Financialisation in the circuit
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Abstract: The relationships between financial systems and the macroeconomy with emphasis on the saving—investment relationships and the nature of money are set out. A ‘circuitist’ framework is extended to reflect some major features of the era of financialisation since circa 1980.

Key words: monetary circuit, financialisation, saving, investment

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1. Introduction

This paper seeks to explore how the ‘circuitist’ framework may be developed to reflect some important features of the evolution of the financial system in the past three decades which have been associated with what may be termed ‘financialisation’. The purposes in doing so are threefold. First, it enables an understanding of the causal relationships between saving and investment, and draws the distinction between ‘initial finance’ and ‘final finance’ [or what may be termed funding] for investment and indeed other forms of expenditure. It has implications for the role of banks [as provider of initial finance] and of the financial system [as provider of final finance]. Second, it provides a view of the macroeconomic system in which the financial system can be represented, though it is recognized that the system outlined is a relatively simple one. Third, we argue that it provides a framework within which a range of features of financialisation can be set out. In this context, financialisation is viewed in terms of Epstein’s definition that ‘financialization means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies’ [Epstein, 2005, p.3], and we focus on what are perceived to be significant features of processes of financialisation which have been underway in the past three to four decades [but without any claims that these are the only or the most important features].

2. Financial systems and the macroeconomy

A financial system necessarily involves the financing of economic activity, by which is meant that possession of money [as a means of payment] is generally required before expenditure can take place. Keynes (1937) spoke of the ‘finance motive’ for the [temporary] holding of money [alongside the transactions motive, the precautionary motive and the speculative motive of Keynes, 1936]. Since expenditure needs to be financed [if it

1 ‘Now, a pressure to secure more finance than usual may easily affect the rate of interest through its influence on the demand for money; and unless the banking system is prepared to augment the supply of
is to undertaken), the ways in which the finance is obtained by the individual and [more]
how it is created and by whom becomes of importance.

This leads on to the question of what is regarded as money, and how is money created and
destroyed. The Chartist approach to money focuses on the role of the State in the
determination of the unit of account and what the ‘money thing’ is. The State sets out what
is regarded as legal tender [though that is a rather limited role] and what is accepted by
the State in payment of taxes, fines and discharge of debts. The distinction can be drawn
[roughly corresponding to what Gurley and Shaw, 1960 labelled outside and inside money]
between the money issued by the State or by the Central Bank and the money which is
created by the banking system. Some [e.g. Bell, 2001 for example] would view this in
terms of a hierarchy of money with Central Bank money at the peak of the pyramid. Others
[e.g. Graziani, 2003] would view money issued by the Central Bank (or the State) as having
the same credit nature of money as that issued by commercial banks.

The creation of money through the banking system as a result of the loan processes has a
number of significant implications. The first is that the provision of loans by banks [and the
subsequent money creation which that involves] is crucial to the expansion of the
economy. In the words of Kalecki: ‘the possibility of stimulating the business upswing is
based on the assumption that the banking system, especially the central bank, will be able
to expand credits without such a considerable increase in the rate of interest. If the
banking system reacted so inflexibly to every increase in the demand for credit, then no
boom would be possible on account of a new invention, nor any automatic upswing in the
business cycle. ... Investments would cease to be the channel through which additional

money, lack of finance may prove an important obstacle to more than a certain amount of investment
decisions being on the tapis at the same time. But ‘finance’ has nothing to do with saving. At the ‘financial’
stage of the proceedings no net saving has taken place on anyone’s part, just as there has been no net
investment. ‘Finance’ and ‘commitments to finance’ are mere credit and debit book entries, which allow
entrepreneurs to go ahead with assurance.’ [Keynes, 1937, p. 247]. ‘But if the banking system chooses to
make the finance available and the investment projected by the new issues actually takes place, the
appropriate level of incomes will be generated out of which there will necessarily remain over an amount of
saving exactly sufficient to take care of the new investment.’ [Keynes, 1937, p.248]
purchasing power, unquestionably the *primus movens* of the business upswing, flows into the economy’ (Kalecki, 1990, p.489).

The second is that banks create money through the loan processes insofar as deposits with banks are indeed regarded as money – that is possess the characteristics of being readily transferred between economic agents and generally accepted as a means of payment. This can be expressed by saying that banks are here viewed as those institutions whose liabilities (i.e. deposits with those institutions) are generally accepted as a means of payment.

