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***REDESIGNING FINANCE TOWARDS JOB-CREATING LONG-TERM DEVELOPMENT: SOME REGULATORY ROOTS***

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*(Must be quoted as a first draft)*

**Abstract:**

Financial development is usually assumed to play a key role in the evolution of modern capitalism. A substantial strand of the academic literature, referring to Schumpeterian Creative Destruction, points out this role in the process of technology-based growth and puts the emphasis on the contribution of new financial techniques and products to the funding of global mergers but also to the financing of small enterprises and start-ups in innovative sectors. It is argued that growth-enhancing financial development might rely on liberalised and more competitive financial markets that could generate efficient devices to fund productive activities by improving regulatory-repression-free financial innovations. The second “race to reach the moon”, e.g. a new accumulation regime, mainly resting on speculation-based and finance-led growth, is therefore launched on the rule of state-supported free-market self-regulation. This new regime is also a new deindustrialisation process as it provokes an expansive financialisation of the entire economy at the expense of long-term productive activities fuelling systemic crises and resulting in a sharp increase in unemployment since the 1980’s. To date, the balance of this regime seems negative as the stabilisation policies, implemented in the aftermath of the 2007-08 crisis, failed to mitigate cumulated disequilibria and to give markets relevant incentives to generate productive activities able to prevent persistent unemployment. In light of such balance, it seems to be suitable to imagine a reindustrialisation process throughout the definancialisation of economies by redesigning regulatory rules to make financial markets and institutions able to support job-creating real growth.

**Keywords:** Financialisation and deindustrialisation, financial development and instability, financial regulation, institutional design of financial markets

**JEL Classification Codes:** B52, G18, G20, O16

**Related EAEPE research areas:**

[G] Macroeconomic Regulation and Institutions

[J] Monetary Economics, Finance and Financial Institutions

## **I. Introduction**

It is usually assumed that finance and financial markets play a key role in the evolution of modern capitalism. Their development, considered as an outcome of the working of efficient free markets and private actors, is then stated as a necessary condition for economic growth and development. The supposed causality from finance to growth mainly rests on the hypothesis that free market price mechanisms have the full capacity to make economy work efficiently through the encounter between supply and demand in order to set equilibrium prices at lower transaction costs and lead to most efficient use of scarce resources, including the financial needs of productive activities. It is then expected that if financial repression is moved out - thanks to financial liberalisation process and policies -, the working of financial markets should allow every efficient (and then growth generating) economic activity to be realised and then to enhance the society's welfare. This happy picture should also be improved thanks to financial innovations that should be generated under the incentives of new competition due to the liberalisation process in financial and bank markets. A substantial strand of the academic literature, referring to Schumpeterian Creative Destruction, points out this role in the process of technology-based growth.

Theoretical development and political implementation of such assertions led in last decades to the development of hi-tech markets that was accompanied by worldwide mergers financed by syndicated loans and LBOs and gave rise to concentrated industries while new techniques to fund small enterprises and start-ups gained ground. It is maintained that such operations, assumed to feed growth, might rely in liberalised financial markets that could generate efficient devices to fund productive activities by improving regulatory-repression-free financial innovations. The second "race to reach the moon", e.g. a new accumulation regime, mainly founded upon speculation-based financial growth, is therefore launched. In this direction, most emerging economies experienced several crises in the 1990s while hi-tech and mortgage bubbles fuelled systemic crises in advanced economies in the 2000s and resulted in a sharp increase in unemployment. To date, the balance of this regime seems negative as expanding

finance is related to poorly performing production and the stabilization policies, implemented in the aftermath of the 2007-08 crisis, failed to mitigate cumulated disequilibria and to give markets relevant incentives to generate productive activities able to prevent persistent unemployment. In order to deal with this issue this paper seeks to show that the ongoing 2007-20?? crisis is a result of a new institutional accumulation regime (financialisation, finance-dominated) which is a new process of deindustrialisation in the last decades, moving from productive real economy related profit accumulation into speculative financial rent generating operations. It is then maintained that the necessary definancialisation for a reindustrialisation calls for alternative policies that must aim at preventing finance-led markets domination over the whole economy and redesigning financial structures, institutions and regulatory framework able to support job-creating time-consistent growth. Therefore it seems that one of the required conditions for the sustainability of accumulation regime lies in the reframing of financial activities and markets according to alternative regulatory rules able to give private actors strong incentives to undertake long-term productive activities and to reduce speculative pressures on economic decisions and strategies.

