Financialization of the Economy

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Abstract

Financialization refers to the increasing importance of finance, financial markets, and financial institutions to the workings of the economy. This article reviews evidence on the causes and consequences of financialization in the United States and around the world, with particular attention to the spread of financial markets. Researchers have focused on two broad themes at the level of corporations and broader societies. First, an orientation toward shareholder value has led to substantial changes in corporate strategies and structures that have encouraged outsourcing and corporate disaggregation while increasing compensation at the top. Second, financialization has shaped patterns of inequality, culture, and social change in the broader society. Underlying these changes is a broad shift in how capital is intermediated, from financial institutions to financial markets, through mechanisms such as securitization (turning debts into marketable securities). Enabled by a combination of theory, technology, and ideology, financialization is a potent force for changing social institutions.

INTRODUCTION

Over the past 30 years, financial markets became increasingly central to the daily activities of households, corporations, and states. Families became enmeshed in financial markets as their pensions and college savings were invested in mutual funds and their mortgages, auto loans, credit card accounts, and college debt were turned into bonds and sold to global investors (Krippner 2011). Corporations now asserted that they existed to create shareholder value and adopted a host of structures and strategies to demonstrate their primary allegiance to their shareholders (Fligstein & Shin 2007, Zuckerman 1999). After the bust-up takeover wave of the 1980s, the bloated conglomerates that provided long-term employment and stable retirement benefits were replaced by disaggregated corporate structures sanctioned by financial markets through higher valuations (Davis 2013). States around the world also adopted finance-friendly policies, from reducing capital controls and creating domestic stock markets to rendering their central banks independent from political oversight (Polillo & Guillén 2005).

This was financialization. Epstein (2005, p. 3) defines financialization as "the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies." By this definition, there can be little doubt that the past generation has witnessed financialization in the United States and around the world. Owing to a combination of economic theory, information technology, and a supportive turn in ideology, financial markets spread widely, both in geographic space (the number of countries with a domestic stock market doubled after 1980; Weber et al. 2009) and in social space (such as creating financial instruments based on life insurance payoffs from the terminally ill; Quinn 2008).

This article reviews recent sociological research on financialization. As our article shows, financialization has implications for nearly every aspect of contemporary society, from inequality and mobility to the conduct of war. No single article could cover all this territory. We therefore focus on a central unifying theme, namely how and why financial markets have spread and with what effect on central research domains in sociology. Countless topics related to finance merit attention but are necessarily left out by this focus, e.g., the pricing of life insurance for children, the spread of payday lenders, the role of technology in market microstructure, or the economic valuation of slaves. We constrain our review primarily to recent sociological work on the antecedents and effects of the spread of financial markets since the 1970s.

The argument that emerges from our review is that how finance is intermediated in an economy—that is, how money is channeled from savers (investors) to borrowers (households, companies, governments)—shapes social institutions in fundamental ways. Households make different choices about housing and education when mortgages and student loans can be resold as securities rather than held by banks until they are paid off (Davis 2009). Businesses funded primarily by financial markets, as in the United States, look different from businesses funded by families or banks, as in Germany (Zysman 1984). When they raise money exclusively through taxes and loans, states' capacities look different from when they raise funds on financial markets (Carruthers 1996). Financialization entails a shift in which finance is intermediated by markets rather than banks and other institutions. The displacement of financial institutions by financial markets creates qualitative shifts that we are only beginning to understand.

We first present evidence on financialization and arguments about its causes. The spread of financial markets was enabled by the confluence of supportive ideology and historical circumstance, economic theories that allowed the creation of financial instruments, and information technology that sped up their valuation. We then review how financialization connects with central concerns in sociology. First, we examine the effect of the shareholder value movement on corporations, finding that financial markets have favored disaggregation of the corporation into dispersed supply chains.

Second, we survey the influence of financialization on inequality, culture, areas beyond markets, and social change. In each case, financial markets have had a surprising and pervasive influence. In the final section we argue that a fundamental feature of financialization is a shift from financial institutions to financial markets. This shift accounts for the unbalancing effect of financialization on different varieties of capitalism. We speculate that underlying these diverse outcomes is a similar dynamic: Information enables markets that undermine institutions.

EVIDENCE FOR FINANCIALIZATION

Financialization describes a historical trend since the late twentieth century in which finance and financial considerations became increasingly central to the workings of the economy. The concept of financialization gained significance particularly because it marks a fundamental discontinuity between the postwar economy, driven by industrial production and trade of goods, and the current economy, focused mainly on financial indicators. Reflecting this historical transition, Krippner (2005) defines financialization as "a pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production" (p. 174).

Financialization of the economy is observable at three levels: industry, firm, and household. At the industry level, the financial industry gained increasing prominence as the most profitable, and arguably the most important, industry among all in the United States. The financial sector's share of GDP increased from 15% in 1960 to approximately 23% in 2001, surpassing manufacturing in the early 1990s. The percentage of corporate profits in the financial industry increased from 20% in 1980 to 30% in early 1990s and to roughly 40% by 2000 (Krippner 2005). In the years leading up to the recent financial crisis, bank profits reached a historic high (Tregenna 2009). This soaring profitability was reflected in employee earnings. Kaplan & Rauh (2010) report that the top five hedge fund managers in 2004 earned more than all the CEOs in the S&P 500 companies combined.