It will then become necessary to distinguish between those financial institutions which we will call commercial banks whose liabilities are generally accepted means of payment and other banks (e.g. investment banks) and financial institutions. It is, of course, the case that many financial institutions do not have the characteristic of their liabilities counting as means of payment, and others have some of their liabilities so counting. It is this view of banks (that is identified with money creation) which has dominated the macroeconomic textbook representation of banks, and we could label this as the macroeconomic definition of banks, though we will here use the term ‘commercial banks’ (clearing banks would be an alternative). This definition of banks is a narrower one than the legal definitions of banks – the precise nature of which varies over time and space and can relate more generally to financial institutions which accept deposits and/or those which are regulated by central bank or other authorities.

It is often said that a major role of the financial system is to link together saving and investment (investment used here in the macro-economist sense of capital formation). Perspectives on financial systems are embedded in [often implicit] approaches to macroeconomic analysis. Within macroeconomic analysis there are major distinctions between schools of thought with regard to the aggregate relationships between saving and investment, and the related views on the nature of money.

The mainstream approach can be viewed as ‘savings leads to investment’, with equality between savings intentions and investment intentions at full employment and with money
is treated as exogenous (or weakly endogenous). There is seen to be a desire to save which is satisfied and the volume of investment adjusts. The rate of interest (portrayed as a single interest rate though often linked with that of the Central Bank) is viewed as capable of equating savings intentions and investment intentions at full employment, and the ‘natural rate of interest’ is the rate of interest which would be determined by supply and demand if no use were made of money and all lending effected in the form of real capital goods’ (Wicksell 1936, p.102). An element of this view is that the economy is treated as though it is non-monetary in the sense that money is viewed as ‘neutral’ to the level of economic activity etc., and that money is no more than a convenience to facilitate exchange. Money is then treated as exogenous (to the private sector) in the sense that the stock of money is determined by the Central Bank (from which flowed the monetarist propositions to control the growth of the stock of money in order to control the rate of inflation). The stock of money may be treated as Central Bank money (notes and coins, reserves at Central Bank) or as a broader money including bank deposits albeit with the assumption of a credit multiplier relationship between CB money and the broader money, and there may elements of a ‘flexible’ credit multiplier. Money can be described as weakly endogenous when there is some allowance for the banks’ ability to create money but where the degree to which it can do so is limited by the availability of Central Bank money.\(^3\)

The central bank is part of the financial system and through its ability to create central bank money (or State money) and to set key policy interest rates which strongly influence the general level of interest rates plays a key role. Its relationship with parts of the banking system (which is not shared with non-bank financial intermediaries nor with the market-based parts) as a ‘lender of last resort’ has significant implications for the stability of the banking system particularly in the face of liquidity problems.

\(^{2}\) For further discussion see Fontana and Passarella Veronese (2013).
\(^{3}\) See Arestis and Sawyer (2006)
The heterodox Kaleckian/Keynesian view is that it is investment expenditure that generates savings, and that investment has to be initially financed and after the investment expenditure has occurred, a corresponding amount of savings (in a closed private economy) will be generated. Loans are provided by the banking system, and money is credit money endogenously created by the banking system. The significant aspect of this (as will be developed below in the circuitist framework) is that bank loans are required to initiate the investment expenditure.

The mainstream view entails a loanable funds approach, whereas the heterodox Kaleckian/Keynesian view entails a more liquidity preference approach; in the former the general level of rate of interest from interaction between savings and investment (as in Wicksell’s natural rate); in the latter central bank sets key interest rate (though under influence of economic variables). The former has often employed an exogenous money (issued by or controlled by central bank) approach; when as in the ‘new consensus macroeconomics’ it is only concerned with the setting of the interest rate by the central bank (and then by means of a pass through on interest rates of the commercial banks). Further, the latter approach involves a ‘finance motive’ for the (temporary) holding of money, and emphasises that expenditure has to be financed.

