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Macroeconomic Lessons from the Financialisation Process

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1 Introduction[1]

Although the financialisation process can be considered a historical and structural phenomenon, mainly in the most developed economies, it is true that in the more recent decades, mainly since the 1990s, it has suffered an unparalleled increase. This is due to the policies of domestic and international liberalisation and deregulation of financial markets. In this sense, a rising number of contributions argue, as we argue below, that the rising size of finance is the main cause of the financial and economic crises that emerged in the world economy, mainly in the developed economies, since 2007. This contribution, which is mainly based on the research carried out along the FESSUD research project, tries to collect, with the obvious limitation of space, the main macroeconomic lessons that can be extracted from the macroeconomic consequences generated

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by the financialisation process in most developed and emerging market economies, with a special focus on the case of European economies.

This chapter is structured into three main sections. The first section will focus on the definition of the financialisation processes. The second section will focus on the consequences of the financialisation process on economic activity in general and on the activity carried out by particular sectors and agents. The third section will deal with the Great Recession (GR) in terms of an extended consensus on the key role played by the excessive growth of finances on the burst of the crisis. This study pays attention to the different impacts of the economic and financial crises on European countries and to the consequences generated on the management of macroeconomic policies, mainly in developed and European countries. The final section will be devoted to the consequences of financialisation on the European integration process. Finally, we summarise and conclude.

2 Definition of the Financialisation Process

The last decades have witnessed a fast growth of financial sectors not only in developed but also in emerging and developing economies. This expansion of financial sectors, financial institutions and financial products has given rise to what is labelled as the "financialisation" process. Not only does this concept encompass the rising size of the financial sector but, mainly, the rising influence of finances in non-financial agents' decision-making: "financialisation means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies" (Epstein 2005, p. 3).

However, although we refer to a recent and typical of modern economies' phenomenon, "capitalist economies have always relied heavily on finance" (Brown et al. 2015, p. 6). Therefore, what actually defines, and is characteristic of, the current financialisation process is the fact that the influence of finances in the economic process, that is, in the processes of decision-making of private (financial and non-financial) and public agents, and in the political and social arenas, is significantly larger than in the past (Sawyer 2015, 2017).

For this reason, most studies about the financialisation process begin with a definition of this process that is mainly focused in the description (and further explanation) of the consequences of financialisation instead of a precise definition of this process. Thus, for instance, for Hein and van Treeck (2010), the main consequences of financialisation would be their effects on the objectives and constraints of corporations (financial and non-financial, mainly large corporations), with the consequent impact on corporate investment, the creation of new opportunities and risks for families due to the larger influence of wealth and indebtedness on households' decisions about consumption, and, lastly, the impact generated in income distribution due to the change in the power relations among shareholders, managers and workers.

Fine (2013) emphasises that the financialisation process has involved

> the phenomenal expansion of financial assets relative to real activity (…); the proliferation of types of assets, from derivatives to future markets (…); the absolute and relative expansion of speculative as opposed to or at the expense of real investment; as shift in the balance of productive to financial imperatives within the private sector whether financial or not; increasing inequality in income arising out of weight of financial rewards; consumer-led booms based on credit; the penetration of finance into ever more areas of economic and social life such as pensions, education,, health, and provision of economic and social infrastructure; the emergence of a neo-liberal culture of reliance upon markets and private capital and corresponding anti-statism despite the extent to which the rewards to private finance have in part derived from state finance itself (…) the continued role of the US dollar as world economy (…) And however financialisation is defined, its consequences have been perceived to be: reductions in overall levels and efficacy of real investment (…); prioritizing shareholder value, or financial worth, over other economic and social values; pushing of policies towards conservatism and commercialization in all respects; extending influence of finance, more broadly, both directly and indirectly, over economic and social policy; placing more aspects of economics and social life at the risk of volatility from financial instability and, conversely, places the economy and social life at risks of crisis from triggers within particular markets. (p. 6)

In a shorter, and more operative, way we can state that the main elements that define the financialisation process are (i) the rising weight and

size of financial activities, sectors, institutions and products, in modern market economies; (ii) the rising size of indebtedness of private agents (families and financial and non-financial corporations); and (iii) the rising influence of financial variables on the non-financial private agents' decisions on their resources allocation processes.

Having said that, it is evident that although financialisation is a common process to all developed economies, among them the European ones, and to many emerging and developing economies, and that the main reasons of this process have been the widespread policies of liberalisation and deregulation of the financial system (Sawyer 2011, 2017; Stockhammer 2011; Tyson and McKinley 2014; Hein 2015), it must be recognised that the intensity and the consequences of this global process differ markedly among countries, leading to a variegated process of financialisation (Brown et al. 2015, 2017; Hein et al. 2016; Sawyer 2015, 2017).