In this aim the paper is organised as follows. The second section summarises the arguments about the finance-growth nexus to underline links between banks/financial system and the financing of productive activities. It then shows that from the 1970s-1980s advanced countries have witnessed a strong financial liberalisation process that transformed those economies into financialised structures at the expense of industrial activities. Debt-led rent-seeking activities created old but renewed speculative rent sectors (real estate), tax structures have been modified to give bad incentives (low capital taxation) to the use of capital and bank credit, replacing productive-long term activities and gains. The third section states that this evolution resulted in a new finance-led accumulation regime implying job-destructive deindustrialisation process where service sector domination is transformed into deindustrialisation through financialisation-rentierisation. The last section then maintains that subsequent and successive crises seem to point to the fact that financialisation is not the

panacea for growth. In this line, the crucial question asked is: how long before sustainable long-term financing mechanisms and supportive regulatory rules can be designed and implemented as a consistent growth framework?

## II. Financial development, liberalisation and finance-growth nexus

A substantial strand of the academic literature maintains that financial development and deepening would favour productivity and growth in general and industrialization in particular<sup>1</sup> because of the multiple functions that finance/financial system performs in the process of economic development and growth: mobilization of savings and their efficient allocation to productive uses, facilitating (and reducing the costs of) transactions, improving risk management and corporate control, etc. Barajas et al. (2012), in a comprehensive survey on those arguments state that: “Through these functions, a country providing an environment conducive to greater financial development would have higher growth rates, with much of the effect coming through greater productivity rather than a higher overall rate of investment”.

These assertions underline the importance of the development of financial markets in the growth process. As it is stated in Ülgen (2013a) the financial development (*financial deepening*) is defined through the *breadth* (broad markets with wide transactions, numerous actors), the *depth* (deep markets with wide range of products) and the *liquidity* (liquid markets without restriction on financial transactions) of financial markets. Such a development is assumed to spur growth throughout its effects on the real economy either on the supply side (supply-push) increasing and improving availability of finance for the real economy, on the demand side (demand-pull process) designing new financial tools in accordance with the demand of entrepreneurs who need further specific finance.

Dorrucci et al. (2009: 19) maintain that: "A domestic financial market is developed when it consists of complete markets where: (i) an equilibrium price is determined for every asset in every state of the world; (ii) assets are available

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<sup>1</sup> For a comprehensive synthesis of such an assertion, see Hartmann et al. 2007.

that protect against adverse shocks and (iii) other important features supplement completeness, such as transparency reducing asymmetric information problems, competition and the rule of law". Related to the aforementioned view, it is also stated that: "Domestic financial development is the capability of one country to channel savings into investment efficiently and effectively within its own borders owing to (i) the quality of its institutional and regulatory framework, (ii) the size of its financial markets, the diversity of its financial instruments and private agents' ease of access to them and (iii) the financial markets' performance, e.g. in terms of efficiency and liquidity" (Ibid.). This definition gives the common ground of standardized approaches in the studies on the finance-growth-development nexus that assume that the efficiency of a financial system is positively influenced by financial development. This latter –also called financial modernization– refers to “the process of financial innovation as well as institutional and organizational improvements in a financial system that reduce asymmetric information, increase the completeness of markets, add possibilities for agents to engage in financial transactions through (...) contracts, reduce transaction costs and increase competition” (Hartmann et al., 2007: 5).

In the literature quoted above, financial development is usually related to the liberalisation process. Following the well known works of Goldsmith, McKinnon and Shaw in the 1960s/70s, it is asserted that liberalized finance would improve the competitive incentives leading to innovations and then allowing banks to provide more efficient financial services (Levine, 2005). Consequently, more competition and opened markets would foster growth and improve economic stability, at least in the long run.

Therefore, one can draw from this approach the following critical assertions:

- 1) The financial development does mean financial liberalisation since it is assumed to rest on the opening of capital account (Chinn and Ito, 2005);
- 2) There is a positive (and sometimes causal) relation between financial development and economic growth. Klein and Olivei (1999) maintain that capital account liberalisation can accelerate economic growth throughout financial development and intensification of competition and importation of efficient

financial services from abroad. Bekaert et al. (2005) then argue that liberalised capital account does directly and instantaneously spur economic growth. La Porta et al. (2002) explore the effect of state ownership of the banking sector in economic growth and show that state ownership and control of banks in the 1960s/1970s is associated with slower subsequent growth since it is assumed that the publicly owned/controlled banks prevent the development of financial markets and then hamper the reallocation of capital (Hartmann et al, 2007).

