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Is the systemic rise in income inequality likely to reverse and, if so, for which reasons?

Pascal Petit

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Is the systemic rise in income inequality likely to reverse and, if so, for which reasons?

Pascal Petit *

Abstract

Recent works have linked the big increase in income inequality in many developed economies since the mid 70s with a mainly market led internationalization, which, on one side puts a downwards pressure on the wages of low qualified workers and on the other side pushed upwards the wages of CEOs. This market led internationalization is fueled by a finance sector, facilitating mergers and acquisitions across the world. The endebtment of firms, countries and households thus induced by these mediations of the finance sector, opened an era of financial crises. Has the 2008 global financial crisis (GFC) altered this phenomena? Is financialization the only factor of this lasting rise in inequality? Why is this issue not more predominant in national political debates? The many factors fueling income inequality contribute to obfuscate the ensuing damages, at a time when a more egalitarian society seems necessary for a successful transition to environmentally sustainable modes of development.

Key words: inequality, financialization, welfare, crisis, environmental change

1. A systemic rise in inequality in the post 1980 period

Most of the time, debates on inequality are referring to income inequality and more precisely inequality between household disposable incomes over a year. The long term evolution of this inequality has been largely popularized by the work of Piketty and Saez (2001) on the distribution of wage incomes in the US over the whole 20th century, showing how the high level of inequality of the pre second world war started to decrease rapidly in the early forties, then more slowly, but still decreasing until the early 1980s, when it started to increase steadily until the present day, as shown in figure 1 displaying the evolution of the top 10% income share in the US over the century 1917-2017. This pattern, as we shall see, is more or less the same all over the developed economies.

* CEPN (Centre d'Économie de Paris Nord). Email: pascal.petit@univ-paris13.fr

The slopes of the increase and of the decrease are a bit sharper when considering how evolves the top 1% share of national income. Two observations are particularly striking in these patterns : 1) all along “the golden years of capitalism”, eg the post world war II period, income inequality is reducing, 2) immediately after the neo-liberal economic turn of the 1980s, inequality starts to rise again. This assessment is valid whether we consider pre tax or post tax income. Let us notice though that, in the US case, post tax inequality has not caught up in 2017 with its 1917 level. This general pattern leads to think that effectively the trends in income inequality may be tied with the type of growth regime at work, as the turn of the 1980s corresponds to a change of growth regime in the “western economies”, turning from what has been called Fordist growth regimes towards growth regimes where the dominant figure has been the central role of finance and of international liberalization of markets. Now this rise could have taken many forms. Thus the rise in inequality for the top percentiles could have corresponded to the success of a small elite, while the rest of the households would have experienced a much more egalitarian distribution of income. It is obvious that the detailed shape of a rise in overall income inequality matters, if only in terms of the political perspectives it suggests in democratic countries. As a matter of fact, as it shows in Fig2 for the US , the rise in the top percentiles is associated with a simultaneous decline of the share of the 50% bottom, thus leading to a marked opposition between rich and poor.

This pattern is not especially linked with a special type of income; it is much the same when considering only wage incomes. Overall, considering the empirical data, one is led to conclude that distribution regimes have changed both after WWII and at the turn of the neo-liberal economic revolution. The fact that the units of observation are households does not change this conclusion. The household economy cannot compensate for the income gap. Moreover, by and large, the poorer are also the ones with the worse health and education situations. Thus a really surprising fact , established by many empirical studies as we shall see, is that situations of high levels of income inequality are directly associated with poor health situations. This is puzzling as it implies that income inequality is somehow related to specific social relations, quality of institutions and governance. In other words income inequality is a symptom in a society which tells more than simply a span of differences in purchasing power. This strengthens the need to investigate in all its dimensions the significance of income inequality. What does it say on the societies under view?

We shall hereafter come back on the systemic aspect. Let us in section 2 rapidly consider how such a general pattern fits with the well known diversity of capitalism.