The existence of a variegated financialisation process is a key element to study and define, as it was stipulated at the Description of Work (DoW) of the FESSUD Project the "main policy implications of the financial crisis of 2007/09 and the events leading to that crisis, and the policy recommendations coming from the work of FESSUD". Throughout the research developed in the FESSUD project, it was clear that the origins of the current financial and economic crisis must be found in the financialisation process. Also, and consequently, we cannot correctly understand the origins and the consequences of the GR if we do not pay the necessary attention to the huge development of finances that has taken place in the last decades and the consequent larger size of financial activities and the unparalleled larger size of the financial sector (Detzer and Herr 2014; Hein et al. 2015; Hein and Dodig 2014).

Although the elements that have triggered the financialisation of modern economies are common to all of them (the deregulation and liberalisation of financial sectors) and the consequences are similar (in terms of an unparalleled rising size of the financial sectors and agents), in each case country a number of different and specific elements converge that have contributed to defining the particular model of development and working of the financial systems and the relationships between the financial sector and the non-financial private agents, thus implying that the

"processes of financialisation are not uniform across countries and time" (Sawyer 2015, p. 4).

3 Macroeconomic Implications of the Financialisation Process

Although financialisation processes are country- and time-specific, most studies share the opinion that these processes, mainly when the size and influence of financial markets exceeds a certain threshold, generate a set of negative macroeconomic consequences, with all of them operating in the same direction, although the intensity of these effects may differ.

It is commonly argued that one of the main features of the financialisation process is the huge increase in the size of financial sectors, and, consequently, in the size of financial assets and liabilities, usually measured as a percentage of gross domestic product (GDP). Ferreiro and Gómez (2016) analysed the evolution between the years 1999 and 2014 of the size of financial assets and liabilities in the countries that belong to the Eurozone. The analysis was carried out not only for the whole economy of each euro country but also for the main agents, namely, non-financial corporations, financial corporations, households, general government and the rest of the world. The objective of that paper was twofold. The first was to detect the existence of significant differences in the size of the financial balance sheets of the different institutional agents in the euro countries. The second was to analyse whether the differences in the macroeconomic performances of these countries were associated with the differences in the size and evolution of those financial balance sheets. Thus trying to check the hypothesis that the financialisation process (the larger sizes and increases in financial assets and liabilities) was associated to a better (or worse) macroeconomic performance.

The main findings of this study can be summarised in the following four conclusions. First, larger financial balance sheets are not associated with higher growth of economic activity in the euro countries. The authors analysed the existence of a relationship between the variation of GDP and the change recorded in the net financial assets, in the financial assets or in the financial liabilities, both for the whole period 1999–2014

and for the two sub-periods 1999–2008 and 2008–2014. The authors did not find any significant relationship between the aforementioned variables neither when a linear relationship was analysed nor when a quadratic relationship between the dependent and the explanatory variable was analysed. This result implies that the financialisation process was not a significant determinant of the expansion registered before the onset of the great financial crisis (GFC) and of the decline in economic activity registered during the GR.

The second conclusion was that more finance was not associated to a more intense fixed capital formation. The authors analysed whether the change (measured as a percentage of real GDP) of net financial assets, financial assets or financial liabilities recorded for each period in the euro countries had a significant effect on the evolution of gross fixed capital formation (GFCF) in the total economy. They did not find any significant relationship between the variation of the GFCF and the change recorded in the net financial assets, in the financial assets or in the financial liabilities, neither in the period 1999–2008 nor in the years 2008–2014.

A similar analysis was carried out for the investment of non-financial corporations. Checking whether the changes in the main components of the financial balance sheets of non-financial corporations in the Eurozone countries (i.e., the change measured as percentage of the GDP of net financial assets, financial assets and financial liabilities of non-financial corporations) had an impact on the investment made by this sector.

In this case, the conclusions reached in the study differed depending on the period analysed. Regarding the period 1999–2008, Ferreiro and Gómez (2016) did not find a significant relationship between the change in the size of real investment of non-financial corporations and the change in the size of net financial assets, financial assets or financial liabilities of these corporations. This result implies that the financialisation of non-financial corporations between 1999 and 2008 would have not been a significant determinant of the average increase of investments of non-financial corporations in the euro countries.

However, the authors detected a significant impact of the change of financial assets and liabilities in the years 2008–2014 on the investment of non-financial corporations. The analysis showed the existence of a

quadratic relationship between the change of investment and the change in the size of financial assets of non-financial corporations. The sign of the coefficients implied that the change of financial assets had a positive but decreasing effect on the change of the gross capital formation made by the non-financial corporations, with the inflexion point being an increase of financial assets equivalent to 189.3 per cent of GDP. This result implied that over this figure, the rise of financial assets had a negative impact on GFCF of non-financial corporations. The sign and the values of the constant and the coefficients of financial assets implied that the increase in the size of financial assets contributed to compensating the declining trend in the investment of non-financial corporations. Indeed, the investment of non-financial corporations would have only grown in the countries where the financial assets of these companies increased above 39 per cent of GDP, something that happened during those years only in Ireland and the Netherlands.