Papaioannou (2007, p. 13) remarks that those works are supportive to political public-choice theories of state control: “according to which state intervention to credit leads to resource misallocation. Their results contradict "development" theories of state ownership that emphasize the positive effect that government can have in banking, for example by mitigating negative externalities, encouraging risk-taking investment, financing strategic sectors, etc.”

It is worth noting that works on the finance-growth nexus claim to take place in a Schumpeterian perspective as Schumpeter argued that the services provided by financial intermediaries (mobilizing savings, evaluating projects, facilitating transactions, etc.) are essential for technological innovation and economic development as a monetary complement of the growth process (for a critical analysis of such an assertion see Ülgen, 2013a). King and Levine (1993) state that Schumpeter might have been right about the importance of finance for economic development as financial services would stimulate economic growth by increasing the rate of capital accumulation and by improving the allocative efficiency of markets<sup>2</sup>.

In this vein, recent evolution of markets has been encouraged by the conviction that deregulated markets can self-work at equilibrium without prudential regulatory mechanisms since it was assumed that free financial markets should minimise the possibility of financial crises and the need for government bailouts. Therefore, more decentralised and private control practices

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<sup>2</sup> Trew (2007) offers a critical analysis on the finance-growth nexus from a long-run historical and theoretical perspective, putting the emphasis on the interrelations between scale, finance and infrastructural development.

– the so-called micro-prudential mechanisms – are substituted for macro-prudential public supervision rules. The light-touch regulation of financial institutions and markets allowed banks to manage their risks through their own internal models and through ratings they purchase on the securities they issue.

Greenspan (1997) maintains that detailed rules and standards have become both burdensome and ineffective, if not counterproductive. He then asserts that the main regulatory rule must be to assure that effective risk management systems are in place in the private sector in order to foster financial innovation without imposing rules that inhibit it. In the same vein, Beck et al. (2006) argue that regulatory policies that restrict entry and banks' activities are negatively associated with bank stability and that banking systems with more restrictions on banks' activities and barriers to bank entry are more likely to suffer systemic banking distress. Van Hoose (2010) presents also some pitfalls of highly regulated banking systems.

Such a theoretical and policy perspective is at the core of deregulatory policies that have been implemented since the late 1970s. Regulatory and technological barriers among different types of intermediaries have tumbled while new financial instruments and practices have proliferated. This new financial environment would support the Schumpeterian vision of creative destruction process by which innovations replace old methods and goods with better process, commodities, and services.

Structural changes occurred from the 1970-80s, along with financial innovations supported by supervisory agencies and legislators, helped modify the traditional banking business model. The change came on both the liability side of bank balance sheets (for instance, through money market mutual funds), and on the asset side, with the growth of public capital markets, and led to several large, complex and highly leveraged financial companies. The financial engineering on securitization and associated derivative instruments accompanied this evolution and changed the character of the financial sector. Obviously, banks' innovations change the economic conditions as much as the entrepreneurial innovations. They affect the functioning of economic engine because they modify the monetary and financial conditions on which the whole economic structure is founded. Most

of the recent monetary and financial innovations seem to increase the elasticity of finance. However, in view of the current financial disequilibria faced by numerous economies in the world, such financial innovation dynamics present a real challenge to the systemic stability.

The question is: does financial development/financial deepening that one can also name today as financialisation (as it is assumed to be related to the openness and liberalization of markets in order to allow free market-price mechanism to play their “natural equilibrating” role on the path of higher efficiency) lead obviously to better financing conditions of efficient economic activities and then to economic growth. The answer of this paper is no since the evolution of modern capitalism brought to the fore a new unsustainable accumulation regime generating expansive deindustrialisation in favour of expansive financialisation. The alternative suggested consists in reframing financial markets and institutions according to some collectively consistent rules aiming at attaining a desired level of productive activities able to give more stable employment and sustainable long term growth directed towards economic and social development.