2. On the variety of capitalism

A literature has developed at the turn of the 21st century, stressing that beyond the common patterns of the growth regimes of the welfare states, existed differences in their institutional setting that mattered ,as it implied different reactions when these growth regimes were exposed to new challenges, as it was the case in the last two decades of the 20th century , after the turn towards more market oriented regimes. The first distinction was introduced by Hall and Soskice(2001) between countries (mainly the anglo-saxon ones), in which market mechanisms had always been given some priority that strongly increased in the post 1980 period, the Liberal Market Economies LME, and countries (like in continental Europe, basically Germany and France) in which public interventions were the first answers to any new challenge (the Coordinated Market Economies CME).

Authors of the Regulation School (Amable, Barré and Boyer, 1999; Amable, Petit, 2001; Amable, 2003) extended this distinction to five categories: the LME (as above), the social-democratic model (basically Scandinavian), a Mesocorporatist (taylor-made for Japan), a Continental European(with Germany, France and the Netherlands) and a South European. There are good reasons to observe very different levels of income inequality at any time between countries according the model they belong to. Indeed during the "Golden years of capitalism" the US had the reputation of having relatively large income inequalities, while on the opposite Scandinavian countries (and Japan) had the reputation of having relatively low levels of income inequality. We can check at a given year whether this qualification holds.

To measure income inequality we could as in figures 1 and 2 consider the share of income allocated to some percentiles of top incomes. A more current indicator is the Gini coefficient which gives an idea of the distant between the curve of the effective income distribution and the straight line, that would correspond to an equal income for all (see insert 1).

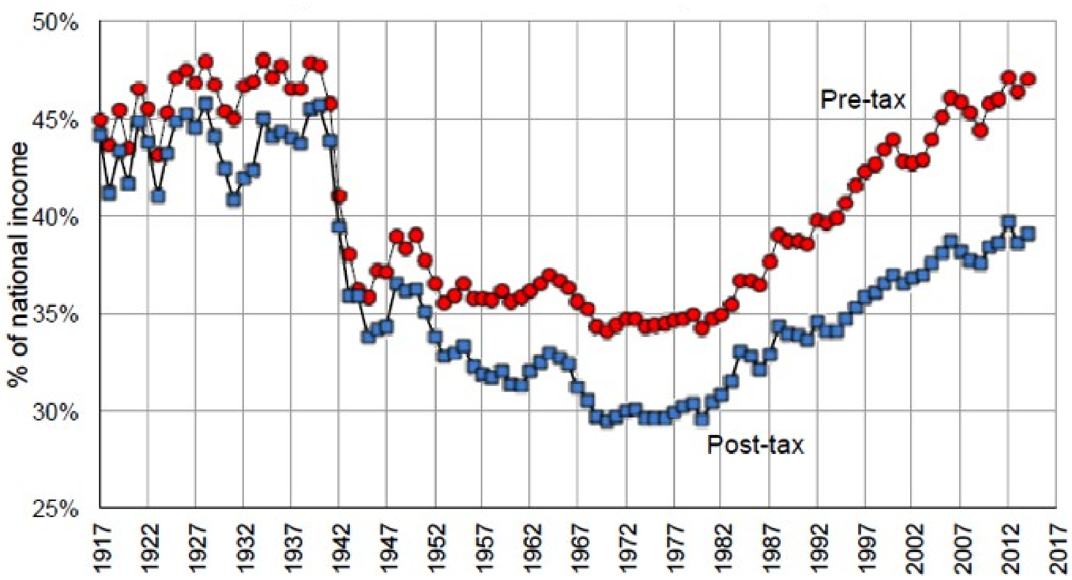


Figure 1. Top 10% national income share: pre-tax vs. post-tax (1917-2017)
Source: [Piketty T., Saez E., Zucman G. (2016)]