In the case of the financial liabilities, the impact of this variable on the gross capital formation of non-financial corporations would have been positive, although the investment of non-financial corporations would have been positive only in those countries where liabilities grew above 114 per cent of GDP, something that happened only in Ireland (where the increase amounted to 308 per cent of GDP).

The above results imply that the deleveraging process carried out by non-financial corporations during the crisis was associated with a strong decline of GFCF by non-financial corporations.

Finally, Ferreiro and Gómez (2016) also analysed the influence of financialisation of the consumption and savings decisions made by households in the euro countries, concluding that larger financial balance assets in booms have led to larger households consumption but deleveraging (decline of financial liabilities) has led to a significant decline in consumption.

During the years of the GR, they did not find any significant relationship between the change in the size of households' private consumption and the change in the size of net financial assets, financial assets or financial liabilities of these agents. However, for the period 1999–2008, they did find a significant impact on consumption of the change of financial assets and liabilities. Ferreiro and Gómez (op. cit.) argued that the change

of financial assets had a positive and rising effect on change of private consumption. Therefore, before the GR the declining rise of households' financial assets would have contributed to moderate the growth of private consumption. However, the evolution of households' financial liabilities would have had a larger impact on private consumption. Therefore, that result reinforced the idea that before the GR private consumption had been fuelled by the larger households' borrowing.

The authors also analysed the impact of the changes in the components of the financial balance sheets of households (i.e., the change measured as percentage of GDP of net financial assets, financial assets and financial liabilities of non-financial corporations) on households' savings rate. Before the year 2008 only a significant direct relationship between the change in households' gross savings rate and the change in net financial assets prevailed. The study concluded that, by itself, the decline in households' net financial assets would have generated a fall in the savings rate amounting to 1.3 percentage points (higher than the registered fall). However, when the determinants of the change in gross savings rate during the GR were analysed, the only significant relationship was with the change of households' financial assets. During the GR, only the change of the size of financial assets had a significant impact on the change of households' gross savings rate. Thus, the larger size of financial assets in the euro countries would have led to a decline of the gross savings rate in the years 2008–2014.

Financialisation processes are also associated with the existence of significant changes in income distribution, both in the personal and the functional distribution. Thus, financialisation is related to significant declines in the wage shares, that is, in the size of wages as a percentage of GDP. But, financialisation is also generating a more inegalitarian income distribution with a decline in the share of low earnings coming from a rising share of ten per cent or even one per cent of population.

It is important to emphasise that the causation relationship between an inegalitarian income distribution and the financialisation process is bidirectional. In this sense, it is frequently argued that the decline in real wages, mainly in low-paid workers, is leading to a rise in the size of borrowing held by low-paid earners. Thus, households would be funding a significant part of their consumption, including here the purchase of a

house, on external indebtedness; thus contributing to rising the size of the liabilities held by households, and consequently, the financial balance sheets of households and financial (mostly, banking) institutions.

Not only does financialisation generate changes in primary income distribution but also in the secondary income distribution by affecting redistributive public policies. The last decades have witnessed a process of privatisation of services formerly supplied by public institutions, like housing or pensions. As a result, financialisation has made those public institutions lose leverages to modify secondary (available) income distribution.

This process has occurred in parallel to a decline in taxation and public spending. In the case of public revenues, more than an absolute decline in total revenues, financialisation has come with a change in the composition of total public revenues, in the form of a decline in direct taxation and a rise in indirect taxation. In the case of the public expenditures, there has been a decline in the items directly related to the welfare state and social policies. All in all, these changes have implied a decline in the capacity of states to alter the income distribution in a more egalitarian way.

In recent years, a number of studies have argued that the relationship between finance and economic growth is not a linear one; certain thresholds exist, above which a higher size of finances would exert a negative impact on economic activity and growth (e.g., Arcand et al. 2015; Bouis et al. 2013; Creel et al. 2014; Dabla-Norris and Srivisal 2013; Law and Singh 2014).

The final result of the financialisation process would have been the break of the presumed positive nexus between economic growth and financialisation; and, thus, nowadays, mainly in the case of developed countries, which are the economies with the largest size of finance, the excessive size (and growth) of the financial sector would have a negative impact on economic activity and economic growth (Arestis 2016).

The financialisation process, fuelled by financial liberalisation and deregulation, would also have come in parallel with a rising financial instability and a higher occurrence of banking and financial crisis (Saidi et al. 2017). This financial instability would have increased the possibility that episodes of stress generated in certain segment of the financial sector

would get the category of systemic risks, affecting the whole financial sector. Moreover, the liberalisation and deregulation of international capital flows would have boosted the contagion effects of crisis arisen in certain countries. It is important to note that, as Creel et al. (2014, 2015) have shown, there is a negative relationship between financial stability and economic performance, and thus financial instability would be an element exerting a negative impact on economic activity and growth.