### **III. Financialisation: new deindustrialisation pattern as a new accumulation regime**

Deindustrialisation can usually be defined as the relative decline of the share of industrial activities in total output and employment, replaced by service activities even if in most modern economies industrial activities are in strong interdependence (accompanied, strengthened, reframed, etc.) with service activities. However, the decline of industries, the deindustrialisation phenomenon can be thought as a major concern in the evolution of economies when a growing and persistent unemployment and output decline are observed. That means that the deindustrialisation is studied as a major economic concern when the service sectors are not able to generate employment and growth to compensate the structural transformation of modern economies in their transition from agricultural to industrial and from industrial to service activities dominated societies. This kind of concern becomes more worrisome faced with

institutional changes in domestic economies and changes in international economic relations.

In the theoretical framework of deindustrialisation (Rowthorn and Wells, 1987; Maroto-Sanchez, 2010, to quote but a few) two types of de-industrialization can be considered: the positive deindustrialisation – due to productivity growth differentials between the manufacturing industry and the service industry such that higher productivity growth in the manufacturing industry generates a shift of employment into to the service industry -, and the negative deindustrialisation –due to the recession in the manufacturing industry that make (only) part of unemployment move from the manufacturing into the service industry.

Studies on the deindustrialisation-reindustrialisation phenomenon in advanced economies enjoy renewed interest in the aftermath of the 2007-2008 crisis and in the wake of subsequent worldwide recession that fuels persistent unemployment in most developed economies (Tregenna, 2011). Parallel to this, issues related to the links between finance and financing conditions of innovative productive activities come again into the picture in the aim of studying the recurrent debate on the finance-growth nexus (Mina et al. 2012) and on financing constraints and frictions in the credit markets which might preclude high-quality productive entrepreneurial plans (Kerr and Manda, 2009; Ülgen, 2013b).

Transformations of institutional forms and of growth regime may be studied in terms of institutional regime of accumulation (O'Hara, 2012) or through the social structure of accumulation theory (SSA) as Kotz (2008) maintains that the particular institutional form of capitalism has changed periodically since capitalism emerged several centuries ago. Modern capitalism, i.e. neoliberalism can be understood as the latest institutional form of capitalism. The SSA suggests then an analysis of coherent long-lasting capitalist institutional structure that promotes profit-making and forms a framework for capital accumulation<sup>3</sup>.

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<sup>3</sup> Kotz (2008) maintains that Hilferding's finance capital and current financialisation are distinct phenomena as the former lies in a relationship between financial and industrial capital, with the banks serving as coordinating centers for financial groups In an ordered environment to prevent excessive competition and speculative fervors of decentralized actors in markets. The financialisation is the process that allows operators to seek purely financial and short-term

From the same perspective, the theory of regulation (Boyer and Saillard, 2002) can be used to apprehend the deindustrialisation of the 1990-2000s that lies in a structural change of regime of accumulation of capitalist (and related peripheral) economies. As synthesised by Tahara and Uemura (2013), in a Fordist schema of accumulation, productivity gains are distributed into wages and profits. Profit increase positively affects the expected investment since there is a cumulative causality between the profit rate and the accumulation rate. Parallel to the profit side, an increase in wages reads to more consumption demand that will increase the capacity utilisation in the manufacturing industry. If the increase of consumption is sustained at the long-run, that will improve the long-run expected return of investment that would lead to a continuous increase in investment generating an accelerator effect. In this schema, two different patterns of growth can determine the path of evolution. The profit-led growth dominates if investment is highly sensitive to profits and the wage-led growth holds when investment is sensitive to demand expansion. These linkages mainly based on the links between productivity gain and demand formation give a specific accumulation regime called the demand regime. As stated by Petit (1986) in the deindustrialisation process, contrary to the strong cumulative causation between output growth and productivity growth in the manufacturing industry, the cumulative causation is relatively weak in the service industry. Therefore, if the service industry expands with a long-term shift of demand from the manufacturing industry to the service industry, the cumulative causation may become weaker in the economy as a whole<sup>4</sup>.

However, in the financialisation-led deindustrialisation we do not deal with the traditional manufacturing-service arbitraging schema as it is studied in Rowthorn and Coutts (2004) where deindustrialisation is explained primarily by the internal evolution process of capitalist economies as a secular phenomenon of decline in the share of manufacturing in national employment as it was the case when economic development got under way, the share of agriculture in national

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profits independent from the evolution of productive activities and usually generates a separation of finance from non financial activities.

<sup>4</sup> For a comprehensive discussion about the links between services and growth, see Maroto-Sanchez, 2010.

employment felt in favour of the employment in manufacturing in the process of industrialisation. In their study of the transformation of the growth regime in Japan in the 1990s, Tahara and Uemura (2013) maintain that structural changes were caused by institutional changes in both the financial system and wage-labor nexus without the re-establishment of the mode of *regulation*: “In this situation, de-industrialization has been accelerated with institutional changes ...”. Eckhard (2011) then argue that finance-dominated capitalism modified the redistribution schema at the expense of the labour income share that increased inequality in household income and worsened the growth conditions: “Given that aggregate demand and capital accumulation, and hence growth, in most of the economies examined here have found to be wage-led in recent empirical research, this should have had a depressing effect on economic performance”. This weak performance of lower income and real investment (“decoupling of profits and investment” (Guttmann, 2008)) was compensated by the financialisation of aggregate demand and growth partly founded on increases in household debt ratios that coincided with property bubbles (Stockhammer, 2010). Thus it appears that for the past decade (in the aftermath of the dotcom crash of the early 2000s), the U.S. economy growth has been driven by a real estate bubble that continued to fuel the financialisation process and financial gains, started in the late 1970s. Hudson (2010) notes that “mortgages account for 70 percent of the U.S. economy’s interest payments, reflecting the fact that real estate is the financial system’s major customer”. Economic evolution was then such that the entire U.S. economy, and in its lap, all the world economy, had become a real estate agency completely buried in speculative positions.

In the financialisation process, the accumulation regime is founded on the expectations that sustain economic engagements. These expectations rest on speculative positions mainly related to the likelihood of short-term high rents whatever the industrial-productive linkages behind the process. As the increase in investment is mainly in the financial sector or in some related speculative activities (as the home industry in the pre-crisis period), there is no necessarily causality from the increase in investment to an increase in industrial productivity which would rest on the introduction of new capital equipments and

the scrapping of old ones as in the case of Schumpeterian entrepreneurial innovations. Furthermore, the sense of the cumulative causation is different since the ripple effects of changes in the economy may be such that new things in the finance area (financial innovations) will cause a cascade of other changes that will not necessarily be positive for the system's long-run stability. The financialisation process of capitalism then reduces the attractiveness of traditional productive activities resting on medium/long term financial and organisational engagements and substitutes the industrial and wage stagnation to employment based growth, finance replacing production and rent-seeking replacing long-term profit expectations.

Lapavitsas (2011: 622-623) argues that financialisation is a systemic transformation of mature capitalist economies with three distinguishing features that change the sources of capitalist accumulation: "First, relations between large non-financial corporations and banks have been altered as the former have come to rely heavily on internal finance, while seeking external finance in open markets. Large corporations have acquired independent financial skills – they have become financialised. Second, banks have consequently transformed themselves. Specifically, banks have turned toward mediating transactions in open markets, thus earning fees, commissions and trading profits. They have also turned toward individuals in terms of lending and handling financial assets. The transformation of banks has relied on technological development, which has encouraged 'hard' as opposed to 'soft' practices of risk management. Third, workers have become increasingly involved with the financial system both with regard to borrowing and to holding financial assets. The retreat of public provision in housing, health, education, pensions and so on has facilitated the financialisation of individual income, as have stagnant real wages. The result has been the extraction of bank profits through direct transfers of personal revenue, a process called financial expropriation".

Stockhammer (2010) remarks that financialisation is one of the key components of a broader societal shift in social and economic relations from a Fordist accumulation regime to a new (neoliberal) regime where the increasing role of finance is a remarkable evolution: activity on financial markets has

increased faster than real activity; financial profits make up an increasing share of total profits, and households as well as the financial sector are taking on a lot more debt. Stockhammer then notes that according to data for the USA, from the late 1990s, stock market capitalization exceeds GDP with a spectacular turnover (383% in 2008), the share of financial profits and profits from abroad to total corporate profits has risen from just above 12% in 1948 to a peak at 53% in 2001. Palley (2007) remarks that: “The last two decades have been marked by rapidly rising household debt-income ratios and corporate debt-equity ratios. These developments explain both the system’s growth and increasing fragility, but they also indicate unsustainability because debt constraints must eventually bite. The risk is when this happens the economy could be vulnerable to debt-deflation and prolonged recession”. In the same way, in the late 1970’s bank assets were about 100% of British GDP while at the end of the 2010’s, they reached 500% of GDP and more than 2/3 of profits accrued to the financial sector (Bayer, 2009). But as O’Hara (2012: 7) states it speculation-based growth is not a “covered growth”, i.e. growth sustained long enough to provide funds and for potential resources including debt and the financing of debt burden, to sustain profit rate and government surpluses.