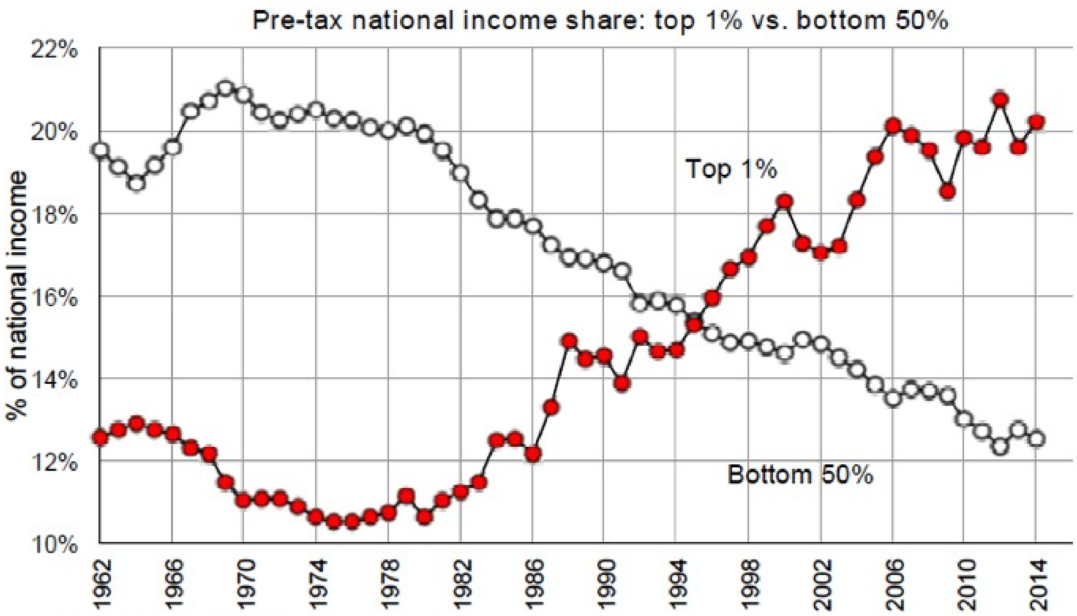
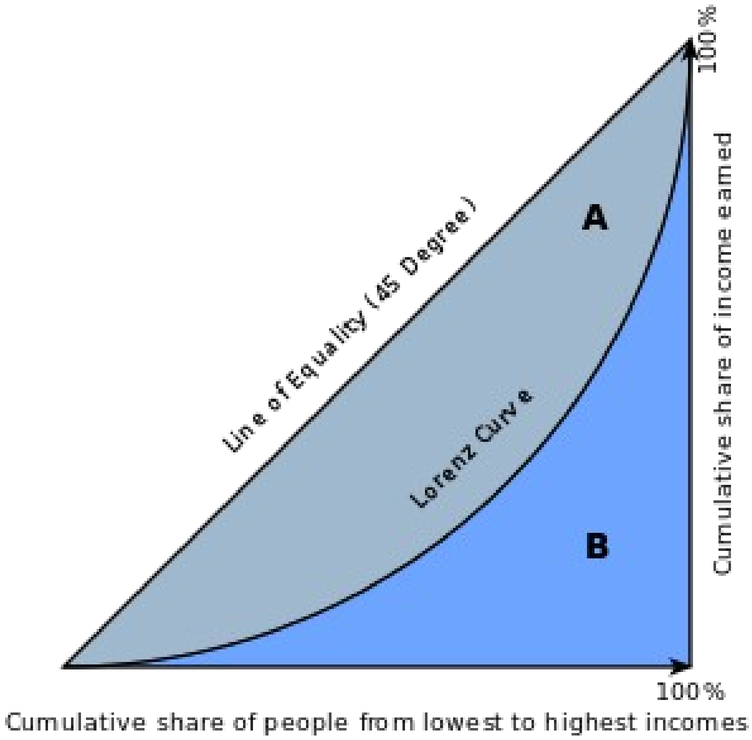


Figure 2. Pre-tax national income share: top 1% vs. bottom 50% (1962-2014)
Source: [Piketty T., Saez E., Zucman G. (2016)]



Insert 1. Gini as an indicator of the inequality of a distribution: Graphical representation of the Gini coefficient

The Gini coefficient is equal to the area marked A divided by the area marked A+B; eg Gini= A/(A+B) or , as A+B=0,5, Gini = 2A.

