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The Monetary Root of Financialization

***By* LUO YU**[*]

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Abstract

Marxism has a strong influence on Western left-wing economists' understanding of financialization, in that they regard financialization as the consequence of the transformation of capitalism. Neoclassical economics and finance scholars tend to think of financialization (financial development) as not exclusively occurring within the economic system of capitalism but as existing throughout an entire human history filled with numerous financial innovations. The unprecedented change of the monetary system ascribed to the collapse of the Bretton Woods System, among all historical and systemic changes, is the strongest underlying impetus to financialization. Financialization is the unintended consequence of a change in the monetary system from commodity money to credit money. Taking a more in-depth point of view, financialization is philosophically a means for human beings to cope with the advent of a risk society, reflecting the advance of instrumental rationality, and hence is the embodiment of late modernity.

Keywords: Financialization; monetary root; risk society; instrumental rationality

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1. Introduction

Finance's pervasive role in the economy and society over the last four decades is often referred to as the process of 'financialization' (Arrighi 1994; Epstein 2005; Palley 2008;Van der Zwan 2014). However, interpretations of the definition, origin, and nature of financialization vary among scholars, who can roughly be divided into two ideologically opposing parties. Lapavitsas (2011) states that the concept of financialization has emerged from within Marxist political economy in an effort to relate a boom in finance to poorly performing production, but there is no general agreement on what it means, and other areas of the economic and sociological literature have also become involved in this issue. The so-called "heterodox economists" have commonly used this terminology to describe the current development of capitalism. For example, left-wing economists, influenced by Marxism and post-Keynesian economics, frequently use the term to depict capitalism as it enters a new stage. A classical broader definition of financialization is 'the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies' (Epstein2005,3), while from more narrow perspectives, financialization is defined as 'a pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production' (Krippner2005, 174), 'the engagement of non-financial businesses in financial markets' (Stockhammer 2004, 721), or 'the shift in gravity of economic activity from production (and even from much of the growing service sector) to finance' (Foster 2007, 8). In general, left-wing scholars emphasise the negative effects of financialization. They criticize the process behind it and the policy framework that accelerates it, and they propose 'de-financialization.' By contrast, mainstream economics and finance scholars hold positive or at least neutral attitudes towards financialization, regarding it as a phenomenon or a consequence of financial innovation and financial development. Although mainstream scholars do not use the term 'financialization' often, they use alternative terminologies that express a similar meaning. From a macro perspective, both Goldsmith's (1969)theory on the evolution of financial structures and MacKinnon's (1973) and Shaw's (1973) theories on financial deepening can be considered to represent a branch of the origin of financialization. It has been stated that an essential function of finance is to enhance liquidity for less liquid assets: once liquidity is increased, assets can be allocated more efficiently, thus creating economic value(Levine1997). In his bestseller *Capitalism in the 21st Century*, Piketty (2014) also mentioned the effect of financialization on enlarging the income gap. From a micro perspective, financialization is defined as the securitization of commodities or assets with the help of financial innovation. Tang and Xiong (2012) reveal that commodity prices behave similarly to typical financial assets and that the futures prices of different commodities have become increasingly correlated since the early 2000s in the US, which they identify as the start of the financialization of commodities markets. The financialization of commodities implies that market pricing does not mainly rely on supply and demand, but on series of financial factors. The securitisation of assets is also known as a typical pattern of financialization. The nature of securitisation is to transform less liquid assets into more liquid assets (Chen et al.2013).

Despite differences in interpreting the term 'financialization,' all opinions stand on three stylized facts: (1) financialization enhances the relative importance of the financial sector vis-à-vis real sectors, which means that the socio-economic and political influence of the financial sector has increased since the 1970s; (2) non-financial enterprises become increasingly involved in financial activities, which leads to greater income transfer from non-financial sectors to the financial sector; and (3) financialization exacerbates the inequality of income distribution, i.e., the labour share of national income shrinks and income gaps between executives and employees grow (Lin andTomaskovic-Devey2013). Numerous studies have attributed financialization to neoliberalism, deregulation, capital monopoly, the increasing scale of institutional investors, shareholder value orientation movements, among other things. After the 2008global financial crisis, left-wing scholars argued that financialization reflected an inherent defect in contemporary capitalist institutions; hence, they see de-financialization as a must to cope with a series of socio-economic problems. However, mainstream economists have unshakeable faith in fundamental economic theory, which claims that financial innovation and financial development are needed and should be encouraged. Meanwhile, economists must rethink the role that finance plays in benefiting society, and financial rent-seeking should be more prudently regulated (Zingales 2015). The aim of finance is to build a 'good society' (Shiller2013).