The circuitist approach is interlinked with the Keynesian/Kaleckian approach, as it aims to develop some aspects of the monetary theory of Keynes, Kalecki and their heirs. A feature of this approach (as will be outlined) is that loans (initial finance) allow a circuit to open, but there is a closure of a circuit when loans have been extinguished (and correspondingly money destroyed), and savings have been generated. Savings will initially accumulate in the form of holdings of money but will be transferred into financial assets. The financial system operates to in effect allow there to be ‘surplus units’ and ‘deficit units’ – that is individuals and corporations, government and the foreign sector some of whom have a surplus of income over expenditure and others a deficit of income over expenditure, and the former are able to lend and the latter to borrow. In any accounting period, it has to be the case that the sum of surpluses and the sum of deficits must be equal.
3. The financial sector in a circuitist framework

The circuitist approach in its simplest form describes a single circuit in the form of a ‘thought experiment’. The first point to note about this is that at the end of the circuit, saving has been made, financial assets acquired with financial liabilities issued; loans had been extended but are paid off at the end of the circuit. There would then be no net creation of money by the end of the circuit in the simplest representation. On that basis for money (bank deposits) to exist, there have to be circuits which remain open. It could also be noted that if saving takes the form of non-transferable bank deposits, then the amount of money (transferable bank deposits) may not have increased though the sum of bank deposits and the sum of bank loans will be equal.

The second is that the issue of financial assets and financial liabilities will be based on future payments by the borrower to the lender, and those future payments will have to be based on prospects for future income generation (whether profits by companies or income by households).

Amongst the roles of a financial system there are the payments system and the linkages between savers (surplus unit) and investors (deficit units). As such the financial systems and their operations have to be consistent with macro-economic and monetary analysis. This specifically includes how is money created and destroyed, and by whom; and what are the causal relations between saving and investment and how does that influence views on the operation of the financial system. The reason for using a circuitist framework is that it provides a structure within which the financial flows within an economy can be analysed, and is firmly based on a credit money creation perspective. The MCA [monetary circuit analysis] describes the functioning of a sequential economy, which involves three macro-agents: banks, firms and workers. The banking system creates money, ex nihilo, in accordance with the idea that loans make deposits; firms pay wages and produce commodities; and workers supply labor power’ [Forges Davanzati, 2011, p. 34]. This is the heart of the circuitist approach and a version of this in its simplest form is shortly set out.
We then use that simpler form to elaborate for changes which we associate with the financialisation era.

The circuitist approach⁴ in its simplest form can be represented in Figure 1. It is set in an endogenous money system in which banks play a central role in the provision of credit. The processes involved as set out by Graziani in the following terms: ‘The first step is the decision taken by banks of granting credit to firms in order to enable them to start production. If we consider firms as a whole, their only external purchase is labour, which means that credit requirements are determined by the scale of production and by the money wage rate prevailing on the labour market ... The second step is given by production and expenditure decisions. ... Money spent on the commodities market or on securities goes back to firms and is available for repaying debts to the banking system ... The third and final step, coinciding with the final destruction of money, is the repayment of debt.’ [Graziani, 1994, p. 275]

Production takes time, and has to be financed, and financing requires possession of purchasing power, i.e. money. Production will though respond to demand. In this presentation of the circuit, the focus is on investment goods and their production. In order for investment to be undertaken, the purchase of the investment goods has to be financed, and the production process whereby the investment goods are produced has to be financed. Firms approach banks for the loans in order for the investment goods to be produced; provided that the firms and their proposals are deemed credit-worthy, the banks provide the loans.

A firm approaches a bank for a loan in order to undertake investment; provided that the firm and its proposals are deemed credit-worthy, the bank provides the loan. A bank sets an interest rate at which it will provide loans to credit-worthy customers, and having set the interest rate it meets the demand for loans with which it is presented [or more that the interest rate on loans is set for each credit rating category, and requests for loans which