4 Lessons from the Great Recession

There is a widespread consensus, mainly among heterodox economists, on the idea that the excessive growth of the financial sector is the main determinant of the financial crisis that burst in 2007 and the subsequent GR and the later period of low economic growth that is affecting most developed economies, mainly in Europe (García-Arias et al. 2017). In this sense, this long-lasting period of stagnation offers a set of lessons that should be taken into account not only to get the needed economic recovery but, mainly, to avoid the existence of a new financial crisis of similar dimensions and consequences to that of the GFC.[2]

Perhaps, the main lesson from the GFC and the GR is that finance matters in all economies. Although in the 1970s and 1980s, when there was a wave of banking crisis in a high number of developed economies, the belief that these kind of crises were exclusive of developing countries was widely extended. Indeed, the recommendations and policy prescriptions from economists and international institutions focused on measures to deregulate and liberalise (domestically and internationally) the financial sector and institutions with the final objective of making them similar to those existing in developed economies, mainly in the USA, whose financial sector was considered the most efficient one in the whole world.

The GFC, however, proved to be a global phenomenon, affecting both developed and developing and emerging economies. However, its origin was in the financial sector of the USA, the most developed country in the world, and its impact, not only on the financial sector but also at the whole economic activity, has been more intense in the developed coun-

tries (mainly in Europe) than in emerging and developing countries (Carrasco et al. 2016; Ferreiro and Serrano 2011; Esteban et al. 2010). As Table 8.1 shows, only the GFC (with the exception of the Commonwealth of Independent States) led to a decline in economic activity in the group of advanced economies, mainly in the case of the European Union and the euro area.

In this sense, it is important to notice that the euro economies only returned to the level of GDP registered in the year 2007 in the year 2015. As a result, the GDP of the euro economies in the year 2016 was only 3.2 percentage points higher than in the year 2007. By comparison, the real GDP of the emerging markets and developing economies in 2016 was 56.4 percentage points higher than in 2007, and in the case of the emerging and developing Asian economies, the increase was even much higher: 89.1 percentage points higher.

Another lesson from the GR is that large financial and banking crises have an enormous impact on public finances. Besides the impact on public expenditures resulting from the public assistance to troubled financial and banking institutions, serious financial crises exert a significant impact on public budget balances and on the fiscal policy stance, usually measured as the changes in the public budget balances. Thus, the impact on public finances of the episodes of financial crises determines to a great extent the orientation of fiscal policies and in many cases leads to the implementation of measures of fiscal austerity directed to the adjustment of fiscal imbalances, what in turn has a depressing impact on the level of economic activity (Ferreiro et al. 2015; Ferreiro et al. 2016a).

Directly related to the former point, it must be emphasised that large financial and banking crises have a deep and long-lasting negative impact on economic activity. There are a number of different channels that explain the impact on the GDP of the systemic financial and banking crisis and the collapse of financial and credit markets through the consequences generated on private consumption and investment. Moreover, as mentioned in the previous paragraph, these effects can be exacerbated by the implementation of restrictive fiscal policies, which also contribute to dampen the economic activity. As a whole, these negative effects do not only imply a temporary decline in the real economic activity, but also

Table 8.1 Gross domestic product, constant prices (2007=100)

Group of countries	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
World	100	103.0	102.9	108.5	113.1	117.1	121.1	125.3	129.5	133.5
Advanced economies	100	100.1	96.7	99.7	101.4	102.6	103.9	106.0	108.3	110.1
Euro area	100	100.4	95.9	97.9	99.4	98.5	98.2	99.4	101.4	103.2
Major advanced economies (G7)	100	99.7	96.0	98.7	100.3	101.6	103.0	104.9	106.9	108.5
Other advanced economies (advanced economies excluding G7 and euro area)	100	101.7	100.8	106.7	110.3	112.7	115.4	118.8	121.2	123.8
European Union	100	100.6	96.3	98.3	100.1	99.7	100.0	101.7	104.1	106.1
Emerging market and developing economies	100	105.8	108.8	116.9	124.3	131.0	137.6	144.0	150.2	156.4
Commonwealth of Independent States	100	105.3	98.6	103.2	108.0	111.8	114.2	115.4	112.9	113.3
Emerging and developing Asia	100	107.2	115.3	126.4	136.3	145.9	156.0	166.6	177.8	189.1
Emerging and developing Europe	100	103.1	100.1	104.7	111.5	114.2	119.8	124.5	130.3	134.3
ASEAN-5	100	105.4	107.9	115.4	120.8	128.3	134.8	141.0	147.8	155.1
Latin America and the Caribbean	100	104.0	102.1	108.4	113.4	116.8	120.3	121.7	121.8	120.6
Middle East, North Africa, Afghanistan and Pakistan	100	104.8	106.3	111.4	116.3	122.5	125.4	128.8	132.3	137.5
Middle East and North Africa	100	104.8	106.3	111.6	116.6	123.0	125.6	128.9	132.2	137.2
Sub-Saharan Africa	100	105.9	110.1	117.7	123.6	129.0	135.8	142.7	147.5	149.6

Source: Our calculations based on World Economic Outlook Database, April 2007, accessed at 29 July 2017 (available at the IMF's website: http://www.imf.org/external/pubs/ft/weo/2017/01/weodata/index.aspx)

they can imply a decline in the long-term rates of economic growth—or, in other words, in the rates of growth of potential output.