We can see that effectively, by and large, the five categories of capitalism are ranked as suggested by decreasing order of inequality levels: first the LME group of the anglo-saxon countries, second the South European, third the Continental Northern Europe, fourth the Scandinavian[1].

It is interesting to check how countries of the various groups are rating, not only to check the relative consistency of the categorization, but also to see which characteristics are associated with high or low levels of income inequality. Clearly with the LME, rating first with the highest Gini indicators, the importance of market mechanisms is a key factor "determining" the relative magnitude of income inequality. Let us also notice that the new East European countries, that entered the EU only in 2004 (and were not included in the study on the variety of capitalism, mainly done at the turn of the year 2000), are scattered all along the scale, with

1 Japan is not in the sample, but South Korea belongs to the mesocorporatist group and ranks approximately with the low inequality group as the Scandinavian.

countries like Hungary, the Slovak and Czeck Republic ranking with the Scandinavian while Estonia, Latvia and Lituania are ranking with the Anglo-Saxon ones.

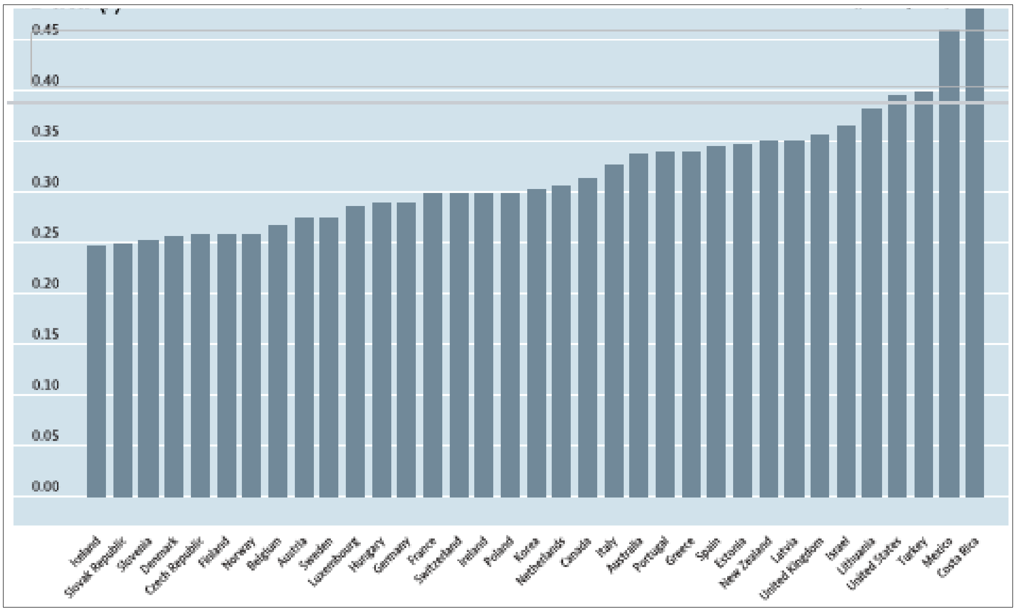


Figure 3. Gini coefficient of income distribution in OECD countries in 2005

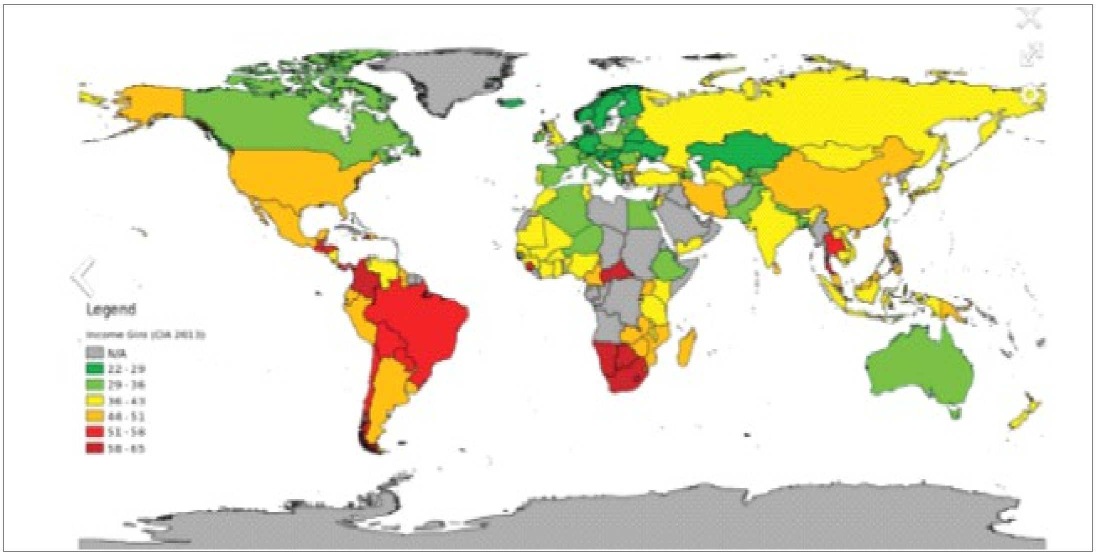


Figure 4. A perspective on Gini coefficients around the world (2013)

Let us also notice that we mainly considered rather developed economies where Gini coefficient ranged between 0,25 and 0,40, while, if we take a broader set of countries, as in the map in Figure 4, then all Europe appears as having relatively small Gini coefficient (except the UK), while some regions (in red) like Latin America turn out to have income distribution even more unequal than in the US. These Latin American countries are not included in the categorization of varieties of capitalism assessed above and there are good reasons to think that, if they had been included in the comparison of institution structures that led to the categorization under view , they would not have been placed in the same category as the anglo-saxon countries. Hence our conclusion that, if market mechanisms are significantly inducing income inequality, other characteristics may also play in that direction.