⁴ See, for example, Gnos [2006], Graziani [2003] and Realfonzo [2006].
are deemed credit worthy met at an the interest rate set for that credit rating category].
For simplicity a single loan interest rate is invoked here, but the essential argument would not change if there were a number of loan interest rates each for a specific risk-class of customer. The loan interest rate is subject to change by the bank, and such change can be triggered by a change in the Central Bank policy interest rate, by the bank reassessing its liquidity position or its perceptions of the demand for loans.
The circuit opens, the firm start the process of production utilizing the loan, corresponding bank deposits are created [hence the stock of money expands], the bank deposits circulate as a means of payment. The expenditures generate production and employment, wages are paid to workers who spend most of the money received and save the remainder.
The focus here is on the finance for production and investment, and this is particularly important in the context of the savings-investment causal relationships. However, the provision of finance [in the form of loans] by banks in order to enable expenditure to proceed is a much more general one. As will be indicated below, the uses to which those loans are put in terms of expenditure, whether on consumer expenditure [and hence involving household debt] or on the purchase of existing financial assets, are significant in the ways in which the financial system operates.
Money is created by banking system through loans to firms. It necessarily involves a credit/debt relationship – raising the relationship between lender and borrower and the basis of which credit is extended. As the loan is debt bearing an interest rate, it is [almost] inevitable that the demand for loan is closely linked with plans for expenditure, though the expenditure can be on goods and services, on labour or on acquisition of financial assets. It is a part of a monetary system – a circuit. Loans are extended and repaid, money is created and destroyed.
A circuit not only opens but, of course, also closes. Loans are taken out and then repaid, bank deposits [and hence money] created and destroyed. Money [in the form of the means of payment] is generally held temporarily between receipt and disbursement. A bank deposit only remains in existence when held by someone. An increase in the stock of
money [bank deposits] clearly depends on the ‘transactions holding’ of bank deposits having increased, though hoarding of money is also possible which can disrupt the circuit and hoarding is generally seen here as rather temporary as other financial assets are a more attractive way in which to hold savings). This could arise, for example, if other circuits were opening up and the general level of economic activity rising. But in accounting terms, the increased holding of financial assets [that is in this case bank deposits] corresponds to savings having occurred. In order for an individual’s holding of money to have risen, the inflow of money must have exceeded the outflow, and savings occurred [assuming here that the inflow did not come from sale of financial assets].

A loan does not create money [in the form of a bank deposit] unless the institution who creates the loan is also one whose liabilities [bank deposits] are treated as a means of payment [hence money]. In general, a financial institution which is able to create money [in this sense] also carries out a range of other functions as well. But there are a range of financial institutions which are not able to create money as their liabilities are not treated as a means of payment, and serve only to re-cycle deposits as loans and other forms of lending [and may provide other financial services].

In the context of the monetary circuit, it is the clearing banks which are at the start of the process, provide loans which generate bank deposits [and thereby money], that is ‘initial finance’, whereas it is the investment banks [and other financial institutions] which are involved in ‘final finance’.

The circuit approach clearly relates to the opening of the circuit with bank loans [and money created] and then the closing of the circuit when loans are repaid [and money destroyed]. Savings occur during the circuit and financial assets acquired as a consequence. Whilst loans provide initial finance, the final finance comes from the creation and sale of other financial assets. Transactions which occur within the financial sector [including the banks] as the asset [and liability] portfolios are rearranged. The role of the financial institutions other than clearing banks is then one of portfolio rearrangement rather than the initial finance for investment. The growth of the financial
institutions (other than clearing banks) and the growth of financial assets (relative to GDP and to the capital stock) would then be viewed in terms of the re-arrangement of financial asset portfolios rather than the stimulation of savings or the (initial) financing of investment. This simple circuitist approach highlights the role of banks as creator of loans and of money (bank deposits) with the provision of initial finance and the role of financial system (and others) in the provision of final finance. Before discussing these issues further, we now introduce a more complex picture which brings some features which we associate with financialisation.

Before doing so, as an aside, we apply a similar analysis to the case of government, budget deficits and the central bank, and this is illustrated in Figure 2.

A circuitist analysis can be used to portray government activity and central bank, and this is illustrated in Figure 2. In this case, a circuit opens when government in effect borrows from central bank – this is usually more in the form of reducing its balance with the central bank and when that is received by the private sector it becomes recorded as an increase in the stock of money (in the narrow sense of central bank money). The money is spent and circulates, incomes are generated; tax revenues return to government which are banked at the central bank and money thereby extinguished. Savings also accrues, some of which returns to the government in the form of bond purchases, and other would acquire financial assets from corporations.