Ideology imposes its conspicuous role in the existing study. In the author's opinion, financialization is not a unique feature of capitalism, nor should it be tagged good or bad. Neoliberalism plays an important role indeed; however, the fundamental causes behind the prevalence of financialization lie in the great changes in finance itself. Some studies have more or less deviated from the intrinsic logic of finance when discussing financialization in an attempt to understand financialization from peripheral factors. They prefer a grand narrative to explain the origin and nature of financialization, rather than micro mechanisms. There is value in seeking the monetary root of financialization to better clarify the related controversies and to reconcile the understanding of heterodox and mainstream economists on the origin of financialization. The well-known post-war international economic order, the Bretton Woods System, lasted for less than thirty years, from its establishment in 1944 to its collapse in 1971, but it still had a far-reaching impact. Thecurrent global monetary system was formed after the end of the Bretton Woods System, but the influence that the end of the Bretton Woods System imposes on monetary and financial development is sometimes undervalued. Ordinary people may take for granted that credit money, e.g., legal tender notes, is a product with a long history, while in fact, pure credit money is a modern creation ascribed to the collapse of the Bretton Woods System.

This paper attempts to reveal the connection between the collapse of the Bretton Woods System and the advent of the financialization era. We believe that the unprecedented change in the monetary system, among all historical and systemic changes, is the strongest underlying impetus behind financialization. Financialization is the unintended consequence of changes in the monetary system, for which the collapse of the BrettonWoods System serves as a watershed. From a more in-depth point of view, financialization is philosophically a natural choice made by human beings to cope with the advent of a risk society; it reflects the advance of instrumental rationality and hence is the embodiment of late modernity.

The remainder of this paper is organized as follows: First I provide a literature review on the origin of financialization. The following section describes the relationship between the collapse of the Bretton Woods System and the advent of the financialization era, in which we try to identify the monetary root of financialization. Next, I further discuss the nature of financialization against the theoretical background of a risk society and late modernity. The last section concludes the paper.

2. A literature review on the origin of financialization

Neo-Marxism economics

Radical political economics

Radical political economists are the earliest scholars to systematically address the concept of 'financialization.' They commonly follow Karl Marx's analysis of capitalism, Hilferding's (2006)analysis of finance capital, and the thinking of Paul Baran and Paul Sweezy (1966)on monopoly capital to explain the changes in capitalism over the last four decades. They often characterise these changes as three mutually reinforcing trends: 'neoliberalism', 'globalisation', and 'financialization.' Financialization is now increasingly seen as the dominant force in this triad (Foster 2007), resulting in 'financial hegemony' (Duméniland Lévy 2011). Financialization, according to Foster (2007), is 'the shift in gravity of economic activity from production (and even from much of the growing service sector) to finance'. It is believed that the emergence of financialization correlated with the stagnation of the capitalist economies after the 1970s.The stagnation stemmed from the slowdown of the capital accumulation process and an inability to absorb the enormous surplus generated within production. This in turn reflected the continual shortage of profitable real investment outlets due to a growing degree of monopoly in the economy(Magdoff and Foster 2014).The only potential source of economic stimulus was the expansion of financial sectors, which, according to Baran and Sweezy (1966),could serve to stimulate the economy by partially soaking up surplus capital. Magdoff and Sweezy (1983) argue that financial explosion under conditions of economic slowdown was the main factor counteracting stagnation. When the capitalist economy fell into stagnation, the excessive expansion of capital and rise of the elite rentier class offered a way to absorb economic surplus. The owner of capital regarded financial investment as a method of capital preservation and appreciation, creating increasing demand for financial products and innovation. Economic surplus was absorbed through financial speculation, which provides another channel for the usage of capital aside from putting it into production.

Although the capitalist economy has changed as a result of financialization, Foster (2007) did not regard it as an entirely new stage of capitalism. Instead, he coined the term 'monopoly-finance capital' to epitomise capitalism's tendency towards capital accumulation and financial expansion, in which financialization has become a permanent structural necessity of the stagnation-prone economy. He explained that 'monopoly-finance capital' is a new hybrid phase of the monopoly stage of capitalism that is the consequence of financialization. In the era of monopoly-finance capital, real accumulation becomes subordinated to fictitious capital, and speculative assets expand at the expense of real investment; capital is trapped in a seemingly endless cycle of stagnation and financial explosion.

The social structure of accumulation theory

The social structure of accumulation theory, a French left-wing school that originated in 1980s, refers to financialization as a natural consequence of developed capitalist economies' entrance into the stage of neoliberalism (e.g. Gordon 1978; Gordon, Edwards, and Reich 1982). According to the social structure of accumulation theory, every society has an accumulation structure within which production is organised, and profits are generated and distributed in a particular institutional form. Hence, the social structure of accumulation can be interpreted as a coherent, long-lasting institutional structure that promotes profit-making and forms a framework for capital accumulation. Each social structure of accumulation functions effectively at promoting profit-making for a period of time, but at some point, it ceases to do so. This brings crisis, and eventually a new social structure of accumulation replaces the previous one (Kotz 2008).

The social structure of accumulation theory offers an analysis of the periodic changes in the capitalist institutional structure (Kotz, McDonough, and Reich 1994; McDonough, Reich, Kotz 2010).It asserts that the social structure of the accumulation of capitalism has changed periodically since it emerged, and thus neoliberalism is the latest institutional form of capitalism. The social structure of accumulation under neoliberalism represents a sharp break from the previous structure. Kotz (2008) summarises its main features as(1) the removal of barriers to free the movement of goods, services, and especially capital, throughout the global economy;(2) the deregulation of economic activity; (3) privatisation; (4) capital fully dominating labour; and so forth. Under the institutional framework of neoliberalism, financial deregulation unleashes the financial sector, promoting development of the financialization process. As financial sectors play a crucial role in capital accumulation and profit-making, financialization accordingly becomes a characteristic tendency. Therefore, the social structure of accumulation theory holds that financialization has a close relation to the transition of the accumulation structure to neoliberalism. It appears that the beginning of neoliberalism set the stage for financialization. However, some scholars of this theory admit that financialization also has deeper roots that are unrelated to neoliberalism (Kotz 2008).

Regulation School

The Regulation School originated in France in the 1970s and focuses on analysing the long-term transformation of capitalist economies. A core concept of the Regulation School is that a special regime of accumulation needs an accompanying mode of regulation – a set of institutions and policies – to make economic and social reproduction feasible. The regulationists suggest that capitalism has undergone different accumulation regimes in a system to maintain balance between social reproduction and consumption. Each regime refers to a particular pattern that regulates the process of accumulation (Boyer and Sailard 2001).The Regulation School considers financialization to be the successor of the Fordist regime of accumulation, which declined in the 1970s (Aglietta 1979), and they argue that a new regulation regime is now being formed. The regulationists have several proposed terminologies to describe the new regulation regime, such as 'finance-led growth regime' or 'financialized growth regime' (Boyer2000), 'financial wealth-induced growth regime'(Aglietta 2000), and 'financialized regime of accumulation' (Aglietta and Breton 2001).

As to the origin of financialization, Boyer (2000) postulated that the financialized growth regime was the latest candidate for replacing Fordism. The new regime began to develop in response to declining productivity in the late 1960s, when the relationship was severed between rising wages and demand for industrial production. The new regime combined flexible labour markets with the expansion of credit, and the hierarchy among institutional forms drastically shifted: the financial regime plays the central role formerly attributed to the wage-labour nexus under Fordism.

In addition to offering an explanation for the shift from Fordism to the financialized growth regime of accumulation in developed capitalist economies, the Regulation School also analysed the path towards the financialization of developing economies in an integrated framework. Developing economies have experienced a shift from different forms of 'peripheral Fordism' to forms of financialization locally specific to their economies (Becker et al. 2010).

World system theory

The world system theory initiated by Immanuel Wallerstein is applied to the study of financialization by Marxist sociologist Giovanni Arrighi. Arrighi (1994) situates the manifestation of financialization in the long history following the emergence of capitalism. He believes that financialization is not a phenomenon that solely appears in a particular historical period but that it is a component of accumulative changes occurring periodically and repeatedly throughout the history of capitalism. Each accumulation regime is endangered due to excessive accumulation and consumption, which reduces the profit from trade and production. Hence, the embodiment of crisis that occurs in any accumulation regime is the declining profitability of production and the occurrence of financialization. Financialization occurs during a period of hegemonic transition, when capitalist elites respond to increased international competition by shifting their investments from trade and production to finance. Arrighi asserts that the final quarter of the twentieth century represented the height of American hegemony.

Many other scholars influenced by world system theory have also contributed to the study of financialization. They postulated a series of important theories, such as Amin's (1994) 'dependency theory,' Panitch and Gindin's (2004) 'global capitalism and American empire' theory, and Harvey's (2003) 'new imperialism' theory, to focus on the origin and systematic long-term impact of financialization. Some studies echo the idea of Arrighi that financialization is not new but, from a historical point of view, one of the theories of crisis (Tomé 2011).

Post-Keynesian economics

Financialization is a prime research subject in post-Keynesian economics. Post-Keynesian economists use the term 'financialization' to depict the change of relations between the real economy and the financial sector. In addition to Gerald Epstein's broad definition of financialization as 'the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies' (Epstein 2005, 3), Stockhammer (2004), Palley(2008), Skott and Ryoo(2008), Van Treeck (2009) and Hein (2013) also provide various analytically precise definitions for financialization. For example, Stockhammer (2004, 721) explains financialization as 'the engagement of non-financial businesses in financial markets.' Other terminologies are simultaneously used to express the sometimes different meaning of financialization, e.g., 'finance-led economies'(Van Treeck2008), 'finance-dominated regime' (Stockhammer2008), 'neoliberalism' (Duménil and Lévy2001; Crotty2003), 'shareholder value orientation'(Froud et al. 2000), and 'transformation of corporate governance'(Lazonick and O'Sullivan 2000). Indeed, the lack of an integrated definition reflects to some extent the incompatibility between various understandings offinancialization. Different economists study financialization based on partial stylised facts, from either the macro perspective or the micro perspective, and focusing on income distribution or on economic accumulation. Thus, the interpretations of financialization vary even in post-Keynesian economics.

Post-Keynesian economics has ideological similarities to other left-wing schools. It began to elucidate financialization when it highlighted capital and income distribution. Starting from the concept of a 'rentier'(Crotty1990;Epstein2005;Pollin2007), especially moneylenders, post-Keynesian economists believe that the elite rentier class gains benefits from the financial investment of production profits, therefore sharing some points with Neo-Marxists. They also share concepts in common with the Regulation School. In the understanding of the regimes of economic accumulation, post-Keynesians believe that capitalism, after the decline of the Fordist accumulation regime, entered a 'finance-dominated regime,' while regulationists prefer the term 'finance-led growth regime.' Despite certain differences, they have the same belief in the importance of finance in the new institutional system of economic growth (Stockhammer2008; Evans 2009). Post-Keynesian economics has a close connection to Michal Kalecki's theory, as post-Keynesian scholars often apply a post-Kaleckian distribution and growth model when analysing the channels through which financialization influences the real economy(Hein2013).There are connections between post-Keynesian economics and Hyman Minsky's theory. The two are often considered to be the origin of both theories on financialization, however, distinctions still exist. Minsky (1982) notes that financial innovation may become an accelerator of economic growth; however, he is also concerned that financial innovation could impede economic development by increasing risks. Post-Keynesians study the allocation of gains or losses due to financial disturbances among different groups in the economy.

Post-Keynesian economics believes that financialization interplays with the economic accumulation regime. Duménil and Lévy(2001) find that the growth rate of real capital accumulation depends on that of retained profits – profit after interest and dividend payments – which has diminished in recent decades. Crotty (2003) states that non-financial corporations have increased financial investments in response to high interest rates and the low rates of profit associated with real investments. Stockhammer(2004) holds that financialization is a phenomenon involved in the slowdown of real capital accumulation in advanced capitalist economies since the 1970s. Orhangazi's(2008) investigation reveals the negative relationships between real and financial investment, which implies a crowding-out effect of financial investment. Accordingly, the average growth rate of advanced capitalist economies since the start of the financialization process has been lower than in the period between post-WWII and the 1970s.

Some studies emphasised the impact of micro-level changes on financialization. One of the most important changes is so-called 'shareholder value orientation' in cooperate governance. A shift in management behaviour has occurred from a 'retain and reinvest' strategy to a 'downsize and distribute' strategy. Rather than striving for the management-labour balance of the Fordist era, firms in the financialized era are transiting toa management-shareholder balance. Management strategies have changed to focus more on the maximisation of shareholder value and less on long-term growth(Lazonick and O'Sullivan 2000).The shift is correlated with the stagnation of real investment and a sharp increase of financial investment returns, e.g., interest payments, dividend payments and stock buybacks, in recent years.

Post-Keynesian economics naturally links financialization to deregulation and the neoliberal policies instituted since the 1970s (e.g. Epstein2005; DuménilandLévy 2011). The deregulation of financial markets increases the frequency of capital flows, income inequality and indebtedness for households and firms. As a consequence, volatile financial asset prices and excessive indebtedness can lead to an increase in risks and repeatedly cause financial crises. This, in turn, promotes broader demand for finance to manage risks in the economy.

Financial development theory

Although the terminology of 'financialization' is not widely used in mainstream neoclassical economics, it appears in the literature in regard to financial development theory, which was established based on neoclassical economics, in similar expressions such as 'financial deepening' and the evolution of 'financial structure.' The core argument of this theory focuses on the need to unleash the control of government over finance, fulfil the transition to a stage of 'financial liberalisation' where the market plays a dominant role in financial resource distribution, and realise 'financial deepening.'

The financial development theory and financialization theory appear to differ only in terminology, but they actually differ in their understanding of the role finance plays in economic development and, to deeper extent, in ideology. Financial development theory holds that financial development can, most of time, enhance economic growth and that, accordingly, deregulation of the financial sector is worthwhile. Nevertheless, many financialization theorists hold a negative position on financialization as well as on related concepts such as neoliberalism. From the author's point of view, financialization theory mainly focuses on developed capitalist economies, while financial development theory mainly focusses on less developed economies. When the degree of financial development for a country reaches a higher stage, there is perhaps no significant difference in the meaning of the two terms.

The analytical method on financial structure proposed by Goldsmith(1969) and theories on financial development by Gurley and Shaw (1960, 1967), Mckinnon(1973), and Shaw(1973) can be considered to be the origin of neoclassical financialization theory. Gurley, Shaw, and Mckinnon highlight money and capital in their studies, as monetisation was the central topic of that time. Goldsmith, however, focusses on the entire financial sector and notes that financial development refers to changes in financial structure – more financial tools, improved financial services and functions, and a more advanced structure – that feature financialization. He also specifically develops a series of financial development indicators, of which 'financial interrelations ratio' is one of the important indicators used in the present study of financialization. According to Levine (1997), the core function of finance is to inject liquidity into less liquid assets: once liquidity is added, assets can be allocated more efficiently, thus creating economic value. In *Capitalism in 21st Century*, Piketty (2014) examines the rate of capital accumulation in relation to economic growth and traces the causal relationship between financialization and wealth and income inequality in Europe and the US since the 18th century.

Mainstream economics has believed in the efficiency of the financial market for quite some time. Alan Greenspan once said, 'Financial innovation will slow as we approach a world in which financial markets are complete in the sense that all financial risks can be efficiently transferred to those most willing to bear them' (Greenspan 2003).After the 2008 global financial crisis, mainstream economists gained an unshakeable faith in the fundamental economic theory that financial innovation and financial development are needed and should be encouraged, but economists must rethink the role of finance. Zingales (2015)notes that academics' views of the benefits of finance vastly exceed societal perceptions. Finance can easily degenerate into a rent-seeking activity without proper rules. Hence, immoderate financialization currently reflects insufficient regulation over finance. We should promote good finance and minimise the bad. As noted earlier, the aim of finance is to build a 'good society' (Shiller 2013).

Financialization in financial markets

'Financialization' in financial markets, from a micro perspective, refers to the financialization of commodities and assets. The financialization of assets often entails securitisation. With the development of financial innovation led by the Wall Street, the expected future cash flow of special assets is converted into current financial securities. The fundamental aim of financialization is to convert assets with low liquidity into highly liquid assets to benefit financial market trading (Chen et al. 2013).

The term 'financialization' has frequently appeared in literature concerning the commodity market in recent years. The main point is to discuss how futures contracts can be operated as securities (e.g.Cheng and Xiong 2013).Empirical studies find that commodity futures have become a popular asset class for portfolio investors, similar to stocks and bonds, in recent years. As a consequence, the price of an individual commodity is no longer simply determined by its supply and demand. Instead, commodity prices are also determined by a whole set of financial factors, such as the aggregate risk appetite for financial assets and the investment behaviour of diversified commodity index investors (Tang and Xiong 2012). In the process of financialization, commodities, once excluded from financial assets, can enjoy the same importance as common securities in a portfolio. Financialization blurs the boundary between commodities and underlying financial assets and establishes correlation between them. Capital is free to move between the commodity futures market and other security markets. Financialized commodities share the properties of financial assets. Differences across various commodities have also faded, as capital is free to flow between different markets, strengthening the correlation of prices. All of these traits distinguish financialized from unfinancialized assets.

Derivatives are considered to play a central role in financialization in the financial market. Wigan(2009) states that the advent of limited liability and absentee ownership spurred risk management through derivatives. The use of derivatives disengages the direct ties between ownership and a particular asset and accordingly excludes the possibility of a conceptual link between property and stewardship. Instead, ownership proceeds on the basis of financialization. Such analysis in fact provides an entirely finance-based explanation for the ascent of financialization.

Financialization beyond the economics discipline

The discussion of financialization issues is no longer restricted to economics but is related to broader disciplines including economic geography, sociology, political science and even humanities. Economic geographers investigate the impact of financializationon the spatial development of capitalism (Leyshon and Thrift 2007);some argue that the financialization of capitalism is compromised by the 'anaemic geographies' that structure and animate it (Christophers 2012).Among sociologists, Dore (2002) introduces stock market capitalism as a consequence of financialization, while Krippner (2011) investigates the political origins of financialization in the United States. The concept of financialization came under public scrutiny in the 1990s thanks to the political scholar Kevin Phillips and his books *Boiling Point* (1993) and *Arrogant Capital* (1996). He distinguishes the real economy from finance, asserting that the latter rules over the former. Humanists have also noticed the advent and impact of financialization: Martin (2002), a humanist, uses the concept of financialization to depict the encroachment of finance into the realms of everyday life. Pryke and Du Gay (2007)discuss the cultural aspects of finance in contemporary capitalism. Langley (2008) highlights the far-reaching psychological consequences of financialization as individuals must develop new forms of financial self-discipline.

Comments on different theories

All of the definitions of financialization or explanations of its originnoted above are based on stylised facts in developed capitalist economies over the last four decades, reflecting more or less partial interpretation of the term. Since the 1970s, the United States and the United Kingdom, so-called ‘Anglo-Saxon model’ counties, have implemented neoliberalist policies to deregulate the market and revitalise an economy undergoing a slowdown. As an unintended consequence, the finance sector has drastically expanded and has taken a dominant role in the economy, even becoming a self-sustaining system. However, things may be quite different in developing countries and in other developed countries, such as those in Continental Europe, as the Anglo-Saxon model is a market-dominant economic system, while systems may be bank-dominant or may have less developed financial markets.

