Financialization is Marketization!
A Study on the Respective Impact of Various Dimensions of Financialization on the Increase in Global Inequality
(Sociological Science – forthcoming)

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Two major changes in world capitalism

• Increasing (wage, income, & wealth) inequality (Piketty et al.)

• Growth of finance
  – #OCCUPY (Wall Street, La défense, London Geneva)
    • Linking Finance & inequality
      – Are those two phenomena related and how?

• A link with multiple issues
  – A larger approach of the social impact of finance beyond booms and busts
  – A possible indicator on the rent extracting nature of finance
  – A case study on elite formation
What do we know yet?

- **Sector decomposition of wage & income inequality**
  - 1/6 to 1/3 of the rise in income inequality in United-States (Philippon and Reshef 2012; Bakija, Cole, and Heim 2010)
  - ½ in France (Godechot 2012)
  - 2/3 in UK (Bell and Van Reenen 2013)

<table>
<thead>
<tr>
<th>Country</th>
<th>Start</th>
<th>End</th>
<th>Increase in the share</th>
<th>Contribution of finance to this increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>France Panel</td>
<td>1996</td>
<td>2007</td>
<td>1.29%</td>
<td>51%</td>
</tr>
<tr>
<td>France Panel</td>
<td>1996</td>
<td>2007</td>
<td>1.32%</td>
<td>47%</td>
</tr>
<tr>
<td>France Panel</td>
<td>1996</td>
<td>2007</td>
<td>0.81%</td>
<td>57%</td>
</tr>
<tr>
<td>France Panel</td>
<td>1996</td>
<td>2007</td>
<td>0.38%</td>
<td>69%</td>
</tr>
<tr>
<td>France Exhaustive files</td>
<td>1996</td>
<td>2007</td>
<td>2.03%</td>
<td>33%</td>
</tr>
<tr>
<td>France Exhaustive files</td>
<td>1996</td>
<td>2007</td>
<td>1.54%</td>
<td>39%</td>
</tr>
<tr>
<td>France Exhaustive files</td>
<td>1996</td>
<td>2007</td>
<td>0.85%</td>
<td>48%</td>
</tr>
<tr>
<td>France Exhaustive files</td>
<td>1996</td>
<td>2007</td>
<td>0.38%</td>
<td>57%</td>
</tr>
<tr>
<td>UK 1998-2008</td>
<td>1998</td>
<td>2008</td>
<td>3.00%</td>
<td>33%</td>
</tr>
<tr>
<td>UK 1998-2008</td>
<td>1998</td>
<td>2008</td>
<td>1.80%</td>
<td>39%</td>
</tr>
<tr>
<td>UK 1998-2008</td>
<td>1998</td>
<td>2008</td>
<td>-</td>
<td>57%</td>
</tr>
<tr>
<td>US 1997-2005</td>
<td>1997</td>
<td>2005</td>
<td>2.54%</td>
<td>73%</td>
</tr>
<tr>
<td>US 1997-2005</td>
<td>1997</td>
<td>2005</td>
<td>1.65%</td>
<td>72%</td>
</tr>
<tr>
<td>US 1997-2005</td>
<td>1997</td>
<td>2005</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>
Towards a generalization of the finance/inequality link?

• Exploitation of inequality & finance databases: *Word Top Income Database, and Swiid, OECD & World bank*
  
  – Link between financialization and inequality with the Gini and top 1% (swiid) (14 countries, 20 years) (Kus 2013; Dünhaupt 2014).

• Analyze with more precision the impacts of financialization at several levels of the income distribution

• Discriminate between different varieties of financialization
What we want to show

• Financialization
  – A major factor of increase in income inequality
  – Increases income gaps especially at the top of the income distribution
  – Especially when this financialization is a marketization/securitization
    • Marketization as the increase in social energy devoted to the trade of financial securities.

• Three parts
  – Which financialization should matter and why?
  – A sector approach of financialization
  – Varieties of financialization and their respective impact
The sector approach as first proxy of financialization

- (Simple) Share of the financial sector (with or without insurance)
  - $\times 1.7$ in the US (from 5 to 8%) between 1980 and 2007 (Greenwood and Scharfstein 2012)
  - Sector decomposition of wages (Godechot 2012; Bell and Van Reenen 2013; Boustanifar, Grant, and Reshef 2014) of income and profits (Tomaskovic-Devey & Lin, 2011)
  - Rents in finance and the unequal share of the rents

- Internal limits
  - Traditional finance (retail banking / bankarization of the 1960s) not that much unequal
  - Market finance

