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Global Challenges and Policies of the European Union
– Consequences for the "New Member States"

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THE INSTITUTIONAL CONTEXT OF FINANCIALIZATION

1. Introduction

The phenomenon of financialization of non-financial corporations has been widely observed in the US economy since the 1980s and since the 1990s in some European economies as well. This is as a pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production [Krippner 2005, p. 181]. "Financial" here refers to activities relating to the provision (or transfer) of liquid capital in expectation of future interest, dividends, or capital gains. There is a range of research that points to the increasing salience of finance in the economy [Brenner 2002; Epstein (ed.) 2005]. The literature addressing the problem with reference to firms tends to focus either on organizational developments with strong link to shareholder view in corporate governance [Lazonick, O'Sullivan 2000; Williams 2000], or on activities inside financial markets [Phillips 2002]. This paper deals with the financialization from the perspective of institutional economics. This means an approach broader than a mere "technical" analysis of corporate balance sheets, which aims to identify relation between such corporate behaviour and the nature of contemporary economy, described by a range of social science research since the 1980s.

The financialization has a wide international impact. Having started in the USA, it was diffused with various velocity and to different extent to the economies in the West of Europe. Since the phenomenon means as much a change in pattern of accumulation as change in pattern of thinking in executive boards, and since the American and European corporations often stand at the top of the global value chains, this process has its consequences for the developing South [Palpacuer 2008]. The referred patterns and problems are also transferred to other peripheral economies, new member states of the EU included.

2. The changing pattern of accumulation of non-financial corporations

There is strong evidence that finance has become an extremely lucrative source of profits. In general, profitability of financial corporations is higher than profitability of non-financial corporations. In the US this advantage appeared and has been on constant rise since the early 1980s [Dumenil, Levy 2005, p. 38]. In France and in other EU countries it has been observed since the early 1990s [Morin 2000]. A thesis can be risked that at the turn of the 21st century the returns from financial activities rather than from manufacturing became a vehicle of the developed market economies.

It makes a context for a changing pattern of accumulation in non-financial corporations which seem to be increasingly interested in non-productive and non-trade activities. Whether and how can this change be measured? After G. Krippner [2005, p. 174] this paper refers to an index, projected as portfolio income related to cash flows, with the former containing interest income, dividends and share buybacks. The index reveals a rapid relative increase in income accumulated through financial channels in the US non-financial corporations ever since the end of the 1970s. In the peak years at the turn of the 1980s and the 1990s, as well as in 2000, this revenue made almost a half (more than 0.4) of cash flows [Krippner 2005, p. 185]. During the 1980s and 1990s it multiplied and fluctuated around the levels 3-5 times higher than the levels of the 1950s and the 1960s.

The data show a shift in the accumulation pattern of non-financial corporations in the USA to financial activities. The shift is even more spectacular in those corporations which invested overseas in 1977-1999 [Krippner 2005, p. 196]. This is an important message for the host countries for American FDI, in particular – for countries from the West and East of Europe.

The phenomenon of financialization was imported to Europe along with the US investments and managerial skills. Financial liberalization of the 1980s (in Western Europe) and of the 1990s (in Eastern Europe) resulted in a surge in FDI; both the American subsidiaries and the domestic corporations, which were made to compete with them, used to recruit heavily from Anglo-Saxon executives. Having in mind that any convergence among countries is a debatable issue, it is interesting to follow some data which suggest the similar shift in pattern of accumulation in non-financial corporations in Europe.

Let us have a look at a sample of global leaders in food industry, exposed in Table 1. In this case the index contains dividends and share buybacks as related to cash flows, that is the interest income included in Krippner's index has been skipped. Neither are the figures in Table 1 to be compared with the figures quoted by G. Krippner for other reasons. Namely, the sample here is far more narrow since it contains hardly more than dozen corporations which represent only one branch of manufacturing, whereas the indices for the US corporations discussed above refer either to manufacturing as a whole or to all non-financial industries. However, these comments do not devalue the data presented beneath, since financialization is meant as a process here and therefore the dynamics rather than the levels seem to be relevant.

Table 1. Dividends and share buybacks as % of cash flows, 1996-2000, food industry

Year	European multinationals (*n*=11)	American multinationals (*n*=8)	Total multinationals (*n*=19)
1996	26.6	101.7	48.8
1997	28.1	67.0	42.1
1998	32.6	116.0	54.9
1999	47.1	93.1	59.0
2000	33.3	68.1	46.2
Average	**33.5**	**89.2**	**56.4**

Source: based on [Palpacuer, 2008, table 2].

The data on selected global non-financial corporations of European origin reveal an increasing significance of financial channels of income in their accumulation pattern (Table 1). In this group such multinationals like Danone, Nestle and Unilever can be named. The above finding is also valid for 40 largest French corporations [Palpacuer et al. 2008; Morin 2000]. Of course, the process should not be treated as a complete one, especially with reference to Europe, where industries as well as regions exist where companies have weak interest in making profits due to financial activities. For example, the European firms from textile industry are practically absent in capital markets, and in Scandinavia the phenomenon of financialization along with its consequences is hardly known [Palpacuer 2008].

