-term capitalist development rather than business cycles" (Whalen 1999, p. 3).

„In this period [1994}, Minsky thought it was essential to combat the dominant trend with an analysis grounded in history and institutional reality." (*ibid,* p. 2)

Minsky formalized this approach in his last papers, rooted in the "institutional" line he was working on. Minsky and Whalen (1996) developed a "theory of capitalist development" later formalized by Whalen (1999). This theory fulfills the objective of conducting "an analysis grounded in history and institutional reality" (Whalen ibid, p 2). It may be recalled that Keynes, like the American Institutionalists, defined the „problem" that the economic theory must explain as a path through the development of a cumulative capitalist economy through history. Minsky proposes an analysis of the stages of development of capitalism, anchored in an institutionalist approach, which is inspired by Keynes and rooted more specifically in Commons works (Sinapi 2012). The articulation between the development of capitalism, institutional forms, financial innovation and dynamics is in our view at the heart of Minsky's history-based approach.

Minsky elaborates this analysis of the development of capitalism by studying the changing economic systems of the United States between 1929 and the 1990s. This lead him to identify five stages in the development of capitalism: merchant capitalism (1607-1813), industrial capitalism (1813-1890), banker capitalism (1890-1933), managerial capitalism (1933-1982), and money manager capitalism (1982 - ...)(Minsky and Whalen 1996);(Whalen 1999). Rather than a succession of stages, Minsky described the development of capitalism as a permanent and dynamic adjustment of institutions. Through time, the development of US capitalism is associated with the rise of corporations' external funding, corporations' ownership structuresand an economic power shift towards finance and constant financial innovation.

This analysis is in essence institutionalist. The development of capitalist institutions is understood in reference to Historic Institutionalisms and Commons, as both the organizations themselves and their rules and norms. Financialization is the last stage of development identified by Minsky, which he calls „money manager" capitalism. It consists in the domination of finance not only in corporations and economic mechanisms, but also in norms, logics and rules of the economic system. That is the domination of the financial prospects in the institutions that shape the economy.

The „type" of capitalism is determined by Minsky via its institutional forms, which are in permanent evolution. Minsky's historical approach relates to the long tradition of American Institutionalism. This dynamic is non-determinist. Capitalism can take various forms. In reference to a Heinz slogan, Whalen recalls that Minsky stated that

„capitalism comes in as many varieties as Heinz has pickles" (Whalen, 1999, p. 3).

Profit seeking and financial innovation are the engine of the institutional dynamics which shape the development of capitalism in historical times. Financialization is viewed as the last step achieved by the US economy in its historical institutional permanent adjustment:

„capitalist development is shaped by the institutional structure, but this structure is always evolving [...]. The financial system takes on special importance in this

theory not only because finance exerts a strong influence on business activity but also because this system is particularly prone to innovation. [...] [F]inancial evolution plays a crucial role in the dynamic patterns of the economy". (Whalen 1999, p. 3).

Financialization and the FIH: An institutionally driven articulation

We argue here that the fragility dynamics at the heart of the financial instability hypothesis (second theorem of the FIH) are rooted in institutional mechanisms. During long periods of prosperity, economic entities take up "speculative" positions and thus financial fragility gradually increases. Macroeconomic instability is fundamentally endogenous, because of two complementary processes of institutional character that are actually behind financial fragilization. If we return to Minsky's fundamental hypothesis, these two mechanisms are identified as the „internal dynamics of capitalist economies" and the „system of interventions and regulations":

„*The hypothesis holds that business cycles of history are compounded out of (i) the internal dynamics of capitalist economies, and (ii) the system of interventions and regulations that are designed to keep the economy operating within reasonable bounds*". (Minsky,1992, p. 9)

The first dynamic (i) corresponds to what might be identified as "spontaneous" institutional mechanisms and the second (ii) as "intentional" institutional mechanisms. These two "dynamics" correspond respectively to the action of informal (usage and incentives) and formal (rules, authorities, regulatory organizations / „administrative actions") institutional forms described by Minsky (DelliGatti, Gallegati et al. 1994) and (Arestis, Nissanke et al. 2003, Sinapi 2012).