- Financialization beyond finance sector:
  - Non-finance firms and households
Financial markets might produce specific inequality mechanisms

• Human capital important on the market but does not account well for pay discrepancies

• Superstar market mechanisms (Gabaix, Landier, 2008, Célérier, Vallée, 2015).
  – Requires a perfect knowledge of productivity
  – Innate talent not at odds with evidence of rents (Oyer, 2008)

• Hold-up mechanisms (Godechot, 2008, 2014)
  – “Acquired talent”: financiers appropriate and carry financial activity (knowledge, know-how, customers, teams)
  – Can (threaten to) move those assets, they did not fund, elsewhere.
Financialization of non-finance firms:  
1/ Shareholder orientation

- A new governance regime in firms giving priority to shareholders (Fligstein, 2002)
  - Dividend distribution and shares buy-backs (shifting from *retain and reinvest* to *downsize and distribute*) (Lazonick & O’Sullivan, 2000)
  - Debt as a resource and a discipline (Dobbin & Jung, 2015)
  - Stock-options and alignment of CEO interests and that of shareholders
  - Dediversification (Zuckerman, 1999)
  - CFO (Zorn, 2004)
  - An ideology serving institutional investors (managers) rather than shareholders (Dobbin & Jung, 2015)
Financialization of non-finance firms: 2/ bankarization

- Non corporate firms behave more and more as banks
  - Automobile industry selling more car credits than cars
- Krippner (2005)
  - Rising share of cash flow coming from portfolio income
  - 10% to 40% between 1970 to 2000
- Lin, Tomaskovic & Devey (2013)
  - Rising share of financial income over realized profits
  - Strong change in manufacturing firm
- Consolidation issue
Financialization of non-finance firms

• Shareholder orientation inequality mechanisms
  – More dividends for shareholders
  – Low wages crushed through downsizing pressure
  – Higher wages for executives
  – Financial sector intermediation

• Bankarization inequality mechanisms
  – Same as previous
  – Shift from production towards banking like activities
Financialization of households

• Savings through financial securities
  – Rise of popular capitalism (Harrington, 2008; Fligstein & Goldstein, 2015)
    • But decline of securities (outside pension funds) in the bottom 90% as a form
      of saving (Saez & Zucman 2014).
    – Shift towards pension funds retirement system; More market organized
      (ERISA Act 1974 ; Montagne, 2006)
  
• Promotion of credit (Fligstein & Goldstein, 2015)
  – Mortgage / Student loans / Credit card (Jorda, Schularick, Taylor, 2014 ;
    Poon 2009)
    – Subprime crisis as the climax
    – credit scoring as a disembedding technology

• The emergence of a portfolio society (Davis, 2009)
Financialization of households

• Inequality mechanisms
  – More dividends for wealthy households
  – More investment opportunities through debt with low interest rates for wealthy households
  – Poor households go into debt and pay high interest rates to the wealthy households who hold securities
  – Financial sector intermediation
Inequality and top incomes as the dependent variable

• World top income database
  – Top 10%, Top 1%, Top 0.1%, Top 0.01%
  – Piketty, 2013 corrections
  – Income only (capital gains excluded)

• OECD inequality measures
  – D9toD5, D9toD1, D5toD1

• Gini (Swiid database)

• 18 OECD countries used (top 1%):
  – Australia, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom, United States

• Period: 1970-2012
Model

Panel model

\[ \text{Inequality}_{it} = \text{financialization}_{i(t-1)} + \text{Controls}_{i(t-1)} + g_i + a_t + \text{error}_{it} \]

Country and time fixed effects:

- Explanation in terms of evolutions
- Common business climate captured by time fixed effects

One year lagged independent variables

\[ \Rightarrow \text{Better causal interpretation} \]

Panel robust standard errors (Beck & Katz 1995)
Base model: the sector approach

- Financialization = Increase in the share of finance & insurance to GDP
  - Control for GDP, union rate and import rate
- Financialization effect is higher for explaining inequality at the top of income distribution.
- 1 standard-deviation (intra-country) of finance => 0.23 standard-deviation of top 0.1% share and 0.4 s.d. of top 0.01% share