At the firm level, financialization manifests itself in the form of a stronger emphasis on maximizing shareholder value and an increased engagement in financial activities by nonfinancial corporations. The rise of the financial sector was accompanied by doctrines arguing for shareholder primacy in corporate governance (Davis 2005, Fama & Jensen 1983). An increasing emphasis on shareholder value was reflected in a shift of power from traditional functions such as manufacturing and marketing to financial executives (Fligstein 1990, Zorn 2004). The change was also observed in the source of profits in nonfinancial firms, as they derived a growing proportion of their overall income from financial sources by financing the lease or purchase of their products. The proportion of portfolio income (i.e., corporate income from interest payments, dividends, and realized capital gains on investments) relative to the entire corporate cash flows had been relatively stable until the early 1970s and started to grow sharply since then through the years of financialization (Krippner 2005).

Financialization is also evident at the household level. The proportion of financial assets relative to total household assets grew significantly, and this trend was not confined to the wealthy (Keister 2005). This growth was due primarily to the long-term shift from defined benefit to defined contribution pensions, such as 401(k) plans (Hacker 2004), and soaring household involvement in the stock market through direct share ownership or mutual funds (Davis 2008). Increased household debt also played a major role (Hyman 2008). Owing to greater access to credit by the general population, accompanied by stagnant income, household consumption was increasingly maintained not by earnings but by accumulating debts. The proportion of median household debt to income grew from 0.14 in 1983 to 0.61 in 2008, and the median debt service ratio (i.e., the percentage of income devoted to required debt payment) increased from 5% in 1983 to 13% in 2007 (Dynan 2009).

ANTECEDENTS TO FINANCIALIZATION

Households, corporations, and states are increasingly connected to financial markets, which themselves are increasingly global. What accounts for the spread of financial markets?

Macro-Level Explanations for Financialization

Scholars from diverse disciplines have provided various explanations for how financialization came about at the level of the economy. Three major explanations are given from political economy, economic sociology, and political/historical sociology perspectives. The academic roots of financialization are found in the early studies of political economists and Marxist theorists. They characterized financialization as the rentier class's alternative regime of capital accumulation in the face of stagnationist tendencies of mature industrial capitalism (Sweezy & Magdoff 1987). Marxist theorists argued that advanced industrial capitalism has a natural tendency toward stagnation because the absence of a wealth redistribution mechanism prevents market demands from keeping up with the increased production capacity of oligopolistic corporations. As the dwindling income of the general population could not afford the growing supply of industrial production, the rentier class increasingly turned to financial activities to maintain the existing rate of wealth accumulation. Therefore, financial capitalism arose as a novel regime of accumulation alternative to industrial capitalism (Foster 2007). Related to this, world-systems theorists connect this stage theory of capitalism to the history of world hegemony and understand financialization as an effort to protect American hegemony in the world polity (Arrighi 2010). These theorists argue that similar transitions to finance happened in previous transitions, such as the final decades of Genoese, Dutch, and British hegemony, when new hegemons arose to replace those in decline. Financialization in this account is an indication of imminent decline for economic great powers.

Economic sociologists understand financialization as resulting from the confluence of diverse factors, including macroeconomic conditions, regulatory changes, and technological advances. In this perspective, financial domination over corporations was caused largely by the emergence of a corporate takeover market, which in turn is a product of disappointing corporate performance in the 1970s, deregulations of the financial industry by the Reagan administration, and a series of financial innovations such as junk bonds (Davis 2005). Through the active operation of a corporate takeover market, large conglomerates were broken into leaner and more focused firms, and compensation for executives was tied more closely to stock market performance. Along with this trend, corporate ownership became increasingly concentrated in a handful of institutional investors, who encouraged corporations to spin off inefficient parts, lay off employees, and engage in corporate restructuring, all in the name of maximizing shareholder value (Useem 1996).

Last, political sociologists place more emphasis on the role of the state and explain the rise of finance as an unintended consequence of political responses to the administrative crisis in the 1970s. At the end of postwar prosperity, the US government faced three types of crises, all of which resulted from a mismatch between increasing demands by diverse social groups and shrinking economic resources under government control: increasing tension and conflict between social groups (social crisis), the structural gap between government spending and revenue (fiscal crisis), and declining confidence in government (legitimacy crisis). Krippner (2011) explains that the US government overcame these crises essentially by delegating difficult decisions on prioritizing diverse social needs to the market mechanism and by deregulating financial markets that created the (false) sense of resource abundance through increased accessibility to credit and the influx of foreign capital. Through these moves, the government "transformed the resource constraints of the 1970s into a new era of abundant capital" (Krippner 2011, p. 22) and successfully resolved (or delayed) the crisis. However, these policy decisions created unintended but more serious consequences: explosive growth of the financial sector and the transition to structurally unstable financial capitalism.

Micro-Level Explanations for Financialization

A defining feature of financialization is a shift in how capital is intermediated, or channeled, from savers to borrowers. Broadly, the shift can be seen as one from financial institutions, such as banks, to financial markets. The shift from institutions to markets was enabled by both theory and information technology. First, conceptual developments in finance were central in changing market practices. Financial economics developed a set of sophisticated mathematical tools for valuing financial assets, from discounted cash flow analysis to the capital asset pricing model to the Black-Scholes options pricing model. New tools allowed markets to develop for new kinds of financial instruments. Performativity—the idea that theories guide practices in a way that leads them to become true—is a recurring theme in finance (Callon 1998, MacKenzie et al. 2007). MacKenzie & Millo (2003) document how the Black-Scholes options pricing model shifted from being a clearly inaccurate description of pricing to a guide for trading that thereby became true. Methodologies for assessing creditworthiness, from rating systems for small businesses (Carruthers & Kim 2011) to the ratings for bonds issued by Moody's, Standard and Poor's, and Fitch (Rona-Tas & Hiss 2010), become guides to behavior for those seeking credit. All these in turn help enable tradability. These tools convey an image of impersonality and precision and contrast with the personal touch (and potential for bias) of a human banker.