The relatively recent interest of corporate boards in accumulation through financial channels can be discussed in many respects. For sake of precision until now the statistical measures were used. However, the phenomenon should be meant as an outcome of changing patterns in managerial decision-making rather than as a statistical or an accounting question.

3. The context: Institutional interlocking in the contemporary economy

Since non-financial corporations with sales comparable to some countries' GDP and involved in transnational activities are at stake, their increased interest in profit-making through financial channels should not be neutral for values shared by the political and intellectual establishments both in countries of their origin and in their host countries. To put it differently, the financialization is not without consequence for coordination, stimulation and enforcement systems within corporation as well as at national economy level. The systemic change is backed by changing rules of the game [North 1990]. In this section some points will be made on the institutional context of contemporary developments in corporate governance, within economic systems and in social and economic policies. Due to the space limit only a blueprint of these complex issues can be afforded.

3.1. New institutional arrangements in the corporate domain

Financialization is directly associated with corporate strategy and coordination. With the phenomenon spreading from the US to Europe (and in the late 1990s to Japan), new institutional arrangements have diffused, enhancing so called "shareholder view" in corporate governance. The new components in systems of motivation and control make executives in non-financial corporations care about dividends and be involved in share buybacks – the change of behaviour signalled by the indices quoted in the preceding section of the paper.

In the European corporations under investigation [Palpacuer et al. 2008], following the American pattern a new form of executives' reward became institutionalized. So called "stock options" make executives' earnings dependent to a considerable degree on stock prices and on corporate value.

Also the reporting systems make managers of non-financial corporations sensitive to expectations of the financial markets. For example, an Economic Value Added index (EVA), introduced in some European corporations at the turn of the century, includes among others return on equity expected by the investors. It means trending away from the former practices when the return was calculated *ex post*, that is as a residual, and it shifts risks from shareholders to stakeholders.

Thus, managers, involved in stock markets and dealing with rising indebtedness of their corporations, tend to communicate intensively with brokers and bankers. The corporate boards and the financial markets agents establish consulting procedures. Such institutionalization of mutual communication implies for some authors a new alliance that gains significance the more, the more traditional social compacts with employees, that is with major stakeholders, erode.

The institutional change at the top of corporation is not without consequence for coordination and enforcement system in the whole organization. Managerial practices, along with concepts drawing from the agent-principal theory and from the property rights theory, assign to managers a role of professionals who are hired to create value for shareholders. Human resources are treated like a commodity, which means, abruptly speaking, that if an employee's price turns out to be non-adequate to his or her input into increase in value, he or she is to be fired. Analogously, relations with other stakeholders, such as business partners, bankers and suppliers, become commodified. This can be contrasted with the traditional stakeholder view in corporate governance, basing on cultivation of long-established relations with the groups just mentioned. The shareholders benefit chiefly due to dividends and share buybacks, that is thanks to financialization. This implies an increase in significance of stock markets, firstly – as a source of income, and secondly – as a "market for corporate control." The latter means that managers are disciplined and stimulated in their shareholder-value creation activities by potential hostile take-overs and acquisitions.

This relatively new approach in the corporate domain seems to have been prevalent in the USA since the 1980s. It is also reported to be crowding out an alternative approach (i.e. stakeholder view), of which the best representation is still believed to be embodied in German corporations and in Japanese *keiretsu* [Lazonick 1998; Dore 2000]. The encounter, however, can be observed not at corporate level alone (see Table 2).

Table 2. Two competing (since the 1980s) ideational systems concerning resource allocation and social relations

The level	Social-value-oriented system	Market-oriented system
Corporate governance	Stakeholder view	Shareholder view
Economic system	Traditional German model (D-model, Rhein capitalism, etc.), traditional Japanese model	Contemporary Anglo-Saxon model (managerial capitalism, stock-market capitalism, etc.)
Economic and social policies	Socio-liberal policies, regulations	Neo-liberal policies, deregulation
Behavioural premises	Cooperative attitudes: collective action and common objectives, trust-based	Economic individualism: individual interest, economic rationalism, oportunism

Source: elaborated by the author.

3.2. Changing social coalitions and values in the domain of state

Institutional change at corporate level influences institutions in the domain of state and thus it has impact on the whole economic system. This is the field elaborated by comparative political economy, the Varieties of Capitalism school (VoC) among others [Aoki 2001; Dore 2000; Hall, Soskice (eds.) 2001]. Following M. Aoki, economic systems are modelled in result of researching into two fundamental fields: the types of the state (liberal democratic state, developmental state, etc.) and the conventions of organizational architecture along with institutional forms of relational-contingent governance (functional hierarchy, participatory hierarchy, network-integrated hierarchy, etc.). According to this approach, the state contains government as well as the government-made and government-enforced rules. Nevertheless, the state means also a political exchange played by the government and private agents which results in a stable order of relationships [Aoki 2001, p. 152]. The governmental decision-making is being influenced by economic agents, firms among others, through different channels of access in the polity domain. Since corporate organizations have their share in shaping the government, the evolution of organizational architecture and governance is not without consequence for the nature of the state and, logically, for the economic system.