Minsky assigns to the institutional structure of the financial system the function to stabilize the system, by countering the fragilization process at work in the FIH and by acting as „circuit breakers" to counter the crisis dynamic. This function is taken up and clarified subsequently:

„*In a world where the internal dynamics imply instability, a semblance of stability can be achieved or sustained by introducing conventions, constraints and interventions into the environment.*" (Ferri and Minsky 1991, p. 20).

„*To contain the most evident evils that market systems can inflict, capitalist economies have developed sets of institutions and authorities, which can be characterized as the equivalent of circuit breakers. These institutions in effect stop the economic processes that breed the incoherence, and restart the economy." (DelliGatti, Gallegati et al. 1994*, p. 5*).*

These two mechanisms are embedded in business cycle–led institutional mechanisms. The first, related to internal dynamics, is described by Minsky in terms („orthodox barrier" / cautious usages „relaxed", risk underestimated with the „euphoria of good times") that echo more modern analysis related to the procyclicality of risk taking. In modern terms we may refer to „behavioral biases" including herd behavior, myopia, and cognitive dissonance. For Minsky, change in usage and behavior arising from a degraded and optimistic perception of risk determines financial fragilization and explains the incoherent behavior of the financial system (crisis and cumulative depression), as modeled by (DelliGatti, Gallegati et al. 1994). Minsky anchors this perspective in profit seeking and innovation, which he sees as inherent to financial systems.

His approach is not yet normative. In this respect, the reference to „behavioral biases" is inappropriate. Minsky explicitly rejected the asymmetries of information approach as meaningful to construct an economic analysis:

„[T]he asymmetric information approach to constructing a meaningful macroeconomics is logically flawed". (Minsky 1992 a, p. 9)

Let us now consider "failings" of market mechanisms: both information failings (asymmetric information in particular) and failings in the supposed "rational" behavior of agents (behavioral bias) seems similarly irreconcilable with Minsky's hypotheses. Considered as failures compared to a prevailing norm of market and rational behavior implies the acceptance of the existence of such norms of pre-existing or natural market equilibrium. Minsky clearly rejected such an approach. He would have seen them as institutional characteristics, with institutions understood according to Commons as the „collective actions which guide individual actions".

The second institutional dynamic (ii) sustaining the financial fragilization process under the FIH arises from the action of the system of interventions and regulations, that is, from the formal institutions (regulations, oversight capacities, and regulatory organizations). If the system is effective, it acts as a "circuit breaker," that is, it counters the first mechanism (the internal dynamics of capitalist economies) which promotes risk taking. These institutions are a stabilizing force. But, under the effect of innovation and development of capitalism, Minsky argues that the regulatory structure becomes inoperative. If the institutional system is complete (and effective), then the cyclical risk-taking dynamic is contained. To prevent instability, it "would suffice" to develop a complete institutional system, which notably includes prudential rules, rules and norms enforcement mechanisms and effective regulatory instances.

In order to be complete, the institutional structure must apply to all of the agents of the financial system: this is, in the current context, banks, but also financial intermediaries, investment funds, etc. This control therefore involves prudential regulation of banks but also shows the need to regulate the other actors of the financial system and more especially the agents that emerge from financialization.

This is the stumbling block for the effectiveness of the institutional system: such a system can only be effective if it is constantly adjusting to the development of the financial system and to innovation. This idea is asserted by Minsky:

„*[T]he Keynesian view recognizes that agents learn and adapt, so that a system ofintervention that was apt under one set of circumstances can become inept as the economy evolves*".(Minsky 1991, p. 1991).

Concluding remarks: Theoretical and political economic implications

Following Minsky, we argue that the effectiveness of an institutional system can only be evaluated in a historical perspective, based on the analysis of the stages of development of the financial system in question. Under the effect of the evolution of financial systems (changes in the form of capitalism), an institutional structure that might so far have countered the dynamics of financial fragilization becomes inoperative as it is no longer suited to the financial system's new form. Innovation (both financial and organizational) is behind such changes and is in itself a source of institutional unsuitability.