Taking the case of Latin America and some other developing countries (see Figure 4), one may suggest that the importance of informal sectors can also induce higher income inequality (and all the more so that informal economy gives way, not only to unregistered income but also to non monetary benefits, a dimension that we neglected as we were considering only developed economies, where the importance of income in nature (advantages) is supposedly negligible. The explanation of the ranking of some Baltic European countries, which entered only in 2004, may also be tied to some specific nature of their transition to capitalism[2]. After having positioned the variety of capitalism issue in our framework of investigation on the nature and role of income inequalities, we can proceed looking further at the systemic dynamics that increased these inequalities and what role did finance play in this evolution.

3. Whatever happened after the welfare states era?

Much has been written on the *Golden Years of Capitalism* or the *welfare states era* or the *Thirty Glorious Years* , which all made sense, despite the different perspectives taken. Clearly the post world war II decades saw, in the western part of the developed world, the emergence of a model of development that had rather clearly set its governing principles. We can see the essence of these different, still congruent, conventions in all the debates in the aftermath of WWII on the full employment conventions.

These conventions were more or less committing, more or less enacted in regulatory frameworks but still all sharing roughly the principles put forward at the Philadelphia conference organized by the ILO in 1944[3]. The final

2 Either giving right away a large place to market mechanisms or on the contrary leaving room to the informal economy during the transition phase.

3 ILO which, like most parts of the league of United Nations system, was hibernating since the late 1930s came back to life in organizing this conference in May 1944, as WWII was ending.

declaration, approved unanimously by the participants[4], reaffirmed four principles (now in the constitution of the ILO), which are worth recalling to see on which basis a modernized capitalism (à la Shonfield, 1967) could regain some legitimacy after the blunder of the 1929 economic crisis and the incapacity of the capitalist system to get out of it, leading to WWII massive destructions and horrors.