Table 1. Impact of the finance share of the GDP on income inequality

<table>
<thead>
<tr>
<th></th>
<th>Gini Index</th>
<th>D5/D1</th>
<th>D9/D1</th>
<th>D9/D5</th>
<th>Top 10% share</th>
<th>Top 1% share</th>
<th>Top 0.1% share</th>
<th>Top 0.01% share</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP per capita (t-1)</td>
<td>-0.51***</td>
<td>0.62***</td>
<td>0.34**</td>
<td>0.13*</td>
<td>-0.21*</td>
<td>0.04</td>
<td>-0.02</td>
<td>0.02</td>
</tr>
<tr>
<td>Union rate (t-1)</td>
<td>-0.27***</td>
<td>-0.16**</td>
<td>-0.23***</td>
<td>-0.25***</td>
<td>-0.36***</td>
<td>-0.23***</td>
<td>-0.1**</td>
<td>-0.14***</td>
</tr>
<tr>
<td>Import rate (t-1)</td>
<td>-0.15***</td>
<td>0.41***</td>
<td>0.17*</td>
<td>-0.03</td>
<td>-0.11**</td>
<td>-0.13**</td>
<td>-0.15**</td>
<td>0.17*</td>
</tr>
<tr>
<td>Finance &amp; insurance/GDP (t-1)</td>
<td>-0.04</td>
<td>-0.04</td>
<td>0.16**</td>
<td>0.18***</td>
<td>0.12***</td>
<td>0.23***</td>
<td>0.28***</td>
<td>0.41***</td>
</tr>
<tr>
<td>Adj. within R2</td>
<td>0.150</td>
<td>0.081</td>
<td>0.086</td>
<td>0.152</td>
<td>0.174</td>
<td>0.147</td>
<td>0.127</td>
<td>0.229</td>
</tr>
<tr>
<td>Nb. obs./ countries/years</td>
<td>673/18/42</td>
<td>391/18/42</td>
<td>391/18/42</td>
<td>391/18/42</td>
<td>604/18/42</td>
<td>623/18/42</td>
<td>538/17/42</td>
<td>368/14/42</td>
</tr>
</tbody>
</table>
Which variety of financialization counts the most?
Non-finance firms financialization don’t impact much inequality

- Dividends could have a modest effect as in Dünhaupt (2014)
- No effect or negative effect of non-finance firms bankarization.

Contrarily to Lin & Tomaskovic-Devey 2013

### Table 2. Impact of non-financial firms’ financialization on income inequality

<table>
<thead>
<tr>
<th></th>
<th>Finance/GDP</th>
<th>Gini Index</th>
<th>D5/D1</th>
<th>D9/D1</th>
<th>D9/D5</th>
<th>Top 10% share</th>
<th>Top 1% share</th>
<th>Top 0.1% share</th>
<th>Top 0.01% share</th>
</tr>
</thead>
<tbody>
<tr>
<td>1Corporate debt / GDP (t-1)</td>
<td>0.17***</td>
<td>-0.03</td>
<td>0.13*</td>
<td>0.09</td>
<td>0.04</td>
<td>-0.07*</td>
<td>0.01</td>
<td>0.05</td>
<td>0.05</td>
</tr>
<tr>
<td>Nb. obs./ Countries / years</td>
<td>563/16/600/16</td>
<td>373/16/373/16</td>
<td>373/16/373/16</td>
<td>373/16/373/16</td>
<td>536/16/555/16</td>
<td>503/15/384/13</td>
<td>42/42</td>
<td>42/42</td>
<td>42/42</td>
</tr>
<tr>
<td>2Net distributed income / Operating surplus (t-1)</td>
<td>-0.71***</td>
<td>0.01</td>
<td>-0.01</td>
<td>-0.1*</td>
<td>-0.1*</td>
<td>0.16*</td>
<td>0.16</td>
<td>0.13</td>
<td>0.15</td>
</tr>
<tr>
<td>Nb. obs./ Countries / years</td>
<td>289/15/304/15</td>
<td>224/15/224/15</td>
<td>224/15/224/15</td>
<td>224/15/224/15</td>
<td>266/15/280/15</td>
<td>226/13/150/10</td>
<td>42/42</td>
<td>42/42</td>
<td>42/42</td>
</tr>
<tr>
<td>3Fin. income/Operating surplus (t-1)</td>
<td>0.08</td>
<td>-0.12*</td>
<td>-0.36***</td>
<td>-0.33***</td>
<td>-0.09</td>
<td>-0.4***</td>
<td>-0.3***</td>
<td>-0.23**</td>
<td>0.07</td>
</tr>
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<td>226/13/150/10</td>
<td>42/42</td>
<td>42/42</td>
<td>42/42</td>
</tr>
<tr>
<td>4Financial assets/ GDP (t-1)</td>
<td>-0.09</td>
<td>-0.17*</td>
<td>-0.3***</td>
<td>-0.16*</td>
<td>0.04</td>
<td>-0.35***</td>
<td>-0.19***</td>
<td>-0.15*</td>
<td>-0.18*</td>
</tr>
<tr>
<td>Nb. obs./ Countries / years</td>
<td>267/16/287/16</td>
<td>236/16/236/16</td>
<td>236/16/236/16</td>
<td>236/16/236/16</td>
<td>260/16/260/16</td>
<td>225/14/165/11</td>
<td>/23</td>
<td>/23</td>
<td>/23</td>
</tr>
</tbody>
</table>
Households financialization counts more than that of non-finance firms