Second, equally important are technological changes that enabled rapid valuation of financial assets. Discounted cash flow analysis is easier with a calculator than with a slide rule, easier still with a computerized spreadsheet. The ability to gather, analyze, and share data rapidly, combined with the elaboration of financial tools, made valuing financial assets more tractable and therefore made trading on markets more plausible. Take a simple example: What is the value of a pool of 1,000 viaticals, that is, the rights to the future payoffs of life insurance contracts for 1,000 currently living individuals? Relevant information would include the value of each policy's payoff; the age, health history, and predicted life span of the insured; the financial state of the insurer; the rate of inflation; and the Fed's discount rate; among other factors. Until fairly recently, it would have been difficult to imagine a bond based on viaticals as a reasonable investment, because the information demands for valuation were far too great. Now, owing to advanced information technology, viatical-backed bonds are entirely plausible, if not commonplace yet (cf. Quinn 2008).

One of the most critical yet underappreciated enablers of financialization is securitization. Securitization is the process of taking assets with cash flows, such as mortgages held by banks, and turning them into tradable securities (bonds). A single mortgage is illiquid and its payment is often unpredictable: The homeowner might lose his or her job due to a medical emergency, or the homeowner might win the lottery and pay off the mortgage early, or the neighborhood might be leveled by a tornado. But when bundled with hundreds of other mortgages in other parts of the country, the payoff becomes more predictable, owing to the law of large numbers, and suitable for being divided up into bonds, with different tranches having different risk profiles. Mortgage-backed bonds are the most familiar form of securitization, but the same basic process can be done with almost any kind of cash flow, including auto loans, college loans, credit card debt, business receivables, insurance and lottery payoffs, veterans' pensions, property liens, and more. Quinn (2008) describes the origins of the viatical market, in which investors purchase the life insurance payoffs of the terminally ill or elderly. Naturally, the sooner the viator dies, the quicker (and thus more valuable) the payoff, creating some potentially malign incentives. This can work both ways: In the United Kingdom, the enhanced annuity provides better pension rates to retirees who have impaired health conditions, including those who smoke, are overweight, or have high blood pressure, under the assumption that those with impaired health condition will not live as long as their healthy counterparts, therefore requiring fewer annuity payments (French & Kneale 2012).

Securitization may seem obscure or peripheral, but it represents a fundamental shift in how finance is done. A loan represents a relationship between a bank (or other institution) and a borrower. A traditional 30-year mortgage or business loan reflected a lasting mutual commitment, and both banker and borrower had reasons to maintain that relationship for mutual benefit (cf. Carruthers 1996). From the bank's perspective, a loan is an asset. Selling that asset through securitization fundamentally changes the relationship. From the borrower's perspective, the bank looks more like an underwriter than an ongoing partner. Securitization thus shifts debt from a concrete relationship with an entity (a bank) to an abstract connection to the financial markets. This shift became clear during the mortgage meltdown, when far-flung buyers of asset-backed securities that were plummeting in value sought to locate the borrowers on the other end, relying on the haphazard paperwork documenting their ownership.

Commercial banks, traditionally the most powerful financial institutions, look very different when their loans are merely temporarily illiquid assets intended to be resold on the market. Commercial banks traditionally took in deposits (or issued bonds) and used the proceeds to fund loans to borrowers. Their marble-pillared façades conveyed a sense of permanence and security. But if the loan will be quickly resold, then the bank was little more than a one-time intermediary. There is little functional difference between underwriting a bond issue (which investment banks did) and issuing a loan that will be quickly resold and securitized (which is what commercial banks came to do). In this sense, the wall between commercial banking and investment banking erected by the Glass-Steagall Act had become largely moot. With widespread securitization, the largest American commercial banks were transformed into universal banks with substantial investment banking operations. Meanwhile, whether they knew it or not, borrowers had become issuers on financial markets. Their debt was owned not by the bank (or credit card issuer, or auto financer) that issued it, but by the market (Davis 2009).

The effects of financialization were most visible early on in changes in the strategies and structures of corporations, particularly in the United States. As markets spread more broadly, so too did their influence on social dynamics. The next two sections review recent research on each of these effects.

FINANCIALIZATION OF THE CORPORATION

Sources of Corporate Financialization

In the United States, the proximate cause of the financialization of the corporation was a wave of hostile takeovers in the 1980s. After two decades of conglomerate expansion, the typical American corporation in 1980 was highly diversified, operating in many unrelated industries (cf. Fligstein 1990). Diversification created a pervasive conglomerate discount in which firms operating in multiple industries were worth less on the stock market than they would be if they were a collection of separate focused firms (Zuckerman 1999). In other words, the whole was worth less than the sum of the parts.

Although some scholars linked bloated conglomerates to the sluggish performance of the American economy in the 1970s, to corporate raiders they presented a get-rich-quick opportunity via the "market for corporate control" (Manne 1965). Outsiders could buy the firm from its existing shareholders, fire its managers, and sell off the parts for a quick profit. After the election of Ronald Reagan in 1980, this became possible on a grand scale owing to relaxed antitrust guidelines, changes in state antitakeover laws, and financial innovations that enabled raiders to get relatively short-term financing on a large scale (Davis & Stout 1992). Within a decade, nearly one-third of the Fortune 500 largest industrial firms had been acquired or merged, often resulting in spin-offs of unrelated parts, and by 1990 American corporations were far less diversified than they had been a decade before (Davis et al. 1994).

At the same time, corporations increasingly shifted employees from defined benefit pensions, which guaranteed an income in retirement, to defined contribution 401(k) plans that were owned by the employee (Hacker 2004). These plans were overwhelmingly invested in the stock market, and by 2000 more than half of American households owned shares, compared to just one in five two decades earlier—another aspect of financialization (Davis 2008).

During the 1990s, executive compensation practices became increasingly oriented toward share price. In the early years of the Clinton administration, changes in corporate tax policies aimed at reining in executive compensation limited the deductibility of executive salaries over $1 million unless the additional pay was linked to performance (Davis & Thompson 1994). The ironic consequence was that executive pay, now linked to stock market measures of performance, subsequently skyrocketed. One of the most popular innovations was the use of stock options, in which executives are awarded the option to buy shares at a strike price (typically the price on the day the options were issued), giving them strong incentives to increase the value of the company's shares while providing no punishment if the share price falls (Westphal & Zajac 1998).

Because compensation was tied to stock market performance, corporate CEOs now routinely earn incomes several hundred times higher than those of average workers (Bebchuk & Grinstein 2005, Englander & Kaufman 2004), with annual salaries hitting eight and even nine figures. Contemporary compensation systems for top executives are tied much more directly to the firm's stock market performance and the compensation of peers rather than to product market performance (DiPrete et al. 2010). Meanwhile, those lower on the corporate hierarchy receive lower wages and fewer benefits (Fligstein & Shin 2007, Lin & Tomaskovic-Devey 2013).

By 2000, as stated by Lazonick & O'Sullivan (2000), maximizing shareholder value (MSV) had become a dominant ideology for corporate governance. Mission statements in the late 1990s announced a common focus on a single constituency: shareholders. Coca-Cola stated, "We exist to create value for our share owners on a long-term basis by building a business that enhances The Coca-Cola Company's trademarks." Sara Lee said, "Sara Lee Corporation's mission is to build leadership brands in consumer packaged goods markets around the world. Our primary purpose is to create long-term stockholder value." Yet corporate managers were notably selective in the types of prescriptions they adopted: While dediversifying, awarding stock options to executives, and taking on more debt were embraced, governance reforms that would limit the discretion of CEOs were generally avoided (Dobbin & Jung 2010).

The scholarly rationale for an orientation toward share price is not that shareholders are somehow more morally worthy than other stakeholders, but that trade-offs, and even rational action itself, require having a single-valued objective. According to the efficient market hypothesis, for which Eugene Fama was awarded the Nobel Memorial Prize in Economic Sciences in 2013, the stock market is the best-available device for putting a value on the firm, and maximizing the value of the firm is the best way to enhance the well-being of society. Thus, "200 years' worth of work in economics and finance indicate that social welfare is maximized when all firms in an economy maximize total firm value. The intuition behind this criterion is simply that (social) value is created when a firm produces an output or set of outputs that are valued by its customers at more than the value of the inputs it consumes (as valued by their suppliers) in such a production. Firm value is simply the long-term market value of this stream of benefits" (Jensen 2002, pp. 237–39). According to this view, shareholder value isn't good just for shareholders, but for society overall.

Corporate Governance and Strategy

MSV created a single-objective yardstick for corporate performance that was visible to all. Manne (1965), a founder of the law and economics movement, argued that share price provided a continuous measure of management performance and that compensation tied to share price gave executives a direct incentive to maximize shareholder value. Moreover, widespread stock ownership by the public and ubiquitous financial media meant that by the late 1990s firms were under relentless pressure to deliver. The general public now relied on stock market returns to afford college and retirement (Hacker 2006).

Most large firms created an investor relations office to deal with their shareholders (Rao & Sivakumar 1999), and their rationales for corporate action were increasingly rooted in the expected influence on share price (Zajac & Westphal 1995). Yet the focus on share price was not merely rhetorical; it had real consequences for industrial organization.

MSV has had a pervasive influence on corporate structure and strategy. The standard answer to where the corporation should place its boundaries comes from transaction cost economics: Transactions should happen inside the organization's boundaries when they have high asset specificity, and be left to the market otherwise. But in an MSV world, choices of boundaries reflect the judgments of the stock market. Sara Lee's CEO explained that "Wall Street can wipe you out. They are the rule-setters. They do have their fads, but to a large extent there is an evolution in how they judge companies, and they have decided to give premiums to companies that harbor the most profits for the least assets." Corporate executives no longer made decisions solely on the basis of a classic product market strategy, but in large part on the ability to craft good stories to investors and analysts (Froud et al. 2006).

Where conglomerates aimed to be as large as possible, MSV firms aim to be as small as feasible, maintaining the lightest possible base of assets and employment through spin-offs and layoffs (Zuckerman 1999). Firms that pursued tactics of MSV (e.g., mergers, layoffs, investments in labor-saving technology) were likely to reduce employment, particularly among unionized workers (Fligstein & Shin 2007, Lazonick & O'Sullivan 2000). The widespread use of contractors for manufacturing and distribution has come to be called Nikefication in honor of the firm that pioneered this approach. Now Nikefication has spread widely across the economy, not just in clothing and consumer packaged goods but in electronics and pharmaceuticals (Davis 2013), with broad implications for labor markets and mobility. In a number of industries (televisions, cameras, computers, phones), the top-selling brands are managed by corporations that do little or no production themselves and employ relatively few people directly. Apple—which regularly tops the list of the world's most valuable corporations—relies on assemblers in China for nearly all its goods, while the majority of its 80,000 employees work in its retail business. (By comparison, Walmart has 2.2 million employees.) Other firms, such as Amazon, rely heavily on temporary employment services and contract workers for staff to limit the traditional obligations of employers. The laborers whose employment and work schedules are uncertain and variable from week to week because of these corporate practices have come to be called the precariat.

Owing to the growth of free-standing contractors for production, distribution, computing power, and temporary employment—which corresponded with the rise of MSV—it is now possible for firms to rapidly grow in revenues and market capitalization without investing in physical assets or employment. Blockbuster Video, which operated over 9,000 stores in 2004 and employed over 80,000 people, has been displaced by Netflix, which streams videos over the Internet, rents capacity on servers owned by Amazon, and employs a mere 2,000 people. Whereas the conglomerate firms of the 1960s and 1970s sought to straddle the Earth, the contemporary share-priced-oriented firm seeks to dance on the head of a pin.

Not all changes to the corporation were as consequential as Nikefication. Many firms adopted a Potemkin village approach to corporate governance, reframing changes in compensation systems in shareholder-friendly terms, ceremonially announcing sanctioned practices (e.g., share buybacks) without following through, or appointing board members for their investor appeal rather than for their demonstrated expertise (Davis 2005, Davis & Robbins 2005, Westphal & Zajac 1998). But there is little doubt that the corporate sector has been massively restructured by the shareholder value revolution.

FINANCIALIZATION BEYOND THE CORPORATION

The broad effects of financialization were previewed in the corporate sector, particularly in the United States, beginning in the 1980s. The spread of financial markets in geographical and social spaces has introduced parallel dynamics in other spheres.

Financialization and Inequality

One area with which financialization was frequently associated is increased economic inequality. Research has shown that the rise of finance heightens income inequality because the increased payback from financial investment is not reinvested in the firms for productive activities, causing stagnation of real wages and increased indebtedness of wage earners (van der Zwan 2014). This trend essentially turned America from a nation of savers to a nation of borrowers, as personal savings declined and consumer debt replaced stagnant or declining income (Carruthers & Ariovich 2010, Hacker 2006). Increased debt, in turn, led to increased mental stress, and this association was greatest among middle- and lower-class Americans who are forced to borrow but have the least resources for repayment (Hodson et al. 2014). Simply put, whereas those who have extra assets to invest enjoy increasing returns, those who cannot join such markets suffer more, enlarging the wealth gap of the entire society (Fligstein & Goldstein 2015).

Increasing income inequality is attributable partly to the disproportional income increase in the financial sector. Prior to 1980, employees in the broad financial sector earned no more than their per capita share, but since the 1980s, their compensation levels skyrocketed, and by 2000, their compensation level was 60% higher than the national average (Tomaskovic-Devey & Lin 2011). In terms of average weekly wages, employees in the investment banking and securities industry of Manhattan earned 6 times more than average workers in Manhattan, and 20 times more than average workers in the United States (Sum et al. 2008). Consequently, the top end of income earners in the United States is increasingly populated by investment bankers and investment managers (Kaplan & Rauh 2010). Income from financial investment was found to be one of the most important contributors to income inequality (Nau 2013), and the asset bubbles in stock and real-estate markets made a major contribution to the wealth of the top one percent (Volscho & Kelly 2012). Reflecting this overarching trend, Tomaskovic-Devey & Lin (2011) found that since the 1980s the American economy experienced a transfer of between 5.8 and 6.6 trillion 2011 dollars in income to the finance sector, mostly as profits, and that this increased rent in the finance industry was concentrated primarily in white male workers with managerial and professional roles.

The financialization of other actors in the economy, such as nonfinance firms and the state, also exacerbated income inequality. Nonfinancial firms' capital investment in new productive assets declined while gains from investment were reinvested in other financial assets (Stockhammer 2004). Owing to this general tendency, nonfinancial sectors experienced slower growth in employment and real wages, again contributing to further increases in the income gap (Crotty 2003). Moreover, reducing labor costs was a major focus of shareholder-oriented firms, represented by the decline of defined benefit pension plans (Cobb 2012) and reduced retiree health benefits (Briscoe & Murphy 2012). The combination of these general trends—increased share of top executives and reduced share of labor income—resulted in a significantly widening income cap in US society (Lin & Tomaskovic-Devey 2013). Financialization of the state also contributed to the maintenance and exacerbation of societal inequality at large. One revelatory example is the financialization of the criminal justice system. Recently, the use of monetary sanctions in the US criminal justice system has significantly increased, as the increasingly financialized state charges the inmates a fee (plus interest) for using the social service of law enforcement and correction. The consequent rise of legal debt led to further disadvantages for former inmates, most of whom were already economically challenged (Harris et al. 2010). Summarizing these findings at the global level, Zalewski & Whalen (2010) report a weak but growing correlation between the IMF financialization index and national income inequality (0.184 in 1995 to 0.254 in 2004).

Financialization and Culture

The impact of financialization extends to the everyday life of ordinary people, as participation in finance arguably reshapes the way people think about their lives and the world around them. Financialization underwrites narratives and discourses that emphasize individual responsibility, risk-taking, and the calculative nature of financial management (Martin 2002). Our physical environment is filled with pervasive images and texts of financialization, such as "advertising campaigns, money magazines, investment manuals and financial literacy campaigns" (van der Zwan 2014, p. 112). This prevalent "finance culture" creates an image of the individual as an "investing subject" (Aitken 2007, p. 13), who "insures himself against the risks of the life cycle through financial literacy and self-discipline" (van der Zwan 2014, p. 113). For the investing subject, the uncertainty of the future is not something to be feared but to be embraced, because financial theory posits that only those who bear risks can achieve investment returns. Moving away from the security provided by the postwar welfare schemes, ordinary American citizens are told to embrace such instability as an opportunity to bear risk and be successful in the "ownership society" (Davis 2010).

This identity extends to perceptions of political interest. According to Cotton-Nessler & Davis (2012), stockholders identified themselves as Republicans to a far greater extent than did nonstockholders in the early 2000s, due in part to explicit recruitment efforts by Republicans and policy moves by the Bush administration to appeal to shareholders. Surprisingly, this effect persisted through the 2008 election even after the collapse of the stock market. However, unlike the promise of the ownership society, the success of an investing subject is unevenly distributed across the levels of preexisting wealth. Fligstein & Goldstein (2015) find that while the consumption of financial services increased across all levels of income, only those in the top 20% of the income distribution seemed to have thrived in the ownership society by actively leveraging their assets and engaging in financial management. In the meantime, those at the bottom of the income distribution were forced to pursue careers as "financially self-determinant professionals," otherwise known as "precarious workers" suffering from job insecurity (Chan 2013). Moreover, the flip side of the ownership society was the return of debtor's prisons not seen since the time of Charles

Dickens. Stricter enforcement of individual financial responsibility by the state is reflected in the recent spike of arrest warrants to prosecute borrowers who fail to repay small debts, as low as $250 (Lebaron & Roberts 2012).

Financialization Beyond Markets

Along with the financialization of everyday life, financial interest now extends to areas traditionally considered outside the market economy. For example, financial markets and actors have become central to the production of urban spaces. The proliferation of predatory equity (i.e., private equity's extensive investment in affordable rental housing) is shaping urban living conditions. The higher profit expectation of predatory equity led to aggressive efforts to increase tenant turnover rates (through harassing existing residents) and to reduce maintenance expenditures, causing a rapid physical deterioration of living conditions of underprivileged urban populations (Fields 2013). Another example is increasing ownership of timberland and farmland by institutional investors. Unlike corporate landowners who directly used the land for industrial production, financial landowners treat land as a financial asset that produces a short-term return on investment through asset price appreciation. Gunnoe (2014) reports that this leads to the similar trouble with any commodity embraced by the financial market: ungrounded price rises (bubbles) in farmland and timberland.

Financialization beyond markets accelerated as financial practices such as securitization extended to domains traditionally considered to be outside of financial transactions. Financialization of local politics provides one representative example. In the form of tax increment financing, the predicted increases in property tax receipts to local governments are securitized to raise funds for urban redevelopment, consequently leading to the financialization of urban politics, in which economic development professionals exert an unprecedented influence on municipal budgetary decisions (Pacewicz 2012). In the same vein, Chicago attracted billions of dollars from global investors by bundling and selling future property tax income, but this also subjected administrative decisions about urban redevelopment to the logic of investment and speculative thinking, causing an oversupply of space and a property bubble in the city (Weber 2010). Even the notion of sustainability is becoming financialized by introducing devices such as sustainability accounting, which integrates noneconomic factors such as social, environmental, and ethical values into the realm of financial calculation (Hiss 2013). Although these new tools enabled corporations to measure their noneconomic impacts, they also led to the omission of key sustainability-related aspects that are difficult to objectively measure and quantify—essentially, while water usage or greenhouse gas emission attracts greater attention, complex social consequences of corporate actions on local communities are more likely to be overlooked.

Financialization and Social Change

The rise of finance has created both new targets for social movements and new tools for activism. The emergence of financial control and particularly the recent financial crisis have been accompanied by the rise of oppositional movements such as Occupy Wall Street and its progeny. This movement created a new focus on the linkage between inequality and the excessive influence of Wall Street, fueling public discourse on reinstating regulations on the financial industry and providing an alternative narrative to the ownership society.

At the same time, the prevalence of finance was adopted as a tool to advance social movements. For example, various social movements have embraced divestment as an effective tool to achieve their political goals. Social movement organizations often place pressures on institutional investors of more public funds (e.g., public pension funds) to divest shares in corporations that cause environmental/social harms or adopt objectionable policies (Soule 2009). The emerging movement of socially responsible investment is also employing a similar tactic. Socially responsible investment funds exert significant influence on corporate behaviors as well as global political issues by subjecting investment decisions to explicitly political criteria (Sparkes & Cowton 2004).

In line with the antifinance movements, various alternative organizational forms either newly emerged or regained interest in recent years to provide ways of organizing economic activities that are relatively free from financial control. More incremental forms include benefit corporations, flexible purpose corporations, and low-profit limited liability companies (L3Cs) that relax the institutional (if not legal) mandate that corporations exist to maximize shareholder value. In contrast, cooperatives that are owned by workers, producers, or consumers, or mutuals owned by the users of products, constitute both more radical and more traditional alternatives. Schneiberg (2011) shows that, although largely outside the mainstream focus, these forms have been establishing an important base of the American economy and provide an alternative template for organizing that is less affected by the instability of financial markets.

Simultaneously, there are initiatives that actively utilize the power of finance to construct an alternative order. In the United States, for instance, employee stock ownership plans are becoming a popular way to democratize the capital control of the society (Kruse et al. 2010). In fact, there are cases in which labor unions have successfully gained their ownership in public corporations through union-controlled pension funds (Jacoby 2008). Discussions of more systematic approaches for harnessing the power of finance to overcome financialization are also under way. Block (2014) provided a more deliberate and specified strategy of using finance to create an alternative economic foundation—a network of nonprofit financial institutions that redirect household savings to fund sustainability-related projects such as clean energy and community-based small businesses.