It is also worth noting that governance and management structures change with the financialisation process. Woolley and Vayanos (2012: 59) then argue that value managers are replaced by growth managers as the technology bubble inflated in 1999- 2000 and “once mispricing gets into the system, investors are tempted to ride the trends for short-term advantage instead of investing patiently on the basis of underlying worth”.

Following Araújo, Bruno and Pimentel (2012), one can consider the formation and the organisation into a hierarchy of institutional forms that determine the realisation domain of an accumulation regime *à la* theory of regulation (see Boyer and Saillard, 2002): It is assumed that an institutional form is superior to another when it can impose restrictions on the structural configuration of the latter. That means, for instance, that when the public power implement liberalisation policies and sustains market freedom of private actors, the economic policies are therefore submitted to the interests of market actors,

those interests being assumed to give the entire economy an efficient operating way. Thus, an institutional form will be considered superior in the hierarchy to another if its development implies a transformation of this second form. In the finance-dominated regime, manufacturing activities become dominated by financial aims and tools as the short-term horizon of speculative rent decides of the best way of governance of enterprises and direct financial mechanisms toward immediate gain potentials without worrying about the needs of long-term production plans. Therefore the development and the dominance of financialised accumulation regime come into conflict with the characteristics (needs, conditions and consistent means) of industrial development and sustainable economic growth.

#### **IV. Bad performance and regulatory consistency for a stable capitalism**

Davidson (2002: 104-105) states that financial markets are a double-edged sword for the real economy. The good edge lies in the fact that financial markets makes real investments appear to be liquid for individual savers: “The result is that very large investment projects –projects often too large to be funded by any single individual or small group of partners – can be funded by pooling the small sums of many savers. As long as financial markets are orderly, financial asset holders believe they have a readily available *fast exit strategy* for liquidating their ‘investment’ the moment they become dissatisfied with the way matters are developing. Without the liquidity provided by orderly markets, fast exits, even if they were possible, would involve very large costs and therefore the ‘risk of making an investment as a minority owner would be intolerable’. In the absence of liquid financial markets, the small sums of many savers could not be readily pooled and mobilized to fund the accumulation of large capital-using projects. The bad edge is that the existence of financial markets makes investments that are fixed for the community only appear to be liquid for the individual. The fast exit strategy that calms all financial asset holders’ fears of the uncertain future is available to all only as long as the vast majority of these people do not simultaneously try to execute this strategy. When fear of the uncertain future is rampant, many holders of financial assets may simultaneously rush for the exit.

The result is a market liquidity crisis. The resulting market crash adds to the instability of the real economy”.

In the liberal area of the last four decades, the dominant wisdom was that free and open markets would be able to self-adjust in case of disequilibria as it is case in the neoclassical/new classical models of competitive economic equilibrium. However, recurrent emerging and transition markets’ crises of the 1980s-1990s and the central economies’ crashes of the 2000s cast doubt on the relevance of such assertions. Boyer (2000) then asks if a finance-led growth regime can be a viable alternative to Fordism. He states that the viability of a finance-led growth regime rests on a consistent monetary and financial policy able to maintain the new system in a stable path against all odds. New financial norms, such as shareholder value, new distribution rules such as financial-rent seeking mode of governance of firms, increased flexibility and system wide liberalization in labour market and wage-labour nexus become dominant and underlie a structural shift from manufacturing to services. The 2000s dotcom bubble crisis and the last 2007-08 financial crisis are both related to this transformation of capitalist growth regime and to the weaknesses of its new regulation principles.

Goodhart (2010) remarks that in the course of the years 1998-2006, central banks interventions strongly anchored on the price stability without paying due attention to their other major core purpose, of maintaining financial stability. Epstein (2002) also offers a critical analysis of such a policy orientation in a financialised environment. From this perspective, the problem was not a lack of foresight about dangers of the massive credit expansion and housing bubble, but a lack of instruments to content it mainly because of a lack of willingness to design and to use preventive rules and tools against markets’ failures. The blind ideological faith was much stronger than the scientific logic about the potential of malfunctioning of decentralised and deregulated markets and micro-decision units.