- Household debt and moreover intermediated finance (mutual funds) count more than the direct ownership of financial securities

<table>
<thead>
<tr>
<th>Income Inequality Measure</th>
<th>Finance/GDP</th>
<th>Gini Index</th>
<th>D5/D1</th>
<th>D9/D1</th>
<th>D9/D5</th>
<th>Top 10% share</th>
<th>Top 1% share</th>
<th>Top 0.1% share</th>
<th>Top 0.01% share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shares and other participations without mutual funds/ GDP (t-1)</td>
<td>-0.29***</td>
<td>-0.25**</td>
<td>-0.16*</td>
<td>-0.25***</td>
<td>-0.24***</td>
<td>-0.18***</td>
<td>-0.04</td>
<td>0.06</td>
<td>0.1</td>
</tr>
<tr>
<td>Mutual funds/ GDP (t-1)</td>
<td>0.1</td>
<td>0.41***</td>
<td>0.3***</td>
<td>0.55***</td>
<td>0.5***</td>
<td>0.07</td>
<td>0.11*</td>
<td>0.17**</td>
<td>0.36***</td>
</tr>
<tr>
<td>Nb. obs./ Countries / years</td>
<td>245/15</td>
<td>263/15</td>
<td>219/15</td>
<td>219/15</td>
<td>219/15</td>
<td>238/15</td>
<td>238/15</td>
<td>211/14</td>
<td>155/11</td>
</tr>
<tr>
<td>Household debt/ GDP (t-1)</td>
<td>0.52***</td>
<td>0</td>
<td>0.1</td>
<td>0.29**</td>
<td>0.27***</td>
<td>0.03</td>
<td>0.11*</td>
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<td>555/16</td>
<td>503/15</td>
<td>384/13</td>
</tr>
</tbody>
</table>
Market activities rather than classical credit activity

- Traded volume has a strong impact as in Dünhaupt (2014) and Kus (2012)
- Similarly the growth the assets sides invested in financial securities as in Kus (2012)

Table 4. Impact of financial sector securitization on income inequality

<table>
<thead>
<tr>
<th></th>
<th>Finan</th>
<th>Gini</th>
<th>D5/D1</th>
<th>D9/D1</th>
<th>D9/D5</th>
<th>Top 10%</th>
<th>Top 1%</th>
<th>Top 0.1%</th>
<th>Top 0.01%</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Volume of stocks traded to GDP/GDP (t-1)</strong></td>
<td></td>
<td>0.39***</td>
<td>0.1*</td>
<td>-0.06</td>
<td>0.18*</td>
<td>0.22***</td>
<td>0.24***</td>
<td>0.28***</td>
<td>0.3***</td>
</tr>
<tr>
<td>Nb. obs.</td>
<td></td>
<td>356/18</td>
<td>385/18</td>
<td>308/18</td>
<td>308/18</td>
<td>308/18</td>
<td>355/18</td>
<td>355/18</td>
<td>285/15</td>
</tr>
<tr>
<td><strong>Loans in asset/ GDP (t-1)</strong></td>
<td></td>
<td>0.42***</td>
<td>-0.07</td>
<td>-0.05</td>
<td>-0.06</td>
<td>-0.05</td>
<td>-0.14</td>
<td>-0.06</td>
<td>0.18**</td>
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<td>Nb. obs.</td>
<td></td>
<td>267/16</td>
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<td>236/16</td>
<td>260/16</td>
<td>260/16</td>
<td>225/14</td>
</tr>
<tr>
<td><strong>Shares and related equity assets / GDP (t-1)</strong></td>
<td>0.12</td>
<td>0.31**</td>
<td>-0.08</td>
<td>0.15</td>
<td>0.26*</td>
<td>0.14*</td>
<td>0.17*</td>
<td>0.43***</td>
<td>0.61***</td>
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<td>236/16</td>
<td>260/16</td>
<td>260/16</td>
<td>225/14</td>
</tr>
</tbody>
</table>
Overall view