These dual roles that finance plays in various endeavors for social change may suggest the need to distinguish major actors in the financial industry and financial institutions from the financial market itself. At the surface, financialization appears to be a power shift from industrial corporations to the financial sector, but the deeper underlying trend may indicate a shift from social institutions to markets as the dominant organizing principle of contemporary societies.

FINANCIAL MARKETS AND SOCIAL STRUCTURES

Our review thus far suggests that the implementation of financial markets can reshape social institutions. Below we speculate on a theoretical account for how this happens, and how it might vary cross-nationally.

Financial Markets and Economic Power

A shift in financial intermediation from institutions to markets has important implications for economic power. It is not simply a transfer from Main Street to Wall Street, but a qualitative change in the nature of power relations. Indeed, many features of contemporary financial markets have historical roots in the political struggles between the monarchy and an increasingly empowered British Parliament in the late seventeenth century. The Parliament's eventual victory in this struggle limited the discretion of the Crown, facilitated the development of an international credit market for state-building, and assured the strict enforcement of financial property rights, all of which constituted the foundation of modern financial markets (North & Weingast 1989). Strong financial markets resulted in constrained executive power and a particular framework of laws for governing finance, features that endured for centuries (Carruthers 1996).

Moreover, the distinctive gestation of financial markets in Great Britain, and their effective absence in France, left enduring marks in national economies around the world through the subsequent growth of the British Empire. British colonies generally inherited a common-law legal tradition and its associated investor protections, whereas French colonies generally inherited a civil-law tradition. The economics literature on legal origins suggests that financial markets developed more actively in the common-law legal tradition (La Porta et al. 2008). Consistent with this argument, most former British colonies have domestic stock markets, whereas few former French colonies do, arguably because the former have legal systems with more comprehensive protection of investor rights (Weber et al. 2009).

With this historical origin, modern financial markets are ingrained with the tendency to limit the concentration of power in the hands of particular actors by endorsing coordination through impersonal rules and the aggregation of economically rational actions. Consequently, the expansion of financial markets arguably transformed power relations in the broader economy in a counterintuitive way: Rather than move power from one identifiable set of actors to another, financial market expansion limited the concentration of power in the hands of any discrete actor.

In contrast to the conventional belief that financialization augmented the influence of Wall Street and its international counterparts, the recent shift to the financial markets may have ultimately weakened the significance of financial institutions, both commercial and investment banks. One might hear that Wall Street has never been more powerful and that bankers exercise a shadowy but pervasive influence on society. Yet in 2008, three of the five major independent investment banks in the United States (Bear Stearns, Lehman Brothers, and Merrill Lynch) disappeared. The biggest insurance company (AIG) along with the two biggest mortgage-funding companies (Fannie Mae and Freddie Mac) were effectively seized by the state. The biggest thrift (Washington Mutual), along with the two biggest freestanding mortgage issuers (Countrywide and New Century), went bankrupt. It is a particularly cagey form of power that ends up with businesses being liquidated or taken over by the government and their top ranks of executives fired.

The American case vividly illustrates this shift from institutions to markets. From the turn of the twentieth century to the 1980s, money center commercial banks held a distinctive place in the flow of capital in the American economy. One sign of their prominence is that banks' corporate boards were particularly large and well-connected, populated by prominent directors who were often CEOs of major companies. In 1982, for instance, Chase Manhattan's board included top executives from Ford, General Foods, Macy's, Exxon, Xerox, AT&T, Pfizer, Cummins Inc., Bethlehem Steel, and several other Fortune 500 companies. A prominent board provided high-level intelligence to guide the bank's lending and gave a sheen of legitimacy to the bank itself (Mintz & Schwartz 1985). Yet over the next 15 years, as lending by commercial banks was increasingly displaced by money markets and other forms of market-based finance, bank boards shrank substantially and cut back on the recruiting of CEOs. Within a few years, as banks shifted to more transactional businesses, their boards were no better connected than those of other firms (Davis & Mizruchi 1999).

Meanwhile, a wave of bank mergers reduced the number of commercial banks dramatically, and most large cities lost their major local bank to a handful of acquirers (particularly Bank of America and JPMorgan Chase). As a result, the cities' local power elite no longer had a regular connecting point. Chu & Davis (2013) found that the interlock network had largely collapsed by 2012, as boards shunned the well-connected directors they had previously sought.

Mizruchi (2013) describes how this and other factors led to a fracturing of the American corporate elite. Changing from a densely connected class able to act cohesively to influence state policy, business executives in the United States had become increasingly hapless and incapable of locating and acting on common interests, such as health care, taxes, investment in infrastructure, and foreign policy. In a sense, a cohesive corporate elite was a casualty of the shift from relationship-based businesses (such as commercial banking) to markets. Although this is most evident in the United States, similar effects are observable around the world.

Financialization and Varieties of Capitalism

The spread of financial markets around the world over the past 30 years has changed the way business is done in many economies, which have often become more Americanized (cf. Useem 1998). The number of countries with domestic stock markets doubled after the debt crisis of 1982, often encouraged by international agencies such as the IMF and the World Bank (Weber et al. 2009). Dozens of countries privatized industries, removed constraints on foreign investors, and made their central banks independent (Polillo & Guillén 2005). In an effort to attract foreign investors, many governments employed US-trained economists who were well acquainted with neoliberal orthodoxy to signal their free-market credibility (Babb 2005).