Ideology has heavily influenced the above study. Left-wing economists often negatively link financialization to financial crisis, economic decline, and a parasitic rentier economy. More orthodox economists regard financial development/financialization as a generally neutral or positive influence. In the author’s opinion, financializationis not a unique feature of capitalism, let alone tagging it as good or bad. It is more meaningful to seek the underlying impetus behind financialization, among all of its historical and systemic origins, rather than becoming entrapped in ideological debates.

3. The collapse of the Bretton Woods System and the advent of the financialization era

Characteristics of monetary systems

Any monetary system entails ‘dual anchors’: one anchor is the form of money and the other is the social institution within which it circulates (Wicksell1898; Simmel 2004). An effective monetary system must overcome the adversities that impede its functioning: (1) counterfeit money in circulation; (2) concerns about a loss of value when holding money; and (3) money not being accepted by third parties. The ‘dualanchors’ of a monetary system mean that the viability of the monetary regimes relies on either the physical form of money or the social institution to eliminate these three worries. Differences in monetary systems lie in their usage of the dual anchors (Dembinski2009).

Monetary history reveals that the public is inclined to put its trust in the physical form of money when the social institution is weak, while when the social institution becomes strong, and the monetary system becomes complex, trust in the physical form of money is gradually replaced by trust in the social institution (Davies and

Bank 2002). In the era using commodity money, e.g. metal coins, the genuineness and quality of the monetary material were the main concern. In the credit money era, money circulates in a dematerialised form as symbolic information under legal and technological support. As a result, concerns about material quality and counterfeit money from the past have been gradually transformed into worries about financial fraud and other illegal bank account invasion, along with the fear of shrinking purchasing power. The public's confidence in money solely relies on the government: the government must ensure the technical security of the money exchange process; meanwhile, it should also maintain a stable value for money through monetary policies. The public's trust depends on whether monetary policy can effectively protect the purchasing power of money from macroeconomic fluctuations and inflation. However, governments often have unreliable credibility. Political intervention may destroy price stability. Thus, we can observe that various countries are struggling to find an external anchor to consolidate the sole anchor left (the social system) in order to maintain price stability. Creations such as inflation targeting and central bank independence have emerged accordingly.

When social institutions become the sole source of faith in monetary systems, they become more sophisticated. Money loses its intrinsic value. The two core functions of money – payment means and value storage – also change over time. For the means of payment, in addition to notes and cash, payment becomes a process of transferring the information symbol. Money symbols flow from a virtual account to another account. The development of information and communications technology has greatly influenced money. With the economies of scale brought by information technology, transaction costs have been greatly reduced. A growing number of transactions must rely on a third party that is capable of processing payments, meanwhile charging a transactional fee; the third party also helps to maintain liquidity during the settlement process, since transactions become more efficient. The status of financial intermediation is strengthened in the face of an increasing need for financial services. This provides an opportunity for the ascent of money and finance (Ferguson2008).

As for value storage, money is being gradually replaced by various types of financial assets. When money and financial assets exist in symbolic form, with the help of information technology, any temporary, idle money can easily be transformed into financial assets, thus creating interest income, which of course also bears the corresponding risks. Due to the efficiency and convenience of the transformation, it is inefficient to count physical money as a means of value storage. Currently, idle cash of any kind can be converted into financial assets with the help of financial institutions. The value storage function of money has been replaced by a more specialised field, namely 'financial investment' or 'wealth management,' which has greatly stimulated the demand for financial services. Financial innovation promotes asset liquidity, and some assets play the role of 'quasi money.' This has led to the emergence of a series of highly liquid financial assets, which are not considered to be money but still function as money. In fact, the boundary between 'quasimoney' and money has become very blurred.

The collapse of the Bretton Woods System and its historical significance

From the usage of commodity currencies in ancient times to the 1970s when credit money prevailed, money was never detached from the anchor of its material form throughout most of the world. The gold standard system (or the gold exchange standard) is a typical ‘dual anchor’ monetary system. During the 1920s-1930s, the gold standard system collapsed due to the economic crisis, but at the end of World War II, the Bretton Woods System revived nostalgia for the metallic monetary system, and a legal commitment was made to the interchangeability between gold and the US dollar as well as other currencies. The dollar was actually the last currency fixed on gold standard, and in turn, the dollar was attached toall other currencies. The Bretton Woods System collapsed in the 1970s. When the United States abolished the gold ‘anchor,’ the world also irreversibly cut off its connection. After the collapse of the Bretton Woods System, money was detached from the real value ‘anchor’ as commodity currency. Human beings entered the pure credit money era at that point. It can be asserted that until the 1970s, money in the Western world has never really been detached to become a commodity currency. Ultimately, as representatives of the social institution, governments control the issuance of legal tender, which has no intrinsic value and solely relies on the credibility of the government to circulate. The ‘dual anchors’ of the monetary system, for the first time, became a ‘sole anchor.’

