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Introduction: The Political Economy of Financialization

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The literature on financialization is less than a decade old.[1] Epstein (2005) contains some of the earliest papers presented at a 2001 conference and updated for publication. While a common definition of financialization has not emerged in the existing literature (Epstein 2005: 3) nor in the papers in this issue, clear tendencies have emerged. The most dominant trend has been to follow the lead of Hilferding (1981 [1910]) by contributing to what can be considered a sequel to *Finance Capital*. For the purposes of this introduction, I employ this concept of financialization as a process that alters the fundamental aspects of capitalist micro and macro dynamics.

Hilferding's class-based study of a new phase of capitalist accumulation associated with the concentration and centralization of capital and the rise to power of a class of finance capitalists provides a general framework that has proven useful for analyzing the resurgence of influence that finance capitalists and financial markets have over economic outcomes and policies in the neoliberal era.[2] This dominant portion of the political economy financialization literature,[3] on the macroeconomic level, explores the rise to power of financial capitalists and the impact of financialization on real capital accumulation, the production and distribution of surplus value, rising inequity, macro instability, economic crisis, and macro policy formation. Subtopics include a financial squeeze of industrial profits and a finance-led accumulation regime. On the micro level, changes in corporate governance and firm behavior have been considered, including how the "shareholder value movement" has impacted the firm.

Other avenues of exploration include assessing the macroeconomic impacts of financial institutions and financial innovation in an environment of deregulated and empowered financial institutions (D'Arista 2005; Dodd 2005; Parenteau 2005). Additionally, the shift in profit making from production paths to financial channels (Krippner 2005) and a

1. A search of the key word "financialization" on the EconLit database resulted in 79 papers with the earliest dating to the year 2000. Of the 79 papers, around 60 percent can be associated with the political economy literature of which 17 entries derive from the volume edited by Epstein (2005).

2. Despite Hilferding's Marx-inspired approach, I include other heterodox approaches to financialization that analyze similar issues as following in the tradition of Hilferding.

3. In addition to the papers in Epstein (2005), see Demir (2007), Crotty (2003, 2005), Orhanganzi (2008a, 2008b, 2009), Krippner (2005), Stockhammer (2004), and Goldstein (2008, 2009a, 2009b).

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reconceptualization of the methodological framework used to analyze financialization have both been at the core of alternative approaches.[4]

The five papers in this special issue make important contributions to this nacent and burgeoning literature.[5] The papers consist of three theoretical contributions and two applied papers in the form of case studies. Two of the theoretical papers (Dallery and Vasudevan) follow the dominant approach in the literature, while the third (Bryan, Martin, and Rafferty) re-conceptualizes Marxian categories to produce an alternative analysis of financialization. The applied papers analyze the virtues of an alternative mode of finance in the form of Islamic finance in Malaysia (El Gindi, Said, and Salevurakis) and the impact of financialization on the supply-chain of internationally traded coffee produced in Uganda and Tanzania (Newman).

Despite the diversity of subject matter in these papers, there are some common themes. Each paper considers the impact of financialization on alterations in social/power relations, the distributional consequences of such changes, and the macroeconomic implications of both for the stability/volatility of accumulation.

Without the dedicated and hard work of the other members of the editorial collective for this special issue – Dorene Isenberg, Ron Baiman, John McDermott, and Al Campbell – this volume would never have come to fruition. Their insightful guidance and constructive criticism has resulted in a series of papers that make important contributions to this growing literature.

The lead paper by Bryan, Martin, and Rafferty considers how financialization necessitates the re-conceptualization of Marxian categories/concepts, particularly a reconstituted understanding of class and class interactions.

The authors reconsider the role of labor as capital. In addition to labor power as variable capital, under financialization it is argued that the reproduction of labor is now a source of surplus value transfer in the form of interest payments. The "financialization of daily life," particularly credit as a condition of reproduction, designates labor as capital in a new financial light.

Additionally, the competition among capitals is argued to be intensified by financialization. New classes of financial instruments, such as securitization and derivatives, are seen as transcending the fixed/illiquid physical form of capital into fluid competitively driven capital. The determination of the relative value of physical assets by the markets for these financial instruments dramatically increases competitive pressures on firms to maintain their relative valuation.

The implications of increased competition among industrial capitalists emanating in the financial sector is an intensification of the capital-labor conflict over the extraction of relative surplus value. In particular, it acts as a new source of the competitively driven intensification of labor. Thus, along with limits to the working day and rising real wages as the reserve army of unemployed shrinks, the authors add a new motivation for the production of relative surplus value derived from the pressure that markets place on the firm to maintain its market value.