A further relevant lesson from the GR has to do with the general strategy of macroeconomic policy. Since the 1990s, the economic authorities in most developed economies, mainly in Europe, adopted the axiom that price stability, in the form of a low and stable inflation rate, was a sufficient condition to achieve both financial stability and macroeconomic stability. The latter is understood as the achievement of a rate of economic growth equal to the rate of growth of potential output, in other words, as the absence of output gaps.

With this objective a rising number of central banks, not only in developed countries but also in developing and emerging market countries, adopted the strategy of the so-called inflation targeting. In this framework of monetary policy, central banks gained an increasing degree or independence from the political authorities, while price stability, at least in the medium term, was considered the main objective of the monetary policy. Moreover, the management of short-term interest rates by central banks adopted the role of the main tool of monetary policies.

The key role given to monetary policy implied the parallel downgrading of fiscal policies, being subordinated to monetary policies (Ferreiro et al. 2011). Thus, fiscal policy focused in this strategy on the removal of fiscal imbalances, that is, unsustainable levels of fiscal deficits and public debt, with the objective of generating a balanced public budget, or even a fiscal surplus, over the business cycle.

In any case, it must be noted that the very concept of macroeconomic policy has experienced a significant change. The final objective of macroeconomic policy is no longer to achieve a precise (high) rate of growth of GDP or a full employment level of economic activity. Macroeconomic policies are now implemented to avoid cyclical fluctuations of economic activity. However, these cyclical fluctuations are now defined, as previously mentioned, as the differences between the current levels of economic activity and the potential outputs.

Macroeconomic policies, or demand-side policies, by affecting aggregate demand only have a temporary impact, affecting economic activity on a short-time basis. In other words, the impact of these policies in the long term is minimal. Long-term economic activity, the potential output,

is determined by factors related to the supply-side elements (existing levels of capital and labour inputs, technology, and certain institutions like those of the labour markets). These supply-side elements can only be influenced by structural policies, but not by fiscal or monetary measures. Consequently, macroeconomic policies do not have an impact in the long term on variables such as the rate of growth of GDP, the level of employment or full employment.[3]

As mentioned earlier, according to this theoretical framework, business cyclical fluctuations are generated by changes in the aggregate demand, basically by fluctuations in private consumption and investment decisions. In a world formed by rational agents, these fluctuations were explained by the mistakes in the inflation expectations of private agents (households and firms). Price stability, in the form of a low and stable inflation rate, favours the generation of correct inflation expectations, that is, inflation expectations of private agents, and in the absence of any inflationary surprise or unforeseeable events, would equal the inflation rate set as target by the central bank. In other words, price stability, by anchoring inflation expectations, would guarantee the absence of deviations of current economic activity from the potential output (zero output gap). This implies that price stability guarantees the macroeconomic stability, with the economy growing at the rate of growth of potential output and unemployment rate being that of the NAIRU (Carrasco and Ferreiro 2011, 2013a, b, 2014).

Furthermore, price stability would also guarantee financial stability, avoiding the existence of financial bubbles or an excessive growth of credit or monetary aggregates. As Montanaro (2016) argued, before the GFC there was the "prevailing belief that financial markets were naturally efficient and resilient, the pre-crisis consensus was that a low and stable inflation, together with 'light touch' micro-prudential supervision, was also the best way to deliver financial stability" (p. 4). Consequently, "monetary policy should not react to asset prices bubbles, except to the extent that they affect price stability, and should only intervene after the bubble had burst" (p. 4).

However, the GFC and the GR took place in a context of very low inflation, thus proving that, contrary to the widespread belief in the

Table 8.2 Inflation, end of period consumer prices (percentage change)

