Reconfiguring the Financial Markets

■

Ion Bucur
Universitatea din București
ion.bucur@drept.unibuc.ro

Abstract. *The debut of the new millennium is marked by the increased economic and social imbalances. An important task of economic science is to identify the causes and factors that contributed to the radical transformation of the unfolding conditions of economic activity. The existence of different perspectives to approach the new realities may offer greater opportunities for decrypting the conditions that generated so far unknown developments, as well as for shaping solutions to promote new paths of progress and civilization.*

The defining with profound implications on the economy and society is represented by the globalization. From this perspective, we have analysed the new dimensions of capital accumulation and economic growth in the context of deregulation and liberalization of the international capital movements. In this context, we have noticed the increasing influence of the financial markets on the economy, the tendency to remove the finances from the real economy requirements, the growing role of external financing using more volatile capital goods, increased competition regarding the access to financing, the significant increase of power of the international capital markets whose characteristic is represented by the increased instability, the implications of the investors' obsession with an excessive profitableness of their own funds and the expansion of using sophisticated financial products. Realities of today's financial markets, which are the subject of numerous studies and analysis, have contributed to the association of the arguments that are contesting the thesis on the virtues of self-regulation markets and promoting a new paradigm, within which finances should subordinate the requirements of a balanced and sustained economic growth.

Keywords: cognitive capitalism; the financialization of the economy; financial innovations; volatile capital; institutional investors; derivative products.

■

JEL Codes: G01, G18.
REL Code: 11B.

In a world divided by ideological, cultural and religious tensions, the economic confrontations are becoming particularly acute and are subject to the concerns of the decisional factors.

Over the past three decades, capitalism has reached its peak succeeding in imposing its own individualistic representation and behavioural model, to the detriment of collective logic (Kempf, 2009, p. 11).

During this period, the global economy has registered sustained growth periods, but interrupted by financial and economic crisis. The world has become more unstable, more unpredictable and the inequalities have widened.

The new wave of globalization has substantially influenced the economic and financial environment. There is an extensive process of economic, social and political transformations on world scale, which equates with the emergence of a new society and a new capitalism.

The economies of the developed countries have experienced in the last quarter of the twentieth century a profound reorganization. New information and communication technologies have contributed to the radical transformation of the conditions of economic activity. With the new conditions, the economy is placed in the centre of the power issue and contributes to a new configuration of the global geo-economy (Harbulot, 2007, p. 64).

In a deeply reorganized capitalism, the emergence of an economy of immateriality, the modification of the productive model of the enterprise, on the one hand, and the growing role of externalities, on the other hand, disqualifies the institutional commitments of the industrial Fordist capitalism.

The characteristic of the present stage, represented by cognitive capitalism, is the accumulation based on knowledge and creativity, namely on forms of investment in which the immateriality plays a predominant role (Boutang, 2008, p. 284).

In the countries that joined the neo-liberal value system, the financial globalization has occurred in the climate specific to the 80's. A controversial process challenged by the "losers" and praised by the "winners", financial globalization is approached differently. For the liberal vision, financial globalization is immanently virtuous because it identifies itself with an unprecedented financial liberalization movement. In this light, improving the functioning of financial markets is one of the important consequences of this process. However, for most interventionists, financial globalization entails dangers of instability and financial crises.

Although there are different angles of approach, it is essential to reveal the mechanisms by which globalization affects the process of capital accumulation and the regime of economic increase, as well as the stability of the economic and financial environment. For this it is necessary to analyze some significant processes, such as the tendency to finacialize the economy, the progressive elimination of the financial regulations, accelerating the financial innovation, etc.

Globalization and the financialization of the economy

The genesis and evolution of "the global finance" have considerably marked the defining processes of capital accumulation, economic growth, economic and financial stability, etc. The edifying aspects are highlighted by the problem of the "historic" role of finance in the contemporary capitalism.

During the "thirty glorious years" (1945-1975), the economy and finances were organized on national basis, with an increase interventionism from the State. This is the so-called period of "Fordism".

Subsequently, the politics considerably intervenes in favour for finances. Starting with 1979, a radical change of the direction occurs in the monetary policy in the USA and other industrialized countries. The fight against inflation, exacerbated by oil shocks, becomes the primary purpose. This results in a spectacular increase in interest rates in the US and global economy, leading to the appreciable modification of the balance of forces between creditors and debtors. Thus, the first victory of the financial capital holders occurs.

During the 80's, it is applied a new financial system where capital markets acquire priority over bank financing. The rapid increase of the international finance is also due to financing the public debt, which was the engine of financial modernization performed by the public powers.

As the debt was increasing, the national public treasuries could not rely anymore solely on domestic investors. Hence, the State resorts more and more frequent to international investors, especially institutional investors to purchase national public bonds. Thus, in the 80's, states have become active players of the institutional financial markets.

Deregulation of the banking and financial sector, relocation of the business and deposit banks, not intermediating bank credits by shifting to market finance represent defining features for the development of international financial activities under the influence of globalization.

The place of the finance in the global economy has changed radically. Financial markets extend their influence on economy having an important role both in financing the market and in risk assessment and redistribution. However, the external financing of the economy is made using more volatile capital, which has led to the emergence and development of industry volatility. Also it should be noted the engagement of the private finance in developing emerging economies, which may represent a major risk factor for the recipient countries. Abrupt withdrawal of private investors is always a crisis accelerator.

Financial globalization has tightened competition for access to finance. International financial players – pension funds, mutual funds and banks – which offer equity focus, have the means to impose on the states. The liberalization of financial markets, considered an important dimension of financial globalization is a phenomenon characteristic to the last quarter of the last century. Financial markets, which for some analysts represent a new form of governmentality, are in the process of fully globalization of their components based on the increasing worldwide integration.

These markets become interdependent on the planetary level as their main variables (interest rate, exchange rate and stock exchange) interact with each other (phenomenon of markets correlation). In an equal extent, stock markets, money markets and hedging markets are subjected to the globalization process. After mid 90's, these markets have seen significant developments that can be compared to the entrance into a new paradigm. The reference point may be represented by the formation of financial bubbles, starting with 1995, as a result of the very rapid increase of the financial assets' price.

As the financial liberalization is intensifying, interest rates are beginning to emancipate themselves from the tutelage of the states; under these circumstances, private powers, represented by big international banking groups, have the possibility and can fix in the most part, the evolution of these rates. With this considerable power of banks, financial market capitalism dominates today the real economy through exorbitant levies that occur within it. The significant increase in power of international capital markets is accompanied by the development of some "offshore" or "parallel" markets dominated by large banking groups.

The process of financial liberalization has a twofold dimension: the booming market or financial assets and institutionalization of population's savings. The profound instability of these markets, the speculative aspect of the operations that aim at different currencies and financial instruments have made some analysts to link the financial liberalization to the recurrence of business cycles (Aglietta, 2001, p. 92).

Financial globalization had great implications on the international mobility of capital and opened new horizons to investors. Movements of financial capital met considerable values in the last decades and there were abundant savings. The formation of savings massively oriented to the stock market is undoubtedly a feature of the new capitalism. The opening of the borders permitted the rapid transfer of the savings from the areas where they were made (Asia and Europe) to those where the savings were used (especially USA). The result was the very rapid growth of global liquidity and the low level of the long-term interest rates, favourable to credit growth. Then, the rapid growth of credit has been closely linked to the price of assets (the shares, the late 90’s and 2005-2007, and the real estate sector between 2002 and 2006).

The contemporary development of finance can be explained by the emergence of a new stage of capitalism, characterized by a new regime of growth and new forms of accumulation. Under these conditions, cyclical fluctuations are strongly influenced by the prices of financial assets.

The prospect of a new “patrimonial” growth regime resettles the relations between the financial form of organizing the capital and the economic structures of the productive activities. There are close relations of dependency, even domination, between these. Some analysts prefer the thesis of a finance power over the real sphere, while others acknowledge the existence of two distinct spheres.

Within the recent mutation of the capitalism, finance and the perspective of a new “patrimonial” growth regime have an important role. The progress of finance can be explained by the emergence of a new period of capitalism, characterized by new forms of “real” accumulation. Regarding the current orientation of capital accumulation, two analytical perspectives were outlined: on one hand, the analysis is focused on the central actors of capitalism. From this point of view, the capitalist firm is the subject of numerous reconsiderations; on the other hand, the importance of global financial markets is revealed the.

The objective is not only to highlight the current “exuberance” of these markets, but also to illustrate the mechanisms by which finances actually put a strong pressure on the real economy, with particular implications on the direction of capital accumulation.

Without doubt, globalization has inspired and emphasized the trends of financialization of economies, a notion associated with the concept of financial capitalism. If the signs of financialization are evident (the increase of the bond portfolio held by households, increasing the ratio of funds held between mutual funds and pension and equity capitals of unfinancial corporations, the ratio between financial assets of households and their available income, etc.), there is no consensus yet on the definition of this process.

For some authors, financialization means increased importance of financial markets, players and financial institutions in the functioning of national and international economy (Paulré, 2008, p. 187). The theoretical contributions, which explain the crucial role of finance in the current capitalism, as well as the importance of financial accumulation, plead to a comprehensive vision of finances and point out the role of the financial system in managing risk.

When the financial logic comes first compared to the economic logic, the financialization highlights “the patrimonialisation” of behaviours. On macroeconomic plan, financialization expresses itself through the emergence of the asset economy. Accumulation is financializing under the effect of the current functioning of financial markets.

Firms' financialization represents a process resulting from the new "governance", which was imposed in the 90's. The concepts of financialization and corporate governance capture the realities within companies, directly related to the new shareholders represented by institutional investors. A large part of the investors' activities was dedicated to the risk transfer regarding their sale to other players: employees, savings, pensioners, emerging countries.

In this context, financialization translates into the uncoupling between risk bearers (shareholders) and the bearers of investment decisions. Thus, it is created a new image of capitalism in which financial markets become, in fact, privileged places of action and expression of the ownership relation.

The new players of capitalism (international banks, institutional investors which act to delegate administration) have the ability to participate and influence the firms' strategy.

Transformations that have aimed at the functioning of financial markets and financial form of organizing the capital are characteristic to the shift from the industrial capitalism to cognitive capitalism, represented by another system of accumulation, in which the central role belongs to knowledge and creativity. In its essence, the cognitive capitalism is a financialized capitalism.

Deregulation, uncertainty and risk

Another phenomenon that has marked the international expansion of the finance period was represented by the centralization and globalization movement in the savings management. It is about the development of the collective management of savings and the emergence of a new type of financial players, designated as institutional investors. These institutional representatives administrate a "collectivised" saving, which determines Michel Aglietta to talk about a "social ownership" of capital. Financial assets held by individuals are more frequently managed by pension funds, mutual funds or investment companies, as well as by insurance companies.

Financial deregulation and the favourable development of tax over saving have favoured the development of pension funds. Through the volume of managed assets and investment policy, these financial operators are actively participating to the development of capital markets.

At the same time, in the 90's, the active role of the pension funds is noted in implementing corporate governance. As a result of their considerable power, institutional investors manage to impose their targets to large enterprises. Their weight becomes significant in the global economy.

All of these financial investors were managing more than 50,000 billion dollars in 2003, which represents 160% of the GNP of the OECD countries. Five of the richest countries are massing more than 80% of the assets managed by these investors.

The influence of institutional investors' activity is exercised both on the markets and the management of the firms through corporate governance. As a result, several trends become significant within the developed countries: the growths of the share of institutional investors' activity at the expense of direct ownership; investing a considerable part in shares; the presence of the institutional investors within the shareholding of the large companies becomes a major economic fact (Batsch, 2002, p. 16).

To achieve the desired objectives (minimizing risks, portfolio liquidity and profitability of the investments), the institutional players were aiming at the permanent diversification of placements.

The collective management of savings provided by professionals has contributed to ensuring a more effective management of risk, hence increasing the proportion of shares, which represented the riskiest securities within the financial wealth of households. An important part of financial assets is owned in the form of shares, which has represented a significant change in behaviour.

An important effect of collective management of savings was the concentration of capital firms in the hands of few large investors whose power becomes significant worldwide. Thus, institutional investors, through their importance, exercise great influence on the dynamics of financial markets. The behaviour and the practices used have contributed to emphasize the international financial instability.

Unlike the heterogeneity of investment options that characterize individuals, a professional institution is interested in maximizing its market part in managing the global saving or a segment of it (life insurance, investment funds in shares, etc.).

It has been noted a great similarity of the behaviour of fund managers, as a result of carrying out their activity according to standard rules, the market reference, asset allocation methods, etc. In a world where there is a fierce battle to seize a market segment, imitating the behaviour of others is justified. It is a skilled imitation often labelled as "rational" and considered the main disease of finance (Artus, Virard, 2008, p. 99).

This attitude of investors largely explains the processes of progress and frequent instability in financial markets and they are evident in the financial bubble of the 90's: as indexes increase, the acquisition of shares increase, which have had shares unrelated to the real value of the enterprises that issued them. It is produced the so-called "financial inflation", meaning a tendency to rise the price of asset by rapidly raising the main stock indices. This pressure is due to the imbalance created between a strong demand of bonds from investors and the insufficient bond offer.

The devastations of the mimesis are obvious in the case of the Asian crisis from

1997-1998, on which occasion it is proved the pro-cyclical nature of foreign capital flows to emerging countries. In the event of a favourable situation, higher productivity is expected and there are recorded excessive capital inflows, which stimulate credit and economic growth. When expectations become unfavourable, investors simultaneously withdraw their capital and investments, which leads to streamlining credit and the prospect of recession.

Studies on the effects of the crisis from the ninth decade revealed the implications of the rational mimesis on economic and social destabilization.

The investors' obsession to an excessive profitableness of their own funds contributed to a great extent, to the weakening of the capital. In this regard, it is mentioned the "15% myth" the profitableness of their own funds or the return non-equity dictatorship. These objectives of profitableness seem more surprising the more it is considered that the world economy came for a long period in an era of low productivity on the financial assets that can be classified as "normal" (Artus, Virard, 2007, p. 100).

With a low inflation, the monetary policy has recorded expansionist tendencies. Therefore, after the 2003 "the world monetary system" increases by 15-20% annually, while global GDP increases by three times less.

At the origin of the financial system instability was also the development of new markets and financial practices, as well as sophisticated financial instruments. The risks manifested in the financial markets have increased significantly since the mid 70's, as a result of abandoning the fixed rates system in 1973, of generalizing, in the early 80's, the monetary policies by adjusting interest rates, as well as the wider process of deregulation and liberalization of economies, which has particularly affected the financial sector. In response to this increased risk, there have been introduced new instruments to hedge unfavourable market developments. These new instruments, called derivatives, are negotiated within the derivatives markets. These markets appear during the 90's, as a result of the uncertainties that overwhelm the development of some liberalized variables at that time: exchange rates and interest rates. The companies want to cover, first, against unexpected changes resulting from market liberalization.

Thus, derivative products are becoming absolutely necessary but very expensive instruments of the liberalized finances. With their help, financial markets have created new means of financing and insurance against risks of changing the value of an asset (stocks, bonds, interest rate, and exchange rate). Derivative products represent contracts whose value depends on (or "derives" from) the value of an asset. In essence, derivatives are estimates on the value development of these assets.

The general principle which was the basis for booming the derivatives products was the disintegration of risk. Using derivatives, which are risk transfer instruments, only known risks can be assessed. However, the risks that generate financial crises are impossible to predict and therefore ensuring against losses becomes practically impossible. Moreover, derivatives markets favour the emergence of new risks. As main causes of deepening the vulnerability of derivatives markets, the following are mentioned: strong involvement of banks as supporters of the market; considerable risks of contamination on the structure of these markets; weaknesses in the regulation and supervision area. (Aglietta, 2001, p. 62).

Resorting to some complex financial instruments was due to the investors' desire to obtain high yields, which were superior to the yields specific to the financial assets considered "traditional". Their use in increased proportion was mainly due to the low level of interest rates, a level that was far from being consistent with the appetite of investors hungry for yield. Some investors were willing to take different and practically uncontrollable risks in an effort to obtain high yields in the short term.

Conclusions

In the light of the recorded results, capitalism can be considered the most efficient economic system that humanity knew. However, economic stability remains a goal. In the past 30 years, market economies have had over 100 crises of various types. For these reasons, uncertainty and instability have become a fact of national economies.

Financial globalization has provided the opportunity for quick gains, but it also generated significant losses as a result of these crises, caused by the international volatile and pro-cyclical capital flows. The alternation of exuberance and pessimism causes determines strong and sustainable financial and economic environment fluctuations. The instability in the financial sphere draws the performance irregularity and the possibility of major risks. The uncertainty has become the main feature of this period. For an increasing number of economists the intensification of regulation becomes an essential component of market economies functioning to prevent crises and limit their scope for expansion.

The climate of deregulation that characterized the Bush-Greenspan era, led to the expansion of a new banking model, where securitization was within its centre. Banks have developed a variety of new techniques to transfer credit risk to other investors.

The philosophy of deregulation has exacerbated the virtues of self-regulation, which proved to be a misconception. Realities have shown the need to replace the old paradigm that supports the balance and efficiency of financial markets.

Financial markets have proven to be fundamentally unstable, while the financial speculation was in the centre of the new economy. The systemic risk became part of the dynamics of financial markets. Pronounced relaxation of the regulatory environment, the invention of new financial instruments and techniques, launching increasingly sophisticated financial products, developing a collective asset management industry and revolutionizing risk management have become features of the new capitalism, that is increasingly in the trap of the finances.

References

Aglietta, M. (2001). *Macroéconomie financière*, Édition La Découverte, Paris

Artus, P., Virard, M. P. (2008). *Globalisation, le pire est à venir*, La Découverte, Paris

Artus, P., Virard, M. P. (2007). *Le capitalism est en train de s'autodetruire*, La Découverte/Poche, Paris

Batsch, L. (2002). *Le capitalisme financier*, La Découverte, Paris

Boutang, Y.M. (2008). *Financiarisation et capitalisme cognitif*, in G. Colettis, B. Paulré, *Les nouveaux horizons du capitalisme*, Economica, Paris

Harbulot, C. (2007). *La main invisible des puissances*, Ellipses, Paris

Kempf, H. (2009). *Pour sauver la planète, sortez du capitalisme*, Edition du Seuil, Paris

Paulré, B. (2008). *Capitalisme cognitif et financiarisation des économiès*, in G. Colletis, B. Paulré, *Les nouveaux horizons du capitalisme*, Economica, Paris