THE PROCESS OF FINANCIALIZATION IN THE EURO AREA

[a] TOMASZ FLORCZAK

University of Lodz, Faculty of Economics and Sociology, Institute of Finance, Revolution of 1905 St., no. 39, 90-214 Lodz.
email: [a]tomasz.florczak.91@gmail.com

Abstract: Financialization is a process of increasing the importance of the financial sector in the economy. The first signs of this increase were noticed in the 1950s. Financialization causes many effects – positive and negative – in the economy. The objective of the article is to show the process of financialization in the euro area countries. Therefore, the author used four indicators, which are related to the growth of the financial sector. Finally, an attempt was made to determine the regularities regarding the process of financialization in a selected group of countries.

Keywords: financialization, process of financialization, financial sector, euro area.

Introduction

Financialization is an inseparable element of the economy in the 21st century. The process of financialization is visible in the growth of the role of the financial sector. These changes have many positive and negative effects. The impact of the process of financialization depends on many factors. The determination of the strength of its impact often varies depending on the country which is being studied. The objective of the article is to show the growth of the financial sector in the countries of euro area.

It is important to indicate the significance of the finance sector in both the individual countries and the entire euro area. This will help to indicate the impact of financialization on the economies of the studied countries and the entire group. The author has made an indicator analysis that may show the size of the financial sector and its share in the economy.

1 The definition of financialization

Generally financialization means an excessive growth of the financial sector. This applies to both economic and social life. Literature describes this phenomenon as a growing advantage of the financial sector and its entities over other sectors and their units in the economy[1].

There are several terms for the growing importance of the financial sector in the economy. Many of them refer directly to the part of the sector affected by financialization. Terms such as "stock-exchangization", "bankization", "financial capitalism"[2] are used in this case.

Financialization is difficult to define with only one definition. In the literature there are process descriptions that refer to different areas of its impact. Below there are a few of them.

T. I. Palley thinks that financialization is an increasing importance of categories related to finances. These categories include markets, motives, institutions and elites that have a role in the operating of the economy and the managing of its institutions. This applies to both national and supranational levels[3].

According to S. Dallyn, the process of financialization means the expansion of credit money, which is available to a growing part of the society. It is also the process of opening new and converting old loans and credits into derivative financial instruments. This mainly applies to derivatives and securitization[4].

M. Ratajczak applied a different approach of defining financialization. In his opinion, financialization should be determined in two perspectives: narrow and wide ones. In the narrow perspective, there is an increase in the activity of non-financial entities on the financial market. In the wide perpective, financialization is the process of releasing the financial sphere from the real sphere. It is also a process of achieving advantage of the financial sphere, an increase in the importance of markets and elites of this sphere in the achieved effects of management[5].

G. Gołębiowski and P. Szczepankowski believe that financialization is a progressive superiority of the financial sector over the activity of economic units that operate in other sectors of the economy. It also concerns mechanisms of the impact of the financial sphere on the real sphere[6].

2 History of events preceding the process of financialization

The foundation of the philosophy leading to creation of financialization was a new approach to the economy which was defined in the 1950s. The economy was perceived through risk and profitability. Over the next years, this approach has been disseminated[7].

The perception of the economy by risk and profitability resulted in the disappearance of system security. It resulted in the implementation of new financial instruments that were beyond the control of central banks in the early 1960s. Commercial banks introduced innovative currency exchange tools that included the exchange of US dollars (USD) into euros. Next instruments concerned the conversion of the euro to other currencies of European countries[8]. These events resulted in the decreasing impact of Bretton Woods system.

In the 1970s, there was a significant change in the financial sector. The years 1971-1973 included the collapse of Bretton Woods system, which allowed the exchange of the national currency for US dollars at a stable price. The guarantee of the price was the convertibility of the US dollar into gold. The collapse of the system caused instability in the market. Therefore, the market was directed towards flexible exchange rates. The guarantee of a stable course, which was gold, disappeared. These events caused uncertainty in the financial market, which resulted in the growing costs of investment security. New financial instruments were introduced in order to lower the cost of collateral. The trade of these instruments was done on new markets[9]. The first derivatives market was established in 1972. It was Chicago Mercantile Exchange[10].

The collapse of Bretton Woods system and the increase in derivatives markets contributed to the increased importance of the financial sector in the economy. At the same time, the role of financial market participants increased and the topic of finance became a media one. During this period, sociologists introduced the term of ‘’financialization”, which describes the process growing importance of the financial sector[11].

The economic crisis of 2007 has been one of the largest events of this kind to the economy since the 1930s[12]. During the crisis

[1] Gołębiowski G., Szczepankowski P., Finansyzacja gospodarki krajów Europy Środkowo-Wschodniej, [w:] Ruch prawniczy, ekonomiczny i socjologiczny, Rok LXXVII – zeszyt 4 – 2015, s. 197.
[2] Ratajczak M., *Finansyzacja gospodarki*, Ekonomista Nr 3/2012, s. 281-282.
[3] Palley T. I., *Financialization: What it is nad Why it Matters?*, Macroeconomic Policy Institute (IMK) in the Hans-Boeckler-Foundation Workin Paper 04/2008, 2008.
[4] Dallyn S., *Innowation and financialisation: Unpicking a close association*, [w:] Epherema: theory& politics in organization V.11(3), 2011.
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[7] Szczepankowski P., *Wpływ zarządzania wartością na finansjalizację przedsiębiorstw*, [w:] *Zeszyty naukowe Uniwersytetu Szczecińskiego: Finanse, rynki finansowe, ubezpieczenia nr 73*, Nr 854, Szczecin 2015, s. 497.
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[9] Vogl J., *Taming Time: Media of Financialization*, [w:] Grey Room 46, Inc. And Massachusetts Institute of Technology, 2012, s. 73-75.
[10] Ibidem, s. 73-75.
[11] French S., Leyshon A., Wainwright T., *Financializing Space, Spacing Financialization*, [w:] ESRC Financialization of Competitivness Seminar, 2008, s. 3.
[12] Gkanoutas-Leventis A., Nesvesailova A., *Financialisation, oil and the Great Recession*, [w:] Energy policy 86 (2015), s. 892.

there was a sudden collapse on the financial markets. The reason for this was the excessive creation of credit money. An additional element, which drove the process was the new financial instruments. These instruments were created on the basis of debts of financial institutions. As a result of these activities, there was the problem of credit money looping. The effects of the crisis drew people's attention to the significant overgrowth of the financial sector in the economy[13]. The financial crisis showed the large role of the financial sector in the economy[14].

In the modern form of capitalism, economic crises cease to be exceptions. They become phenomena that occur with a certain regularity. Each crisis proceeds in a different way and is caused by various factors. Reason for one crisis may be seen in excessive financing of households with credit money, cause of another crisis may be a liquidity problem among enterprises. Despite various reasons and courses of action, crises have one common element which is the overgrowth of the financial sector - financialization[15].

3 The financialization process in the euro area countries

3.1 Materials and methods

The process of financialization is determined by the growing importance of the financial sector and its variables. In order to indicate their significance for the whole economy, several indicators were applied. The used indicators concern the most important elements of the financial sector.

The following indicators were used in the study:

- ratio of the budget balance to GDP;
- ratio of financial transaction assets to GDP;
- ratio of employment in the financial sector to total employment;
- ratio of household debt to household income.

The indicators from above will allow determining increase in indebtedness of the economy as well as households. They will make it possible to indicate the participation of the financial sector in the economy. In order to obtain a thorough analysis of the financialization process, other indicators should also be taken into account, such as: the balance of financial and capital flows, salaries in the financial sector to wages,ratio of investment in the economy to GDP.

3.2 Results

Financialization can be examined by indicators which determine the level of given economic values in relation to the size of the economy. The author used four indicators: the ratio of budget balance to GDP; ratio of financial transaction assets to GDP; ratio of employment in the financial sector to total employment; ratio of household debt to household income.

In order to facilitate the interpretation, the results are divided into three groups:

- countries that joined the euro area in 2002 - countries that joined the euro area at the time of its creation;
- countries that joined the euro area after 2002 - countries that joined the euro area in the following years;
- the euro area (19 countries).

Charts 1 to 3 indicate the ratio of the budget balance to GDP. This indicator shows the share of budget surplus or deficit in GDP. In this way, it can be seen if the country tends to spend too much money. It is also possible to determine the tendency for the government to indebt the economy.

Chart 1. presents the ratio of the budget balance to GDP in the countries that joined the euro area in 2002. In most countries, this indicator has a negative value. This means that these countries apply a budget deficit policy. Ireland and Greece are most likely to have a large budget deficit. The expenditure is partially financed from external sources. It supports the growth of the financial sector.

Chart 2. shows ratio of the budget balance to GDP in countries that joined the euro area after 2002. In the majority of these countries this indicator is characterized by a negative value. Most countries that joined the euro area after 2002 have a negative budget balance. Its ratio to GDP is usually around 3-4%. In the years 2014-2015, Cyprus and Malta had the lowest ratio of the budget balance to GDP. A negative budget balance means that countries are willing to incur debt in order to cover the deficit.

Chart 3. presents the ratio of budget balance to GDP in the euro area, which consists of 19 countries. The indicator has had a negative value since the beginning of the studied period. In the years 2007-2016 its value ranged between -0.65% and -6.26%. This means that the euro area countries tend to have a budget deficit. This allows the development of the forms of external financing and the simultaneous increase of the financial sector importance.

In the majority of the surveyed countries as well as in the entire euro area the ratio of the budget balance to GDP is negative. This means that the studied countries apply a loose budget policy that favors the creation of a budget deficit. At the same time, it contributes to the indebtedness of the economy. The result of such activities is the growth of the financial sector.

Charts 4. to 6. present the ratio of financial transactions to GDP. This indicator shows share of financial sector assets in the wealth of the economy. It also allows noticing whether the financial sector is the main element of the economy.

Chart 4. presents the ratio of financial transactions to GDP in the countries that joined the euro area in 2002. In most countries this indicator does not exceed 20%. This means that the financial sector is of great importance in the economies of the surveyed countries. The financial sector is the most important in Ireland. This country also faces large fluctuations in the value of financial.

Chart 5. shows the ratio of financial transactions to GDP in countries that joined the euro area after 2002. In the majority of surveyed countries the indicator does not exceed 20%. This means that operations on the financial market are an important element of the economy. The financial sector is the most important in Cyprus and Malta.

Chart 6. presents the ratio of financial transactions to GDP in the euro area (19 countries) and Luxembourg. The graph shows Luxembourg as an example of a country where financial assets in relation to GDP often exceed 1000%. In the case of the euro area, this indicator in the audited period ranged from 6.47% (2008) to 51.39% (2007). In these years there are large fluctuations due to the financial crisis. After the shock related to the crisis, the rate increased. Since 2014 financial assets in relation to GDP have amounted to approximately 20%. This means that the financial sector plays an important role in functioning of the euro area economy. It is important that the role of the financial sector is not decisive.

The ratio of financial transactions to GDP in the surveyed countries and the euro area varies around 20%. This means the financial sector is an important element in the functioning of the economy. In some countries (ie Ireland, Cyprus, Malta, Luxembourg) it plays a very important role in functioning of the economy.

[13] Pike A., Pollard J., *Economic Geographies of Financialization*, [w:] Economic Geography 86(1), 2010, s. 30.
[14] Theurillat T., Corpataux J., Crevoisier O., *Property Sector Financialization: The Case of Swiss Pension Funds (1992-2005)*, [w:] European Planning Studies Vol. 18, No. 2, 2010, s. 190.
[15] Roubini N., Mihm S., *Ekonomia Kryzysu*, Oficyna a Wolters Kluwer business, Warszawa 2011, s. 33.

Charts 7. to 9. present the employment relationship in the financial sector to the employment in the entire economy. This indicator allows observing the role of employment in the financial sector in relation to the employment in the economy. The higher the index, the greater the role of the financial sector in the economy. Data for 2017 include results from the second quarter.

Chart 7. presents the ratio of employment in the financial sector to the total employment in the countries that joined the euro area in 2002. In most countries, the ratio varies from 2% to 4%. Only in Ireland this rate is around 5%. A separate case is Luxembourg where the employment of the finance sector is 10% of the total number of employees. This may be due to the specificity of the economy of this country.

Chart 8. presents the ratio of employment in the financial sector to the total employment in the countries that joined the euro area after 2002. In the majority of countries, this ratio is from 2% to 4%. A higher employment in the financial sector occurs in Cyprus (around 5-6%) and Malta (4-5%).

Chart 9. presents the ratio of employment in the financial sector to the total employment in the euro area - all 19 countries. This indicator varies around 3%. This means that the employment of the financial sector is about 3% of the total employment in the euro area countries. In the entire euro area one can observe the decline in the employment of the financial sector.

The employment ratio in the financial sector to the total employment in the surveyed countries ranged from 2% to 4%. In the whole euro area, the indicator varies around 3%. These results mean that the financial sector does not have a decisive role in the employment of employees in the economies of the studied countries. This does not mean that the financial sector does not play an important role in the functioning of the economy.

Charts 10. to 12. present the ratio of the household debt to the household income. Thanks to the indicator, the tendency of households to indebt may be observed. The increase in the financial sector means an increase in the number of products through which it is possible to raise funds. Therefore, the high value of the indicator means that the financial sector is of great importance in the economy of a given country.

Chart 10. presents the ratio of household debt to the household income in countries that joined the euro area in 2002. In most countries, the rate is below 100%. Therefore, households are not willing to indebt themselves above their incomes.Exceptions are households in the Netherlands and Ireland, where the debt is above 150% of revenues.

Chart 11. Presents ratio of the household debt to the household income in countries that joined the euro area after 2002. In most countries this rate fluctuated around 50%. This means that households in these countries are not willing to overburden their income. An exception in this group of countries is Cyprus, in which the household debt has amounted to over 150% of revenues since 2009..

Chart 12. presents the ratio of the household debt to the household income in the euro area (19 countries). Over the period considered, the index exceeded 90%. This means that households in the euro area have over 90% of their income.

The ratio of debt to the household income in the euro area and its member states in most cases does not exceed 100%. Households in the countries that joined the euro area in 2002 have a greater propensity to borrow more than their revenues. A high level of household debt indicates an easy availability of credit money. It is also possible that there are many financial instruments that facilitate borrowing. A high level of the household debt also indicates a large, well-developed financial sector.

4 Conclusions

The process of financialization is an inherent element of the economy of modern states. It is present in many aspects of the economic life. The overflow of the financial sector became visible in the 21st century. The article attempts to determine the importance of the financial sector in the economy by making an index analysis.

In order to verify the research problem, the author compared results of the indicators defining the role of the financial sector in the economy. The following indicators were taken into account during the test:

- the ratio of the budget balance to GDP;
- the ratio of financial transaction assets to GDP;
- the ratio of employment in the financial sector to the total employment;
- the ratio of the household debt to the household income.

The ratio of the budget balance to GDP indicates that the euro area countries are willing to reach a negative level. This means that some budget expenditures are covered by the deficit. In turn, the deficit is financed from external sources. This is an opportunity for the development of the financial sector.

The ratio of financial transactions to GDP in most cases is around 20%. This means that assets derived from financial transactions constitute a significant part of the state's revenue. At the same time, they point to the important role of the financial sector in the economy.

The employment ratio in the financial sector to the employment in the entire economy ranges from 2% to 4% in many countries. This indicator was around 3% during the surveyed period in the entire euro area as well.. These results show that the financial sector has a significant share in employment in the entire economy.

The ratio of the household debt to the household income is usually below 100%. This means that households are willing to borrow. On the other hand, they do not indebt themselves above their revenues. The results of this indicator show that there are many instruments on the financial market that allow household loans. This indicates a well-developed financial sector.

The analysis allows concluding that euro area countries have well-developed financial sectors. On the other hand, the level of financialization is not visible in the majority of cases. Some of the surveyed countries tend to have a financialization process. The examples of such countries are Ireland, Cyprus, Greece and Luxembourg. In order to clearly determine the occurrence of financialization, an extended indicator analysis should be performed.

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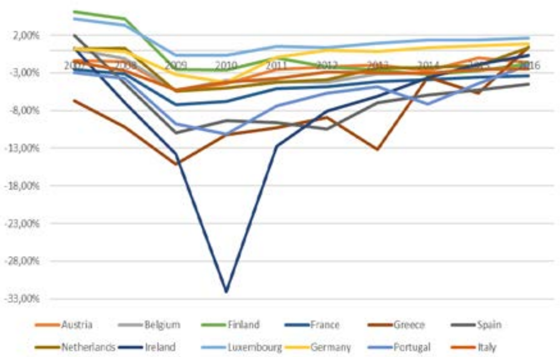
Primary Paper Section: A

Secondary Paper Section: H

Tables, figures

Chart 1. Ratio of the budget balance to GDP in the countries that joined the euro area in 2002 (in%).



Source: Prepared on the basis of Eurostat Database, ec.europa.eu/euros tat/data/database [access 26/12/2017].

Chart 2. Ratio of the budget balance to GDP in the countries that joined the euro area after 2002 (in%).

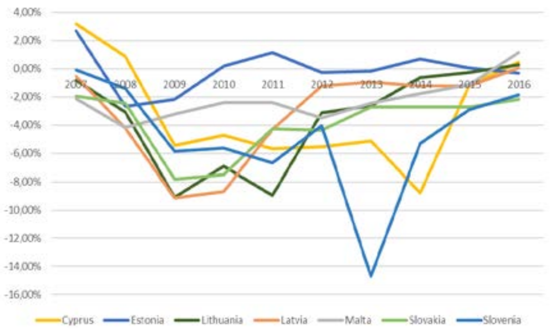


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Chart 3. Ratio of the budget balance to GDP in the countries in the euro area (19 countries) (in%).

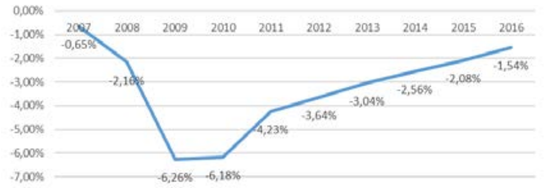

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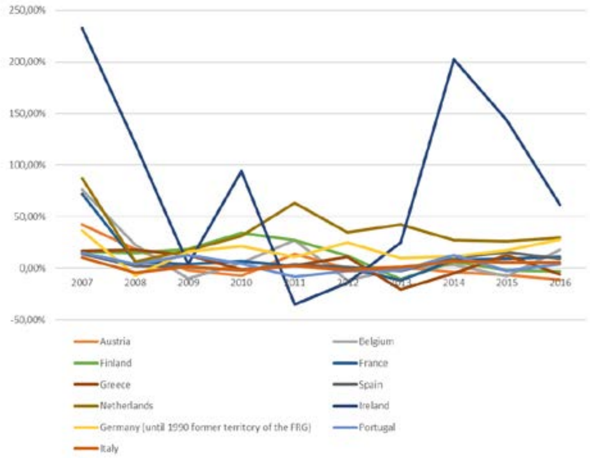
Chart 4. Ratio of financial transaction assets to GDP in countries that joined the euro area in 2002 (in %).



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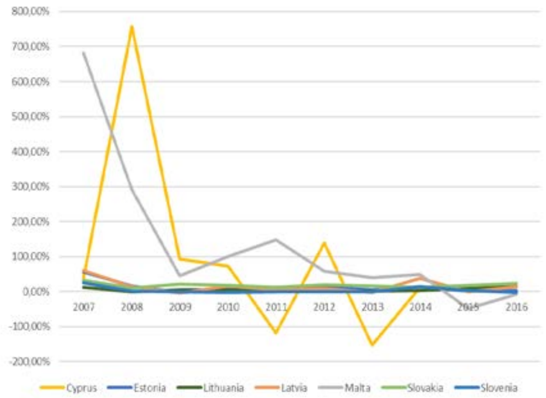

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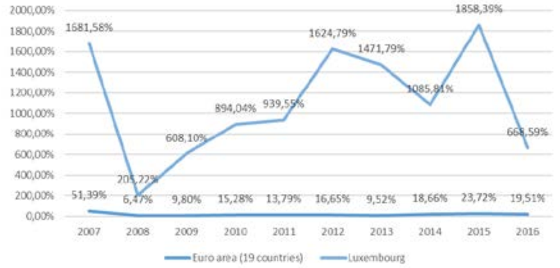
Chart 6. Ratio of financial transaction assets to GDP in the euro area (19 countries) and Luxembourg (in %).