Group of countries	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
World	4.8	4.0	4.0	3.6	4.1	3.9	3.9	5.3	4.6	3.3	4.3	4.7	3.9	3.3	2.9	2.9	3.1
Advanced economies	2.5	1.4	2.1	1.6	2.4	2.5	1.9	3.1	1.6	1.1	1.8	2.7	1.7	1.3	0.7	0.5	1.5
Euro area	2.6	2.1	2.3	2.0	2.4	2.3	1.9	3.1	1.6	0.9	2.2	2.8	2.2	0.8	−0.2	0.2	1.1
Major advanced economies (G7)	2.3	1.1	1.9	1.5	2.4	2.4	1.8	3.0	1.2	1.1	1.6	2.6	1.6	1.3	0.8	0.5	1.6
Other advanced economies (advanced economies excluding G7 and euro area)	2.6	1.5	2.2	1.4	2.1	2.3	1.9	3.4	3.0	1.7	2.4	2.8	1.8	1.5	1.0	0.7	1.4
European Union	3.4	2.7	2.5	2.2	2.4	2.4	2.2	3.2	2.2	1.4	2.6	3.1	2.4	1.0	0.0	0.2	1.1
Emerging market and developing economies	8.2	7.5	6.6	6.2	6.2	5.5	6.2	7.5	7.8	5.3	6.6	6.5	5.8	5.0	4.7	4.7	4.4
Commonwealth of Independent States	21.7	16.9	13.2	11.3	11.3	10.3	9.2	13.0	13.8	8.6	8.8	8.7	6.3	6.1	11.4	14.0	6.5
Emerging and developing Asia	3.0	3.2	2.6	3.6	3.7	3.9	4.7	6.5	4.6	4.7	6.0	5.3	4.5	4.5	3.1	2.6	3.0
Emerging and developing Europe	25.9	29.6	14.0	10.1	7.1	5.6	6.0	7.0	6.7	4.9	5.4	6.7	4.9	3.8	3.4	3.9	4.2
ASEAN-5	5.6	6.3	5.5	3.4	5.4	9.1	5.2	5.1	8.2	3.3	5.5	4.9	3.5	5.5	4.8	2.0	2.6
Latin America and the Caribbean	8.3	6.2	8.6	6.9	6.5	4.8	3.7	4.9	6.7	3.3	5.0	5.3	4.4	4.5	5.0	6.2	4.6
Middle East, North Africa, Afghanistan and Pakistan	2.3	3.7	5.2	5.7	7.9	6.4	10.2	9.7	12.8	5.6	8.9	9.2	11.4	7.1	6.7	5.0	5.9
Middle East and North Africa	1.9	3.9	5.1	6.2	7.8	6.1	10.5	10.0	11.8	5.1	8.5	8.7	11.5	7.3	6.6	5.2	6.2
Sub-Saharan Africa	17.2	11.8	12.5	10.4	7.9	7.9	7.7	7.6	13.4	9.2	7.7	10.0	8.2	6.1	6.1	8.2	12.7

Source: World Economic Outlook Database, April 2007, accessed at 29 July 2017 (available at the IMF's website: http://www.imf.org/external/pubs/ft/weo/2017/01/weodata/index.aspx)

1990s and 2006, price stability was neither a guarantee for macroeconomic stability nor for financial stability. Thus, as Table 8.2 shows, the inflation rate in the 2000s was very low, mainly in the case of the developed economies, whose inflation rate was slightly above the figure of 2 per cent.

This result implies that inflation targeting (or similar monetary policy strategies focused on price stability as the single or main objective of monetary policy) must be abandoned. Consequently, monetary authorities must adopt objectives of real macroeconomic variables (rate of growth of GDP, employment, unemployment, income distribution, etc.) and financial stability ones. In this sense, it is important to emphasise that fiscal and monetary policies must pay attention not only to real and monetary variables and (domestic and external) imbalances but also to financial imbalances: paying attention, first, to the evolution of the size of financial balance sheets of financial and non-financial corporations and of households and, second, to the size and growth of their components (Ferreiro and Gómez 2016).

As mentioned above, the relationship between the size of the financial system and the impact on macroeconomic performance is not a linear one (Arcand et al. 2015; Cecchetti and Kharroubi 2015; Cournède et al. 2015). Therefore, we need to know whether the size of the financial system has exceeded the threshold since from that point on a larger size of finances exerts a negative impact on economic activity and growth (and, obviously, welfare). If we focus on the case of the European Union countries, the answer would be that such a threshold has been exceeded in most of these economies, mainly in the most developed ones. Thus, in the year 2012, the (unweighted) mean of financial liabilities in the EMU-11 countries reached 1088 per cent of GDP, 672 per cent of GDP in the EMU-6 countries and 1421 per cent of GDP in the EU-10 countries. Moreover, this size of financial liabilities had increased during the GR, and thus, since the year 2008, the size of financial liabilities had increased in 114 percentage points of GDP in the EMU-11 countries and in 111 percentage points of GDP in EMU-6 countries, and had only declined in the case of the EU-10 countries where the size of financial liabilities had fallen in 70 percentage points of GDP (Carrasco et al. 2016).

Creel et al. (2015) have concluded that the financialisation process (identified with the financial depth) has not had a positive impact on economic growth in EU economies. For the authors, this result is explained by the fact that the level of financial depth in the European Union is so high that it has stopped generating positive effects on economic growth.