There is some evidence that a traditional system of the major economy of Europe is being eroded. In so called D-model by M. Aoki, which draws from the stylized observations of German economy before 1991, the corporatist state plays an important role as a complement to particular form of corporate governance structure – co-determination [Aoki 2001, p. 165]. Since the 1990s institutions in the domain of state seem to be sensitive to the change in the corporate domain, related to the ideology of shareholder value creation. In this context a question of diffusion of the "Anglo-Saxon model"[Dore 2000] or of the "transnational model"[Aoki 2001] in Europe is under debate (see Table 2). Traditionally, as the German example suggests, in the domain of polity the role of social partners, such as trade unions, industrial associations and NGOs, in the decision-making is significant, and naturally enough, the issues of labour and welfare matter [Mączyńska, Pysz (eds.) 2003, Koźmiński 2003]. At the background of such a corporatist model of coordination and of the welfare type of the state there used to be a "social compact" between employers and employees, which nowadays erodes due to the financialization of major employers [Silver 2003]. Social solidarity seems to be crowded out by consumerism, whereas the propensity to massive consumption is inflated mainly due to advertising and marketing of global corporations.

3.3. The changing institutional framework for economic policies

The hierarchies of social values as well as the formal procedures, mentioned in the previous section, constitute an institutional framework for economic and social policies. Political preferences and vested interests are transformed into practical recommendations for macroeconomic and structural policies. In Europe social needs are treated differently than in the US, and social consequences of economic policies seem to be more relevant. Reasons for security of the unemployed, of consumers, of bank's customers imply regulation of those activities which seem "socially vulnerable." However, due to the institutional change drafted above, the "Americanization" can be observed in Europe also in the field of economic policies. The traditional approach has competed since the 1980s with the policy paradigm which was introduced first by the Reagan's and Carter's administrations in cooperation with the FED under Volcker in aim to facilitate firms' restructuring and regaining competitive advantage, in the face of mostly Asian competitors [Panitch, Gindin 2005]. Consequently, economic policies turned to be about economic efficiency and about social environment friendly first of all to entrepreneurs and investors as the leading agents of economic growth. More precisely, recommendations are for increasing the market domain through deregulation of the activities under the state's control as well as through their privatization. Due to the same premises, macroeconomic policies focus on tax-burden decreases and on constraining inflation. The role of the state in market economy, so differently defined in the course of the post-war economic history, can be labelled here respectively as a social-liberal and a neo-liberal view (see Table 2).

The discussed trending away from social-liberal policies in the member-states can be also observed at the UE level. A dilemma of Europe's integration could be expressed in questions, whether institutions of the social dialogue as well as the welfare function of the state should be nourished as significant traces of the European success and identity, or if rather the welfare state should be constrained and the market domain expanded for sake of enhancing innovation and improving competitive advantage over the nations less concerned with social security. The welfare model founded on social dialog is still supported by the EU declarations, however, social policies are basically discussed in the sense of both required expenditure cuts and loss in terms of efficiency and GDP growth. Actually, the neo-liberal option became institutionalized in the founding treaty of the European Union as well as in the statute of the European Central Bank ["Pełne zatrudnienie..." 2004].

Institutions at the transnational level and those at national and other levels interact and co-evolve. Political institutions and economic policies in the leading countries, first of all in the US, in Japan and in Great Britain, turned out to be crucial for the wake of global financial markets in the 1970s and the 1980s [Sobel 2005, pp. 207-220]. On the other hand, globalization of finance became a challenge to national governments in the case of both developed and emerging market economies, no matter to what extent the on-going debate constitutes a constraint to national economic and social policies. The value added by this paper to the abundant literature of the issue [Cerny 1996; Gill, Law 1988; Hirst, Thompson 1999; Strange 1996; Wade 1996] could be as follows. The interlocking institutions, governing economic activities at different levels, result in ideational systems, exposed in the last column of Table 2, which seem to be adequate to the complex contemporary meaning of globalization. If so, the phenomenon of financialization, identified in the opening section of this paper, represents a relevant foundation of this mega-process.

Students of contemporary economy try to identify main trends in many ways. Those, who focus on the activities critical for economic growth, name post-industrial phase, knowledge-based economy, etc. Those, who were followed in this paper, focus on changing pattern of accumulation in the leading corporate organizations, that is in the multinationals large enough to influence a national economy's performance and to contribute to globalization of competition. According to the latter perspective, the observation which matters refers to the increased profit-accumulation by these agents, especially those from non-financial sectors, through financial channels as well as to their increased vulnerability to developments in financial markets. Finding out that such a behaviour, called here the financialization, gained significance in the core and may be diffused to the peripheries, can make a nature of contemporary economy easier to comprehend. That is what this paper attempted at.

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