Israel represents an extreme case of how financial markets transformed the business sector, as the country transitioned from a distinctive form of socialism as late as the 1970s to hyper-entrepreneurial capitalism in the 1990s. Domestic high-tech entrepreneurs discovered that they could access global financial markets and achieve rapid growth by skipping local financial channels while amassing personal fortunes. By 2000, over 70 Israeli companies had listed on US stock markets, often legally incorporating in the United States and adopting the standard practices of Silicon Valley start-ups (Drori et al. 2013). The opportunity to go public created a new class of overnight billionaires and shifted the traditional collectivist business culture toward a more individualist orientation in which it was possible to get rich quick.

Development experts anticipated that similar transformations would occur in other countries that implemented market-friendly policies that enhanced domestic access to international capital. Financial market reforms, which happened simultaneously in many parts of the globe for the last few decades, represent the global diffusion of financialization that was essentially achieved by the export of Anglo-American economic policies and practices. This was accomplished mostly by eliminating or weakening developmental states, promoting the rule of law, and facilitating an Anglo-American type of corporate governance (Woo 2007). For example, after the 1997 East Asian financial crisis, which was facilitated partly by liberalization of the domestic economy, South Korea opened its domestic firms to foreign shareholders and transformed its banking sector, leaving core companies increasingly reliant on outside investors (Crotty & Lee 2005).

The United States clearly stands out as the most financialized economy. A recent cross-national comparison of financial industry growth reveals that the US economy exhibited the steepest increase for the past 30 years in terms of the share of financial industry and the wage of financial sector workers. This trend is not universally common in other advanced economies, where the financial industry's share either reached a plateau or even experienced slight decline (Philippon & Reshef 2013). Yet financialization has happened to a greater or lesser degree in countries around the world.

Some scholars predicted that financialization would end with global convergence on American-style finance capitalism (Coffee 1998). But financialization took on a different character according to local circumstance. Unlike franchise restaurants, financial markets do not come with a handbook that ensures uniformity. For instance, institutional entrepreneurs aiming to transform their domestic economies, e.g., via pension reform, worked through existing arrangements that yielded different outcomes (Dixon & Sorsa 2009).

It is clear now that simply following a checklist of financial reforms, no matter how significant, will not lead to convergence on a common economic template. History matters. For example, the development of consumer finance in the United States, but not in other advanced economies such as France, is attributed to particular contingencies in US history, such as labor unions actively supporting the expansion of credit access to workers as a type of welfare, and banks embracing small-scale consumer lending as one of the main revenue sources (Trumbull 2012). A comparison between the American and Russian credit card industries is another good example of the historical contingencies and the trajectory of financialization. Without a stable institutional context that turns uncertainty into calculable risks, the Russian credit card industry developed in an alternative way; it relied on the personal-level trust embedded in existing social relationships, consequently hindering the wider expansion of the market (Guseva & Rona-Tas 2001).

Research under the rubric of varieties of capitalism suggests that national economies can be described in terms of a matrix of institutions (North 1990) that shape the appearance of economic organizations (corporations, banks) and the prevalence of different sectors. This matrix includes institutions that regulate product market competition, labor markets, capital markets, education systems, and the provision of social welfare (cf. Amable 2003, Hall & Soskice 2001). In industrialized economies, these institutions combine, akin to an institutional terroir, to enable particular types of firms and industries to thrive.

The globalization of finance can shape the balance of institutions in an economy by tilting the cost profile of using markets. But how this plays out depends crucially on existing institutions. One ambitious effort to assess the influence of financial globalization on national economies is Kogut's (2012) collection *The Small Worlds of Corporate Governance*, which examines networks of corporate boards and corporate ownership in two dozen countries in 1990 and 2000. The study provided distinctive insights into how highly diverse economies responded differently to financial expansion.

The varieties-of-capitalism approach is not without its critics. There is a hazard of devolving into neofunctionalism. Streeck (2011) points to the danger of treating economic transitions as case studies of generic processes of institutional change. But, without oversimplifying, this approach provides a useful starting point in contemplating different trajectories of financialization at a national level.

CONCLUSION

Over the past 30 years financial markets have spread broadly across geographic and social spaces. Stock markets have opened in dozens of new countries, changing the ways businesses are structured and how they operate. In some countries, as in Israel, a new class of entrepreneurs, enriched by IPOs and changing the culture of business and society, has emerged (Drori et al. 2013). Public policies have become more accommodating to both domestic and foreign investment. More types of assets, from student loans to lawsuit settlements, have been securitized. Domains not normally considered assets were transformed into tradable financial products, such as tax increment financing premised on predicted increases in future property tax revenues (Pacewicz 2012). It seemed that almost any kind of cash flow could be securitized and turned into a financial instrument.

Our review suggests that these processes introduce dynamics of financial markets into areas where they were previously absent, and as a result can have pervasive social consequences. We have explained several of these consequences, such as the transformation of the corporate sector, increases in inequality, and new means and targets of social movement activism. We have also outlined some of the evidence on how financialization varies cross-nationally and how national institutions interact with the incursions of financial markets. Along the way we have aimed to summarize a unifying account. We have described how theory and technology enabled trading: Information enables markets. We have also conveyed the many ways that financial markets challenge long-standing institutions, such as banks and the notion of home ownership: Markets undermine institutions.

Nearly every domain of our social life, from inequality and social mobility to local politics and urban planning to social movements and state power, has been touched by financialization. This trend makes financial markets and the logic of finance an increasingly influential force that shapes the future of our economy and society. By offering a brief and occasionally speculative overview of this emerging force, we intend to increase sociologists' awareness of a fledgling but potentially significant shift in the underlying mechanisms of the contemporary economy, and encourage a more expansive sociological focus on the issue. We have just started to comprehend the nature of change, and certainly, much work remains to be done.

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