Accepting this conclusion implies that economic growth in the European Union would rise if the size of finances in the EU shrinks. In the short run, a widespread de-leveraging process and reduction of the size of financial balance sheets of households and financial and non-financial corporations can negatively affect economic activity, mainly if no offsetting measures are adopted. This impact is highly probable in the current situation. Thus, as Hein (2015) argues, "stagnation after big financial crises becomes likely when the balance sheets of economic units are not quickly cleaned, when the nominal wage anchor breaks, and when there is no big and longer stimulus by the government" (p. 9).

Nonetheless, from the above conclusion, it cannot be automatically inferred that a de-financialisation process implies a stimulus to economic growth. In other words, we are not defending the hypothesis of an expansionary de-leveraging or de-financialisation process. On the contrary, as Hein (op. cit.) argues, unless it comes with the proper offsetting measures, this process will unavoidable have a negative impact on economic activity in the short and perhaps medium term. Indeed, there would be doubts about the size of this offsetting impact. What we are actually arguing is that the de-leveraging process is a necessary condition to recover the path of high and sustained economic growth that allows the reach and maintenance of a level of economic activity compatible with full employment.

It is important to emphasise that large de-leveraging processes (i.e., the decline in the size of financial balance sheets), after a big financial crisis, have an even greater negative impact on economic activity unless offsetting measures are adopted, for instance, fast cleaning of financial balance sheets, nominal wage anchors or big fiscal stimulus.

5 Financialisation and European Integration

As far as international capital flows are concerned, they are at the origin of some national imbalances and they are a transmission channel of domestic (real and financial) shocks; consequently, there must be a coordinated strategy to reduce the size and volatility of international capital flows. The experience since the 1980s with financial crises in certain countries has proven that international capital flows are a powerful transmission mechanism of economic shocks. Thereby, the real and/or financial crisis episodes that emerged in certain countries become systemic. Moreover, it is widely argued that, for instance, in the case of the Eurozone, certain macroeconomic imbalances (like the surge and increase of external, i.e., current account imbalances, or the generation of fiscal imbalances) or even financial imbalances (e.g., the housing bubbles in countries like Ireland or Spain) generated in the peripheral countries are associated and explained by the huge capital inflows coming from third countries, in particular in the Eurozone from the core countries, like France, Germany or the Netherlands (Carrasco and Serrano 2014; Hein and Truger 2014; Carrasco and Peinado 2015; Dodig and Herr 2015). Therefore, to ensure national and global financial and economic stability, it is necessary to adopt measures at a global level to reduce the size and volatility of international capital flows, like the setting up of capital controls, tighter regulations of capital movements or the taxation of international capital transactions. However, this can only be made under the umbrella of a coordinated international strategy that encompasses the most significant developed and emerging economies.

It is important to note that the aforementioned problems are exacerbated in a context of open economies. Thus, in an environment of intense internationalisation and globalisation, an appropriate coordination of national economic policies becomes essential to guarantee a harmonious and sustained global economic growth. This coordination is even more necessary in those economies where interactions are so large that put limits to the effectiveness of economic policy measures unilaterally (domestically) implemented. In the case of monetary integration processes, like

the Eurozone, for instance, this coordination is more necessary because, along with the freedom of capital and goods-services movements, joins the disappearance of the exchange rates and the existence of a single monetary policy for all the member states of the monetary union.

Furthermore, the experience of the Eurozone shows, first, that a monetary union alone does not lead to a real convergence process among member states and, second, that member economies can suffer asymmetric shocks, with the result that individual economies can be at the same time operating in different phases of the business cycle and/or that the intensity (depth and duration) of national shocks may significantly be different. This implies that in a monetary union there is no guarantee that the national business cycle is synchronised, a problem for the implementation of countercyclical macroeconomic policies, mainly in the case of the single monetary policy, which in this case can operate in a procyclical way in some countries. Obviously, if the freedom of capital movements within the monetary union can result in a lack of synchronisation of the national business cycle, the larger the capital flows, within the Eurozone, the weaker the effectiveness of monetary policy and the larger the domestic imbalances in the euro countries.

Indeed, financialisation alone (i.e., the complete liberalisation and deregulation of financial markets) has not produced a process of convergence or catching up of less developed economies. As Ferreiro et al. (2017) argue, since the creation of the European Monetary Union the existing real divergence among the euro countries has not declined; on the contrary, it has remained constant and even has increased in many parameters that show the macroeconomic performance of the euro economies. Actually, as has often been argued, the implementation of a single monetary policy, joined to the deregulation of financial markets and the liberalisation of capital movements among euro countries, has contributed to fuel domestic (inflation and assets bubbles) and external (current account imbalances) in those euro countries (mainly Southern countries) with the weakest macroeconomic fundamentals. Thus, the existence of these imbalances would be one of the main causes of the deepest impact of the GFC and the GR in these countries.