The institutional forms governing the financial system cannot adapt fast enough to organizational change and to innovation. This explains the second dynamic sustaining financial fragility: under the effect of the development of financial systems, formal institutions ("the system of interventions and regulations") become ineffective and no longer sufficiently counter the endogenous dynamic of risk taking. This second mechanism is a failure of the action of formal institutions in a changing historical context, which may also be characterized as a failure of "intentional" mechanisms. This leads us to two remarks.

First, the stabilizing action of formal institutional forms in Minsky's approach is subject to their adaptation to the development of capitalism. If these regulatory institutional forms become inoperative, then an endogenous dynamic of financial fragilization, which sustains the endogenous financial instability predicted by Minsky in the FIH, is set in place. Two institutional dynamics power the financial fragilization of the FIH. The internal dynamics of capitalist economies (i) or spontaneous mechanisms (incentive to risk taking inherent in the financial system)are no longer countered by prudential usage (ii) in the upward phase of the economic cycle.

Second, the unsuitability of the system of interventions and regulations consists in the failure of the intentional mechanisms. The formal regulatory institutions become inoperative under the effect of the evolution of the financial system and of innovation.

These two mechanisms, rooted in the changing forms of financial systems and in innovation constitute what we shall name "institutional fragility", echoing Minsky's „financial fragility". This, we argue, underlies the process described by Minsky in his Financial Instability Hypothesis (FIH), as he very explicitly suggests:

„Innovation, the key to capitalist development is not just a technique and product phenomena: Financial institutions and usages are also subject to innovation. New financial institutions and practices are introduced and have an impact upon the asset and liability structures. They also have an impact upon the overall stability of the economy". (Minsky 1991, p. 18)

This last quote synthesizes, in our view and in a somewhat predictive way, how financialization interacts with instability and crisis. Financialization has certainly interfered directly with the current crisis mechanisms and favored its spillover effects. Yet, the more significant financialization „danger" lies, in our view, in the fact that the major shift in the dominant form of capitalism corresponding to financialization, implies a profound mutation of institutions, in their logic and in their action. We argue that financialization triggers a form of „institutional fragility" which in turn triggers the financial fragilization process of the FIH.

This institutional fragility is twofold. First, it plays a role in the short term dynamics described by Minsky. Financial fragility develops with the business cycle, via the reduction of risk-controlling informal institutional mechanisms. This first institutional mechanism creates the risk of underestimation and over-optimism associated with the boom, and in innovation and profit seeking which characterize financial systems' institutional arrangements. Second, the institutional fragility lingers in the long term dynamics of capitalism, where the financialization process has been at play for several decades now. By sharply modifying the forms and features of institutional arrangements within the financial systems, it leads formal institutions (regulatory frameworks and supervision mechanisms) to inefficiency. The „institutional fragility" results from the vacancy of institutions adjusted to the new context and from the inadequacy of pre-existing institutions, which are no longer able to *„stop the economic processes that breed the incoherence, and restart the economy"*. The system of intervention has become „inept"; lacking innovationdue to economic evolution and the adaption and learning capacities of agents.

Yet, financialization cannot be considered as the sole or main institutional shift at the origin of institutional fragility. In developed economics, financialization has been associated with globalization and financial liberalization. International financial integration, both *de jure* (liberalization of capital flows) and *de facto* (increase in trans-national financial flows) has accelerated since the 1980s and 1990s to reach a peak in the 2000s (Prasad, Rogoff et al. 2003), both in developed economies and emerging economies. These three conjunct processes - financialization, liberalization and globalization of financial systems, constitute in our view a 6th stage of the development of capitalism: the „global-financialized capitalism".

This new era requires a new institutional framework for the financial system, which has to include regulation and supervision of new financial organizations and transactions created by innovation in the financialization process, such as securitization of hedge funds, the inclusion of all transactions within a formal and regulated framework, that is the end of OTC instruments and transactions. It also requires a global supervision of financial instruments and institutions, which appeal for transnational cooperation and political agreements, and seem today out of reach. Both the context and challenges of developed and emerging economies have to be addressed in a global manner. This is the only way we will avoid US and Eurozone monetary policies that lead to capital surges and sudden stops in developing economies; in this way, we will have a chance to stabilize the economy.