Credit money has no intrinsic value and therefore cannot be mutually exchanged with any metal currency; it mainly exists in the form of deposits in bank accounts. With monopolistic issuance rights and no longer being subject to moderate metal, governments have supreme power over money. The immoderate issuance of paper money by governments with low self-discipline has frequently caused inflation. Inflation has become a common phenomenon since the 1970s and the tendency appears to be irreversible. Figure 1 shows the long-term tendency of inflation for six representative countries in the twentieth century and the early twenty-first century. Regardless of whether in developed or developing countries, regardless of whether the country implemented inflation targeting as the monetary policy regime, inflation gained significantly increasing momentum after the 1970s. The hoarding of money is irrational in light of persistent inflation. The increasing demand for wealth preservation and appreciation stimulates financial investment and financial services. It provides the breeding ground for financialization.

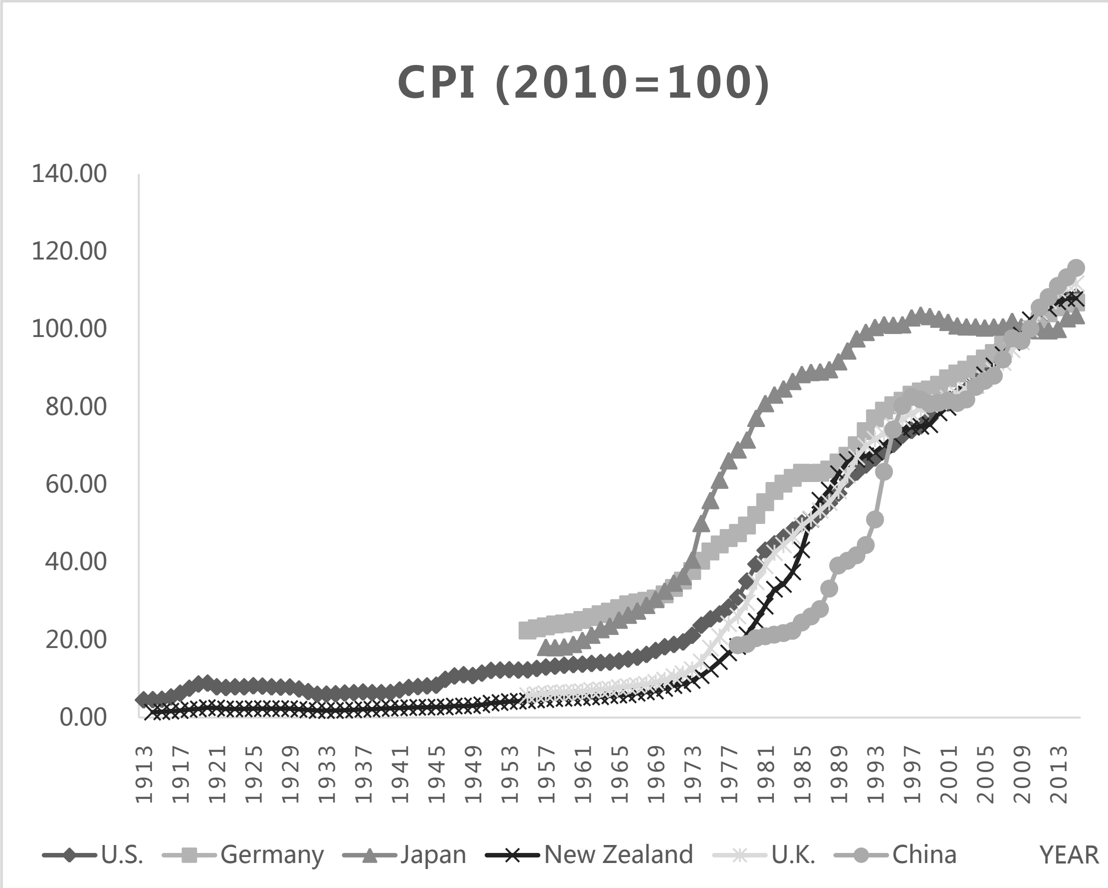

Figure 1. Long-term inflation among representative countries.

Data source: OECD dataset.

Note: CPI data are all index numbers with a fixed base period, 2010=100.

After the advent of the pure credit money era, the general acceptability of money became subject to the power of the nation that issued it. Only a very small amount of money is used for international payment and reserve. The currency exchange rate fluctuates frequently, and speculation is prevalent in foreign exchange markets. Worldwide commodity flows and currency flows look like a game. Dollars given by developed countries to purchase commodities in developing countries are returned to the developed countries in the form of financial investment, e.g. treasury bonds or stocks. These dollars then quickly disappear in the circulation of the financial system and are used to generate cheaper credit, which has induced the rapid development of various forms of securitisation and asset price bubbles. All of these phenomena are identified as characteristics of financialization.