Therefore, the adjustment of domestic imbalances must be addressed in a coordinated way among all member states of a monetary union. This

coordination implies that economic imbalances must be symmetrically defined, thus, leading to the adjustment of those imbalances in which the value of a variable is below the target value but also to the correction of those imbalances in which the value of the objective is above that target. Thus, for instance, countries with, for instance, high inflation rates (see footnote 4) of current account deficits must implement fiscal or wage policy measures to adjust these imbalances, at the same time that countries with lower inflation rates or current account surpluses must also adopt measures to correct them (e.g., implementing an expansionary fiscal policy or setting a wage growth guideline above productivity growth). In other words, in monetary unions there must be rules and norms that ensure a symmetric burden of the adjustment of macroeconomic imbalances.

Monetary unions and the European Monetary Union in particular are, therefore, an evident case that the free international movement of capital is an element that contributes to generate unsustainable growth strategies and to increase the size of economic imbalances. Furthermore, we cannot forget that the expansion of national financial systems is directly related to the existence of international capital movements that allow the acquisition of financial assets but also the higher indebtedness of national financial and non-financial agents. Lastly, we cannot forget that international capital flows are a powerful transmission mechanism of economic shocks, making the real and/or financial crisis episodes that arise in certain countries become systemic. This implies that monetary unions, in general, and the Eurozone, in particular, are not exempt from suffering contagion effects, like the Greek sovereign debt crisis proved. Nonetheless, the Greek crisis showed that the contagion effect was not generally affecting some economies, like Ireland, Portugal, Italy or Spain. It is important to note that these economies were not only those with the weakest macroeconomic imbalances (Carrasco and Ferreiro 2016), but also those that suffered before the crisis—with the highest increases in the size of their financial balance sheets and the deepest deterioration of the financial balance sheets of private agents, both financial and non-financial (households and corporations).

It is, therefore, important and necessary to ensure national and global financial and economic stability in a monetary union and also to adopt

measures to reduce the size and volatility of international capital flows, like the setting up of capital controls, tighter regulations of capital movements or the taxation of international capital transactions. However, this can only be made under the umbrella of a coordinated international strategy that encompasses the most significant economies. This kind of measures can help to avoid an excessive size of financial balance sheets and the surge of internal and external financial balances that can generate real macroeconomic, domestic and external, imbalances.

6 Summary and Conclusions

The burst, first, of the GFC and, later, of the GR, has been a painful proof that the financialisation process, fuelled by an intense liberalisation and deregulation of financial markets, is a source of financial and real economic instability. In the current situation, it can be stated that the size of the financial markets, proxied by the size of the financial balance sheets of the total economy and those of the agents that form it, is excessive.

This excessive size of finance is not only generating a negative impact on economic growth but also leading to the appearance and rise of financial and real imbalances. It is only affecting negatively to the effectiveness of the traditional macroeconomic policies, such as fiscal and monetary policies. These problems are exacerbated in the case of highly integrated economies, mainly in the case of the countries belonging to a monetary union, as it is the case, for instance, of the European Monetary Union. Therefore, it is not an accident that the Eurozone, with the highest degree of economic and financial integration, but also with the highest size of the financial sector, has been the region of the planet that has suffered most deeply the negative consequences of the financial crisis that began in 2007.

It is, therefore, evident that in order to achieve a full recovery of the negative consequences of the GFC and the GR, it is necessary to implement a re-orientation of macroeconomic (fiscal and monetary) policies. Nonetheless, such a change in the general framework of macroeconomic policies would be useless unless it is accompanied by a re-regulation and rationalisation (downsizing) of the financial system.

Notes

1. The conclusions and arguments presented at this contribution are the result of the research carried out throughout the FESSUD research project (see www.fessud.eu). In particular, this contribution is based on Ferreiro (2016).
2. In a survey conducted to evaluate the foresights of a set of experts about the future of finance up to the year 2025, 88 per cent of experts estimated highly likely (i.e., with a probability above 50 per cent) the burst of a new financial crisis, whose origin will be at the non-banking financial sector (Ferreiro et al. 2016b).
3. It must be emphasised that in this scenario even the concept of full employment changes. The concept of full employment abandons its Keynesian meanings. That is, it is no longer defined as a low unemployment rate (say, three per cent of active population) or a situation in which any worker willing to work at the prevailing market wage has a job. In the New Consensus Macroeconomics terminology, full employment is identified as a non-accelerating inflation rate of unemployment (NAIRU) or non-accelerating wages rate of unemployment (NAWRU). That is, it is the unemployment rate compatible with the target of inflation rates, keeping stable such a rate. This implies that the labour market is at an equilibrium situation (a market-clearing equilibrium). Therefore, full employment, or the NAIRU, can exist with any unemployment rate, regardless how high it can look. If such a figure of unemployment is socially, politically or economically considered as excessive, then structural reforms in the labour market, making it more flexible, would have to be implemented.

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