> ***Principle 1: labour is not a commodity*** which encapsulates that workers as persons are at the heart of labour legislation and should be protected.
>
> ***Principle 2: freedoms of expression and association*** are essential human rights.
>
> ***Principle 3: war against poverty*** (required as poverty anywhere constitutes a danger to prosperity everywhere) ***and want*** (with unrelenting vigour within each nation and by continuous and concerted international effort).
>
> ***Principle 4: Tripartism*** (in which the representatives of workers and employers, enjoying equal status with those of governments, join with them in free discussion and democratic decision, with a view to the promotion of the common welfare).

Principle 3 seems to focus on the reduction of income inequality (although not very specifically, hinting more at a war against radical poverty), while principle 2 and 4 are specifying the means that should be at disposal of the workers. This last principle 4 , asking for a tripartite governance, has been distinctively less respected by the nation states in the LME group, while the other groups, especially the Scandinavian, the Mesocorporatist and the Continental Europe ones did in the post war period used tripartite institutions.

All these good resolutions of the aftermath of WWII have by and large geared the governance of countries under view during three decades. Even if the capital-labour relationships have been many times under tension in this process, it is the international arrangements, accompanying this post war arrangements, which collapsed in the early 1970s. The whole system of fixed exchange rates, arranged at Bretton Woods, was based on the convertibility of the dollar into gold. But the continuous deficits of the US balance of payments , following external expenditures, of which the Vietnam war was the largest, led

On the Phliadelphia conference see Servais Jean Michel (2011) and Supiot (2010).

4 Let us notice that the USSR did not participate to this Philadelphia conference.

foreign countries, suppliers of raw materials and oil, to loose trust in the dollar and to claim their gold counterpart. In 1971 the US government had to declare that the dollar was not anymore convertible. The western Nation States, concerned by this change, decided to turn to a flexible exchange rates system in 1973. By then the turmoil on exchange rates markets and the claim of exporters of raw materials had launched a price inflation and provoked an oil crisis, setting the developed world in a new era of problems. To stop price inflation and restore confidence in external transactions, the anglo-saxon countries succeeded to impose a neo-liberal medicine, celebrating all the merits of market liberalization. Milton Friedmann, the big advocate of this remedy, succeeded to convince President Reagan and Prime Minister Thatcher, who became great propagandists of the neo-lib economics, as well as the major international institutions such as the OECD, the IMF and the World bank.

This turn, that came in the early 1980s, after a period of questioning, was never debated or supported by the type of conventions that occurred in the aftermath of WWII. The 1970s unemployment and inflation had strangely enough reappeared and the neo-lib remedy was seen as partly temporary. Moreover, as it was claimed by the propagandists, trade liberalization would bring some benefits to the consumer, being then able to enjoy lower prices on their consumption and durable goods. There was no debate on the fact that this crude trade liberalization will also put a pressure on jobs and that this loss might well largely be superior to the overall consumer surplus, and all the more so that this liberalization did not concern only trade but also capital flows, paving the way for externalization of large parts of production processes to lower wages countries. Because of this absence of large debates for a turn in governance which rapidly appeared as a major change, some will evoke the entry in a post democratic period (Crouch, 2004; Streeck 2014).

The relative silence on this transformation has been noticed by politicians, either in retrospect as Michael Higgins, ex prime minister of Ireland, underlining that "*the transition in its day between The theory of Moral Sentiments (1759) of Adam Smith and his Wealth of Nations (1776) drew a more extensive debate in the eighteenth century than the changes in contemporary international economies that are in our time presented as near inevitable, and that are being delivered as their sole policy choice to publics suffering the burden of what Pope Francis has called a "plague" of indifference"*[5]. Another revealing quote

5 See Higgins Michael (2018).

can be taken from Barroso's speech in June 2010, when as President of the European Commission, he qualified of *silent revolution* the measures of austerity that countries had agreed to take in order to get out of the 2008 crisis. Gill (2008) rightly stresses the silence accompanying this free-market led transformation over three decades, in big contrast with the lively debates, which took place at the Philadelphia convention and then at national levels, around the full employment conventions.