Figure 3 (influenced by Passarella Veronese, 2014, Seccareccia, 2013) incorporates three features coming from or associated with financialisation. The first, and most significant, is the perceived relationship between commercial banks and the rest of the financial system. This has been expressed in terms of securitisation in Figure 3, and of particular relevance to the circuit is the ways in which commercial banks raise funds from the rest of the financial system, whether in the form of securitisation of loans or through borrowing in the wholesale markets. Figure 3 in a sense understates the degree to which there is a financial circuit in which financial institutions buy and sell financial assets and liabilities to
each other. The banking system moves from an ‘originate and retain’ model with regard to loans to an ‘originate and distribute’ model.

The second and third are postulated features (or tendencies) which have been suggested by a range of authors as features of the present era of financialisation. The second is the relationship between banks and households, and specifically consumer credit. The usual representation is for saving to flow from households, and here there is allowance from some reverse flows in terms of credit to households and hence dissaving by some. The net flow from households may still be in the direction of saving but the flows of loans to particular groups and the variations in those flows are important elements of the circuit.

The third is the degree to which at least some corporations have become net savers (retained profits in excess of investment), and consequently lending to, rather than borrowing, from other sectors [represented in the circuit by lending to the financial system, which in turn would be lending to households and to government.]

A fourth feature which is elaborated below relates to the extent to which financial assets and liabilities in various forms are traded between financial institutions, and the degree to which there is a growth in the volume of financial assets (and of liabilities) relative to the scale of the economy (in terms of GDP or in terms of productive assets).

In the simple circuit (Figure 1), whilst the commercial banks provide initial finance, the financial system was portrayed in terms of final finance whereby firms sold financial assets to the household sector, and in effect the asset portfolio of households was matched against the liability portfolio of firms. In the circuit with financialisation, the financial transactions which take place within the financial sector are represented in terms of the relationships between banks and other financial institutions.

The simple circuitist view focuses on the role of banks in loan provision and bank deposits. As such it portrays a specific approach to causes of instability of the financial system. Although not explicit in the formulation above, it could be readily located in a fractional reserve banking system. One source of instability viewed from the interaction between investment and loans could be portrayed in the following manner. During a cyclical
upswing with investment plans expanding, and with banks willing to provide the loans, expansion of the economy takes place.

In effect, in the circuitist approach a pool of savings is created, held initially in the form of increased holding of money (bank deposits) and there is a similarity with the mainstream approach in which there is a pool of savings but there is a crucial difference. The investment has already in effect occurred and has ‘caused’ the savings. However, the savings have to be allocated through portfolio decisions. The route in the simple circuit is that [new] financial assets issued by firms are bought by households. But it would be obviously recognized that there is ‘churning’ in that a ‘new’ saver purchases both new and old financial assets [sold by ‘old savers’]. In the more complex world illustrated in Figure 3, there is a great deal of ‘churning’. The purchase of existing financial assets and property and the possibilities of asset price inflation are of some significance here. A choice between acquisition of a ‘new’ financial asset such as bank deposit yielding a given rate of interest and the acquisition of an existing financial with possibilities of capital appreciation may well lead to asset price inflation.

In Figures 4 and 5 two illustrations of a financial circuit are given. Figure 4, from Adrian and Shin (2010), illustrates the developments in terms of financial intermediation between households. Figure 5 portrays the chain through financial assets as between savings and investment.

A point to be made here is that the central bank is present within the circuit and has relations with the financial sector. The banks [in the narrow sense] in the creation of loans and deposits can be seen as involved in the exchange of liquid assets [bank deposits] for illiquid ones [loans], and as such always run the risk of illiquidity arising from deposit withdrawal. This leads to the central bank’s ‘lender of last resort’. The operations of the other parts of the financial sector may or may not involve the central bank.

The Central Bank can be said to often operate as a ‘lender of last resort’ in two respects. First, in the sense of Bagehot, the central bank provides central bank money to the banking system in the face of a liquidity crisis in the banking system. Banks borrow short
and lend long, and in a fractional reserve system face the possibility that withdrawal of funds by depositors from the banks will leave banks in a position where they are unable to meet the depositors requirements – the ‘run on the banks’ scenario. In this setting, the ‘lender of last resort’ facility applies to financial institutions registered as banks, and to a situation of illiquidity but not to insolvency [though the two may be difficult to distinguish]. Second, the central bank is a provider of finance to the government, and can act to ensure that the government always has sufficient finance to undertake expenditures including meeting any debt interest obligations and can act to purchase [if indirectly] government debt.