Minsky assigned this role to institutions, authorities, and supervision. The institutional form that he considered to be the most essential – the theoretical framework underlying economic and political decisions - has thus far been lacking from the discussion. This is certainly where our role, as economists is the most challenging – to make the dominant economic framework change, and make this post-Keynesian institutional view central to the analysis. The Institutional approach is non-determinist and built on history. Institutions are social constructs, which makes the job all but simple. We will leave the final word to Minsky:

„[In] *real world economies the simplistic propositions of laissez-faire no longer hold. Economies with the financial system of modern capitalism can implode, as happened between 1929-33. [...]There is need for rethinking the system of intervention into capitalist economies that has evolved out of the New Deal structure which was mainly put in place before World War II.*" (Minsky and Whalen 1996, p. 5).

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Uloga finansijalizacije u finansijskoj nestabilnosti: post-kejnzijanska institucionalistička perspektiva

Finansijalizacija* je svakako jedan od najznačajnijih aspekata evolucije finansijskog sistema u celom posleratnom periodu. Zanimljivo, dok se početak procesa može identifikovati u ranim 1980-im, većina ekonomista prepoznala je njen značaj tek nakon početka finansijske krize 2007–2008. godine. Sadašnja, i dalje aktuelna kriza otkrila je neke od karakteristika finansijalizacije (npr. sekjuritizacija*, CDO, CDS, bankarstvo iz senke) i uticaj koji ona ima na nejednakost, nestabilnost i investicije (Orhangazi 2008, Onaran, Stockhammer et al. 2011, Hein 2012, Palley 2013). Uloga sekjuritizacije, bankarstva iz senke i finansijske kompleksnosti u izazivanju finansijske krize 2008. godine je sada poznata stvar. Šire razumevanje finansijalizacije i njenog socio-ekonomskog uticaja je, međutim, još uvek predmet istraživanja.

Mada se može reći da je većina ekonomista bila „slepa" pred ovom pojavom, pripadnici post-kejnzijanske ekonomske misli već dugo raspravljaju o ovoj problematici i i dalje nastavljaju da doprinose ovoj debati. Među njima je Minski već početkom 1990-ih isticao (Minsky 1990), (Minsky 1992) da kapitalističke privrede evoluiraju i da je tadašnja faza (u SAD) kapitalizma bila faza „novčanih rentijera", što odgovara onome što danas nazivamo „finansijalizacijom". Minski je verovao da se ona pojavila početkom 1980-ih (Zalewski and Whalen 2010) i tvrdio je da će ona negativno uticati na već postojeću inherentnu nestabilnost kapitalističkih privreda. Na osnovu ove teze, kao i još nekoliko drugih, istorija je pokazala da je Minski bio vidovit i svakako ispred svog vremena. Detaljnija analiza njegovih teorijskih uvida je ključni sastojak koji nam može pomoći da razumemo današnju situaciju.

Stručni krugovi se obično pozivaju na tvrdnje Minskog da su finansijski sistemi inherentno nestabilni. U manjoj meri, tek nedavno, definisanje finansijalizacije u odnosu na njegovu analizu evolutivnog razvoja kapitalističkih sistema se takođe razvio. Veza između ove dve komponente njegove analize je, međutim, retko prisutna. I to je ono što mi nameravamo da uradimo u ovom radu. Mi tvrdi-

mo da je za razumevanje finansijalizacije i njene veze sa njegovom hipotezom finansijske nestabilnosti potrebno detaljnije ispitati institucionalni pristup Minskog. Pored toga, nedavno kretanje kapitalizma dovodi u vezu finansijsku liberalizaciju i međunarodnu finansijsku integraciju sa finansijalizacijom. Verujemo da su ova tri aspekta međusobno povezana i da ih treba razmatrati zajedno, kao karakteristike „pete" faze kapitalističkih privreda, sklonim krizama i „tromom" ekonomskom razvoju.

Ključne reči: finansijalizacija, Minski, kriza, institucionalizam

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