In silence a mechanic play of free market forces did fuel the rise in income inequalities. On one side the low paid blue collar workers in developed economies were more and more facing the competition of low wage developing countries, putting a strong downwards pressure on their wages. (See Freeman, 1995). On the other side the CEOs (high executives) of big multinationals enjoyed significant wages increases, boosted by financial markets[6] for which well paid CEOs were signs of potential appreciation of the stocks[7]. Waves of mergers and acquisitions had the same objective. By and large the game of financial sectors was meant to increase the share holder values. To see to what extreme this widening gap has gone up to, let us remind that Henri Ford suggested at his time that a fair ratio between the highest and lowest wages in a firm should neighbor 10, while we have now reach figures 60 times bigger in some cases (eg ratios close to 600)!

Period	**Fraction of total growth captured by top 1%**	**Fraction of total growth captured by bottom 99%**
GDP expansion 1993-2010	**52%**	48%
GDP expansion 1993-2000	45%	55%
GDP expansion 2002-2007	65%	35%
GDP expansion 2009-2012	95%	5%

Figure 5. Pro-rich economic growth (1993-2013)
Source: Saez (2013)

6 While low wages norms were set in Beijing, as Freeman said, wages of CEOs seem to be determined in Wall Street.

7 See for instance in France the data available here and Steiner (2011).

These market mechanisms accrued income inequalities in continuous ways in all countries (see Franzini et al. 2016, Petit 2010), where finance operated freely, as no massive protest came to limit this move. Rises in poverty and want among the low paid and precarious workers should have launched the expected protest, if only on the basis of principle 3 of the Philadelphia declaration. One of the reason for this lack of protest has often been attributed to the fact that at the same time, while downwards pressure on low wages were exerted, household indebtment was made easier. Specific loans to the poor helped them to keep up with the Jones (eg symbolically with the middle class standards they had reach during the Golden years of capitalism), all of which directly contributed to the well named Subprime crisis which started off the Global Financial Crisis (GFC) .

The growth regime that came to prevail at the end of the 20th century, where finance facilitated capital mobility, indebtment of firms as well as of households and widening of the wage distribution, has been rightly qualified of financialization regime (see Boyer, 2000; Van Treeck, 2009; Tridico, 2017) for instance). The only question was whether or not such financialization was sustainable enough to be considered as a regime. Speculative actions were so numerous and irrational (if only to quote Shiller, 2000), referring to the irrational exhuberance of finance) that this “regime” was very prone to crisis and thus highly unsustainable. So that, when the Global Financial Crisis occurred in 2008, many thought that it would mean the death of the neo-liberal economic ideology. Some years after the surprise was the strange non-death of neo-liberalism (to quote Crouch 2011).