It is the former on which attention is focused here, though sovereign debt crises can be related to the latter when, as in the case of Euro Area countries, governments have debts which are denominated in a foreign currency.

4. Financial system and instability

In a monetary production economy, it is difficult to separate out the real from the monetary/financial in the discussion of the determinants of the level of economic activity and in the generation of fluctuations of economic activity. Following from the circuitist view above, fluctuations in demand have to be financed, and at a minimum the financial system [specifically the clearing banks] have to provide finance to enable the fluctuations to occur.

One of the tenets of a monetary production economic analysis is that the separation of monetary and real cannot be undertaken, and that a portrayal of a non-monetary [barter] economy as a benchmark is not feasible. Thus notions such as the ‘natural rate of interest’ and ‘natural rate of unemployment’ which rely on separation between money and the real economy [as reflected in the quote from Wicksell above] are unhelpful (to say the least). Thus it is not feasible to discuss the role of the monetary/financial sector in economic fluctuations by reference to a barter economy. Instead we can seek to address the mechanisms through which economic fluctuations are amplified through the workings of the financial sector. The purpose here of taking this track is to see whether it is possible to
get a ‘handle’ on the ways in which different forms of financial system may be more or less conducive the generation of economic fluctuations.

Among mainstream contributions dealing with financial instability, some of the most interesting are those focusing on the so-called ‘financial accelerator mechanism’ [pioneered by Bernanke in early 1980s and then incorporated in a number of collaborative collective during the subsequent decade]. The general idea of the ‘financial accelerator’ is that the workings of the financial sector in their lending activities amplifies changes creating a feedback loop. The theory underlying this has been set out as:

‘First, external finance is more expensive than internal finance, unless the external finance is fully collateralized. The higher cost of external finance reflects the agency cost of lending [the inevitable deadweight loss that arises because of asymmetric information].

Second, given the total amount of finance required, the premium on external finance varies inversely with the borrower’s net worth, which we define as the sum of his internal funds [liquid assets] and the collateral value of his illiquid assets.

Finally, a fall in the borrower’s net worth, by raising the premium on external finance required, reduces the borrower’s spending and production. This last result is the heart of the financial accelerator: To the extent that negative shocks to the economy reduce the net worth of borrowers [or positive shocks increase net worth], the spending and production effects of the initial shock will be amplified’ [Bernanke, Girtler and Gilchrist, 1996, p.2].

Although it is perhaps not an inevitable feature of the ‘financial accelerator’ approach it is developed in the context of loans and interest on debt [along with risk ratings], which relates it more to the banking system than the workings of the stock market. Bernanke et alia also point to the role of inter-bank lending and lending to households as further elements in the workings of the ‘financial accelerator’

The ‘financial accelerator’ approach can be compared with the writings of Minsky [though as Fontana and Passarella Veronese, 2013, point out there are few references in the work

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5 For further elaboration on the role of the ‘financial accelerator’ see Fontana and Passarella Veronese (2013)
of Bernanke and others to Minsky). Minsky distinguished three income-debt relations, namely hedge, speculative and Ponzi finance, whereby ‘if hedge financing dominates, then the economy is an equilibrium-seeking and deviation-containing system, whereas the greater weight of speculative and Ponzi finance, the more likely that the economy is a deviation-amplifying system’ (p. 157).

‘The first theorem of the financial instability hypothesis is that the economy has financing regimes under which it is stable and financing regimes under which it is unstable. The second theorem is that, over periods of prolonged prosperity, the economy moves from financial relations that make for a stable system to those that make for an unstable system’ [Minsky, 1994, p. 157]

One postulate we advance here is the key role played by clearing banks in the creation of credit and loans (and thereby at least temporarily increases in the stock of money in the form of bank deposits) in the generation of economic fluctuations. When finance is seen ā la Keynes as a revolving fund, the possibilities of fluctuating economic activity are restrained. The finance motive has to be satisfied, and this can only come from money creation.