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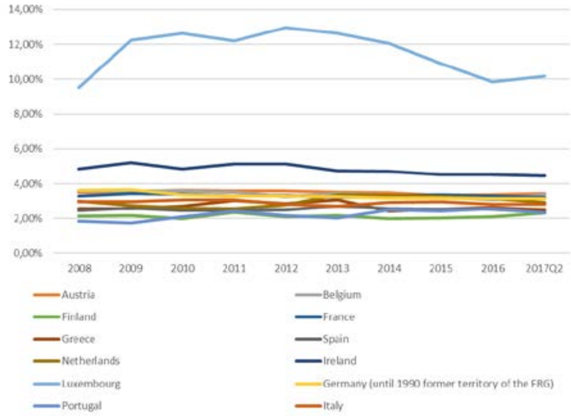

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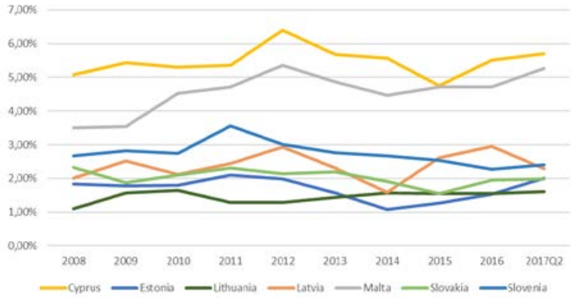

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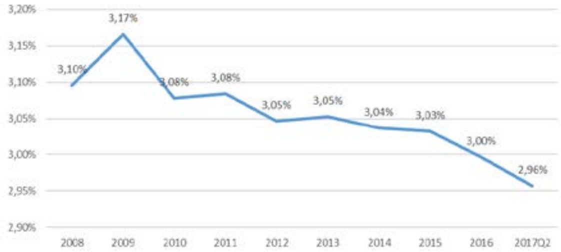

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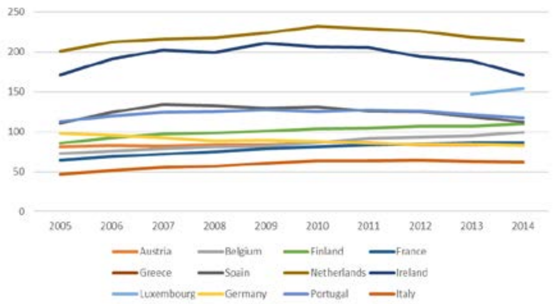

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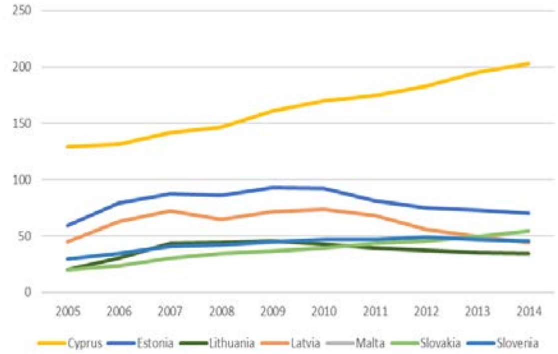

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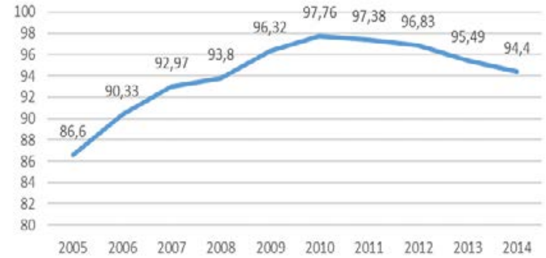

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