4. This last approach has only recently emerged. The paper by Bryan, Martin, and Rafferty in this issue is an example. Additionally, Lysandrou (2008) and Teixeira and Rotta (2009) develop alternative conceptions.

5. The papers in this issue do not address the current global financial crisis which is only one aspect of the process of financialization. The call for and submission of papers for this issue preceded the onset of the crisis. For a summary of heterodox analyses of the crisis, see the review essay by Goldstein in this issue.

The paper by Vasudevan provides a historical overview of international monetary arrangements using Marx's theory of money, particularly his concept of world money, as an organizing principle. The author analyzes monetary systems from the gold standard to the current floating dollar standard with an emphasis on how constraints on world reserves are overcome by the financialization of foreign exchange markets.

The very mechanisms that overcome these external constraints – in general fictitious capital/credit money as a world money and the various forms that it has taken as a result of financial innovation – are viewed as extending the power of core imperialist powers over the periphery and in contradictory fashion facilitating the export of financial fragility, debt deflation, and financial crises to the periphery.

Dallery presents a post-Keynesian theory of the firm's investment/accumulation decision under the influence of financialization. The microfoundation developed extends the traditional post-Keynesian theory of investment developed by Robinson (1962), Wood (1975), and Eichner (1973). In that approach, the internal financing of investment plays a critical role in the determination of the pace of accumulation. Dallery uses the extension of this post-Keynesian framework by Stockhammer (2004) that considers financialization as a jumping-off point for his own alternative incorporation of financialization. While Stockhammer considers a tradeoff between the growth and profit rate objectives of the firm as a clash between the respective interests of managers and stockholders, Dallery models the influence of stockholders differently.

Dallery considers two approaches. The first models financialization as a constraint for the managerial firm, while the second consideres a finance-dominated firm by integrating shareholder interests as the objective of the firm. Dallery concludes that the behavior of the post-Keynesian firm under financialization results in a reduced rate of accumulation, increases in financial fragility, and the potential for macro instability.

The paper by El Gindi, Said, and Salevurakis explores an alternative to the current capitalist mode of finance in the form of Islamic finance. The authors conceptually distinguish Islamic finance from Western finance as a more desirable mode of finance and then conduct a case study of the mixed banking system in Malaysia, using conventional measures of bank performance to compare the relative success of the two modes of finance.

On the conceptual level, the emphasis placed on profit-loss sharing (equity) finance over debt financing and the non-speculative nature of the latter results in greater microeconomic stability. This stability further results from a reduction in individual and social conflicts through partnerships, returns based on actual profits rather than rents extracted on the basis of potential returns, a reduction in uncertainty, and more egalitarian access to financial markets. In theory, these attributes of Islamic finance should increase the stability of financial institutions, while restricting potential macro excesses in the form of financial crises and bubbles.

The authors support the micro stability argument via their case study that concludes that Islamic banking operations can be expected to outperform Western ones. This conclusion is reached on the basis of statistically significant differences between the variance and mean of conventional and Islamic banking operations for profitability, liquidity, and asset quality indicators in Malaysian banking operations.

On the macro level, the authors argue that the Islamic mode of finance is likely to result in more stability, more growth, and a more equitable distribution of income. These outcomes result from less speculative activity, more accurate pricing of assets, a longer term perspective, and less barriers to financial access. Given that modes of Islamic finance are typically intermingled with Western methods in a single macroeconomy, these macro claims remain speculative in nature.

The paper by Newman considers the financialization of the world commodity market for coffee. Newman examines how neoliberal structural changes, particularly structural adjustment programs and financial liberalization, in international coffee markets altered the social relations of coffee production, marketing, and trading and the accumulation process in coffee production. In particular, the replacement of multi-lateral trade/price agreements at the country level with individual agent (market-based) price-risk management (PRM) strategies, advocated by proponents of liberalization, resulted in increased price volatility and the further consolidation of the power of already concentrated components of the supply chain. Newman analyzes the distributional impacts of these structural changes on different actors in the supply chain and the effects on the accumulation process both conceptually and with the aid of two country case studies for Uganda and Tanzania.

She carefully develops the social relations of the coffee supply chain and the PRM strategies in the form of hedging on derivatives markets and fixed-price-forward contracts. She concludes that the uneven access of particular groups to futures markets and other PRM strategies, particularly smaller, less organized factions of the supply chain – smaller traders and small producing country middlemen and farmers – are impacted negatively by the structural changes analyzed. In particular, a greater divergence emerges in incomes earned by chain actors at opposite ends of the chain: "favoring international actors and causing downward pressure on real accumulation at the producer level." Not only is agricultural accumulation limited by growing income disparities, but the ability of concentrated actors to speculate on derivate markets allows fictitious capital to further replace real capital accumulation.

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