So, it seems that, although the forerunner signs of an increase of the potential systematic risk became perceptible (through the increase of the amounts marketed and the number and the nature of participants in these markets unable to bear the constraints of a rapid self-adjustment), regulation

schemas remained rested on the principles of self-regulation. A contradiction results from this because the dominant regulatory system leaves the care of correcting the possible failures of market mechanisms to the market mechanisms themselves! The efficiency of such a mode of regulation is extremely reduced because of the limits of decentralized self-evaluation models coming from the absence of long-term macroeconomic vision and the lack of consideration of the interconnectedness among private actors (Ülgen, 2011). The deep interconnectedness among market actors and operations has a macroeconomic character and must be treated as such (at a macro level) while the mechanisms of self-regulation, based on individual evaluation, cannot include, by definition, tools and ways of systemic macro-regulation.

While the regulation is based on a separation between regulators and regulated, the self-regulation admits the coincidence between both. However, as the self-regulation is more intended to protect the interests of regulated establishments in its own logic, the whole regulatory system is put out of the domain of systemic stability. The adoption of international accounting standards, the participation of private rating agencies to the accountability and the compliance (conformity of the operations with the standards) are rules of the art in this new structure.

US Securities and Exchange Commission (2003) already questioned the risks inherent to the current mechanisms further to the scandals of Enron and WorldCom and underlined conflicts of interests and exclusively micro-prudent nature of self-evaluations (Securities and Exchange Commission, 2003). Sy (2009) and Cantor and Mann (2009) show that the principle of self-regulation, through the private rating agencies involved themselves in the market activities of banks, generates a pro-cyclical movement by feeding the financial growth during the periods of boom and by abruptly stopping the evolution of asset prices during the periods of distress. They do not play a stabilizing role against the swelling of the systemic bubbles. However, analyzing the stability concerns of financial markets' evolution the European Commission stated, in 2006, that a suitable equilibrium has been reached between the market legislation and the self-regulatory system without necessitating further macro regulatory rules (Journal officiel, 2006).

Does not it a kind of self-agreement without any objective relevance? In that respect, the supervision authorities played a very risky game and they lost their bet with the arrival of the crisis of 2007-08!

The usual models of risk and crisis which are the formal references of the dominant regulatory schema do not take into account the interconnectedness among actors' decisions on markets (these decisions are assumed to follow a Gaussian normal distribution). Therefore they do confuse micro-prudential regulation with macro-prudential regulation and then fall in the fallacy of composition (incompatibility between micro-rational behavior and macro-consistency). The micro-prudential regulation is about variables which concern directly individual risks of establishments whereas the macro-prudential regulation considers the factors which affect the stability of the financial system in the whole. A critical component of the macro-prudential regulation is to understand the mechanisms capable of counterbalancing the effects of the reduction in the risk perceived by markets in period of expansion and those of the increase of the risk in period of contraction. The basis of macro-prudential regulation is that financial actors who can follow individually careful strategies, can collectively generate systemic concerns. Private actors as well as their regulators try to adopt behaviour consistent with the aim to extend the period of expansion on short-term speculative positions. A "macular degeneration" then settles down by making actors unable to consider the evolution beyond the peripheral opportunities they immediately expect. Dominating the behaviour and expectations of agents in time, this degeneration is transformed into *blindness to the disaster* (Orléan, 2009).

Minsky's most fundamental hypothesis about capitalism, which seems to be relevant in the capitalist evolution, is the statement that "Legitimate or not as "Keynesian doctrine", the financial instability hypothesis fits the world in which we now live. In a world with sharp turnabouts in income, such as that experienced in 1974-75, the rise and fall of interest rates, and the epidemic of financial restructuring, bailouts, and outright bankruptcy, there is no need to present detailed data to show that a theory which takes financial instability as an essential attribute of the economy is needed and is relevant" (Minsky, 1982:

69). A possible reindustrialisation process cannot ignore the necessary transformation of liberalised financial markets into more stable mechanisms and tools of financing of productive activities, able to create sustainable employment at the expense of unsustainable speculative profits that are usually disconnected from the real time horizon of economies. But to do this, we must think about financial regulation in macroprudential terms by admitting that the system is endogenously instable and go beyond the sole analysis of incentives the supervision authorities must give banks to take and manage risks (in particular, the moral hazard implications of existing deposit insurance rules).

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