To summarise, many changes have taken place since the 1970s in the world economy. These are directly or indirectly connected to the transition from the commodity money system that had been implemented for nearly two thousand years to a pure credit money system. Despite other influential factors in the origin of financialization, the grand transition of monetary systems is the most fundamental driver.

4. Financialization, Risk Society and Late Modernity

Taking a more in-depth point of view, financialization is philosophically a natural choice because it allows human beings to cope with the advent of a risk society; this reflects the advance of instrumental rationality and hence is the embodiment of late modernity. Although this type of analysis is slightly beyond the disciplines of economics and finance, it is conducive to the understanding of financialization against the backdrop of the historical changes of human society.

Risk refers to potential loss, disaster or other unpredictable uncertainties. With the acceleration of technological change, the emergence of new forms of risk causes more uncertainties for individuals, whose futures are far less determined than the futures of those in traditional societies. In modern society, the impact of the uncertainty of nature on human life has been significantly reduced. However, a growing number of manufactured or artificial risks have emerged. Some of the major risks in modern society – global nuclear threat, environmental pollution and economic crisis – are the consequences of modernisation. Based on this observation, the German sociologist Ulrich Beck proposed the concept of 'risk society.' Beck defines the risk society as 'a systematic way of dealing with hazards and insecurities induced and introduced by modernization itself' (Beck 1992, 21). The risk society is one of the social features of modernity, and 'modernity' is a philosophical and sociological concept referring to a common understanding of the innovative mode of production, social structure and cultural spirit after the birth of capitalism, particularly to the social conditions, processes, and discourses consequent to the Age of Enlightenment. Giddens (1991) called the modernity of contemporary society 'late modernity', considering it to be a developed, radicalised, 'late' modernity in order to distinguish it from post modernity. [1] Late modernity highlights the more severe and more pervasive consequences of modernity, but does not acknowledge that global societies, mainly capitalist economies, have entered into a new era that is completely distinct from the past.

The advanced development of instrumental rationality and its irrational consequences provide a clue to understanding the boom of financialization from the philosophical level. Instrumental rationality is one of the human capacities for reasoning. It focusses on the most efficient or cost-effective means to achieve a specific end, but not on the value of that end itself. The counterparty of instrumental rationality is valuerationality. Max Weber prompted the identification of these as generic motives for rational behaviour. Weber (1978, 2-5) argued that instrumental rationality – choosing means as instruments for coping with conditions to achieve temporary ends – motivates instrumentally rational action and that value rationality – choosing permanent ends that are valuable in themselves – motivates value-rational action.

Within risk society, the establishment of risk prevention mechanisms is the consequence of the development of instrumental rationality. People continually create new techniques, rules and bureaucracy as they try to manage the uncertainties of the

[1] Late modernity is the characterisation of contemporary highly developed societies as thecontinuation of modernityrather than as part of succeeding era known as postmodernity.

world. Financial instruments are a typical embodiment of instrumental rationality. Risk management is one of the core functions of finance, which relies on effective financial instruments. Some important financial innovations, aiming to spread risk, thrive in a highly uncertain society where demand for risk management is larger than it is in a less risky environment.

As technology advances, more people are facing manufactured risks rather than natural risk. Inflation becomes a common phenomenon; ordinary people are forced to become involved in the process of financialization, in which financial risks are inevitable; financial risks become highly contagious worldwide and increase with the intensification of globalisation. Individual responsibility alongside risk-taking and calculative assessment in financial management are emphasised through the specific narratives and discourses set by elites (Martin 2002, 34). To cope with these risks, elites believe that more sophisticated financial instruments and innovation are needed. This leads to an endless loop: addressing risk requires financialization, but financialization itself brings new risk. With the advance of financialization, complex financial activities are created, which may result in the endless expansion of instrumental rationality. The outcome may well be irrational and reflected by frequent financial crises.

5. Conclusion

This paper explores the existing theories of financialization. We find that Marxism has a strong influence on the understanding of financialization among Western left-wing economists in that they regard financialization as the consequence of the transformation of capitalism. The latter investment in Marx's classical capital circulation formula, the 'investment-profit-investment' cycle, changes from real investment into financial investment, thus beginning a new accumulation regime. The financialized accumulation regime implies the loss of the productivity advantages of capitalism. Neoclassical economics and finance tend to think that financialization (financial development) does not exist exclusively within the economic system of capitalism but that it was present throughout an entire human history filled with numerous financial innovations. Finance is supposed to benefit society, although sometimes it does not do so.

The author argues that financialization is the unintended consequence of the development of instrumental rationality in the risk society. The collapse of the Bretton Woods System and the drastic changes in the monetary system aggravated risks in a society, and financialization is the means to cope with this. Financialization is not the exclusive property of contemporary capitalism. Capitalism itself has probably not stepped into a new institutional system that is distinctive from the past hundreds of years. The world is entering a new phase, in which the consequences of financialization will be more severe and prevalent than ever before.

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