From national accounts perspective: saving is equal to investment; and in the circuit approach causation runs from investment to savings but then the savings which initially are in the form of holdings of money (cash and bank deposits) has to be allocated; it is then assumed that there is a match between portfolio of savers and portfolio offered by investors. But households receive not only income in the GDP sense but also capital gains/losses on assets including financial assets; on the other side households allocate saving between additional financial assets and existing financial assets. Returns on (financial) assets include interest, dividends and the like and prospect of capital gains/losses.

Financial markets can be viewed in terms of linking savings with the funding of investment through equity issues, but involving the possibility that asset price bubbles in the trading of existing equity occurs. However, the latter is unlikely to develop without some expansion
of credits provided by the banking system. In the bank-based system, the provision of loans enables investment to be financed ahead of savings and financial fragility comes from the evolution of credit provision, leverage and debt repayments.

It is also relevant to consider equity and other asset prices, and the generation of asset price inflation and price bubbles. The point was made above that the savings which has been made in terms initially of an increase in holding of money soon seeks outlets in the acquisition of financial assets: at the level of the individual that can be the acquisition of new assets or existing assets. The portfolio decisions being made by ‘new savers’ will not in general match the portfolio of financial assets which are being made available. For example, ‘new’ savers may have wishes to place their funds into equity to a greater extent than the combination of existing and new issues of equity. The flows into the equity market would be influenced by perceptions of the returns on holding equity including dividend payments and capital gains. At this point we do not propose to advance a theory of equity pricing! – but rather simply indicate that within a circuitist framework asset price inflation (or indeed deflation) and price bubbles can be accommodated from consideration that after investment occurred, savings takes place which feeds into the financial markets.

5. Concluding comments

The first purpose of this paper has been to argue for the distinction to be drawn between banks as money creators (through the loan processes), banks and other financial institutions as acceptors of deposits, and equity and other markets which deal in existing financial assets. The second purpose was to provide a simple representation of the financial flows in a circuit in the era of financialisation. This is a representation, and does not represent an analysis of those flows, their causes and consequences. Instead we would view the representation as highlighting some features. These features would include: (i) the creation of loans for households for consumption purposes and the consequences of consumer debt, (ii) the degree to which corporations have become net lenders rather than net borrowers, and the implications of that for
consumer debt and for government deficits\textsuperscript{6}; (iii) identification of where views on financial instability could feature within the circuit.

\textsuperscript{6} On the basis that if the corporate sector is a net lender, then other sectors (in combination) has to be net borrowers, and here the focus is on households and government. A fuller analysis would also include the foreign sector.
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Figure 1. The simplest circuit scheme.

Figure 2. Government budget deficit and central bank.
Figure 3. Financialisation in the monetary circuit scheme.
Figure 4. Long intermediation chain.

Source: Adrian and Shin (2010).

Figure 5. The chain through financial assets as between savings and investment.
Financialisation, Economy, Society and Sustainable Development (FESSUD) is a 10 million euro project largely funded by a near 8 million euro grant from the European Commission under Framework Programme 7 (contract number: 266800). The University of Leeds is the lead co-ordinator for the research project with a budget of over 2 million euros.

THE ABSTRACT OF THE PROJECT IS:

The research programme will integrate diverse levels, methods and disciplinary traditions with the aim of developing a comprehensive policy agenda for changing the role of the financial system to help achieve a future which is sustainable in environmental, social and economic terms. The programme involves an integrated and balanced consortium involving partners from 14 countries that has unsurpassed experience of deploying diverse perspectives both within economics and across disciplines inclusive of economics. The programme is distinctively pluralistic, and aims to forge alliances across the social sciences, so as to understand how finance can better serve economic, social and environmental needs. The central issues addressed are the ways in which the growth and performance of economies in the last 30 years have been dependent on the characteristics of the processes of financialisation; how has financialisation impacted on the achievement of specific economic, social, and environmental objectives?; the nature of the relationship between financialisation and the sustainability of the financial system, economic development and the environment?; the lessons to be drawn from the crisis about the nature and impacts of financialisation?; what are the requisites of a financial system able to support a process of sustainable development, broadly conceived?"
THE PARTNERS IN THE CONSORTIUM ARE:

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<tr>
<th>ParticipantNumber</th>
<th>Participant organisation name</th>
<th>Country</th>
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<td>UK</td>
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<td>2</td>
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<td>3</td>
<td>School of Oriental and African Studies</td>
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<td>4</td>
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