4. Post Global Financial Crisis: rising consciousness and new perspective

In effect, the neo-liberal discourse of the majority of economists has not changed much after the global financial crisis. The free market ideology has still been the big support for the austerity policies that were retained all across the world to get out of the crisis. Even the quantitative easing policies, that central banks pursued to avoid bankruptcies of many financial institutions, were unconditional and fueled more speculation than productive investment. Household endebtment continued to rise, maybe less on housing (to avoid a new sub prime crisis) but on cars , on student loans and the like, to cope with reduction of the purchasing power of middle and low income classes. As again, in such financialized environment the rich got a bigger share of GDP and income inequality continued to rise (see figure 5), Crouch (2011) was right in underlining the non death of neo-liberalism, but the dogmatic neo-liberalism of the past decades may have received a deadly blow in the process. The reason for that could well be a growing consciousness that the propensity to increase inequality, embedded in this ideology, could be fatal to our societies. Two main reasons for that. First, it has become clear that income inequality goes altogether with many social distresses, if only in terms of health and education attainments. Second, the environmental challenge, which has become more clearly pressing in the last decade, after having been rather marginalized after the first alarm in the early 1970s (with the Meadows report 1972), requires to increase social cohesion and to develop inclusive actions. The fact that after the COP 21, in December 2015, the reduction of inequality was retained as one of the 17 Sustainable Development Goal (SDG) is very telling in that respect. It was not only a matter of reducing intrinsic poverty (which has been a continuous objective of the UN organizations) but more specifically to reduce also the far ranging inequality of incomes[8]. SDG target 10.1 commits countries to progressively achieve an income growth of the bottom 40 per cent at a higher rate than national average.

The unanimous support for this objective somehow echoes the declaration of Philadelphia and one can hope that it will remain on the agenda of the climate negotiations. If we get there, it is in particular due to the many warnings that have been issued in the last decade on the harms of continuous rises in income inequality.

The success of Piketty's book[9] illustrates the changing social consciousness of the harms of inequality (and the book makes references among other things to contemporaneous novels and television for that), but it also makes the point that if capital income growth is bound, in the present institutional context, to always overtake the growth of GDP, then in a long term perspective of slow growth, the rising trend in income inequality is also bound to continue over a long period of time.

8 For a report argumenting the importance of this specific objective at the COP21, see Genevey et alii (2013).

9 More than 2,5 millions copies sold of his 700 pages book worldwide by fall 2016 see here.

This rising consciousness is not only occurring among educated readers in developed economies. Global attitudes surveys, done by the Pew research centre, show clearly that over 60% of the populations in 2014 in developed, but also developing and emerging countries, considered perceived inequalities as a serious problem[10]. In this relative awakening of the social consciousness of the harms of income inequality, a major factor remains the whole set of empirical studies, showing surprising correlation between income inequality and social problems, be it health, education, criminality or sociability. The research works of Kate Picket and Richard Wilkinson (2005 and 2009) are impressive in that respect (see figure 6 for instance).

Figure 6. Index of health and social problems related to income inequality

The diffusion of such empirical findings play somehow a similar role to the one that the publications of the hygienists had in the mid 19th century, which stressed how continuing poor labor conditions would damage the reproduction of the human species.

Still the drawback of this type of scientific warnings is that it will take time to diffuse, while its empirical validation will have to be thoroughly debated, provided that it is relayed by medias and that professionals in human and social sciences take part in these debates without prejudices. And time running too

10 Interestingly among developed economies, one finds some countries like the US, Germany and Japan with lower than average percentages of population worried about income inequality. See Voituriez et alii (2015).

fast is precisely a major risk to fail to meet the environmental challenge. Economists have a clear responsibility in that respect. The silence of a majority of orthodox economists, reluctant to rebuke the free market ideology[11], may unfortunately slowdown the process as they have kept some influence in the governance of the complex global system which has been developing in the past four decades. In this perspective the fact that this specific reduction of income inequality has been integrated in the SDGs and therefore will be tracked down every year along with the other actions followed in the climate negotiations is a good sign, which can help to convince majorities of public opinions including at last, who knows, a majority of the economist profession.

To go back to the questions initially raised, yes indeed the Global Financial Crisis has helped to see the harm of financialization on society. Still it takes time to adjust to a new regime. But the consciousness of the necessity of such turn is also largely supported by the need to meet the environmental challenge. Does that mean that the required turn to environmentally and socially sustainable development paths will be achieved? This is not so certain, the turn may be too slow and/or replace by authoritarian regimes, a political risk clearly shown in Russia and in the US. Threats on democracy is clearly an issue on the road to the sustainable development paths we are looking for.

11 For an assessment of the resistance to this specific consciousness of the harm of income inequality see here.

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