- Sample reduced due to loopholes in data
- Household financialized collective savings => intermediary inequality
- Household debt effect disappears once controlled for marketization
- Traded volume and shares in banks’ assets => gaps between income elites and the rest

Table 5. Overall view

<table>
<thead>
<tr>
<th></th>
<th>Finance /GDP</th>
<th>Gini Index</th>
<th>D5/D1</th>
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<th>Top 0.01% share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Household participations in mutual funds/ GDP (t-1)</td>
<td>-0.12</td>
<td>0.28***</td>
<td>0.38***</td>
<td>0.43***</td>
<td>0.24**</td>
<td>-0.08</td>
<td>-0.01</td>
<td>-0.01</td>
<td>0.15*</td>
</tr>
<tr>
<td>Household debt / GDP (t-1)</td>
<td>0.18 ·</td>
<td>-0.08</td>
<td>-0.28**</td>
<td>-0.14</td>
<td>-0.03</td>
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<td>0.28***</td>
<td>0.24**</td>
<td>0.21 ·</td>
</tr>
<tr>
<td>Shares and related equity in banks’ assets / GDP (t-1)</td>
<td>0.26**</td>
<td>0.14</td>
<td>-0.3***</td>
<td>-0.01</td>
<td>0.24**</td>
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<td>238/15</td>
<td>211/14</td>
<td>155/11</td>
</tr>
</tbody>
</table>
Summary of findings

• Financialization foster the growth of inequality, especially at the top of the income distribution
  – Financialization of non-financial firms not tied to the increase in inequality
  – Financialization of households through mutual funds and debt tied to the increase in inequality
    • But impact at the top mainly through their impact on the financial sector, especially via marketization

• Financialization or marketization?
  – Marketization as the growing social energy devoted to the trade of financial securities
  – Strongly impacts inequality, especially at the top.
  – How? Via financial wages
  – What’s specific to financial markets labor markets? Superstars? Hold-ups?
Interpretation
The importance of hold-ups in finance
A case of hold-up (Godechot 2008)

• 17 millions for a head of trading room and his deputy at Neptune Bank in early 2001.

• A contract
  – Resignation of the 2 for a German rival bank
  – 48 hours given to their bank to match the rival offer
  – Formula 8,5% + 6,5% of the bonus pool
  – On the eve of a major Securities Transaction

• A great year in 2000
A well done negotiation

• **Timing**
  – Exploiting the feeling of urgency linked to the securities transaction.

• **Choice of the bank**
  – Secret
  – Not involved yet in equity derivatives
  – Credibility.

• **Percentage**
  – Benefiting from the growth of money invested without being affected by the growth of headcount
  – Rate used in the formula would probably be applied on very different pools.
  – Remains acceptable for the bank (short term profit not diminished)
A well done negotiation (2)

- **Overall context**
  - Very good economic conditions for the following year. But probable reversal.
  - Leveraging the frenzy of *last-movers*
  - Without taking the risk of going with *last-movers*

- **Resigning together**
  - Resignation: signal of determination
  - Collective. Difficult to replace
  - Social Capital. Credible threat to take their whole team with them

=> A sense of *kairos*.
The mechanics of hold-up

• Appropriation of the firm’s key assets
  – The “talent” of the financial worker is not innate.
  – Progressive accumulation of “talent” through the accumulation of financial experience
  – Financial experience. Appropriation of key assets collectively produced
    • Knowledge
    • Know-how
    • Customer Relations
    • Team work

• From appropriation towards the test of strength
  – Legitimization: Forgetting the collective origin and claim for profit
  – Taking advantage of an external offer in order to renegotiate
  – Credible threat of moving part of key assets and part of the activity
Types of collective moveable assets

• Physical capital
  – Computers
  – Software
  – Documentation

• Human capital
  – Knowledge (Traders, sales)
  – Know-how (traders)
  – Financial secrets (arbitrage techniques, etc.)

• Social capital
  – Client relationships (especially sales, M&A, Private equity)
  – Reputation (financial analysts, M&A)
  – Teams (head of...
What do we know and what do we know less?

• A rent sharing mechanism on the financial market
  – Superstar and winner-take-all mechanisms:
    • Rosen (1980), Gabaix and Landier (2008), Célérier (2012)
  – Asset appropriation and hold-up: Godechot (2008)

• Long term maintenance of the rent
  – Deregulation and limited competition
  – Hold-up mechanism compatible with the transfer of all the rent to wage earners
Thank you!
Questions?

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More in papers:


