Financialisation in South-Eastern Europe

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Content

1. Introduction 1

1.1 Research topic: Financialisation in South-Eastern Europe 1

1.2 State of the art 4

1.2.1 Comparing financialisation in peripheral countries 4

1.2.2 The present state of research on financialisation in South-Eastern Europe 7

1.3 Research question 11

1.4 Structure of the dissertation 13

1.5 Academic contribution 14

2. Financialisation: From theory to application 17

2.1 Financial power ascendance 20

2.2 Theoretical approaches to financialisation 23

2.2.1 Marxist approaches 24

2.2.2 Regulationist approaches 29

2.2.3 Post-Keynesian approaches 33

2.2.4 Institutionalist approaches 37

2.2.5 Interim summary 43

2.3 Financialisation approaches in peripheral countries and comparative perspective 45

2.3.1 Financialisation in comparative perspective 46

2.3.2 International financialisation in peripheral countries 56

2.3.3 Interim summary 65

2.4 Criticism of financialisation 67

2.5 Chapter summary 70

3. Research Design and methodology 75

3.1 Refinement of the research question 76

3.2 Research approach and methodology 78

3.3 Determination of geographical and temporal scope 81

3.4 Comparing financialisation across the region 84

3.4.1 Concept: Levels and indicators of financialisation 85

3.4.2 Data description: Quantitative data 89

3.5 Case studies on financialisation 96

3.5.1 Concept and operationalisation: Analysis of trajectories and its drivers 96

3.5.2 Data description and analysis: Secondary data and expert interviews........................104

3.6 Limitations...107

4. Comparing financialisation across South-Eastern Europe 109

4.1 Financial sector financialisation in South-Eastern Europe 111

4.2 International financialisation in South-Eastern Europe..119

4.3 Financialisation of non-financial corporations in South-Eastern Europe 124

4.4 Household financialisation in South-Eastern Europe...128

4.5 Summary of this chapter 131

5. Case Study: Financial sector financialisation in Bulgaria...135

5.1 Starting point: The financial sector in historical perspective 138

5.1.1 The history of the Bulgarian financial sector – the troubling ’90s 140

5.1.2 The year 1997 and thereafter: Shock therapy 2.0 143

5.1.3 Interim summary..146

5.2 Bulgaria’s pre-crisis trajectory of financial sector financialisation 147

5.2.1 Banking sector structure and evolution...148

5.2.2 Financialisation through consumer loans..151

5.2.3 The second Spain: Bulgaria’s real estate bubble 153

5.2.4 How regulatory efforts lead to next-level financialisation..161

5.2.5 Employment and performance-based salary schemes 169

5.2.6 Interim summary 171

5.3 The repercussions of Bulgaria's financial sector financialisation in times of crisis...........173

5.4 Bulgaria's post-crisis financialisation trajectory 178

5.4.1 Persistence of financialisation of the financial sector 178

5.4.2 The bankers' new clothes? 183

5.4.3 Expansion of shadow-banking 186

5.5 Chapter summary...192

6 Case study: International financialisation in Serbia...199

6.1 Starting point: International finance in historical perspective..201

6.1.1 The SFRY and international financial flows 206

6.1.2 The FRY– wars, sanctions, overthrow..212

6.1.3 Interim summary 215

6.2 Serbia's pre-crisis trajectory of international financialisation..217

6.2.1 Banking sector structure and evolution...217

6.2.2 The dynamics of financial inflows..222

6.2.3 The vicious repo circle 227

6.2.4 Foreign currency lending 232

6.2.5 Interim summary 242

6.3 The repercussions of Serbia's international financialisation in times of crisis 244

6.4 Serbia`s trajectory of international financialisation after the crisis 248

6.4.1 International financial flows – from private to public 249

6.4.2 Foreign currency lending in the post-crisis phase..255

6.4.3 Stagnation and fast cash loans 261

6.5 Chapter summary 265
7 Case study: Household and NFC financialisation in Croatia 271
7.1 Starting point: NFC and household financialisation in historical perspective 274
7.1.1 Gradual transition and the Tudjman rule 275
7.1.2 The banking crisis of 1998 and end of the Tudjman reign 278
7.1.3 Interim summary 280
7.2 Croatia's pre-crisis financialisation trajectory 281
7.2.1 Evolution of the financial sector 281
7.2.2 Household financialisation in Croatia: The liability side 286
7.2.3 Household financialisation in Croatia: The asset side 296
7.2.4 The institutionalisation of the stock market: Tepid financialisation of NFCs 301
7.2.5 The relevance of financial income for Croatian NFCs 307
7.2.6 Interim summary 310
7.3 The repercussion of Croatia's financialisation in times of crisis 313
7.4 Post-crisis financialisation trajectory of Croatia 316
7.4.1 Household financialisation after the crisis 316
7.4.2 Financialisation of NFCs after the crisis 320
7.5 Chapter summary 323
8. Conclusion 329
8.1 Summary of the thesis 330
8.2 Region-based synthesis 333
8.2.1 Trajectories of financialisation across SEE 333
8.2.2 Explanatory mechanisms for financialisation across SEE 338
8.3 Contribution to academic discourse on financialisation in SEE 342
8.4 Contribution to the academic discourse on financialisation 345

8.5 Outlook and implications for research and policy 348
Appendix 353
Declaration 353
Exemplary interview guide 354
List of Interviewees 356
References 357

List of Figures

Figure 1: Financialisation: a conceptual framework 50
Figure 2: Original indicator matrix of financialisation 86
Figure 3: General drivers of financialisation..99
Figure 4: Drivers of financial sector financialisation..100
Figure 5: Drivers of international financialisation 102
Figure 6: Drivers of NFC financialisation..103
Figure 7: Drivers of household financialisation 104
Figure 8: SEE – Gross value added of financial and insurance activities 113
Figure 9: SEE – People employed in the financial sector 115
Figure 10: SEE – Development of financial sector financialisation 117
Figure 11: SEE – Fee-to-income ratio of banks 118
Figure 12: SEE – Financial inflows (excluding FDIs) 121
Figure 13: SEE – Foreign currency and indexed loans 123
Figure 14: SEE – Stock market capitalisation 126
Figure 15: SEE – Gross disposable income of households to household debt 129
Figure 16: Bulgaria –Financial sector financialisation 136
Figure 17: Bulgaria –Financial sector’s asset composition..139
Figure 18: Bulgaria – Asset decomposition of banks 149
Figure 19: Bulgaria –Banking sector loan portfolio composition...150
Figure 20: Bulgaria – Home ownership breakdown 155
Figure 21: Bulgaria – Housing loan portfolio 156
Figure 22: Bulgaria – FDI flows related to construction 157
Figure 23: Bulgaria – Housing market development 159
Figure 24: Bulgaria – Mortgage bond issuances 160
Figure 25: Bulgaria – Exemplary securitisation of a loan portfolio..164
Figure 26: Bulgaria – Cross-border loans 165
Figure 27: Bulgaria – Sales and repurchases of loans 166
Figure 28: Bulgaria – Household loan portfolio composition...168
Figure 29: Bulgaria – Banking sector profitability 179
Figure 30: Bulgaria – Non-bank credit institutions development 187

Figure 31: Serbia – International financialisation 199
Figure 32: Serbia – Composition of financial inflows 203
Figure 33: Serbia – Composition of foreign currency loans 205
Figure 34: Serbia – Banking sector development 219
Figure 35: Serbia –Banks' loan portfolio 220
Figure 36: Serbia – Cross-border loan development 224
Figure 37: Serbia – The repo market 229
Figure 38: Serbia – Loans and deposits in foreign currency 233
Figure 39: Serbia – Snapshot of the housing market 238
Figure 40: Serbia – Composition of external debt 250
Figure 41: Serbia – Public debt currency composition 252
Figure 42: Serbia – Foreign currency lending after the GFC 256
Figure 43: Serbia – Household loans decomposition 262
Figure 44: Croatia – Household and NFC financialisation 272
Figure 45: Croatia – Financial sector asset breakdown 283
Figure 46: Croatia – Banking sector decomposition 284
Figure 47: Croatia – Household loans breakdown 286
Figure 48: Croatia – Foreign currency household lending decomposition 288
Figure 49: Croatia – Income and unemployment 291
Figure 50: Croatia – The housing market 295
Figure 51: Croatia – Decomposition of financial assets of households 297
Figure 52: Croatia – Stock market key indicators 303
Figure 53: Croatia – Stock market turnover breakdown 305
Figure 54: Croatia – NFC financial income to total output 308
Figure 55: Croatia – NFC financial income to disposable income 309
Figure 56: Croatia – Pension fund's Pillar II asset breakdown 319

Abbreviations

BGN	Bulgarian lev
BIS	Bank for International Settlements
BNB	Bulgarian National Bank
CHF	Swiss franc
CNB	Croatian National Bank
CPF	Croatian Privatisation Fund
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
EU	European Union
EUR	Euro
FC	Foreign currency
FDI	Foreign direct investment
FIRE	Finance, insurance, and real estate
FRY	Federal Republic of Yugoslavia
GDP	Gross domestic product
GFC	Global Financial Crisis
HANFA	Croatian Financial Services Supervisory Agency
HDZ	Croatian Democratic Union
HH	Household
HRK	Croatian kuna
HSLS	Croatian Social Liberal Party
IFI	International financial institutions
IME	Institute for Market Economics
IMF	International Monetary Fund
IPO	Initial public offering
LHS	Left-hand side
LSE	London Stock Exchange
LTV	Loan-to-value
N. Macedonia	North Macedonia

NBFI	Non-bank financial intermediary
NBS	National Bank of Serbia
NFC	Non-financial corporation
NPL	Non-performing loans
OECD	Organisation for Economic Co-operation and Development
OTC	Over-the-counter
PAYG	Pay-as-you-go
PTI	Payment-to-income
REIT	Real estate investment trust
repo	Repurchase operation
RHS	Right-hand side
RSD	Serbian dinar
RSQ	Research sub-question
SDP	(Croatian) League of Communists
SEE	South Eastern Europe
SFRY	Socialist Federal Republic of Yugoslavia
SME	Small and medium-sized enterprise
SPV	Special purpose vehicle
UK	United Kingdom
USA	United States of America
USAID	United States Agency for International Development
USD	US dollar
VSE	Varaždin Stock Exchange
WB	World Bank

1. Introduction

1.1 Research topic: Financialisation in South-Eastern Europe

Financialisation made its academic debut in the special issue of Finance and Society in the year 2000 (Williams 2000) and has since then gained traction in various disciplines in the social sciences (van der Zwan 2014, 99). An early attempt to delineate the phenomenon described it as "*the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies*" (Epstein 2005b, 3). This line of thought has identified a structural transformation in that the financial sphere has grown in weight and importance – and hence power (Epstein 2005a) – over the rest of the economy. Most prominently, Krippner (2005) has demonstrated this shift for the case of the US through the comparative rise of the financial, real estate and insurance (FIRE) sector in economic growth, employment and profits, as well as through the relative growth in financial income of non-financial corporations (NFC). In doing so, the term has come to provide an academic response to the supersession of the post-Fordist growth regime (Boyer 2000a); at the same time, it has contributed to our understanding of the higher frequency and gravity of financial crises in the last decades (Palley 2007).

As the majority of subsequent contributions have focused on Anglo-Saxon and other mature economies, among other aspects in his critique, Christophers (2015, 198) suggests widening the 'spatial optics' of financialisation research. It is argued that such a process would typically not only occur in the Anglo-American core (Bonizzi 2013; Sokol 2013) but is co-constitutive to similar processes in other geographies. Indeed, in the course of the second decade of the 21st century, financialisation research has broadened its scope to include larger emerging economies and peripheral countries in the Global South and North (Fernandez and Aalbers 2020; Kaltenbrunner 2010; Rethel 2010). These studies have revealed that the international dimension is of crucial importance for these types of countries (Bortz and Kaltenbrunner 2018) and that the process of financialisation is variegated in nature (Karwowski 2020). Nevertheless, the geographical research map on financialisation is still rather patchy and concentrated on core economies, an imbalance that could be rectified by further study of non-core regions and countries.

One of those patchy spots may be found in the peripheries of the Global North, more specifically in South-Eastern Europe (SEE)[1], where credit increased at a considerable pace before the Great Financial Crisis (GFC) (Murgasova et al. 2015, 64) and more than doubled from 2000 to 2005 alone (EBRD 2006, 45). The expansion of the financial sector in the region was supported by positive investor sentiment (Tran 2003) and international financial development agencies (European Bank for Reconstruction and Development 2006, 52), which viewed it as conducive to economic growth (Levine 1997). The GFC of 2008 exposed the unsustainability of this path, however, as imports and consumption dwindled, growth reversed, and credit contracted, which was even more pronounced in SEE than in Western countries (Connolly 2012, 38). Among other adverse impacts, this led unemployment to surge persistently above 20% in the region and caused external debt levels to surpass gross domestic production (GDP) (Bartlett and Prica 2013, 370–74), with non-performing loans climbing to double-digit values across SEE countries (World Bank 2018a). Even after the GFC, growth did not reach pre-crisis levels and the expected increase in living standards failed to materialise (Uvalić and Cvijanović 2018, 1). These empirical hallmarks foreshadow that finance did not merely serve its traditional role as an intermediary between creditors and debtors or as an enabler of sustainable growth, but that it also took on a life of its own in the countries of SEE. Studying financialisation in SEE hence would not only contribute to expanding our understanding of the financialisation process around the world, but would also problematise the role of finance in the region, which was viewed by international development organisations (dos Santos 2011, 2013) as a panacea for stimulating growth, addressing intransparency, and abolishing pocket banking (European Central Bank 2006, 94).

In addition to providing fertile ground for studying the relationship between finance and the economy, SEE presents a worthwhile case for analysis since the countries in the region featured different types of socialism (Soviet bloc, Socialist Federal Republic of Yugoslavia and the socialistic autarchy of Albania), and all of them endured bumpy rides on their way to adopting a capitalist system. Their early transition years were marked by armed conflicts (Melčić 2007) and rent-capturing in the privatisation process (Ganev 2007) as well as by a range of financial crises (e.g. Bezemer 2001). Contrary to their Eastern European neighbours, the countries of SEE have neither formed a distinct variety of capitalism nor have they hewn closely to an existing one (Bohle and

[1] Albania, Bosnia, Bulgaria, Croatia, Kosovo, North Macedonia, Montenegro, Romania and Serbia (Connolly 2012, 35).

Greskovits 2012; Cernat 2006), leading scholars to speak of 'cocktail capitalism' in the region (Ban 2013). The incongruent institutions in SEE render it difficult to formulate any expectations about the way they would drive, respond or adapt to novel processes such as financialisation. Posited between the two world powers of the EU and Russia (Stojanović 2018), the region is subject to strong external influences that continue to shape their growth trajectories (Bohle 2017) and policymaking (Uvalić 2012). Hence, given the diversity of institutions, an analysis of an assumed common process of financialisation and its country- or region-specific drivers across the countries of SEE should be of scholarly interest both for a better understanding of the region and for financialisation research as such.

Along with expanding academic research on financialisation to the region of SEE, the third line of interest for the topic at hand is to engage with and apply a comparative financialisation framework as well as to test hypothesised causal factors on a rather unexplored area. Yet, scholars grapple to agree on a common definition of financialisation (Mader, Mertens, and van der Zwan 2020a, 7). To illustrate this conundrum, Mader, Mertens, and van der Zwan (2020a, 1) employ a parable about a group of blind men who encounter an elephant for the first time and individually try to make sense of it through their sense of touch. Due to their lack of sight, narrow focus on a few aspects, and isolated approach, however, they come up with divergent impressions on the nature of the assumed giant (of financialisation) leading to a fierce argument. At the same time, a multitude of comparative financialisation concepts have emerged (e.g. Brown, Passarella, and Spencer 2015; Lapavitsas and Powell 2013) and commenced to measure the variance of the dependent variable of financialisation across countries but employ different forms of assessment. Yet only a few of these studies critically address the problems of pinpointing indicators for measuring financialisation (Karwowski, Shabani, and Stockhammer 2020), and the comparative studies have not engaged in much critical and productive discussion of each other's frameworks, which mirrors the blind men's problem. The underappreciation of conceptual clarity and discourse is manifest in two forceful critiques of certain widely used measurements of financialisation (Rabinovich 2019; Van Gunten and Navot 2018) which have neither received much reception nor led to a wider debate on such indicators. The same can almost be said for the state of discussion on the causal factors of financialisation, as studies often exhibit difficulties in treating financialisation as either a dependent (i.e. to be explained) or independent (i.e. explaining) variable (Aalbers 2019, 2). Staying within the parable, we are in need of a critical review and discussion of the blind men's perceptions, i.e. make them speak to each other about their backgrounds and limitations. Based on this, we can advance

a conceptualised framework that will enable us to not only measure the elephant and figure out why the creature arrived in SEE in the first place, but also to rescue the term 'financialisation' from being relegated to a "*nebulous and even, arguably, unhelpful signifier*" (Christophers 2015, 187).

1.2 State of the art

In order to address the criticism and questions raised above, we need to review the state of art against the three criteria. Firstly, to compare financialisation, the state of the art of existing comparative frameworks should be examined and evaluated in terms of how thoroughly conceptually grounded they are, i.e. the extent to which they address the blind men's problem. Secondly, we need to examine the existing literature on financialisation in SEE to determine the extent to which it has already measured the relative degrees of financialisation in the countries of the region. A depiction of the variance of financialisation is a necessary first step for the geographical expansion of the research. Thirdly, we have to assess whether and to what extent country- and region-specific as well as theory-guided causal factors have been discerned and analysed for this specific geographical area, which would add to our understanding of the processes of financialisation in the region and countries. To outline the potential gap in the literature, two strands of literature are reviewed in this section against these criteria. On the one hand, the state of the art in the financialisation literature vis-à-vis its application to peripheral countries and with regard to comparative frameworks is studied. On the other hand, this section presents the existing research on financialisation in SEE. Next to a review of the relevant literature on processes of financialisation, this section also looks at whether the existing research has already identified certain explanatory mechanisms and drivers.

1.2.1 Comparing financialisation in peripheral countries

What is financialisation? The phenomenon of financialisation, which has been accused of going hand in hand with financial instability and growing inequality (Tomaskovic-Devey and Lin 2011), has become a popular focus of enquiry in a multitude of disciplines. In addition to the academic interest in grasping these shifts, recent events in the global economy, such as the dot-com bubble and the GFC, as well as a (persistent) neglect of the role of finance in the dominating theoretical approach in economics and in other disciplines, such as geography and sociology, have motivated this line of research, which has been thriving, especially in the field of International Political Economy (IPE). However, a consensus on the specific meaning of the term has not yet been reached

(van der Zwan 2014, 101). While scholars were apt to find manifestations of financialisation, transitioning towards a clear-cut conceptualisation has remained one of the key challenges. Apart from the most cited definition by Epstein (2005b, 3), others have pointed to the importance of the differing channels of (profit) accumulation (Krippner 2005, 174), a new regime of accumulation (Boyer 2000a), the ascendance of shareholder value maximisation (Froud and Williams 2000), or the proliferation of financial norms as co-constituted processes in daily life (Chima and Langley 2012; Langley 2008; Martin 2002). The variety of interpretations and the wide disciplinary applicability documents the open but also potentially superficial and hazy character of the concept (Christophers 2015). This makes an unambiguous conceptualisation, based on a theoretically inspired delineation, indispensable when studying financialisation.

The early studies of financialisation have primarily focused on the Anglo-Saxon experience of the US and UK (e.g. Krippner 2005, Orhangazi 2008; Boyer 2000) and saw related processes as intertwined with a transformation of the market-based system or movements towards market-based financial systems (Aglietta and Breton 2001, 438; Froud and Williams 2002, 124). This view originated in the idea that the financial industry, growing considerably in size through securitisation, other new forms of leveraging, asset trading, and ultimately speculation, propels a shift towards a system with a less regulated financial industry, scattered ownership of large firms and active capital markets. This engendered a rearrangement of NFCs to engage in (short-term) financial ventures instead of directing funds to more long-term productive and company-specific investments. Implicitly, it was held that financialisation is a phenomenon that can be found in these kinds of mature countries, or at least in places where such an industry exists.

The GFC spawned a second wave of research, which revealed similar shifts in peripheral countries (Bonizzi 2013; Carroll and Jarvis 2014; Gabor 2010; Kaltenbrunner 2010; Rethel 2010). While the overall tendency of the financial system's increased power vis-à-vis the real economy was likewise confirmed, it was uncovered that the institutional, regulation-related and ideational setting that fostered these developments were different in this type of geography (Karacimen 2014, 166). For example, it has become palpable that substantial financial flows to and from such countries are characteristic manifestations of financialisation, as they may lead to (inter-)dependencies. More specifically, this is evident in the exorbitantly high foreign currency reserves of the central bank and in the foreign-currency-denominated debt of enterprises and households, thereby connecting domestic debtors to the instability of global currency markets (Gabor 2013). Other instances of

financialisation in peripheral countries allude to the sterilization of financial inflows by the central bank (Gabor 2011) or the reworking of financialisation processes by domestic elites to serve their interest (Rethel 2010) The growing international financialisation of peripheral economies prompted the emergence of a strand of literature that is concerned with revealing how domestic actors cope with and navigate this increasing degree of financial interconnectedness (Bortz and Kaltenbrunner 2018), giving rise to phenomena called subordinated (Bonizzi, Kaltenbrunner, and Powell 2020; Kvangraven, Koddenbrock, and Sylla 2021) and dependent financialisation (Becker et al. 2010; Gabor 2013).

At the same time, scholars have increasingly worked on comparing financialisation across countries. This line of research commenced with comparing the financialisation of NFCs (Demir 2007) and different regimes of accumulation (Stockhammer 2004), while subsequent studies enlarged their geographical focus as well their indicators of financialisation (Brown, Passarella, and Spencer 2015; Lapavitsas and Powell 2013). This enables one to speak of the (relative) 'degree', which denotes the intensity of financialisation indicators or processes in one country compared to that of other countries (Karwowski, Shabani, and Stockhammer 2020, 965; Lapavitsas and Powell 2013, 365). Such relative degrees of financialisation are of crucial academic interest as they guide one's research to explain e.g. extreme cases. Most notably within this comparative financialisation literature, Karwowski and Stockhammer (2017) and Karwowski, Shabani, and Stockhammer (2020) provide a compelling discussion of their understanding and measurement of financialisation and apply their concept to a wide range of countries across time, which renders both studies of interest to the questions raised in this thesis. Though these two latest, eclectic conceptualisations provide a first attempt to bring together the different viewpoints of the blind men, they do not engage in critically discussing the indicators nor do they distinguish clearly enough between the dependent variable of financialisation and its drivers. This may be exemplified in that one of the 'interpretations' of financialisation is 'financial deregulation' (Karwowski and Stockhammer 2017, 69), which in the majority of the literature is listed as a factor causing financialisation in the first place (e.g. van der Zwan 2014, 106). A more coherent separation of variables is found in Karwowski, Shabani, and Stockhammer (2020), yet this contribution fails to account for the pivotal international level of financialisation while it covers the financialisation of households, banks and NFCs. With regard to these comparative approaches (a more in-depth treatment is provided in chapter 2.3.1), a critical review of the indicators and variables, which is indispensable when comparing countries across a region over time, has thus far been absent in the literature.

1.2.2 The present state of research on financialisation in South-Eastern Europe

To date, an ample number of studies have analysed processes of financialisation either in Anglo-Saxon or European countries (e.g. Alvarez 2015; Deeg 2012, 2014; Krippner 2005, 2012; Schwan 2017; Tomaskovic-Devey and Lin 2011). A range of further contributions complemented the research body for larger emerging economies, such as Brazil (e.g. Kaltenbrunner 2010), South Africa (e.g. Rodrigues 2014) and Turkey (e.g. Karacimen 2014). Regarding the Eastern European periphery of the Global North, substantial research has been undertaken for the Visegrad countries and the Baltics (e.g. Ban and Bohle 2020; Bohle 2014; Dünhaupt and Hein 2019; Gabor 2010, 2011, 2012; Juuse 2015; Raviv 2007, 2008), covering aspects from housing to financial sector financialisation and cross-case analysis. In these two regions, financialisation most notably manifests itself in an increasing number of loans in foreign currency for real estate and consumption purposes, driven by the European Union (EU), Western banking groups and local policy in these countries. The degree of financialisation varies between the countries and has taken place at different paces. The studies confirm the pre-formed notion that financialisation in peripheral economies is of a different nature. Besides the domestic forces that are at play and the interactions of the financial sector, financialisation in these countries is heavily influenced by their (economic and financial) integration into the global capital markets (Juuse 2015, 418).

Adding to this line of research on the financialisation in peripheries of the Global North, Holzner (2017) provides a comparative analysis of financialisation, post-crisis deleveraging effects and the link between financialisation, the propensity to save and household income inequality across four regions in Eastern Europe. In order to measure financialisation, he deploys the concept of dimensions and interpretations put forth by Karwowski and Stockhammer (2017) and finds that SEE ranks lower than the Baltic and Visegrad region but higher than the Commonwealth of Independent States (CIS) in its degree of financialisation. Although he confirms a negative effect of financialisation materialising in the crisis (Holzner 2017, 50), due to the design of the contribution, he neither assesses the drivers of financialisation nor establishes the degrees of financialisation for the individual countries of SEE.

Bartlett and Prica (2013, 373) identify financialisation in the countries of SEE as an observable phenomenon consisting of massive credit expansion and capital imports as well as a surge in house

prices, but they do not delve more deeply into the topic or differentiate their findings across countries. In another publication, the same authors assess the varied impact of the crisis on the countries of the region (Bartlett and Prica 2011), but they fail to connect this diversity to the phenomenon or to conceptualise their observation of what they term financialisation. Taking up this gap in a follow-up publication, Bartlett and Prica (2017b) assert that financialisation in SEE arises from under-consumption and over-accumulation in 'core' Europe, which prompts finance to search for new spheres of revenue generation in the peripheries of Europe to counter the tendencies towards (secular) stagnation in the core. They argue that growth patterns in the super-periphery of the Western Balkans became susceptible to growth and crisis events in the core, which has created a certain dependency. Nevertheless, the authors deem financialisation to be a phenomenon solely of the core countries that impacts the peripheral countries, without further analysing the individual countries of SEE. While this line of research provides some notable empirical insights, it fails to properly assess them with a theoretical concept and to speak to the relevant literature in the field.

Another line of research on the region has worked on assessing financialisation in SEE on the basis of a Regulationist framework inspired by Dependency theory. Most prominently, Becker and Jäger (2010, 13) highlight the region's specific form of 'dependent financialisation'. They argue that this type of financialisation is characterised by high imports, increasing euroisation, a dominance of Western banks and soaring private debt, which poses a mixture of dependency on foreign actors or developments and a growing financial sphere (Becker et al. 2010, 229). Theoretically, this framework discerns different axes of accumulation that account for the form of domestic financialisation as well as the direction of trade dependency. While here the assessment of the degree of financialisation remains rather vague, along with a questionable conceptual distinction between a productive and financialised regime (Aygül 2014, 285), the authors briefly describe the pathway that led to (their understanding of) financialisation in Serbia (Becker et al. 2010, 237). They assert that the country's trajectory was driven by the privatisation of larger companies directed towards FDI, an unfavourable local currency regime and an insufficient international production network. Thus, while they unveil a few causal explanations that led to financialisation in Serbia, a more in-depth analysis of the drivers and processes of financialisation is clearly called for, as the contribution's focus is primarily on the unsuccessful recovery of the real economy after the 1990s rather than on altered financial relations.

From a similar theoretical standpoint, Becker, Ćetković, and Weissenbacher (2016a) compare financialisation in SEE and the Visegrad countries. We learn that the former group features a financial-dominated growth model whereas the latter is characterised by export industrialisation with financialisation. While this provides for a valuable comparison between the two regions in terms of the dependent variable of financialisation, it neither exposes the differences between the countries in SEE nor sheds light on the causes of financialisation on its diverse levels. Through their comparison of regions, the authors find that financialisation occurred in SEE to a slightly lesser degree than in the Visegrad countries, similar to Holzner (2017). As the latter region has already been researched to a great extent, this substantiates the need for further analysis of financialisation in the different countries of SEE.

Another notable contribution consists of an edited volume by Radošević and Cvijanović (2015) that contains topical contributions with different geographical foci from a wide range of authors. Rodik and Zitko (2015) theorise that the financialisation of households stems from the extraction of profit from personal income through consumer loans and support their claim with an analysis of Croatia,[2] providing a rich description of the process of household financialisation there; unfortunately, though, they refrain from making comparisons to other countries or applying their framework to them. In the same edited volume, Becker and Ćetković (2015) outline patterns of financialisation in SEE and the Visegrad countries through their particular theoretical lens (similar to Becker, Ćetković, and Weissenbacher (2016a)). Financialisation is narrowly measured as the growth in loans and through the share of foreign currency loans. While the article omits some countries in SEE (Albania, Bulgaria, North Macedonia) from the analysis, the authors find various common factors, such as de-industrialisation, a price-stability-oriented monetary policy and foreign banks, that are conducive to financialisation in SEE. As they do not delve much further into the empirical realities of the different countries in the region, this opens the door for a more granular analysis of the explanatory mechanisms. The volume deals exactly with both the geographical region and phenomenon central to this thesis, which highlights the relevance of the subject matter, yet it leaves space for further inquiry for a couple of reasons. Firstly, some countries, like Albania, North Macedonia and Bulgaria, are not covered in the volume, while Hungary (Vidakovic and Zbasnik 2015), a country belonging to the Visegrad group, and various Baltic countries are covered

[2] On this specific issue, Mikuš (2019a) highlights the contestation of Croatian Swiss franc and home-equity loan debtors, which formed part of the financialisation of households in Croatia, by deploying the Polanyian double-movement concept. See also Rodik (2015) on the effects of the Swiss franc loans in Croatia.

(Kordic 2015). Secondly, the volume lacks a consistent comparison of the countries situated in SEE except for Croatia and Slovenia (Cvijanović and Kešeljević 2015; Radošević 2015). Thirdly, the conceptualisations of financialisation remain rather fuzzy – in part due to the limited length of the articles – which renders it difficult to compare the analyses across the contributions.

The application of a richer theoretical framework to the region is found in Živković (2017), who builds on the insights of Gabor (2012) and her concept of dependent financialisation. He traces the history of central banks and monetary policy in the post-Yugoslav region and finds that the current reliance on foreign currency can be partly explained by the historical dependence of the domestic productive sector on foreign currency in the former Socialist Republic. Together with the loss in confidence in the local currency, this caused a sort of a subordination to the hegemonies of the West. While the respective national trajectories are only briefly touched upon, he delivers a compelling narrative of this specific regional aspect of financialisation. This calls for a more country-specific analysis of the issue of foreign currency. A deeper analysis of each country's institutional setting of monetary policy would likewise substantiate or explain differences in these findings, while also adding to our understanding of the present state of financialisation in the individual countries (and not 'Yugoslavia').

Another set of contributions is provided by Mikuš (2019d), who first conceptualises and operationalises the financialisation of the state in Eastern Europe, accounting for notions of dependency, subordination and peripheral financialisation. Mikuš (2019c) sets out to analyse multiple indicators via descriptive statistics over eleven countries, including Bulgaria and Croatia from SEE. His results lead him to conduct an extreme case study on the financialisation of the state in Croatia (Mikuš 2019b, 2020), in which he problematises the surge of public debt and the interrelated process of pension financialisation. Over the four publications the author delivers a coherent conceptualisation, an empirical cross-country comparison and a case study analysis on the financialisation of the state in a country of SEE. This fruitful approach could be utilised to conduct a similar assessment of other levels of financialisation in SEE that are of interest to the academic literature (such as households, NFCs or banks).

The review of the literature exposes that financialisation in SEE has already been researched, albeit sketchily. While some saw the massive credit expansion as closely linked to the region's 'financialisation leads to crisis' experience, others have drawn attention to the style of post-socialist

transformation that has favoured finance over the real economy, though both issues were not studied in-depth. The topic of different currencies producing hierarchical structures through financialised channels has been fruitfully addressed. However, all of the contributions to date seem to focus on certain parts of the elephant, do not speak to each other and lack a clear assessment of the relative degree of financialisation over the region's countries, with the exception of Mikuš (2019c). Thus, on the basis of the state art, we can assume that the process of financialisation is occurring in SEE. Yet, before trying to make sense of the shape of the giant and its potential effects on the ground – as the existing literature has done for individual cases – we first need to determine the size of the elephant in the different countries of SEE.

Secondly, the few comparisons of financialisation between the countries have only touched upon certain parts of the elephant due to the authors' focus or theoretical background, but do not seem to mirror the state of the art in (comparative) financialisation conceptualisations. What is missing is the deployment of a coherent conceptualisation of financialisation applied to the countries of the region so as to provide a more holistic picture. Thirdly, the lack of case studies (except for Rodik and Zitko (2015) and (Mikuš 2020)) has forced researchers to draw limited conclusions with regard to the explanatory mechanisms enabling different trajectories of financialisation (i.e. asking why the elephant went there). This calls for a review of the known or assumed drivers of financialisation in the different countries of the region in order to generate detailed descriptions and analyses of individual trajectories, which at the same time would enrich the geographical scope of financialisation research. Such analyses contribute not only to our understanding of the individual case but potentially also to other cases outside of the region (such as e.g. countries belonging to the Commonwealth of Independent States).

1.3 Research question

The exposition of the state of the art shows that there is a general need for further analysis of financialisation processes in peripheral countries, such as those that form part of the region of SEE. It was revealed that a range of comparative frameworks exists, which are capable of depicting the variance of the degree (i.e. the extent) of financialisation, but they have neither seen a major revision nor critical discussion. As for the study of financialisation in SEE, it was shown that some research has already been conducted, but it is argued that the literature would benefit from a more

structured approach towards the processes and its drivers based on an assessment of its relative degrees across countries. Accordingly, the research question of this thesis is as follows:

> *What are the different degrees of financialisation in the countries of SEE and how can we explain them?*

The first part of the research question addresses the variance of financialisation in SEE, which is posited as the dependent variable. This is the logical next step in iterative research, as the variation over the regions in Eastern Europe has already been addressed in the literature. Since financialisation is a process and countries exhibit distinct trajectories of financialisation, the temporal component is of crucial relevance and should be determined in a way that sufficiently explains the process. The same applies to the geographical scope, which, however, is already limited by the number of countries in the region. Outlining the variation of financialisation requires a comparative financialisation framework, of which a multitude exist that deploy quantitative methods, such as descriptive statistics (e.g. Lapavitsas and Powell 2013). As financialisation is a complex process, it might seem advisable to break it down into smaller sub-processes on different levels (similar as to Karwowski, Shabani, and Stockhammer 2020), which would also make it easier to measure them through indicators.

The second part of the research question addresses the trajectory of the dependent variable on its different levels and asks for the independent variables that have contributed to it. Hence, the research question goes one step further than the typical comparative analyses exposed above. The sequence of analysis suggests taking an approach similar to the one found in Mikuš (2019c, 2020), who first conceptualises his framework for comparing state financialisation across Eastern Europe and then conducts a case study in Croatia, which he identifies as the country exhibiting the most extreme degree of financialisation on this level. Akin to this approach, this thesis endeavours to chart the emergence of and to identify the reasons for pronounced degrees of financialisation on other levels. The literature on financialisation has identified a myriad of drivers and explanatory mechanisms that might have triggered or been conducive to the emergence of financialisation, and which could serve as potential drivers for the second step. At the same time, the research approach should be designed in a way that allows room for the emergence of novel or domestically specific factors for financialisation. The next section describes the structure of this thesis and how it thereby seeks to answer the research question.

1.4 Structure of the dissertation

In view of the research question, the structure of this thesis is as follows. Chapter 2 presents the state of the art on financialisation in order to arrive at a conceptualisation of a comparative framework for the first research step and at a conceptualisation of the process and drivers for the second step. Before revealing the backgrounds of the various blind men's approaches (i.e. theories), section 2.1 reviews the reason of disciplinary interest in finance and the origins of the term financialisation. The outline of the different theoretical approaches in section 2.2 serves not only scholarly interest but also reveals different independent variables that are assumed to cause financialisation. Next to this, the depiction of the theoretical advances aid in discussing the plethora of comparative frameworks in section 2.3 that are shown to lack the international facet of financialisation. This neglected level of financialisation is argued to give rise to different understandings of the hierarchical financial relationship between the local (peripheral countries) and the global, denoted by the terms subordinate and dependent financialisation. The thorough review of the criticism against financialisation in section 2.4 sheds light on the conceptualisation of the research design in the third chapter of the thesis.

The research design (chapter 3) refines the research question for the subsequent conceptualisations in section 3.1 by breaking it down into four research sub-questions. In order to answer the research sub-questions, the chapter advances a two-step, mixed-methods approach in section 3.2 and then outlines the temporal and geographical scope in section 3.3. After having established the general design, the chapter proposes a refined conceptualisation of a comparative financialisation framework, discusses the method of measurement and problematises the data availability for the first research step in section 3.4. Based on extreme case selection, the chapter outlines the conceptualisation for the case studies in section 3.5 and presents the data that were mobilised in order to answer the second part of the research question; these data were chiefly gathered through expert interviews. Section 3.6 outlines the limitations of the research design. The comparison of financialisation across the countries of SEE is undertaken in chapter 4, which starts by problematising the different starting points of the countries that already provide certain explanations for the initial degree of financialisation. The chapter then depicts the degree of financialisation on the different levels and identifies for each level one country which has been financialised to the highest degree (i.e. the extreme case).

Chapter 5, chapter 6 and chapter 7 are devoted to the analysis of extreme cases. They describe the trajectories of financialisation and analyse the reasons for their emergence. In this way, the case studies answer the second part of the research question. This was undertaken via field trips, expert interviews and desk research. Chapter 5 conducts a case study of financial sector financialisation Bulgaria. In line with the conceptualisation, the chapter opens by delineating the starting point of analysis before moving to an analysis of the evolution of the financial sector and the business strategies of the financial institutions. The chapter provides an overview of the development of financial sector financialisation before and after the GFC and also presents the impact of the crisis in line with the temporal distinctions. In doing so, the chapter scrutinises the assumed drivers of financialisation while also exposing the explanatory mechanisms for the financialisation trajectory of Bulgaria. Chapter 6 advances a case study analysis on international financialisation in Serbia and moves along a similar pathway by examining the starting point and the trajectory of financialisation before describing the explanatory mechanisms. In a similar vein, chapter 7 delivers a case study analysis on two levels of financialisation in Croatia, which has been identified as the country exhibiting the highest degrees of financialisation on the levels of households and of NFCs. The chapter presents the trajectory of financialisation on each level in the country, also by referring to the respective literature that was identified in the state of the art.

Chapter 8 summarises the thesis and provides an assessment of the variation of the dependent variable as well as a review of the analyses of the independent variables. In doing so, it seeks to partially engage in cross-case synthesis based on the available insights that further enhance our understanding of the degrees and processes of financialisation across SEE. On this basis, the chapter depicts how the gap in the literature is addressed by this thesis and offers a view on what future research should focus on. Lastly, the implications for policymaking are outlined.

1.5 Academic contribution

This thesis contributes to academic research in multiple ways. Firstly, it widens the spatial optics of financialisation (Sokol 2013) in that it deals with a region which, although not unstudied, as the state of the art has shown, was revealed to be understudied in variety of directions. In doing so, the study assesses whether and to what extent the countries of the region have financialised or not, which enriches our understanding of the breadth of financialisation around the globe. Analysing more non-core geographies on the dependent variable of financialisation allows us to zoom in on

its variation in the periphery (Bonizzi 2013; Bortz and Kaltenbrunner 2018). In this way, this thesis seeks to scrutinise and address the role of the assumed independent variables by the financialisation literature and their influence on the degree of financialisation., but also to leave room for emergent explanatory variables that might be novel, region- or country-specific. Given that the countries of SEE may be termed peripheral economies, the role of domestic and external factors is of specific interest not only for the countries themselves but also for the development of the literature on financialisation in peripheral economies (Bonizzi, Kaltenbrunner, and Powell 2020).

Secondly, the thesis seeks to provide an academic contribution to our understanding of the degrees of financialisation in the countries of SEE. Holzner (2017) and Becker and Ćetković (2015) compare the region to other regions in Eastern Europe, while Mikuš (2019c) comparatively analyses the financialisation of the state in Eastern Europe. Hence, the next iterative research step is to compare the countries in SEE using an approach similar to the one applied by Mikuš (2019c) to analyse the levels of financialisation, which have not been addressed by the literature so far (i.e. households, NFCs, international level, financial sector). Thus, the thesis addresses not only the general demand to research non-core countries but also the specific research area on financialisation in Eastern Europe and, more specifically, SEE.

Thirdly, the last decade has seen the publication of a series of comparative frameworks which have neither 'spoken' to each other nor adequately problematised their use of indicators (except for Rabinovich 2019). Hence, to measure financialisation, this study reviews different theoretical approaches and compares the frameworks. On this basis, it engages in selecting the most adequate among them and proposes a few adjustments stemming from the review of the theoretical literature and from the aforementioned criticism. In this way, the thesis strives to promote the barely audible debate on the design of comparative conceptualisations and to illustrate the geographical variation of financialisation, which feeds into recent research endeavours (Schelkle and Bohle 2020). Likewise, the study addresses a certain lacuna within financialisation research with regard to the international sphere. Though the study focuses on nation states (Christophers 2012) as the unit of analysis, it devotes particular attention to the interconnectedness of the local and the global in relation to finance and to the way in which domestic actors cope with and navigate the increasing international financial relations that (may) have given rise to subordination and dependency (Bortz and Kaltenbrunner 2018).

Along with the different contributions to the literature on financialisation, the thesis strives to address the lacuna of IPE in dealing with the region of SEE in general. While the same is true for most other non-Western countries, the region has not received much attention in the discipline since the end of the wars waged by the various autocratic regimes in the 1990s. In addressing the development of the financial realm in the region, the thesis also speaks to the literature, proponents and critics of the finance-growth nexus (dos Santos 2011; Levine 1997; Stein 2010). This view has informed much development policy in the region and led to a high degree of focus and support being granted to the financial sector, behind which stood the idea that economic growth and welfare would soon follow. As was briefly outlined, this might not have been the case across the board. Financial stability was largely achieved in the sense of the non-appearance of systematic failures, but real economic growth and international competitiveness have not developed as expected or desired. Thus, reviewing the trajectory of financialisation in the countries of SEE might additionally help us to understand how the relationship between the financial and other levels in the economy has evolved over time.

This leads us to the next non-academic contribution, which is in the realm of policymaking. Depicting the degree of financialisation and uncovering the explanatory mechanisms supplies arguments for debating the causes but also the consequences of financialisation. Though this is not the topic of this thesis, it was shown that financialisation can, for instance, foster inequality (Tomaskovic-Devey and Lin 2011) or hamper competitiveness (Stockhammer and Kohler 2020), among other outcomes. Hence, policymakers in the region may be informed through this thesis to seek policies that promote de-financialisation (Ban and Bohle 2020) in view of these drawbacks. Lastly, to address the problematisation illustrated at the beginning of this chapter, the study seeks to provide a humble (empirical) attempt to bring together the different views or conceptions of the blind men, not only in relation to measuring financialisation but also to providing a description and explanation for the intensity of financialisation. By deploying a theoretically inclusive approach, the research design takes into account the different backgrounds in order to arrive at a more coherent picture of the elephant.

2. Financialisation: From theory to application

> "*I confess to an uneasy Physiocratic suspicion [...] that we are throwing more and more of our resources [...] into financial activities remote from the production of goods and services, into activities that generate high private rewards disproportionate to their social productivity*." (Tobin 1984, 14)

This chapter deals with financialisation as a process derived from theoretical accounts and with its comparative application, with special emphasis on peripheral countries. The aim is to arrive at a holistic picture on what constitutes financialisation, where it derives from, how it may be measured and what its drivers are. Answering these questions informs the subsequent conceptualisation in the research design in order to answer the research question. This chapter opens by delineating the persistent lacuna of finance in economics, which is one of the motivations of financialisation research and this thesis. The first section briefly traces the history of the term financialisation itself and provides a genealogical background (section 2.1). The following section critically locates the different strands according to the theoretical lenses through which the various scholars perceive the financialisation concept, hence explicating the apprehensions by the different blind men (section 2.2). In doing so, specific focus is placed on the issue of whether or what current financialisation research has to say on the particularities of peripheral countries, on financial sector interactions, and on the possibility of comparative deployment. In order to identify potential frameworks for comparing financialisation, such comparative studies are described and analysed in sub-section 2.3.1. As the majority are found to inadequately address the international facet of financialisation, which is argued to be paramount component for peripheral countries, studies on international financialisation are reviewed in sub-section 2.4.2. The recent criticism of financialisation is outlined in sub-section 2.4.3 as a means to guide the research design in the following chapter. The last section summarises the chapter.

One of the key reasons for the emergence of financialisation research in the late 1990s and the 2000s was the persistent neglect of finance not only in the dominating economic paradigm but also in other social sciences. This lack of attention was all the more surprising given the obvious empirical facts (Asian Financial Crisis, DotCom bubble) and seminal historical considerations by Minsky (1986) and Kindleberger (1978) that had been spelled out long before but then consistently disregarded (Block 2016, 5; Pasotti and Vercelli 2015, 4; Summers 2011) until the GFC. Early and mid-20th century scholars in economics devoted considerable effort to understanding finance and

specifically its impact on business cycles around the devastating experience of the Great Depression (Landreth and Colander 2002, 436; The Economist 2009; Trivedi and Bhattacharya 2018; Watson 2014, 74–75). The most well-known contributions range from Hilferding (1910) with his notion of finance capital to Fisher (1933) with his debt-deflation hypothesis to Keynes's (1936, 158) remarks about uncertainty and herding that pervade financial and capital markets (Akerlof and Schiller 2010; Ippoliti and Chen 2016, 143). The tranquil years of the 1950s and 1960s seemed to have eroded interest in the workings of finance. Besides the monetarist interlude and related debates in the 1970s with some focus on the workings of financial markets (Friedman 1963; Tobin 1978), the ensuing mainstream economics consensus in the time of the 'great moderation' proved to be toxic for interest in this subject. The equilibrium fetish developed in economics in this period was, with regard to financial markets, built on the rational expectations hypothesis and the resulting Efficient Market Hypothesis (EMH), developed in the works of Lucas (1976) and Fama (1970) (Davidson 2004; Nesvetailova 2007, 25ff). As a result of these 'new classical models', banks were viewed solely as intermediaries between borrowers and lenders.[3] In this way, they would increase efficiency through overcoming problems of moral hazard and adverse selection (Binswanger 1999). Financial markets were portrayed as efficient allocators of capital with prices reflecting all present and future information and risk (Hill and Myatt 2010, 145–49). Finance and financial markets were thus not seen as a category within the economy obeying its own logic ('endogenous view'), but rather as efficient providers of capital, only being susceptible to shocks from elsewhere ('exogenous view'). Late efforts to account for financial markets in the dominant dynamic stochastic general equilibrium (DSGE) models (Smets and Wouters 2003) were proven otiose by the GFC (Keen 2011). Newer quantitative approaches have by now arrived at a reformulation of the role of finance, at least within (mainstream) economic history (Jordà, Schularick, and Taylor 2013, 2016), though it remains to be seen whether this empirical turn will lead to a change in the discipline in economics.

Against the backdrop of this disciplinary excursion, the subject swiftly became a field of inquiry in the nascent field of international political economy (IPE) (Strange 1986, 1998), here with regard to its overall decoupling but also concerning its pervasiveness in daily life (Watson 2007, 1). Often,

[3] By now, this view has been finally officially repudiated by the Bank of England (Michael McLeay and Amar Radia and Ryland Thomas 2014).

interest in international relations and in the role of states was connected with the topic of an emerging (international or global) financial order (Helleiner 1996). Overall, the issue of finance and its development is not viewed as exogenous in IPE, but rather as one that needs explanation, acts as a driving force and is co-constituted by a variety of other factors. Financial markets are not assumed to develop spontaneously, as they are in mainstream economics, but rather are created by political agents and interest groups, rendering them inherently contested. The GFC has definitely sparked renewed interest in the workings of finance as postulated by IPE (Drezner and McNamara 2013; Knafo 2009, 2013; Mosley and Singer 2009), a subject which deserves constant re-questioning (Blyth and Matthijs 2017; Cohen 2017).

The enduring neglect of finance in economics on the one hand and the continuing interest shown by IPE has motivated a wide range of scholars from other disciplines to come up with an explanation for the structural phenomenon of the increasing power of finance (Engelen 2008, 112–13). This inter-disciplinary discourse has given rise to the (international) political economy of financialisation (Heires and Nölke 2014a). In this vein, scholars of geography have stressed the importance of spatiality and temporality within the process of financialisation (Langley 2008), development studies have highlighted financialisation within financial assistance agendas (Mader 2015), and sociology has focused on, for example, social stratification and rent theory to explain income redistribution as the core of financialisation (Tomaskovic-Devey and Lin 2011). Hence, it is now widely acknowledged that one has to view finance '*beyond its traditional role as provider of capital for the productive economy*' (van der Zwan 2014, 99). Until now, a variety of different strands within this field of inquiry have emerged, and these are further outlined below. Financialisation research was obviously not only motivated by academic appeal, but even more so by the explosion of finance and financial activities, which lately even inclined mainstream economics to cover the topic (Admati 2017). Even a cursory glance at the numbers reveals that global debt has more than doubled since the year 2000 and accounted for 286% of GDP in 2014 (Dobbs et al. 2015). Taking a longer-term perspective, Jordà, Schularick, and Taylor (2017, 7) found that bank loans in 17 larger countries increased six-fold in relation to total income between 1870 and the crisis in 2008. Their hypothesis of a financial hockey stick describes the waves of debt increase that have become increasingly correlated to the real economy in the last 50 years. These snapshots highlight why a closer look at the development of the relation between finance and the real economy is of pivotal importance to the academic world. The next section reviews the genealogy of the study of such

processes of financialisation, which over the years has matured into a conceptualised field of research on its own.

2.1 Financial power ascendance

After Marx, Hilferding, Fisher and Keynes, the first authors to describe a financialisation-like process were Baran and Sweezy (1966). They discussed the oligopoly-creating tendency of the capitalist system, which would make it difficult for investors to find profitable investments in the phase of over-accumulation. In order to efficiently invest the ever-increasing surplus, investors would search for alternatives. Contrary to their theoretical predecessors, they argued as early as 1966 that one of these alternatives was debt in its diverse forms, which would eventually lead to a 'financial explosion' and ultimately to a crisis (Magdoff and Sweezy 1987, 149). While the specific term 'financialisation' was not used, the tendency that the authors described in the course of their theoretical delineation (and backed by factual developments in the US) is quite similar to the one that is later described by others (Amin 2018, 64–65; Foster 2007; Lapavitsas 2011, 612).

The first mention of the term 'financialisation' dates back to Kevin Phillips in his biting critique *Arrogant Capital* (1994) and to Giovanni Arrighi in his magnum opus *The Long 20th Century* (1994). Phillips (1994) analyses the detachment of American politics from society, a phenomenon he blames on Wall Street, which had the power to influence regulations and laws in its favour. As in every metropolis and capital city in world history, when politics are subsumed by private capital, the country will eventually begin to decay. Phillips uses the term 'financialisation' in the fourth chapter of his book to describe a recurring pattern in history, which manifests itself both in everyday life but also as a general '*split between the divergent real and financial economies*' (Phillips 1994, 82). In this context, he draws parallels to the gold frenzy in Spain in the 16th century and to the tulip mania in 18th century Holland. The breakdown of the Bretton-Woods system with its dollar-gold convertibility (i.e. no longer providing an 'intrinsic' value to the currency) and the end of the system of fixed exchange rates and capital controls figure as the crucial elements in the current period of financialisation. According to the author, the usurpation of power by the financial sphere manifests itself in the ensuing currency speculation, the ability to marketise every economic interaction and the surplus creation of the real sector. This sectoral shift is evidenced by the high wages in the financial sector, which incentivise the market to draw more resources into the realm of fi-

nance. Derivatives and other speculative financial products become the spearhead of this development (Phillips 1994, 82–83). Building on Phillips's work (1993, 194), Arrighi (2010, 325) also describes financialisation as financial expansion that goes hand in hand with social polarisation in times of concentration of capital preceding and heralding hegemonic transition.[4] Arrighi expands the conventional usage of the term 'hegemony' as dominance to include the ability of a leading state to govern over a system of sovereign states, including the power exercised through moral and intellectual leadership (Arrighi 2010, 28). The recent phase of financial expansion that began in the late twentieth century only differed from other historical phases of financialisation – as a means to postpone the inevitable decay of the regime of accumulation – in the 'bifurcation of financial and military power' (Arrighi 2010, 372).[5] The difference between the two authors lies in their view vis-à-vis the driving political force behind financialisation: for Phillips, the main actor is the private economy, i.e. rentiers or capitalists, whereas for Arrighi it is the decaying state.

With respect to the empirical reality of the transition countries of SEE, these early accounts of financialisation give rise to the question of what kind of development we would observe outside of the hegemony. An insight we can already gain from these first reports on financialisation is the importance of alterations in currency regimes and capital controls, meaning the systematic (international) set-up in which finance moves. Second, increased employment and wages in the financial sector in comparison to the rest of the economy might serve as an indicator for financialisation in terms of sectoral change. Third, investments in speculative – e.g. securitised – assets but also in real estate are hallmarks of financialisation that can materialise concomitantly within the context of peripheral economies. Lastly, if financialisation is a sign of transition in hegemonies, would similar processes in peripheral countries challenge this assumption? Or do weakened degrees of financialisation validate this transformation? What does this tell us in general about the relationship between the hegemony and the periphery? Since Arrighi devoted much attention to the workings

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[4] Hegemonic transition describes a period of upheaval in which a newly emerging potentially hegemonic bloc brings about structural changes in the world system (Robinson 2011, 273).

[5] While Phillips aptly describes the development especially for the United States, Arrighi uses the term financialisation only once. In contrast to the general depiction of the emergence of the term financialisation, he explores the subject in greater detail in the updated version of the book, which dates from 2010. Stockhammer (2008, 200) even argues that Arrighi's use of the term instead describes a process of fiscalisation, which describes the increased lending of the state from financiers once the productive resources are exhausted in a cycle of accumulation.

of the world system and developments in the centre, which prompted some authors to call his perspective Eurocentric (Robinson 2011, 274), this hegemony-focused and historical account of financialisation can only superficially assist us in answering the research question.

Keeping these questions in mind, the financialisation research agenda essentially took off at the end of the 1990s. This was most notably visible in the special issue of *Economy and Society* in 2000 (Williams 2000), which contains several articles dealing with different aspects of the subject matter. From that point forward, it is no longer viable to follow the chronological evolution of the research strand given the vast body of thought that emerged from it. Hence, some categorisation of the contributions is advisable, also as a means to counter the 'fuzziness' of the concept. Scholars typically classify approaches within financialisation research into different levels of analysis: macro, meso, and micro (Deutschmann 2014, 15; Karwowski, Shabani, and Stockhammer 2016, 3; Nölke and Heires 2011).[6] Macro approaches focus on the systemic and structural nature of processes of financialisation, which may be described as a new finance-led or -dominated regime of accumulation (e.g Stockhammer 2004; van der Zwan 2014, 103). Analyses of firms or corporate governance (typically in the realm of critical business studies) are interested in the meso(economic) character of financialisation, which manifests itself for example in the current era of shareholder value (Froud 2006; Froud and Williams 2000, 2002). Cultural political economists and economic geographers have instead placed more emphasis on the micro aspects such as the increasing impact of finance on the daily life experience and the changing subjective understanding within society (Chima and Langley 2012; Langley 2008; Martin 2002).

With regard to the research question, comparing financialisation in a region could fruitfully engage on all three levels. However, this would entail researching a myriad of units if all three levels were to be compared across all the countries in the region. This would require the researcher to render the units comparable, especially so on the meso and micro levels. On the macro level, the unit of analysis is limited by the nation-state and can thereby be operationalised in a more consistent manner. A comparative analysis on the meso level would entail a large amount of data gathering, which could be a difficult undertaking given the scant statistical base in SEE, or comparative case studies of firms, which would necessitate a longer engagement within these companies, as public information is typically not available. As micro-level analyses are mostly focused on a specific geographical locus and might be even more impacted by the specific domestic institutional setting,

[6] Van der Zwan (2014, 101) also speaks of three different approaches which loosely correspond to this depiction.

they are not the best choice if we wish to generalise findings for the national scale. Given the rather explorative nature of this study, a comparison on the macro level should initially suffice to assess the state of financialisation in SEE in view of the research question.

Most approaches on this analytical level may be categorised as departing from a specific theoretical lens, which is exposed in the next section. Among the theoretical approaches, the most prominent are Marxism (sub-section 2.2.1), with early formulations by Magdoff and Sweezy (1987); Regulation theory (sub-section 2.2.2) as foreshadowed by Arrighi (1994); and Post-Keynesianism (sub-section 2.2.3), with Minsky (1986) and other scholars as forerunners. A slightly different take on financialisation is proposed by institutionalism (sub-section 2.2.4). Lately, this approach has increasingly focused on financialisation as an explanation for institutional change, for example in financial systems (Deeg 2010) and as a means of overcoming the ideal-type dichotomous varieties of capitalism approach (Nölke 2009). As will be shown, it fills the void that the other three approaches exhibit. The interim section (sub-section 2.2.5) returns to this specific point.

2.2 Theoretical approaches to financialisation

This section outlines four different theoretical approaches to financialisation on the macro level. It highlights how the phenomenon is woven into the theoretical body, constitutes a process in the form of a structural transformation, or serves as an explanation for institutional change. The aim is to first provide a substantiated understanding of the process from different angles within each theoretical lens (Marxism, Regulation School, Post-Keynesianism and Institutional approaches) and then to describe the specific concepts that were carved out from them. The last sub-section highlights both the differences and commonalities of the concepts as well as the (dis-)advantages of each considering the topic under scrutiny in this thesis. Each theoretical body reveals different degrees of theoretical coherence as well as different emphases on the effects of financialisation. Interestingly, similar causal explanations for financialisation are ubiquitous in all approaches: liberalisation, privatisation and shareholder value maximisation. However, these are not exhaustive. On the other hand, it is revealed that the concepts largely focus on financialisation as a domestic phenomenon with very scant attention paid to the role of international financial streams, actors and regimes.

2.2.1 Marxist approaches

Scholars working in the Marxist tradition depart from the conventional analysis of the evolution of the capitalist system. When economies mature, more and more constant capital is deployed in relation to variable capital (Marx 1999, 154). Marx argued in the third volume of *Capital* that this would necessarily lead to a general tendency of the rate of profit to fall (as long as the surplus is not temporarily or artificially increased) due to the increase in productivity and technical progress. However, given the countervailing tendencies arising from the intrinsic nature of production, circulation and distribution, the rate of profit might temporarily rise and fall back and forth (Marx 1999, 165ff). Based on the general tendency of the rate of profit to fall, one might argue that increased investment in financial assets constitute a way of (temporally) circumventing this problem. On the other hand, Baran and Sweezy (1966, 57) proposed the notion of 'surplus absorption', which projects quite the opposite view. Starting from the assumption of monopoly firms being price-makers and maximising their profit, they deduce an ever-increasing surplus (Baran and Sweezy 1966, 72). This surplus has to be invested in production, consumed or simply wasted (Baran and Sweezy 1966, 79) so as not to lead 'into a bog of chronic depression' (Baran and Sweezy 1966, 108), meaning economic stagnation. Thus, to put this surplus to work, monopoly capitalists engage in unproductive investments such as advertising, military spending, and lobbyism. Sweezy and subsequent Marxist scholars engaged in explaining the search of (surplus) capital for investment channels beginning in the 1970s (stagflation period) and the ensuing increasing engagement in finance. They did so by referring to the monopoly-creating tendency of multinational corporations as a common starting point but then diverged in opinions about either the problem of surplus absorption or aspects of the slow-down of the rate of profit (in the productive sphere). Departing from this problematisation, several authors engaged in inserting financialisation into a Marxist narrative.

Building on the insight of Magdoff and Sweezy, Foster (2007, 2008) argues that (1) capitalists are actually dependent on the growth of finance to preserve and enlarge the generated surplus in the form of money capital, (2) the financial superstructure can only expand to a certain degree from its productive economic base, leading to financial crises, and (3) financialisation can only be a temporal fix for stagnation in the productive sphere but cannot overcome it. One might conclude that financialisation as understood here only prolongs an already apparent decay of capitalism. Looking at peripheral countries, Foster (2007) argues that financialisation leads to greater imperial penetration through financial dependence. Common features of de-industrialisation, financial vulnerability

and slow growth are viewed as the result of the imperative of sound economic fundamentals to attract foreign investment and serve external debt. While limning the overall trend in capitalist accumulation towards financialisation, this '*Monthly Review'* stream in Marxist theory has, however, failed to produce more specific analyses of companies and banks or other financial institutions, as Lapavitsas (2013, 18) notes. Contrasted with the reality of peripheral economies, such a tendency as described by this line of Marxist financialisation scholars needs further substantiation but links the developments in the core (surplus absorption) to those in the periphery (financial dependence). Again, financialisation is portrayed here as originating in the core with certain repercussions for the periphery but fails to either describe or problematise financialisation in the periphery. It seems as if financialisation in the periphery only takes place in the form of hierarchical financial streams, while declining real production is seen as a result of unfavourable growth imperatives. The notion of imperialist tactics as a factor for financialisation in peripheries thus requires further elaboration, while the question of domestic financialisation in peripheries is undertheorised in these early Marxist financialisation contributions.

Other contributions in this field include the French Marxist tradition. Duménil and Lévy (2004, 2006) empirically substantiate the findings of higher profits in the financial sectors of mature economies but contradict the insights provided by the previously mentioned scholars. They contend that in the current era financial capital does not dominate industrial capital. Contrasting the first period of financial reign at the beginning of the 20th century with the current age of neoliberalism, they show how the class of owners now primarily holds financial assets, while at the same time a new managerial class (e.g. of CEOs) emerges that draws profits from enterprises in the form of abnormal wages. Essentially, they understand financialisation as a new form of class struggle, in which the new class will eventually become a (different) faction of the capitalist class, drawing attention to the difference between ownership and management. In turn, Chesnais (2004, 2006) stands in closer affinity to the Regulation school and puts more emphasis on the liberalisation of trade and capital flows, which in his view has engendered a reconfiguration of the international political economy favouring the US. As the only country with a truly financialised accumulation regime, it created massive inflows of capital from peripheries, financing both imports and domestic credit-taking to boost internal consumption. In the light of the SEE region under consideration here, this would mean that they only serve as providers of capital and are not financialised in the same way as the US. As the EU plays a much greater role in international power relationships for SEE, this would, however, call into question a mono-country hegemonic analysis as put forth by Chesnai.

Nonetheless, it is notable that the French Marxist authors' work features a description of core-periphery relationships under the auspices of financialisation. Besides the important notion of a rising managerial class which engenders a new class struggle, the French Marxist authors concerned with financialisation did not contribute much to a better understanding of financialisation in the periphery or of how to compare financialisation across countries.

Lately, some authors have attempted to carve out specific hypotheses and frameworks for analyses of financialisation (Bayliss, Fine, and Robertson 2013; Lapavitsas 2013), which have given rise to a theoretical debate within the Marxist strand focusing on financialisation. Before we delve into this area, the notions of capital within Marxist analyses require some clarification. Central to understanding Marxist scholars concerned with financialisation is the distinction between different forms of capital. Borrower-lender conditions are characterised as an advance of ownership rights of money capital with the promise to pay later, typically between two capitalists, and topped up by interest.[7] Therefore, this type of capital is called interest-bearing capital (Lapavitsas 2013, 112). Taking this into class analysis, such lenders are viewed as 'money' or 'monied' capitalists, in contrast to 'functioning capitalists' (Lapavitsas 2013, 114). All money capital that is available to be transformed into interest-bearing capital is called 'loanable' money capital. On the other hand, fictitious capital represents the value attached to income streams generated in the future discounted by an interest rate, for example in share prices. Trading such financial assets can generate financial profit, which would be the value of fictitious capital in relation to the actual capital raised at the point of sale, thereby transforming it back into (loanable) money capital (Lapavitsas 2013, 161).[8] But how do these theoretical discussions relate to financialisation?

Drawing on these distinctions, two Marxist scholars developed divergent conceptual apparatuses of financialisation. On the one hand, Lapavitsas (2013, 118) highlights a further possibility on the formation of loanable money capital, which is 'idle' money. This type of money capital is regularly created and released within the circuits of industrial capital and lies temporally idle in the form of

[7] For Marx, this act of exchange highlights three features: (1) tradability, (2) the borrower seeking to undertake a project and (3) the interest being a fraction of the additional surplus generated by this undertaking. In contrast to mainstream economic theory, the lender has the ownership right of the money capital and interest is the return of it being loaned out (Lapavitsas 2013, 113).

[8] Consider the following example: You hold a share and value it by discounting the future dividends by an interest rate set through the natural rate of interest on money markets plus a risk premium generated by a combination of a market-specific and a company-specific beta value. The value you attach to this share through this derivation is fictitious capital. If you sell the share at a price higher than this value, a financial profit is realised. As the share price attached by you is computed by future incomes, it was called 'illusionary' or 'fictitious' by Marx.

money hoards. Mobilising these idle funds transforms them into loanable money capital. Money hoards do not necessarily need to come from the monied capitalist class but may also derive from productive capitalists (e.g. over-liquidity of firms) or even from workers through savings from their personal income (e.g. deposits in banks). The mobilisation of idle funds changes the notion of loanable money capital and lies at the root of financialisation processes. Simultaneously, the notion of interest-bearing capital changes as it becomes the '*reallocated money capital of the capitalist class*' (Lapavitsas 2013, 118). In describing this process, Lapavitsas terms the insertion of funds from social strata other than the capitalists and the subsequent investment of these funds into unproductive activities (such as household lending) 'financial expropriation', as (financial) profits are increasingly generated through payments of interest to financial institutions from these income groups. Based on his scheme of credit relations in the financial realm of capitalism and broader observations, Lapavitsas (2013, 170) claims that financialisation represents a transformation on several levels:

a) the ability of corporations to access financial markets directly and not through banks, making them autonomous financial agents (e.g. holding financial assets)
b) banks in turn being increasingly engaged in earning fees, through trading, finance-to-finance and household lending, instead of providing capital to firms (e.g. increasing broker function of banks)
c) workers relying on the financial sector to finance the accession to previously public goods such as housing, health, education and handling savings for pensions and insurance in the face of a retreat of the state and depressed wages (e.g. private pension schemes)

On this note, one could argue that the act of companies turning to open capital markets induced a shift in the nature of banks towards other activities.[9] Regardless of the line of reasoning and the outcome – and this is far from clear given the apparent disagreements among Marxist scholars – he states that 'at the root of financialisation lies loanable, not fictitious, capital' (Lapavitsas 2013, 29).

[9] Interestingly, this would validate the convergence hypothesis of some Varieties of Capitalism scholars, i.e. that Coordinated Market Economies with relational bank-lending converge to Liberal Market Economies in which companies borrow on capital markets (Froud and Williams 2002, 124; Aglietta and Breton 2001).

On the other side of the discourse, Ben Fine (2013, 62–65) rejects the concept of financial expropriation and puts forward a different notion of interest-bearing capital. To him, the latter is primarily located within the productive accumulation of the capitalist economy, but not if a loan is taken for unproductive, non-surplus creating purposes. Once liabilities of this kind are combined into an asset (e.g. mortgage loan packages into a mortgage-backed security), it becomes interest-bearing capital in paper form and has a fictitious (capital) value (Fine 2013, 55). The proliferation of such interest-bearing capital in the same (financial) sphere is called intensive, while the proliferation into other spheres (from public to private pension schemes) is termed extensive financialisation (ibid.). Subsequently, he develops a 'systems of provisions approach' that highlights the implied pervasiveness of this understanding of financialisation (Bayliss, Fine, and Robertson 2013). For Fine (2013, 56), financialisation is thus a *"peculiar modern form of incorporating a variety of credit relations into the orbit of fictitious capital"*. While this indicates a different understanding of the nature of financialisation between the two authors, the strength of Fine's approach lies in the distinction of the (potentially all-encompassing) spread of financialisation, while Lapavitsas's approach highlights the internal transformation of the financial realm and the ensuing repercussions for its interaction with other sectors of the economy such as households and NFCs. For (semi-)peripheral countries, Rodrigues, C. Santos, and Teles (2016, 486) comment that Lapavitsas's approach is more useful against the backdrop of bank loans (especially loans to households), as they constitute the key manifestation of financialisation in these countries. The notions of intensive and extensive financialisation by Fine nonetheless provide a tool for differentiated comparison, though he does not apply the concepts to peripheral countries.

The strength of the Marxian approach lies in its (relatively) coherent theoretical derivations, despite disagreements between authors. Peripheral states are mainly depicted to serve the developments in the core – surplus absorption or falling rate of profit – either through providing capital to the USA or through providing additional surplus extraction opportunities. This hierarchical relationship was termed 'imperial' while some Marxist authors delved more deeply into this aspect, as described in the next section. One strand of Marxist research on financialisation pointed to the differentiation between intensive (within finance) and extensive (extend finance to other spheres) financialisation. The mobilisation of loanable funds was argued to lead to a transformation on different levels of the economy: households, companies and banks. Marxist financialisation research also highlights the systemic forces behind financialisation and how this influences the formation and the role of social classes, especially the way in which the working class is increasingly drawn into financial markets.

All of these arguments may become important when looking at developing countries. However, the (domestic) policy choices that underpin such developments have little role in the analysis. Having outlined the Marxist take on financialisation, the next section presents the approach of the Regulation School, which is somewhat grounded in the Marxist tradition.

2.2.2 Regulationist approaches

The Regulation School's take on financialisation builds upon the work of the French *Annales* school and especially Fernand Braudel's (1984) argument of a recurrent historical pattern of world trade and its relation to finance. More broadly, it asks how the capitalist system, given its crisis-prone character, has been able to survive for so long, and answers this question with the notion of regulation (Aglietta 1979; Boyer 1986). Theoretically, the mode of regulation mediates a combination of institutional forms (Grahl and Teague 2000, 161), which produces a (stable) regime of accumulation: (1) the wage-labour nexus, (2) money and credit relations, (3) competition, (4) international (trade) integration, and (5) the role and form of the state (Boyer 2000a).[10] The regime of accumulation is thus defined as how the surplus is produced and distributed, while the mode of regulation secures these patterns of production and distribution. In contrast to Marxist approaches, this theory places more emphasis on the set and interaction of institutional forms rather than on the productive forces.

Looking back in history, the period since the beginning of the 20th century and the mode of accumulation of the US and other advanced economies has been described as (varieties of) Fordism. It was characterised by a growth regime of mass consumption and mass production with a specific institutional architecture, such as a stable compromise between capital and labour and limited international openness (Boyer 2000a, 117). Central to this conceptual approach is that different regimes of accumulation may exhibit distinct modes of regulation in their respective settings (Boyer 2000b, 285). However, in line with the Marxist analysis, it was observed that the 1970s and 1980s saw a general decline in productivity. From a regulationist perspective, this marked a shift in the mode of accumulation. But where to? While a potential synergy of mass consumption and product differentiation was discussed, to which this development might have given birth, the Japanese crisis apparently put an end to this idea (Boyer 2000a, 113). Other ideas revolved around the emerging and diffusing information and communication technologies on the one hand or the transition to a

[10] Earlier, Aglietta (1979) spoke of three different structural forms of social relations that are organised in institutions and which result out of class struggles.

service-led economy on the other. Both would potentially herald a new productive paradigm but would not lead to a completely new set of institutional arrangements. Focusing on newer developments in the US and partly in the UK, Boyer (2000a, 118) then advanced a (hypothetical) novel, 'finance-led' accumulation regime governed by (1) employment flexibility, (2) financial market competition, (3) financial bubbles and (4) integration into global finance, while (5) the state/society relation was not yet fully carved out. From this angle, an accumulation regime dominated by the financial realm impacts upon several levels:

a) Privilege of shareholder value affecting corporate governance
b) New capital-labour relations and forms of competition
c) Shift of household behaviour in the light of potentially declining wages or longer working hours towards self-engaging in financial activities
d) Rationalisation of public expenditure and link of government finances to expectations of financial markets in the light of mobile capital
e) Central bank policy focused on price stability and guidance for financial markets
f) Shift of pension and insurance systems affecting financial markets and employment relationships (Boyer 2000a, 120–21)

After advancing a model based on stylised facts, Boyer (2000a, 123) notes that these effects pertain solely to domestic financialisation but not so much international financialisation. Another influential Regulation scholar, Michel Aglietta (1976, 2000), takes the argument of a new accumulation regime one step further by contending that what we are actually witnessing is a new social compromise leading to a novel wage-labour nexus. Financial investors now play an increased role in corporate governance, but because households are essentially providing the funds for them, social legitimacy should in theory be ensured (Aglietta 2000, 157). While acknowledging the inherent instability of this new financial imperative, he underscores that only prudential rules can discipline and ensure the existence of a wealth-based growth regime such as this (Aglietta 2000, 159). But how does this play out in different countries? Are we able to discern finance-led accumulation regimes from other type of regimes and assess their degree? Is this applicable to developing countries as well, for which hardly any analysis of accumulation regimes exists?

First of all, the Regulation scholars' assertion regarding a finance-led accumulation regime was answered for the case of the US. Krippner (2005, 174–77) sees herself in the tradition of the early

Regulation theorists such as Arrighi and juxtaposes an activity-centred with an accumulation-centred view with regards to financialisation. The activity-centred view denotes a focus on changes in employment or contribution to GDP. In the accumulation-centred view, the emphasis is on changes in profit generation. What is more, she strives to empirically and conceptually substantiate the economic change that is taking place. Focusing on where profits are generated, she describes the dramatic growth of the FIRE sector over the last 30 years. More specifically, she highlights that financialisation as a long-term structural shift has both sectoral (FIRE) and extra-sectoral (non-FIRE) effects. Regarding the latter, a typical example is NFCs relying increasingly on portfolio income within their cash flow generation. As for the former, financial companies earned comparatively more through interest, as did NFCs through capital gains and dividend pay-outs. Although outsourcing and foreign subsidiary formation limit the results of the analysis, the empirical facts are firmly established in her seminal contribution *Capitalizing on Crisis* (Krippner 2012). Contrary to the other Regulationist scholars mentioned earlier, Krippner refrains from engaging in further theoretical implications or arguing that this economic change signals a novel phase in capitalism (Krippner 2005, 199). As such, scant attention is paid to developing countries or international aspects of financialisation, as her geographical focus is elsewhere. Nonetheless, the distinction between sectoral and extra-sectoral effects as well as between the accumulation- and activity-centred views can be useful when comparing different countries because they provide a framework of analysis. Interestingly, the units of analysis are similar to the ones encountered in the Marxist conceptualisations, except that hierarchical relationships between countries or originating from the US are neither mentioned nor problematised.

In an attempt to fill this gap, Becker et al. (2010) have worked out a specific conceptualisation of financialisation departing from a Regulationist framework inspired by Dependency theory. Their modified concept strives to makes sense of the specific heterogeneous nature of financialised regimes of accumulation of peripheral and semi-peripheral countries. Regarding the accumulation regimes (i.e. generation of incomes and surplus), Becker et al. (2010, 227) distinguish between three typological axes of accumulation: productive versus financialised, extensive versus intensive, and introverted versus extraverted.[11] In a productive regime of accumulation, the surplus would be

[11] The first axis describes whether capital flows, in the form of investments, are geared towards the real/productive sector or the financial sphere. The second axis refers to the form of the productive accumulation. Intensive accumulation exists when consumption expenditure is derived from wage incomes on the internal market and the surplus value held by the capitalist class is increased by reducing the price for these consumption goods (Becker and Jäger 2010, 6). Extensive accumulation refers to the increase in surplus value by an elongation of the working time or an increase in

generated and invested within the non-financial part of the economy. In relation to a financialised regime of accumulation, the authors draw on the Marxian distinction between an expansion of either fictitious capital or interest-bearing capital, typically in the form of loans (Becker and Jäger 2012, 172). Given this understanding, one may argue that their arguments are closer to Lapavitsas's line of reasoning. They contend that interest-bearing capital prevails in (semi-)peripheral countries as capital and that stock markets are only rarely developed in these geographies. Further on, Becker et al. (2010, 230–31) differentiate between two ways in which the different strata of societies are intertwined with the financialised accumulation regime. Elite-based financialisation refers to a regime in which the middle and upper classes (the bourgeoisie) mainly participate in activities surrounding financial markets and to which they are increasingly linked. In relation to financial markets, this can be understood as the expansion of housing or mortgage loans to the middle and upper classes as well as the provision of investment vehicles for private wealth accumulation. On the other hand, mass-based or popular financialisation refers to the ways in which households, primarily those in the low-income brackets, are becoming dependent on and are linked to financial markets. The increasing volume of easily accessible consumer finance leads these households to unsustainably raise their standard of living in emulation of an ever more affluent elite class.

Besides this notable modification of the concept and application, making it quite relevant for the research question of this thesis, there has been limited reception and some criticism. In contrast to Krippner's account, closer examination of the notion of an expansion of interest-bearing capital does not clarify at which point a country exhibits a productive or a financialised regime of accumulation (see also Aygül 2014, 285). This is especially important for the question of whether and to what degree peripheral countries, in which growth in both the productive and the financial spheres takes place at the same time, can be labelled financialised. Also, Becker et al. (2010) view financialisation as something that is mainly externally imposed, which hardly allows for domestic mediation or for secondary outcomes of other policy decisions. The concept of financialisation by Becker et al. (2010) thus highlights both aspects of domestic and international financialisation but it does not really address the other institutional forms of Regulation theory.

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the intensity of work. The third axis refers to the interaction of the analysed unit with the world. Extraverted accumulation regimes show a strong outward orientation of trade and flows of capital; high imports make the country passively extraverted and high exports make it actively extraverted. Countries that are characterised by an introverted accumulation regime are mainly focused on the internal, domestic market and related consumption.

Regulation scholars have so far paid little attention to analysing financialisation in peripheral or emerging economies (besides Becker et al. (2010)). It seems as if have they have followed Arrighi's initial approach of viewing financialisation as mainly occurring in the core, which has prevented them from analysing peripheral countries' financialised mode of accumulation in detail. Another reason could be that regulation and regimes of accumulation as starting concepts have primarily been applied to advanced countries up to now. In comparison to the Marxist accounts, however, the Regulation School pays more attention to the different empirical realities, to the role of institutions and to state policies in general. In particular, Krippner's account of the US economy shows how state actors played a key role in laying the groundwork for processes of financialisation to develop. As such, the mediation of the different forms of regulation through policy is firmly woven into the theoretical body of research. However, there are distinct differences between Regulation scholars in terms of their closeness to Marxian thought. The difficulties experienced by this theoretical school at the end of the 1990s[12] demonstrate that conflicts and spontaneous shifts or changes pose a challenge to its long-term view. The fact that the state-society relation in the financialised regime of accumulation is still being left as an open question (or not? - Streeck 2013) underlines this point. Still, Becker's contribution has shown how a combination of Regulation theory with Dependency theory could be applicable to the peripheral countries under scrutiny in this thesis, but it has left little room for comparison between countries. More promising in this regard are the differentiations Krippner makes between sectoral and extra-sectoral financialisation as well as an accumulation-centred and an activity-centred view, which account for variation but neglect the international facet of financialisation. Moving on, Post-Keynesian theorists grant even more importance to actual policy in shaping outcomes, although the theoretical link between policy and their deductions are comparatively vague, as outlined in the next sub-section.

2.2.3 Post-Keynesian approaches

Post-Keynesian approaches present another theoretical way to unpack financialisation. Originally, the theoretical body was developed as a response to the Neo-Keynesian or 'bastard Keynesian' (Robinson 1978, 256) policy doctrines and models first advanced by Hicks (1937)[13]. In contrast to the now mainstream New Keynesian approach, Post-Keynesian theory stresses the notion of effective demand and the pivotal role of money in the development of the economy (Lavoie 2015, 35),

[12] The difficulties relate to the development of new types of growth regime as successors to Fordism (Boyer 2000a).
[13] Hicks actually retracted his interpretation of Keynes 40 years later (Hicks 1981). Nonetheless, his IS-LM model is taught in most economics classes even today and continues to shape common misunderstandings of Keynes.

with the financial sector being deterministic for the dynamics (Lavoie 2009, 16). Typically, three areas of emphasis within this body of research in relation to financialisation can be distinguished: (1) the ascendancy of the rentier as a structural, long-term transformation, (2) divergent growth models within or caused by financialisation and (3) short-term financial instability induced by asset bubbles.

Drawing on Kalecki and Keynes, Post-Keynesian scholars interested in financialisation depart from the break-up of the traditional worker-capitalist relation by distinguishing between two types of (income-gaining) capitalists: the rentier (through interest, dividends and rents) and the entrepreneur (through profit). A similar distinction was formulated by Marxist approaches considering the different characteristics of productive and monied capitalists. However, the approaches differ in their analysis of how the increased power and influence of the rentier leads to financialisation. The key proposition in Post-Keynesianism is the rise in financial profits and incomes of the rentiers on the one hand, at the expense of the entrepreneurs' profit from the productive economy and of the wages paid to the workers on the other hand. The reason for that is twofold.

Formerly, one could witness a 'managerial capitalism' which 'had a preference for growth' (Stockhammer 2004, 720), as analysed by Post-Keynesians such as Alfred Eichner (1976). However, in the current period, the interests of the rentiers as shareholders and those of the managers or entrepreneurs are now aligned in the direction of profit maximisation. Stockhammer (2004, 726) attributes this alignment to carrot-and-stick incentives, with new financial instruments for hostile takeovers serving as the stick and performance-based payments in the form of stocks and options supplying the seductive carrots. These new types of salaries, which are increasingly connected to performance and take the form of stock options, can even induce managers to unsustainably boost the short-term share price (Palley 2007, 18). Taking rentiers' incomes, i.e. dividends and interest, as proxies for his understanding of financialisation, Stockhammer (2004, 738) finds that this leads to a slowdown of accumulation due to a lower desired growth rate of non-financial firms. The second reason for structural change lies in the increasing engagement of NFCs in financial markets in order to arrive at higher profits (Epstein and Jayadev 2005; Krippner 2005; Orhangazi 2008). Broadly speaking, Crotty (2002, 4) described this development as a shift from 'patient' to 'impatient' finance, which entails an increase of the real interest rate and of cash flow payments to financial agents by NFCs. Overall, this triple movement on the firm level (shareholder value orientation,

increased interest payments and engagement in financial activities) leads to less productive investment.

These elaborations inspired Post-Keynesian scholars to establish the notion of a finance-dominated capitalism rather than one that is finance-led, as argued before by Boyer (2000a). In contrast to the finance-led variant, which entails an increase in financial norms leading to growth, finance-dominated capitalism can also lead to negative growth (Stockhammer 2008, 185) and change the income distribution at the expense of the worker (Hein 2008, 2009; Onaran, Stockhammer, and Grafl 2011; Orhangazi 2008; van Treeck 2008, 2009). From a macroeconomic standpoint, financialisation can thus be understood not so much as a structural blockage in the real economy, as it is seen by Marxist theory, but rather as a force that leads to a lack of aggregate demand due to depressed wages, in which debt becomes the fix to this problem. The causes of depressed wages are found in the switch from a wage-led to a profit-led growth system.[14] What are the drivers of this development? It is argued that the reasons for these changes are to be found in neoliberal policies encompassing privatisation, deregulation, a retreat by the state from providing social welfare, and price stability as the sole focus of monetary policy (Crotty 2002, 2008, 2009; Stockhammer 2008, 187). Contrary to Marxist analyses that emphasize capital-induced pressure, Post-Keynesian scholars argue that policymaking plays a much greater role in promoting financialisation and may even reverse the paths previously taken.

While the overall tendencies are clearly established, the question remains: how do countries react to such a development, i.e. a lack of aggregate demand coupled with slow growth? Stockhammer (2012, 41) argues that this leads to a bifurcation in the growth regime of countries within the finance-dominated accumulation regime, thereby converging Regulationist and Post-Keynesian theory. Focusing on sectors instead of institutions, he writes that one set of countries departs on a path of debt-driven consumption (Anglo-Saxon countries) with large current account deficits on the back of capital flow liberalisation, while the second group pursues export-driven growth, displaying current account surpluses resulting from capital outflows, which eventually create financial bubbles elsewhere (Stockhammer 2012, 63). This provides with a typology of growth regimes that could serve as the starting point when analysing sets of countries. Baccaro and Pontusson (2016)

[14] With regard to effective demand, we can distinguish between (1) a wage-led system characterised by an increasing share of labour compensation to GDP, which leads to higher consumption and (2) a profit-led system marked by a surging share of profits in domestic product, which boosts investments (Bhaduri 2008, 148).

advanced the growth regime debate within IPE and comparative political economy even further. Departing from the established fact of a switch from wage-led to profit-led growth regimes caused by the processes of financialisation, they carve different trajectories for countries that encompass either consumption-led or export-led growth, or both. In contrast to other scholars, Baccaro and Pontusson (2016, 177) explicitly do not engage in building typologies. Nonetheless, these growth regimes are (again) a reaction to financialisation and do not constitute variegations in financialisation itself, even when we consider developing countries. Thus, they do not help in situating, explaining or differentiating financialisation processes but rather take it as a precondition for further analyses (partly reducing it to an independent variable). Setting this issue aside until the next subchapter, we can sum up that both sets of countries face a common destabilising threat through increased financial flows marked by a rising share of profits.

Financial instability constitutes the third area of emphasis in Post-Keynesian research on financialisation. In this direction, it is argued that increasing financial activity leads to leverage effects and thus more debt, which causes financial fragility and instability, as put forth originally by Minsky (Juuse and Kattel 2015, 9). In Minsky's view, bubbles are created through overconfidence and ensuing decreased liquidity preference in times of tranquillity, which leads market participants to take riskier and more leveraged positions. The stages heading towards crisis move from 'hedge' to 'speculative' to 'Ponzi' financing (Lavoie 2015, 20). This build-up period prior to a financial crisis is what some Post-Keynesian scholars understand as financialisation (Kregel 2007; Wray 2007, 2008). Eventually, once the safety margins have decreased and asset prices start to decline ('Minsky moment'), a downward spiral unfolds, leading to a crash (Minsky 1982, 1992). Although Minsky's work is widely cited within financialisation research, the relationship between his concept and the first two Post-Keynesian arguments is not straightforward. While financialisation typically leads to Minsky-like financial instability, such movements are not necessarily connected to financialisation (Lapavitsas 2013, 30) – or at least only to a small degree. While financialisation is widely held to be a longer-term structural transformation of finance and the economy, Minsky bubbles are rather a short-term development. Despite the relevance of the Minsky framework, understanding and comparing financialisation must go beyond the financial instability concept.

In relation to peripheral countries with underdeveloped asset markets, however, the Minsky framework remains relevant and was extended in this regard (the 'Minsky-Kregel' framework in Juuse and Kattel 2015, 10). The purpose of this model is to grasp financial inflows, cross-border loans

and currency speculation, all of which are significant in peripheral countries. These financial flows are argued to exhibit the same patterns as Ponzi financing and are driven by the psychological forces of overconfidence, which at a certain point are 'followed by a crash' (Palley 2007, 16). The liberalisation of international capital markets and the ensuing unequal as well as unstable current account flows play a great role in Post-Keynesian contributions (Hein and Dodig 2015; Herr 2011; Horn et al. 2009). While one may remain sceptical as to whether this is a clear sign of financialisation given the broadness of such an account, increased and volatile capital inflows are clearly one aspect that needs to be considered in the light of international financialisation.

The research contributions of Post-Keynesian theory are largely quantitative and display less conceptualisation than Regulation theory. The key insights lie in their analysis of the firm embodied in the notion that rentiers and entrepreneurs now have aligned shareholder value maximisation interests, leading to a transformation of patient to impatient finance. Instead of maximisation of growth or of market share, time horizons are increasingly shortened by investors and managers. Overall, financialisation is argued to be co-constitutive for the switch from a wage-led to a profit-led regime and then to a debt-driven regime of accumulation, an aspect which yet again indicates a combination of two theoretical approaches. While the first insight is an important cause of financialisation, the second aspect would allow for deeper analysis and also differentiation. However, it does not allow us to differentiate between degrees of financialisation but rather argues that the level of exports and imports decides the respective regime. In this respect, financialisation is maintained to be rather the cause of the bifurcation of growth regimes, which is of little help for our research question. Despite these two important contributions, most Post-Keynesian contributions to financialisation tend to focus on the effects of financialisation rather than on the political and economic causes of it – even though they emphasise that neoliberal policy brought about the changes. This leaves us with the view that domestic policies, institutions and international organisations, whether intentionally or unintentionally, do not play much of a role, as neoliberal ideology is the main driver of change. A body of research that addresses this gap is elaborated upon in the next section.

2.2.4 Institutionalist approaches

The institutional take on financialisation strives to fill the gap that was identified in Post-Keynesian analysis: the social, economic and institutional factors that caused financialisation to emerge in the first place. The Institutionalist tradition as such may be traced back to the German Historical School (Clift 2014, 79; Hodgson 2000; Hodgson 2001) and some older American Institutionalist scholars

(Backhouse 2002, 195ff). While one branch has evolved into New Institutionalist Economics (e.g. Coase 1960; North 1992), an institutional-inspired comparative capitalisms framework gained traction in the last decade of the 20th century in the field of IPE, with the 'varieties of capitalism' (VoC) model being the most prominent. In their seminal book, Hall and Soskice (2001) identify a multitude of institutional co-ordinating mechanisms, such as education and training systems, legal frameworks and industrial relations systems, and describe the institutional complementarities that develop from them. They borrow from the New Institutionalist theory in that they stress the importance of increasing returns, feedback effects and path dependencies (Clift 2014, 107). Applying their framework to a range of OECD countries, they singled out two central ideal-typical institutional forms: co-ordinated market economies (CMEs, such as Germany or Japan) and liberal market economies (LMEs, such as the UK and US). Later on, scholars applied the framework to other geographies with findings ranging from dependent market economies (Nölke and Vliegenthart 2009) to BICS varieties of capitalism (Nölke 2014) to mixed market political economies (Hall and Gingerich 2009; Hancké, Rhodes, and Thatcher 2007). Central to our topic at hand within this framework is first the distinction of financial systems as one institutional mechanism, which are either bank- or (capital) market-based, drawing on Gerschenkron (1962). Second, the notion of institutional change is central, which may lead to or co-constitute financialisation (Deeg 2010).

The distinction between bank-based and market-based financial systems (Allen and Gale 2000; Schmidt, Hackethal, and Tyrell 2001) informs a framework for analysing financial systems through different dimensions.[15] Bank-based systems are often characterised by 'patient capital' and relational banking (often related to CMEs) (Deeg, Hardie, and Maxfield 2016), whereas capital market financing and arm's length relations prevail in market-based systems (related to LMEs). However, Deeg (2010, 313) maintains that there is no simple one-to-one correspondence between financial systems and varieties of capitalism. Before the dichotomy was established, a third type of financial system, state-dominated, also surfaced in the literature but was later dropped due to convergence (Deeg 2010, 312).

While financial economists have amply analysed cross-national changes with regard to the respective ideal-type financial system (Hackethal 2001; Levine 2002; Zingales and Rajan 2003), political

[15] (1) The structure of financial markets and their regulation, (2) financing patterns, (3) corporate governance and (4) corporate strategy (Schmidt 1999, 10).

economists strive to identify the underlying causes for such changes since institutions always present a battleground for political struggle. In this vein, the institutional approach differs from some of the others in that it lends more importance to the role of concrete actors and decisions in shaping these political outcomes, which may give rise to institutional change. What are the structural explanations for change in financial systems? Some scholars have argued that national diversities will be eroded by the forces of market globalisation and converge towards a single global financial style (Dore 2008; Tabb 2012). With regard to the dichotomy, they expect financial systems – even in CME countries – to converge to a more market-based financial system or develop a new globalised hybrid financial system. The resulting unleashed mobile capital would demand financial innovation and liberalised capital flows, which would then lead to an increasingly aligned corporate governance (capital mobility thesis) (Deeg 2010, 321; Watson 2007). In this setting, institutional investors and other global financial actors would serve as the agents of change, driving other market actors to adhere to e.g. shareholder value maximisation principles. To a certain degree, Hardie et al. (2013) have shown that in the run-up to the GFC, banks' credit provisioning – including in CMEs – was influenced by movements on financial markets, which is why they conclude that such market-based banking hints at the convergence of national financial systems.[16]

However, scholars who espouse the VoC concept or the economic geography view argue that the convergence hypothesis fails to take into account differentiation, path dependencies and trajectories of different countries, regions and other spaces (Clark 2005; Lee et al. 2009; Peck and Theodore 2007, 758). While there have undoubtedly been some common trends, exemplified by financial market structures (e.g. Capital Markets Union of the EU), corporate governance and accounting (IFRS 9, Basel I-III), institutional scholars argue that national responses to and thus the degree of for example financialisation varies (Engelen and Konings 2010; Engelen, Konings, and Fernandez 2008; Wood and Wright 2010). Even from a more narrow interpretation of the VoC concept, one could argue that economic actors in CMEs would resist extensive financialisation since it is not in their interest to vote for impatient capital, as it potentially endangers investments in specific, longer term assets (Deeg 2014, 48). A recent empirical examination supports this finding, as financial firms' leverage ratios as a simple proxy for financialisation do not seem to converge over time

[16] Other structural change explanations include (1) the State-Power thesis, which postulates coercion by international organisations through persuasion and first mover advantage, (2) the technological change argument connected to performativity of financial product innovation and (3) the stages of development view seeing a general transformative trend towards market-based in the evolution of capitalism (Deeg 2010, 322).

when taking the US/UK as benchmarks – except for the largest and most international banks (Maxfield, Winecoff, and Young 2017). Similarly, Jackson and Deeg (2012, 1115) find different trajectories of change in financial systems for several countries when looking at long-term institutional change. With regard to the research question, the resistance of national firms and actors to transformations that do not serve their interests could provide an explanation for the different degrees and trajectories of financialisation. Given these divergent views, Deeg (2010, 327) even suggests abandoning the ideal types and looking at different major dimensions of analysis and related patterns instead. This is exemplified by the study of Mertens (2015), who scrutinises the indebtedness of households in Germany from a dynamic perspective.

Institutional change in the financial systems of different countries, whether connected to financialisation or not, is necessarily of great importance to the subject matter at hand. If a more structured view is taken, financialisation can also be understood as institutional change occurring in different dimensions. Institutional scholars typically discern three to four dimensions in which such change may take place: micro, meso, macro and international relations (Deeg and Jackson 2007; Jackson and Deeg 2012, 1110). The macro level concerns national politics, while the meso level looks at state policies and their effect in particular institutional domains. On the micro level it is studied how firms and other economic actors cope, interact and reproduce, and the international relations domain scrutinises foreign dependence and external effects. For example, Lagna (2015) fruitfully combines both the macro and meso aspects by analysing a political alliance in Italy that devised derivative-based and other financial innovation strategies by the state to comply with criteria set by the European Monetary Union.

Combining both the basic VoC distinction and the financial system dichotomy, it is now possible to look at how institutional change, here financialisation, impacts inter-temporally upon either different countries or specific units of analysis in different loci (Nölke and May 2013). Deeg (2012) compares a CME (Germany) and an LME (UK) by testing for hypotheses of financialisation and differentiating between two angles: 'profit financialisation', referring to the relative growth of profits from financial transactions (Deeg 2012, 124), and 'control financialisation', which is understood as the growing influence of financial actors over management decisions (Deeg 2012, 133). Deploying an actor-centred view, he finds that firms in the UK display both patterns of financialisation, while in Germany firms hardly exhibit any profit financialisation and only little control financiali-

sation, owing largely to the deliberate, more innovative financing of SMEs (Deeg 2012, 144). Moving towards such institutional change on a grander scale, Engelen and Konings (2010, 609) analyse stock marketisation, the evolution of pension funds, financial openness, securitisation and bank fee income in relation to overall income. Whereas before the focus was on firms, in this study the authors single out three trajectories of financialisation of financial systems within the VoC of OECD countries: 'consensual financialisation' (LME – US and UK), 'contested financialisation' (CME – Germany) and 'compartmentalised financialisation' (Hybrid – Netherlands) (Engelen and Konings 2010, 617).

As an example of a specific (institutional) unit of analysis, Fernandez and Aalbers (2016) evaluate how financialisation interacts with national systems of housing. In contrast to other contributions, they view housing not as a bearer or vehicle of financialisation but as systematically linked to it. This is due to its nature of being a store of value, collateral for debt and an investment outlet. They ask if the dynamic transformation to higher levels of debt leads to housing-centred processes of financialisation and come up with four groups with different trajectories within their large sample of OECD countries. Likewise, they contend that financialisation, and in their case housing, poses a challenge to the VoC framework. Deploying this concept, O'Callaghan and McGuirk (2020) argue that the financialisation of housing in Ireland and Australia forms part of a wider neoliberal restructuring, especially after the GFC trajectories diverged.

This approach was refined by Van Gunten and Navot (2018), who point to the differences between more households borrowing (as a means to reach homeownership – 'inclusion' or through participation in the mortgage market – 'extension') and households borrowing more (through larger average loans – 'intensification'). They claim that it is the latter that explains the variation in European household debt, whereas other scholars working on housing financialisation focus exclusively on inclusion (Van Gunten and Navot 2018, 92). The empirical findings across countries are then linked to the varied adoption of certain regulations and institutional changes but also to other diverse domestic institutional peculiarities (Van Gunten and Navot 2018, 104). By doing so, they shed renewed light on the importance of inter-temporal analysis to depict institutional variation. For financialisation studies as such, the distinction made here between inclusion, extension and intensification is a pivotal one, reminiscent of the debate among Marxists mentioned earlier. Financial expansion and financialisation often go hand in hand, but do not necessarily signify the same structural change. On this point, Kohl (2020) describes how the expansion of mortgage debt

has not necessarily led to an increased supply of housing. Reviewing a sample of 17 countries across more than 100 years, he shows that initially, increasing housing finance was on a par with rising house prices and construction activity. The trajectories diverged, however, when mortgage financing and prices spiralled downwards while the supply of housing stagnated or even decreased, as similar studies on the topic have found (Aalbers 2016; Fuller 2019). Though these studies on housing do not necessarily aid much in answering the research question, they illustrate how the institutional approach may be comparatively employed. On the other hand, they show how institutional scholars struggle to arrive at a clear definition of financialisation, especially when it comes to such comparisons.

In sum, institutional approaches offer two ways of analysing financialisation. First, departing from the canonical dichotomy of financial systems, financialisation can signify institutional change leading either to convergence to a market-based financial system and a liberal market economy or to new hybrid forms of financial systems. Second, financialisation may reflect changes in the institutional set-up of a given country. In this context, path dependency plays a crucial role (Pierson 2000). However, both approaches necessitate a certain degree of prior analysis of the institutional system. For the under-studied region of SEE, this prerequisite can pose quite a challenge, as scholars (Bohle and Greskovits 2012) have so far been unable to identify a variety of capitalism. It is also problematic that the institutional approaches to financialisation do not offer any assumptions regarding the question of which institutions change under financialisation, or how they change, except for financial systems. Another criticism of institutional approaches is their often actor-centred view, which necessarily leaves out other actors or units of analysis (such as households) and which might fail to highlight inter-dependencies between institutional units. Nevertheless, this view is able to identify the political origins of occurrences connected to financialisation, which other studies in the literature often miss (Nölke, Heires, and Bieling 2013, 210). For example, Nölke (2017, 37–39) describes how specific political decisions in European countries and at EU level have caused varying degrees of financialisation, but have also hindered the construction of a 'Social Europe'. Institutional approaches therefore seem particularly fruitful when it comes to analysing the trajectory of financialisation in a given country. With regard to the research question, the institutional view is not able to inform a comparative analysis to any great extent, because it lacks precise conceptualisations or indicators of financialisation (except a shift to a market-based financial system). Nonetheless, the notions of institutional change, trajectory and path dependency aid in understanding specific cases of financialisation.

2.2.5 Interim summary

The aim of this section is to outline the theoretical underpinnings of different understandings of financialisation, i.e. the background of the blind men's approaches. Post-Keynesians assign a role to public policy in driving financialisation through financial deregulation, privatisation, liberalisation and specific central bank strategies. The rise of the rentier within the trend towards greater short-termism and shareholder value maximisation on the part of firms (through performance-based salary payments) leads both to financialisation and to greater inequality. (Crotty 2002; Palley 2007; Stockhammer 2004). Lately, scholars have also focused on the distinct growth regimes that emerge out of the tendencies described (Stockhammer 2012) – besides the financial instability that they breed (Kregel 2007). It was noted that the shift from a wage-led to a profit-led regime is decisive in causing financialisation. In comparison to all other approaches, Post-Keynesians place the greatest emphasis on finance itself. One might argue that scholars within this theoretical body take a comparatively short-term view and use financialisation as both explanans and explanandum. Yet it is the only theoretical strand that regards the international aspect – in the form of international capital flows – as a serious constituent factor of financialisation.

Marxist accounts provide a more coherent picture, despite two seemingly opposing concepts (Fine 2012; Lapavitsas 2011). Here, financialisation is viewed as a structural transformation as a consequence of capital searching for further profits ('surplus-absorption') or of the tendency of the rate of profit to fall, be it either through financial expropriation or through the proliferation of interest-bearing capital. The concept of financial expropriation places more emphasis on the changing behaviour of banks, firms and households, while the proliferation of interest-bearing capital highlights the internal and external spread of financial activities. Marxist scholars point out that the working class is increasingly drawn into the financial realm, be it through consumer loans offered by banks or due to the change in the provision of social security (e.g. from public to private pensions). On the one hand, this generates more loanable funds, which are available to be channelled into financial activities, while on the other, depressed wages lead to increased financial engagement and proliferation of financial products. The conceptualisation by Lapavitsas (2013) proves to be more relevant since it sketches out the processes of financialisation of the different economic units in a more coherent manner. Compared to the other theoretical approaches, the role of public policy and institutions in shaping financialisation is of much lesser importance to the analysis, as it is capital itself that searches out new avenues of self-preservation and proliferation. Whereas the

original Marxist take on financialisation (Magdoff and Sweezy 1987) derived from an analysis of core countries, newer Marxist approaches started to focus on peripheral countries. Thus, further evaluation is needed in order to determine whether the need for profit, which is said to drive financialisation in the core countries, can also be regarded as the sole factor explaining financialisation in peripheral countries.

Neither theoretical apprehension is far from the Regulationist accounts that typologised the changes into a new finance-led accumulation regime with an altered mode of regulation, which is rooted in the breakdown of the Fordist regime of accumulation (Boyer 2000a; Krippner 2005). The shift was caused by new capital-labour relations, declining real wages and shareholder value maximisation leading to novel corporate governance forms. This trend is further engendered by privatisations, flexibilisation of the labour market and state policies such as the central bank's focus on price stability. The typology between different regimes of accumulation was extended by Becker et al. (2010) for peripheral countries, including a class typology (elite vs mass financialisation). However, the concept was shown to be incoherently connected to Regulation theory itself and did not allow for a distinction between a financialised and a non-financialised regime. Within this realm, peripheral economies are typically seen as featuring different levels of external dependency within a wider core-periphery context. The long-term view of the Regulation School makes it well-suited to study the shift from the real economy to the financial sphere (Krippner 2012), but this temporal scope hinders the Regulationists' ability to account for sudden ruptures and conflicts.

Institutionalist approaches depart from the question of how to elucidate institutional change (Deeg 2010), which derived from the inability of the rather static VoC approach to explain recent developments. This institutional change of financialisation is argued to be occurring on several dimensions (Jackson and Deeg 2012). Financialisation may take the form of political changes (Heires and Nölke 2014b) to existing sets of institutions, which may cause countries that alter the pre-existing formations to follow common or divergent trajectories. This was demonstrated by the alterations made to different financial systems in recent decades, shifting them towards a more liberalised, market-based or hybrid structure (Engelen and Konings 2010). A wave of mobile capital has been unleashed that needs to be satisfied by financial innovation, which brings with it a focus on short-term goals. Political change was shown to derive from alliances of joint interests or from compliance with national or international constraints set by frameworks, laws or agreements, such

as the European Monetary Union. Compared to the other approaches, financialisation as institutional change is less theoretically grounded, as institutionalism does not proffer a grand 'worldview'. With its rich set of conceptual tools, the Institutionalist literature lends itself most openly to the study of change within national systems, allowing for variegation of financialisation when studied as a dependent variable. So far, peripheral economies have not been aptly dealt with by institutional scholars, but there is no good reason for this except for the assumed absence of institutional coherence in these nation states. The institutional notion of path dependency for individual countries is central to understanding different trajectories of financialisation.

Summarising the distinct theoretical views against the research question, one could argue that the approaches of relevance to this thesis are the ones that understand financialisation as a change in behaviour or in the role of different socio-economic units in line with the macro focus. At the forefront of interest are banks and the financial sector (internal or sectoral), which increasingly generate relatively more profit through financial innovation and fee income, employ more people and pay higher salaries as a consequence of declining real wages, capital searching for new profit channels, deregulation and financial liberalisation, among other factors. On the other (external or extra-sectoral) side we have firms that now tend to access funding on financial and capital markets and derive an increasing part of their income through financial investments, driven by shareholder value maximisation, short-termism and performance-based payments. Households are increasingly engaged in financial markets as a result of the privatisation of social welfare, the liberalisation of working conditions, and depressed wages. All units are directly or indirectly affected by the international sphere, but upon consideration this aspect was shown to lack theoretical substance. Most theoretical accounts to date were developed from observations in Anglo-Saxon and Western countries. The next section considers the literature on financialisation of peripheral economies and comparative financialisation studies with a view to coming closer to conceptualisation and measurement.

2.3 Financialisation approaches in peripheral countries and comparative perspective

As we have seen, several theoretical schools of thought have tried to view financialisation as a structural transformation emanating from various developments that entail changes in the role and behaviour of different socio-economic units. All of these diverse approaches depart from their spe-

cific ontological base, define financialisation and the emergence or the result of it slightly differently, and have offered merits and pitfalls. They also delivered their particular notions of financialisation, which, despite the theoretical differences, are not as heterogeneous as one might assume. Against this theoretical backdrop, several questions were left unanswered, namely how to apply the concepts comparatively, the international aspects of financialisation, and elaborations on financialisation in the periphery. To answer the question of whether there are differences in financialisation in SEE, how large these are and how they came, these gaps must be addressed. As pinpointed in this section, comparative financialisation approaches exist and build on specific theoretical claims, and some of them merge several of these bodies of thought (section 2.3.1). However, it was revealed that such frameworks do not account for the level of international financialisation, i.e. how domestic processes of financialisation are intertwined with the global economy. For this very reason, it is pivotal to review studies of international financialisation and country studies of financialisation in peripheral countries (section 2.3.2). The final section returns to the criticism of financialisation and singles out the preconditions for conceptualising the phenomenon in view of the following chapter, which deals with the research design.

2.3.1 Financialisation in comparative perspective

The previous sections have shown how different theoretical approaches conceive of financialisation and how national forces such as policies, capital-labour relations and institutions shape and co-constitute specific domestic trajectories of financialisation. This section considers the existing comparative frameworks in view of the research question. More specifically, are they able to assess whether a country is more or less financialised, and if so, how? How do they evaluate these different degrees of financialisation? The contributions presented henceforth present different answers to these questions and consider unresolved issues arising from them.

In one of the earliest comparative financialisation contributions, Stockhammer (2004) looks at four countries, the US, UK, France and Germany, to test the Post-Keynesian-inspired hypothesis that financialisation has a negative effect on NFCs' investments and thus on their accumulation. Due to the microeconomic assumptions concerning a macroeconomic phenomenon, he relies on (corporate) firms' interest and dividend income in relation to business investment as a proxy for financialisation. Strong support for this hypothesis is found for the cases of the US and France, some

support for the UK, but none for Germany (Stockhammer 2004, 739).[17] In a similar line of reasoning, Demir (2007, 356–57) looks at the investment decisions of a micro-level company data set from Argentina, Mexico and Turkey. His results show that increased volatility and risk in these countries induced firms to allocate more of their portfolio to financial (short-term) assets; they were also motivated by the higher rates of return on those assets. Stronger correlations for this were found in the data for Argentina and Mexico, while in Turkey capital inflows and financial profits were more often used for productive fixed investments. Hence, these contributions provide a framework for comparing the financialisation of NFCs.

Based on Fine's conceptualisation of financialisation,[18] Brown, Passarella, and Spencer (2017) deploy descriptive statistics to analyse whether a range of EU countries have been financialising and if this process was varied or rather uniform. Regarding the financial sectors of the economies, the researchers analyse their development in terms of employment share, value added to GDP (similar to Krippner (2005)) and financial assets to GDP. Surprisingly, employment in the financial sector relative to total employment has been rather stagnant and low over the years, with the exception of pronounced increases in CEE countries and (as expected) the US and the UK. Both value added to GDP and financial assets surged in almost all countries. Again, contrary to what one would expect, bank profitability remained stagnant over the years, while household debt increased in all countries except in the core EU economies. The strength of the contribution clearly lies in its analysis of the financial sectors and of their position relative to productive industry. However, the size of the sample did not allow for further and deeper discussion of the outlying cases. Instead, the authors propose the notion of 'variegated financialisation' (Brown, Passarella, and Spencer 2017, 67), which in their view captures the systematic, cross-border nature of the concept, as well as the differences in mediation in domestic political and institutional contexts. Nevertheless, the contribution fails to further analyse other levels of financialisation apart from the financial sector.

Building on their Regulationist framework, Becker et al. (2010) scrutinise the developments of four quite diverse peripheral economies – Chile, Serbia, Brazil and Slovakia – with a special emphasis

[17] It should be noted that the outcome of the statistical exercise can be criticised due to the large number of holding companies in advanced countries that manage subsidiaries elsewhere. This globalisation trend leads to higher dividends, as noted by (Rabinovich 2019).

[18] Fine (2012) identified eight features of financialisation: (1) relative expansion of financial assets and activities, (2) proliferation of financial assets and derivatives, (3) increase of financial at the expense of real investment, (4) increasing dominance of finance over industry, (5) increasing weight of credit- and asset-based consumption, (6) penetration of finance into other areas of social life, (7) spread of financial norms, and (8) re-configuration of the role of states towards fostering financialisation.

on the social, political and institutional arrangements. The cases of Chile and Brazil prove to be quite interesting in this regard, since the more liberal Chile experienced two phases of financialisation and de-financialisation, with a number of richer families owning a large number of companies in both the productive and the financial spheres. In Brazil, however, the state proved to be a promoter of broader elite-based financialisation. Serbia experienced its phase of financialisation in the 2000s after the end of socialism and the ensuing crony capitalism on the back of liberalisation and privatisation. The case of Slovakia is different in that it has seen mass-based financialisation due to flat income taxes, wage moderation and a minimal welfare state, while at the same time experiencing quite dominant and often foreign-owned productive accumulation. Relying on a lighter-handed version of the concept with more focus on the development of manufacturing, Becker, Ćetković, and Weissenbacher (2016b) compare the Visegrad countries with Baltic and South-Eastern European countries. The former are shown to exhibit export industrialisation with financialisation, while the latter two regions experienced dependent financial-dominated growth models. This claim is substantiated in Becker and Ćetković (2015), who provide a closer look at the banking sectors of Visegrad and South-Eastern European countries. In this regard, the share of household debt, a form of interest-bearing capital, increased sharply in all countries and was heavily sustained by capital inflows in SEE. However, all countries were essentially found to be financialised and featuring a high degree of extraversion. As such, despite the typological outline, the approach is of limited use for distinguishing for measuring the degrees of financialisation on different levels.

Grounded in a Post-Keynesian take on financialisation, the work of Hein and Dodig (2015) outlines three types of regimes under financialisation while analysing a set of 15 countries over roughly 15 years: (1) a debt-led private demand boom regime, (2) an export-led mercantilist regime, and (3) a domestic demand-led regime. The specifics of the different growth regimes are expressed in either positive, negative or undefined balances of sectors (external, state, companies, households) respective to their growth contributions. Within the domestic demand-led regime, they further distinguish between a 'mature' domestic demand-led regime, which is characterised by moderate overall growth, and a 'catching-up' demand-led regime, which displays high growth rates (Hein, Detzer, and Dodig 2015, 5). The study highlights how the relationship between the financial and other economic sectors has changed over time in favour of the former and then looks at how this trend affected macroeconomic sectors. The outcome of this analysis leads them to speak of distinct

growth regimes under financialisation. However, the authors only look superficially at macroeconomic fundamentals, which are partly related to financialisation, as established above. Nonetheless, the findings suggest that the trend was most pronounced in the set of countries featuring a debt-led regime and somehow piecemeal in those operating under a demand-led regime – thereby pointing to different degrees of financialisation. As such, the framework does not allow for further differentiation between distinct levels, as it deploys financialisation rather as an explanandum for different growth regimes.

In a similar vein, Stockhammer and Kohler (2020) analyse how different degrees of household financialisation before the GFC gave rise to distinct regimes of demand across countries in Europe, thereby providing a more clear-cut distinction between the independent and dependent variables. In line with Post-Keynesian deliberations, they distinguish between a wage-led and a profit-led demand regime as well as between debt-driven and export-driven growth regimes. The authors argue that the differing degrees of household financialisation, as measured by the change of household debt and of real house prices, were partly driven by external credit inflows. Hence, Southern European and Anglo-Saxon countries featured a high degree of household financialisation and house price booms, while inequality and a continuously negative current account were more pronounced in the Anglo-Saxon countries. In contrast, Nordic countries tend to be characterised by export-led growth regimes with moderate financialisation. Though the publication contributes to our understanding of different regimes of growth and demand as driven by household financialisation, it is less useful for grasping or explaining the differences in financialisation as such.

Figure 1: Financialisation: a conceptual framework

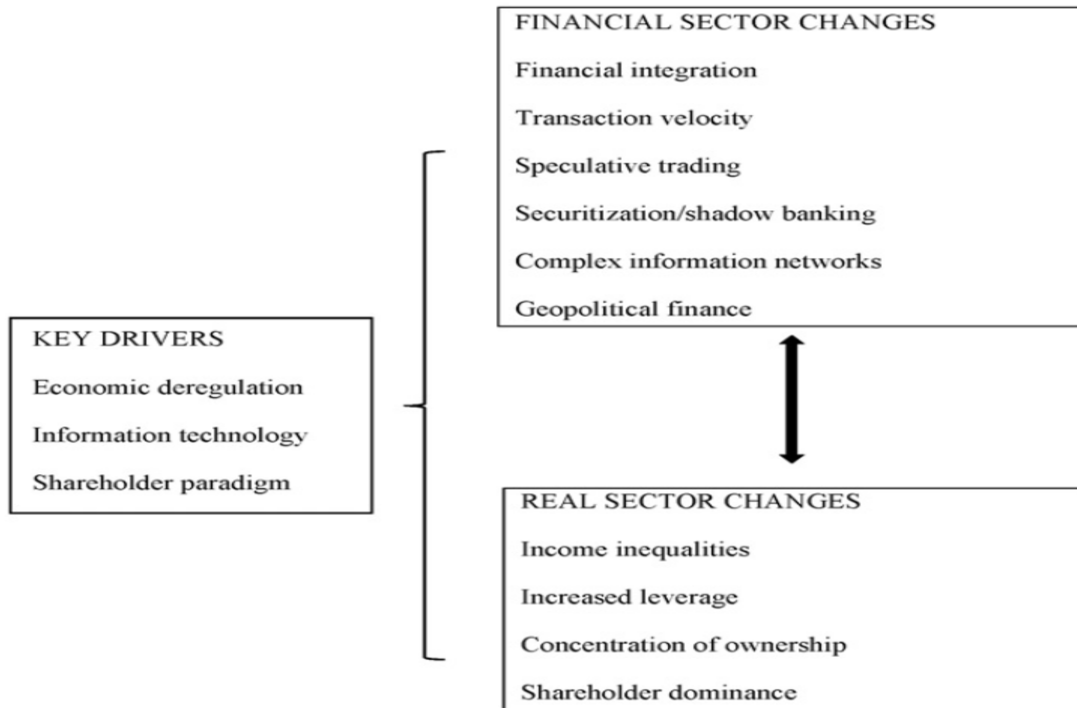

Fig. 1. Financialization: a conceptual framework.

Source: Lagoarde-Segot (2017, 114)

In an attempt to provide a new research metaphor in response to calls for changing the definition of finance (Lagoarde-Segot 2015), Lagoarde-Segot (2017) puts forth a simple and eclectic framework for financialisation (see Figure 1). To each of the changes in the financial sector, he assigns exemplary indicators (liberalisation index, financial product statistics and wealth inequality) as stylised facts, finding reinforcing and corresponding financial and real sector changes across a wide range of OECD countries. Possibly due to the fact that the author is posited on the fringe of the mainstream, no connections to the theories presented above are visible and the very process of financialisation is highly under-conceptualised. However, this contribution points not only to the increasing relevance of the topic but also to the possible fruitfulness of an eclectic comparative approach. It is also one of the few approaches that attempts to sketch out drivers or hypotheses and the processes of financialisation in the real and financial spheres.

Another empirical study deals with the financialisation convergence hypothesis, which postulates the gradual convergence of finance capitalism (Maxfield, Winecoff, and Young 2017) in the form of institutional change towards market-based banking (Dore 2008; Hardie et al. 2013; Hardie and

Howarth 2013; Tabb 2012, 13). Market-based banking is understood here to entail loan-making for the purpose of securitisation and incentivising share buybacks, hedging and option trading of NFCs (Maxfield, Winecoff, and Young 2017, 4). Starting from the puzzle of overall convergence versus variants of financialisation, the leverage ratio (equity divided by total assets) is deployed as an indicator for the shift to market-based banking. The authors run several tests to assess e.g. the distributional similarity of the US or the UK financial system to a large number of OECD countries, the share of prudent firms in national aggregates of firm-level data, and the distributional similarity of the largest banks in each country. They find that especially large transnational firms tend to converge, while on the domestic level diversity persists despite the fact that common trends are observable (Maxfield, Winecoff, and Young 2017, 19). While one might disagree about the use of leverage as an indicator (both for market-based banking and for financialisation), which is also subject to different national regulations and thus domestic specificities, the study is a promising example of how to compare processes of financialisation.

Enlarging the geographical scope of comparative financialisation studies, Schwan (2017) advances an insightful study on the financialisation of regions in the EU. Financialisation is measured by the share of finance and insurance activities relative to the regional gross domestic product. Surprisingly, different forms of debt are hypothesised to cause the financialisation of the region, including the debt of the public sector, companies and households, which in most other publications figure as indicators of financialisation. Additionally, banking leverage, foreign direct investment, stock market capitalisation, the existence of a financial centre and whether the region is part of a lead currency regime are deployed as hypotheses to test for the dependent variable of financialisation (Schwan 2017, 670–72). Despite the great appeal of the author's design, which exposes the variation of the dependent variable of financialisation and then asks for the reasons of variation by means of regression, it remains unclear why certain indicators that are viewed by the majority as part of the dependent variable of financialisation are deployed as independent variables in the study.

Alongside research that describes the financialisation of households, NFCs and the financial sector, more recent studies have exposed how states and public institutions have become financialised (Fastenrath, Schwan, and Trampusch 2017; Lagna 2015; Schwan 2017; Schwan, Trampusch, and Fastenrath 2020). The management of public debt in particular has undergone a profound structural transformation in recent decades. The narrative of financial markets and the logics of financial markets have by now become governing mechanisms for the management of public assets and

liabilities. Within this strand of the literature, Fastenrath, Schwan, and Trampusch (2017) sketch out the financialisation of sovereign debt management (logics) across 23 OECD countries over 30 years with descriptive statistics, assigning three financialisation indicators respectively to financial markets, governance mechanisms and financial economics as a 'sense-making' framework (Fastenrath, Schwan, and Trampusch 2017, 276). Though their findings suggest both striking commonalities and cross-national variegations, they claim that these are two sides of the same coin and leave the detailed analysis of explanatory factors to future research.

Similarly, Mikuš (2019c, 2019d) provides a conceptualisation, operationalisation and analysis of state financialisation in Eastern Europe. His conceptualisation differs from the previous contribution in that he includes indicators for patterns of financialisation in the following areas: monetary policy (capital account movements, carry-trade activities, the central bank's domestic debt and equity position and capital account liberalisation); public service provision (foremost: pension fund arrangements); law-making and regulation; and investment policies, alongside the patterns of state financialisation related to sovereign debt management (Mikuš 2019d, 22). The outlined indicators are then analysed via descriptive statistics in Mikuš (2019c) and the outcome suggests a common process of peripherality but with a variegated outlook. In contrast to some earlier works on comparative financialisation, Mikuš (2019d) provides a coherent concept of financialisation but includes indicators that are widely viewed to be drivers of financialisation rather than part of the pattern, such as capital account liberalisation or the privatisation of pension funds. Taking up the thread of a relationship between the independent and dependent variables, Schwan, Trampusch, and Fastenrath (2020) first revisit the indicators of the dependent variable of state financialisation, distil four central indicators and then set out to elaborate on the drivers for it (independent variables). The authors then advance their hypotheses regarding the level of public debt, financial market liberalisation, the level of foreign capital and the level of supranational economic integration as factors causing state financialisation. While this provides a worthwhile analysis of the variations of state financialisation and its causes, the data and the statistical framework do not allow for temporal variation. Nevertheless, the recent literature on the financialisation of the state has produced a variety of promising comparative frameworks.

Starting from their Marxian account of financialisation, Lapavitsas and Powell (2013) analyse five advanced economies while contending that financialisation is, by nature, 'varied'. In their view,

financialisation refers to the changed behaviour of corporations, the financial sector and households, which they break down into specific indicators measured over time. The altered behaviour of firms financing their investments with retained earnings, engaging in foreign borrowing and financial activities, is measured by the share of loans to total liabilities and of financial assets to total assets of NFCs. While the second indicator has its drawbacks as argued by Krippner (2005), the first indicator is highly questionable as companies in a capitalist system typically finance themselves with bank loans. Any change in this respect by no means signifies financialisation but rather reflects the business cycle. Banks are understood to engage more in open markets and in household lending, measured by both banks' non-FIRE loans and household loans to total loans. Households increasingly rely on financial institutions in the face of stagnant wages and retreating public provision, which they measure by the share of households' financial liabilities to gross disposable income. In doing so, they are able to show differences across countries over time. The UK and US exhibit the most pronounced developments, Germany and Japan less so, and France falls in between the two extremes (Lapavitsas and Powell 2013, 375). The framework thus allows for a comparative, time-sensitive and sectoral analysis, but leaves out the international facet of financialisation and makes use of some doubtful indicators.

Among the comparative financialisation studies, both Karwowski and Stockhammer (2017) and Karwowski, Shabani, and Stockhammer (2020) present a coherent framework and analyse the evolution of private sector financialisation across countries as foreshadowed in chapter 1. Karwowski, Shabani, and Stockhammer (2020) perform a cross-country analysis based on indicators as in Lapavitsas and Powell (2013) for financialisation regarding the different sectors (financial sector, NFCs, households). After ranking the countries under analysis according to the highest average values from 1997 to 2007 in each level and indicator of financialisation, they conduct a Spearman's rank correlation test in order to test their hypothesis of a 'strong financialisation view', i.e. financialisation occurring in all sectors simultaneously.[19] Contrary to the early claims in the literature, the results of their findings do not concur with the 'strong' financialisation view, meaning simultaneous financialisation on all three levels. Only household financialisation turns out to be a process

[19] This can be viewed as critical since we have seen that financialisation can but does not necessarily need to occur on all levels at the same time. While testing indicators against each other might make sense from the point of view of correlation, it serves other scholarly interest. To be able to conduct the Spearman correlation, the authors determine the relative rank of each country over the different indicators by taking the 10 years before the crisis of 2007 as a time span. Unfortunately, the time period is neither discussed nor problematised. As they do so with the help of a simple average, they are also not able to grasp the dynamics behind the indicators, which is important if we understand financialisation as a temporal process and not a static picture.

connected to other forms of financialisation. In a third step, Karwowski, Shabani, and Stockhammer (2020) test for other hypotheses related to financialisation, which they distil from the respective literature: a slowdown of rates of profits and investments (Marxist approach), financial deregulation (Post-Keynesian approach), a shift towards market-based banking (Institutionalist/Regulationist approach), a debt-driven demand regime (Post-Keynesian approach), foreign financial inflows and asset price inflation (Post-Keynesian approach). To each of the hypotheses they assign indicators, which are then evaluated by averages over time in the decade before the crisis. Besides this, they find support for the hypotheses of financial deregulation, a debt-driven demand regime and asset price inflation as being correlated with financialisation, and reject the others. However, they concede that the focus on mature economies might influence the results associated with the financial inflow hypothesis.

The strength of the contribution therefore clearly lies in the distinction between a dependent variable (financialisation) and independent variables (hypotheses) and the way in which this eclectic hypothesis-testing statistical evidence is presented. What seems of different research interest is the test for correlation between the levels of financialisation, as it is a statistical exercise over a large sample, which does not aid in illustrating or explaining financialisation in any given country, at least with respect to the research question of this thesis. Apart from this, some of the hypotheses (most prominently growth regimes) are not a cause of financialisation but rather an outcome, while others were argued earlier in this thesis to co-constitute financialisation (i.e. the shift to market-based banking). Besides these caveats, the conceptualisation of the financialisation indicators, their first step, encompasses the varieties of approaches presented in the theoretical review so far and provide a suitable toolkit for assessing financialisation in its multitudinous forms across countries and over time.

The second publication by Karwowski and Stockhammer (2017) deploys a more compressed version of the framework and compares 17 emerging countries with two Anglo-Saxon economies (US and UK). The authors deal critically with the financial deepening hypothesis, which postulates a positive finance-growth nexus that was often used as an argument by international development organisations to foster financial market expansion in developing countries in the 1990s. The authors contend that understanding financialisation as only externally driven is too simplistic. In contrast to the aforementioned study, they undertake an analysis of the time period before and after the

GFC. However, they do not differentiate between the hypotheses of and the phenomenon of financialisation, but rather speak of six 'interpretations' of financialisation,[20] in that way conceptualising and then researching differences in the dependent variable.[21] Due to the comparative nature on a grand scale, and especially due to the inclusion of the city-states Hong Kong and Singapore, the results are far less homogeneous than expected, which is why the authors once again draw attention to the different domestic but also regional specificities. Regarding the interpretations of financialisation, it needs to be critically noted that this term runs the risk of conflating drivers of financialisation (i.e. here: financial deregulation) with the phenomenon of financialisation itself (i.e. rising household indebtedness). Also, the measurement indicators of financialisation require a more critical discussion, as the authors measure for example NFC financialisation by its debt relative to GDP, which would account for financial deepening rather than a structural transformation of financialisation. Nonetheless, the framework presented in Karwowski and Stockhammer (2017) is able to assess financialisation across time and countries in a manner similar to the first research step in Karwowski, Shabani, and Stockhammer (2020). The fruitfulness of the approach is substantiated by the fact that Holzner (2017) employs the concept to analyse financialisation across different regions in Eastern Europe.

Complementing her earlier contributions, Karwowski (2020) discerns the different geographical scales, on which financialisation takes different dimensions: the urban/city level, the nation state and the international scale. Financialisation is understood through the six dimensions described in Karwowski and Stockhammer (2017) and additionally through accounting for the presence of global companies, financial centres and government financialisation. However, she fails to discuss the dimensions and indicators in more detail. This leaves considerable room for questioning as the dimensions include independent variables identified elsewhere (e.g. financial liberalisation, interest rate policy) as well as a novel indicator for financial sector financialisation (financial market capitalisation to GDP) (Karwowski 2020, 166). Nevertheless, it is the only comparative financialisation study that explicitly addresses the present and pressing lacuna of the international facet of financialisation, which is highly relevant for the context of peripheral economies.

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[20] The interpretations are financial deregulation, foreign financial inflows, asset price volatility, a shift to market-based finance, NFC financialisation and household financialisation (Karwowski and Stockhammer 2017, 69).

[21] East Asia is found to be comparatively starkly financialised, although Eastern European countries have liberalised their financial markets more intensively. Latin America shows consistently low degrees of financialisation in comparison. House price volatility is specifically pronounced in emerging economies, often more so than was the case in the UK and the US.

The early comparative studies of financialisation have focused on specific aspects of financialisation, such as the share of financial income of corporations or housing, or have challenged the ability of the Comparative Capitalism literature to grasp institutional change. Lately, however, the comparative contributions have aspired to take a grander view, synthesising different measurements and researching them on larger samples. A persistent challenge in this regard, though only scantly discussed in these contributions, has been how to clearly distinguish between the causes of financialisation (independent variables) and financialisation itself (dependent variable). Since the aim here is to study financialisation as such in SEE, it is necessary to discern possible causes, mechanisms and effects on the one hand and the process or structural change of financialisation on the other. Also, the formulation of indicators of financialisation has not seen major discussion or criticism, which is necessary if this vein of research is to move ahead. One contribution to the discussion is the paper (related to housing financialisation) by Van Gunten and Navot (2018), who problematise debt expansion. In another contribution, Rabinovich (2019) provides a forceful critique of the existence and measurement of NFC financialisation. There is a general consensus that domestic institutional, historical and political relations are pivotal for understanding financialisation processes, yet none of the contributions has engaged in explaining the differences in the findings (except Mikuš (2020)).

Finally, the issue of international financialisation in emerging economies has so far played only a minor role in comparative financialisation studies (except for Karwowski 2020). Besides international financial inflows and liabilities, there is a multitude of financial interconnections between the local and the global levels, such as foreign currency loans or foreign currency reserves. This aspect marks a crucial gap in the comparative financialisation research to date. In order to inform a comparative financialisation analysis of the region of SEE, the next section reviews financialisation in peripheral countries with special emphasis on aspects of international financialisation.

2.3.2 International financialisation in peripheral countries

For a considerable time now, authors have called for an enlarged geography of financialisation that goes beyond the capitalist core (Bonizzi 2013; Sokol 2013, 2017, 679). There are three arguments supporting this venture. First, to substantiate the basic claim of the financialisation research agenda, additional empirical verification (or falsification!) leads to more academic insight and greater recognition. Second, such research might give answers to the financialisation convergence hypothesis, i.e. whether all countries follow the same or divergent trajectories. Lastly, recent contributions

looking at relationships within an enlarged geography, the Eurozone (e.g. Fuller 2017), have revealed that core-periphery relationships play a crucial role when it comes to (international) financialisation, i.e. enlarging the geographical focus enlarges the spatial optics. In order to fill the gap that was identified in comparative financialisation frameworks, this section first reviews the growing body of literature on financialisation in peripheral countries, and then more specifically looks at accounts of international financialisation, including studies that connect financialisation with a problematisation of core-periphery relations.[22] Doing so enables us to enrich our understanding of financialisation for the purpose of deriving a framework for the research question.

The last decade has seen the publication of numerous in-depth studies on the Global South and peripheries of the Global North, the majority of them conducted for larger emerging economies. Deploying the Marxian-inspired financialisation framework of Lapavitsas (2013), Rodrigues (2014, 259–62) finds that domestic banks increasingly turned towards households and engaged in money-market instruments in the course of the 2000s. Contrary to the hypothesised expectations, firms were found to be mainly financed through 'normal' bank credit, albeit with the option of equity market financing at hand. Mortgage lending has also surged in the last decades, being mainly concentrated in the upper-middle-class segment of the population, which disconfirms the US experience of the 2000s. Drawing on the concepts established above, South Africa exhibited signs of elite-based and domestic financialisation caused by a Washington Consensus-inspired public policy programme in the post-apartheid period (Rodrigues 2014, 82) and by financial inclusion programmes mainly aimed at the middle class (Rodrigues 2014, 262).[23] Besides a fruitful application of a Marxian-inspired financialisation framework on the different units of analysis (banks, NFCs, households), international financialisation neither plays a role nor is heavily researched in this study.

In a similar theoretical vein but with contrary findings, Powell (2013) reveals in his study on Mexico that domestic monetary policy and domestic corporations (through their financing conditions)

[22] Core-periphery thinking in general derives from the view that geographical regions are divided into centres or empires and peripheries. An empire or imperialist unit describes any relation in which one state or society is more powerful than another one (Howe 2002, 13), thereby exerting a certain form of influence over their economic and social relationships that leads to dominance. Countries that suffer from ineffective and inefficient control over resources, a comparative lack of local innovation, and migration outflows can be described as peripheral (Gambarotto and Solari 2015, 795).

[23] For financialisation in South Africa, see Ashman, Fine, and Newman (2011) and Ashman and Fine (2013).

became subjugated to international capital markets, creating risk, indebtedness and profit extraction. According to Powell (2013, 192) the reason lies in the fact that large Mexican NFCs have increasingly engaged in issuing bonds and investing in financial assets, among which derivatives played a growing role. The hierarchical financialisation is rooted in the fact that the state failed to construct a proper banking sector, which would efficiently serve companies that in turn subjugated them to international financial markets (Powell 2013, 299).[24] The same processes were found for Turkey, which registered strong increases in consumer debt and foreign-financed corporate borrowings due to domestic bank concentration after the 2001 crisis. High interest rates and aggressive targeting of salary-earners by banks through agreements with the employing firm contributed to this development (Karacimen 2014, 175). Other explanatory factors range from stagnating real wages despite rising productivity, to deregulation of the labour market and a greater role for markets in public welfare provision.[25] Foreign borrowing by firms thus magnifies international financialisation and can also be considered a specific trait of NFC financialisation with repercussions on the banking sector.[26] Both contributions show how a financialisation concept may be applied to non-Western economies, but they only accord limited space to an analysis of external financial interconnections.

Using a Post-Keynesian view of financialisation (Kaltenbrunner 2011), Kaltenbrunner and Painceira (2015) document the volatility of the Brazilian currency in the GFC due to the foreign exposure in short-term domestic currency. In her earlier study, Kaltenbrunner (2010, 296) describes the need of international investors for liquid assets to generate income and diversify risk, which were accessible in the form of Brazilian blue chip shares.[27] Eased restrictions, the removal of limits on currency exchange by the Lula government of the 2000s and an already financialised domestic financial market created the necessary openness and liquidity for the global financial market. By adopting this approach, the studies strikingly highlight an interplay between institutional change and financialisation, while accounting for the international dimension of financialisation and its relation to domestic configurations.

[24] For financialisation in Mexico, see also Correa, Vidal, and Marshall (2012).
[25] For financialisation in Turkey, see also Tellalbasi and Kaya (2013). For a comparison between Turkey, Mexico and Argentina, see Marois (2011) and Demir (2009a, 2009b).
[26] For financialisation in Turkey, see also Tellalbasi and Kaya (2013). For a comparison between Turkey, Mexico and Argentina, see Marois (2011) and Demir (2009a, 2009b).
[27] For financialisation in Brazil, see also Kaltenbrunner (2011) and Araújo, Bruno, and Pimentel (2012).

These four countries are specific in that they belong to the group of what are termed semi-peripheral[28] or large 'emerging market' countries, as they play a non-negligible role in their respective regions and feature a substantial domestic market. So far, the studies have revealed varying degrees of international and domestic financialisation with some common (households) and some divergent processes (international integration). In this vein, May (2013, 282) even argues against other scholars that particularly the BRIC countries dissociated themselves from the global finance-led accumulation regime, understood as the interconnection with global financial markets in the form of paper-based assets such as portfolio investments, public debt and cross-border loans. This makes it necessary to turn to peripheral countries and small open economies to substantiate any claims regarding diverse forms of financialisation and to problematise international financialisation further.

In an early path-breaking study of financialisation in a peripheral country, Rethel (2010) documents how Malaysia experienced a strong shift towards capital markets in the form of corporate bonds and towards household debt in the decade before the GFC. The turn to corporate bonds had been a long-term attempt of the rather interventionist government to broaden the capital base for local corporations, motivated by the desire for risk diversification and by constraints in foreign financing due to capital controls in the aftermath of the Asian Financial Crisis. The focus on household debt was instigated by domestic economic policy seeing private consumption as a main driver for growth. In the face of declining demand for business loans, induced by government policies, banks supported the turn towards households. This highlights the financialisation in local structures and institutions, which cannot be solely attributed to neoliberal policies, as in this case interventionist policy sought to promote a finance-friendly macroeconomic environment for growth, promoting domestic mass-based financialisation. This example shows how local elites reworked part of the international policy pressure in a way that served their own interests. Financialisation can thus be seen not only in terms of financial flows, but also in norms and ideas that are then reworked locally.

[28] World-system scholars distinguish between semi-peripheries and peripheries, allowing for more differentiation and mobility between the countries (Arrighi 1985, 1990; Wallerstein 1979; Nölke 2010, 315). In this line of reasoning, semi-peripheries are defined by having already developed partial industrialisation or a considerable financial sector, thus exhibiting some activities of the core, such as for example light manufacturing or the high-tech industry (Becker et al. 2010, 226).

Moving towards Eastern Europe, Juuse (2015) draws on the Minsky-Kregel framework and the historical Institutionalist tradition to outline the factors that created increased fragility and that promoted financialisation in Estonia in recent decades. Juuse (2015) shows how, in a small, extremely open economy, large capital inflows fuelled consumer and real-estate-related loans, creating a bubble that burst in the GFC. Liberalisation of capital accounts, policies geared towards securing down payments for housing loans and tax reforms favourable to both borrowers and lenders fostered this development. The case reveals how policies from the Washington Consensus apparatus have caused the build-up of severe vulnerabilities in the peripheries of the Global North and created a specific, extreme form of international (and partly domestic) financialisation driven in part by international banking groups (Juuse and Kattel 2015; Raviv 2007, 2008).

For Romania, Gabor (2010, 2011, 2012, 2013) has amply demonstrated how a shift from patient to impatient finance took place, spearheaded by foreign-currency-denominated loans as a further specific risk-shifting aspect in this locus. For Eastern Europe in general, she points to the changing relation between banks and the central bank in terms of liquidity management. While the central bank had previously been a net domestic creditor, in the course of the 2000s financial inflows through foreign loans led the central banks in Romania and other Eastern European states to sterilise the money inflow in order to ward off depreciation. This account illustrates how the domestic institutional setting, in this case the central banks with their low inflation and stable exchange rate regime, reacted to financialisation pressures. As exemplified by a multitude of other studies on financialisation in the Global South or peripheries of the Global North, it has become obvious that financialisation as a process occurs not only at the levels of households, NFCs or the financial sector, but also at the international level.

From a theoretical point of view, Bonizzi (2013) summarises three approaches that are used in studies on financialisation in the Global South or peripheries of the Global North to capture the international aspect. The approaches range from Marxism ('subordinate financialisation') to Post-Keynesianism ('rentier-capitalism') to the Regulation School ('dependent financialisation'), hence blending into the theoretical accounts presented above. Both Bonizzi (2013, 89) and Karacimen (2014, 166) add some general observations on international financialisation, such as increased borrowing by domestic corporations and banks on international financial markets, (foreign) banks focusing heavily on household financing in turn, central banks devising new instruments to cope with

capital inflows and a switch to market-based finance. Garcia-Arias (2015, 26) adds that international financialisation materialises in the increased volatility of international macroeconomic variables such as exchange rates and in heightened macroeconomic imbalances, which exacerbate the proneness to financial crises. Despite diverse domestic configurations, they all lead to an increasing sectoral role of finance, investment directed towards (short-term) finance and the mobilisation of different societal strata towards finance. While some general processes of financialisation are the same as in the countries of the Global North, though with a higher degree of variegation, the difference underlined in these studies lies in the increased quantity of diverse capital in- and outflows and in the way they are domestically mediated. Such a broader international perspective on financialisation was missing in the comparative but also in the early general financialisation literature (Sokol 2017, 681). Alongside this mainly quantitative appreciation of international financialisation, there have also been distinct qualitative changes in the way socio-economic relations and economic agents are integrated into the international financial sphere in the periphery. Bortz and Kaltenbrunner (2018) argue that the process of financialisation emanates from a larger financial liberalisation agenda that started in mature, core countries. The agenda was then transmitted to peripheral countries, which has altered their relationship, but it was also decisively shaped and reworked domestically (Bortz and Kaltenbrunner 2018, 376).

Reviewing one of the approaches (dependent financialisation) to international financialisation (Bonizzi 2013), Becker, Jäger, and Weissenbacher (2013) posit the core-periphery relationship in their framework of accumulation regimes. Rooting their argument partially in Dependency theory[29], they argue that the strong extraversion leads economies to run high trade imports that can be temporally financed with capital inflows from the core. The disbalance is sustained by a high interest rate policy regime in the periphery and by the search for profit-yielding investments in the core. Gabor (2013, 24) roots the dependency in the presence of transnational banks, increasing financial interconnectedness (connecting local currency and asset markets with international markets) and interconnected regulatory agencies, supported by public and central bank policy. These

[29] Dependency theory is one of the few non-Eurocentric research programmes and postulates a structural power relationship between the core and the periphery (Cardoso and Falleto 1979; Frank 1966). In contrast to simply positing a political hierarchical relationship, it devises a sociological analysis of forms of control and of social stratification that actually give rise to political-economic arrangements, portrayed as the outcome of domestic contestation between social factions (Ebenau 2012, 218). The dependency of peripheries arises from the external influence on the political struggle and on relationships between domestic social classes. Such 'imperialist' tactics then lead to structural underdevelopment due to adverse productivity developments and subdued interaction between peripheries (Heinrich 2010, 297; Prebisch 1950). In contrast to Imperialist theories, Dependency theory places more emphasis on the periphery itself, on the issue of social struggle and on unequal trade of capital goods, and less emphasis on financial flows.

changes have given rise to a general change from patient to impatient finance. Providing an account of inter-dependency, Bartlett and Prica (2017b) see dependencies materialising within financialisation through capital inflows and the presence of foreign banks. Secular stagnation fears and under-consumption necessitate these financial flows from the core to the peripheries, which in turn rely on financing for the trade deficit (Bartlett and Prica 2017b, 130). Deploying the concept of dependent financialisation, Bohle (2017) elaborates on different dependent growth trajectories (export-led versus debt-led/financialised) and crisis-related policy responses in Eastern Europe and the Baltics in the light of EU accession policies. Gambarotto and Solari (2014) elucidate how the institutional framework of the euro currency system has asymmetrically integrated the Southern European varieties of capitalism, creating and co-constituting peripherality through financialisation.

Another strand of research deploys the concept of subordinate financialisation (Powell 2013; Živković 2017), which one could regard as being rooted in Marxism and (Classical) Imperialism theory.[30] Scholars in this realm mainly account for the fact that developing countries tend to hoard foreign reserves, lending further legitimacy to the US dollar as a world currency. Powell (2013, 144) further highlights how the turn towards market-based finance of domestic NFCs in peripheries leaves them more interconnected to the international financial markets, thus subjugating them to increased risk through the extraction of profit. In a similar vein, Fernandez and Aalbers (2020) combine their studies on housing financialisation with the concept of uneven and combined development to arrive at a comparative concept for the financialisation of housing in the Global South and the peripheries of the Global North. For them, the excess liquidity of the Global North in search of yields gives rise to a surge in mortgage lending, thus forming the subordinate financialisation in the Global South as part of the globally uneven and combined development. By carving out the

[30] On this note, Classical Imperialism theorists developed differing understandings of how imperialism was related to the development of capitalism and finance. Hobson (1902) argued that under-consumption and over-accumulation in the core drove the British Empire to establish colonies to overcome both problems. Finance played a key role in this by lubricating the monetary flows and financing debt. Drawing heavily on Marx, Lenin (1916) saw imperialism as the 'highest stage' of capitalist development. Core economies turn into parasites that extract super-profits, but not in terms of trade, as Hobson argued, but rather in terms of investment (Cope and Kerswell 2016, 1054). The merger of bank capital and industrial capital into finance capital enabled this investment and potentially sped up the process of industrialisation in the periphery while creating a dependent and weak bourgeoisie (Powell 2013, 116). Luxemburg (1913) concurred with the argument of under-consumption in the core, but maintained that conflicts in capitalism do not only derive from the traditional labour-capital struggle but also from the competition between rich capitalist (empires) and non-capitalist countries (peripheries) (Osterreich 2016, 1067). Arguing that imperialism is the necessary outcome of capitalism, she was wary of seeing any emancipation of peripheries in this capital transfer but rather saw it as a means to maintain the core's influence on these states. Hence, finance can be seen as a having a coordinating function in Classical Imperialism contributions, with the local capitalist class serving the interests of the centre's capitalists.

forms of subordinate financialisation in the different typologies of the Varieties of Capitalism in developing countries, they expand the concepts of state-led economies and dependent market economies by adding the concept of less-financialised economies (Fernandez and Aalbers 2020, 694). Nonetheless, their assessment of financialisation remains limited to indicators of financial development and simple debt levels, and is thus of little aid for an analysis of financialisation in the peripheries of the Global North (such as SEE).

Blending Marxian and Classical Imperialism views, Bonizzi, Kaltenbrunner, and Powell (2020) contend that subordinate financialisation takes place both as a cyclical process and as a secular change in the relations of capitalist accumulation. Emerging economies experience financialisation from a subordinate position primarily in the internationalisation of production, in circulation and in profit realisation as well as in financial markets. While their reference to the internationalisation of production might seem like old news, they connect this argument with the financialisation of NFCs, which impacts differently on the firms in advanced and emerging economies. Surging asset prices and rising indebtedness serve as a fix for the problem of secular stagnation in advanced economies, which pushes emerging economies to become net exporters to the debt-led economies of the Global North (primarily the US) (Bonizzi, Kaltenbrunner, and Powell 2020, 181). With regard to the financial sector and subordinate financialisation, these authors remain close to Bortz and Kaltenbrunner (2018) in highlighting volatile financial inflows, foreign currency lending to NFCs, reserve hoarding and sterilisations by central banks. While the issue of internationalisation of production is primarily a topic for globalisation studies, the circulation of profits and interdependence was already touched upon by Bartlett and Prica (2017b) for SEE. The thread of international financialisation outlined in this study would aid in assessing different forms of financialisation in SEE.

Hence, different theoretical approaches exist, as outlined by Bonizzi (2013), but the delineations have shown that they all share certain commonalities in their interpretation of international financialisation. The case for a rather eclectic understanding of the phenomenon may be exemplified by Kvangraven, Koddenbrock, and Sylla (2021), who provide an empirical overview of financialisation in Africa.[31] The authors view subordination as "*the need for actors in the Global South to react*

[31] They understand financialisation as financial liberalisation, the emergence of novel financial instruments and the intrusion of financial actors in traditionally public or household-mediated fields. To assess financialisation across their four case studies, they deploy several measurements, but these are based solely on standard financial development or

and adapt to actors, practices and financial flows originating in the Global North" (Kvangraven, Koddenbrock, and Sylla 2021, 121), which is how they define the term '*dependency*' (Kvangraven, Koddenbrock, and Sylla 2021, 121). In doing so, they merge the Marxian-Imperialist and Regulation-Dependency theory views on international financialisation and on financial subordination.

Thus, to summarise the different interpretations, the level of international financialisation is highlighted by several manifestations and caused by a multitude of factors. Foreign currency loans induce a shift of currency risk from the bank to the debtor, which becomes problematic if the debtor does not have any foreign currency inflows and the local currency depreciates or the rate on the international money markets (LIBOR or EURIBOR) rises (Becker et al. 2010, 238; Gabor 2010, 257). As well as constituting a power relationship and a risk shift, cross-border loans also signify a dependence on foreign financing, as they are often denominated in foreign currency and priced at variable international interest rates (Ćetković 2011, 16; Gabor 2013, 123). Both insert the debtor either into global financial markets or make the debtor dependent on a specific core economy. Debt securities held by non-residents and inflows of portfolio investment are part of the other side of the coin (Gabor 2010, 259; Karwowski and Stockhammer 2017, 65), suggesting both dependency on the debtor side and dominance on the creditor side. Foreign ownership in strategic sectors of the economy – such as the financial sector – is a distinct feature of peripherality, as discussed above, and a driver of international financialisation (Ćetković 2011, 8; Raviv 2008, 303).

Cross-border funding is part of the level of international financialisation. Such inflows of liquidity to fund lending in domestic markets often occur against the backdrop of insufficient mobilisation of local funds (Gabor 2013, 45). External inflows of capital require buying up local currency, which is normally issued by the central bank as it seeks to build up foreign reserves. To avoid depreciation, the liquidity is sterilised in open market operations through the issuance of government bonds, central bank bills or simply by taking deposits on the central bank accounts in line with a monetarist monetary policy – but at the expense of yielding free interest income for financial institutions. The shift is highlighted by an increasing number of transactions with the central bank on money markets and a simultaneous stagnation of interbank markets (Gabor 2013, 102; Živković 2017, 125). An accompanying decline of interbank operations on the currency market demonstrates how over-the-counter operations – known as carry-trades, which often take the form of derivative contracts –

financial sector indicators and therefore can only serve the purpose of measuring financial deepening rather than a structural transformation of financialisation.

lead to "*financialised [...] practice par excellence*" (Gabor 2013, 19). This phenomenon no longer reflects real economy trading but speculative short-term currency risk gambling. These shifts not only imply a shift from patient to impatient finance but intrinsically link domestic and international financialisation processes.

Financialisation in the periphery thus takes a myriad of forms, both quantitative and qualitative, while the spotlight of studies has been on monetary policy, NFCs, banks and households. Their changing pattern of behaviour was possibly enabled or forced by domestic institutional change, which was influenced to varying degrees by international factors. The process was accounted for by the notions of centre-periphery, dependency and subordination. Both the literature on financialisation in peripheral countries and the studies on international financialisation aid us in complementing comparative frameworks with this level of financialisation as well as in analysing its trajectories and explanatory mechanisms.

2.3.3 Interim summary

Lately, comparative financialisation frameworks have gained traction but have also given rise to diverse interpretations. While some studies focus exclusively on the Post-Keynesian notion of changing firm behaviour or on the issue of institutional change, other frameworks have either relied on eclectic sub-hypotheses testing or on eclectic financialisation indicators. These different approaches are summarised in Table 1. Firstly, they are distinguished in terms of their theoretical nature and their units of analysis. With respect to their interpretation of economic change, the table broadly differentiates between activity-centred views (relative sectoral increase of finance) and accumulation-centred views (locus of profit- or income-generation), following Krippner (2005, 177). This makes it possible to distinguish among the approaches regarding the empirics utilised but should not be misconstrued as a typological distinction.

Table 1: Comparative financialisation studies

	Theory	**Level of analysis**	**Economic change**
Lapavitsas and Powell (2013)	Marxian	NFCs, banks, households	Activity/ Accumulation
Brown, Passarella, and Spencer (2015)	Marxian	Financial sector, households	Activity
Demir (2007); Stock-hammer (2004)	Post-Keynesian	NFCs	Accumulation
Hein, Detzer, and Dodig (2015)	Post-Keynesian	NFC, public, household, external sector	Activity
Becker et al. (2010); Becker and Ćetković (2015)	Regulation /Dependency	NFCs, banks, households, (external), institutions and policy	Activity/ Accumulation
Deeg (2012)	Institutional	Financial markets, institutions and policy	Activity/Accumulation
Stockhammer and Kohler (2020)	Post-Keynesian	Households	Activity
Engelen and Konings (2010)	Institutional	Financial markets, institutions and policy	Activity/ Accumulation
Lagoarde-Segot (2017)	None	Financial markets	Activity
Fastenrath, Schwan, and Trampusch (2017);	None	State	Activity
Mikuš (2019d);	None	State	Activity
Schwan, Trampusch, and Fastenrath (2020)	None	State	Activity
Maxfield, Winecoff, and Young (2017)	Institutional	Banks	Activity
Karwowski, Shabani, and Stockhammer (2020)	Eclectic	NFCs, financial sector, households, financial markets, external, real estate	Activity/ Accumulation
Karwowski and Stock-hammer (2017)	Eclectic	NFCs, financial sector, households, financial markets, external, real estate	Activity/ Accumulation
Karwowski (2020)	Eclectic	NFCs, financial sector, households, external, real estate, cities	Activity/ Accumulation

Source: Author

Many of the comparative approaches deploy both a combination of an activity and an accumulation view. While the activity view serves as a broad indicator for structural change, the accumulation view enables one to dig more deeply into the specific nature of financialisation for the respective level of analysis or for the economy as a whole, giving these hybrid approaches a further edge. It is equally remarkable how little attention has been paid to the international facet of financialisation

to date (except Karwowski 2020). The findings of the comparative studies are diverse and have been described either as varied and bearing variability (Lapavitsas and Powell 2013, 360) or as variegations of financialisation (Brown, Passarella, and Spencer 2015, 2; Karwowski, Shabani, and Stockhammer 2016, 14). Interestingly, both strands of literature root these differences in the domestic social, political and institutional processes that underpin the processes of financialisation but without much substantiation of the terms. Since there has been a long discussion about this (Bruff 2011; Peck and Theodore 2007; Streeck 2010), it will be necessary to come back to this point at a later stage.

In response to the dearth of comparative financialisation approaches that give more weight to the international contributing factors and take the reality of developing economies into account, the second section presents a review of the studies that lean in this direction (Bonizzi 2013; Bortz and Kaltenbrunner 2018). As was shown, financialisation in developing countries often takes forms that are quite distinct from those that were ascertained for mature economies. Changes in the corporate behaviour of NFCs (shareholder value, financial income) has not yet been observed in these countries to any great extent; instead we have witnessed a change of financing channels among corporations, which are now borrowing on international financial markets (Demir 2007). As a result, banks seem to be engaging more actively in household lending. On the national level, financialisation can be facilitated both by specific domestic policies geared towards the liberalisation of capital inflows and by policy programmes targeted at specific income groups to encourage their engagement in financial markets. The embeddedness of peripheral economies in international financial markets further takes place on the scale of banks borrowing from abroad, leading to (foreign exchange) risk and investors using local asset classes as part of their investment portfolios, which creates domestic volatility. It was noted by the authors that this not only links the domestic sphere to the vagaries of international financial markets, but also contributes to hierarchical power relationships between developing countries, the periphery, and the advanced or core countries through the notions of subordinated and dependent financialisation.

2.4 Criticism of financialisation

As financialisation research gathered speed, especially after the GFC, various scholars pointed to possible limitations of the concept and criticised it from different angles (Christophers 2015; Deutschmann 2011; French, Leyshon, and Wainwright 2011). The sheer number of definitions of

the term (e.g. in Epstein 2005b; Fine 2010; Krippner 2005; summarized in Mader, Mertens, and van der Zwan 2020a, 7) is already problematic, while at the same time it is indicative of the interdisciplinary and pluralistic nature of this field of research. These characteristics are a mixed blessing in that they offer the advantages of flexibility and adaptability, but they can also lead to incoherency and arbitrariness. This section engages with this criticism in order to inform the conceptualisation in the research design.

The ostensible surfeit of financialisation studies has led scholars to ask whether we should dispense with the term financialisation altogether since it does not confer '*analytical significance and coherence in its own right*' (Christophers 2015, 187) given the meagre conceptual clarification. While this is undoubtedly true for a range of financialisation studies, this would relegate the concept to a supportive role, with the primary focus being placed on for example the growing penetration of financial logics. Although the criticism of the plethora of definitions is totally valid,[32] the theoretical delineations that were described in the first section of this chapter attempt to yield a different reading. As we have seen, financialisation is indeed not a theory in its own right, but a framework woven into several larger theoretical bodies, which then allows for further conceptualisation and hypothesisation. Not surprisingly, the distinct lenses of the authors led them to formulate different definitions of financialisation. However, a humbler attitude, meaning less of a 'philosopher's-stone-finding' demeanour on the part of researchers as they try to come up with yet another definition, would be more than welcome.

Relatedly, this calls for a clearer conceptualisation of financialisation. This line of criticism as voiced by the relevant literature (Aalbers 2019, 2; Mader, Mertens, and van der Zwan 2020a, 6) alludes to the striking ambiguity in many publications as to whether financialisation constitutes a dependent or independent variable, and whether it explains or is to be explained. Indeed, in a range of publications the concept appears without much clarification, conceptualisation or referencing, or it is simply used out of context. While one could argue that this reflects the complexity of the subject matter, it would certainly help if financialisation ceased to be thought of as a catch-all term, and greater clarity would very likely foster meaningful conversation within financialisation research.

[32] See Mader, Mertens, and van der Zwan (2020a, 7) for an overview of the different definitions in the literature.

In the same vein, Christophers (2015, 188) argues that the phenomena described by such theoretical conceptualisations are not necessarily new, citing various self-confessed Marxist scholars. Similar to Post-Keynesian scholars (e.g. Minsky), they rely heavily on previous theoretical work. But even if such phenomena are not new – here Christophers (2015, 188) only refers to the Marxist understanding of a changing capital-labour relationship – one could legitimately ask: Is the fact that financialisation has taken a much stronger hold than ever before not a reason to delve more deeply into the subject matter? It is only natural for academics to rely on previous work, evaluate it, and if possible, extend it. We have seen from the previous sections that this is what the Marxian, Regulationist, Post-Keynesian and institutional scholars have undertaken to do. Being conscious of the theoretical shoulders on which one's own research stands should nevertheless be a prerequisite in scholarship.

Deutschmann (2011, 365) underscores that financialisation has to be understood as a novel, structural phenomenon, though it should not be conflated with crisis theories such as the one formulated by Minsky, which may readily explain each individual financial crunch but not the underlying forces. In particular, he argues, Post-Keynesian scholars are prone to equate financialisation with the emergence of a crisis although it in fact describes a long-term structural transformation. This dovetails with the prior finding that Post-Keynesians sometimes conflate independent and dependent variables. Along the same lines, authors like Arrighi (1994) have pointed to financialisation being a repeating phenomenon in the light of hegemonic transitions, making it a specific recurrent pattern within long historical waves. However, we should nevertheless heed the note of caution by Deutschmann (2011): although a crisis may be related to financialisation, the two are not one and the same. The theoretical accounts described above, especially those produced by Regulationist scholars, make this abundantly clear.

Another critique is directed at the heavy focus of early financialisation research on the UK and the US as exemplary cases. According to these authors, viewing financialisation as divorced from international flows bears the risk of overstating its breadth (Christophers 2015, 192; French, Leyshon, and Wainwright 2011, 808; van der Zwan 2014, 119). For example, this can occur if one fails to consider patterns of globalisation which lead larger firms to own more production networks outside of their home countries. As they receive financial incomes from these external networks, this could potentially lead to exaggeration of the 'financial income of NFCs' hypothesis (Rabinovich 2019). Lately, research has tried to bring in the international facet of financialisation, as argued before

(see also Bonizzi 2017). Nonetheless, establishing financialisation as a broader and more substantial claim entails widening both the spatial and temporal aspects to international financial spheres and other regions (Sokol 2017). Only accounts that consider the international factors of financialisation are able to substantiate the claims that are made in much of the financialisation literature, while carefully acknowledging the empirical and internal limits of the subject at hand (Christophers 2015, 196), which is what this study aims to do.

What can be taken away from these considerations? Certainly, it does not mean that the criticism should be dismissed altogether. On the contrary, it means that '*broad-brush accounts*' (French, Leyshon, and Wainwright 2011, 806) must be avoided and instead a narrower conceptualisation of financialisation should be pursued. This entails a clear conceptualisation and a concrete spatial and temporal focus, thereby considering both the internal and external facets of financialisation against the backdrop of historical contingency and embeddedness in the international financial system, as put forth by Krippner (2012). The overarching criterion should not be to see financialisation everywhere, but to allow for disproof and variation, and thus account for the empirical limits of the concept (Christophers 2015, 194).

2.5 Chapter summary

The scant research on financialisation in SEE to date has not delivered a consistent conceptualisation of financialisation itself before analysing the subject at hand, which weakened the subsequent analyses. Secondly, within these studies, there has been a lack of separation between the process itself and the explaining mechanisms. In an attempt to fill this gap and answer the research question with regard to the different degrees of financialisation and their explication, this chapter has served to chart the emergence of financialisation and the different theoretical interpretations of it. The earliest mentions of financialisation were found in Marxist scholarship, which viewed it as a fix for concentrating markets and problems of overaccumulation and surplus absorption. Early Regulation scholars argued that financialisation heralds the latest phase of decaying regimes and hegemonies. The field began to flourish from the turn of the century onwards and may be broadly categorised as macro, meso or micro in focus, of which the macro focus best serves to answer the research question. Four theoretical bodies have thus far engaged with financialisation within IPE.

Overaccumulation and a slowing rate of profit require novel spaces of investment, as argued by Marxists. The mobilisation of idle money into loanable money capital lies at the core of the financialisation process. Marxists differentiate between fictitious capital (e.g. share prices) and interest-bearing capital (e.g. loans); from there they disagree as to whether the process of financialisation consists of the proliferation of interest-bearing capital or the increasing transformation of such capital into fictitious capital (e.g. securitising loans). Despite their disagreements on these questions of detail, these scholars generally agree that financialisation takes the form of capital invested in non-surplus-generating assets, such as household loans, and have termed it financial expropriation. These scholars also agree on the change of role of and insertion of new units into the financial sphere, such as households and NFCs. Regulation theorists advance the notion of a finance-led regime of accumulation with new forms of relations and diverse effects on certain levels, such as public welfare and corporate governance. These shifts materialise in the increased importance of the FIRE sector relative to the rest of the economy (sectoral shift) as well as in business practices geared towards financial assets and financial income (inter-sectoral shift). Within this framework, scholars have distinguished between an activity-centred view (changes in employment or contribution) and an accumulation-centred view (changes in profit generation). Different parts of the population might be drawn into the financialised accumulation regime. The increased reliance on financial markets for low-income brackets is termed mass-based financialisation, while in other regimes the term elite financialisation is used to denote the phenomenon when it affects the middle and upper strata of society.

Post-Keynesian scholars broadly distinguish between the ascendancy of the rentier, different growth models and financial-instability-related financialisation. These processes of financialisation are caused by the breakdown of the traditional worker-capitalist relation, the replacement of capitalists by rentiers and entrepreneurs (giving rise to the shareholder value maximisation doctrine) and the increasing engagement of NFCs in financial markets. Increased debt becomes the fix for problems of effective demand created by the shift from wage-led to profit-led growth systems. Neoliberal policy and a price-stability-oriented central bank policy are among the conducive and explanatory mechanisms. On the other side, Institutionalists view financialisation as co-constitutional to institutional change. Hence, financialisation may induce a shift from bank-based financial systems in CMEs to hybrid or market-based financial systems, such as those found in LMEs. Patient capital and relations would be superseded by impatient finance. Institutionalists track the trajectories of countries or systems in which institutional change exhibits distinct path dependency,

but which could also be subject to sudden change or emergence. Financialisation may hence effect changes within institutions such as the housing market, which has seen a grand reworking in that homes were transformed into stores of value, collateral and investments.

The theoretical delineations have hence informed our understanding about the roots of financialisation, the concomitant causes for it and the process of financialisation itself occurring on several levels, foremost in financial sectors, NFCs and households. In order to assess the different degrees of financialisation across SEE, a range of comparative frameworks were reviewed that exhibit different theoretical underpinnings, levels of analysis and views on the processes of financialisation. The frameworks compared either certain units (such as NFCs) and non-private levels (such as the state) or related financialisation to growth regimes. Other approaches exhibit more breadth and are able to eclectically analyse countries over time (Karwowski, Shabani, and Stockhammer 2020; Karwowski and Stockhammer 2017), which made them highly relevant for the research question. Nevertheless, most of the studies neglected the international facet of financialisation, which was the motivation for reviewing international financialisation studies targeting the geographies of peripheral economies in this chapter. The examination of these different country studies have revealed that financialisation is variegated, driven by broader agendas of neoliberalisation and by a conducive central bank policy, while it is underlined that these policies are also mediated domestically in order to push certain agendas, satisfy political alliances or propagate the image of more finance leading necessarily to growth. International financialisation was shown to link domestic actors to the vagaries of international financial markets through foreign currency loans, cross-border loans, reliance on foreign funding by banks and other types of financial inflows. At the same time, larger companies in peripheral countries resort to international markets for finance and capital, while the domestic financial institutions intensify their focus on household lending. The Imperialist-Marxist-inspired notion of subordinated financialisation and the Dependency-Regulation concept of dependent financialisation capture the increased interconnectedness and subjugation of the local to the global in financial terms.

The last section of this chapter reverted back to the criticism with which this thesis commenced. Besides the need to expand the spatial optics, the critics bemoaned the lack of conceptual clarity in financialisation studies, which may be exemplified by the myriad definitions of and the repeated conflation of financialisation as either a dependent or an independent variable. The genealogical background already points to the fact that financialisation is not necessarily a new concept but was

already dealt with by earlier scholars. At the same time, it was argued that the majority of concepts emerge from the reconsideration of older research, which was demonstrated through the presentation of the different theories' views on financialisation. A note of warning was cast to not conflate theories of crisis with financialisation, as often occurs in Post-Keynesian contributions, but to continue viewing financialisation as a process and long-term transformation. Hence, with regard to the research question, this chapter has provided a rich but criticism-aware understanding of the process of financialisation and frameworks to measure the degree of financialisation on four different levels: Financial sector, international sphere, NFCs and households. Likewise, several mechanisms as well as key drivers were identified that cause or promote financialisation. Based on the elaborations and the criticism, the next chapter reconsiders the research question and develops a concept in order to provide answers to it.

3. Research Design and methodology

In an attempt to flesh out the concept of financialisation, the previous chapter presented diverse theoretical approaches to illustrate and explain the process of financialisation on the different levels. While the processes (dependent variable) themselves were shown to be rather similar on the various levels (though playing out differently in the domestic contexts), the theoretical explanations and explanatory drivers for them diverged (independent variables). The presented comparative studies packed these understandings into frameworks that served to assess the degree of financialisation on distinct levels but which exhibit certain deficiencies in their operationalisation, focus, and indicators. Most importantly, the frameworks neglect the international level of financialisation. Studies on financialisation in emerging economies have endeavoured to fill this gap, since financial linkages across borders are typically much more relevant for those countries and revealed that financialisation is not a uniform process, but rather one that plays out differently depending on space and time.

Reconsidering the existing research on financialisation in SEE against the theoretical background supplied in the previous chapter, Becker and Ćetković (2015) and Holzner (2017) provide a comparison of financialisation of the region with a Regulation-theory-inspired and eclectic framework, respectively. Yet both publications compare SEE against other regions in Eastern Europe but do not elaborate further on the differences between the countries within the region(s). Based on an eclectic concept, Mikuš (2019c, 2019d) analyses the financialisation of the state in Eastern and South-Eastern Europe and singles out a few extreme cases. Hence, the next logical research step is to conduct a comparison between the individual countries in SEE so as to expose the variance of financialisation (dependent variable) *within* the region for levels of financialisation other than the state, which constitutes the first research gap. Outlining the variance and the extreme cases yields us the research puzzle, similar to Mikuš (2019c), as the different degrees provoke further description of the processes of financialisation and, importantly, call for explanations.

In that vein, the existing research has so far focused on and explained only singular aspects of financialisation in a few countries in SEE. In the case of Serbia, Becker et al. (2010, 236), from a Regulation-inspired perspective, point to the importance of lending from foreign banks and affiliates, often in foreign currency, which has contributed to peripheral financialisation, while the reasons and processes behind them remain hidden. Živković (2017) roots the facilitation of capital imports and ensuing subordinate financialisation in the monetary policy and historic dependency

of firms on foreign loans in Post-Yugoslavia, while the specific domestic central banks and their policies remain unmentioned. Rodik and Zitko (2015) sketchily describe the financialisation of households in the region but then focus more closely on the specific topic of Swiss franc loans in Croatia. While all three publications add to our understanding of the processes of financialisation and its drivers, they tend to be either rather broad or conceptually unclear, without speaking to or integrating themselves into the other research on the countries in the region or on the region itself. For that reason, the second research gap lies in further describing and explaining the different degrees based on a conceptualisation of the theoretical elaborations of chapter 2.

Based on this restatement of the research gaps, section 3.1 reiterates and refines the research question, which guides the subsequent research design of this chapter. Section 3.2 provides an outline of the research approach to answer the different sub-research questions, which consists of a two-step analysis. Section 3.3 lays out the geographical and temporal scope to obtain a defined space and time for the analysis. Section 3.4 describes the concrete design for the first research step, which entails a discussion and presentation of the comparative financialisation concept to be undertaken via descriptive statistics and an extreme case selection technique. The discussion of the data to be employed foreshadows the difficulties in obtaining coherent and comparable empirics. Section 3.5 presents the design for the case study analyses, containing the depiction of the concept and operationalisation for the analysis of the trajectories of the levels of financialisation and its causes, and also presents the method of data inquiry (documentary analysis and expert interviews). Section 3.6 discusses the limitations of this study in terms of its focus and research design.

3.1 Refinement of the research question

This section restates the research question and engages in breaking it down into sub-components that lead the remainder of the research design and the rest of the thesis. As stated in the introductory chapter, the research question is as follows.

> *What are the different degrees of financialisation in the countries of SEE and how can we explain them?*

The research question attempts to find answers to explain the variance of the dependent variable (financialisation) across the region, so as to create a link to the studies that compare the region with other regions (Holzner 2017) and thereby add additional value with respect to the degrees of financialisation in the different countries. The comparison should shed light on which countries have

financialised to higher degrees (relative degree) at the different levels of financialisation. The second part of the research question calls for an explanation of the degrees of financialisation, which requires a certain clarification at this stage. The historical trajectories of the levels of financialisation and the conducive causal mechanisms are naturally of specific interest to this inquiry, for which case studies (George and Bennett 2005, 5; Gerring 2004) are considered to be a suitable research method (which is elaborated further below). Adding to this, the different levels of the dependent variable identified in chapter 2 and the number of countries in SEE render the space of research a small-N study, which is a key characteristic of case study research (Blatter, Langer, and Wagemann 2018, 174). Due to this anticipative methodological reasoning, it is necessary to select case studies that will serve to answer the research question (Schnapp and Bock 2020, 225). The literature (Seawright and Gerring 2008, 301) suggests choosing cases that exhibit extreme values (in this case, on the levels of the dependent variable) since causality should be the most evident in such cases (Levy 2008, 7) and since they might be representative or indicative for others in the region (Schnapp and Bock 2020, 228).[33] Based on these elaborations, we can decompose the above-stated research question into several research sub-questions (RSQ) for the sake of operationalisation:

> *RSQ1: How has the degree of financialisation developed over time in the different countries of SEE?*
>
> *RSQ2: Which countries are the most financialised on each level of financialisation?*
>
> *RSQ3: How are the trajectories of financialisation characterised on the different (extreme case) levels and what caused them?*
>
> *RSQ4: Which conceptual mechanisms help explain the (extreme case) degrees of financialisation and how?*

RSQ1 enquires about the variance of the dependent variable in the different countries on each of the levels of financialisation. RSQ2 questions which of these levels (households, NFCs, financial sector, international) exhibits the most extreme development. These first two RSQs resonate with the comparative financialisation approaches presented in section 2.3.1 (e.g. Karwowski, Shabani, and Stockhammer 2020; Lapavitsas and Powell 2013; Mikuš 2019c) and, in depicting the variance

[33] The extreme case selection is elaborated further below.

of the dependent variable, they suggest following the typical avenue for new fields of inquiry and exploratory studies (Gschwend and Schimmelfennig 2007, 22–23). The comparison necessarily leads to RSQ3, which asks about the evolution and character of the trajectory of financialisation on the different levels in the respective countries, mirroring the existing country studies on financialisation in developing countries (see section 2.3.2). This detailed description of case-specific causes follows a temporally sensitive, rather inductive approach. RSQ4 deductively reviews the conceptual explanatory mechanisms conducive to financialisation against the case study in order to confirm or disconfirm the hypotheses of the literature. Besides identifying and examining the independent variables, in doing so both RSQ3 and RSQ4 inquire into the interrelation between the dependent and independent variables. Hence, the last two RSQs serve multiple generalised objectives of case studies as they ask for a description of the phenomenon, identify causal relationships and review the effect of specific causal factors (Blatter, Langer, and Wagemann 2018, 176). The next section describes the research approach in more detail by making reference to the specific RSQs and how they are methodologically addressed.

3.2 Research approach and methodology

This section outlines the research approach and presents the methodology that was identified to be the most suitable to answer the RSQs and thereby address the identified gap in the literature. The review of the theoretical contributions has revealed that the majority of the existing studies on financialisation have followed a single research strategy by focusing either on qualitative (e.g. Rethel 2010) or quantitative methods (e.g. Van Gunten and Navot 2018). The same applies to the region-specific literature as depicted in the state of the art with the exception of Mikuš (2019c, 2020). The RSQs of this thesis, as argued in the last sub-section, already propose a combined approach by inquiring into the differing degrees of the levels of financialisation, their trajectories and the reasons for them. Adding to this, quantitative data on the countries of SEE is only scantly available, which is discussed in more depth at a later stage (see section 3.4.3). The secondary literature on the region and the countries is also rather scarce. Hence, the RSQs, the state of the art and data availability suggest a mixed-methods approach. The next paragraph pinpoints the strengths and pitfalls of such an approach, while the remainder of the section outlines the concrete research steps on the basis of the RSQs and the methods employed.

Methodological pluralism has always been one of the strengths of political sciences when compared to other disciplines (Gschwend and Schimmelfennig 2007, 14). It is known to select and integrate quantitative and qualitative approaches as a way to more thoroughly scrutinise a phenomenon (Teddlie and Tashakkori 2010, 8). The strength of a mixed-methods research design also lies in its ability to simultaneously address a range of exploratory questions (Teddlie and Tashakkori 2010, 9), which is the case in this thesis. For the purpose of answering the research question, multi-method research therefore combines the strengths of a quantitative (large-N) design for depicting the variance of the dependent variable of financialisation (RSQ1 and RSQ2) and addresses the issue of the mechanisms (independent variables) that help in explaining the variance, for example by conducting a case study analysis (Fearon and Laittin 2010, 758) (RSQ3 and RSQ4).

With regard to the first research step, RSQ1 and RSQ2 are geared towards exposing the variation of the dependent variable of financialisation, as was already undertaken or attempted in other comparative financialisation studies (Brown, Passarella, and Spencer 2015; e.g. Lapavitsas and Powell 2013). Similarly to these studies, it seems advisable make use of descriptive statistics in order to account for both time and space, i.e. time series values and country-specific values. A summary of a univariate analysis for a single or multivariate analysis for multiple variables is called descriptive statistics (Lewis-Beck, Bryman, and Liao 2004, 1159). Given the fact that we are dealing with an exploratory study, this kind of approach is sufficient as it depicts the variance of the dependent variable (financialisation) without asking for a quantitative analysis of the causes or their correlation through for example regression (Pennings, Keman, and Kleinnijenhuis 1999, 167ff). In that sense, descriptive statistics of the interval and ratio values (Black 1999, 305) attributed to financialisation enhance our time-sensitive understanding of the difference in the degree of financialisation for each country in the region (RSQ1).

Based on such graphs and the underlying data, it is possible to ascertain the most financialised country for a given indicator (RSQ2). As argued in section 3.1 and as the thesis has an exploratory character, we then proceed with selecting the extreme cases (Gerring 2007, 101; Seawright and Gerring 2008, 297) at each level of analysis by relying on the theoretically informed indicators (Yin 2009, 130) instead of comparing cases against each other. Hence, the analysis engages in cross-case analysis only on the basis of the quantitative comparative indicators but not on a case study basis. Given the four levels, this yields a maximum number of four possible cases. The extreme cases are identified through comparing the averages of the indicators on the different levels

of financialisation. Section 3.4.1 discusses the comparative concept and indicators in more detail, while section 3.4.2 outlines the data to be mobilised.

With regard to the second research step, RSQ3 and RSQ4 inquire into the trajectory of the level of financialisation and its case-specific causes and explanatory mechanisms. Based on the elaborations in section 3.1 and given the fact that we are dealing with a sample of small-N cases within our region, the literature suggests case studies as a means of subsequent research (Gschwend and Schimmelfennig 2007, 29). They are useful for deriving explanatory mechanisms and allow greater confidence in the findings (De Vaus 2001, 51) through possible generalisation. The case studies substantiate our understanding about the trajectories of financialisation on a certain level and scrutinise the mechanisms that explain them (RSQ3). Also, they serve to confirm or disconfirm established drivers or factors of financialisation (RSQ4). Given the nature of financialisation as a temporal phenomenon of structural transformation, the case studies follow a chronological structure (Yin 2009, 177) from a retrospective view, i.e. feature a historical analysis. Since we have come to understand financialisation as a process, and if we are to trace the processes and explaining mechanisms of financialisation, then we must find an appropriate technique for this task. Financialisation was argued to be influenced by multiple types of mechanisms and to be caused by longer chains of explaining factors. A method that can serve this task is process tracing. This method has been employed in case studies on financialisation (Mertens 2015, 26) and is especially useful for e.g. a historical-institutional analysis of an individual case (Bennett 2010, 704) or cases that have already been yielded by a prior quantitative analysis. In this way, process tracing enables us to conduct an analysis of the most financialised cases.

Conducting an analysis with the help of process tracing involves searching for explanations and evidence which contribute to or negate the theoretical explanation for a phenomenon and thereby tracing causal mechanisms (Beach and Pedersen 2013, 1; Bennett and Checkel 2015, 7). Causality within process tracing is understood in terms of mechanisms, which themselves are composed of entities engaged in activities (Beach 2017, 6; Beach and Pedersen 2016, 306). Applied to this framework, this would, for example, entail tracing the mechanism(s) that led to the surge in short-term and volatile capital inflows brought about by capital account liberalisation in a specific country, which could have taken several steps in between the potential underlying cause and the materialisation of financialisation. Necessarily, this involves taking a closer look at the empirics rather than solely relying on the theoretically derived explaining mechanisms of financialisation, as they

tend to be quite broad. Hypothetically, this bears the risk of infinite regress, i.e. going ever deeper into the details of steps leading to other steps, which could possibly disprove the hypothesis (Bennett 2010, 705). Given the small size of the countries under scrutiny, the exploratory design and the mixed-methods approach, the thesis thereby attempts to minimise this risk.

Process tracing techniques can be differentiated into theory-centric and case-centric types. The former is engaged in building and testing theories, while the latter serves to deliver a comprehensive explanation for a specific historical case (Beach and Pedersen 2016, 305). As the focus of the second step is to describe and explain the extreme cases of financialisation in SEE (RSQ3 and RSQ4), case-centric process tracing is the appropriate tool and resonates with the eclectic conceptualisation of financialisation and its drivers (Beach and Pedersen 2016, 309), which is presented in section 3.5.1. It is argued that process tracing is only recommended for single case studies, as it aims to make within-case causal inferences (Beach and Pedersen 2013, 2). However, several case studies researched with process tracing may help in mapping positive cases in order to draw generalisations (Beach 2017, 24). As the case studies were researched apart from each other, there is limited risk in terms of overlapping causal inferences. Process tracing thus serves to illuminate the working mechanisms behind the financialisation of the individual countries and, when integrated into the mixed-methods strategy, it may add to validation or re-interpretation of the previously undertaken quantitative work (Dunning 2015). As the case studies attempt to describe and analyse the trajectory and explanatory mechanisms of financialisation along the time periods identified above, a process-sensitive approach such as this also enables us to determine whether certain aspects of financialisation emerged suddenly or whether they are part of a path-dependent process set in motion earlier in time. Having outlined the methodology for the two research steps to answer the RSQs, the next section discusses the actual object of scrutiny, i.e. the region of SEE, in terms of time and space.

3.3 Determination of geographical and temporal scope

As was shown in chapter 2.1, scholars have tended to treat financialisation as an Anglo-Saxon phenomenon. A structural blockage in the real economy, the problematics of surplus absorption, and a change in the regime of accumulation have led the advanced economies, primarily the US and the UK, to undergo a process of financialisation. This has even prompted scholars to talk of an ‘Anglo-Americanisation’ of global finance (Fichtner 2014). While processes of financialisation

were amply shown for advanced countries, scholars have called for (Sokol 2013) and engaged in (e.g. Rethel 2010) depicting and analysing processes of financialisation outside of the core, namely in emerging and developing countries. At least against the notion of a pure Anglo-Saxon phenomenon, such least-likely cases (George and Bennett 2005, 9) of peripheral countries exhibiting financialisation have contributed to the understanding of financialisation as a global phenomenon. Studying these processes in SEE thus adds to this understanding and enlarges the geographical scope of the research body. In order to pinpoint the geographical and temporal scope of this thesis, we first need to consider the geographical literature on SEE and the literature on financialisation of SEE.

What constitutes the region of SEE and which countries are part of it? While earlier accounts considered Slovenia, Slovakia, Hungary and Turkey (Hösch et al. 2004, 664) to be part of SEE, more recent contributions (Bartlett and Prica 2012, 1; e.g. European Bank for Reconstruction and Development 2008, ii) describe the region as comprising Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, North Macedonia, Montenegro, Romania and Serbia.[34] The region is thus rather heterogeneous, populated by multiple ethnic groups speaking different languages. Following the violent conflicts that accompanied the fall of the Iron Curtain and the break-up of Yugoslavia, peace (albeit a fragile one) has reigned between the Balkan countries since the early 2000s. While Romania and Bulgaria did not experience similar ethnic and military conflicts, they nonetheless harboured a considerable amount of tension and civil upheaval in the aftermath of the end of socialism in these countries. Given this sort of disparity, it is pivotal to discuss both the temporal and geographical scope for each case in the analysis, mainly from the perspective of an explorative design.

If one is to undertake a comparative study of financialisation, mapping the region and the countries on the financialisation landscape, it seems advisable to choose an adequate time horizon to capture financialisation as a temporal process due to the fact that trajectories of financialisation do not arise overnight. Looking at similar comparative financialisation studies, Lapavitsas and Powell (2013) review the development of financialisation from around 1980 up to the crisis of 2008 in advanced economies. Karwowski, Shabani, and Stockhammer (2016) opt to study the decade before the GFC (1997-2007) based on the data availability at the starting point of their analysis. Karwowski and

[34] Moldova falls somewhere between SEE and the Commonwealth of Independent States (CIS); here it is considered to be a CIS country. Greece is excluded as it is part of the EU periphery.

Stockhammer (2017) split their analysis in two time periods (1997-2007 and 2008-2015) as a means to capture recent occurrences of financialisation, such as in China. Scholars working on Eastern Europe also start their analysis from the late 1990s (Bohle 2014, 2017; Raviv 2008), given that capitalism as the form of economic organisation was only 'put in place' around 1990. This suggests employing a similar logic by starting from around the year 2000. Due to the magnitude of the GFC of 2008, splitting the time period in two parts (plus the GFC phase) seems an advisable approach, similar to the one employed by Karwowski and Stockhammer (2017). If we follow the logic of looking at two time periods of similar length and employing the most recent data, this yields us the time periods from **2000 to 2008** ("pre-GFC phase") and **2009 to 2017** ("post-GFC phase"), with the GFC serving as the main juncture.

Moving on to the topic of geographical scope, we first need to consider the approach of the thesis, which is primarily exploratory, i.e. comparing and analysing financialisation in countries that have thus far not been sufficiently studied. Looking at the contributions on financialisation of the individual countries, there has been some research on Croatia (Cvijanović and Kešeljević 2015; Rodik and Zitko 2015), while Serbia has received rather superficial treatment (Becker et al. 2010; Živković 2017). In contrast, Romania has inspired a considerable body of research (Gabor 2010, 2011, 2013), in which patterns of (de-)financialisation of the country are compared to and summarised within a specific trajectory of financialisation in Central Eastern Europe (Gabor 2011, 2012, 243, 2013; Voinea 2013, 984). This goes in line with analysis from other domains in international political economy that posit Romania (and also Slovenia) as a Dependent Market Economy (Ban 2019) rather than as an adherent of 'cocktail capitalism' (Cernat 2006, 75; Nölke and Vliegenthart 2009, 692) found in the rest of the countries of SEE (Ban 2013). Thus, there exists considerable research on financialisation in Romania. However, given that the country is considerably larger in terms of both geographical size and population, and can also be considered part of Central Eastern Europe (Light and Phinnemore 2001, 247), it is decided to exclude Romania from the regional sample of countries in this thesis.

In further reviewing the sample of countries against the temporal scope from around 2000 to 2017, we can see that two of them were actually only formed in the middle of the 2000s, namely Kosovo and Montenegro. Both declared independence only in the mid-2000s, which makes it nearly impossible to render a comparative temporal analysis. Furthermore, data availability on these countries is quite sparse, as the central banks and statistical offices for the countries were also founded

only in the middle of the 2000s. For these reasons, Kosovo and Montenegro do not form part of the regional sample of countries in this thesis. However, given the fact that they both broke away from Serbia, care must be taken to exclude them for the period before the separation. These considerations leave us with the following countries in our sample: **Albania, Bosnia, Bulgaria, Croatia, North Macedonia, and Serbia**.

But what unites the countries and how do they differ? The countries of SEE all went through a period of socialism spanning half of the 20th century and they all declared independence around 1990. Bosnia, Croatia, North Macedonia and Serbia were part of the Socialist Republic of Yugoslavia, in which they experienced a light version of socialism featuring free movement of people and some sort of market economy. Albania experienced a unique autocratic form of socialism; Bulgaria was part of the Soviet bloc, but an independent country within it. The early transition processes were marked by violent conflict, corruption, privatisation, and state- and institution-building in all countries. Three of the four countries (Bosnia, Croatia, Serbia) fought a war in the 1990s, which caused any (formal) economic activity to halt to varying degrees. Albania experienced a very short period of anarchy in the 1990s. Several clashes between the Slavs and the Albanians characterised the 1990s in North Macedonia. Two of the countries are now part of the EU (Bulgaria and Croatia), albeit with different accession dates (2007 and 2013, respectively). These historical facts will not only prove relevant when discussing the trajectories of financialisation, but they also underscore the heterogeneous character of the region. Against this temporal and spatial background, the next two sections deal with the two research steps, the operationalisation, methodology and data description.

3.4 Comparing financialisation across the region

In line with the outlined research logic, this section deals with the research design of the comparison of financialisation in SEE in order to answer RSQ1 and RSQ2, as well as to provide a basis for the analysis of RSQ3. The first sub-section reviews the understanding of the dependent variable of financialisation, and chooses and refines the comparative concept. The second sub-section describes the data for the indicators of financialisation (dependent variable) in detail and exposes a certain lack of credible and comparable data.

3.4.1 Concept: Levels and indicators of financialisation

This sub-section advances the concept for comparing financialisation in SEE and presents the indicators for the dependent variable of financialisation in order to answer RSQ1 and RSQ2. Chapter 2 outlines the distinct theoretical approaches as well as a variety of comparative financialisation approaches. Out of the range of these frameworks, I argue that the two publications by Karwowski and Stockhammer (2017) and Karwowski, Shabani, and Stockhammer (2020) encompass different theoretical approaches and also provide a coherent background and explanations that will be most useful for scrutinising financialisation in different countries. Most other comparative approaches only analyse certain aspects of financialisation or lack a sound explanation for the choice of indicators. Hence, the two publications are taken as a basis for the development of the comparative concept in this thesis.

To reiterate, Karwowski and Stockhammer (2017) provide an empirical depiction of the variance of financialisation through multiple interpretations and across a wide range of countries, while Karwowski, Shabani, and Stockhammer (2020) rank countries across a complex set of indicators of financialisation and then locate the results against their theoretically derived hypotheses. Both publications are extensively reviewed in section 2.3.1, which this section draws upon. In order to arrive at a concept for answering RSQ1, both studies are mobilised and compared against the aspects of measurement, time periods and differentiation of levels or sectors. It should be noted that they use different terminologies in their analysis, such as indicators, hypotheses and interpretations, which seem to correspond to each other only in part.

With regard to measurement, the 'interpretations' of financialisation as used in Karwowski and Stockhammer (2017, 69) are not fully congruent with the indicators identified in sections 2.2 and 2.3, and the term itself is too vague to be deployed. Yet the methodological approach, descriptive statistics, serves to measure financialisation over time and across countries. The indicators used in Karwowski, Shabani, and Stockhammer (2020, 966) correspond to the elaborations in chapter 2, but the Spearman rank test does not adequately reflect the temporal dimension of financialisation and serves different scholarly interest. Therefore, with regard to time, the approach employed by Karwowski and Stockhammer (2017) seems more suitable for answering RSQ1, as it incorporates the temporal dimension. However, this study only juxtaposes the averages over two time periods before and after the GFC. In contrast, for the purpose of answering RSQ1, it is necessary to view

and depict the development of the indicators across the entire time period. With regard to the differentiation between sectors or levels of financialisation, the approach taken by Karwowski, Shabani, and Stockhammer (2020) (see Figure 2) corresponds to the deliberations of chapter 2 and is even more suited to answer RSQ2. In Karwowski and Stockhammer (2017), the interpretations are only one dimensional and are not connected to levels or sectors of financialisation.

Figure 2: Original indicator matrix of financialisation

Table 1. Financial activity and financial vulnerability measures of financialisation by sector.

Sector	Indicator	
	Activity measure	Vulnerability measure
Households	Gross financial income (% of total income)	Household debt (% of disposable income)
Non-financial companies	Gross financial income (% of total income)	Non-financial companies' debt (% of total income)
Financial sector	Financial sector value added (% of GDP)	Financial sector debt (% of GDP)

Source: Karwowski, Shabani, and Stockhammer (2020, 965)

In view of the RQ and the deliberations of chapter 2, it seems advisable to adjust the presented indicators of financialisation. One major correction lies in accounting for the level of international financialisation, which is not properly highlighted in these two contributions. In Karwowski, Shabani, and Stockhammer (2020, 964), international financial flows form a hypothesis for financialisation. In Karwowski and Stockhammer (2017, 69), the international facet is part of the 'interpretations' of financialisation. As the theoretical considerations in chapter 2 have shown, financialisation also occurs on the international level, which is especially important for the case of emerging economies. Hence, I argue that this level (or sector, as in Karwowski, Shabani, and Stockhammer (2020, 965)) needs to be added to the matrix of indicators, as was done in Karwowski (2020, 166). I propose to measure international financialisation with the indicators of financial inflows (Bortz and Kaltenbrunner 2018, 379; Karwowski and Stockhammer 2017, 69), which accounts for the increasing relevance of financial streams for the domestic economy and foreign currency loans (Becker et al. 2010, 238; Bortz and Kaltenbrunner 2018, 387; Gabor 2010, 257), which link domestic debtors to the ebbs and flows of international financial markets. Second, regarding the structuring of indicators, Karwowski, Shabani, and Stockhammer (2020) propose to separate them into an activity and vulnerability measure, which is also discussed in section 2.3.1. In doing so, they follow Krippner (2005, 176), who cautions that '[t]*he intention here is not to reify these labels into higher-order abstractions but to describe reasonably succinctly the kinds of data mobilized by these two perspectives in arguing for different interpretations of economic change*'. Hence, in line with the reasoning advanced by Krippner (2005) and Karwowski, Shabani, and Stockhammer

(2020), it seems reasonable to follow the same logic and structure the indicators into flow values (activity measure), which depict financial streams, and into stock values (vulnerability measure), denoting stocks or financial debt.

After having ascertained the four levels of financialisation and separating the indicators, a closer, one-by-one review of the indicators of the other levels in Figure 2 reveals that most of them are in line with the previous theoretical elaborations, while some of them require adjustment or replacement. Starting with the level of households, the indicators align with the deliberations from chapter 2 and with the comparative approaches presented above (Lapavitsas and Powell 2013, 374). Both indicators capture the argumentation of especially Marxist approaches, which highlight the immersion of households into the financial realm, be it through debt (Lapavitsas 2013) or financial income (Fine 2013). Households are increasingly engaged in financial markets through private pension schemes or other dividend payments, meaning that they increasingly derive *financial income* instead of 'regular' (wage) income. On the other hand, Post-Keynesians have argued that this tends to apply to the more affluent part of the society, as co-constitutively households are prone to take on more loans for securing a steady income or for 'catching up', which is evident from the *higher indebtedness levels* compared to disposable income.

As was argued especially in Post-Keynesian and Regulation approaches, NFCs become more financialised if they derive an increasing part of their *income through financial investments*. Hence, this indicator is in line with the literature despite the fact that Rabinovich (2019) has lately cast some doubt on the magnitude of the financial turn of companies while also providing a problematisation of the components of the indicator. An alternative way to measure an increase in financial investments would be to look at the financial assets to total assets of NFCs (Demir 2007, 354). However, the vulnerability measure of NFCs, as in Karwowski, Shabani, and Stockhammer (2020, 965), i.e. debt to income, is neither reflected in the relevant comparative financialisation literature nor in the theoretical accounts presented above, which calls for adjustment. A similar indicator was only employed by Maxfield, Winecoff, and Young (2017), who use the debt-to-equity ratio as an indicator of the financialisation of firms. However, both indicators are geared towards financial expansion (similar to the argumentation in Van Gunten and Navot (2018)) rather than financialisation. Typically, NFCs use debt in order to finance real investments, hence an increase of the ratio does not imply a shift from the real economy to the financial sector. It would only signal a possible unsustainable indebtedness level of firms, which needs to be seen as structurally different from the

over-indebtedness of households,[35] also because it would not be a (novel) altered corporate behaviour. Hence, I suggest modifying our understanding of the notion of financialised NFC debt management. As a means to capture whether NFCs increasingly rely on market financing instead of bank financing, thereby creating fungible share, bond or other products, I argue that it is necessary to include the domestic *stock market valuation* as argued by institutionalists (Deeg 2010; Engelen and Konings 2010). This sort of increased engagement on open exchanges potentially reinforces the urge to strive for shareholder value maximisation that pervades capital and stock markets. Incidentally, a similar indicator features as an interpretation of financialisation in Karwowski and Stockhammer (2017, 69).

The increasing *share of the financial sector* vis-á-vis the real sector in terms of the contribution to gross value-added captures the very essence of the various definitions of financialisation (Krippner 2005, 178), but also denotes the evolution of the financialisation of this sector. One may argue that this level of financialisation could even be considered a meta level of financialisation (of an economy or country) as it measures financialisation in general and the financialisation of other levels merely follows from it. Yet this separation of levels, including the financial sector (or the banking sector), is in line with the literature (Karwowski, Shabani, and Stockhammer 2020; Lapavitsas and Powell 2013), and furthermore, it may well be the case that the financial sector does not financialise but other sectors do. To capture the transformation of the financial sector, I suggest adding the indicator of *employment in the financial sector* as proposed in Krippner (2005, 177) and Brown, Passarella, and Spencer (2015, 12).

On the vulnerability side, Karwowski, Shabani, and Stockhammer (2020, 965) propose financial debt to GDP as an indicator for the financialisation of the financial sector. As with NFCs, this indicator tends to depict the expansion of or the depth of the financial sector as understood by the finance-growth nexus literature (Levine 1997, 704). Besides using the improper term of 'financial sector debt'[36], it also does not show what actually changes with financialisation. It is neither a novel phenomenon nor a structural transformation that banks increase their debt relative to GDP. Thus, in line with the literature (Engelen and Konings 2010, 609; Lapavitsas 2013, 170), I argue that banks were shown to increasingly invest in financial assets instead of loans. This increases the *share of fee income* at the expense of interest income as a result of an expanding engagement in

[35] To put it very simply: In a capitalist system, households save and firms take on debt.
[36] The authors do not specify which debt they mean.

broker-like functions, which can readily serve as an indicator for the financialisation of the financial sector and denotes the changing activity of the banking sector. Table 2 summarises the different indicators according to the presented modifications and to the separation of indicators by Karwowski, Shabani, and Stockhammer (2020, 963). In the first column, the **levels** of financialisation are portrayed, separated by activity and vulnerability indicators (first row). The intensity of the respective indicators on one level is termed the **degree** of financialisation.

Table 2: Modified indicator matrix of financialisation

Level\Indicator	**Activity measure**	**Vulnerability measure**
Financial sector	Fee income (in % of total income) Financial sector value-added (in % of GDP)	Employment (in % to total employed workforce)
International sphere	Financial inflows (portfolio inflow and other excl. FDI in % of GDP)	Foreign currency loans and foreign-currency-denominated loans (in % to total loans)
Non-financial corporations	Gross financial income (in % of total income)	Stock market valuation (in % of GDP)
Households	Gross financial income (in % of total income)	Household debt (in % of disposable income)

Source: Author

3.4.2 Data description: Quantitative data

This section reviews and describes the data to be employed for comparing financialisation across the region with the help of descriptive statistics. Based on the data, the extreme cases are selected for the subsequent case study. Obtaining data for the region of SEE is a tedious undertaking since not all data are available and the sources are not uniform. Hence, this section engages in detailing the individual sources and availability for each indicator and in conveying the alternatives that were sought in the event that a certain value was not readily obtainable. The respective sub-sections discuss the data for each level of financialisation.

3.4.3.1 Financial sector financialisation

An integral part of measuring financialisation within the economy is analysing whether the financial sector performs a greater role with respect to the real economy. This is measured by gross

value-added of the financial sector to GDP. Eurostat (2019c) provides data on the share of value-added of financial services and the insurance sector for the countries of Bulgaria, Croatia, North Macedonia and Serbia for 2000 until 2017 and for Albania and Bosnia from 2008 to 2017. It does not provide data for financial intermediation only, which is why the values including the finance and insurance sector are used. For both Albania and Bosnia, it is possible to display earlier yearly figures. The Institute for Statistics Albania (2019) provides data on value-added by finance and insurance activities in percent to total GDP from 2000 to 2007.[37] The Agency for Statistics of Bosnia and Herzegovina (2008, 5) indicates the gross value-added by financial intermediation for the years 2004 to 2007.[38] Combining these statistics, it is possible to analyse this indicator for the whole time period from 2000 onwards, except for the first four years for Bosnia.

The value-added of the financial sector measures the level of income and profits. The level of employment in the financial sector serves as an additional indicator to measure its relative employment level in comparison to other sectors in order to depict its development vis-á-vis the real economy. As for some of the countries, it is only possible to obtain data for the banking sector; the employment statistics are confined to financial services activities and do not include figures on employment in the insurance sector as with the previous indicator. Since a data series for the entire time period on the countries is not available from one data source, the data series was constructed through multiple data sources.

As for the denominator, data on the total labour force was sourced from the World Bank (2019d) and multiplied by the inverse of the unemployment rate from the same data base to arrive at total employed people. As for the nominator, for Albania, the figures on people employed in financial services were sourced from the quarterly IFRS reports published by the Albanian Association of Banks (2005, 2006, 2007, 2008, 2009, 2010, 2011, 2012, 2013, 2014, 2015, 2016) for the years 2005 to 2016. Earlier figures are not available. This excludes employees of other financial institutions that are not registered as banks in the country. The same holds true for the figures from Bosnia. Measuring total banking employees in Bosnia requires merging the figures of the individual reports on the banking system issued by the Banking Agency of Republika Srpska (2000, 4, 2003, 5, 2005, 4, 2007, 4, 2009, 6, 2011, 9, 2013, 9, 2015, 11, 2017, 12) and by the Banking Agency of the Federation of Bosnia and Herzegovina (2001, 15, 2003, 15, 2005, 11, 2008, 16, 2011, 15, 2014,

[37] Data definition: Indicators by economic activities by Economic activity – A11 Financial and insurance activities.
[38] Data definition: Gross value-added – Financial intermediation.

17, 2016, 17, 2018, 21). These figures are available for 2000 until 2016. The figures for Bulgaria were sourced from Eurostat (2019c).[39] The Croatian Bureau of Statistics (2019) offers employment statistics for the years 2000 until 2013[40]; from that point up until 2017, data was taken from Eurostat (2019c). North Macedonian figures are available from 2006 to 2017 from the State Statistical Office of the Republic of North Macedonia (2019).[41] For 2000 to 2005, data on bank employees was taken from National Bank of the Republic of North Macedonia (2002, 40, 2004, 24, 2006, 12). Since the numbers do not add up, the figures were multiplied by an average mark-up[42] that was derived from the difference between the numbers from the statistical office and the central bank for the years 2006-2010 (National Bank of the Republic of North Macedonia 2008, 11; 2011, 7), as both figures overlap for these years. Presumably, the difference in the numbers of employees derives from the large number of savings houses that are not registered as banks in North Macedonia. The Statistical Office of the Republic of Serbia (2019) reports employment by sectors from 2000 until 2017.[43]

The first two indicators show the evolution of the financial sector in comparison to the real economy. Financialisation also highlights a transformation of the activities of the financial sector in terms of how income is generated. The fee-to-income ratio argued to depict this change was sourced from the World Bank (2018b) by using the indicator of non-interest income to total income, which is available from 1997 until 2014 for all countries. Fee income of banks denotes income derived from any specific provision of service, which may be occasional (e.g. account opening fee) or regular (e.g. account maintenance fee, brokerage). Interest income is the revenue stream generated from granting loans.

3.4.3.2 International financialisation

International financialisation is argued to connect local income or expense streams to international financial markets and to create financial liabilities that are tied to the vagaries of global capital markets. Most importantly, this includes foreign currency and foreign-currency-denominated loans as well as other types of financial inflows (except FDI). Though all types of financial inflows might

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[39] Data definition: National accounts employment data by industry - Financial service activities, except insurance and pension funding.

[40] Data definition: Persons in paid employment - Financial service activities, except insurance and pension funding.

[41] Data definition: Labour market – activity of the population - Employed by sectors of activities – financial intermediation.

[42] The mark-up value is 46.5%.

[43] Data definition: Number of employees at legal entities, persons individually running business, unincorporated enterprises and their employees, by divisions of NACE Rev.2 (from 2000).

contribute to the stock of foreign liabilities, FDIs are considered to be more long-term investments (Karwowski and Stockhammer 2016, 12) and thus are not included in the indicator. Financial inflows were sourced from the IMF Dataset on Capital Flows in Developing Economies, which covers the years 1997 until 2014 (International Monetary Fund 2015). Financial inflows of debt include portfolio investment liabilities, financial derivatives and other investment liabilities net of government liabilities. The indicator 'private financial inflows excluding FDI' captures the change in external private debt position in percent of GDP, thereby denoting the process of international financialisation. Data is available from this source for all the countries from 2000 until 2014, except for Serbia, for which data is only available from 2007 until 2014. In order to overcome this shortfall, other data sources have been employed. Similar to Karwowski and Stockhammer (2017, 69), this analysis relies on the dataset in Lane and Milesi-Ferretti (2017), which provides data on total outstanding external debt stock and FDI stocks in USD on Serbia from 1999 onwards. However, external government liabilities are not listed separately in this dataset. For that reason, long-term and short-term external public debt statistics were drawn from the National Bank of Serbia (2019b)[44] and converted from euros to US dollars (Federal Reserve Bank of St. Louis 2019). Based on the stock data of total external debt and public external debt, the annual private financial inflows net of FDI inflows and net of the change in external government liabilities in percent to GDP can be derived for the years 2001 until 2006. Replicating the exercise for the remaining time period reveals that the figures of the two time series are not equal but tend to move in the same directions and by and large reflect the same values.

Foreign currency loans denote loans in any currency other than the local one, typically euros, US dollars or Swiss francs. Foreign-currency-denominated or -indexed loans can be local currency loans that change either the loan sum outstanding or the interest rate according to changes in the currency conversion rate. For all national bank data, foreign currency loans in total or the sum of foreign currency loans to firms and households were summed up and then divided by total loans. The data series for Albania and Bulgaria were sourced from the statistics of the Bank of Albania (2019) and the Bulgarian National Bank (2019c) and are available for 1998 until 2017. For Bosnia, figures are available from the Central Bank of Bosnia and Herzegovina (2019), but do not seem to show the real picture due to extremely low values. An updated data series by the Central Bank suggests that indexed and denominated loans were not included in the original data series. Due to

[44] Databranch: Analysis of the Republic of Serbia's Debt - External Debt of the Republic of Serbia, by Type of Debtor.

these inconsistencies, data for Bosnia was taken from the World Bank (2019a), which has figures from 2003 until 2017.[45] The same problem holds true for the reporting of the National Bank of the Republic of North Macedonia (2006), for which data was also taken from the World Bank (2019a) instead, available for the years 2006 to 2017.[46] A country report by the International Monetary Fund (2006a, 43) contains values for the years 2002 until 2005 on foreign currency and foreign-currency-indexed loans for North Macedonia.

For Croatia, data is available from the World Bank (2019a) for the years 2006 until 2017.[47] For the years 2000 until 2005, data on foreign currency and foreign currency indexed loans is presented on the basis of reports issued by the International Monetary Fund (2005a, 23, 2006b, 25). The data from the National Bank of Serbia (2019a, 5) is only reliable from 2008 until 2017, as the statistics prior to this date do not include foreign-currency-indexed loans. For the time period before the outbreak of the GFC, data is available for 2002 to 2007 from Barisitz and Gardó (2008, 114) for the Republic of Serbia.

3.4.3.3 The financialisation of non-financial corporations

NFCs financialise when they 'go public' and thereby subjugate their business strategy to the shareholder value maximisation principle and short-termism that prevails in financial markets. To measure this trend, the total value of listed companies in percent to GDP was selected as a ratio. It was sourced from the Global Financial Development Database (World Bank 2018b) for Bulgaria, Croatia and North Macedonia from 2000 to 2012, for Serbia from 2003 to 2012 and for Bosnia from 2005 to 2011. The stock exchange in Albania is currently not functional and only served as a platform to buy and sell government bonds (Albanian Securities Exchange 2018, 6). Statistics are not available. Lately, there was a private effort to create a novel platform for trading securities, which at the time of this writing has not yet materialised in any meaningful activity. To compile a more expanded data series on the countries, other sources were mobilised. From the Bulgarian Stock Exchange (2019), stock market capitalisation was sourced for the years 2013 to 2017. Total stock market capitalisation for Bosnia for the years 2012 to 2017 was obtained from the Banja Luka Stock Exchange (2013, 2014, 2015, 2016, 2017, 2018) and then divided by GDP (Eurostat 2019c).

[45] Financial soundness indicators for Bosnia: Encouraged FSIs for deposit takers - Foreign-Currency-Denominated Loans to Total Loans.

[46] Financial soundness indicators for North Macedonia: Encouraged FSIs for deposit takers - Foreign-Currency-Denominated Loans to Total Loans.

[47] Financial soundness indicators for Croatia: Encouraged FSIs for deposit takers - Foreign-Currency-Denominated Loans to Total Loans.

The same procedure was applied to data from the North Macedonian Stock Exchange (2018, 2019a, 2019b) and the Belgrade Stock Exchange (2014, 2015, 2016, 2017, 2018) for North Macedonia and Serbia, respectively, for the years 2013-2017.

The financialisation of NFCs entails both a structural transformation to more market-based financing, which is indicated by a higher number and market capitalisation of listed companies, as well as a change in their business activities. This second trail of the financialisation of firms is evidenced in the increased sourcing of income from financial activities. These can be measured as financial income to total income. Unfortunately, this data is only available for Bulgaria and Croatia (Eurostat 2021b). An alternative way to measure this shift in activities would be to look at the financial assets to total assets of NFCs. However, this data is not available either. In general, it is extremely difficult to obtain data on business on an aggregate scale in the countries of SEE. Therefore, both of the possible measurements for the financialisation of NFCs have to be dropped and we are left with the indicator on stock market capitalisation.

3.4.3.4 Household financialisation

Household financialisation is measured by the development of household indebtedness and of the share of financial assets held by households. Debt to disposable income data is not readily available for all the countries from one single data source for the entire period[48], which is why the data was gathered from various data sources. This enables us to produce figures that can be compared across countries and time. Data for the indicator is available from Eurostat (2019d) for Bulgaria for the whole period and for Croatia for the years 2002 until 2012. For the rest of the countries, a proxy was constructed based on the definition from Eurostat on gross debt to income for households. It is defined as "[…] *loans, liabilities divided by gross disposable income with the latter being adjusted for the net change in pension entitlements liabilities*" (Eurostat 2019d). Loans and liabilities are defined as loans to households, whereas disposable income is the sum of all wages minus taxes minus social security contributions.

For the nominator of the ratio, loans and liabilities of households by banks are readily available from the central banks of Albania (Bank of Albania 2019) Bosnia (Central Bank of Bosnia and Herzegovina 2019), North Macedonia (National Bank of the Republic of North Macedonia 2019), Serbia (National Bank of Serbia 2019b) and from the European Central Bank (2019a) for Croatia

[48] To the best knowledge of the author.

in local currencies. They were converted into EUR with the respective years' exchange rates.[49] Unfortunately, gross disposable income is not available for the remaining countries for the denominator of the ratio. Based on the OECD's indicator description on net disposable income for households[50], it seems reasonable to make use of final consumption expenditure plus the change in savings as an alternative to gross disposable income. Gross household consumption expenditure is available from the World Bank (2019c)[51] in USD for all countries from 2000 until 2017 and was converted into EUR for reasons of calculation. Data is missing only for Bosnia for the years 2000 until 2004.

The denominator is thus composed of total final consumption of households plus the change in savings and the change in pension entitlements. Pension entitlements are not available as data series in any statistical database. However, they can be considered negligible because pension benefits are based on a pay-as-you-go scheme and benefits are extremely low (Kidrič 2009, 46). The change in pension entitlements was therefore excluded from the calculation for reasons of negligibility but also of data availability. Nonetheless, the result must be analysed with caution given this drawback. Additional savings expressed as the change in deposits of households form another part of disposable income. This data is available from the national central banks (Bank of Albania 2019; Central Bank of Bosnia and Herzegovina 2019; Croatian National Bank 2019b; National Bank of Serbia 2019b; National Bank of the Republic of North Macedonia 2019). The change in household deposits year-on-year was subsequently converted into EUR and then added to final consumption expenditure. Disposable income was thus constructed on the basis of total expenditure by households and savings in one year. Based on this calculation, debt to income as an indicator for the financialisation of households is available for Albania, North Macedonia and Serbia from 2000 until 2017, for Bulgaria until 2016, for Croatia from 2002 until 2017 and for Bosnia from 2005 until 2017.

Gross financial income to total income as a means to measure the possible immersion of households in the financial sphere is not available. While total income of households is available, the part which is related to income derived from financial activities cannot be found in any database for the countries, except for Croatia (Croatian National Bank 2019a). Therefore, this indicator has to be dropped and debt to income serves as the only measurement for household financialisation. In that

[49] Exchange rates were sourced from the individual central banks' databases.
[50] "Real household net disposable income is defined as the sum of household final consumption expenditure and savings, minus the change in net equity of households in pension funds" (OECD 2019).
[51] Indicator name: Households and NPISHs Final consumption expenditure (current US$).

sense, we are not able to measure the extent to which households are increasingly intertwined with global financial markets on the asset side, but only on the liability side.

The data were subsumed into one unique dataset ready for statistical analysis. Despite the inability to source some of the indicators, the richness of the indicators and the availability of at least one of the indicators for each level of analysis allows us to determine the relative degree of the levels of financialisation over a time span of nearly 20 years. It is only in the case of NFCs that we are unable to measure financialisation as understood by Orhangazi (2008) and other, especially post-Keynesian, scholars who point to their increasing engagement in financial activities. Thus, it is only possible to measure the structural transformation towards stock exchanges and thereby an assumed altered focus on shareholder value maximisation.

3.5 Case studies on financialisation

This section depicts the conceptualisation for the second research step with regard to the case studies of financialisation in SEE. The cases were selected based on the comparison of financialisation and through the extreme case method. Akin to the previous section, this section outlines the concept for the description and analysis of the trajectory of financialisation and its explanatory mechanisms and also describes the data.

3.5.1 Concept and operationalisation: Analysis of trajectories and its drivers

This section describes the fields of consideration for the description and causes of the historical evolution of the different levels of financialisation based on the theoretical elaborations from chapter 2.1. Next to providing aspects of observation for an inductive analysis of the dependent variable and its case-specific factors (RSQ3), this section exposes the hypothesised independent variables (RSQ4), i.e. drivers and explanatory mechanisms, which were distilled from the elaborations of chapter 2, including the comprehensive reading of the existing literature on the drivers on financialisation. The level-specific drivers are elaborated upon in the following sub-sections.

As a first step, the case study starts by describing the trajectory (Engelen and Konings 2010, 617) on the specific level of the selected countries in order to learn more about financialisation in SEE. The trajectories are caused by diverse political determinants (Nölke, Heires, and Bieling 2013, 214) or could be the result of unintended consequences, as exemplified by Krippner (2012). The analysis

of the historical evolution follows a chronological approach by inductively scrutinising case-specific factors, which might reveal sudden ruptures or path dependencies (Pierson 2000; Siewert and Wagemann 2020, 162). As for the fields of observation, the case study analysis comprises a review of the evolution of the financial sector as undertaken in some of the studies outlined in the previous chapter (e.g. Gabor 2013; Rodrigues, C. Santos, and Teles 2016). This depiction characterises the process of financialisation on the case-specific level, such as e.g. households' growing indebtedness, altered company financing or financial flows in and out of the country, as it analyses the trail of changes to (domestic and international) financial relations. Similarly, reviewing the monetary system provides an understanding of the workings of financial in- and outflows and insight into the regulation of consumer loans and of the financial sector in general (Crotty 2009; Gabor 2013; Stockhammer 2008), both of which may constitute causes of the process of financialisation. The setup of and changes to the welfare system prove insightful for the study of financialisation on multiple levels (Boyer 2000a; Fine 2013; Lapavitsas 2013), especially with regard to households and the financial sector. Hence, the study of this non-exclusive list of institutional fields and arrangements as well as their historical evolution and political determinants informs the analysis of the trajectory of financialisation on the case-specific level and its indicators.

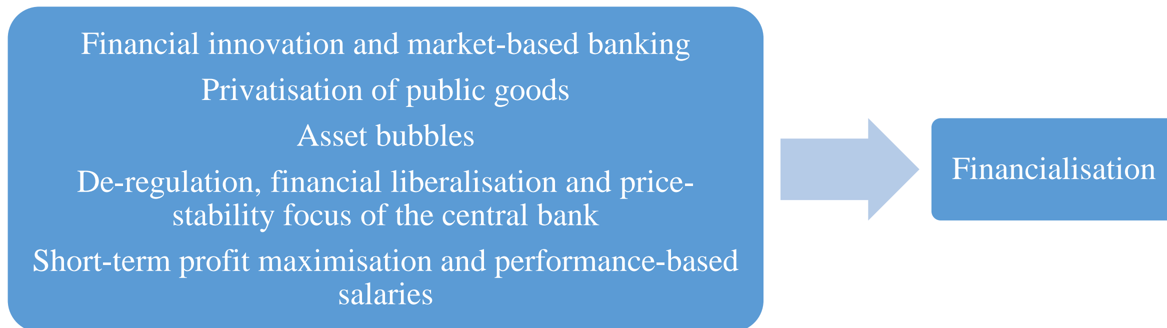
Concerning the second research step, the case study follows a rather deductively instructed process tracing analysis to confirm drivers and display its explanatory mechanisms. The conceptualisation of these drivers follows an eclectic approach, drawing on a pluralist understanding of financialisation. This sort of eclectic approach to financialisation implicitly pervades a fair share of the research body as noted by Lapavitsas (2011, 617) and Pagliari and Young (2020, 113). In line with the seminal contribution from Sil and Katzenstein (2010), eclectic approaches are able to create complex causal stories on the relationship between different explanatory mechanisms and the dependent variable. It is also expected that this approach delivers a deeper understanding of the extreme cases. Moreover, this pluralist approach aligns with the eclectic conceptualisation of the comparative financialisation concept and its indicators as presented in section 3.4.1 and with that of other studies on the financialisation of countries in the Global South and peripheries of the Global North (see section 2.3.2).

These conceptually derived drivers are split into two sets. Chapter 2 identified common drivers of financialisation on all levels (elaborated below), while it also revealed level-specific drivers that do not apply to other levels (elaborated in the next sub-sections). As for the common drivers, the

dawn of financial liberalisation and deregulation (Bortz and Kaltenbrunner 2018; Karwowski, Shabani, and Stockhammer 2020; Stockhammer 2008) has enabled financial engineering to thrive and to break the traditional, more long-term-oriented bank-company relationship. This served to accelerate the decoupling from the financial sector from the real economy (Krippner 2005) and pushed companies to seek finance on capital markets as well as to list themselves on stock markets (Engelen and Konings 2010; Froud and Williams 2002). The deregulation and excess liquidity on global capital markets fuels asset prices that often go hand in hand with financialisation (Juuse and Kattel 2015; Kregel 2007; Wray 2008). Here, the relationship is not a clear-cut one, as financialisation can cause asset price bubbles as well as vice versa. Yet, the development of the real estate market and its changing institutional arrangements feed into the financialisation of households and of the financial sector (Fernandez and Aalbers 2016; Kohl 2020).

Another common explanatory mechanism for financial sector and NFC financialisation is the shift towards short-term profit maximisation and, concomitantly, performance-based salary schemes (Palley 2007; Stockhammer 2004). Such altered corporate behaviour shortens time horizons and compels banks to engage in financial innovations and corporations to invest in financial products to reap financial income (Aglietta 2000; Crotty 2002; Krippner 2005). Especially with regard to the European periphery, the EU accession process marks another shared explanatory mechanism that has a profound impact on regulations concerning financial markets and on trade and capital barriers (Gambarotto and Solari 2014; Nölke 2017), rendering finance even more mobile within its enlarging borders. Domestic politics play a key role in devising policy and regulations favouring financialisation-related processes in emerging economies (Rethel 2010), since domestic policy-makers often adopt what are considered best practices from the Western and especially Anglo-Saxon world (Bortz and Kaltenbrunner 2018). Such changes may likewise effect financialisation on all levels.

Figure 3: General drivers of financialisation



Source: Author

Some of the common drivers of financialisation are closely linked to the drivers of the different levels of financialisation. The extensive reading of the financialisation literature in chapter 2 has however shown that there are additional or modified drivers for the specific levels of financialisation which might not be conducive to financialisation on other levels. In sum, such 'general' financialisation drivers (see Figure 3) are conducive for all levels of financialisation, while the drivers for the individual levels do not necessarily cause financialisation on other levels. The case-specific drivers are presented in the following section.

3.5.1.1 The financialisation of the financial sector

Financial sector financialisation is linked to a broader move away from patient capital of a bank-based financial system to the more impatient financing practices found in market-based financial systems (Deeg 2010; Deeg, Hardie, and Maxfield 2016) (see section 2.2.4). While they obviously face the same necessity as NFCs to now maximise short-term profit and shareholder value instead of growth, this gives rise to equally short-term behaviour when it comes to finance. Hence, as NFCs are increasingly financed through (international) financial or stock markets, banks and financial institutions are assumed to turn towards household lending on the one hand and towards novel financial instruments on the other hand (Lapavitsas 2013) (see section 2.2.1). Regarding the former, eased requirements for consumer loans (e.g. erasing limits on payment-to-income ratios) or household loans (e.g. reducing down-payment or loan-to-value requirements) form part of the explanation for the financialisation of banks and have to be viewed in a wider liberalisation agenda for financial institutions (Palley 2007; Stockhammer 2008). With regard to the latter, fictitious capital in the form of financial products and derivatives is created (Fine 2013) that generates fee revenue and leads to higher leverage for banks (Schwan 2017). The impatient financial investor uses repo financing or unsecured bank borrowing to finance short-term investments in securities (Gabor

2018). Through increased leverage, they generate short-term margins. These elevated profits in the financial sphere obviously contribute to the higher salaries in the sector, attracting a great share of the workforce (Phillips 1994) (see section 2.1), which is then lacking in the real economy.

Financial sector financialisation is also caused by a low-inflation environment (Boyer 2000a) that depreciates financial assets in local currency at a much slower pace; likewise, banks are argued to benefit from real increasing interest rates (Crotty 2002) (see section 2.2.2). The liberation of capital controls obviously favours banks in the first place as they can mediate and reap the benefits of the inflows of fresh external capital (Chesnais 2004, 2006). The financialisation of the financial sector is also characterised by the rise of shadow banking, which provides new spaces for financial institutions to escape the tight grip of regulators, especially after the GFC (Caverzasi, Botta, and Capelli 2019). Furthermore, the financialisation of the financial sector is fortified by the shift from the welfare state to asset-based welfare, e.g. in the form of private pensions, as they provide the financial sector with additional turf for reaping fees (Boyer 2000a) (see section 2.2.2).

Figure 4: Drivers of financial sector financialisation

Source: Author

3.5.1.2 International financialisation

International financialisation, one of the most recent topics within financialisation research, was argued to be caused primarily by the deregulation of international financial markets and the individual domestic regulations regarding cross-border capital mobility (the drivers in this section are primarily derived from section 2.3.2). This entails limit removals of currency exchange (Kaltenbrunner 2010; Kaltenbrunner and Painceira 2015) and the possibility to grant foreign currency loans and foreign-currency-indexed loans (Gabor 2012). The increasing interconnectedness of regulating agencies and a harmonisation of regulatory regimes in the light of institutionalised regulatory convergence (e.g. EU regulation) contribute to this development (Nölke 2017). The

granted ability of international companies willing to invest in another country or to take over existing companies was often explicitly desired by domestic politicians, constituting domestic drivers of international financialisation.

Agreements over trade, political, monetary or economic unions further heighten international financial interconnectedness, which may then fuel financialisation, either externally imposed or internally demanded. Within this level of financialisation, the vast amounts of inflowing capital are often sterilised by central banks so as to avoid fuelling inflation and to build up foreign reserves (Bonizzi, Kaltenbrunner, and Powell 2020; Gabor 2013), which often constitute handy income generators for banks and international financial investors. Reviewing these causes of financialisation from a core-periphery perspective, two aspects may bring about this kind of international financialisation. First, advanced countries find themselves in a sort of secular stagnation and see promising high-yielding investment opportunities in the periphery (Bonizzi 2017; Fernandez and Aalbers 2020), thereby contributing to a hierarchical relationship and financialisation of the peripheral country (Bonizzi, Kaltenbrunner, and Powell 2020). Monetary policy geared towards price stability and increasing real interest rates have proven to be an additional cause in this regard (Becker et al. 2010; Bonizzi 2017) (see also section 2.2.2). As class struggle also occurs within the peripheral states, it may be of interest to the domestic capitalist class to form alliances with international capitalist or rentier classes to reap the potential benefits from domestic financialisation at the expense of the working class. Certain interest groups may view international financialisation as a beneficial temporal fix to domestic problems of e.g. fair distribution.

As for the actors within the level of international financialisation, foreign-owned banking groups typically contribute to increasing interconnectedness through external funding and cross-border debt (Juuse and Kattel 2015; Raviv 2008), while corporations increasingly opt to attract financing abroad (Bonizzi 2013). Both do so to benefit from carry trades in interest rates, as the domestic interest rate, particularly in developing and emerging countries, is higher than in those of the core (Gabor 2013; Mikuš 2019d). The interest rate difference also emerges from the global currency hierarchy (Bonizzi, Kaltenbrunner, and Powell 2020), which limits domestic monetary policy due to adverse effects in the event of sudden changes. Even if external debt is held in domestic currency, it is always prone to sudden reversals given the increasingly higher fungibility of foreign financial holdings (Garcia-Arias 2015).

Figure 5: Drivers of international financialisation

Source: Author

3.5.1.3 The financialisation of non-financial corporations

NFCs were the first, indeed non-financial, sectors to be financialised. The literature distinguishes between two main threads in the financialisation of NFCs, which are the orientation towards shareholder value and the rise in financial activities at the expense of the original business-related activities. With regard to the first, it is argued that firms are increasingly inclined to focus their attention on maximising shareholder value, which goes hand in hand with a shortening of time horizons (Crotty 2002; Froud and Williams 2000; Lazonick and O'Sullivan 2000; Williams 2000) (see section 2.2.2). The focus on shareholder value brought with it performance-based salary schemes, which fortified the already substantial gap between the salaries of management and an average employee (Palley 2007) (see section 2.2.3). The alignment of the interests of the workers, management and rentiers, thus all stakeholders, to maximise shareholder value plays a critical role in this regard (Stockhammer 2004). Dispersed ownership in firms and a concomitant surge of financialised governance through pension funds have given rise to the complicated relationship between owners (principals) and managers (agents), which is to be mediated by equity-based remuneration (Dore 2008). Hence, firms now tend to compete over stock markets instead of product markets (Crotty 2002). The primacy of shareholder value naturally leads to eased requirements to attract funding on open financial or international markets, which results in less reliance on bank financing for NFCs (Engelen and Konings 2010) (see section 2.2.4). This is connected with a shift towards market-based finance in that NFCs are increasingly listed on stock exchanges and attract funding on public markets.

In a similar vein, the second thread of the financialisation of NFCs consists in their changing activities (Krippner 2005) (see section 2.2.2). On the one hand, they have shifted their corporate behaviour towards increasing their stock price through share buybacks instead of retaining and

investing profits, which has hampered innovation in firms (Palley 2007). On the other hand, NFCs have shifted away from their traditional activities in favour of generating income from financial assets, which leads to declining capital investments (Orhangazi 2008). This results in slowing rates of accumulation and ultimately to increasing inequality (Onaran, Stockhammer, and Grafl 2011; Stockhammer 2004). This has transformed NFCs into financial agents themselves.

Figure 6: Drivers of NFC financialisation

Source: Author

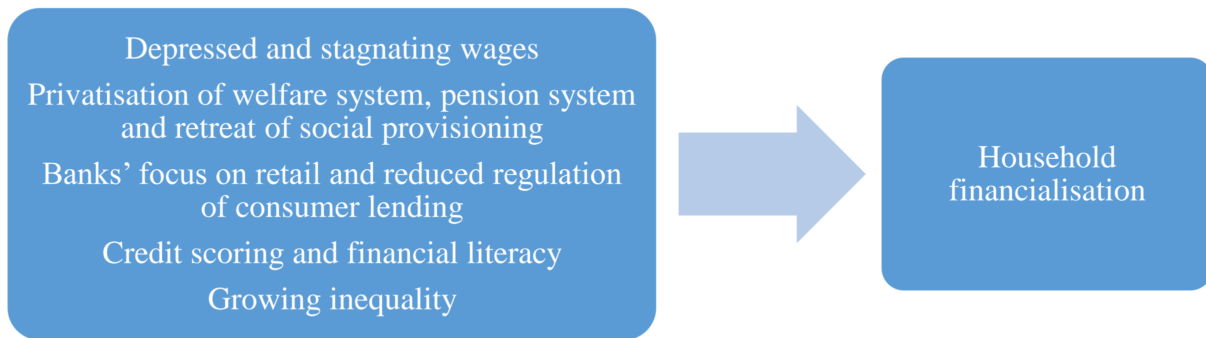
3.5.1.4 The financialisation of households

This issue leads us to the next topic on the nature of household financialisation. As argued in all theoretical accounts (see sections 2.2.2-2.2.4), depressed or stagnating real wages are a prime cause for surging household indebtedness, as people must then struggle to maintain their consumption habits, make a living or 'keep up with the Joneses' (Becker et al. 2010; Hein 2009; Lapavitsas 2013). These can also be a product of the privatisation of public pensions and a general retreat of the state when it comes to social welfare (Boyer 2000a). Specific programmes targeted at these groups to incite engagement in financial markets and products were found to be relevant factors in emerging economies and increasingly render the (future) pensioner or saver a financial investor on the asset side of households (Rethel 2010). The aim of these activities could be to mobilise more loanable capital outside the capitalist class that then in turn fuels a financialised structural transformation (Fine 2013). Another aim is to further entrench the divide between workers and capitalists through such a financial expropriation in the form of household loans, which banks are increasingly focused on (Lapavitsas 2013) (see section 2.2.1).

Overall, the increased availability of loans for households may be termed as the democratisation of credit (van der Zwan 2014). Herein one can distinguish between more finance to an increasing number of debtors (expansion) or more finance to the same number of debtors (intensification) on

the liability side of households (Van Gunten and Navot 2018) (see section 2.2.4). The same categorisation can be applied to the growing role of mortgage and housing loans, which have sped up in the light of falling social provisioning of housing. The attention to households as debtors is further spurred by new credit scoring techniques as well as by the presumption of financial literacy (Finlayson 2009; Santos 2013). Like pension, health and education, housing and real estate have become financialised objects (Aalbers 2016; Fuller 2019; Lapavitsas 2013) that connect the everyday lives of people to financial markets (Langley 2008). According to the literature, one can again distinguish between growing volumes of housing loans to high-income debtors, which would be elite (household) financialisation vis-à-vis fast consumer loans for nearly everyone, even to subprime borrowers, which we can term popular (household) financialisation (Becker et al. 2010) (see section 2.2.2). Especially the latter pattern has gained traction in recent times and needs to be analysed further. All of these explanations form part and parcel of the story of how and why financialisation as a structural transformation on different levels has taken and continues to take place.

Figure 7: Drivers of household financialisation



Source: Author

3.5.2 Data description and analysis: Secondary data and expert interviews

In order to answer RSQ3 and RSQ4 with the help of process tracing, the case study analysis employs mainly qualitative methods in line with the mixed-methods approach but also makes use of statistics where available. This section details the different data employed for the case studies. In order to describe, analyse, and expose the case-specific explanatory mechanisms and check for the conceptual drivers, the case studies comprise a review of relevant documents and other academic literature. Documentary analysis is useful for rich descriptions of specific phenomena and can be defined as "a systematic procedure for reviewing or evaluating documents" (Bowen 2009, 27). It not only provides supplementary research data but is potentially able to track change. This type of

analysis includes texts of all types; in the case of this thesis it primarily entails publications by international organisations, central banks and banks, research articles on the region and the countries, and other types of documents. In order to seek corroboration on the findings of the documentary analysis, documentary analysis is typically combined with other types of analyses (Bowen 2009, 38).

The second source of information, with which the documentary analysis is to be supplemented and guided, consists of expert interviews conducted in the case-selected countries in order to substantiate the qualitative analysis on the specific domestic trajectory of financialisation and its drivers. Expert interviews constitute "a more efficient and concentrated method of gathering data than, for instance, participatory observation or systematic quantitative surveys" (Bogner, Littig, and Menz 2009, 2). In addition to providing data, they can also reveal new directions of inquiry and aspects. According to Roulston (2010, 14–15), this dual role is fulfilled best when working with a predefined list of questions and topics that are open-ended, i.e. leave room for discussion and elaboration (see also Meuser and Nagel 2009, 31). Therefore, the interviews are conducted in a semi-structured manner.

As interviews are "*inextricably and unavoidably historically, politically and contextually bound*" (Fontana and Frey 2005, 695), particular care needs to be taken when it comes to their evaluation because the interviewees are always represented as individuals, as representatives (of an organisation) and as strategists (for any political or personal agenda) (Abels and Behrens 2009, 140). The interpretation of processes or events and new information must be iteratively corroborated. Expert interviews can be analysed using a multitude of methods (Flick 2014). All of them have advantages and pitfalls, which are discussed elsewhere in the respective literature (Fontana and Frey 2005). Given the explorative design of the study dealing with countries that have not yet been analysed on the basis of this method when it comes to financialisation (except for Mikuš (2020)), the analysis makes use of a simple content analysis (Kohlbacher 2006, 7–8). The interviews are scrutinised from the theoretically informed conceptual lens. This method is especially helpful when a previously established theory or concept is 'tested' in a new field without a very specific empirical puzzle to be explained. The opposite tends to be the case in sociological or other types of empirical qualitative research. Methods like grounded theory, which makes use of codes and theoretical sampling (Glaser and Strauss 1967), are more helpful in such research settings. However, given the framework-informed design of this study, the content analysis is sufficient, as its main goal is to

serve as a source of information. Hence, the expert interviews are semi-structured and analysed by means of a simple content analysis. In that way, they play a crucial part in the qualitative analysis of the research questions.

In the course of the research for this thesis, 20 in-depth expert interviews were conducted for the case studies of Bulgaria and Serbia. Three field trips were undertaken to Bulgaria and one to Serbia, while the second field trip planned for Serbia had to be cancelled due to the coronavirus pandemic. The pandemic also made it impossible to undertake further field trips, i.e. to Croatia, and gather the necessary contacts to conduct interviews in the years 2020 and 2021. Hence, the case study on Croatia relies solely on desk research. With regard to the choice of the interviewees, the literature tells us that such experts typically fulfil a specific function within an institutional or organisational context (Abels and Behrens 2009, 139). The experts in the research of this thesis were chosen based on their availability, their historical and political knowledge and their institutional affiliation. They comprise bank managers and employees of banks, central bank staff, local academics and consultants within the broader realm of financial markets, and fulfil or fulfilled pivotal functions in their organisation or in the political economy of the country. The selection of individuals from the private and the public sectors, together with critical observers, aims to minimise the risk of potential subjectivity or political agendas.

The gender distribution of the interviewees is 35% female and 65% male interview partners. The interviews lasted 109 minutes on average. Seven interviews were conducted via Skype while the rest of them were conducted in person. All interviews were recorded with two devices (mobile phone and dictating machine for the physical interviews, Skype recorder and OBS Studio for the online interviews) and the majority of them were transcribed. The contacts were gathered via cold contacting, snowballing and via business contacts of the author. A list of the interviewees can be found in the appendix.

With regard to secondary data, the quantitative data was sourced from the respective central banks and statistical offices of the countries under investigation. Additionally, data was mobilised from databases of international organisations such as the IMF, the World Bank, and the EBRD, as well as from the Eurostat database. Apart from various research contributions, the analyses review qualitative publications issued by the central banks and by other public institutions of the case study

countries. The documentary analysis is complemented by qualitative reports from other international organisations, as for example the country assessments and staff reports by the IMF, which proved to be informative and extensive.

3.6 Limitations

The research design is geared towards answering the research question, while both the RSQs and the design exhibit certain limitations in apprehending financialisation in SEE in general. A range of studies within financialisation research feature an imprecise notion of financialisation as such and do not clarify whether they view financialisation as explanandum or explanans. The research design of this thesis attempts to provide both a coherent concept of financialisation and its drivers as well as to supply a description of what is to be explained and what constitutes the (hypothesised) explanations.

The study is confined to descriptive statistics on the dependent variable and on a qualitative assessment of the independent variables. This design thus limits, to a certain extent, assertions about the degree of causality between the two, as both the dependent and independent variable are necessarily always contextually bound and influenced by so many diverse factors, which would be impossible to account for. The interviews seek to reduce the breadth of this limitation, though the analysis of causality would definitively benefit from further corroboration through e.g. regression analysis. A quantitative test such as this for causality proves difficult, however, due to data limitations. The issue of data limitations itself has already been discussed in the respective sections but deserves another separate mentioning here since it constrains the analysis to some extent.

A series of newer publications within financialisation research have focused on highlighting and problematising the financialisation of the state (Fastenrath, Schwan, and Trampusch 2017; Lagna 2015; Schwan 2017; Schwan, Trampusch, and Fastenrath 2020). The conceptual design of this study does not include this level of financialisation and is in this sense limited. There are two reasons for this. Firstly, the concept deployed in this thesis is close to the approach of Karwowski, Shabani, and Stockhammer (2020), which focuses on private sector financialisation (Schwan, Trampusch, and Fastenrath 2020, 2). Even more importantly, Mikuš (2019c, 2019d) already provides a compelling conceptualisation, operationalisation and comparative analysis of state financialisation for East-Central Europe, including Bulgaria and Croatia. Hence, in this thesis, the state

is viewed as an actor driving or contesting financialisation but not so much as an object of financialisation itself, though it would be worthwhile to study the financialisation of the state in other countries in SEE as well.

Another limitation concerns the academic interest of cross-case analysis. Due to the exploratory nature of this thesis, it focuses on extreme cases, while comparing the levels of financialisation across countries would be the logical next research step. This would aid in ascertaining why certain countries have financialised on certain levels and why others did not do so. In a similar vein, the analysis largely confines itself to analysing the increasing (or extreme) degree of financialisation and does not problematise low degrees or even de-financialisation. Again, further research would concatenate the findings of this study and attempt to answer such questions. The analysis and study of the RSQs was further limited by the challenges arising from the coronavirus pandemic, which hampered the researcher's ability to conduct interviews and undertake more field trips to the countries under analysis, resulting in more desk research than initially planned.

4. Comparing financialisation across South-Eastern Europe

Financialisation occurs on the different levels of (domestic) economies in different countries to varying degrees. Departing from this assumption of variation in financialisation (Karwowski, Shabani, and Stockhammer 2020, 959; Lapavitsas and Powell 2013; Nölke 2017, 32), this section analyses the four levels of financialisation across time and across the countries of SEE. It thereby seeks to answer the first two parts of the research question of this thesis. Based on the theoretical delineations of chapter 2 and the conceptualisation put forth in chapter 3, this chapter investigates the degrees of financialisation by employing descriptive statistics. The analysis contributes to the present research in two ways. Firstly, the comparative framework used in this chapter constitutes a synthesised and refined version of the few existing frameworks that developed in the literature so far. Secondly, it is applied to a region that so far has seen only sketchy research on financialisation or where a consistent comparative framework has been missing to date. The aim of this chapter is to ascertain the relative degrees of the respective level of financialisation of each country and to indicate which country has financialised to the most extreme degree. The findings of this chapter thus serve as a basis for the subsequent case studies that will be used to elaborate on the trajectories of financialisation and to explore the explaining mechanisms behind them.

In order to situate the respective degree of financialisation, it is paramount to describe in more detail the starting point of the analysis, putting special emphasis on the financial sectors and monetary policies. As laid out in section 3.1, the temporal scope distinguishes between two time periods: from 2000 until 2008 and from 2009 until 2017. The year 2000 marks pivotal structural breaks for nearly all the countries of SEE. Why is this the case? For one thing, most countries were now living in relative peace for the first time in a decade; for another, they were just starting to recover from the dire national financial crises resulting from badly managed privatisation policies and the upheavals of the early transition years. Hence, each country has its own individual historical political-economic background that aids in comprehending some of the observed manifestations of financialisation.

For example Albania, departing from Stalinist autarky (Calic 2016, 581), quickly evolved into a poster-child for transition policies including shock-therapy privatisation and austerity (Clewing and Schmitt 2011, 757) in the 1990s. However, due to the absence of control mechanisms, a financial crisis induced by a pyramid scheme impoverished a great part of the population and nearly led to the collapse of the state (Bezemer 2001; Jarvis 1999; Sadiraj 1999). Subsequently, a two-tier

banking system was effectively instated, and Albania experienced the large-scale privatisation of its banking sector, a process that continued until the early 2000s. Bulgaria and Macedonia exhibit similar trajectories. Having been part of the Soviet bloc until 1989, Bulgaria's communist power structures largely stayed in place after the fall of the Iron Curtain (Bideleux and Jeffries 2006, 123), contrary to the case of Albania. However, due to asset stripping, monetisation of government and bank debt and the highest credit expansion in any post-socialist country (Berlemann and Nenovsky 2004, 254), Bulgaria experienced an unprecedented financial and economic crisis in 1996 until 1997 (Daskalov 1998, 12; Dobrinsky 2000; Koford 2000; Wyzan 1998, 99). During this period, large sections of the population lost their life savings. By the early 2000s, a currency board had been introduced, forced bankruptcies and mergers had taken place and the entire banking sector had been privatised at the behest of a now more independent central bank. In Macedonia, a similar financial scandal in 1997 led to the closure of two major financial institutions that accounted for a considerable share of the financial sector (Drummond 2000, 54). Though Macedonia's privatisation efforts were comparatively more targeted in the 1990s than in other countries, it did not lead to a more transparent financial system. If the Macedonian economy subsequently stabilised, it was thanks to better management of the exchange rate and financial supervision. Thus, all three economies went through severe financial crisis at the end of the 1990s, followed by swift privatisation of the banking sector and exchange rate stabilisation.

The other three ex-Yugoslav countries exhibit quite diverse starting points. The end of the war in Bosnia and Herzegovina was marked by the Dayton Peace Agreement, which concomitantly also saw the introduction of a currency board in 1995 (Friedman 2004, 100). Banks continued to serve mainly criminal activities or nationalist interests in the country at the end of the 1990s. The closing of one bank in 2001 (Bideleux and Jeffries 2006, 378) was only one of the actions of the central bank among ongoing privatisations of smaller state-owned banks (Tesche 2002) that pointed the way towards a less crony-inflicted financial system in the new century. During its multiple periods of warfare, Serbia experienced crony capitalism par excellence (Bideleux and Jeffries 2006, 259), coupled with meagre economic development and high inflation (Rüb and Melčić 2007, 335; Thomas 2000, 163). Most banks served political interests, and pyramid schemes bankrupted at least two banks in the 1990s, after it turned out that a significant amount of foreign currency deposits had been stolen from the banking sector (Barisitz 2008, 52). Following the fall of the Milošević regime in 2001, Serbia saw the gradual privatisation of its mostly state-owned banks and a managed float currency regime overseen by the central bank. Despite its participation in the war, the financial

sector of Croatia experienced comparatively less severe hiccups. High inflation characterised the 1990s (Bartlett 2004, 92) which culminated in a financial crisis in 1998. Some (tycoon-owned) banks were closed or privatised (Jovančević 2002, 255), which cost the Croatian state a considerable amount of money at the end of the Tudjman era.[52] Later, this was considered to have been a successful restructuring (Kasapović 2007, 458). From there on, Croatia's policies were hallmarked by continued privatisation of the financial sector and complete alignment to EU directives, accompanied by a crawling peg monetary policy (Roaf and International Monetary Fund 2014, 17).

The brief description of the analytical starting point of the different countries can be summarised by stating that all countries featured highly corrupt and untransparent financial and economic systems and structures during the 1990s, which culminated in various financial crises and in a loss of trust both in the financial systems and in the currencies of the respective countries. In line with the policy narrative of the day, privatisation was thought to be the way to overcome these deficiencies (European Bank for Reconstruction and Development 2000, 22) and financial sector development was considered a panacea that would lead to economic growth (European Bank for Reconstruction and Development 2006, 44). Against this backdrop, the next sections analyse the degrees of the different levels of financialisation across time and space. Each section shortly elaborates on the level and indicator of financialisation and provides a brief historical background before delving into the statistical analysis, which is contrasted with results of existing comparative financialisation studies.

4.1 Financial sector financialisation in South-Eastern Europe

As the term financialisation already entails the growing diffusion of financial norms and of practices as well as the growing power of financial markets, it might seem superfluous to reflect on the financialisation of the financial sector. However, as was argued in chapters 2 and 3, the financial sectors of economies also underwent structural transformations that scholars have classified as being part of the broader phenomenon of financialisation. Marxists pointed out the growing proliferation of interest-bearing capitals that form part of the engagement of finance with finance, leading to a higher share of banks' fee income of its total income. Similarly, institutional scholars contended that the growing share of profits through financial transactions, innovations and securitisation evokes not only the same effect but also leads to an institutional transformation towards (new

[52] Franjo Tudjman was President of Croatia from 1991 until 1999.

forms of) market-based economies. Besides the change in financial business activities, scholars highlighted the sectoral transformation that has taken place, casting the financial (as well as the real estate and insurance) sector as an ever more important economic sector both in influence and in national accounting, visible in its share of value-added to GDP and of employment. This section empirically analyses both the change in business activities and the sectoral transformations of the financial sectors in SEE.

The financial sectors in SEE can look back on a vivid history. In socialist times, the so-called monobank system prevailed in most countries (Roaf and International Monetary Fund 2014, 15; Spendzharova 2014, 32). The state-owned mono-bank provided funding for the state-owned companies, reserves for foreign exchange and savings accounts for the population – a one-tier system. The latest phase of socialism saw some dispersion in the banking sectors with the emergence of specialised banks for specific sectors (e.g. in Bulgaria – Miller and Petranov 2001, 10) or regions (e.g. in Ex-Yugoslavia/Serbia – Vojvodjanska Banka). At the end of the 1990s, a series of banks were privatised mostly to foreign-owned banking groups such as Raiffeisen International, Erste Sparkasse, Unicredit, OTP, National Bank of Greece among others.[53] Thus, at the onset of the 21st century, most banking sectors were largely in private and foreign hands that just recently entered the domestic financial sectors. The non-bank financial sectors including insurance sectors were largely non-existent in the countries of SEE and only started meaningful activities around the turn of the century, as for example in Bulgaria (Miller and Petranov 2000, 371). It seems fair to assume that the financial sectors across the whole of SEE were in a rather similar condition at this time. They were mainly bank-based (Horvath and Petrovski 2013, 82), dogged by financial crises and state-capture by cronies (Nenovsky and Borisova 2015, 4), and subsequently underwent a period of privatisation which involved the international sell-out of their banking sectors.

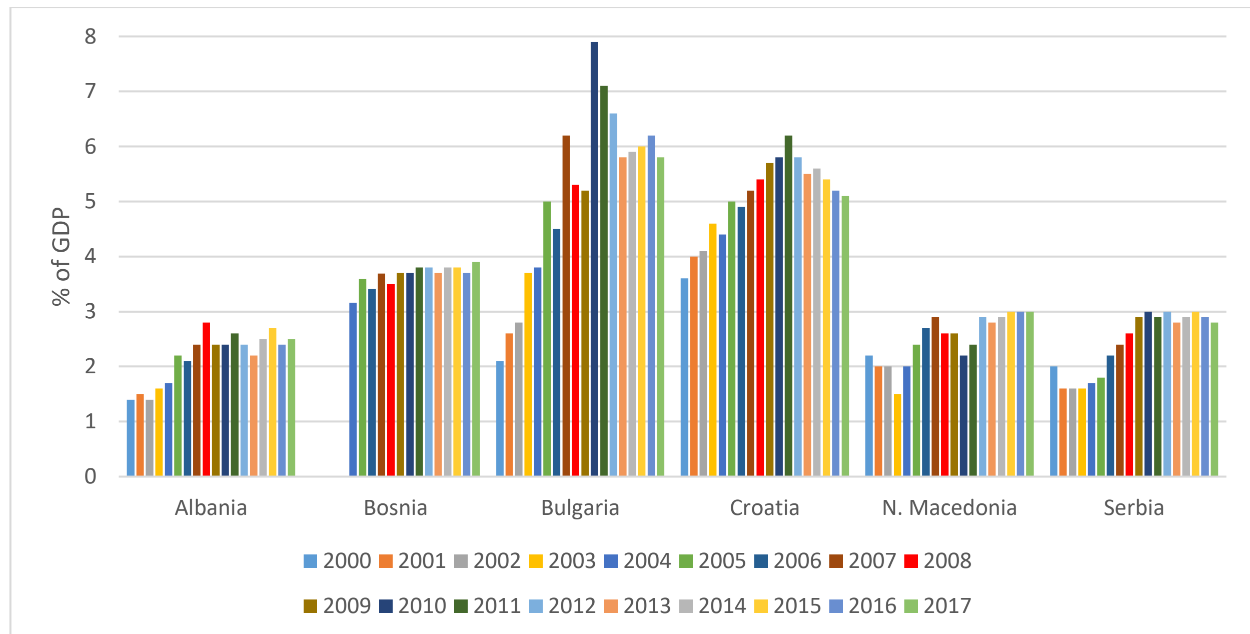
When we compare the relative importance of financial and insurance activities in the different political economies, we are not only able to trace the individual financialisation trajectory on this level for each country but also to determine which country has seen the most pronounced financialisation. In chapter 3, it was argued that the indicators value-added to GDP and employment in the financial sector to total employment provide an insight into the relative degree of financialisation of the respective financial sector. Based on the existing literature, we would expect to see the

[53] See Roaf and International Monetary Fund 2014, 43 for a compelling geographical representation of foreign banks' presence in Eastern Europe.

SEE financial sectors' value-added and employment share increase as an indication of their financialisation (Brown, Passarella, and Spencer 2015, 15; Krippner 2005, 180). Accordingly, we would interpret an increase in the fee-to-income ratio as an indication that banks were turning towards the generation of income through financial services and products rather than through loans. However, as scholars working in the field of financialisation in peripheral economies have shown, banks tend to derive an increasing share of income through consumer loans (instead of NFC loans), which in turn drives up interest income (Bonizzi 2013, 83). This leaves us with mixed expectations about the development of this indicator.

Figure 8 shows the evolution of the value-added, i.e. the net contribution, of financial and insurance activities to GDP over a period of 20 years as a measure of the sectoral transformation of the financial sector.[54] The peak of the GFC of 2008 is marked in red. Apart from a slightly increasing trend for all countries, we can observe rather heterogeneous contributions to gross value-added of the financial sectors in the different countries of SEE.

Figure 8: SEE – Gross value added of financial and insurance activities



Source: Agency for Statistics of Bosnia and Herzegovina (2008); Eurostat (2019c)

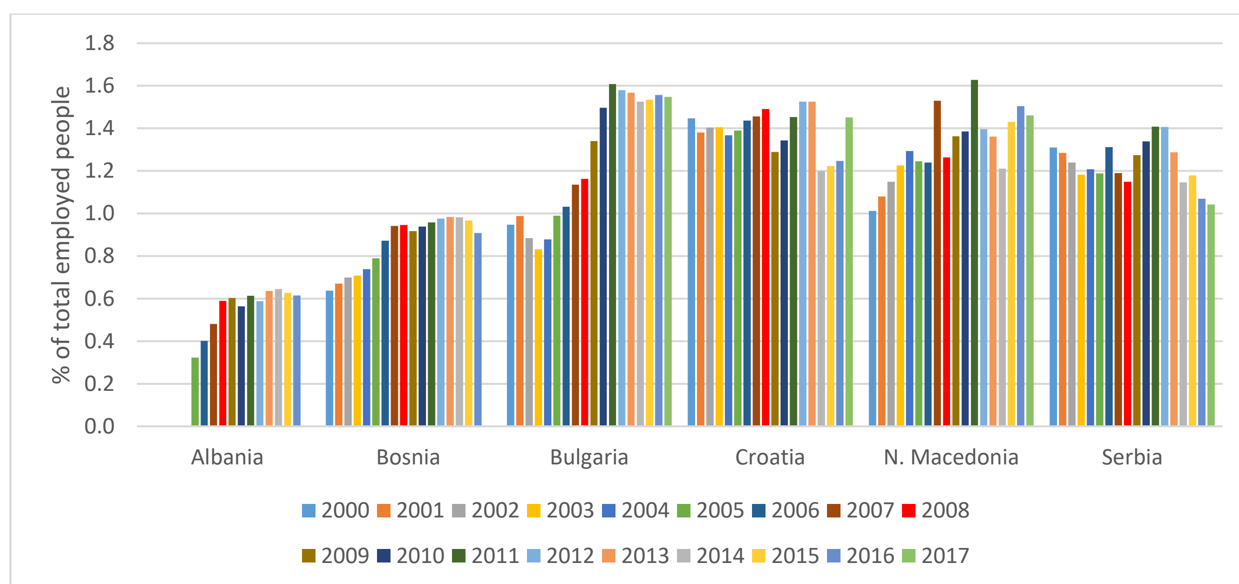
[54] As mentioned in chapter 3, due to data availability, this indicator also comprises the insurance sector. However, as the real contribution of insurance to gross-value added is rather small, the analysis refers to gross-value added of the financial sector only.

An upward trend of value-added of the financial sector is immediately apparent for all the countries across time, which highlights a general financialisation trend of the financial sector. Croatia and especially Bulgaria feature most prominently in this regard. Early on, the financial sectors of Croatia and Bulgaria had been able to appropriate a greater share of the value-added of the economy year by year. Croatia started with a comparatively high figure of 3.8% at the beginning of the century and value-added of the financial sector peaked at 6% before the GFC. Bulgaria's financialisation trajectory is even more extreme since it started at much lower levels of 2% around 2000 and then surged to over 6% and nearly 8% at the outbreak of the GFC and the Eurocrisis, respectively. Unlike Croatia, which has shown a consistent downward trend since the crisis, Bulgaria's financial sector gross value-added has seemed to stably oscillate around 6% even after the global financial turmoil. The third most financialised country on the level of the financial sector in SEE is Bosnia and Herzegovina, a nation riddled with ethnic conflict and political stalemate since the Balkan wars. Values there have increased slowly, stabilising at around 4% of GDP. In Albania, Macedonia and Serbia, the gross value-added of the financial sector was only half that of Bulgaria and Croatia, but displayed similar trajectories. All three countries had witnessed an increasing trend until the GFC and then recorded a slight drop. Subsequently, financial sector value-added seems to have stabilised (Albania and Serbia) or even increased further (Macedonia).

Summarising the findings on this indicator, four out of six countries started at similar levels (of 2%) around the year 2000, which once again indicates a certain homogeneity in starting points in this sample of countries. Financialisation, understood as an increasing importance of the financial sector vis à vis the real economy, is subsequently observed in all countries and is approaching the average on the EU scale (around 4%) (Eurostat 2019c). The most pronounced development is detected in Bulgaria and to a lesser degree in Croatia, which have surpassed the EU average and are approaching the levels of established hubs of financialisation such as the Netherlands (e.g. 8% in 2010) and the United Kingdom (e.g. 8.3% in 2009). A similar trajectory is also visible in Portugal (e.g. 5.1% in 2000 and 7.0% in 2008), while other peripheral EU states in Southern Europe, e.g. Italy and Spain, do not feature such high figures. Both Bulgaria and Croatia faced some adjustment after the GFC. The Croatian financial sector exhibited a constant decline in its value-added after the crisis, while for Bulgaria one cannot perceive a downward trend. Especially Bulgaria's trajectory stands in contrast to that of other peripheral states in Southern Europe after the crisis. Based on these elaborations, it seems fair to conclude that Bulgaria is the most financialised country in SEE, based on this indicator.

While value-added marks a structural transformation of revenue streams, employment figures denote this assumed change in terms of people working in the financial sector. Figure 9 depicts people employed in companies providing financial services as a percentage of the total employed workforce. The crisis of 2008 is again highlighted in red.[55] In contrast to the other indicators reviewed so far, the employment levels of the financial sector seem to be rather homogeneous but also exhibit an upward trend.

Figure 9: SEE – People employed in the financial sector



Source: Albanian Association of Banks (2006); Banking Agency of Republika Srpska (2018); Banking Agency of the Federation of Bosnia and Herzegovina (2019); Eurostat (2019c); National Bank of the Republic of North Macedonia (2019); Statistical Office of the Republic of Serbia (2019); World Bank (2019c); author's calculation

Similarly to the indicator based on gross value-added, Bulgaria and Croatia are among the countries with the highest employment figures, while Albania has the lowest. In Albania, Bosnia and Herzegovina and Macedonia we see growth across the whole period, whereas in Bulgaria the growth stalls around the year 2011. Croatia and Serbia are the only two countries where we can witness a general decrease of employment in the financial sector, especially after the GFC. Interestingly though, all countries except Croatia and Serbia see an increase after the GFC in terms of employment in the financial sector. In all cases, this increased ratio can be attributed to a higher number

[55] It should be cautioned that these figures capture mainly formally employed people in banks, which might leave out the non-banking sector and people not formally employed or working on a freelance basis. Nonetheless, it is possible to analyse the relative degree of financial sector financialisation using this parameter.

of employees in the financial sector (the nominator of the ratio) and not to a decrease in the employed workforce (the denominator). Mirroring its starting point in terms of gross value-added, Croatia entered the century with 1.4% of the population already working in the financial sector. In all other countries, employment in the financial sector at that time was significantly lower, albeit to varying degrees.

From this indicator, we can conclude that primarily Bulgaria and Croatia exhibit higher relative employment levels in the financial sector compared to the other political economies. It is again Croatia that started at high levels in the year 2000 and again Bulgaria that saw the most dramatic increase in the 2000s. Similar to the development of its financial sector value-added, Macedonia has seen an increase in the years 2014 onwards. In all countries except Croatia and Serbia, we observe a constant increase in the number of people employed in the financial sector, which highlights its rising relevance vis à vis the real economy (Krippner 2005). In terms of the FIRE sector, total employment is increasing on the EU level (Brown, Passarella, and Spencer 2015, 55), while the relative employment level in the financial sector is rather constant on average in the European Union (Eurostat 2019a). In the larger economies of Western Europe (including Germany and the UK), financial sector employment is even decreasing. The only country with a similar (upward) trajectory before the crisis is Portugal.[56] Once again, the development in SEE is at odds with that of established hubs of financialisation and rather resembles that of other peripheral EU economies. However, after the GFC, employment levels in the financial sector across all countries decreased in line with the countries of SEE.

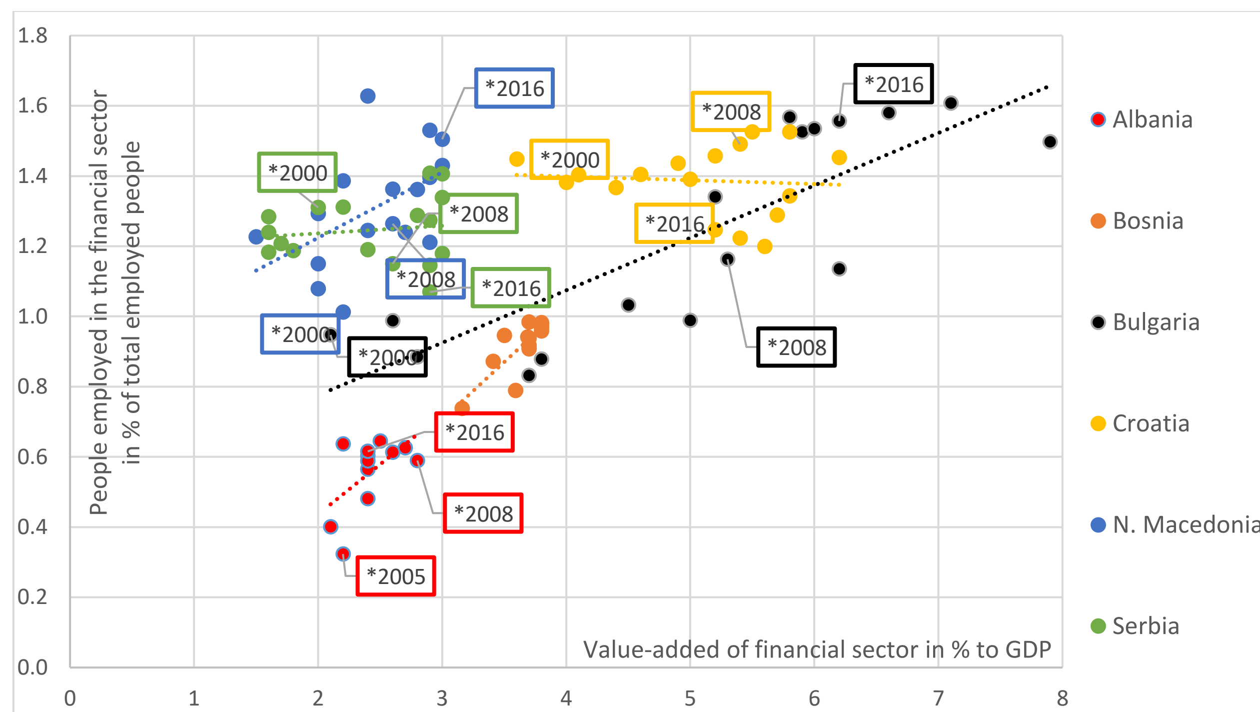
Overall, the findings of recent years partly support those of Krippner (2005, 178) who revealed increasing shares of employment in the US financial sector particularly from 1970 on, until a point was reached, already before the end of the century, when the increase stalled. In that sense, the connection between employment in the financial sector and particularly the financial sector's share of gross value-added needs to be reviewed further, especially against the background of decreasing employment in the years following the GFC.

In order to further elaborate on the interconnection between gross value-added and employment in the financial sector, it seems necessary to view both pivotal indicators of financialisation at the same time. Plotting both indicators on a scatter diagram (Figure 10) summarises the degree of

[56] For Portugal, employment in the financial sector stood at 1.23% in 2002 and 1.42% in 2011.

financialisation of the different countries in SEE. The graphical representation reveals that it is primarily Bulgaria where financialisation has been the most pronounced over the time span of analysis, as its values are the highest in the sample and it has also seen the most pronounced trajectory, as indicated by the length of its linear trendline (dotted line).

Figure 10: SEE – Development of financial sector financialisation

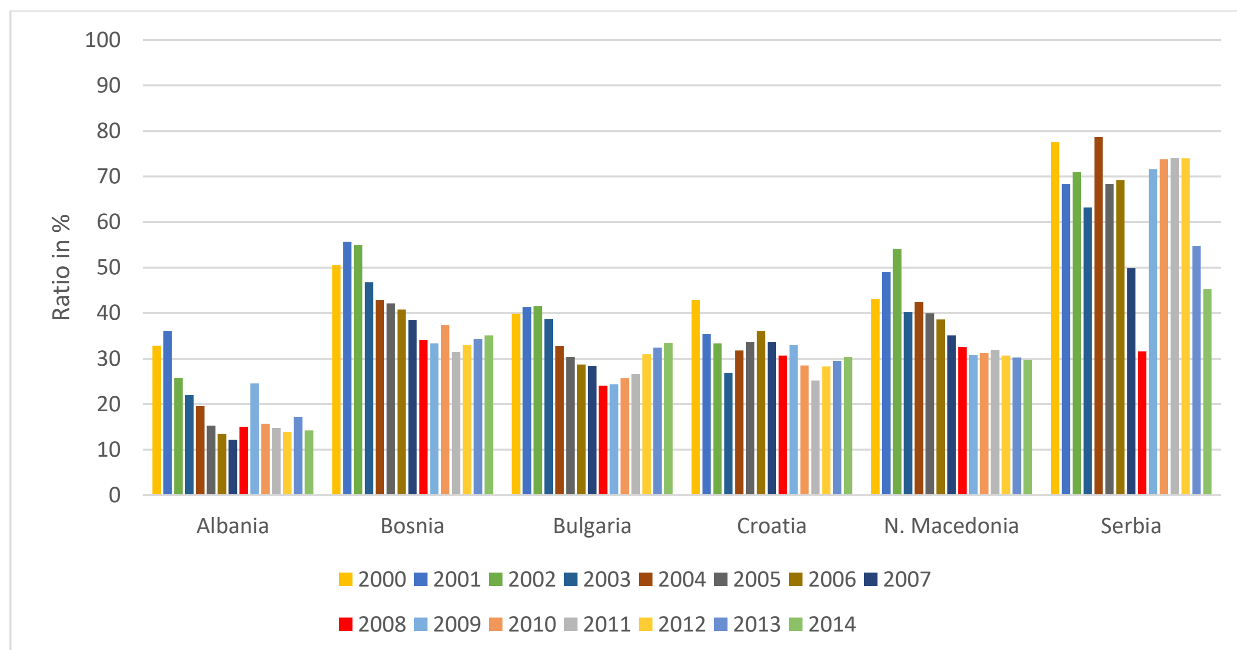


Source: Author

Besides value-added and employment, the fee-to-income ratio informs us about structural shifts in the business models of the financial sectors. Financialisation argues that banks now increasingly derive income through providing services that are charged with fees, and that their focus is shifting away from granting loans, especially given that non-financial companies tend to finance themselves elsewhere. On the other hand, scholars focusing on peripheral countries (e.g. Becker et al. 2010) have found that banks tend to financialise through interest-bearing assets, mainly in the form of consumer loans generating interest income, instead of financial products that would generate fee income. So where does the SEE region stand in this regard? Figure 9 depicts the fee-to-income ratio for the six countries for the years 2000 until 2014. The fee-to-income ratio is shown as a yearly percentage for each country's total banking sector (Figure 11). Contrary to the argumentation by early financialisation scholars, the banking systems seem to have changed their business model from generating fees to generating income from loans. Up to the GFC of 2008 (marked in

red), all countries had witnessed a decrease in the share of fee generation, and conversely an increase in their share of income through loans. After the crisis, this ratio stabilised in most of the countries. However, in Serbia and Bulgaria, the ratio has started to increase again. The ratios for Serbia provoke a question mark since they are extremely high in comparison to the rest of the countries.

Figure 11: SEE – Fee-to-income ratio of banks



Source: World Bank (2018b)

Despite this doubt regarding the data quality of the Serbian figures, it is evident that there has been a structural transformation of the financial system in all the countries. Banks seem to have moved away from generating a large part of their income from services and fees (non-interest income) to generating income from disbursing loans (interest income). Still, on average roughly 30% and more of their income is generated not through interest on loans but through providing financial services. Nonetheless, one could argue that banks in SEE focus on interest-bearing capital instead of financial products and innovations (Lapavitsas 2013), mirroring what Becker and Jäger (2012) argue for the case of semi-peripheral and peripheral countries. The decline in fee-income figures challenges the hypothesis put forward by financialisation scholars that banks are focusing more on generating fee income than on disbursing loans (Engelen and Konings 2010; as e.g. Lapavitsas 2013). For the countries of SEE, the analysis corroborates what other scholars have argued for peripheral and semi-peripheral countries, namely that banks focus on household finance and generate their income

through loans (see section 2.3.2) instead of through fee income. This finding is underscored by the comparison with other countries in the EU, both larger economies (Germany and the UK) and the semi-periphery (Spain, Italy and Portugal). The financial sectors in all these countries registered an increase in non-interest income especially before the GFC which since then has remained at roughly 40% (World Bank 2019b).

On the level of the financialisation of the financial sector itself, Bulgaria is the country that has seen the most noticeable development. Croatia also exhibits a relatively highly financialised financial sector, compared to the EU average, although its trajectory has been much less pronounced than that of Bulgaria. It is generally the case that financial sector value-added and employment have been developing hand in hand. The fee-to-income ratio of most countries has shown a declining trend that goes rather in line with the findings of the literature on the financialisation of peripheral countries.

4.2 International financialisation in South-Eastern Europe

The most recent publications within financialisation research have stressed the past omission but crucial importance of international aspects of financialisation processes, which were argued to be paramount especially in the context of peripheral countries (Bonizzi 2017; Bortz and Kaltenbrunner 2018). In general, international financialisation describes a process in which the domestic political economy becomes further intertwined with the global financial system (chapter 2). Marxist scholars view this process as emanating from core countries taking the form of imperial penetration by creating financial dependence. As was argued by Post-Keynesian scholars, these processes may lead to a higher volatility of financial flows and exchange rates, whereby new risks emerge that put the domestic economy in danger. The domestic political economy becomes subjugated to the vagaries of the international financial system, which according to Regulation theorists re-intensifies the already existing divide between core and periphery. Two indicators were argued to highlight international financialisation (chapter 3). Consistently high and surging financial inflows (excluding FDI) signify a dependence on these flows. Interest rates and yields on these flows are determined on the terms of global financial markets, posing an additional shift of risk. The same logic applies to foreign currency. Instead of financial institutions taking and managing these foreign currency and interest-rate risks, international financialisation alters this logic insofar as banks pass

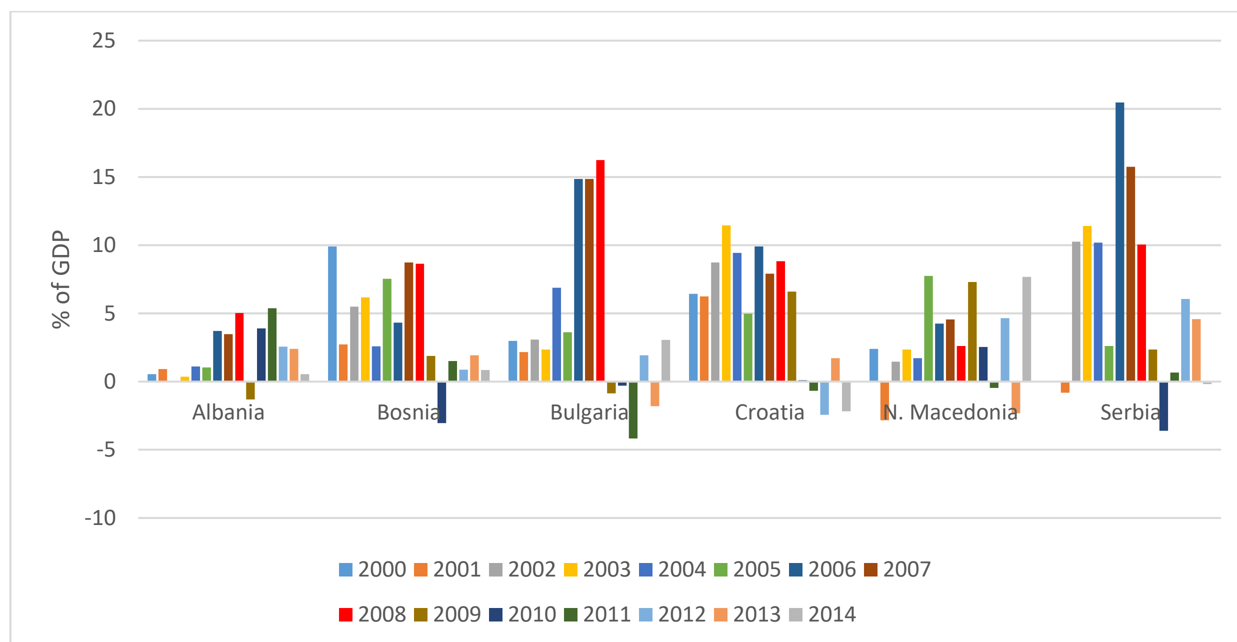
the risks onto their customers. This section investigates the trail of these two indicators for the SEE region.

Most of the countries started to liberalise their capital and financial accounts after the end of the socialist regimes. However, it took until the start of the new century before most of the countries had fully liberalised capital in- and outflows. Already by then, a considerable share derived from the EU (Roaf and International Monetary Fund 2014, 34). Despite a series of other institutional challenges in the phases of transition, free movement of capital was one of the earliest goals to have been realised, starting from a base of practically zero (Albania) or very limited capital movements (Bulgaria and Yugoslavia) in the preceding 50 years. While Bulgaria and Bosnia and Herzegovina enacted currency boards (i.e. fixed exchange rate regimes), all other countries adopted a managed float or crawling peg monetary policy. The Serbian national bank appears to be the only central bank in the region that is managing its currency more freely than in the other countries. Also, as consistent financial supervision only started to be built up around the year 2000, there was no real restriction on the content of clauses on foreign currency loans in any of the countries, meaning that financial institutions were able to devise their loan products at their own discretion (Interviewee 5 2019). Based on the existing studies on Eastern and South-Eastern Europe (Becker and Ćetković 2015; Gabor 2012; Raviv 2008), we would expect significant values for both currency inflows and foreign currency lending for the countries of the region, given their liberal capital movement regimes and the strong presence of foreign financial institutions.

Financial inflows were argued to constitute one central indicator for international financialisation. Apart from FDI, there are other types of financial inflows that have proven to be of a more short-term and volatile nature. A sudden stop of these inflows may pose serious problems for the debtor, who in the past may have relied on the constant inflows of finance capital or the rolling-over of the debt. The surplus generated by the invested capital is normally extracted from the local economy, thereby reducing the added value of these temporary financial inflows for the domestic economy. To capture these developments, it is necessary to take a closer look at this component of the financial account of the SEE economies' balance of payments.

Figure 12 denotes the development of private financial inflows, excluding FDI, as a percentage of GDP from 2000 until 2014. The year of the GFC (2008) is highlighted in red. The figures on the scale of financial inflows are remarkably high for most of the countries in SEE but also prove to be rather volatile over time.

Figure 12: SEE – Financial inflows (excluding FDIs)



Source: International Monetary Fund (2015); Lane and Milesi-Ferretti (2017); National Bank of Serbia (2019b), author's calculation

Huge differences exist between the countries of SEE both over time but also in terms of the degree of this measure of international financialisation. All countries exhibited positive financial inflows until the GFC. Only in 2001 did both Macedonia and Serbia show partial financial outflows. For Macedonia, this was probably due to political instability caused by an ethnic clash (Clewing and Schmitt 2011, 750; Irwin 2010, 342), while for Serbia it could be attributed to the exit of Kosovo from its territory. Apart from these two years, all countries recorded financial inflows of between 1% and 20% of GDP per year. The lowest financial inflows are to be found in Albania, while the highest figures are reported for Serbia, followed by Croatia and Bulgaria. It was only in the three years leading up to the GFC that financial inflows skyrocketed in Bulgaria to a constant 15% of GDP. Croatia recorded rather stable high financial inflows between 5% and 10% up until the GFC, while Serbia recorded inflows of 10% to 20% for several consecutive years prior to the crisis. Only in 2005 did Serbia's financial inflows remain on a low level, which probably reflects the exit and independence of Montenegro in the year 2006. Bulgaria, Croatia and especially Serbia exhibit a substantial increase in the degree of international financialisation: One tenth of the total annual production volume of these countries derived only from private financial inflows, excluding long-term external investment (such as FDI).

The year of the GFC, 2008, marks a turning point for all the countries. Suddenly, private financial inflows stopped, and financial flows even reversed, especially in the case of Bulgaria and Croatia. Both countries showed a net financial outflow for some consecutive years. Bosnia and Serbia also recorded negative values in the year 2010 and inflows remained positive but much subdued thereafter. Albania is the only country that recorded only a minor net financial outflow before returning to largely constant, albeit low, positive financial inflows. On these counts, Albania is the country that is least financialised internationally, as private financial inflows are much lower than in all the other countries. Macedonia figures somewhere in between, as private financial inflows are lower than in other countries, but the development becomes more volatile after the crisis. The most financialised country internationally on the measure of private financial inflows is Serbia, as it recorded the highest peak values and displays the highest values on average over the whole period. Over consecutive years, its domestic production was fuelled by financial inflows, for which it paid the price during the GFC, when the inflows suddenly become much lower and more volatile. The same, but to a slightly lesser degree, is true for Croatia and Bulgaria and partly also for Bosnia and Herzegovina.

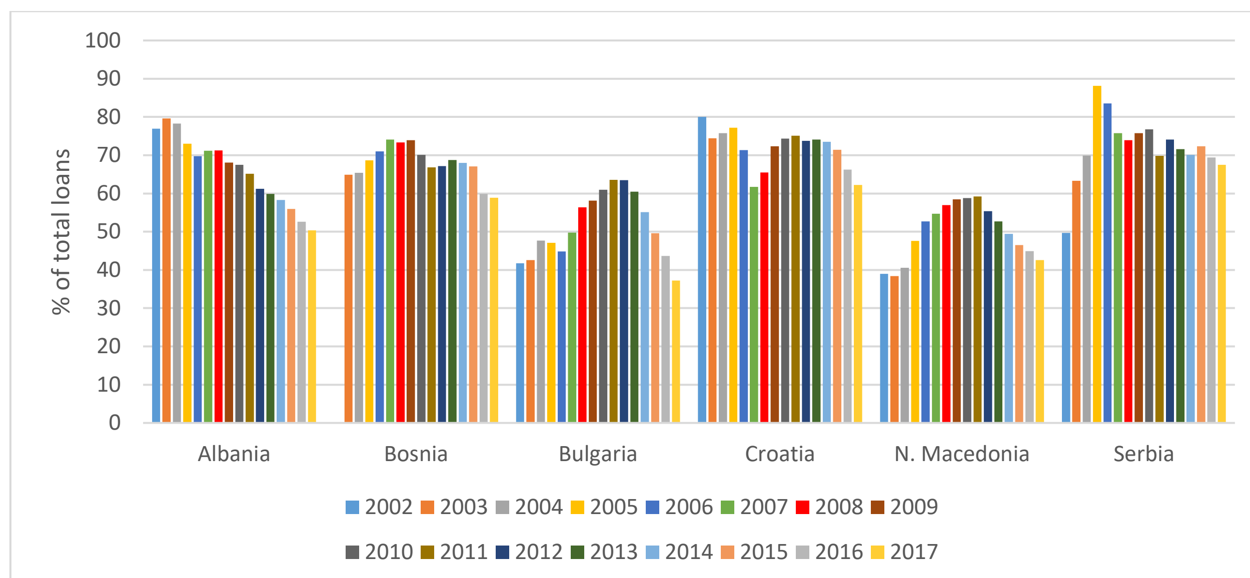
In comparison with EU economies, the magnitude of inflows matches those of semi-peripheral EU economies such as Spain (International Monetary Fund 2015) where in 2007 inflows to GDP stood at 17%. While major EU economies also feature high or even higher inflows, they are able to offset them, or in the case of Germany even surpass them, with corresponding financial outflows. It is only in SEE and EU (semi-)peripheral economies that the inflows are not matched by outflows, leading to a dependence on these flows and a build-up of foreign debt. Thus, the findings for the countries of SEE echo what scholars have argued to be a typical sign of peripheral financialisation. Especially during boom phases, private financial inflows in the form of portfolio or other investments increase the short-term debt of the domestic economy. This short-term nature proves to be toxic in times of crisis, when these inflows suddenly dry up. While the precise composition of these inflows and the purposes for which they were used need to be reviewed in more detail, it can at least be said that times of crisis reveal the peripheral status of the economies and their dependence on financial inflows.

It has been argued that, alongside financial inflows, loans denominated in foreign currency or indexed to foreign currency also link the domestic financial sphere with international financial markets. If the local currency depreciates, this creates a higher debt burden for the debtors, who mostly

derive their income in local currency. Typically, these loans feature lower interest rates than local currency loans but carry a higher risk.

Figure 13 shows all foreign currency loans and loans indexed to foreign currency as a percentage of total loans in the respective country. The year 2008 of the GFC is highlighted in red. The share of foreign currency loans in SEE seems to be extremely high in all countries, with over half of all loans typically denominated in currencies other than the local one.

Figure 13: SEE – Foreign currency and indexed loans



Source: Bank of Albania (2019); Barisitz and Gardó (2008, 114); Bulgarian National Bank (2019a); Central Bank of Bosnia and Herzegovina (2019); International Monetary Fund (2005a, 23, 2006a, 43, 2006b, 25); National Bank of Serbia (2019a, 5); World Bank (2019a)

The descriptive statistics on foreign currency loans paint a heterogeneous picture. Albania shows a constant decreasing trend since the beginning of the century, although starting at extremely high values of nearly 80%. Bosnia, Bulgaria and Macedonia display an increasing trend before the GFC and even some years after it. Since around the outbreak of the Eurocrisis, the share of foreign currency lending has started to decrease. In both Bulgaria and Macedonia, less than 50% of loans are now in foreign currency. At the same time, Bosnia still ranks third highest in the region when it comes to foreign currency loans. The most extreme values are observed in Croatia and Serbia. Already around the turn of the century over 70% of loans issued in Croatia were denominated in foreign currency, while Serbia reached the same figure in 2004. Since then, the share of foreign currency loans has remained at around 70% of all loans in both countries. Both countries registered

a notable drop in the two years preceding the GFC. For the last years of the analysis, we can identify a decrease in the Croatian figures. Serbian foreign currency loans continue to stay around 70% and drop only marginally. Overall, Croatia displays the steadiest degree of this indicator of international financialisation. Quite a different development has occurred in Albania, which has seen a consistently decreasing trend across the whole period of analysis. In one way or another, Albania must have de-financialised according to this measure of financialisation. Based on this criterion, the most pronounced degree of international financialisation is singled out for Serbia, which features the highest average value for the years 2003 until 2017.

The pervasiveness of foreign currency loans in SEE is remarkably high in comparison with Western Europe (European Central Bank 2019b). Aside from a few loans denominated in Swiss francs or US dollars, most debt in the euro area is denominated in euro. Even for a non-euro country like Denmark, the share of foreign currency loans never surpassed 30% of the total debt outstanding in the country in the last 20 years (International Monetary Fund 2016). The values of the South-Eastern European countries in this sample are higher than those of Eastern European countries like Poland or the Czech Republic, which have ranged between 20% and 40% and are generally comparable to those of the Baltic states (International Monetary Fund 2016). Summarising the findings on both indicators, Serbia is diagnosed as the country with the highest degree on the level of international financialisation. Although Croatia also features elevated values on both of the indicators, the case of Serbia is more extreme as we see a higher increase over time, which seems even more startling given the fact that during the 2000s there were still ongoing territorial conflicts over Kosovo and Montenegro.

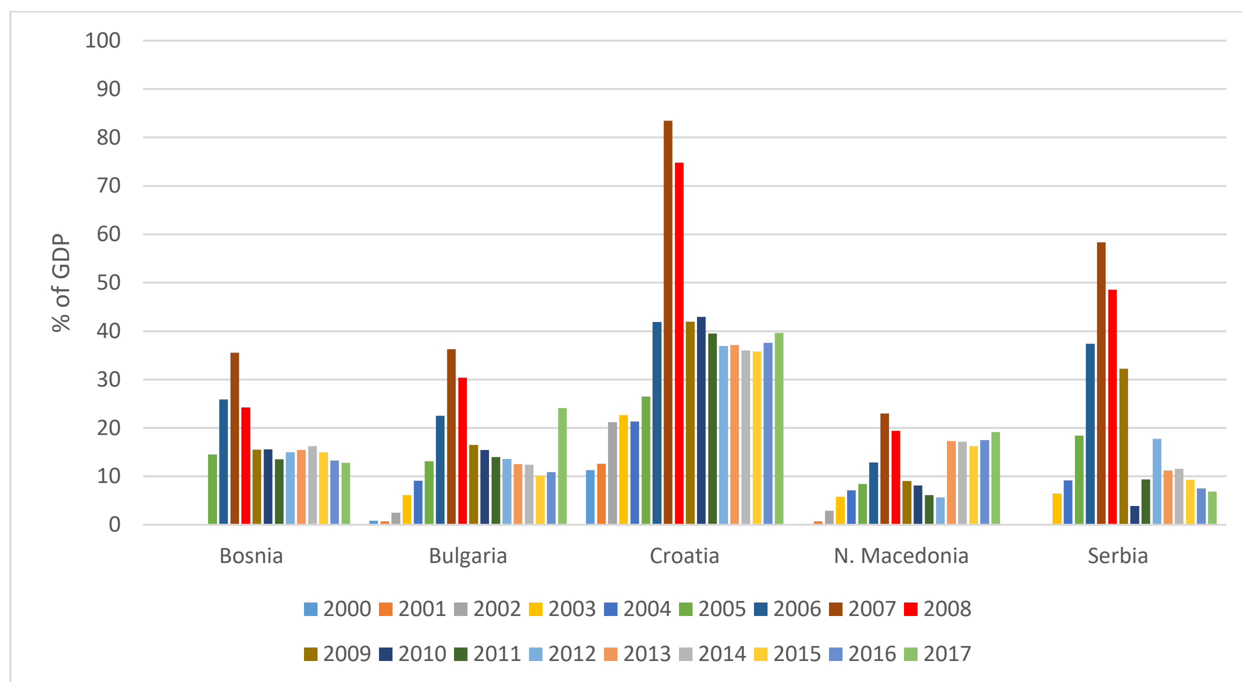
4.3 Financialisation of non-financial corporations in South-Eastern Europe

The financialisation of non-financial corporations was the earliest field of inquiry for scholars working in the field. Changes in business activities, e.g. in the form of surging financial incomes or aligning decisions to short-term shareholder value, were linked with firms being increasingly listed on stock exchanges and accessing financial markets directly for financing instead of through banks (see chapter 2). This highlights the power shift towards the financial sector in that its norms and practices are increasingly taken over by the real economy. In chapter 3, it is argued that this shift on this level of financialisation be measured in two ways. Firstly, stock market capitalisation yields insights into the extent to which companies have been listed on stock exchanges and thereby

are assumed to be subservient to the rules of global finance and thus to shareholder-value maximisation. Secondly, the ratio of financial income to total income of non-financial firms denotes the transformation of corporate practices towards an engagement in financial juggling instead of focusing on their real economic activity. As data on the latter indicator is not available for the South-Eastern European countries (see section 3.7), the analysis is confined to investigating the degree to which non-financial firms went public.

The first stock exchanges in SEE were founded during the so-called first wave of globalisation before the First World War. After the fall of the Iron Curtain in the early 1990s they served to disseminate shares to the workers in some countries as part of large-scale privatisation policies. Typically, workers received options to buy shares during an auction at a local bourse or the stock exchange (Interviewee 5 2019). The only country currently without an active stock exchange is Albania, where a stock market existed that was mainly intended for trading government bills (Bartlett and Monastiriotis 2010, 54). However, this stock market has remained with little activity. Similar to financial deepening of financial markets, the creation, support for and maintenance of stock markets was seen as a crucial factor for development by international (development) organisations (European Bank for Reconstruction and Development 2006, 50). Still, the South-Eastern European countries can largely be considered bank-based financial systems (Horvath and Petrovski 2013, 82). Based on the existing studies on this measure of financialisation (Engelen and Konings 2010; Karwowski and Stockhammer 2017), we would expect an increase of stock market capitalisation in general and a continuous development after the GFC as well, as was the case for other emerging economies (Karwowski and Stockhammer 2017, 75). Figure 14 depicts the stock market capitalisation to GDP for the five countries from 2000 until 2017. The year of the GFC 2008 is marked in red, and one can already see that this year marks the end of a striking increase of stock market capitalisation in the countries of SEE, where values peaked in 2007, right before the crisis.

Figure 14: SEE – Stock market capitalisation



Source: Banja Luka Stock Exchange (2013, 2014, 2015, 2016, 2017, 2018); Belgrade Stock Exchange (2014, 2015, 2016, 2017, 2018); Bulgarian Stock Exchange (2019); Eurostat (2019c); Macedonian Stock Exchange (2018, 2019a, 2019b); National Bank of the Republic of North Macedonia (2019); World Bank (2019d); author's calculation

The starting points of the countries with regards to their stock market capitalisation are rather homogeneous except for Croatia. All other countries featured around 10% stock market capitalisation to GDP in the year 2005. Until the GFC, stock market capitalisation had surged at a rapid pace and peaked the year before. This seems to have been a general pattern across the countries, although the relative values differ significantly. Croatia exhibited the highest values, with all companies on the stock market being worth more than 80% of the country's GDP at that time. In Serbia, stock market capitalisation reached almost 60% of GDP. These are also the two countries that started off with the highest values of stock market capitalisation at the beginning of their respective time series. Comparatively, the stock market capitalisation of Macedonia had been the lowest of all countries before the crisis. After the crisis, the de-capitalisation of the stock markets has been drastic: values plummeted by more than 50% in the years 2009 and 2010 in all SEE countries. Bulgaria and Serbia have registered a continuous downward trend since the GFC. At the same time, stock market capitalisation in Croatia and Bosnia and Herzegovina have been constant, while Macedonia has exhibited a minor increase.

In most of the countries, the capitalisation of stock exchanges since the GFC has been comparatively low, hovering slightly above 10% of GDP. Overall, Serbia and Croatia stand out in their development of stock market capitalisation. Serbia registered the second highest market capitalisation at the height of the crisis and is now the country with the lowest market capitalisation in the region. Croatia features the highest market capitalisation of all countries during the time span of analysis. The capitalisation of companies listed on the Zagreb Stock Exchange has remained at around 40% since the GFC, which is significantly higher than that of all the other countries.

The development of SEE stock exchanges, like that of global financial markets in general, has been bubble-like. Consistent increases in the years before the GFC were followed by a drastic crash. In that sense, the results confirm a Minsky-type apprehension of stock market cycles. However, contrary to the developments in other countries, stock market capitalisation since the GFC in SEE has remained on a level higher than at the starting point of analysis, especially in Croatia. Hence, the development cannot be simply characterised as a bubble, but rather has to be viewed as a structural increase in stock market activity. Contrasting the values with those of developed economies (Engelen and Konings 2010), it becomes apparent that the capitalisation of the stock exchanges in SEE is still far below levels in Western Europe, where they typically hover between 56% (2007) in Germany and 129% (2007) in the United Kingdom (World Bank 2019d). As Engelen and Konings (2010, 611) reason, this could be due to either their bank-based financial systems or the still prevailing pay-as-you-go pension systems.

Nonetheless, the values of Croatia and partly those of Serbia and Bulgaria resemble the stock market valuation of countries in Southern Europe, such as Portugal (51% in 2007) or Italy (50%). While the rally up to the GFC was even more pronounced in SEE than in these countries, the long-term average values of Croatia already resemble those of the EU's southern periphery. In contrast to other emerging economies, stock market capitalisation in SEE has not structurally started to increase again after the GFC as it did especially in East Asia (Karwowski and Stockhammer 2017, 75). Again, this trend goes in line with other countries of the southern European periphery. Still, we can conclude that, comparatively speaking, Croatia is the most financialised country in SEE on the level of non-financial companies due to its more structural transformation and elevated values.

4.4 Household financialisation in South-Eastern Europe

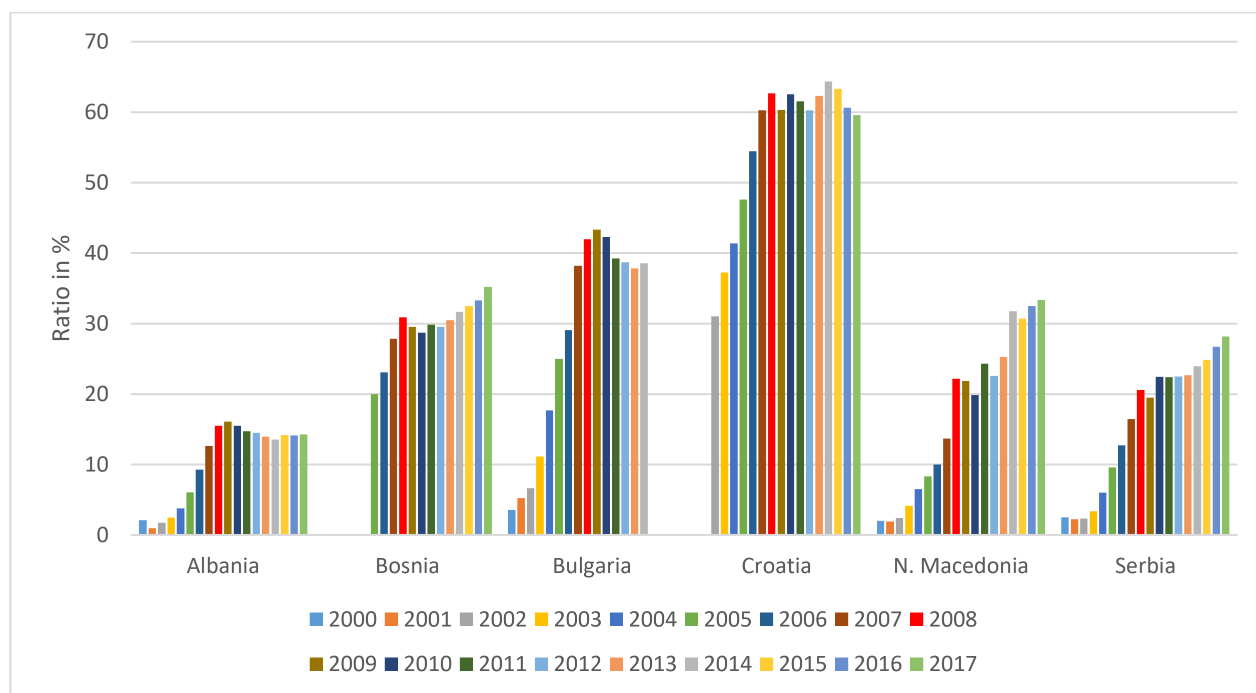
The financialisation of households has recently become one of the prominent fields of inquiry within financialisation research (Amable et al. 2019, 23) and plays a particular role in the financialisation of emerging and peripheral economies (Bonizzi 2013; dos Santos 2013). In chapter 3 it was argued that households increasingly rely on the financial sector in the face of a retreat of the welfare state and due to depressed wages. Equally, it was reasoned that greater income inequality or income stagnation prompt a lack of aggregate demand, a problem to which household debt serves as a (temporary) fix. A significantly less discussed topic is the increased engagement of households on their asset side. Since public pensions are generally declining, private pensions and personal investment (e.g. through open funds) are surging. This trend highlights the interconnections between personal savings and global financial markets, and the concomitant transmission of financial norms into everyday life.

As it is not possible to obtain data to analyse the latter aspect of household financialisation (see section 3.4.2), this section confines itself to measuring the degree of this level of financialisation only on the liability side through the debt-to-income ratio of households (see chapter 3). The section partly replicates the analysis performed by Karwowski, Shabani, and Stockhammer (2020) and Lapavitsas and Powell (2013) on other emerging economies and advanced economies. Both studies have found heterogeneous degrees among regions and countries, especially due to different forms of housing provision, but have depicted a general rise of this indicator of financialisation. Based on these two studies and the related sparse literature on the financialisation of households in SEE (Becker and Ćetković 2015), we can expect similar findings in need of further substantiation. But which situation should we take as our starting point when it comes to analysing the engagement of households with the financial sector in the countries of SEE around the turn of the century?

The engagement of households with the financial sector can be deemed as ‘low’ in the 20th century for all the countries of SEE. In the varieties of socialist and communist systems that existed in these countries, households in general had little or no access to financing. Finance for consumption did not exist and only a few households were granted loans to buy houses or cars. This undoubtedly changed with the fall of the Iron Curtain, though the largely state-owned banking sectors refrained from issuing loans to private individuals in the early transition years of the 1990s (Interviewee 5 2019). In the expectation of enduring prosperity, people kept on depositing their savings in the

state-owned banks and in newly founded private banks which promised high returns, but ultimately failed in the various financial crises (Berlemann and Nenovsky 2004; Bezemer 2001; Jarvis 1999; Winkler 2000). In that sense, the starting point for all the countries around the year 2000 seems to be rather similar. Reviewing the degree of ensuing household financialisation in SEE, Figure 15 presents the percentage of debt to income. Gross disposable income is measured by adjusted final consumption expenditure, which enables us to control for the effects of remittances and non-declared income. For purposes of splitting the time periods, the GFC of 2008 is highlighted in red. While overall the values are rather heterogeneous, a general trend of increasing household indebtedness can be observed across all the countries.

Figure 15: SEE – Household debt to gross disposable income of households



Source: Bank of Albania (2019); Central Bank of Bosnia and Herzegovina (2019); Croatian National Bank (2019b); European Central Bank (2019a); Eurostat (2019d); Federal Reserve Bank of St. Louis (2019); National Bank of Serbia (2019b); National Bank of the Republic of North Macedonia (2006, 2019); World Bank (2019c); author's calculation

The subdued level of engagement of households with the financial sector can be noticed in the low starting points around the year 2000, except for Croatia. In all countries, debt-to-income levels of households increased before the GFC of 2008. The most dramatic surges occurred in Bulgaria and Croatia, where the ratio increased by more than 30 percentage points. In the case of Croatia, household financialisation doubled in this period. Bulgaria started off with similarly low levels to those of most other countries, but then the debt-to-income ratio increased ten-fold within less than a

decade. Also in Serbia and Macedonia the ratio increased many times over, albeit to a lesser degree than in Bulgaria. Reviewing the nominator (household debt) and the denominator of the ratio (gross disposable income) reveals that the income of households developed favourably in the years before the GFC in all countries. On the other hand, the pace of expansion of loans to households was greater than the corresponding increase in income, marking a structural instance of financialisation. After the GFC, the debt-to-income ratio remained stable in Albania and Croatia, while in Bulgaria it even decreased, caused by a de-leveraging of households and slightly increasing income in the last years of analysis. In Bosnia and Herzegovina, Macedonia and Serbia the GFC put only a temporary halt to the development of the indebtedness of households, which had been steadily mounting in the preceding years. Especially the latter two countries exhibit an increase of the debt-to-income ratio by 50% in the decade after the GFC, during which the income of households remained stagnant or even decreased in the last years of analysis.

Overall, we can detect rather homogeneous trajectories in the degree of household financialisation in the countries of SEE before the crisis, while after the crisis the trajectories diverged. Primarily Croatia but also Bulgaria were financialising quite extensively before the crisis and remain the most financialised in absolute terms. Croatia had an already comparatively more financialised household sector at the start of the 21st century, while for Bulgaria the pace of financialisation was extremely high. Albania shows the least pronounced household financialisation and, like the other two countries, shows a rather stagnating trajectory when it comes to the period after the crisis. Bosnia and Herzegovina, Macedonia and Serbia provide an interesting picture since they financialised to a certain degree before the crisis and continued to do so after the crisis, albeit at a slower pace than Croatia and Bulgaria did before the GFC. While all these findings pose more questions than answers, it becomes apparent that despite the shared geographical location, there were and still are differences between the countries in terms of their degree of household financialisation.

Based on this analysis, Croatia is the most financialised country when it comes to the level of households, while Albania features exceptionally low figures in comparison. Bulgaria is the country that has seen the most exponential growth of all the countries, since it started off at much lower debt-to-income values than Croatia around the turn of the century. The most stable financialisation trajectory can be observed in Macedonia, which also started off at low values in the year 2000 and is the only country that has seen its debt-to-income ratio increase by more than 10 percentage points after the GFC.

If we compare the figures with those of Lapavitsas and Powell (2013), it becomes apparent that households in SEE are much less financialised than those of the largest OECD economies, which reported figures ranging between 170% for the United Kingdom and 90% in Germany around the peak of the crisis of 2008. However, the pace of change, especially before the GFC, more closely resembles that of the United Kingdom (roughly 80 percent increase) than that of Germany (stable, slight decrease). While both of these countries can be regarded as core economies, a comparison with the trajectory of debt-to-income in countries on the southern periphery of the EU – Spain, Portugal and Italy (Eurostat 2019d) – reveals that they also saw the debt burden with respect to income double in the same period.[57] In this light, the process of household financialisation in the countries of SEE evolved along the same lines as that of the EU periphery and the Anglo-Saxon financial economies. What is more, although the ratios are considerably below those of the EU economies, the pace of change was far higher given the low starting points of the countries of SEE.

4.5 Summary of this chapter

This chapter has set out to compare financialisation across the region of SEE over the last 20 years. On all levels of financialisation, the analysis has revealed both homogeneous and heterogeneous degrees for the respective countries, while on each level there is one country that leads or stands out in the sample. One of the most pronounced structural transformations was found for households. Households across the region have increasingly financialised over time, a development that was only temporarily halted by the GFC. While Lapavitsas and Powell (2013, 375) separated between 'eager' and more 'reluctant' financialisers, we can place most countries of SEE in the first category, with Croatia exhibiting the greatest household financialisation. In general, this mirrors the development in other peripheral economies (Bonizzi 2013, 92). The least pronounced development across the levels of financialisation was found for non-financial companies. Stock market capitalisation followed a bubble-like development in all countries, and it is only in Croatia that we could speak of first signs of a financialisation of firms. This finding stands in contrast to the general trend in both Western Europe (Engelen and Konings 2010) and East Asia (Karwowski and Stockhammer 2017) particularly for the period after the GFC.

[57] Italy stood at 33% in 2000 and at 60% in 2009. Portugal was already at 74% in 1999 and at 127% in 2009, for Spain the ratios are 64% and 130% respectively (Eurostat 2019d).

The financial sectors in the region have increasingly appropriated a larger share of value-added to GDP and employment, which highlights their growing power. This development was backed by an increasing focus on interest-bearing capital (interest income) instead of fictitious capital (fee income). With respect to value-added and employment, the findings mirror those for other financialising countries (Brown, Passarella, and Spencer 2015; Krippner 2005). The development of the fee-to-income ratio confirms the financialisation pattern in peripheral countries (Becker et al. 2010) and less that of developed economies (Engelen and Konings 2010). Financialisation of the financial sector was found to be most pronounced in Bulgaria, where the value-added of the financial sector had been approaching the same figures as the United Kingdom at the height of the GFC. All countries in SEE have heavily relied on short-term financial inflows that constitute a particular manifestation of international financialisation (Bortz and Kaltenbrunner 2018). Foreign-currency loans were revealed to constitute at least half of all loans in the region but have decreased in most countries over time. It was only in Croatia and Serbia that this intricate type of loan had been increasing and slowly decreasing lately. Overall, Serbia was found to be the country where international financialisation played out to the most extreme levels.

Table 3 Highest degree of financialisation in South-Eastern Europe

Level of financialisation	**Country**
Financial sector	Bulgaria
International sphere	Serbia
Non-financial companies	Croatia
Households	Croatia

Source: Author

The extreme level of household financialisation in Croatia confirms the research undertaken by other authors (Mikuš 2019a; Rodik and Zitko 2015). However, the comparison with other countries shows that its pace of change had been similar to countries like Macedonia and Bulgaria, which have not been mentioned in the respective literature to date. Likewise, the refined approach allowed for an appreciation of the development of incomes of households with respect to their debt.[58] Although the incomes of households had been increasing in most countries before the GFC, their level of debt was rising at a greater speed. Afterwards, debt increased in some countries and incomes remained subdued. The high level of foreign-currency usage in Serbia and Croatia was already

[58] Most studies employ household debt to GDP instead (e.g. Karwowski and Stockhammer 2017, 69).

hinted at in Becker and Ćetković (2015) and Živković (2017), while the analysis revealed that this is a common feature in the other countries as well. The decreasing share of foreign-currency loans in the most recent period have, however, not been pointed out so far; nor has the high reliance on foreign financial inflows, especially for Serbia.

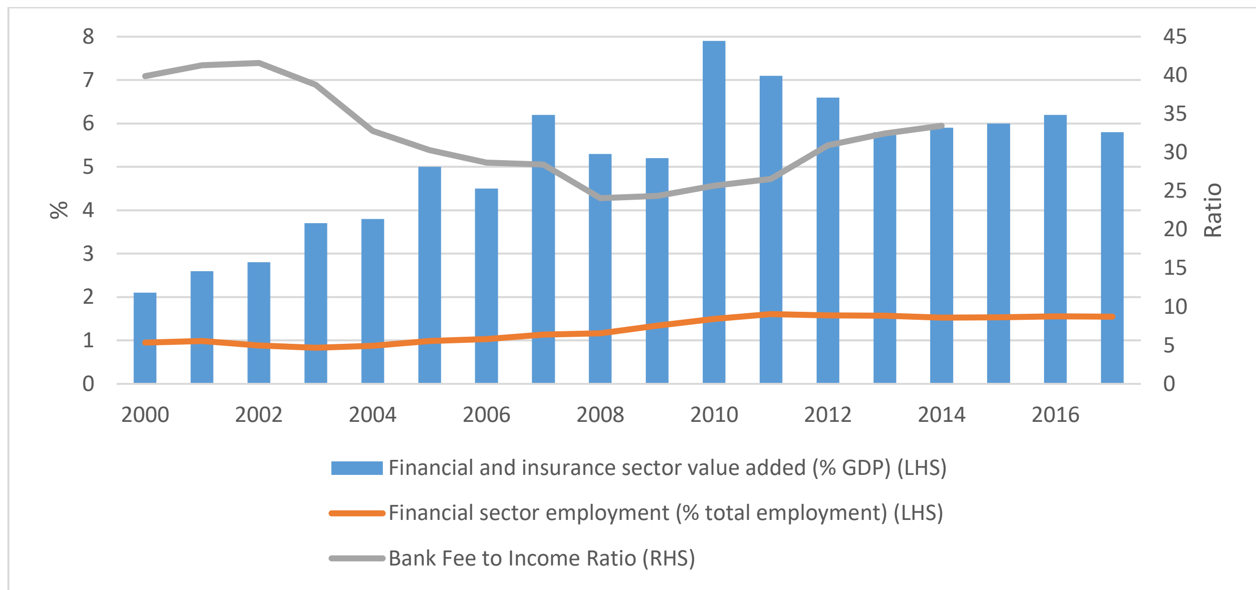
The comparison of financial sector financialisation presents a completely new insight and highlights the need for further research on the countries, especially Bulgaria. To a certain degree, this also contradicts the findings of Holzner (2017), who found SEE not to be as financialised as other regions in Eastern Europe. Likewise, the analysis of the level of non-financial companies in SEE depicted the presently under-researched topic of firms increasingly adhering to the financial and capital market principles of shareholder-value maximisation. This chapter aimed at answering the first two parts of the research question by conducting a comparative analysis. The preceding chapters criticised the lacuna of comparative financialisation studies in contextualising and explaining their findings. In order to address this criticism and answer the third and fourth parts of the research question, the next chapters analyse the most extreme cases that were identified in the comparative analysis on the respective levels of financialisation. Thereby, they aim to contextualise the nature of these distinct traits of financialisation and engage in depicting the explanatory mechanisms that have led to them. The results of the case studies enable us both to learn about the specific case and to engage in inference regarding the financialisation trajectories of other countries based on the results of the comparison set forth in this chapter.

5. Case Study: Financial sector financialisation in Bulgaria

> “Obviously, we […] have reached the stage of finance capital […] as Marx described it.” (Interviewee 3 2019)

This case study sets out to explore the financialisation trajectory of the financial sector in Bulgaria, which was shown to exhibit the highest degree of this phenomenon in SEE (see chapter 4), and to analyse the various explanatory mechanisms. Chapter 3 argued that the financialisation of the financial sector is manifest in its augmented relevance vis-à-vis the real economy, which is first and foremost driven by deregulation and financial liberalisation. At the same time, financialisation contributes to a greater share of the workforce working in the financial sector. The gradual shift from patient to impatient finance and towards a market-based financial system increases the share of fee income and is argued to be explained through financial engineering, favourable tax reforms and the privatisation of public welfare. Monetary policies of low inflation and high real interest rates, as well as eased credit regulation, sustain banks’ diverted focus on consumer lending and novel financial products. The primacy of profit maximisation in the financialised financial sector is reasoned to be amplified by performance-based salary schemes and the relatively high salaries offered in the industry. Lately, the rise of shadow banking has helped the financial sector escape the tightening grip of regulation and continue with its financialised practices. Keeping in mind these processes on the dependent variable of financialisation and its explanatory factors, Figure 16 summarises the indicators of the financialisation of the financial sector in Bulgaria. The graph depicts financial (and insurance) sector value-added, employment in the financial sector relative to total employment, both on the left-hand axis, and the fee-to-income ratio on the right-hand axis.

Figure 16: Bulgaria –Financial sector financialisation



Source: Eurostat (2019c); World Bank (2019b)

Since the turn of the century, the financial sector has gained considerable ground relative to the real economy. It nearly tripled its value-added (in % of GDP) within seven years, i.e. from around 2% in 2000 to 6% in 2007, and remained roughly at that level for the next few years. From 2010 until 2012 the financial sector even contributed more than 7% to value-added. How was the financial sector able to grow so dramatically in such a short period of time? How was it possible for it to sustain this growth in the periods of crisis and stagnation? Why did value-added spike again around 2010 onwards? From 2000 until 2010, the financial sector saw an increase in employment levels, which increased moderately by 50% or half a percentage point, compared to the total employed labour force of the country. Since then, employment in the financial sector has been constant, but at a considerably higher level than in other countries, where relative employment in their financial sectors was actually decreasing. How and why did the financial sector employ increasingly more people? How did the financial sector retain this elevated level of employment after the crisis?

The fee-to-income ratio shows a much more volatile trajectory and provides clues about the source of income of the banking sector. Until the GFC, income was increasingly derived through interest instead of through fees. What was the nature of the increase in interest income? For what purposes were the loans granted? This downward trend saw an end with the outbreak of the Eurocrisis from 2010 onwards, highlighting a shift in business behaviour. From that point forward, the share of fee

income has been rising. Why and how did the banks change the way they generate income, which enabled them to retain their increased relevance with regard to the real economy? How can this be accommodated within the framework of financialisation?

To sum up the questions deriving from the statistical observations, it is paramount to first take a deeper look at the values in order to guide the case study analysis. Answering the questions on the financialisation of the financial sector requires a deeper analysis of which parts of the financial sector grew in value-added, of the compensation levels in the financial sector, and of the nature of first the increasing interest income and then the increasing share of fee income after the crisis. The value-added and the employment of the financial sector of a country are composed of different sectors. Apart from banks as deposit-taking corporations, other financial institutions – such as insurance companies, investment funds, pension funds, credit or leasing companies – might also explain the financialisation trajectory that Bulgaria embarked upon at the turn of the century. Distinguishing between the relevance of the different sectors within this level of financialisation will enable us to conduct more concentrated research.

Then, once we have expanded our quantitative description, we can delve into the explaining mechanisms behind this identified financialisation trajectory. This entails performing an analysis of the institutional configurations and the historical development of the Bulgarian financial sector, as well as identifying possible drivers that might have triggered the financialisation process. In particular, chapter 3 exposed the drivers that could potentially aid in explaining this change. This chapter analyses the mechanisms empirically, taking these assumed drivers as the starting point, which are then sustained or negated by both the qualitative interviews and secondary literature.

This chapter begins by analysing the institutional configuration and general trends within the financial sector in Bulgaria, with special emphasis on the starting point of the analysis, which is highly impacted by the first years of transition and the Bulgarian financial crisis of 1996/1997. Drawing on the separate time periods elaborated upon in chapter 3, section 5.2 analyses the first phase of financialisation, from 2000 until 2008. After the impact of and policy changes triggered by the financial crisis are briefly outlined in section 5.3, section 5.4 sets out to analyse the second phase, from 2010 until 2017. The last section summarises the findings of this case study analysis of Bulgaria.

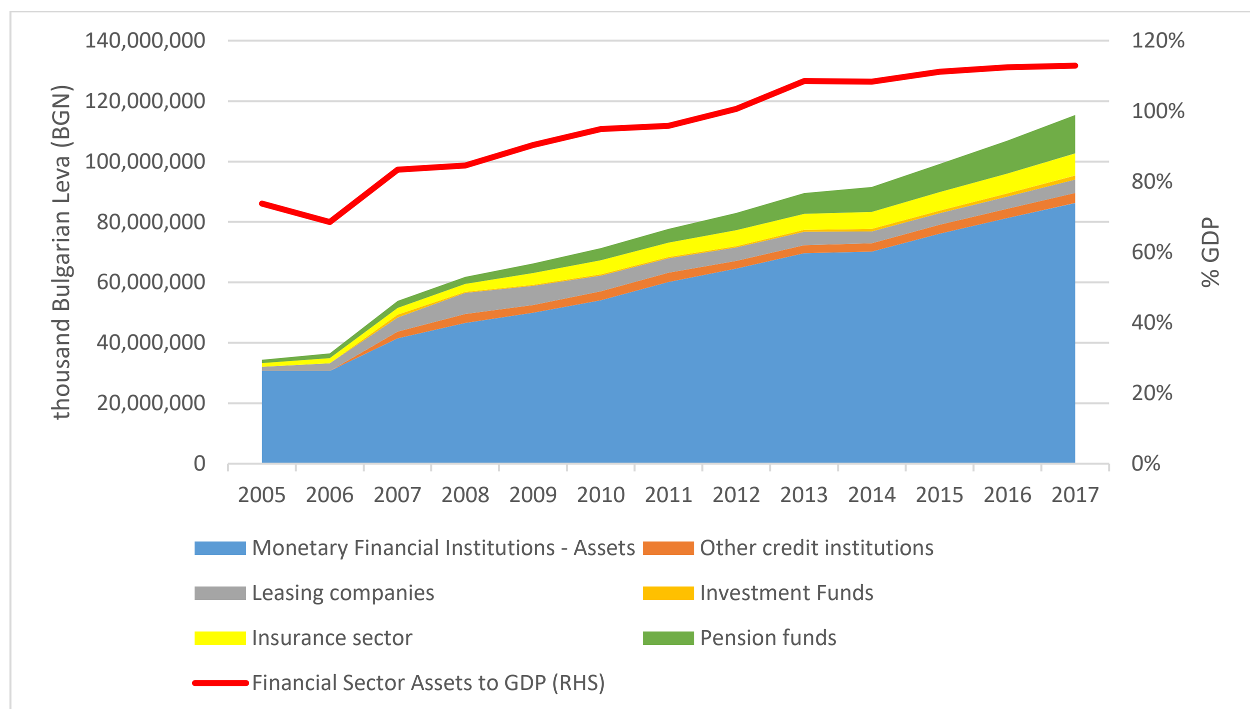
5.1 Starting point: The financial sector in historical perspective

If one is to analyse the financialisation trajectory of a country, it is imperative to underscore that the financial sector is not only composed of banks but also a range of other non-bank financial institutions. This section starts by briefly analysing the composition of the financial sector of Bulgaria as a means to guide the subsequent research. It then continues by revisiting the starting point of the analysis, which proves to be a turning point for the financial sector of the country. Within the realm of the Bulgarian financial sector, 'other monetary institutions' –as a synonym for banks – have by and large been playing the leading role. However, especially in the second phase of financialisation after the crisis, non-bank financial institutions started to take on a sizeable share of the financial sector. Figure 17 displays the size of the assets (in thousands of leva) of the individual sectors within the financial sector and shows the total asset share with respect to GDP.[59] Bank assets rose across the period of analysis, except for the year 2006. The assets of all other sectors also increased, among which pension funds feature the most prominently.

When we compare total financial assets to annual GDP, it becomes obvious that the relevance of the financial sector has risen starkly. In contrast to value-added, it grew even more after the GFC, although the last few years have been rather stagnant (except for pension funds and other credit institutions). Therefore, not only has the financial sector been appropriating a considerable share of value-added and employment in the country, but its total assets have already surpassed annual gross domestic production.

[59] Data breakdown for value-added is only available for after the crisis and is addressed in the respective sub-section.

Figure 17: Bulgaria –Financial sector's asset composition



Source: Bulgarian National Bank (2019a, 2019c), National Statistical Institute (2019c)

Part of the financialisation literature has argued for deploying financial assets to GDP as an indicator of financialisation (see chapter 2). While this ratio can illustrate the relevance of each individual sector within the realm of financial markets in Bulgaria, it merely shows rather constant growth across the whole period (apart from the year 2016). However, looking at value-added (as argued in chapters 2 and 3) provides us with a much more telling picture, revealing that the financial sector more than tripled in size until the crisis struck, whereas afterwards it remained at a rather stable level relative to the real sector. Therefore, these variances in value-added enable us to study the general financialisation trajectory on a more nuanced level.

What insights can we draw from this second, descriptive statistical assessment of Bulgaria's financialisation trajectory? Around the turn of the century, the relevance of the financial sector in Bulgaria was extremely low. Then, financial institutions, especially banks, and their relative weight in the real economy, grew exponentially in the years before the crisis in assets, value-added and employment. After the GFC, financial institutions continued to increase their assets, but the overall value-added of the financial sector remained at a high but constant level. Both in 2006 and 2014 bank assets as well as value-added of the financial sector saw a temporary downturn. Banks were the main driver of the growth in assets in the financial sector throughout the entire period. The non-

bank financial market, which comprises all non-bank financial sectors, increased in total assets over this period, but its relevance in comparison to banks remained constant and only saw an uptick in the second phase of financialisation.

Therefore, it is critical to firstly analyse the low starting point of the financialisation indicators of Bulgaria by scrutinising the history of the financial sector and its institutional configuration. Secondly, in the first phase of financialisation, the focus is placed on banking institutions, while the analysis of the second phase of financialisation entails explaining the puzzling fact that the assets of the financial sector further increased after the GFC while value-added essentially remained constant. As highlighted in this sectoral analysis of the Bulgarian financial system, the increasing financial assets of banks, and importantly of the non-bank financial sector, might aid in explaining the continued pervasiveness of financialisation in the second phase.

5.1.1 The history of the Bulgarian financial sector – the troubling ’90s

This section sketches the history of the Bulgarian financial sector and outlines the drastic changes that were made at the end of the 1990s. The aim is to delineate the starting point of the analysis (the year 2000) but also to explain prior institutional changes that had a profound influence on the institutional configuration of the Bulgarian financial sector. To this end, the sub-section shows that there were only a few path-dependent processes that can explain the financialisation of the financial sector, as the Bulgarian financial crisis had disrupted the country’s financial sector and political economy in general.

The history of financial institutions in Bulgaria dates back to 1875, when the Imperial Ottoman Bank was founded (Koford and Tschoegl 2003, 4). Since then, affected by the two world wars, bank activity surged and plummeted for decades, until in 1951, during the early phase of socialism, the Bulgarian National Bank (BNB) was designated as the country’s monobank after all the other banks were nationalised and merged into a single institution (Miller and Petranov 2001, 10). Contrary to the capitalist system, this entity was supposed to run both monetary policy and commercial banking (one-tier system), but effectively had to allocate credit according to the economic plan (Spendzharova 2014, 32). Alongside the State Savings Bank and the Bulgarian Foreign Trade Bank created in 1964 (Koford and Tschoegl 2003, 16), the financial system operated under the supervision of the communist regime. A series of sector-specific banks were founded in the 1980s as a

means to more effectively serve the various industries of Bulgaria.[60] After the break-up of the communist bloc, the financial sector underwent major institutional reforms, including the transformation of the specialised banks into universal banks and the creation of more than 50 small banks out of the regional branches of the BNB. The law on the BNB passed in 1991 was the last step towards a capitalist financial system, which defined the framework of the central bank and commercial banks (Miller and Petranov 2001, 10) as a two-tier system.

As in the case of other former socialist countries, the transition plan foresaw swift privatisation of the state-owned banks. However, other than the consolidation of a dozen smaller state-owned banks into United Bulgarian Bank and Expressbank, little progress was made. Instead, more than 20 private banks were founded under the liberal licensing regime adopted by the BNB (Miller and Petranov 2001, 11). These banks were typically owned by criminal organisations, ex-directors of state-owned enterprises, or by individuals with certain political or (illegal) economic connections to the rest of the world (Interviewee 2 2019). The main aim of this financial activity was to launder money and transfer profits out of Bulgaria instead of providing productive capital (Interviewee 2 2019). The required equity for these banks was typically granted by friends in the state-owned banks (Miller and Petranov 2001, 39) or by other banks through artificial bookkeeping. In the same vein, four state-owned banks were privatised by means of issuing new capital shares, which were actually financed by the central bank and other state-owned banks, to private investors. This practice was called the 'quiet' privatisation scheme (Andronova 2001, 9). On top of that, equity requirements were low and pre-requisites for proving the origin of funds did not exist (Andronova 2001, 7). Foreign banks were hindered from entering the market, as it was feared that they would outcompete the nascent local private and state-owned financial institutions, and only a few branches of international financial institutions were allowed to set up shop in Bulgaria in the middle of the 1990s (Interviewee 1 2019). These banks were only permitted to provide limited and very specialised services (such as international payments) (Miller and Petranov 2001, 12).

Until 1996, the central bank fuelled the dysfunctional banking system with a high money supply, as bad loans were typically rolled over and more credit was extended.[61] Indeed, Bulgaria was rec-

[60] Electronica CB, Biochim CB, Autotechnica CB, Agricultural and Cooperative Bank, Construction Bank, Transport Bank and Economic Bank (Interviewee 1 2019).
[61] On this point, see Ganev (2007, 85–87) on the exact mechanism.

ognised as the transition economy extending the most credit to NFCs during this time period (Caporale et al. 2002, 221) in nominal terms. Quite naturally, inflationary pressure derived from the surging money supply, which reduced the real value of credit but also of deposits.

In contrast to what happened in the banking sector, the remaining non-bank financial sector developed very sluggishly. The two sub-sectors that displayed some vitality were the stock market and the insurance market. Following the Czech model of mass privatisation, citizens received vouchers for a small fee that could be used to buy shares in the company under privatisation in national auctions and on the Bulgarian Stock Exchange (Miller and Petranov 2000, 363). The idea was to return ownership to the workers but also to generate income by keeping or selling the option through the stock market. However, most of the former workers did not even know what to do with the vouchers (Interviewee 1 2019), which often ended up in the hands of former managers or privatisation funds that paid a small price for them (Miller and Petranov 2000, 368). The remainder of the price, which was to be paid in instalments, seldom materialised. These privatisation funds later transformed themselves into investment companies that did not operate under any regulatory framework. Other than the privatisation transactions, the stock market was also used to collect fresh capital for banks or investment funds. These entities embezzled the money by giving loans to related companies and most people lost their investment (Interviewee 1 2019). The insurance market, as another part of the non-bank financial sector, flourished like the investment company market, as it proved to be a comfortable place to park illegally acquired funds or benefit from a weak regulatory system. Thus, most insurance companies were in one way or another owned or controlled by criminal organisations (Miller and Petranov 2000, 371). The most prominent case of an investment company involved in asset-stripping and other similar activities in Bulgaria during the 1990s is documented in Ganev (2001).[62]

The reckless behaviour of the private financial institutions, the accommodating central bank and intransparent state-owned banks were among the main causes of the deep financial crisis that Bulgaria encountered in 1996 and 1997. The result of a collective ‘preying on the state’ (Ganev 2007), the crisis dwarfed those in all other countries in Eastern and South-Eastern Europe. The general population, inexperienced with the workings of capitalism and financial institutions, lost the majority of their savings, as they were under the impression that their money was safe, even though no deposit guarantee scheme existed (Interviewee 4 2019). To put it bluntly, one member of the

[62] On the specific connectedness between party politics and criminal organisations in Bulgaria see also Petkov (2019).

governing board of the BNB noted that "*[money] was stolen from the society"* (Interviewee 5 2019). Over the years, the consecutive bail-outs of the banks and state-owned companies cost Bulgaria around 75% of its GDP (Ulgenerk and Zlaoui 2000, 3). The direct costs were borne by the central bank and by the state through the origination of (sovereign) ZUNK bonds[63] in exchange for the bad loan portfolio. As a consequence of both activities, Bulgaria's currency depreciated by a factor of more than 30. The so-called "*grabbing hand strategy of regulatory reform, where governing elites created intransparent markets and fuelled corruption*" (Spendzharova 2014, 34) brought about the country's financial and economic collapse. The beneficiaries of these schemes were the infamous 'credit millionaires' (Ganev 2007, 87; Novinite 2012),[64] private bank owners and managers of the state-owned banks and enterprises.

To sum up, Bulgaria's early experience with dysfunctional capitalism and its devastating consequences was one of the many but most certainly one of the costliest in all the transition countries in Eastern Europe and plays a key role in understanding and explaining the nation's continued trajectory. Financial institutions mainly served the interests of the domestic elite, who were plundering the deposits and state assets. The next section takes a detailed look at the changes that were made to the financial system in Bulgaria following the crisis.

5.1.2 The year 1997 and thereafter: Shock therapy 2.0

After the deep crisis of 1996-1997, the central bank saw an extreme shift in its mandate. In contrast to its history of being a highly political animal during socialist times and in the early 1990s, the central bank now took a U-turn and became vastly apolitical. The Bulgarian currency, the lev, was pegged to the deutschmark and later to the euro. This meant that the central bank was obliged to automatically convert currencies at a certain rate. Unlike in the previous period, it was now prohibited from engaging in domestic credit creation (Duenwald, Gueorguiev, and Schaechter 2005, 11), thereby removing the lender-of-last-resort function of the central bank. The IMF, more specifically the head of the European division of the IMF (Interviewee 6 2019), played a key role in this policy shift; it pushed the government and central bank to enact this type of fixed currency regime in a fashion similar to what was done in the Baltic states. Additionally, it required the government to pursue capital and financial account liberalisation and embark on a pathway of fiscal discipline

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[63] A type of domestic Bulgarian bonds that can also be traded internationally with the purpose of recapitalisation (Schönfelder 2012, 856).

[64] It is contended that the credit millionaires, of which a list was publicly available, served as scapegoats for the real benefiters of the schemes, i.e. politicians and former members of the state intelligence service (Interviewee 1 2019).

(Spendzharova 2014, 24). Next to these structural reforms under the stand-by and emergency agreements with the IMF, the programme for Bulgaria included the privatisation of the financial sector in order to maintain debt service and uphold the balance of payments. The real capitalist transformation process, now under the strict auspices of neoliberalism, thus only started from 1997 onwards in Bulgaria (Andronova 2001, 4), eight years after the fall of the Iron Curtain.

Strikingly, the currency board was embraced by the various interest groups in Bulgaria. Against the backdrop of huge losses of private savings, the public was keen to accept a regime that would not only stabilise the exchange rate – and thus inflation – but which would also end the hugely corrupt political system (Interviewee 1 2019). The IMF and the international creditor community were satisfied, as the changes would facilitate the payment of foreign debt. Lastly, the beneficiaries of asset-stripping, who saw their debt levels greatly reduced through the prior hyperinflation, could now enjoy the fruits of the captured assets (Nenovsky and Borisova 2015, 7). Senior employees of the central bank, however, were less enthusiastic about the transformation, as they were largely stripped of their power, and a new generation educated elsewhere was installed in some of the leading positions in the institution.

To illustrate how the transformation changed the Bulgarian financial market, we will briefly review the developments in the different sectors. Within the six years between the introduction of the banking framework in 1991 and the crisis of 1997, no real capitalist transformation materialised in Bulgaria, as banks were first mainly privatised through sales to people with questionable business practices and then re-nationalised during the crisis. In contrast, after the turnaround of 1997, the next six years saw privatisation take place at an unprecedented pace: by 2003, 97.6% of bank assets had already been privatised (Spendzharova 2014, 37). Within this process, priority was given to selling the banks to international investors or banking groups (Valev 2006, 21), and that is exactly what happened: the United Bulgarian Bank was sold to a consortium around the EBRD, which later sold the bank to the National Bank of Greece. The Bulgarian Post Bank was sold to the Greek Eurobank, Expressbank was bought by Société Générale, the former Bulgarian Foreign Tradebank (Bulbank) was purchased by UniCredit, and the State Savings Bank became part of Országos Takarékpénztár (OTP Bank), to name only a few. Due to the prohibition of creating credit domestically, the central bank apparently favoured larger international banking groups, as they would be able to tap into their parent companies' liquidity in times of distress (Koford and Tschoegl 2003, 23).

Similar to the banking sector, the insurance sector faced a series of new regulations and laws that made it much more difficult to obtain a licence. In the course of this process, the sector was heavily restructured and the largest insurers became state-owned (Miller and Petranov 2001, 30). At the same time, branches of international insurance companies opened while several local companies emerged. Capital markets in the form of the Bulgarian Stock Exchange continued to play a minimal role at the end of the 1990s and the early 2000s. There were few changes in regulations and most trades remained connected to large block sales within privatisation deals (Miller and Petranov 2001, 22). The reserve of the state-run pension system was likewise severely eroded in the 1990s due to hyperinflation, reduced birth rates and emigration. The restructuring of this sector foresaw a new three-pillar structure that was based on the recommendation of the World Bank (Nenovsky and Milev 2014, 7). The first pillar remained the state-operated pay-as-you-go system (to be paid into by both the employer and the employee, although the state also contributes to the budget). For the second pillar, Bulgaria, like other Western economies in the decades of neoliberal welfare restructuring, introduced a supplementary compulsory universal pension fund scheme after the crisis for all employees, which was to be run by private pension companies registered with a special licence. These entities had to invest a minimum of 50% of their assets in government bonds, and additional limits were imposed on investments until 2006 (Nenovsky and Milev 2014, 8), but then removed in light of the country's impending accession to the EU. The third pillar consisted of supplementary voluntary pension schemes.

All three non-bank financial sectors were restructured according to the policy recommendations of both the IMF and the World Bank, which foresaw a prototype for a neoliberal-inspired institutional transformation. This experiment was conducted at a time of crisis and distress, in which Bulgaria was on the brink of insolvency and chaos. Reviewing the first ten years of modern capitalism, it is evident that the state of Bulgaria and its citizens paid for the enrichment of certain groups, and this has left a significant scar in the shared memory of the country. After the crisis and subsequent reckoning, the remaining state property in the banking sector had to be liquidated in order to avoid running into a balance of payment crisis similar to that of the Asian Tigers in the same year and to cover up for the prior monetary excesses. Thus, the criminal activities of the local elite led the central bank to undertake a second extreme shift in its policy by inviting foreign financial institutions to take over the state-owned banks. The banking and insurance sectors were now primarily owned by large international financial institutions, whereas the pension sector foresaw the building

up of a mandatory private pension fund. It was exactly this shift that laid part of the groundwork for the financialisation trajectory that Bulgaria would ultimately embark upon.

On this point, an interviewee who was directly in charge of the introduction of the currency board, noted the following:

> "*There has been a power shift, definitively in pure quantitative terms in Bulgaria towards the financial sector. The significant change came in the 1990s. [In keeping with t]he mantra at the time, the so-called Washington Consensus, […] we believed that by transferring ownership to experienced bankers of some of these banking assets that continued these processes in a more orderly and more decent form, it did allow more dynamism … in the economy. In Bulgaria, as everywhere else, the proportion of industry has shrunk.*" (Interviewee 6 2019)

The statement indicates that there was a strong belief held by academics but also the general public that inviting foreign and experienced financial institutions with no political affiliation into the country would increase the transparency of the system as a whole. Secondly, the hope was that they would allocate credit in a more efficient way, which would in turn foster economic growth. As already foreshadowed in the introduction of this chapter, this would turn out to be only one side of the coin.

5.1.3 Interim summary

The international financial institutions did in fact perform banking activities in a more transparent and legal manner; however, as the subsequent sections of this chapter are going to show, their operations and growth led the financial sector to become increasingly more relevant in contrast to the real economy. With the central bank's ultimate mandate to ensure the full convertibility of leva into euros (Interviewee 5 2019), together with an open capital and financial account, Bulgaria chose a path in which it was no longer able to control the monetary supply and influx of foreign capital. This extreme decision resulted out of a situation of crisis marked by asset-stripping, personal enrichment and a dysfunctional financial system, but was also firmly pushed by the international organisations and most prominently the IMF. The central bank's only form of leverage was to regulate the financial system through mandatory reserves or other forms of macroprudential regulation. This obviously limited the (mis-)use of the financial sector for personal enrichment, but also

made it impossible to conduct fiscal and monetary policies conducive to productive, real economic growth.

In sum, the institutional changes in Bulgaria's financial system at the end of the 1990s included a fixed currency regime, an open capital and financial account, and a financial system dominated by foreign-owned institutions. These configurations clearly resonate with what other financialisation scholars have found for other countries as policy choices that are conducive for financialisation. A fixed currency regime limits the possibility of external devaluation (of debt and nominal wages) and of monetary policy. Open capital and financial accounts allow for swift financial flows in and out of the country, heightening the susceptibility to volatility. Thus, the institutional changes at the end of the 1990s paved the way for the financialisation path that Bulgaria was to set out on in the 2000s.

5.2 Bulgaria's pre-crisis trajectory of financial sector financialisation

The previous section showed how the early years of the transition period and personal enrichment triggered a crisis in which drastic, neoliberal-inspired changes were made to the institutional configuration of the central bank and the financial sector of Bulgaria. This section looks more closely at the first period under analysis, i.e. from the year 2000 until the crisis of 2008. As stated in the introduction to this chapter, financialisation mainly occurred in the banking sector. Presumably, the growing relevance of the financial sector vis-à-vis the real economy was due to an extension of loans in the first period of financialisation, prompted by the decreasing fee-to-income ratio and an increase in some types of financial products generating fees in the second phase of financialisation as the fee-to-income ratio started to rise after the GFC.

In order to verify this claim, the first part of this section scrutinises the balance sheet composition and then the loan portfolio composition of banks in order to identify the sources of profit in the banking sector. As profits were chiefly derived through loans to households, the following two sections trace the 'discovery' and subsequent exploitation of the retail market in Bulgaria. The development and mechanisms of consumer loans primarily to the affluent class are outlined in section two. Section three sketches the trajectory of the housing (loan) market, which culminated in a real estate bubble in the country. Based on these developments, the next section discusses the

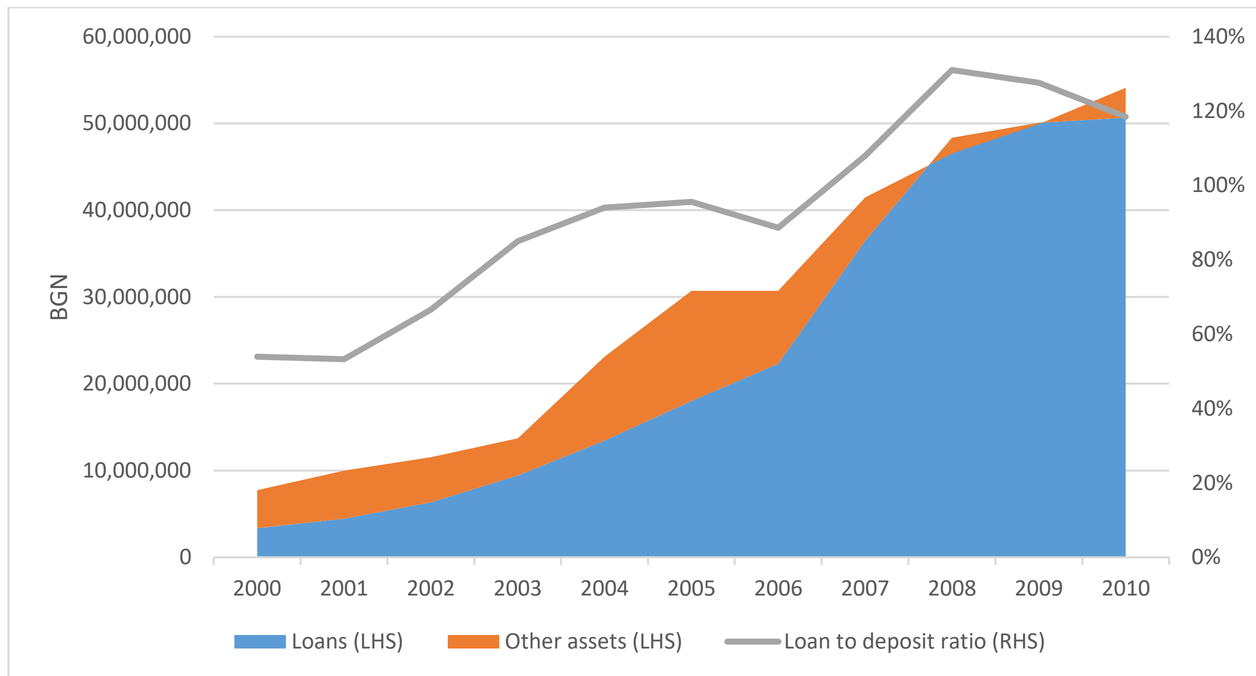
interplay between policies, regulations and the behaviour of banks and shows how the profit maximisation mantra was a main driver of early financialisation in Bulgaria. The last section summarises the findings for the pre-GFC phase of financialisation.

5.2.1 Banking sector structure and evolution

Based on the historical evolution of the financial sector and the extreme shift in the late 1990s, Bulgaria's low starting point with regard to financial sector value-added and employment can be explicated in comparison to the other countries. Apart from Bulgaria, only Albania, and to some extent Macedonia, experienced a similar financial and economic crisis in the 1990s. The criminal penalisation of non-performing loans (NPL) in 1997 led banks to hardly extend any credit at all in the late 1990s, which essentially brought the activities of the banking sector to a standstill (Interviewee 5 2019). A huge volume of loans to state-owned and related companies was written off, which reduced the overall assets of the financial sector. So how can the rising share of value-added and employment in Bulgaria, which are manifestations of its financialisation, be explained? This section looks at the origins of the rise in increasing value-added of the financial sector and employment up until the GFC and highlights the mechanisms through which banks were able to maximise their profits.

The introduction of this chapter already hinted at two essential points that need to be taken into consideration when looking at the origins of the country's financialisation trajectory. The fee-to-income ratio of banks in Bulgaria decreased in precisely the same period as financial sector value-added started growing dramatically. At the same time, financial sector assets outgrew GDP (growth). In order to further analyse the parts of the balance sheets that supposedly led to the increase in relative value-added of the financial sector, Figure 18 depicts assets and loans as well as the loan-to-deposit ratio.

Figure 18: Bulgaria – Asset decomposition of banks



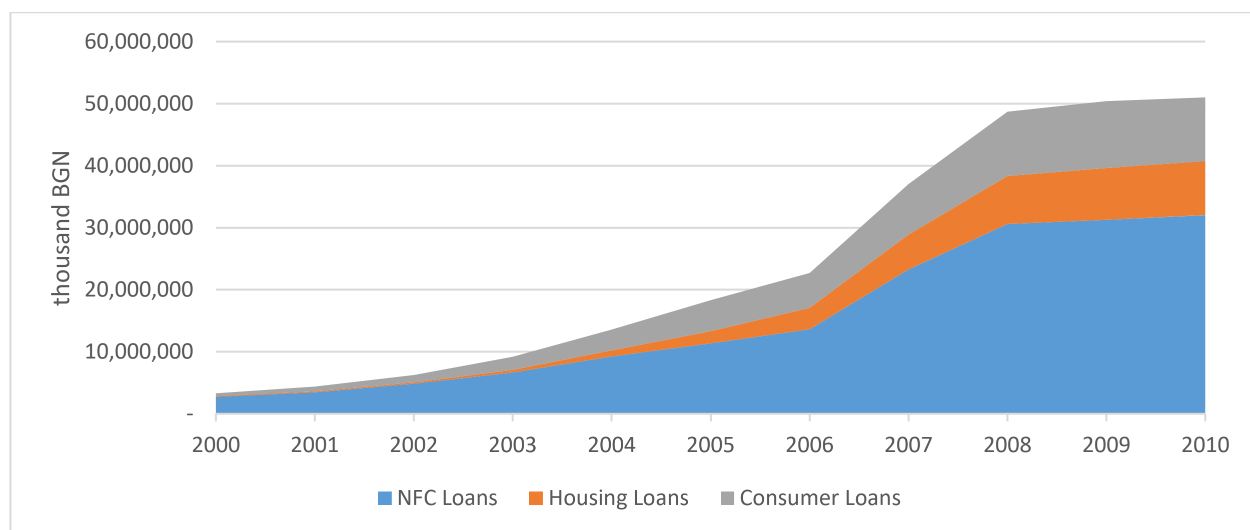
Source: Bulgarian National Bank (2019a)

The loan-to-deposit ratio indicates whether the loans were primarily financed via internal deposit sources or with financial resources from elsewhere. As Figure 18 reveals, already in 2004 internal financial resources were insufficient to finance the growth in loans that had occurred. At the height of the crisis in 2008, the ratio even stood at 130%, which translated into a BGN 14 billion (around EUR 7 billion) negative difference in external financing (around 20% of GDP), which was provided at attractive rates by the foreign banks' headquarters (Interviewee 3 2019). Other assets on the balance sheet of the banking sector were even recording negative figures in that same year due to the (net) foreign assets item. In general, the sector's total assets grew at a moderate pace up to 2003, which is when the last large state-owned bank was privatised and most of the foreign banks had just entered the Bulgarian market. Thereafter, loans grew continuously before exploding in terms of pace before the outbreak of the crisis. The only exception to this is 2005, in which the sector's total assets did not increase.

In that sense, credit producing interest must have been the driving force of income and profit generation, which should have triggered the financialisation of Bulgaria's financial sector up to the GFC. As the proliferation of interest-bearing assets by banks is the form that financialisation took in Bulgaria prior to the crisis, it is paramount to look at how, which and why banks were able to extend such large amounts of credit. To start with, the composition of credit disbursed reveals

whether this profit was mainly generated from granting loans to businesses or households (excluding the government). Figure 19 depicts the composition of credit growth for the first period of analysis.

Figure 19: Bulgaria –Banking sector loan portfolio composition



Source: Bulgarian National Bank (2019a)

The period before the crisis can be split into two phases: from 2000 until 2003, and from 2004 until 2008, as an official from the BNB argued (Interviewee 5 2019). Around the turn of the century, credit levels were comparatively low and mostly composed of loans to NFCs. These loans gradually started picking up in the following years, while loans to private individuals remained virtually non-existent. From 2003 onwards, credit levels increased sharply, and both corporate and private individual lending saw considerable surges year on year. From 2004 until 2008 alone, the total credit level in Bulgaria nearly quadrupled, while the share of loans to private individuals in comparison to total loans more than doubled, from 18% in 2000 to 38% in 2008. Thus, lending not to businesses but to ordinary people contributed a significant amount to the overall loan portfolio volume in that period. The development of housing loans was especially concentrated in the last few years before the crisis, while consumer loans increased markedly across the eight years of analysis.

In sum, a fair share of the proliferation of interest-bearing assets can be attributed to the rise in consumer loans without negating the rise in loans to NFCs. As discussed in chapter 2, this development mirrors the experience of other emerging and developing economies where banks started to increasingly lend to households; in Bulgaria, however, this coincided with banks continuing to

lend aggressively to companies. In that sense, in the period before the GFC, the empirical data suggests that there was no absolute shift of banking activity to the retail sector, as part of the literature on financialisation has found for other countries, but rather that banks 'discovered' households as a source of interest income generation while continuing to provide financing to companies. This finding raises the question of who started and was active in consumer lending in Bulgaria, as this practice has contributed to the financialisation trajectory of the country.

At the beginning of the 2000s, a number of international banking groups entered the Bulgarian market, primarily from Italy, Austria, Hungary, Greece and Germany. While around 1997, foreign bank ownership was nearly non-existent, in 2002 the share of foreign ownership had already reached 80% (Koford and Tschoegl 2003, 23). As the share of foreign-owned financial institutions stayed constant over the years, it can be assumed that both local and foreign banks contributed to the financialisation of the financial sector in Bulgaria. However, as the interviewees reported, they played different roles in this development (Interviewee 9 2019). The main motivation for the foreign institutions to enter Bulgaria was the virgin market of an underdeveloped economy that was soon to join the EU (Interviewee 3 2019; Interviewee 9 2019). Therefore, growth was pivotal to these institutions becoming market leaders and the flexibility provided by the head offices of the international banking groups facilitated this quest (Interviewee 5 2019). Besides the fact that it was politically desirable to invite foreign banking groups into the Bulgarian market, the perception among Bulgarian politicians was that they would be less prone to corruption and feature a higher level of transparency and corporate governance. While the former topic is left to other analyses, after the GFC it became clear that contrary to the assumption of Bulgarian regulators, the local subsidiaries of the international banking groups did not receive an adequate degree of regulatory attention from their home countries. In that sense there was a *"[...] limited [...] extent and intensity of their supervision*" as Carstens (2019), general manager of the BIS, remarked recently on the occasion of the 140th anniversary of the BNB. The next section takes a closer look at the expansion of credit, primarily to households, that was so lightly monitored and regulated and in which these international banks played a focal role.

5.2.2 Financialisation through consumer loans

In Bulgaria, loans for private consumption or housing are a relatively recent phenomenon; in fact, private consumption was seldom financed with debt in the country's history. Housing, however, was occasionally financed in socialist times by the monobank or later by the State Savings Bank,

but the total loan volume never reached a significant level (Interviewee 1 2019). All interview partners who participated in this study confirmed that in the 20th century, Bulgarian society followed the tradition of 'first save and then invest' (Interviewee 1 2019; Interviewee 3 2019). Besides the fact that this was the only possible way to buy expensive goods in the socialist period, this mentality was prevalent in Bulgarian society throughout the industrialised era. In turn, this meant that literacy about financial products and banking services in general was extremely low (Interviewee 3 2019). Even after the fall of the Iron Curtain, there was no public education on financial services. During the period of personal enrichment and the crisis of 1997, private individuals preferred to keep their money in hard currency "under the mattress" and their use of and trust in banks was rather low. With the changes that took place in the aftermath of 1997, this behaviour gradually changed. Nevertheless, a general distrust of the financial system remained after so many people had lost their savings in the 1997 crisis due to bank failures and hyperinflation. It was not until 2001 that the first consumer loan products were launched on the market, and mortgage loans were first offered to the public by banks only in 2003 (Interviewee 5 2019).

As the preceding chapter showed, up until the GFC the household loan portfolio grew dramatically in terms of both consumer and mortgage lending. This can be better understood when one considers that there was no regulation that in any way specified which information a household loan contract should contain and display (Interviewee 2 2019). In the absence of such regulation, these loans provided attractive returns for banks, as interest rates were typically high and maturities were comparatively shorter (Interviewee 4 2019). As several interviewees confirmed, the foreign banks were the primary drivers developing the market for consumer loans in Bulgaria (Interviewee 3 2019). One former supervisory board member of a large international (retail) banking group commented that "*[foreign banks] started to design products, selling to people first consumer and then mortgage [loans]*" (Interviewee 6 2019). This banking group was not the only one to be told by its head office to "*get rid of corporate and go into retail*" (Interviewee 6 2019) by deploying standardised contracts and procedures as well as simple credit risk scoring techniques (Interviewee 3 2019). Shortly thereafter, the domestically-owned banks followed suit in launching consumer-oriented products such as revolving credit cards and fast consumer loans (Interviewee 3 2019).

This went hand in hand with increasing bank outlets and rising numbers of bank employees (Interviewee 5 2019). In many cases, loans were not acquired through the branches of the banks but

through intermediaries or agents in shopping malls (Interviewee 3 2019). Contrary to the assumption posited by the financialisation literature, the banking groups did not enter into the retail market because companies were able to finance themselves on the capital markets, but rather because it offered high short-term gains. Instead of tapping capital markets, the corporate foreign-owned business clients of banks were often able to finance themselves through their parent companies (Interviewee 1 2019; Interviewee 2 2019). Both at the government level and at the bank level, more finance to households was universally seen as positive, as it was argued that Bulgaria had to catch up in its development (i.e. the famous finance-growth nexus). Before 100% of loans-to-GDP was reached, there was thus ample room for further financing (Interviewee 4 2019). Also, at the level of the banking association, the increasing pace of consumer loans was never discussed or problematised at any meeting (Interviewee 7 and 8 2019).

Due to the nearing entry of Bulgaria into the EU, a sense of general euphoria and positive expectations unfolded (as highlighted in all interviews), which is reminiscent of the above-mentioned Minsky cycle. As financial literacy was extremely low and credit risk standards either "*lax*", "*indiscriminate*" or "*irresponsible*" (Interviewee 5 2019), this provided fertile ground for aggressive lending practices. The banks went after wealthier people first and then targeted the less well-to-do (Interviewee 6 2019). Another reason for the enhanced demand for credit was that wages developed at a much slower pace than the overall economy (Interviewee 4 2019). Coupled with sharply lowered import taxes, this invited the population to take loans for consumptive purposes (Interviewee 3 2019). Altogether, as Bulgaria was revealed to be the country with the second highest level of household financialisation, the behaviour of the financial sector, an indifferent central bank and financial illiteracy may explain the growth of retail lending, especially the part of consumer lending that led to the financialisation of the financial sector in Bulgaria in the pre-GFC phase.

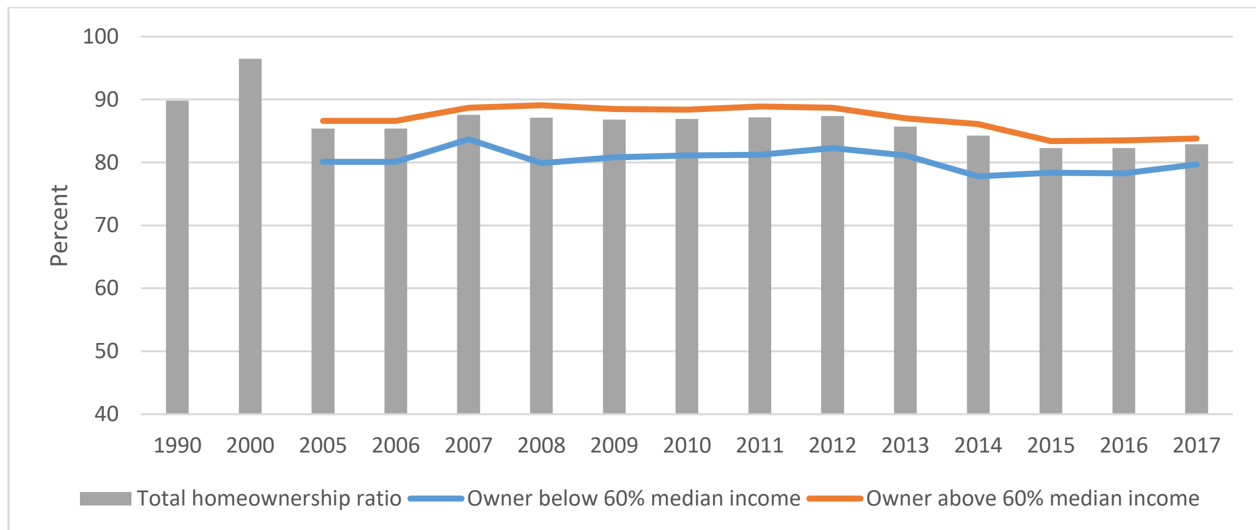
5.2.3 The second Spain: Bulgaria's real estate bubble

Banks were primarily able to appropriate a larger share of value-added and employment through disbursing high volumes of consumer and mortgage loans. As the last section focused on consumer lending, this section delves into the real estate market, with the aim of shedding light on the processes and mechanisms that may explain the financialisation of the financial sector, as well as on other aspects of financialisation in Bulgaria. Specifically, reference is made to the increasing importance of the unholy financialising trinity of the finance, insurance and real estate (FIRE) sector (Krippner 2005) as well as on the financialisation of housing (Fernandez and Aalbers 2016). With

regard to the financial and insurance sectors, real estate plays a particularly vital role as all three areas are often closely interlinked. Financing is, for example, granted for the construction of commercial property, houses or real estate, which is then transformed into commercial or private mortgage loans, or even bundled into collateralised debt obligations. With each new real estate object, the insurance sector registers a one-off premium for the valuation and subsequent income streams derived from insuring the object against any kind of risk. While this might seem to be a very basic mechanism in the development of capitalism that all developed countries have been utilising for decades, it was a relatively new activity for Bulgaria. Its extreme development in a relatively short period of time, however, mirrors that of other financialised housing bubbles in Europe, such as in Spain.

Starting in the late 1990s and early 2000s, Bulgaria saw a general increase in real estate market-related activities. Before this period, most people lived in the former Soviet-style apartment houses. Despite the capitalist transformation, there was no construction boom of new houses in the 1990s due to the difficult privatisation and transformation process as well as to the 1997 crisis (Interviewee 2 2019). Formerly, business-related property and the majority of residential urban property in Bulgaria was state-owned, while other residential homes were owned privately. In the course of the 1990s after the fall of the Iron Curtain, state-owned property was privatised, distributed to its inhabitants, or restituted to its original owners from before the change to a socialist system (Interviewee 1 2019; Interviewee 7 and 8 2019). In 1990, almost 90% of the population was living in their own home, peaking at 96.5% in 2000 as shown in Figure 20.

Figure 20: Bulgaria – Home ownership breakdown



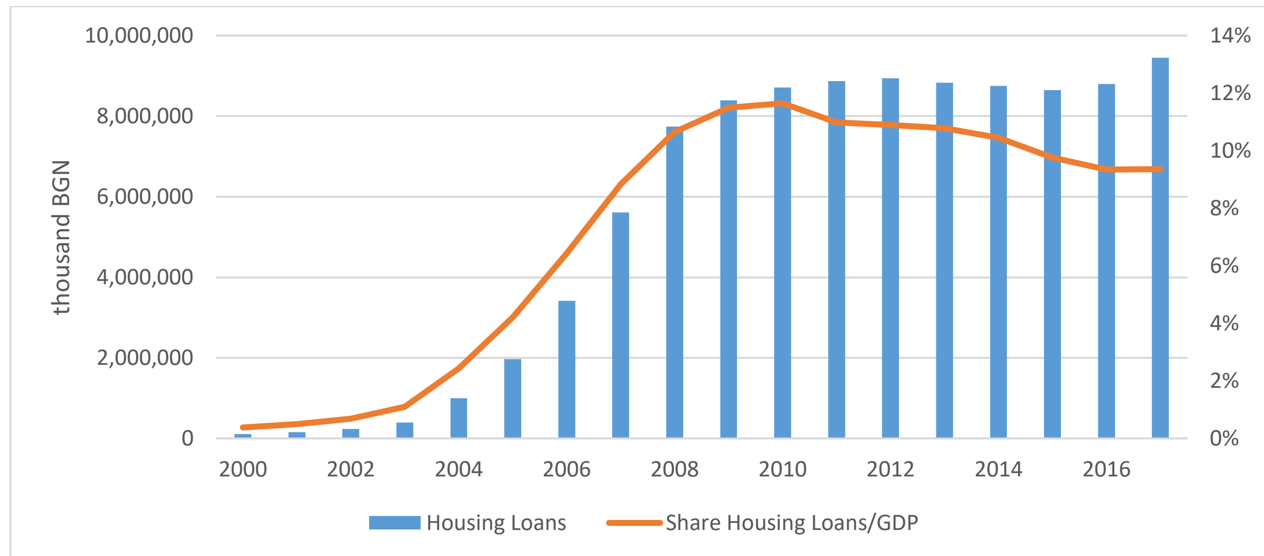
Source: Eurostat (2019b)

At the beginning of the 2000s, the market experienced very favourable conditions as available and official income slowly started to increase after the crisis of 1997; in parallel, urban migration intensified. Most people had outgrown their old Soviet apartments and wished to live in nicer, modern homes (Interviewee 2 2019). The migration from rural to urban areas certainly contributed to a higher tenant ratio; nonetheless, a drop of over 10 percentage points from 2000 to 2005 is remarkable for a country that ranks among the nations with the highest homeownership ratios in the world. Figure 20 displays a general decrease in homeownership since the 2000s, with a mild uptick before the outbreak of the GFC. As one would expect, the ownership ratio for people with a higher available income (i.e. those earning above 60% of the median income) is higher than for those with a lower median income. While the difference between the two income groups can be seen to decrease at the end of the second decade of the 2000s, based on these homeownership ratios, it is difficult to imagine how Bulgaria experienced a house price boom that could explain part of the financialisation trajectory before the crisis.

Against the backdrop of generally decreasing but high homeownership ratios, it is paramount to first analyse the mortgage market before applying further scrutiny to the relevance of the real estate sector within the financialisation of the financial sector in Bulgaria. Like most forms of consumer loans, mortgage loans were rarely disbursed before the 2000s. After housing loans became available to the general public around the early 2000s and were marketed at increasingly attractive interest rates, people started jumping on the offers even though there was no initiative from either the

EU or the Bulgarian government to stimulate homeownership (Interviewee 1 2019; Interviewee 2 2019). What followed then can be termed a typical real estate boom, which is visible when looking at the volume of housing loans and its share to GDP as seen in Figure 21.

Figure 21: Bulgaria – Housing loan portfolio



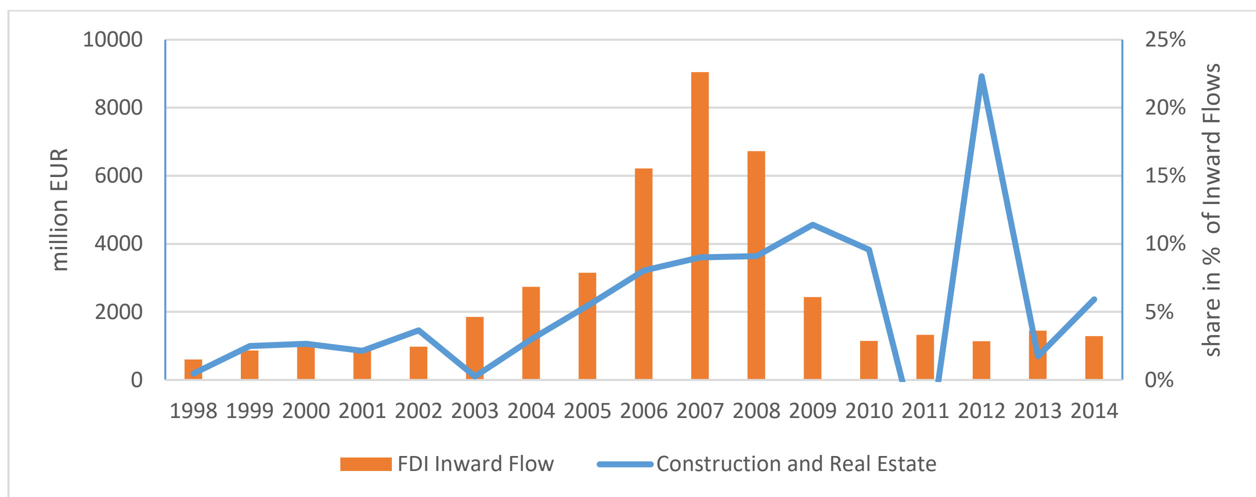
Source: Bulgarian National Bank (2019a)

Within the four years between 2004 and 2008, the housing loan portfolio of commercial banks rose eight-fold. Its share to GDP increased likewise until up to 12%, which once again highlights the nature of economic development in Bulgaria in the 2000s. Still, this is far from the average values in EU member states, even though the pace is comparatively high. After the GFC, the housing loan portfolio stagnated for the remaining period of analysis. The falling housing-loan-to-GDP ratio indicates that despite a revival of activity since 2011, the real estate sector has not yet recovered from its exponential growth in the four years preceding the crisis. Housing loans thus rose exponentially before the crisis, but have stagnated since then. In that sense, one may posit Bulgarian residential capitalism within the familial variety of residential capitalisms (Fernandez and Aalbers 2016, 7) as it features high ownership rates with a rapidly growing but comparatively low share of mortgage loans to GDP. What were the mechanisms that led to the increase in mortgage loans and the subsequent financialisation of housing in Bulgaria?

The interviews revealed that one important cause of the real estate boom was foreigners purchasing houses on the Black Sea Coast or in the mountains, especially British and Russian buyers (Interviewee 1 2019; Vladimirov 2018). At that time, Bulgaria was even dubbed the ‘second Spain’ due

to its scenic landscape and surging construction market (Interviewee 1 2019). The foreign influence on house prices was so high that the Bulgarian parliament even enacted a moratorium on the sale of property to foreign buyers in 2007. This primarily affected individual foreign buyers of houses, with a marginal effect on construction companies and foreign real estate companies (Figure 22 depicts the flows of foreign direct investment into Bulgaria on the left-hand axis). While in chapter 4 foreign direct investment (FDI) was excluded, this chart reveals the magnitude of the flows and the volatility, especially around the financial crisis. On the other hand, since 2004, the share of construction- and real estate-related FDI inflows on the right-hand axis rose continuously until the peak of the crisis to around 11%. These inflows highlight the foreign influence in this sector.

Figure 22: Bulgaria – FDI flows related to construction



Source: Bulgarian National Bank (2019b)

Despite the increasing housing loan portfolio and the mildly decreasing homeownership rate, the share of owners without a loan has hovered around 80% in Bulgaria and remained rather constant over time (Eurostat 2019b). As the interviewees confirmed (Interviewee 2 2019; Interviewee 9 2019), in Bulgaria it was mostly international investors and a certain income group who participated in the housing market. The more affluent members of the society moved from their old apartments into new houses financed by a loan or they bought newly built homes to rent out. This explains the decreasing ownership ratio despite surging housing loans. Another explanation that surfaced in the interviews was the fashion of acquiring a second or third vacation home or flats in bigger cities. In comparison to the US housing crisis, which was caused by predatory mortgage lending to people with no income and no job, in Bulgaria it was the upper strata of society that made use of the newly available financial products. In particular, the extreme developments right

before the crisis points to an intensification of debt with regard to housing (Van Gunten and Navot 2018), as the debt was not taken on with the intent to purchase a house to live in, but for speculative or consumptive purposes. Part of the financialisation of the financial sector in the pre-GFC period can thus be explained by an expansion but also an intensification of debt relations with the elite (Becker et al. 2010) fuelled by external financing. But how was this possible in an economy that did not know about housing loans a few years earlier? What role did the financial sector play in promoting these products? How did house prices evolve (typically serving as an indicator of financialisation)?

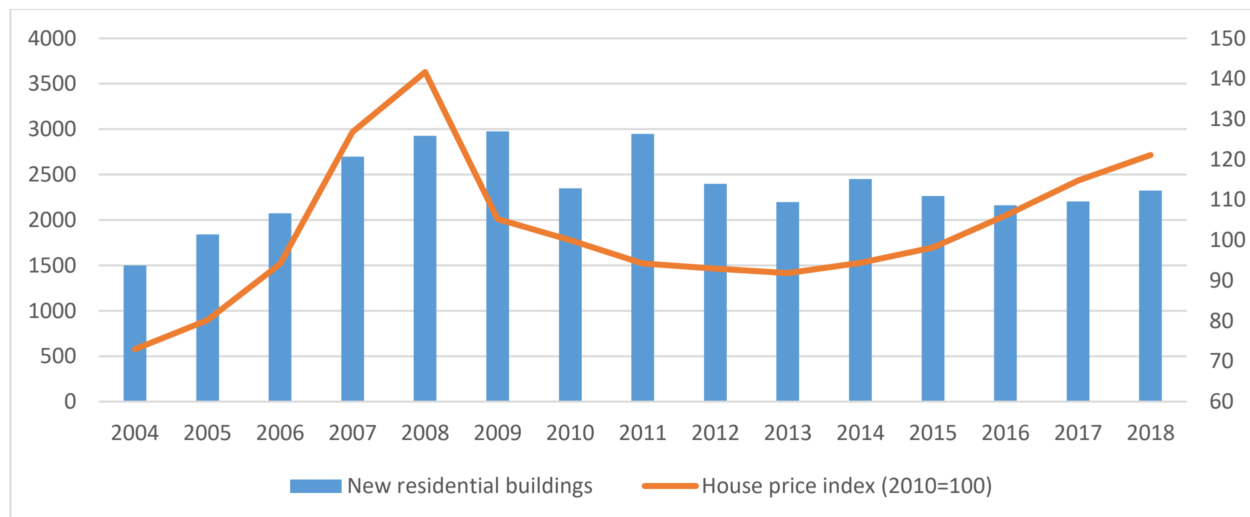
As mortgage loans did not exist as a financial product before 2003, there was no real regulation that had to be followed by the banks. Apart from simple reporting to the central bank within the regular reporting package, banks only had to note the loan-to-value ratio in their reports (Interviewee 4 2019). It was not until July 2016 that a comprehensive framework on mortgage loans was put into place as part of the EU directive on the protection of consumer rights, which defined minimum criteria and information to be provided. Before that, some laws were passed in the direction of advertisements (in 2006) and banks having to provide pre-contractual information and requirements for assessing creditworthiness (in 2010) (Interviewee 4 2019). The central bank mainly steered the mortgage volume through setting risk weights in the calculation of the capital adequacy ratio (Interviewee 4 2019). Mortgage loans with a higher loan-to-value ratio were typically to be factored in higher than loans with a lower ratio. Before the financial crisis, in 2006, the central bank tightened these regulations, which, however, did not have the desired effect, at least on the development of the housing loan portfolio.

One interviewee commented that in the run-up to the crisis, banks loosened their credit risk standards with regard to loan-to-value and more importantly loan-to-income ratios (Interviewee 9 2019). Although they did not officially calculate with it, banks essentially relied on grey income by the debtor to service the loan. And even with that, "*[...] Banks were aware that the customer cannot survive with the residual income, but the banks just wanted to sell, sell, sell*" (Interviewee 9 2019). The same interviewee reported that the standard loan-to-value ratio in the banks was around 90%, which can be assessed as prudent with regard to the standards in Western Europe (Hypostat 2017, 26). However, "*[...] it was OK for the banks to leave clients with 100 euros per month per person for living*" (Interviewee 9 2019). This exemplifies how credit risk standards were increasingly loosened just before the crisis but also shows that central bank regulation was ineffective, as it only

required banks to report loan-to-value figures, thereby leaving out the capacity of the debtor to repay the loan. Secondly, the (market) values were mainly determined by the banks and insurance companies and could easily be adjusted.

Both foreign inflows and loan disbursement fuelled the demand side of the real estate sector in the years preceding the crisis, sustained by the anticipation of the accession of Bulgaria to the EU. However, high internal and external demand was met with a low and predominantly old-fashioned supply, as most buildings had still been constructed during Soviet times. Although the number of newly constructed buildings doubled within four years, it was insufficient to meet the demand of foreign and domestic capital poured into this sector in anticipation of great returns. Although financing was amply provided, it did not lead to a comparable increase in the real economy. Figure 23 denotes the modest increase in new buildings constructed in Bulgaria on the left-hand axis. Between 2004 and 2009 the number of new residential buildings doubled, while house prices surged dramatically.

Figure 23: Bulgaria – Housing market development



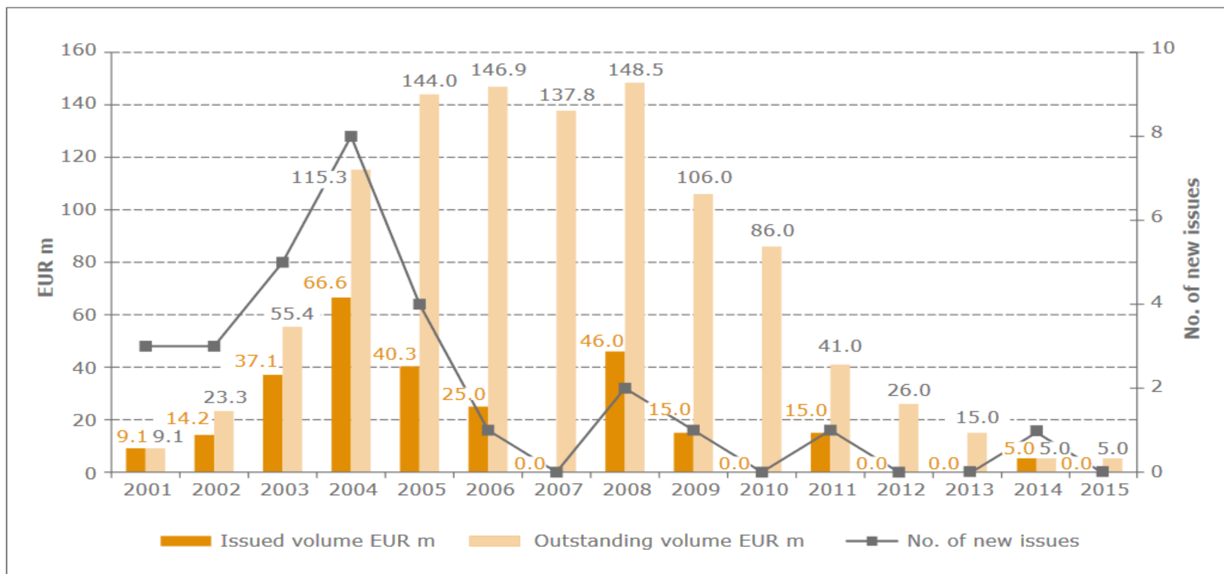
Source: National Statistical Institute of Bulgaria (2019a, 2019b)

Taking the last quarter of 2010 as a basis, the graph depicts how between 2004 and 2008 each year registers a 20% increase compared to the previous year. In the last few years, house prices can be seen to increase yet again, albeit at a slower pace. The increasing market values meant that higher loan amounts could be received for the very same asset with the loan-to-value ratio remaining the same. While this effect explains one part of the financialisation of Bulgaria, banks were still facing a shortage of liquidity and deposits, which the foreign inflows could only satisfy to a certain extent.

This is why, similarly to what has been amply documented for the US, financial institutions made use of a specific product to offload their balance sheets.

Although there was no explicit framework on mortgage loans themselves (European Covered Bond Council 2018, 242), the Bulgarian parliament passed a law in 2000 that defined the legal framework for mortgage bonds (Institute for Market Economics 2007). Such bonds are used to transfer assets from a bank's balance sheet to bond markets as a means to relieve the balance sheet. The law was pushed by the then state-owned DSK bank and the Bulgarian Institute for Market Economics, a neoliberal think tank (Novinite 2011). Since then, banks have made use of this particular product, but the number and amount of issues have not reached the same extremes as in the US, as seen in Figure 24.

Figure 24: Bulgaria – Mortgage bond issuances



Source: European Covered Bond Council (2018, 256)

Since the year 2001, banks have issued dozens of mortgage bonds, with a total value outstanding of around EUR 150 million at the end of 2008. While these figures do not seem high with respect to the overall size of the housing loan portfolio, in 2004 the volume of mortgage bonds accounted for 10% of the volume of the country's housing loans.[65] The bonds were primarily issued by the

[65] Mortgage bonds were also issued on business-related properties (Interviewee 1 2019).

Bulgarian-American Credit Bank and Allianz Bank, that is two banks with a certain foreign affiliation. Nonetheless, the marketisation and subsequent financialisation process of creating tradeable mortgage bonds was given priority above defining a framework for mortgage loans themselves. In that sense, the erection of this securitised bond market, facilitated by the state-owned bank and a think tank, contributed to the financialisation of the Bulgarian financial market.

The real estate sector has seen turbulent times in Bulgaria. Initially characterised by old Soviet-style apartments, it quickly developed into a flourishing business opportunity in the 2000s. While the more affluent class was able to secure loans to move into more modern and pleasant homes, a fair share of the newly disbursed loans in this sector was used to buy vacation residences or homes to let. In effect, homeownership rates actually decreased while social housing became non-existent, as it was supposed to be undertaken by (unfunded) local municipalities (World Bank 2017, 20). The banks actively advertised and supported this development by providing ample financing without much in the way of credit risk assessment. The ensuing house price bubble fuelled the profit statements of banks (and insurance providers) and was met with ineffective political responses or regulatory efforts. After the hangover of the financial crisis, which can be termed one of the deepest and longest-lasting housing downturns among transition countries (World Bank 2017, 4), the development of residential homes did not recover until 2016. Many debtors were no longer able to meet their payment obligations and the value of their houses plummeted in the meantime. In that sense, one could argue that the excessive growth before the crisis hindered a healthier, probably less financialised development path for the Bulgarian housing sector. The next section discusses the excessive growth of the overall loan portfolio and discusses how insufficient attention and regulation fuelled the financialisation of the financial sector in Bulgaria.

5.2.4 How regulatory efforts lead to next-level financialisation

The preceding section focused primarily on the real estate market and on the underlying mechanisms that fuelled its bubble before the crisis. This section examines the period of extreme growth between 2004 and 2008 and analyses the regulations issued by the central bank as well as the reaction of the banks. The high credit growth in Bulgaria was noted by several domestic and international institutions. For instance, the IMF remarked in its report that "*there is a concern that the pace with which they [financial intermediation and levels of monetisation] have risen is not sustainable from a macroeconomic perspective*" (International Monetary Fund 2004, 7). The rapid pace was equally discussed in Bulgaria. A series of regulatory interventions in the last few years

before the outbreak of the GFC and the responses by commercial banks in Bulgaria highlight the intricate ways in which the mantra of profit maximisation deepened and intensified financialisaton in Bulgaria. This section tracks the underlying developments and mechanisms, particularly in relation to the regulations and policies behind this intensification. In that way it can be shown how financial institutions circumvented the half-hearted regulations, which not only served to maintain the breakneck pace of credit growth but also incorporated new techniques of financialising practices, the likes of which had never been seen in Bulgaria.

The first section in this subchapter depicted the proliferation of interest-bearing assets in the form of credits as a main driver of financialisation in Bulgaria. To counteract the rapid rise in credit, in 2004 the Bulgarian Central Bank initiated a sequence of regulations to curb loan portfolio growth, primarily by tightening capital requirements (Interviewee 4 2019). As shown in the graphical representation of the data, this did not have the desired effect, as lending growth continued to spiral upwards. In response, in spring 2005 the central bank initiated a quasi-lending cap on the banks in Bulgaria (Karamisheva 2016, 11). But how and why did it come to this decision?

The initiative was taken by central bank governor Ivan Iskrov and his team (Interviewee 6 2019). According to a central bank official active at that time (Interviewee 5 2019), the bank's staff did not know exactly when and whether the growth was excessive, but they nevertheless felt that action should be taken. According to the same interviewee, the staff did not share the IMF's assessment of the situation: while the IMF lamented the country's surging imports, consumption and widening negative current account, central bank officials were primarily concerned with the level of inflation created by the credit surge. When the central bank announced the measures to the finance ministry, it entered into a clash with the ministers of economy and finance, who were supposed to have said that the central bank "*is stopping growth and killing the business*" (Interviewee 5 2019). Despite these differences of opinion, let alone the fact that none of the three parties recognised the shift of power towards the financial sector, this behaviour highlights the extreme focus of central bank officials on inflation to ultimately ensure the full convertibility of leva into euros, while the financial stability of the banking sector played only a secondary or tertiary role. What shape did the regulations take and were they effective in limiting the extreme growth of loans?

Banks were required to hold a 400% un-remunerated reserve for loans that were extended by banks above quarterly growth of 6%. The central bank announced in February 2005 that the base for the growth calculation would be outstanding loans as of 1 March 2005. Banks responded by artificially

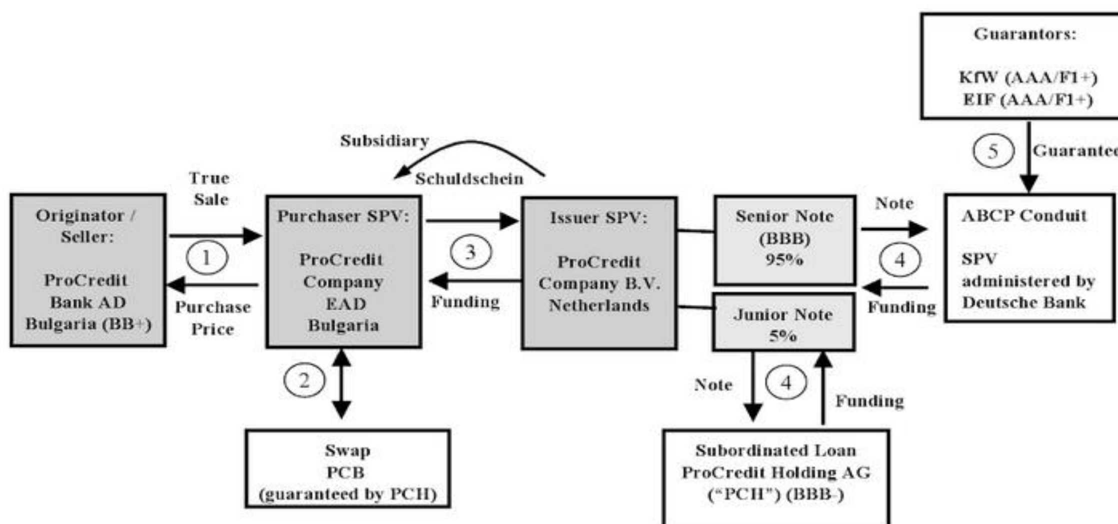
boosting their loan portfolios by the end of February and repaying part of the loans back in early March as a means to enter into the lending cap phase with an elevated credit base (Interviewee 5 2019). This is reflected in loan portfolio figures (Bulgarian National Bank 2019a), as the whole banking sector grew by EUR 1.5 billion just in February 2005, representing growth of roughly 20% and then dropping back by 10% the next month. Acknowledging its policy mistake, the central bank subsequently decided to take the end of February data as a reference base for calculating quarterly growth (Interviewee 5 2019). Once again, this instance shows how the profit maximisation motive of the banks in Bulgaria worked to circumvent any kind of policy that endangered it by means of artificially pumping credit worth 5% of Bulgaria's 2005 GDP into and out of the market within one month.

While the central bank was satisfied with governing inflation and ensuring full convertibility in Bulgaria, the banks soon found other means to maintain high levels of credit growth. The central bank acknowledged that its outright policy slowed the pace of credit growth somewhat but in general did not live up to expectations. One central bank official commented that "*commercial banks are greedy*" (Interviewee 5 2019) and would always find innovative solutions to get their way. Essentially, there were three ways that banks circumvented the regulations set by the central bank, all of which contained some form of new financial practices. Banks either (1) sold part of their portfolios to SPVs outside of the country but with foreign ownership, (2) transferred part of their loans to their parent banks or (3) sold loans to non-bank financial institutions within the country (Interviewee 1 2019). In order to highlight the myriad ways in which banks responded to the regulation so as to maintain their market share and maximise profits, the three avenues taken are briefly outlined in the following section.

5.2.4.1 International true-sale securitisation

At least one foreign bank focused on microcredits at that time, ProCredit Bank Bulgaria, securitised a loan portfolio of EUR 120 million in 2006, transferring the assets to a Bulgarian SPV (true-sale transaction), which was owned by a Dutch SPV. As it was an SPV with foreign ownership, the loans thus no longer had to be consolidated locally into the risk-relevant balance sheet of the bank. This SPV in turn issued a senior tranche and a junior tranche. The senior tranche was up for trade on markets in the form of a first-tier asset-backed commercial paper, administered by Deutsche Bank and guaranteed by the Kreditanstalt für Wiederaufbau and the European Investment Fund (see Figure 25) (Hüttenrauch and Schneider 2009, 335).

Figure 25: Bulgaria – Exemplary securitisation of a loan portfolio



Source: Hüttenrauch and Schneider (2009, 335)

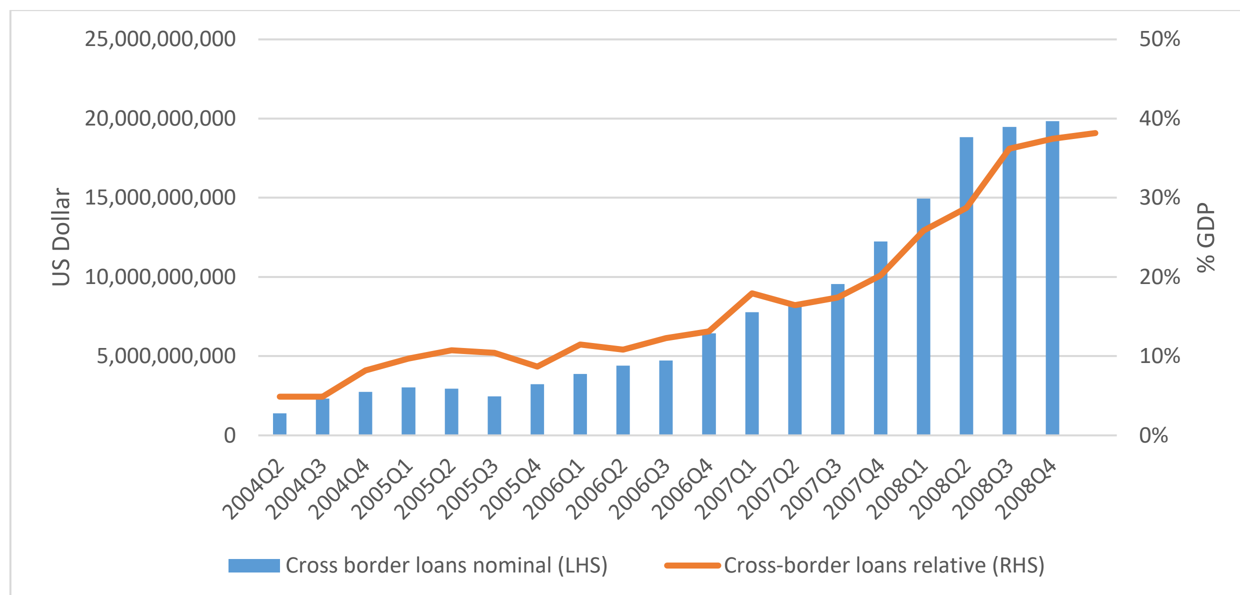
The transaction was mainly done to relieve capital from the parent and the subsidiary company (Interviewee 1 2019; Kyutchukov 2008), but also to circumvent the lending cap (Maurer 2011, 22). This particular transaction did not aid the institution in lowering overall financing costs, however (Godemann 2011, 121). In contrast to the derivatives that partly caused the GFC, this security was asset-backed and the junior tranche was not further bundled into a new synthetic collateralised debt obligation. However, this was the first time that Bulgarian assets were directly pooled into global financial markets and income streams derived from it were made tradeable, heralding a distinct feature of financialisation. This peculiar way of circumventing the lending cap was probably the most innovative method applied in this period in Bulgaria, as it was one of the few true-sale transactions undertaken in Eastern Europe. Other international banks with a parent company owning a banking licence in their home country chose paths that were organisationally more comfortable for them.

5.2.4.2 Cross-border loans

As a means to reduce the outstanding loan base, large foreign-owned bank groups in particular transferred commercial loans, either SME or corporate loans, to their parent company in Greece, Austria or Italy. This was possible due to the country's open capital account and liberal regulation. While the loans were still disbursed in Bulgaria, the credit contract was then sold to and became the property of the parent company. Figure 26 shows the magnitude of loans disbursed from outside the country. Cross-border financing increased six-fold within just over four years, and at the end

of 2008 the volume of these loans stood at 35% of GDP, compared to only 5% at the beginning of this period of analysis in 2004.

Figure 26: Bulgaria – Cross-border loans



Source: Joint External Debt Hub (2019)

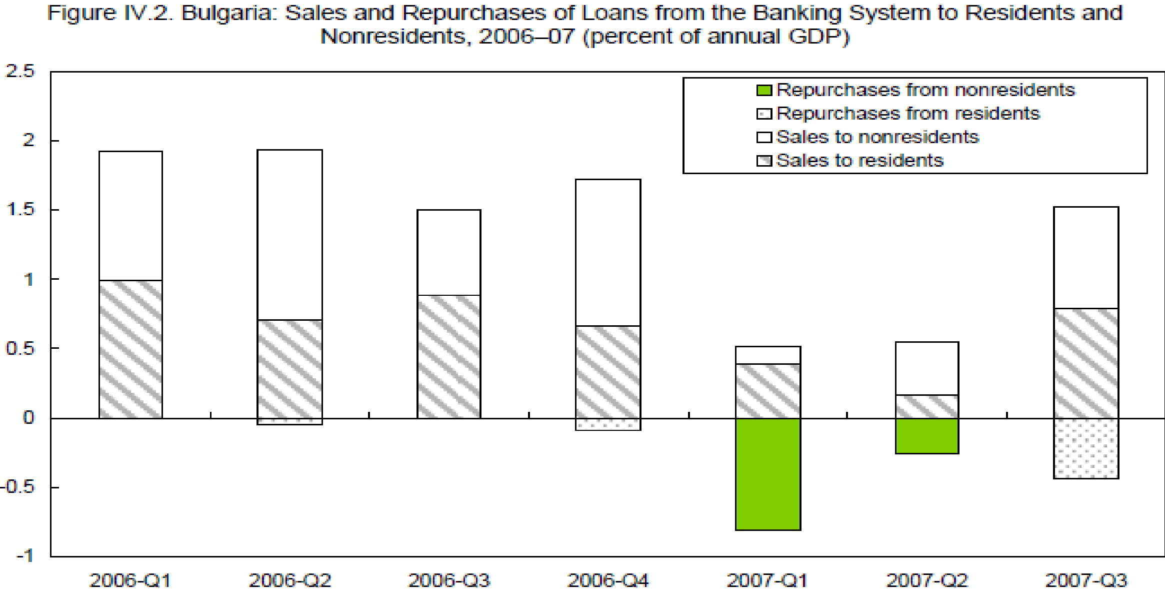
For the parent companies, this meant achieving two goals at the same time: re-enabling lending growth in Bulgaria and effecting the transfer of income and profit streams directly to the headquarters, which was also a way to avoid double taxation (Interviewee 2 2019). For Bulgaria, this meant that profits were extracted without being properly taxed domestically and that lending continued to threaten inflation. This illustrates a particular trait of the financial sector and international financialisation in Bulgaria in that debt liabilities and income streams of an enormous magnitude were rerouted out of the country as a means to maintain market share and uphold profitability. Additionally, these cross-border loans would not be seen in the credit registry for the first few years, which meant that debtors could attain even more financing and that other lenders could not base their credit decision on the credit registry entries (Interviewee 2 2019). On the other hand, loan clients were typically not aware that their loans were being transferred out of the country (Interviewee 9 2019). This second way of circumventing the lending cap constituted the most extreme path chosen, particularly by the foreign banking groups from Austria, Italy and Greece.

5.2.4.3 Transferral to local SPVs

The third avenue primarily deployed by local banks and some foreign banks consisted of transferring part of their portfolio to Bulgarian SPVs, which were typically registered as non-bank financial

institutions (NBFIs). These loans included corporate loans, mortgage-backed securities and consumer loans (International Monetary Fund 2007, 57). These NBFIs did not have specific reporting requirements, were not inspected on site and required a very low equity stake (Interviewee 1 2019). Typically, they were owned by the foreign parent companies in the case of the international banks, like Unicredit or OTP, or by local affiliated companies within the holding network of the local banks. Though the regulations stipulated that there should be no connection between the Bulgarian banks and these SPVs, "*over time this requirement was not strictly enforced because some banks arranged or guaranteed the financing of the non-bank financial companies to which the loans were sold*" (International Monetary Fund 2007, 58). Figure 27 shows the quarterly quantity of sales in percent to GDP from the banking sector to residents and non-residents. Typically, banks sold their loan portfolios to domestic or foreign NBFIs, but at times they also sold them to other banks or their headquarters (which would then constitute a cross-border loan).

Figure 27: Bulgaria – Sales and repurchases of loans



Source: International Monetary Fund (2007, 58)

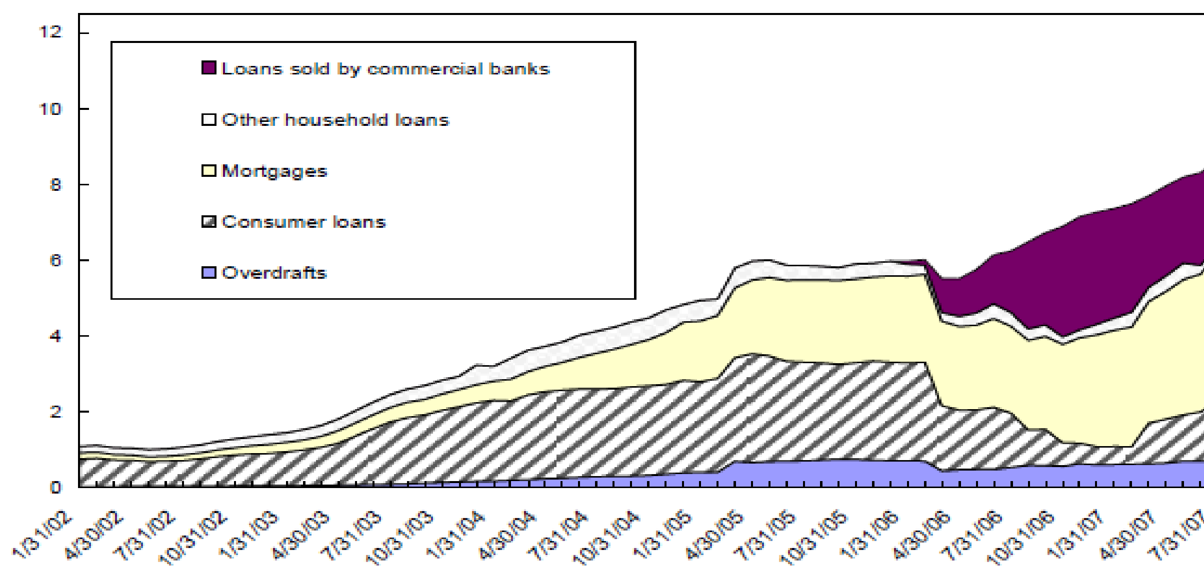
Every quarter, credit obligations worth 2% of the domestic GDP were thus transferred out of the banking sector either within ('sales to residents') or out of the country ('sales to non-residents') to NBFIs (and at times also to banks). Once the regulations were relaxed, some of these loans were re-transferred to the banks (highlighted in green, 'repurchases from non-residents'). As interna-

tional banks invented simple ways to circumvent the lending cap imposed by the BNB, local companies deployed this method to continue their credit growth by off-loading their balance sheet assets onto related SPVs. Once again, this heralds a particular trait of the financialisation of the Bulgarian sector, as ever more financially innovative solutions were sought in order to maintain market share and in the end maximise shareholder value.

5.2.4.4 The spirits that I summoned? After the lending cap

Given these myriad ways to circumvent its rules, the central bank acknowledged that its policies were not entirely effective; in response, it increased the reserve requirements from 8% to 12% so as to increase the cost of funding (International Monetary Fund 2010a, 58). Still, some banks actually preferred to pay a penalty for violating the requirements related to the credit ceiling (Petkova and Manolov 2007), as their net margin was high enough to cover the expense (International Monetary Fund 2007, 57–58). The BNB introduced reporting requirements for cross-border financing when it became apparent that loans were entering and quickly exiting the credit registry at the end of each quarter (Interviewee 5 2019). Paradoxically, it was the EU that required the BNB to lift the lending cap at the beginning of 2007, viewing the regulations as a form of capital control (Interviewee 5 2019). As described above, this did not stop international banks from disbursing cross-border loans, as this simple but inventive way of shifting income streams and liabilities ensured a high profit margin for the parent company, avoided double taxation and relieved capital for the subsidiary in Bulgaria. Securitisation was used in much the same way. Given the still high capital requirements in Bulgaria at that time, banks used this channel and specific financial innovations to further offload their balance sheets. Initially, this was only done for NFC loans, but later it was also used for household loans. Figure 28 shows the volume of loans to households in percent of GDP that were subsequently sold to SPVs.

Figure 28: Bulgaria – Household loan portfolio composition



Source: International Monetary Fund (2007, 59)

The graph illustrates the total volume of household credits in percent of GDP, composed of overdrafts, consumer loans, mortgage loans, other household loans and loans sold by commercial banks. The latter, which corresponds to the volume of the securitised household loan portfolio, thus reached over two percent of GDP at the end of 2006 and the beginning of 2007. The securitisation of the household loan portfolio can be seen as another instance of the pre-GFC trajectory of financialisation that Bulgaria experienced. Income streams and credit obligations were made into tradeable financial products as a way to generate income for banks and to offload their balance sheets in response to the central bank's credit ceilings. Interestingly, though, the role of the IMF in Bulgaria changed at the beginning of the 2000s. While there was a high degree of involvement by the institution in designing the currency board at the end of the 1990s, when it came to the privatisation of state-owned enterprises and the liberalisation of capital and financial flows, there were considerable efforts in Bulgaria to gain more independence from this international entity. Nevertheless, a BSP-led government signed two agreements with the organisation in 2002 and 2004, but over the years the IMF's conditionality slowly evaporated (Spendzharova 2014, 39). The EU was becoming a much more influential player in Bulgarian politics, which meant that policies and regulations became strictly oriented towards the EU frameworks. From this angle, it becomes understandable why it was primarily the IMF that warned against the credit growth and widening current account

imbalance and not the EU, since the latter chiefly benefitted from the increasing imports of European goods and services, often financed by its affiliated banking institutions, which were among those that circumvented the central bank's regulations with ease.

Nonetheless, both the EU and the IMF welcomed the 'diversification' of financial markets in Bulgaria towards the non-bank financial sectors (SPVs and leasing companies), capital market developments (IPOs) and securitisation efforts. "*The benefits of diversified financial sectors are well-known*" (International Monetary Fund 2007, 60) notes the IMF in one of its country reports. Indeed, at that time Bulgaria already had one of the most developed bond and securities markets in Eastern Europe. Therefore, Bulgaria not only witnessed a financialising household credit boom in the pre-GFC phase, as a range of other emerging economies did (dos Santos 2013), but the financial sector was at the heart of a transformation in which sophisticated financial products were being designed as means to reach ever higher profit levels.

5.2.5 Employment and performance-based salary schemes

The previous sections highlighted how financialisation intensified due to an increase in value-added of the financial sector. In parallel, we witnessed a disproportionate increase in overall employment in the financial sector vis-à-vis other sectors of the economy in the period before the crisis. This section tracks the reasons for the increase in employment levels and outlines the terms of the employment contracts, which are argued to have been instrumental in the trajectory of financialisation in Bulgaria in the period before the GFC.

The number of people employed in financial services increased by 45% in absolute amounts in the period before the crisis and even continued to rise until 2011 (Eurostat 2019a). The interviewees maintained that the absolute growth as well as the growth relative to the real economy can be directly linked to the growth and profitability of the financial sector before the crisis (Interviewee 2 2019; Interviewee 3 2019; Interviewee 7 and 8 2019). Additionally, employment in finance continued to rise even during the GFC as the financial sector was initially not so gravely affected by it (Interviewee 7 and 8 2019). As one interviewee described the general sentiment, "*before the crisis, working in the financial sector was a privilege*" (Interviewee 12 2020). Job seekers were drawn to the financial sphere as the salaries were not only mostly formal but also consistently higher than those offered in other sectors in the economy (Interviewee 1 2019; Interviewee 4 2019). Another explanation for the increasing employment in the sector was revealed by an official at the central

bank who argued that in relative terms, local wage costs were still cheap for international financial institutions and thus lower than the potential capital costs incurred by investments in technology (Interviewee 5 2019). The increasing level of employment in the financial sector thus seems to have been driven by the high relative profitability of the sector and the lack of effort to innovate and invest in more capital-intensive projects.

Employees in the industry benefitted from formal employment contracts and the connected social benefits in the context of a still largely informal economy. However, the content and design of the employee contracts quickly changed at the beginning of the 2000s, as all banks seem to have changed their remuneration policy in favour of performance-based salaries. This applied primarily to employees who were directly involved in sales (Interviewee 11 2020) as well as to bank managers (Interviewee 3 2019). The interviewees emphasised that bonuses were paid according to the results of key performance indicators, which included loan volumes, the number of new retail clients, and profitability (Interviewee 9 2019). Unsurprisingly, these indicators did not take into account the soundness of the credit decision, i.e. the ability of the client to repay the debt (Interviewee 9 2019); one of the interviewees pointed out that "*nobody looked at the quality*" (Interviewee 12 2020). This change in practice resulted in the focus being placed solely on short-term growth and profit instead of sustainable, long-term-oriented credit decisions. Salaries for these employees rose two- or even threefold (Interviewee 12 2020), while the bank managers were rewarded with even higher multiples as bonuses, which led them to do "*crazy things*" (Interviewee 5 2019) in pursuit of personal gain. The managers' bonuses were paid as percentages of the banks' profits, which rose to millions of euros in certain years (Interviewee 3 2019). The interviewees thus revealed that performance-based salaries indeed played a key role in promoting short-sighted behaviour, and thus constitute a key explanatory mechanism for the financialisation of the Bulgarian financial system.

Performance-based salaries certainly diverged from the remuneration policy of socialist regimes, but they were also largely non-existent in Bulgaria even after a few years of capitalist experience. In this context, the interviewees reported that international banking groups were the first to reward their employees based on their performance (Interviewee 3 2019). The practice was subsequently taken over by the local banks and became the standard for the whole banking sector. The concept of performance-based salaries "*was a Western introduction, it did not exist before in Bulgaria*" (Interviewee 6 2019) and structurally altered the workings of the Bulgarian financial system. The extreme remuneration schemes even prompted the central bank to issue a questionnaire to the banks

at the height of the GFC (Interviewee 3 2019), as it became obvious that the schemes must have played a certain role in the making of the crisis. While this did not lead to the abolition of the practice, a change in EU regulation in 2013 brought about some change for the financial sector (Interviewee 9 2019). The Capital Requirements Directive and Capital Requirements Regulation required financial institutions to limit excessive risk-taking and to reward employees based on longer-term goals (European Commission 2016). Now, at least technically, bonus payments are phased across a longer term (Interviewee 5 2019), although the practice has not ceased entirely (Interviewee 3 2019). In sum, short-term-oriented performance-based salary schemes were revealed to have been introduced by Western banking groups and played a key role in promoting and accelerating the developments that were described in the previous sub-sections, while the increasing overall employment in the financial sphere was directly related to the growing profitability of the sector.

5.2.6 Interim summary

The pre-GFC phase of financialisation in Bulgaria was marked by an increase both in the share of value-added and in employment in the financial sector. The heightened relevance of the financial sector vis-à-vis the real economy was mainly based on the rapid pace in the creation of interest-generating assets. The main agents in this growth were foreign banks, which first acquired local state-owned private institutions and then brought credit cards, consumer loans and mortgage loans to the market, while the local banks, partly still intertwined with the local criminal organisations (or 'business groups' as they are sometimes called), followed suit. Subsequently, the nascent housing and mortgage loan market was discovered by banks to be a profitable investment source. Sustained by external demand and domestic credit, the real estate market thus developed a bubble, in which financialising practices such as the securitisation of the loan portfolio played a key role. As the sharp growth did not go unnoticed, the central bank stepped in with a range of macroprudential measures. Due to the liberalised financial and capital account and lax control over banks' activities, the financial institutions were not only able to maintain the pace of credit growth, but through novel financial practices transcended the local financial market to achieve a higher level of financialisation.

Some of the drivers of financialisation found elsewhere were equally conducive to its emergence in Bulgaria: privatisation of social provisioning, a liberalised capital and financial account, and strict adherence to the policies recommended by the IMF and later the EU. The currency regime

contributed to financialisation as it made local companies less competitive and secured a safe margin for (international) banks (Interviewee 1 2019). Contrary to the assumption of financialisation scholars, (foreign-owned) financial institutions did not 'go into retail' because NFCs financed themselves on international markets, but rather because this market provided a profitable investment opportunity. Counterintuitively, local banks primarily made use of new financialising practices, such as securitised bonds, as a means to circumvent the regulations of the central bank. In this case, financialisation intensified as a response to restrictive regulations. Another crucial mechanism was the introduction of performance-based salaries in the financial sector through Western banks, a practice that quickly became the market standard and led to a systematic focus on short-term growth targets and profit. In this way, the maximisation of profit was institutionalised within the banking sector. As the next sections show, the GFC constituted the last dance for at least some of these practices.

5.3 The repercussions of Bulgaria's financial sector financialisation in times of crisis

The last section outlined how financialisation greatly intensified in Bulgaria in the early 2000s. This section turns the focus to the GFC of 2008 and its repercussions in the Bulgarian financial sector. Due to the financialisation of the sector, the GFC had a severe effect both on the economy and on the society, as exemplified by the near collapse of the pension system. Similar to other peripheral economies in Europe, Bulgaria remained on its trajectory of fiscal austerity while the financial effects of the boom were to be felt primarily by the debtors.

With a lag of half a year, Bulgaria experienced a contraction of its economic output similar to most other economies of the world in 2009. Its GDP decreased by more than 5% and then returned to slightly positive but effectively stagnating output in the years that followed (Pavlova and Sariiski 2015, 69). In parallel, unemployment doubled, climbing as high as 13%. The effect of the global recession was exacerbated by a corruption-related suspension of EU fund disbursement in 2008 (Vachudova 2009, 54). While the government did not devise any major measures to counter the crisis with counter-cyclical measures, in part due to the need to adhere to the EU maximum deficit rule of 3%, the central bank veered off course to attempt to curb excessive lending growth and relaxed mandatory reserves on funds borrowed from abroad in order to help inject money into the economy (Gligorov et al. 2009, 24). As a depreciation of the currency was impossible due to the persistence of the currency board, few other possibilities remained for the central bank.

At the same time, the banking sector's non-performing loans did not experience a rapid surge but rather rose gradually, from values as low as 2% in 2007 up to 17% in 2013 (World Bank 2019b). Instead of acknowledging the losses and irresponsible lending of the previous years outright, banks engaged in window dressing by pushing bad loans to SPVs, foreclosing the mortgages behind bad loans and recognising them as fixed assets, or rolling over debt (Interviewee 9 2019). Apart from the problematic loan portfolio, foreign-owned banks had to grapple with draining liquidity and the availability of cheap cross-border lending. These types of loans were often transferred back to the local subsidiary in Bulgaria in order to keep the losses off the balance sheet of the parent company – after having enjoyed the profits in the years before (Interviewee 2 2019; Interviewee 9 2019). As a consequence, net financial inflows as an indicator of financialisation decreased and abruptly reversed course, as outlined in chapter 4, which highlights the volatile nature of this phenomenon.

Apart from the macroeconomic reasons causing the reversal of growth, part of the loan portfolio turned sour due to specificities in the loan contracts. Among them, the loans that had been transferred to the headquarters in Vienna and Milan were primarily affected, but also those disbursed by their Bulgarian affiliates if they were registered in foreign currency. "*Most of the[se] loans were extended with variable rates,* […] *three-month market rate* [i.e. Euribor] *was the practice*" (Interviewee 5 2019), while local currency loans were frequently linked to the Sofibor.[66] The euro reference rate rose during the GFC from 2% to more than 5%, which caused problems for the debtors, especially households that could not augment their income streams so easily. Unrepaid interest payments due to interest rate hikes thus turned previously sound housing loans into cases of over-indebtedness. "*Banks were passing this interest rate risk to customers […] they massively increased lending rates […] this led to the increase in NPLs*" (Interviewee 5 2019). During the crisis, there were even internal discussions about limiting these flexible interest rates and draft votes were passed by the finance minister. But then, high-ranking central bank officials convinced the prime minister not to pass these laws so as not to endanger the capitalisation levels of banks. "*Politicians took the side of the banks"* as one central bank official reported (Interviewee 5 2019). The then ruling left-leaning government thus backed away from challenging the role of banks or requiring them to do their fair share in dealing with the crisis (Popivanov 2018, 122). In effect, a "*[…] big part of the shock, especially on the retail side, was taken by households. […] Sometimes I think we went too far because bankers did a lot of stupid things. Sometimes we put too much credibility of the central bank on the commercial bankers to protect them because we care[d] about the systemic effect*", as the same official comments (Interviewee 5 2019). Hence, politicians and the central bank shied away from making the financial sector responsible for the fallout of the financialisation trajectory before the crisis because they claimed that this would endanger fiscal stability and ultimately the currency board.

In the same vein, the central bank nevertheless firmly stood by its quasi-Hayekian dogma and resisted giving in to the demands of (foreign-owned) banks and their home countries. At the beginning of 2009, a number of Eastern and South-Eastern European countries, central banks and banks gathered and agreed on a joint initiative, the so-called Vienna Initiative. Its aim was to help resolve the soaring non-performing portfolio and maintain liquidity levels in Eastern Europe and SEE. Indeed, shortly before the gathering, major Western banks started pulling liquidity away from their

[66] The Bulgarian lev-related money market reference rate.

local banks, potentially jeopardising fiscal stability in the region. Thus, with the public support of the EBRD and other international financial institutions, the Vienna Initiative has credited itself with saving the countries from the sudden exit of the largest banks in Eastern and South-Eastern Europe (Vienna Initiative 2020) by agreeing on maintaining liquidity and credit provisioning in the respective countries. In reality, however, both Epstein (2014a, 2014b) and Interviewee 5 (2019) argue that the Western banks had no choice but to stay in the countries as they had huge sums of equity and sub-debt invested in them, and interested buyers would have only acquired the institutions with a substantial haircut. Rather, the Vienna Initiative served as a signalling mechanism to international financial markets so that the inter-bank funding rates for the exposed Western banking groups would not rise further.

Contrary to other central banks, the BNB did not participate in the initiative and stopped the outflow of liquidity at the end of 2008 through its mandate (Interviewee 7 and 8 2019), enraging both the Western banks' headquarters and their home central banks. The Austrian finance minister was even supposed to have asked the Bulgarian prime minister whether they would participate in a potential bailout for the Raiffeisen group, a suggestion that was declined by the BNB.[67] This was quite remarkable, as a few years before the Austrian and Greek central banks had tried to convince the Bulgarian regulator to loosen the counter-cyclical measures, basing their argument on the solely positive outcomes of "*financial deepening, integration*" (Interviewee 5 2019), known as the finance-growth nexus. Now the very same Western policymakers asked their Bulgarian colleagues to participate in socialising private losses, which highlights a particularly striking instance of peripherality. Not only as a response to the crisis, the BNB enacted the highest minimum capital requirements across the region (European Bank for Reconstruction and Development 2012, 52) so as to at least minimise the threat of a sudden exit of financial institutions.

The central bank's fixation on the currency board and lax regulation of financial practices had, however, facilitated the financialisation of the financial sector. During the crisis, debtors had to bear the costs for the excesses of the banking sector as inter-bank rates increased and credit was no longer available for businesses. At the same time, the central bank continued to firmly refuse to further prop up the banking sector during the necessary clean-out. Yet, its prior decision against

[67] "*When Lehman Brothers went down, the Austrian finance minister called our finance minister and sa[id]: 'We are going to bail out Raiffeisen, and we would ask the Bulgarian government to participate' […] they want to bail out Raiffeisen and want Bulgarians to proportionally participate [..] and we said 'no way'. We did not get the profits here […] They knew they were doing things they cannot sustain, especially Austrians and Greeks*" (Interviewee 5 2019).

imposing tighter regulation during the boom was thwarted by its focus on maintaining the currency board and keeping an open capital account.

Along with the banking sector, financial sector-related industries also registered severe losses in the crisis, influenced by the financialisation trajectory. The domestic stock market crashed completely (80% decrease in the domestic stock exchange index) and private pension funds registered losses of more than 20% in 2008 (Milev and Nenovsky 2012, 81). The three-pillar design of the pension system (as described in sub-section 6.1.2), which was adopted in 2002 and ideologically grounded in a document issued by the World Bank (1994), had been initially framed in very strict terms with regard to the mandatory holding of government bonds, which would have prevented such huge losses. However, the system was changed in view of the EU accession in 2006 and of the harmonisation of related regulations. The amendments then allowed pension funds to more actively invest in other types of financial products (Milev and Nenovsky 2012, 76). Hence, pension fund managers sought more attractive financial products. For example, they invested in the domestic securities market, which, due to the price increases, promised high returns. Among these financial products, real estate bonds and investment trusts accounted for a large share. "*Bulgaria has been one of the exceptions: in addition to physical real estate, pension funds have traditionally invested a certain proportion in real estate investment trusts (REITs)*" (Krzyzak 2010). However, during the crisis, it was exactly these products that suddenly went bust, causing a near collapse of the private pension fund system. In that sense, due to the privatisation of part of the pension system and particularly due to the liberalisation of the system in the years before the crisis, Bulgarian pensioners lost a great deal of their life savings, which were invested in the domestic, heavily corrupt and financialised real estate market. As public dissent erupted during the crisis, a proposal for re-nationalisation of some savings pension accounts was ultimately only declared illegal by the constitutional court. Later, the retirement age and mandatory contributions were increased (Beblavy 2011, 10) in order to cover up the losses that had accumulated during the downturn. Thus, the liberalisation of the Bulgarian welfare system contributed to some extent to the financialisation of the economy, resulting in losses for the general public.

As shown in the preceding section, the finance-growth nexus had served as a panacea for the lack of capital in Bulgaria as well as in other post-communist countries. While the influx of foreign finance fuelled short-term demand, the chosen path went hand in hand with financialisation. Initially, the financial crisis in the Western world and the lack of aggregate demand were seen as the

main culprits for the severity of the GFC in Central and South-Eastern Europe as well as in Bulgaria (Berglöf et al. 2009). Later, it was acknowledged that the financial integration channel rather than the trade channel was the main driver for the transmission of the crisis (Becker 2010, 21). Within this narrative, foreign banks were seen as a mitigating factor in the output decline, as mass-scale exits did not happen. However, these accounts fail to mention that foreign banks massively reduced their cross-border loans, as happened in Bulgaria, which effectively led to the depletion of credit for the whole banking sector and subsequently the real economy. Furthermore, foreign banks in particular were forced to accumulate liquidity to cover for non-performing loans and build reserves as required by their Western headquarters. Therefore, credit provisioning and thus capital investments were restrained (Popov and Udell 2012), which hampered the recovery of the real economy. As the next section will show, banks in Bulgaria did not suffer too much, as the level of financialisation dropped only marginally in the second phase of the process, and new agents of financialisation arose in response to tighter bank regulations.

5.4 Bulgaria's post-crisis financialisation trajectory

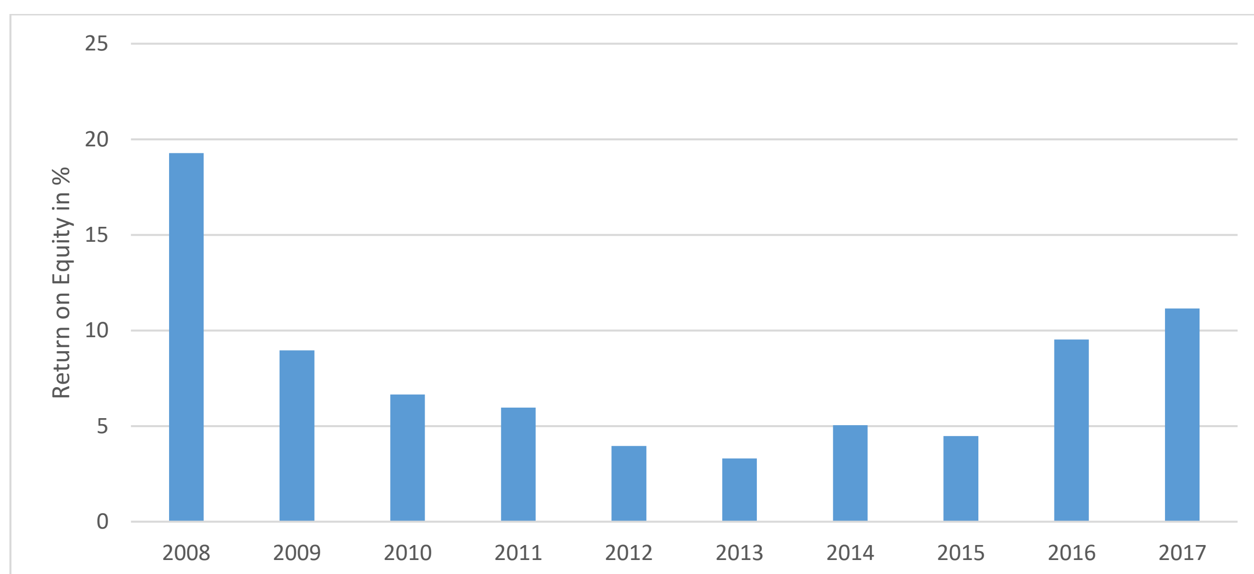
The last section focused on recounting the crisis and its effects on the financial sector in Bulgaria. The impact was greatly exacerbated due to the financialisation trajectory in the 2000s, with serious consequences for the real economy and households. This section continues to explore the second, post-crisis phase of financialisation of Bulgaria after the crisis until the year 2017. As discussed at the beginning of this chapter, the financial sector maintained its level of financialisation in terms of both value-added and employment. In parallel, the statistical analysis revealed a shift in the business behaviour of banks after the crisis, in that banks have increasingly derived incomes from fees instead of from loans. Given the decreasing trend of financialisation in other countries, why did the degree of financialisation in Bulgaria persist? Are we in fact witnessing new, financialised forms of financial practices that might explain the increasing share of fee income? In order to analyse all three indicators of financial sector financialisation, this section first delves more deeply into an analysis of the post-crisis trajectory of financialisation, which stands out in the region of SEE. Building on the main trends, the section continues with an inquiry into the reasons for the enduring degree of financialisation in Bulgaria. While the previous section aptly focused on answering how the financial sector became financialised so quickly, this section concentrates on how the degree of financialisation was maintained in the light of the looming financial crisis, the European debt crisis and two large domestic bank failures. It argues that banks indeed shifted their behaviour towards generating income with sovereign bonds and towards cross-selling financial services, but did not engage in other practices of 'high finance' or in repo activities frequently found in Western Europe and the US. While this may explain the increasing trend vis-à-vis fee income, the lingering degree of value-added and employment financialisation in Bulgaria is claimed to be maintained by a growing shadow financial sector that preys on the most vulnerable parts of the population.

5.4.1 Persistence of financialisation of the financial sector

Despite the economic effects of the GFC and a general retrenchment of credit activity, the financial sector in Bulgaria remained positive overall in terms of profitability, as can be seen in Figure 29. Profitability as measured in terms of return on equity decreased gradually after the GFC, but never turned negative like the overall economy did. With regard to the indicators of financialisation, the value-added of the financial sector in relation to the total gross value-added of the economy peaked in 2010 and has since then remained on an elevated level in Bulgaria (even compared to the EU

average). As the total economy contracted in the year following the crisis and has since then grown only mildly, one can conclude that the financial sector has not increased its relevance vis-à-vis the real economy, but it has also not de-financialised as one might have expected in a financial crisis. In part, the mechanics of window dressing and other circumvention methods that were described in the previous sections aided the financial sector in postponing an outright acknowledgement of the losses. After reviewing the trajectory of financialisation in the post-crisis period, this section argues that the extraordinary performance of two domestically owned banks and a change in the tax system have helped the financial sector to sustain its elevated relevance vis-à-vis the real economy.

Figure 29: Bulgaria – Banking sector profitability



Source: World Bank 2019b

Similar to the pre-GFC period, it is important to analyse the development of the different segments within the financial sector in order to understand which of them contributed to maintaining the degree of financialisation in Bulgaria. For that reason, it seems advisable to scrutinise the composition of gross value-added between pension funds, insurance companies and credit institutions – information that is available from the Bulgarian National Statistical Institute (2019b, 2019a, 2019c) – for the post-crisis period. The statistics reveal that gross value-added of credit institutions began to stagnate in 2008 and saw a mild uptick only from 2015 onwards. At the same time, the (non-life) insurance sector and the pension fund sector grew at a moderate pace. As argued in the previous sections, this can be primarily attributed to the liberalisation of the non-bank financial sector

and welfare regime. A further review of the profit statements of credit institutions reveals that especially 'corporations specialised in lending'[68] (Bulgarian National Bank 2019d), which are part of the non-bank financial sector, have been increasingly profitable since 2013. Thus, with regard to gross value-added, both the continuing high value-added share of the banking sector and non-bank credit institutions are pivotal for understanding the post-crisis financialisation trajectory of Bulgaria and will be reviewed in this and the next two sections.

Looking at the second indicator of financialisation, employment levels within the financial sector were shown to be constant in Bulgaria after the crisis, which stands in contrast to most other countries in the sample of this study but also to the rest of the EU. In terms of absolute employment, contracted labour in the financial sector increased throughout the GFC and only started to decrease from 2014 onwards (National Statistical Institute 2019a). When prompted to analyse this indicator of financialisation, the interviewees unanimously maintained that the high employment levels in the Bulgarian financial sector were directly linked to the high profits enjoyed before the crisis and the meagre impact of the crisis on those gains (Interviewee 2 2019; Interviewee 3 2019; Interviewee 7 and 8 2019). In addition, the growth of the retail lending segment throughout the post-crisis years was described as being labour-intensive, necessitating an influx of employees in order to disburse consumer loans to an increasing number of clients. Due to the stable profits and lack of competition, there was thus no need to reduce the number of employees after the crisis. Overall, the low salaries in the country and underpaid staff in the financial sector after the crisis (Interviewee 11 2020; Interviewee 2 2019) also contributed to this development. A former bank manager offered the additional explanation that strict labour laws with unilateral court rulings in favour of employees further constrained banks in initiating larger lay-offs (Interviewee 12 2020). Despite persisting employment in the sector, the general aversion to banks resurged in Bulgaria after the GFC, which greatly decreased its attractiveness as an employer. One interviewee even commented that "*you are not proud if you work for a bank in Bulgaria*" (Interviewee 12 2020) after the crisis. In that sense, the interviews revealed that the relatively steady employment within the financial sector can on the one hand be explained by consistently positive profitability in the sector and stagnating wages in the overall economy after the GFC, despite its waning general appeal. On the other hand,

[68] The remainder of the chapter refers to these non-bank corporations specialised in lending as NBFIs. Technically speaking, the umbrella term NBFI would also include other institutions, such as insurance or pension funds, which are referenced individually in this study.

the surging retail business, which focused on a high number of low-income clients, necessitated more physical attention from financial sector employees.

What are the other reasons for the stable profitability of the Bulgarian financial sector[69] that contributed to maintaining its elevated relevance in comparison to the real economy? The interviews and research based on secondary literature revealed that besides a return to mild portfolio growth rates from 2010 onwards, the peculiar development of the domestically-owned banks, especially that of Corporate Commercial Bank and First Investment Bank, is striking in this context. From the year of the crisis of 2008 until 2013, both banks nearly doubled their market share. By 2014, they ranked as the third and fourth largest banks in the country (Epstein 2017, 114–16). While it was primarily foreign-owned banks that restricted lending and engaged in accumulating deposits after the crisis, domestic banks, often owned by the aforementioned 'business groups', ratcheted up their lending to households, affiliated companies and state bodies. However, as the Bulgarian banking crisis of 2014 revealed (The Economist 2014), in which a bank run on both institutions occurred, they stepped up their activity through unsolid practices and even artificial bookkeeping. In the case of Corporate Commercial Bank, which was audited by KPMG (Tsolova 2014), more than EUR 1 billion was stolen, for which the deposit insurance fund had to be drained in order to honour the claims on deposit liabilities. The bank was subsequently put under special supervision of the central bank (Bulgarian National Bank 2014). First Investment Bank was saved by the government with state aid likewise amounting to more than EUR 1 billion.

Though the revelations were allegedly sparked by a dispute between two oligarchs or heads of 'business groups' (Epstein 2017, 116), a great variety seems to have persisted between the regulation of foreign-owned banks and their domestic competitors. The interviews even revealed that a bifurcation exists within the banking system, in that a certain number of domestic banks only serve companies within the holding network of their 'business group' (Interviewee 12 2020; Interviewee 9 2019), which is often affiliated with a certain political party. Most foreign-owned banks attempt to stay away from these businesses, which have been termed the 'untouchables' (Interviewee 6 2019). Therefore, the continued robustness of the financial sector in terms of value-added and employment after the crisis can be partly explained by a surge of financial activities that later turned out to be dubious in nature. Domestic politicians played their part in that they actively looked the

[69] Return on equity of the Bulgarian financial sector did not turn negative during the crisis and stayed at almost 5% throughout it (International Monetary Fund 2017, 16).

other way. The trajectory of financialisation in Bulgaria is hence infused by these types of behaviours and is in part case-specific.

Another factor that came to light during the interviews that could potentially explicate the persistence of financialisation was a change in the taxation system (Interviewee 2 2019; Interviewee 3 2019). Bulgaria introduced a flat tax regime[70] right before the GFC in the fiscal year of 2008. Since then, personal and capital incomes have been taxed only 10%, one of the lowest rates in the EU. As the tax is levied on capital gains and personal income, banks benefit through paying lower taxes on their incomes, while employees are taxed less, which reduces wage pressure for the banks, particularly in situations of high unemployment. Next to this, the financial sector is the most transparent sector in Bulgaria.[71] With the grey economy still hovering at around 30% in the country (Medina and Schneider 2018, 18), the financial sector profited the most from the introduction of the flat tax regime in comparison to the rest of the economy.[72] Relatedly, this highlights the fact that the financial sector is one of the most important tax contributors in the country, which yields significant political leverage.

Contrary to what one would expect, it was not so much the representatives of the financial sector who lobbied for the flat tax regime. Rather, it was a conglomerate of interest groups led (again) by the neoliberal think tank Institute for Market Economics (IME) and international financial institutions such as the World Bank, OECD and USAID that lobbied for political change (Appel and Orenstein 2018, 95). The interest of the IFIs in lobbying for such a change can be better understood in the context of development ideology. The adoption of the flat tax in Bulgaria falls into a time period that Appel and Orenstein (2018) call ‘avant-garde neoliberalism’. Together with the privatisation of the pension system, the adoption of a flat tax regime was one of the main political demands of an ideological stance fervently defended by international development institutions (Beblavy 2011), and in the case of Bulgaria, the neoliberal IME.[73] Even more extreme than in Western countries, the flat tax regime was argued to serve as ‘competitive signalling’ and as a link

[70] *A flat tax system levies a single nominal rate of taxation on personal income* [the same applies to corporate or other forms of taxes], *regardless of income level (although usually above a minimum threshold*) (Appel and Orenstein 2018, 27).
[71] This was univocally argued by all interviewees.
[72] Relatively speaking, the financial sector profited the most from the introduction of the flat tax as it is the most formalised. Partly or non-formalised businesses did not profit that much as their relative tax levy was reduced less; however, they had a higher incentive to become more formalised due to the lower tax.
[73] Even the homepage of IME is adorned with a quote by Hayek: “The more the state “plans” the more difficult planning becomes for the individual.” (Institute for Market Economics 2020).

between the attraction of foreign capital and the adoption of neoliberal policy (Appel and Orenstein 2018, 116). Similar to the governments of Schröder, Blair and Clinton, in Bulgaria it was also a centre-left (BSP) government that introduced the tax (Popivanov 2018, 121). The effective lobbying of IME representatives played a key role in this process as outlined in a report by the very same institution (Institute for Market Economics 2016). International development institutions have thus indirectly contributed to the continued high level of financialisation in Bulgaria after the crisis.

Paradoxically, the introduction of the flat tax regime in 2008 must have even acted as a counter-cyclical measure during the crisis, as it increased the capacity of private debtors to repay debt. In reality, the enacted tax relief (since overall, taxes were lowered for top earners) at the peak of the GFC was rather a coincidence, as local politicians even claimed that a financial crisis did not exist in Bulgaria until 2010, according to one interviewee (Interviewee 12 2020). However, the flat tax contributed to the persistence of the financialisation of the financial sector as it made the formalised financial sector more profitable in net terms. One could equally argue that it acted as a redistributor of tax revenue collected from newly formalised businesses and employees as well as the government budget towards the net income generated by financial institutions. As a side effect, the maintenance of net profits of financial institutions as well as the lower costs for employees contributed to the persistently high level of employment in the financial sector (Interviewee 3 2019), while sectors in the real economy had to lay off part of the workforce in response to the crisis.

This section has shown how both employment and value-added as indicators of financialisation remained robust in the post-crisis period through a surge in (dubious) activities of domestic financial institutions and through the introduction of a flat tax regime, which increased profits and depressed nominal wages. The next section focuses on the shifting business activities of banks as they started to increasingly generate incomes from fees instead of from interest. While the liberalised welfare system in the form of pension and insurance funds equally contributed to the persistence of the financialisation of the financial sector, non-bank credit institutions have started to play an increasing role in the financialisation trajectory of Bulgaria that is further analysed in the second to next section.

5.4.2 The bankers' new clothes?

The financialisation literature asserts that banks have shifted towards generating an increasing part of their income through fees instead of through interest. This argument had been challenged with

regard to developing economies, as it was claimed that banks in these geographical contexts tend to focus on lending to households. For Bulgaria, this has been confirmed for the pre-GFC trajectory. However, after the crisis, banks began generating more fees instead of interest income. This could lead one to ask whether financialisation in Bulgaria now rather resembles that of developed economies in that banks derive their income through brokerage services and other financial products that generate fees instead of interest income and whether this can be related to the persisting degree of financialisation of the other indicators. This section scrutinises and discusses the shift of the banking sector towards fee generation and outlines how banks in the post-crisis trajectory have steered their activities towards sovereign bond holding and cross-selling.

Financial institutions were reluctant to provide credit after the GFC in Bulgaria, as they had to clean up their portfolios due to the rise in non-performing loans (International Monetary Fund 2017, 13–17) while still registering positive net revenues. In parallel, deposits increased within the banking sector, causing the deposit-to-loan ratio to increase far above 100%. Due to this increased liquidity, domestic financing has become much cheaper for financial institutions, leading to a decline in cross-border activities. Together with competitive pressures as well as the aggressive monetary policy imposed by the ECB, this led to shrinking net interest margins for financial institutions in Bulgaria (Interviewee 2 2019; Interviewee 4 2019; Interviewee 9 2019) similar to other major Western economies such as Germany. Credit guarantee schemes such as JEREMIE and InnovFin funded by the EU have further brought down interest rates according to the interviewees (Interviewee 2 2019). In order to maintain profitability, banks started to charge higher fees for ordinary transactions and other fees, for example for property evaluations (Interviewee 12 2020). This might in part explain the increase in the share of fee income. Contrary to the explanatory mechanisms, banks did not start to engage in "high finance" investment products such as brokerage services, securities or derivatives. As one interviewee notes (Interviewee 1 2019), "*[…] this market is completely underdeveloped*". The International Monetary Fund (2017, 10) notes that "[Bulgarian] *Banks' business models rely mostly on deposit-taking and loan placement, with little wholesale funding or investment banking activities"*. At first sight, the increase in the fee-to-income ratio can thus not be directly related to practices of financialisation, but was rather an outcome of the market situation.

In a similar vein, the interviews revealed that the Bulgarian banks' objective was "*not to make more profits but minimise the losses*" (Interviewee 12 2020). The accumulated liquidity due to the

restrictive lending policies and tight capital requirements issued by the central bank was placed either on the accounts of the central bank or in government securities (International Monetary Fund 2017, 15). Indeed, claims on the general government rose from around EUR 1.5 billion at the end of 2008 up to EUR 5 billion at the end of 2017. At the same time, reserves held with the BNB increased from EUR 3 billion to EUR 7.5 billion (Bulgarian National Bank 2020). This could lead one to suspect the emerging speculative repo market activities that were one of the hallmarks of post-crisis financialisation (Gabor 2017). However, repos are only infrequently used in Bulgaria, and even the International Monetary Fund (2017, 15) remarks that the high balances with the BNB leave little room for secured funding structures such as repos, and this is also reflected in the statistics of the BNB. In that sense, Bulgarian banks mainly placed their excess liquidity in government securities but did not deploy it for any of the innovative products found in more financialised geographies. As one interviewee put it, "*they are stuck with it [i.e. liquidity]*" (Interviewee 10 2020).

On the other hand, the interviews exposed a critical explanatory mechanism that has contributed to the post-crisis trajectory of financialisation in Bulgaria. Due to the stagnating loan portfolio development, banks increasingly sought ways to generate additional revenue from their existing customer base. Such cross-selling operations grew markedly after the crisis and include targeted offers of car financing, leasing, mortgages, credit cards and home furniture renewal.[74] In this regard, the fact that several banks own insurance companies in Bulgaria, such as the Austrian Raiffeisen Bank and Uniqa, the Belgium KBC Bank and DZI Insurance, the German Allianz Bank and Allianz Insurances as well as the Bulgarian Central Cooperative Bank with its related company Armeec Insurance, came in handy (Financial Supervision Commission Bulgaria 2020). The relationship between the two business lines was argued to be quite close (Interviewee 11 2020; Interviewee 12 2020). Within the regular set of key performance indicators, the bank employees even had a specific target to sell a certain number of insurance products (Interviewee 12 2020). The premiums on these cross-sales, especially those related to insurance, are very profitable. Among them, payment protection insurance has become one of the most popular products, insuring the debtor against

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[74] "*You have a lot of cross-sell, I mean you cross-sell insurance, leasing, cars, you can do many things with retail, you can do mortgage, I mean with the mortgage you sell insurance again, [if] it's for some like fix rate, it's embedded swap, […] other credit that is linked to buying furniture, credit cards, I mean you have fees on these credit cards et cetera et cetera you could cross-sell so many other things […] In terms of cross-selling the banks invented themselves recently because they realised that with the normal way of banking it is very difficult because your profit is always under pressure so you have to invent new ways to do money, then you start doing cross-selling, you sell other products just to compensate this*" (Interviewee 10 2020).

death, illness, job loss and other kinds of risk. While this might seem to be a decent product for any bank client, reality has shown that successful claims against the insurance company are near zero in Bulgaria, according to one interviewee (Interviewee 11 2020). This shows that banks preyed on the gullibility of their clients in order to boost revenues. In light of the rather stagnant state of other bank activities, the intensifying cross-selling tactics highlight a specific pathway of post-crisis financialisation that further entangles the unholy trinity of finance, insurance and real estate and lets financial logics and products, albeit 'basic' ones, proliferate across the society.

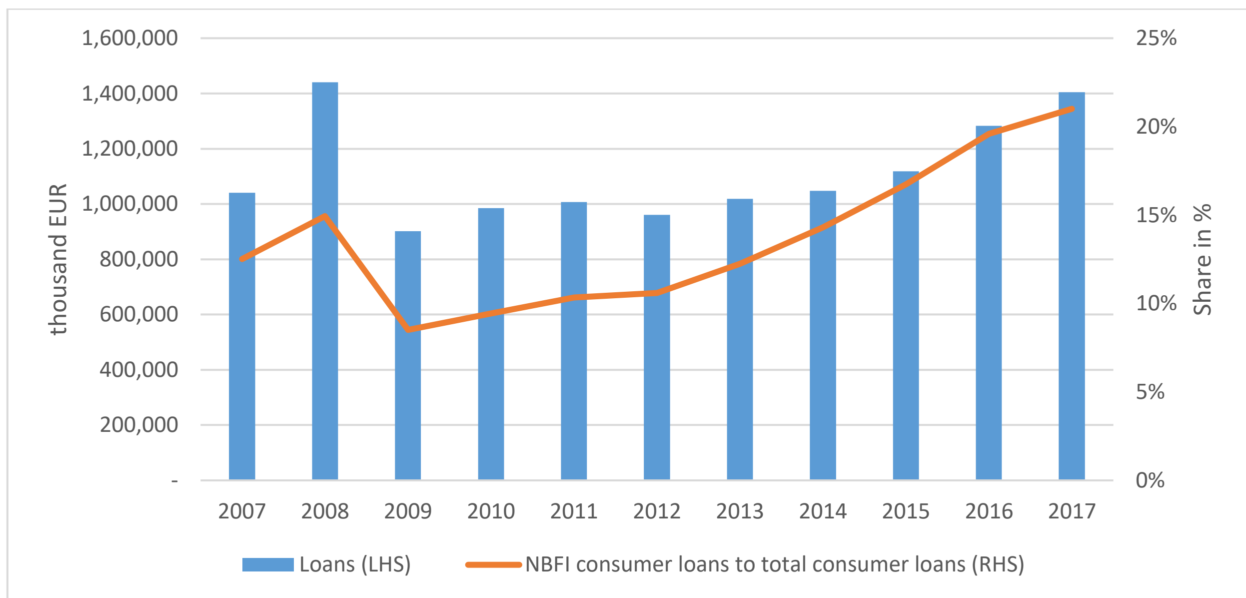
5.4.3 Expansion of shadow-banking

At the beginning of this section it was argued that apart from insurance companies, pension and investment funds, non-bank lending organisations exhibited especially strong growth in the phase after the GFC and may help to explain the continuing high level of financialisation in Bulgaria. The previous sub-section highlighted the difficulties encountered by banks in juggling defaulted loans, new heavy regulatory requirements, and the need to search for novel avenues of profit creation. Apart from cross-selling, it was found that another way to generate revenue was to scale up activities in the non-bank financial market through subsidiaries of banks such as UniCredit and BNP Paribas. The inception of the non-bank financial market was one of the earliest institutional changes in Bulgaria in its recent history after the domestic economic crisis of 1996. Even before, lending, investor and foreign exchange houses played a peculiar role, as laid out in the earlier sections of this chapter. A number of smaller and larger non-bank credit institutions have since then been competing with bank-owned companies on this market. This section describes the trajectory of the non-bank lending market and lays bare how the lax oversight by the EU and the central bank enabled financial institutions to issue vast volumes of loans – especially to the most vulnerable social groups – in the form of (short-term) consumer credit. As one interviewee at the central bank put it, "[…] *bankers are exploiting this [market] because it is less regulated*" (Interviewee 5 2019) and thus generate additional surplus off the beaten track.

The development of the non-bank credit institution market in Bulgaria may be divided into two phases. Dating back to the establishment of a financial sector composed of a banking and a non-banking element, a number of smaller credit institutions started to mushroom in Bulgaria at the beginning of the 2000s. Expansion intensified from 2005 onwards and was only temporarily stalled by the effects of the GFC. It is only lately that the sector "*has been institutionalised*" (Interviewee 10 2020) in its course and embarked upon a path of intensifying existing credit relations, i.e. "*The*

non-bank financial institutions [are] increasing the average loan amount they disburse [as the] Bulgarian non-bank financial market is quite saturated already" (Interviewee 11 2020). Figure 30 depicts the development of loans in euros on the left-hand axis and the share of consumer loans disbursed by non-bank credit institutions compared to the total consumer loan portfolio in Bulgaria on the right-hand axis. The trajectory of the disbursed loan volumes reflects the descriptions provided by the interviewees.

Figure 30: Bulgaria – Non-bank credit institutions development



Source: Bulgarian National Bank 2019d, author's calculation

Starting from the earliest available figures in 2007, the loan portfolio increased sharply up until 2008 before dropping by nearly half in the following year. As we will see later, this drop is not only due to the GFC but mainly due to a change in regulation. In the period before the crisis, banks mainly used non-bank financial institutions as a hideout for their non-performing loan portfolio, as loans parked there were not obliged to be reported to the credit registry, which partly explains the size of the non-bank sector (see Figure 17). Although the central bank changed the related regulation, the practice has not entirely stopped (Interviewee 7 and 8 2019). Since the GFC, the sector's loan portfolio has been slowly increasing again. As revealed by the data, non-bank lending organisations have been particularly active in the field of consumer finance, which fully accounts for the increase in total loans of this sector. The share of the consumer loans disbursed by the non-banking sector has risen continuously since the crisis and in 2017 amounted to up to 20% of total consumer loans. One fifth of all consumer loans in Bulgaria have thus already been disbursed by the shadow

banking sector, and its share of newly disbursed consumer loans will necessarily be even higher. How did the shadow banking sector gain so much traction? What are the mechanisms and who are the main actors? To what extent can this explain financialisation?

Besides the political will to create and maintain a non-banking lending sector, since their inception "*[the non-bank lending institutions] are dealing with sub-prime borrowers*" (Interviewee 10 2020). In the context of Bulgaria, this means lending to people who have no or only grey income and who are barely sustained by the shallow net of social security. While banks were also formerly active in this market segment, since the GFC the regulated banking institutions have mostly withdrawn from lending to sub-prime clients (Interviewee 12 2020), which left the field wide open for their less regulated competitors. However, apart from some smaller local and foreign-owned non-bank lending institutions, the market is starting to be dominated by lending vehicles that are de facto owned by large international banking groups such as UniCredit. Other important players in this sector include the Bulgarian-owned Easy Credit and the French banking group BNP Paribas, which acquired the leading non-bank credit institution in Bulgaria at that time, Jet Finance, in 2007 (BNP Paribas 2007). With regard to business operations, the by now largest non-bank financial institution, UniCredit Consumer Financing, formerly known as Clarima, serves those clients who are rejected by the bank, but at much higher interest rates than it charges its more affluent clients (Interviewee 12 2020). Typical products include credit cards, fast-cash loans and in-store financing. Easy Credit is famous for its home-collected credits, which are sold through local intermediaries, delivered and collected directly at clients' homes. BNP Personal Finance specialises in all-purpose consumer loans, e.g. for trips, cars and home appliances. Common to the business organisation of these companies is the high speed of approval or rejection (often within minutes or hours) of the loan based on a risk analysis with simple and often automated scoring.

The business has proven quite profitable recently, especially for the larger institutions. For instance, market leader UniCredit Consumer Finance increased its profits from around EUR 20 million in 2014 (Unicredit BulBank 2015, 47) to more than EUR 50 million three years later (Unicredit BulBank 2018, 49). This meant that within this period of time, the profit contribution of the non-bank lending company to UniCredit Bank Bulgaria rose from 11% (Unicredit BulBank 2015, 4) to a stunning 25% in 2017. As stated by the company, the focus remained "*on acquisition of new clients and cross-selling*" with the bank (Unicredit BulBank 2015, 49). Similarly, BNP increased its net profit of EUR 13 million in 2015 (BNP Paribas 2016, 518) to EUR 25 million in 2017 (BNP

Paribas 2018, 558), which posits it among the most profitable financial institutions in Bulgaria despite its status as a non-bank financial institution. Escaping from the regulated sphere to the shadows of sub-prime lending thus now accounts for a significant part of the profitability of foreign-owned banking groups and other private investors. What are the laws and regulations that these institutions need to follow and which enabled banks to divert their activities to less regulated spheres?

Financial institutions need to obey laws issued by the national legislator as well as regulations emanating from the mandated authority in the sector, which is the central bank. In the financial sector, relevant laws with regard to lending practices include contract drafting, and therein the relationship between the creditor and the debtor often fall under the umbrella term of "consumer protection". Up until the GFC, credit consumer protection was limited in Bulgaria. This changed with the EU Consumer Credit Directive, which was implemented in Bulgaria in 2010 (Vasileva 2019, 67). The directive contained some basic consumer protection clauses, such as the requirement to display certain information, but in general failed to address the topic of irresponsible consumer lending on the EU scale (Cherednychenko and Meindertsma 2019, 484). Still, all credit contracts and clauses in Bulgaria are checked against the directive and local laws by the Consumer Protection Agency before they are offered on the market (Interviewee 11 2020). The directive comprises a general obligation to check the client's creditworthiness (Vasileva 2019, 67); however, specific guidance or standards on what the risk assessment should look like are lacking in Bulgaria (Cherednychenko and Meindertsma 2019, 494). Loans are therefore disbursed based on a risk-return analysis, i.e. whether the high interest rate can compensate for the (high) likelihood of default. The central bank also refrained from issuing any limit on the payment-to-income ratio or debt-service-coverage ratio, as the credit risk is argued to be on the side of the lending organisation, according to a central bank official (Interviewee 5 2019). In conclusion, consumer protection was practically non-existent in Bulgaria at the non-bank lending organisations, and the EU directive brought only marginal improvements in that direction. In that sense, NBFIs are essentially free to operate however they like.

Apart from establishing consumer protection, the central bank is tasked with regulating non-bank credit institutions. Until 2009, such institutions only had to register with the central bank two weeks after going into operation, with very low equity requirements. In the wake of the GFC, a new regulation was issued requiring all companies to re-register at the central bank, to increase their equity

up to BGN 250,000 and to submit the personal qualifications of the managers (Stoyanov and Krumov 2010). Publicly, this was communicated as trying to limit the excessive behaviour and intransparency that pervaded the sector at that time amidst public discontent. The interviews, however, revealed that the change in regulation was orchestrated by the banks and larger market players within the non-bank sector in order to consolidate it and thereby drive out smaller companies (Interviewee 11 2020). Indeed, a number of companies failed to re-register or did not meet the requirements, causing the market's loan volume to drop by nearly half. In 2014, a second wave of measures aimed at the NBFI market was passed, including an interest rate cap of 50% per annum (Sofia Globe 2014), formulated as a law by the Bulgarian parliament. A change of regulation by the central bank additionally mandated an increase of minimum equity to BGN 1,000,000. The cap on interest rates in particular meant a significant decrease in profitability for the sector, as the interest rates typically far exceeded 100% per annum. Subsequently, the non-bank lending institutions were forced to downsize and re-organise (Interviewee 10 2020). The amendment did not, however, lead to a cessation of activity, as all credit organisations found ways to circumvent the law through the introduction of certain additional fees, e.g. for fast cash delivery. As one interviewee noted, "*every [one] of the players has found their way to bypass that one*" (Interviewee 11 2020), which led to the fact that roughly 90% of their clients are still paying an interest rate higher than 50%.[75] Both instances show that the regulations mainly served either personal or corporate interests or were enacted to calm public criticism, but failed to ameliorate the credit conditions of the sub-prime borrowers.

In conclusion, it is fair to argue that the regulation of non-bank lending institutions was and has been very lax both on the EU and the national level. The European directive on consumer protection leaves ample room for local interpretation (Burton 2017), and on the national level sporadic populist moves prevail over a structured course of action, be it either by the legislative body or the central bank. No on-site visits are taking place and the reporting forms are simple, which is conducive for masking the real figures. Case inquiries remain rare and are mainly driven by anti-money laundering requests (Interviewee 10 2020; Interviewee 11 2020; Interviewee 12 2020). "*I see that*

[75] "*According to regulation, there are some services that do not fall under APR and there are two exceptions, one is, it's written in the law, if a service is not compulsory then it's not supposed to be part of the APR and the second one is […] does not matter. […] They [i.e. NBFI] have an application form and an interest[rate that] is almost 50 percent, actually 50 is very much OK and they have an extra service, which is express delivery of the money. If you don't tick the express delivery of the money you can get the money in two weeks' time […] Nobody is pressuring you to press the express money […] If you need the money now, you need to pay this extra fee […] 10% take the one which is slow service*" (Interviewee 11 2020).

they [i.e. the central bank] more just like observe what's the situation on the market rather than heavily tightening some rules", comments one interviewee (Interviewee 11 2020). It is exactly this lack of regulation of the non-bank sector that allows more and more banks to escape the tight grip of new regulations and intensify their operations in a non-bank environment.[76] In the context of Bulgaria, international banking groups founded non-bank vehicles for factoring, leasing and especially disbursing consumer finance even shortly before the GFC. In the aftermath of the GFC and the Eurocrisis, banks had to grapple with an increasing volume of non-performing loans in their portfolios and rising provisions or write-offs. Their non-bank affiliates offered profitable avenues for increasing profits without further allocating provisions for the losses, as they could simply let the company go bankrupt. However, they did so by providing loans to and preying on a segment of the population with no formal employment.

The flipside of the relentless behaviour of the non-bank credit institutions becomes visible when we look at the defaulted credits in this sector. The share of non-performing loans rose from 4% in 2007 to a startling 30% in 2013 and has remained in the double-digit range since then (Bulgarian National Bank 2019d), in contrast to an overall non-performing loan ratio of around 15% from 2010 to 2016 (World Bank 2019b). Over 75% of the loans disbursed by NBFIs have a maturity that is longer than one year (Bulgarian National Bank 2019d). Given the small individual loan amounts of these consumer credits, this means that maturities are stretched ever further in order to either refinance the loan (due to the borrower's inability to repay) or further increase the loan amount. "Intensification" of customer relations is the magic word, as the market itself is already quite saturated, according to the interviewees (Interviewee 11 2020). In reality though, the companies "*take advantage of the disenfranchised*" (Interviewee 6 2019), with payday lending in particular causing consumer detriment in Bulgaria (Cherednychenko and Meindertsma 2019, 492). In that sense, the expansion and intensification of the non-bank sector may explain why financialisation persisted in the Bulgarian financial system amidst stagnating banking activity during the post-crisis phase.

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[76] "*Probably the first […] motivation is because it's a non-regulated company, I mean in the past, now it is pretty much regulated by the central banks but you don't have equity, regulated equity so able to work if you don't need to basically invest huge amounts of equity before you start printing transactions, cash*" (Interviewee 10 2020).

5.5 Chapter summary

Up to now, Bulgaria has not been studied in the literature of financialisation. The preceding chapter argued that there was no good reason for this: Bulgaria ranks among the countries with the highest gross value-added contribution of their financial sector to GDP in the sample considered in this thesis as well as in the wider EU. Financial sector employment has been equally pronounced, with the fee-to-income ratio mainly mirroring the change in business behaviour of the banks. This chapter therefore set out to elucidate the trajectory of financialisation and to search for explanations based on the those that have already been generated in the literature on financialisation. This analysis goes beyond from the development of the indicators of financialisation (as described in chapter 3), however: Gross value-added of the financial sector surged in the years before the crisis, similar to employment in the financial sector. After the GFC, gross value-added and employment decreased slightly and then remained stable on an elevated level. The fee-to-income ratio decreased in the years leading up to the GFC and afterwards started to increase.

At its outset, this chapter argued that Bulgaria was part of the communist bloc during much of the 20th century and banking was primarily steered by the monobank, which allocated credit and offered savings accounts, while other types of financial services were non-existent. After the fall of the Iron Curtain, Bulgaria's economy was fully liberalised, but very little foreign investment was allowed. In the absence of any control and regulation, the 1990s were characterised by widespread asset-stripping of firms and embezzlement of money in the financial sector. At the same time, the stock market was activated to serve as an institution for mass-voucher privatisations. In both instances, people often fell prey to reckless members of 'business groups' due to their lack of financial and economic literacy, the absence of regulation, and the rosy promises of capitalism. A major part of the Bulgarian public lost their life savings in the economic and financial crisis of 1996/1997 due to bank collapses and later to hyperinflation.

The crisis proved to be a turning point for the country, as a currency board was instituted, thereby fixing the exchange rate of the Bulgarian lev to the deutschmark (later euro). In a similar vein, the financial and capital account was liberalised, the banking sector was privatised and sold to international banking groups, and the pension system was transformed into a three-pillar system, and thus partly privatised. The interviewees who participated in this research confirmed the assumption that this was done in the spirit of the Washington Consensus, with the IMF and the EBRD playing

pivotal roles in the institutional change. However, it should be emphasised that this full alignment with neoliberal policies needs to be seen against the backdrop of the painful early capitalist experience, in which people lost their faith in Bulgarian policymakers and the ruling elites. The institutional setup of the financial system had and has been largely bank-based throughout the Bulgarian capitalist experience; however, the newly enacted regulations foresaw the creation of all types of other non-bank financial institutions, such as private pension funds, investment companies, and insurance companies.

The growth in financial sector assets in Bulgaria was quite pronounced until the GFC and mainly derived from interest-bearing assets, i.e. loans, which generated interest income. A large number of these loans were extended to companies, but from 2004 onwards efforts were progressively directed towards consumer financing. It was found that it was the Western banking groups operating in Bulgaria that brought retail banking into the country. Before the early 2000s, consumer loans were virtually non-existent in Bulgaria, yet banks managed to change the consumer mentality from 'first save then invest' to 'buy on credit'. Regulations governing consumer loans, such as maximum payment-to-income ratio, were missing in action – along with any serious consumer protection measures – while the central bank argued that this issue was not part of its mandate. The growing retail activity helps explain the increase in financial sector employment, because an increasing number of employees were necessary for the thriving number of credit disbursements. Within the segment of consumer loans, housing loans, which likewise were not subject to any consistent regulation, grew sharply. It is no surprise that this produced a house price boom, which was amplified by foreign investments in the real estate sector. The developments even sparked financial institutions to launch mortgage bonds on the Bulgarian stock exchange, similar to what happened in the US; however, the nominal values remained negligible. The same novel practices were revealed for other types of consumer loans, which were turned into tradeable assets both at the domestic and international level. All these activities explain how the financial sector managed to gain relevance vis-à-vis the real economy within a short period of time.

The central bank took note of and reacted to the credit boom by introducing a lending cap, which was, however, successfully circumvented by banks through true-sale securitisation, cross-border loans and hidden inter-company transferral to domestic or foreign SPVs. Although the central bank attempted to further counteract the lending activity, its efforts remained largely unsuccessful, also

due to the nearing EU accession, which precluded certain regulations. On top of that, it was revealed that the local affiliates of Western banking groups were insufficiently regulated by their home central banks, which was even recognised by the Bank for International Settlements, adding to the emerging picture of a Wild West financial sector with a rather helpless central bank that clung to the currency board as the ultimate remedy. Salaries in the financial sector ranked among the highest in the country, reducing the available pool of well-educated workers for the real economy, and due to the high profits, employment levels increased in this sector. The extreme developments described above were revealed to have been further propelled by the introduction of performance-based salaries by Western banking groups, a practice that subsequently became standard throughout the Bulgarian financial sector.

The GFC brought economic decline while the financialised practices of the financial sector significantly contributed to the large number of defaulted loans. Apart from generally questionable credit risk assessment methods, the insertion of variable interest rates in loan contracts suddenly required debtors to service much higher repayments as the Euribor and Sofibor surged during the GFC. It was revealed that the politicians and the central banks took the side of the banks in the financial crisis so as not to endanger financial stability – and ultimately the currency board – while the costs for that were to be borne by households and by the real economy. The peripheral nature of the financialised Bulgarian financial sector became apparent in one interview with a central banker who described the belittling attitude of Western regulators praising the advantages of financial deepening to their Bulgarian colleagues, who were wary of the repercussions of the credit boom. However, the Bulgarian central bank thwarted further domestic socialisation of losses by rejecting the Vienna Initiative. Another consequence of the financialisation trajectory was found in the near collapse of the private pension fund system, which had invested heavily in real estate investment trusts that went bust along with the domestic stock market.

The second phase under analysis was characterised by a persisting degree of financialisation in the sense of rather stable financial sector employment and gross value-added. As politics saved the financial sector from hardship and wages remained stagnant, financial sector profits never turned negative in Bulgaria, which helps explain the continued high level of employment. Another explanatory mechanism for the continuing high profitability, and probably the spike in value-added of the financial sector, was identified in the vast rise in activity of two Bulgarian-owned banks that were later claimed to have embezzled more than EUR 2 billion. This sum had to be covered by the

deposit insurance fund and the state. The introduction of the Bulgarian flat tax regime of 10% in 2008 also reduced the tax burden of the largely formalised financial sector and was successfully lobbied for by a domestic neoliberal think tank. Similar to other European financial sectors, the grip of regulation in the post-crisis era became tighter, which led the financial sector to search for new avenues of profit creation. These were found in increased fees and primarily in cross-sales with bank-owned insurances. Both practices account for the rise in the fee-to-income ratio, but primarily highlight the intricate relationships in the Bulgarian FIRE sector. In addition, non-bank financial institutions became a way to free-ride on regulatory arbitrage and to target sub-prime lenders with a minimal amount of equity, a practice that was carried out with nearly no regulatory oversight. These shadow banking affiliated companies already contribute significantly to the net income of some Bulgarian banks. Despite a legislative effort to cap the interest rate at 50%, this was shown to have been circumvented, meaning that these non-bank financial institutions can still legally charge much higher rates.

The financialisation trajectory of Bulgaria has taken a vivid path that featured the traditional expansion of interest-bearing assets, innovative circumvention of regulations, and the introduction of exotic financial products. While this describes the dependent process of financialisation of the financial sector in Bulgaria, this chapter has both confirmed and debunked several explanatory mechanisms of financialisation (as set forth in chapter 3) as well as revealed some case-specific factors. The lack of regulations governing consumer loans on the part of the central bank has enabled banks to operate in this market with free rein, leaving the resolution of issue to either politics or consumer protection agencies, which only acted belatedly or slowly. This explanatory mechanism was thus confirmed for Bulgaria and explicated through a narrowly focused central bank as well as a lacking mandate. Capital and financial account liberalisation certainly benefitted the real economy in terms of FDI, but also enabled banks to freely receive financing from parent banks or engage in cross-border loans, which undermined the regulatory actions of the central banks and propped up the credit bubble. Bulgaria's accession to the EU further propelled the possibilities for free movement capital and finance. The stable, low inflation environment due to the existence of the currency board was conducive to financial sector activities, as debts did not devaluate and because profits in the local currency retained their value against the currency used at the headquarters of the parent bank. Likewise, the currency board hindered the devaluation of the currency in order to increase

competitiveness and decrease the reliance on financial inflows.[77] All these policies were enacted during the Washington Consensus liberalisation in Bulgaria after the economic and financial crisis at the end of the 1990s, which necessitates viewing this in perspective. Certainly, however, both free capital flows and a low inflation environment were confirmed as explanatory mechanisms for financialisation. Profit maximisation was detected to have been the mantra of the financial sector until the GFC, which was institutionalised through the introduction of performance-based salaries similar to the experience of other financialised economies. The high profits enjoyed in the financial sphere augmented salaries in this sector, drawing qualified professionals away from the real economy and thereby entrenching the growing divide between the real and financial sectors.

Apart from the range of confirmed explanatory mechanisms of financialisation, it should be added that banks did not seize upon households because companies turned to international financial markets, as hypothesised in chapters 2 and 3. Rather, banks became more active in retail as it was simply very profitable and they copied the practice from Western financial markets. However, companies were indeed increasingly financed through parent company-initiated cross-border loans from abroad, but not through bonds, as was the case in other countries. Apart from the hypothesised explanatory mechanisms, a feature specific to Bulgaria was a local neoliberal think tank that played a pivotal role in policymaking, as for example the introduction of a flat tax, the privatisation of the pension system and other issues, all of which contributed to financialisation. Domestic politics were shown to have played only a minor role in the financialisation trajectory, as all interviewees maintained, except for their pro-cyclical attitude in view of upcoming elections or of growing expenditure funds to be distributed. Next to this, the quasi-religious status of the currency board among central bankers hindered them in escaping their narrow focus on financial stability. Another key agent in this regard were the regulators of Austrian and Greek banking groups, which even tried to prevent them from enacting further counter-cyclical measures by relying on financial deepening arguments. The influence of the EU proved to be a double-edged sword. EU accession aspirations and demands required further liberalisation of financial flows and limited domestic regulation, both of which are conducive to financialisation. On the other hand, the introduction of the EU

[77] As one interviewee put it: *"[The] currency board is like you are freezing outside in the winter, with a big cold, and then you piss in your pants. In the first moment, you get warmer, but afterwards ... this is the currency board*" (Interviewee 1 2019).

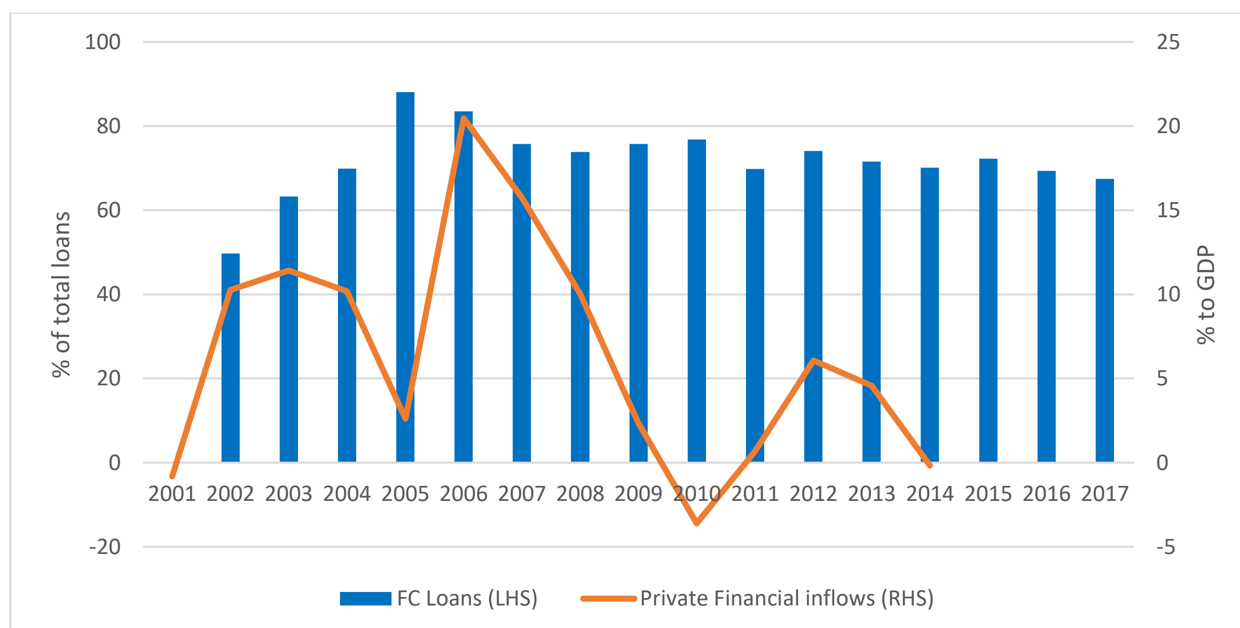
consumer directive, which ushered in some minimal protection for debtors, as well as the phasing out of bonus-related salaries, partly reduced short-termism among financial sector employees.

Following the time distinction of Appel and Orenstein (2018), financialisation in Bulgaria was enabled by the radical reforms of Washington Consensus politics at the end of the 1990s and intensified by Europeanisation aspirations and euphoria until accession in 2007 and the GFC. After the GFC, avant-garde neoliberal policies such as the flat-tax regime helped to sustain the level of financialisation, but as argued in the second to last section of this chapter, financial institutions also found myriad other ways to escape the new grip of regulation. The financialisation trajectory of the Bulgarian financial sector was the most pronounced in SEE, and as this chapter has shown, several incisive, case-specific mechanisms serve to illuminate the process. On this basis we are now able to draw further conclusions about the process of financialisation in the region but also about financialisation research itself.

6 Case study: International financialisation in Serbia

This chapter deals with the trajectory of international financialisation in Serbia. Chapter 3 delineated international financialisation as an increasing financial interconnectedness with global financial markets, chaining the domestic economy to their ebbs and flows. It identified two indicators on this level, private financial inflows and foreign currency loans. To thrive, both benefit from an open capital and financial account, eased handling and exchange of foreign currency, a high interest rate environment and a price-stability-oriented monetary policy. Next to those things, an accommodating stance on the part of domestic politics, motivated by a general financial liberalisation agenda, further enable a trajectory of international financialisation, which often serves as a temporal fix for other structural domestic problems. International financial institutions typically feed and sustain the initial transformation to such a regime, which in the end entrenches the peripheral position of the domestic economy. The comparative financialisation analysis across the countries of SEE showed that in Serbia, the international sphere financialised to the highest degree. Figure 31 once again summarises the trajectory of international financialisation for the country, depicting private financial inflows in percent to GDP on the right-hand axis and the share of foreign-currency-denominated and foreign-currency-indexed loans on the left-hand axis.

Figure 31: Serbia – International financialisation



Source: Barisitz and Gardó (2008, 114); International Monetary Fund (2015); Lane and Milesi-Ferretti (2017); National Bank of Serbia (2019a, 2019b)

Since the turn of the century, the end of the military conflicts and the post-transition Milošević regime, Serbia registered consistently high financial inflows, peaking in 2006 at more than 20% of the country's annual production volume. This leads us to the obvious question of what kind of financial inflows contributed to this extreme development. How were these inflows enabled and mediated, and how did the central bank cope with their entry into the domestic economy? The GFC brought a halt to this development and reversed the path: inflows decreased steadily until 2010, when they even turned slightly negative. Which factors can aid us in explaining the sudden reversal? From that point forward, inflows started surging but plummeted again in 2014, highlighting the erratic character of that year. What were the reasons for such unstable financial flows? Were we in fact witnessing the de-financialisation of this form? The share of foreign currency loans also surged in the pre-GFC period to more than 85%, even though the Serbian dinar – not the euro – is the official currency of Serbia. To whom and by whom were these loans disbursed? What had prompted the creditor and the debtor to enter into a contract denominated in a foreign currency? After a modest decrease, the share of these non-dinar loans remained steady at around 70% until 2017. What was the regulatory environment for these types of loans, and why did they not decrease after the GFC, as was observed to be the case for other countries in the sample used in this thesis?

The extremely volatile nature of these stocks and flows as a particular trait of international financialisation was already discussed in chapter 2 of this thesis. This chapter goes beyond the simple recognition of the statistical facts, first by delving into the trajectory of international financialisation in Serbia and then seeking the explanatory mechanisms that contributed to it. With regard to the first task, more thorough scrutiny of the individual components of the two indicators leads to a more detailed understanding of the trajectory of financialisation; for example, financial flows can take the form of cross-border loans through banks, loans to banks or companies, and many other incarnations. Likewise, an analysis of both the creditors and the debtors of foreign currency loans enhances our understanding of the trajectory of international financialisation and may provide clues about the potential explanatory mechanisms behind it.

This leads us to the second task in this case study. Based on the findings related to the indicators of financialisation, it is vital to grasp the institutional configurations behind the financial interconnectedness of Serbia, which has led to volatility and reinforced the peripherality of the country. Departing from the hypotheses discussed in chapter 3, this analysis aims to elucidate the trajectory of the political economy from the background of international financialisation and seeks to identify

trails of explanatory mechanisms. In this way we will also be able to clarify whether the trajectory of international financialisation is characterised by path-dependent processes or whether it represents a structural break from the past.

To this end, the first section of this chapter provides a brief outline of the political economy of the Socialist Federal Republic of Yugoslavia (SRFY) and argues that certain explanatory mechanisms for the subsequent international financialisation of Serbia are to be found in this time period, suggesting certain path-dependent processes. Section 6.2 deals with the pre-GFC trajectory of financialisation in line with the temporal distinction from chapter 3. The first two sub-sections thus provide a sketch of the domestic banking sector and an in-depth analysis of the potential drivers of private financial inflows, which will aid us in explicating this aspect of the trajectory of international financialisation. The following sub-section exposes the peculiar practice of local repos turning into an endless loop of short-term speculative financial inflows, thereby adding to a holistic understanding of the trajectory and explanatory mechanisms of private financial inflows in Serbia. The fourth sub-section traces the explanatory mechanisms for foreign currency lending both in euros and in Swiss francs so as to shed some light on this process of international financialisation. The last sub-section concludes the findings in the section. The repercussions of the GFC, aggravated by international financialisation, are outlined in the third section. Section 6.4 investigates the post-crisis trajectory of international financialisation. Regarding the decrease in private financial inflows, the first sub-section describes how the state accounted for much of the financial inflows to bolster the balance of payments, which ultimately led to a certain de-financialisation. The next sub-section shows how foreign currency lending to companies persisted due to a politically desired stable exchange rate, while at the same time lending to households in domestic currency increased, thereby trading off international financialisation for household financialisation. The final section summarises the main findings of this case study on international financialisation, contrasts them with the concept and hypothesised explanatory mechanisms, and then discusses them in light of the existing research on financialisation in Serbia.

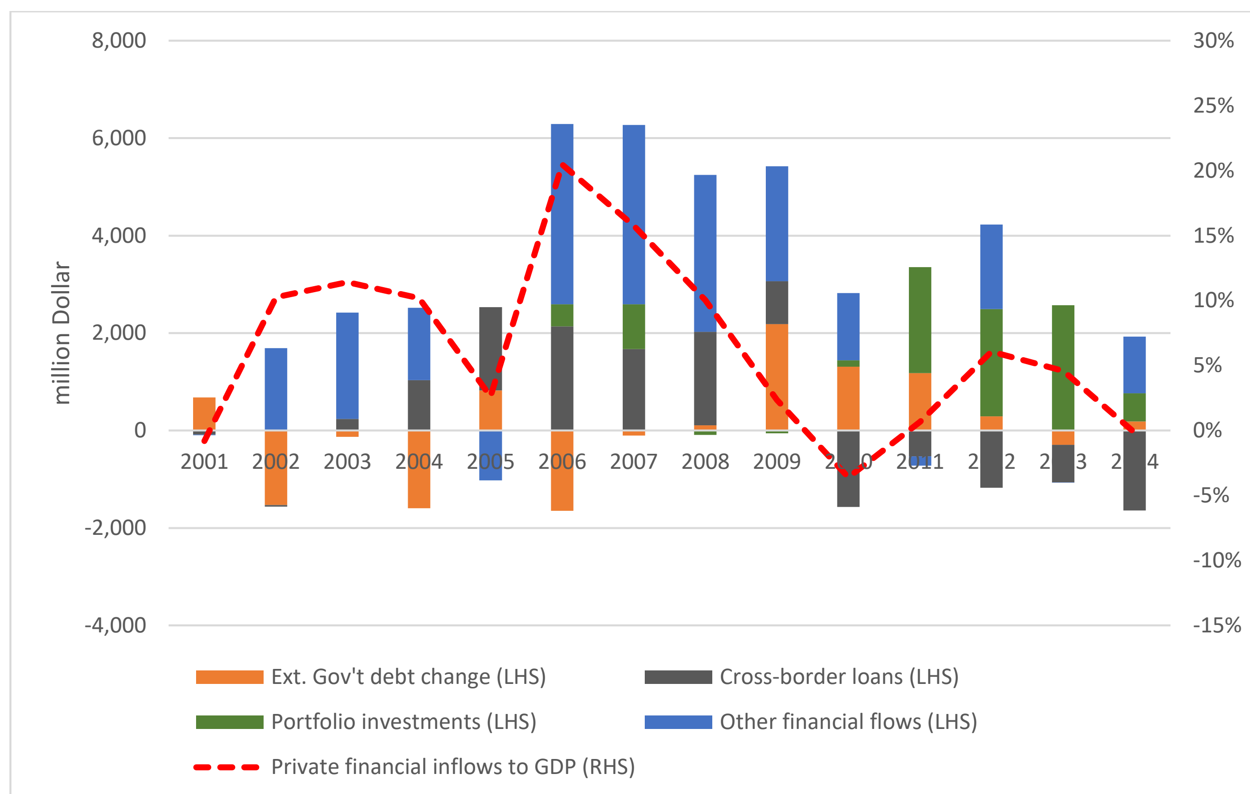
6.1 Starting point: International finance in historical perspective

This section elucidates the starting point of analysis by delving more deeply into the statistics of the indicators of international financialisation and by putting financial inflows and foreign currency in Serbia into historical context. This takes into account the fact that international financial flows

in Serbia feature a much richer history, as one would assume given the relative openness of the country's socialist regime during the 20th century in contrast to its more insulated neighbours from the communist bloc, like Bulgaria or Romania. Yet in order to inform the subsequent historical delineations but also the following sections, we must first decompose the indicators of international financialisation for Serbia. Figure 32 provides information about the composition of financial inflows. The share of private financial inflows in percent to GDP is denoted on the right-hand side. On the left-hand side, financial flows are decomposed into portfolio investments, cross-border loans and other financial flows in US dollars.[78] For illustrative reasons, the figure includes the change in external government debt that forms part of financial inflows on the financial account of the balance of payments (though it is not part of the percentage denoted on the right-hand axis, as the ratio includes only *private* financial flows). The developments highlight that cross-border loans played a particular role in driving the high financial inflows before the crisis, while after the crisis portfolio investment compensated for the corresponding reduction in the cross-border loans.

[78] Statistics about the balance of payments are mostly recorded in US dollars.

Figure 32: Serbia – Composition of financial inflows



Source: International Monetary Fund (2015); Joint External Debt Hub (2019); Lane and Milesi-Ferretti (2017); author's calculation

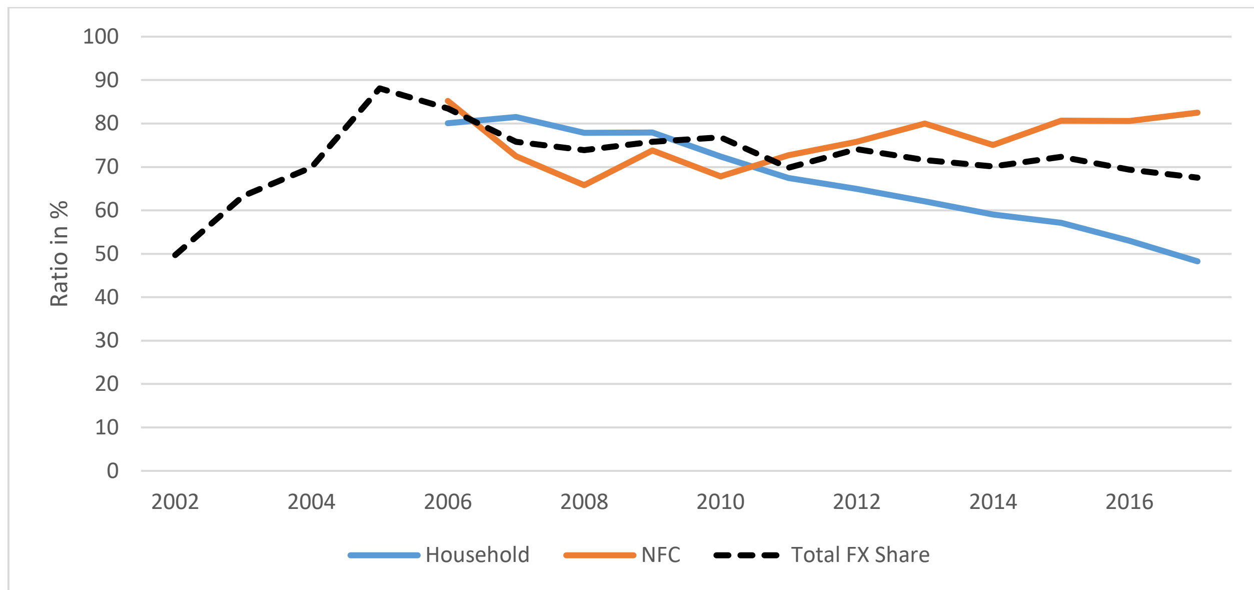
Until 2005 private financial inflows surged, mainly due to 'other financial flows' that cannot be differentiated further based on the available data. At the same time, external government debt decreased substantially. After a one-year dip in 2005 related to the nearing independence referendum of Montenegro, private financial inflows (red, dashed line) shot up and remained at extremely high values until the GFC. As the graph shows, half of these inflows were caused by cross-border loans from BIS reporting banks and the other half by other financial flows. After the crisis, cross-border loan flows turned negative, which led total private financial inflows to dry up within the next few years. It can be seen that in the immediate post-crisis period external government debt increased markedly. While thereafter cross-border loans continued to decrease, portfolio investments started to contribute strongly to financial inflows. Together with other financial inflows, these overcompensated for the decrease in cross-border loans, and external government debt increased only to a very small degree in the last years of analysis. In sum, the most striking factor driving private financial flows and hence international financialisation in Serbia are cross-border loans and other financial flows before the crisis and portfolio investments after the crisis.

Based on these elaborations, the next step is to take a closer look at the nature of cross-border loans and other financial inflows. Both contributed to driving financial inflows to the equivalent of up to or more than 20% of GDP before the GFC. The reduction of both flows highlights the volatile nature of financial inflows as a manifestation of international financialisation. Once these flows dried up, government debt expanded and was substantially attracted from external sources. Understanding the relationship between the sudden reduction in private financial inflows and the corresponding increase in government debt would contribute to explicating the power relations between the financial sector and the non-financial and government sector. The high portfolio inflows in the last period of the analysis deserve particular attention as they overcompensated for the degree of further reduction of cross-border loans.

In which form were these financial inflows of debt put to use? While this is not possible to trace directly, it seems fair to assume that at least cross-border loans contributed to the high share of foreign currency loans in Serbia, as loans originating abroad are typically denoted in foreign currency. Figure 33 depicts the composition of foreign currency loans in Serbia across the entire period.[79] The graph differentiates between loans to households and loans to NFCs. Foreign currency loans increased up until the GFC and then slowly decreased. As outlined in the comparative chapter, the speed of decrease is much lower than in all other countries of SEE. Also, the graph highlights two diverging trajectories after the crisis with regard to foreign currency loans to households and to NFCs, a development that is addressed in this chapter.

[79] Decomposition of the data for the period before 2006 was not possible due to data unavailability.

Figure 33: Serbia – Composition of foreign currency loans



Source: Barisitz and Gardó (2008, 114); International Monetary Fund (2010b, 15); National Bank of Serbia (2020e, 2020i), author's calculation

The total share of foreign currency loans had been increasing at a very high rate from 2002 onwards, peaking in 2005.[80] For the period before 2006, we can assume that the increase in foreign currency loans derives from both new loans disbursed to NFCs and households alike. Until the GFC of 2008, foreign currency loans to NFCs were decreasing, while those granted to households remained at an elevated level. After the crisis, a reverse trend occurs, with loans to households being continuously extended in local currency while the share of foreign currency loans to NFCs surges. This fact may explain why foreign currency loans did not decrease further after the crisis, as the total share of foreign currency loans dropped just slightly below 70% in the last year of analysis. This leaves us with three questions. First, why did both sectors receive loans primarily in foreign currency? Second, why was the period from 2006-2011 marked by a general decrease in the share of foreign currency lending, primarily driven by NFCs? And third, why did international financialisation decrease for households but actually increase for NFCs in the second phase of analysis?

[80] The peak is due to regulations that were enacted in the following year, which led to a decrease of foreign currency loans and is discussed later in this chapter.

With these questions from the more granular analysis of the two forms of international financialisation in mind, chapter 3 argued that the historical-institutional context is essential for understanding international financialisation in Serbia. As was shown, foreign currency loans already stood at more than 50% in 2003, which suggests that this phenomenon has its roots in an earlier point in history. Indeed, Živković (2017, 122) argues that the topic of foreign currency lending was already prominent in the SFRY. Thus, a focused analysis of the history of international financialisation in Serbia with regard to the two forms provides insights into the trajectory that the country has taken since the turn of the century. Are we able to detect path dependencies or do these foreign finance stocks and flows represent a structural break from the past? Answering this question will allow for an assessment of the interest groups that benefit from peripheral financialisation in Serbia and of how this development was institutionally mediated. The financial sector and the central bank play a key role in this, as they are the institutions that managed these stocks and flows. Particular emphasis is therefore placed on the financial relations with foreign entities, financial inflows into the country, and the emergence of loans and deposits in foreign currency in the country – or rather the SFRY in the first subsection. The second sub-section reviews the period of the 1990s after the end of the socialist regime, in which domestic policies contributed not only to the armed conflicts but also further institutionalised the use of foreign currency.

6.1.1 The SFRY and international financial flows[81]

The Socialist Federal Republic of Yugoslavia still remains one of the most remarkable and unique systems of society in recent history, as it combined elements of a market economy and the free movement of people with a socialist vision of planning and workers' self-management (Uvalić 2010, 15). Despite the demise of the SFRY in the late 1980s, the wars that followed and the autocratic regime(s) that replaced it, this section argues that elements of international (and corporate) financialisation seen today can be traced back to certain developments that were set in motion during the socialist regime. To this end, a short review of the institutional set-up of the financial system and of the financing of firms during the SFRY is provided. In addition, the financial relations – primarily with the West – are examined that have a particular connection to trade links and the movement of labour. It is shown that the breakdown of the socialist system at the end of the 1980s not only foreshadowed the fall of the Iron Curtain, but in the case of the SFRY, was also

[81] This section serves as a historical analysis for this chapter and the case study on Croatia.

connected to the mounting foreign currency debt levels, declining terms of trade, intra-regional conflicts and personal enrichment.

6.1.1.1 Political economic development

In contrast to the COMECON countries, the six Yugoslav republics in SEE followed the economic model of 'market socialism' from 1947 until the beginning of the 1990s. The federal set-up lent a certain amount of autonomy to the different republics. In 1948, Tito broke with the socialist bloc; for this act, the SFRY was cut off from foreign aid in 1949 (Uvalić 2018), which on paper made the Federation autonomous from the West and the East. The lifetime of the SFRY until the breakup in the 1990s can be split into four time periods (2005, 91). The period from 1947 to 1952 still resembled that of economic development according to central planning, which was gradually replaced with workers' self-management. The golden years from 1953 until around 1965 were marked by high growth and a solid balance of payments position, in which corporate control was under social ownership through the representative bodies of the workers (Zekić 2005, 93).

From 1966 onwards, the third period, the regime tacitly implemented market reforms that included autonomous enterprise decisions (Uvalić 2010, 15) together with medium- and long-term plans for economic development. Growth rates slowed, but because unemployment was kept low, public discontent was not voiced. In order to keep up with global development, enterprises started to import more and more capital goods, and the balance of payment position worsened in that imports superseded exports (Zekić 2005, 93). At the beginning of the 1970s, two non-preferential trade agreements were signed with the European Community, which Živković (2015, 48) argues worsened the already peripheral status of the Federation, as it was importing capital and intermediate goods while exporting raw materials and unskilled labour. During the 1970s, foreign borrowing rose rapidly but came to an abrupt end in 1979 when Yugoslavia was no longer able to borrow on international financial markets, similar to other developing countries, as for example in Latin America (Palairet 2001, 907). Ex-post, it is obvious that the Yugoslav experiment had already started to turn sour during the middle of the 1970s, when foreign debts were no longer used to renew and upgrade the capital stock but increasingly to finance '*white elephant projects*' (Interviewee 14 2020)[82] such as vacation houses for the top management, as one interviewee commented.

[82] Though this term is often used to mean something else, in the case of the SFRY it is all the more fitting, as Tito did in fact build a zoo with elephants on his vacation island Brijuni.

The second oil shock and the ensuing Third World debt crisis with its interest rate hikes mark the beginning of the fourth and last period of the SFRY from 1981 until its dissolution in 1991. Due to the recognition of possible debt default, long-term stabilisation policies were enacted during the 1980s as mandated by the IMF, including two of the largest structural adjustment programmes (SAP) at that time (Wohlmuth 1984, 230; Živković 2015, 49). Among other elements, the programme mandated an inflation-targeting monetary policy as well as price and capital account liberalisation (Živković 2017, 122). Though the aim was to decrease imports and stimulate exports, the economy contracted because enterprises remained heavily indebted without the possibility to invest (Zekić 2005, 97). In order to cover their foreign currency debt repayment, companies were even forced to export goods below their costs of production (Palairet 2001, 907), typically to COMECON markets (Živković 2015, 48), as they would have been uncompetitive on the world market. The quasi fiscal debt of the state-owned companies was subsequently monetised by the central bank, which fuelled inflation in the 1980s in Serbia (Zekić 2005, 97). Despite attempts to peg a convertible dinar to the deutschmark and to fix wages as well as asset growth in banks, inflation again spun out of control at the end of the 1980s. The central banks of the different republics continued printing money, leading to a devaluation of 30% as recently as 1990 (Zekić 2005, 107, 205), shortly before the Federation dissolved. The breakup itself occurred as a result of the constituent states declaring independence, above all those that had been net contributors to the Federation, such as Slovenia.

While this provides only a brief outline of the trajectory of Yugoslavia, the financial system of the Federation was initially set up with only two banks, the National Bank and the State Investment Bank (Ćetković 2015, 2), while during the 1960s a number of regional, communal and purpose-specific banks were founded (Horvat 1971, 134) in order to serve the financial needs of enterprises and the population, thereby instating a two-tier system (Zekić 2005, 95). At the beginning of the 1970s, each of the six republics instituted their own bank, which became part of the governing council of the National Bank of Yugoslavia. A series of further financial reforms was ushered in during the 1960s until the 1980s, including the closure of certain institutions (Ćetković 2015, 4), which mainly mirrored part of the inter-regional political quarrel within the Federation. Initially, credit was extended according to the state plan, although this was relaxed during the 1960s. Household loans did not play a major role in the SFRY (Ćetković 2015, 17) and few people were granted the privilege of receiving a housing loan for a new home that featured favourable real negative interest rates (Lydall 1989, 29).

With regard to the development of the financial system, credit to enterprises started surging in the 1960s at levels that exceeded output growth (Dyker 1990, 67) and then skyrocketed from the mid-1970s onwards, surpassing the level of savings in the economy (Ćetković 2015, 11). In part, this was driven by the de-centralisation of the banking system, as credit decision-making was left to the regional banks, which followed the demands of local politicians (Lydall 1989, 158). Other explanations include unsustainable wage increases and a general irresponsibility with regard to the firms' business decisions (Uvalić 2010, 20). This was related to the fact that the banks were de facto owned by their own debtors, who exerted a certain degree of pressure with respect to credit decision-making (Madžar 1992, 92). In reality, the debts incurred from the 1970s on were seldom repaid and turned sour (Petrović and Vujošević 2000, 499). The surging inter-company receivables market that evolved during that time period (Uvalić 2010, 21) attests to the chronic illiquidity of Yugoslav firms, although real interest rates ranged in the negative double-digit realm on average between 1975 and 1985 (Dyker 1990, 68; Lydall 1989, 158). As a natural consequence, inflation rates were consistently high, especially during the 1980s (Petrović and Vujošević 2000, 496). A local corporate scandal in the 1980s related to the firm Agrokomerc (Lydall 1989, 168) highlights the myriad ways in which firms sought to attract funds to survive – with the help of local politicians and regional banks – such as the firms jointly issuing a completely unsustainable amount of promissory notes. Far removed from the workings of the regional banks, the central bank pursued a policy of credit planning and determined the exchange rates of the dinar to the dollar, while the black market exchange rate was often much higher than the official one. Its governing board included representatives from each region, which contributed to non-coherent oversight of financial soundness. The financial system of Yugoslavia thus displayed a high degree of heterogeneity, with the central bank ostensibly in full control (on paper, at least), while the republic and regional banks often acted in their own best interest without much regulation.

6.1.1.2 Dollarisation and international flows

While this explains the general political economic and financial market background of the SFRY, the more relevant question is how and why assets in foreign currency started rising from the 1960s onwards, as noted by Ćetković (2015, 13). Banks increasingly attracted deposits in foreign currency but were not allowed to grant loans in foreign currency or to place the foreign currency deposits elsewhere (European Court of Human Rights 2011; Interviewee 17 2020). Deposits started to increase as far back as the 1960s (Ćetković 2015, 13) due to the export of labour to the West. The remittances of the migrant labour force had been clearing the balance of payments starting in the

early 1970s and maintained the solvency of the SFRY during the oil shocks in the 1970s (Dyker 1990, 94).

Foreign currency deposits were introduced in 1963 for the 'workers abroad' or 'gastarbeiter' in order to receive transfers (Lahiri 1991, 6). The deposit accounts received the same interest rates, around 12% (Interviewee 17 2020), as the accounts denominated in dinars, while at the same time they enjoyed the usual state guarantee. Though these accounts were initially intended for the gastarbeiter, restrictions on opening foreign currency accounts were further liberalised in the 1970s (Dyker 1990, 99), when it was made possible for every citizen to open such an account (Baučić 1972, 22). Not only the interest rates on these foreign currency accounts but also the depreciation of the local currency (Zekić 2005, 97) thus made it increasingly attractive to save in dollars or deutschmarks rather than in dinars. Interest income on the foreign currency savings by emigrants in Yugoslavia were also exempt from taxation, another structural cause contributing to the rise of such accounts (Baučić 1976, 99). In that sense, politics enabled citizens to accumulate currency other than the domestic one and even further incentivised the practice (Baučić 1976, 93) with no contemplation of the consequences for the domestic financial system. On the introduction of the practice, one interviewee commented that "*in biblical terms, that was primal sin*" (Interviewee 17 2020)[83] because it created mismatches in the financial system in the form of open currency positions and destroyed public trust in the domestic currency. As will be elaborated in more detail later in this chapter, this planted the first seeds for the high degree of international financialisation.

So why was it allowed in the first place? On the one hand, the practice was driven by the need for foreign currency in order to finance the import of capital goods, which was facilitated by the country's increasing immersion in the world's trade markets. Enterprises were even incentivised to engage in exporting at any price through access to special subsidies for export credit lines (Dyker 1990, 99), which highlights the dire need for hard currency. In rare cases, companies engaged in issuing bonds in foreign currency to the general public to finance their capital goods in exchange for certain job positions (Baučić 1976, 95). On the other hand, the growth of foreign currency deposits by gastarbeiter and domestic citizens positively contributed to the payment solvency of the central bank because it seized the hard currency as soon as it entered the country. The proceeds

[83] One may link the notion of 'biblical sin' mentioned by the interviewee to the term 'original sin', which has its own respective academic meaning (Eichengreen, Hausmann, and Panizza 2005). However, 'original sin' rather denotes government lending in foreign debt (due to the inability to borrow in domestic currency) while in the present context it refers to deposits (by the general public) in foreign currency.

were used to settle public foreign currency debt. The dilemma was exacerbated from 1970s onwards when Yugoslav banks started borrowing on international financial markets in order to extend credit locally in excess of what was needed for imports (Dyker 1990, 115). Apart from widening the existing currency mismatch (Lydall 1989, 165)[84], this contributed to the indebtedness of local banks but not to that of the federal state, which was benefitting indirectly from the practice. The dissonant mechanism was amplified from 1978 onwards when the central bank started to acquire foreign currency deposits from the banks in exchange for cheap dinar credits (Živković 2017, 122) without any settling method against a possible dinar devaluation (Lahiri 1991, 6). The practice propelled the vicious circle in that the central bank bore the exchange rate losses for the foreign currency borrowings of the local banks (Madžar 1992, 91) so that they could further extend credit. The attraction of foreign currency and disbursal thus originated only partly in the foreign currency deposits but also in the unstructured financial system. The race to obtain hard currency ultimately contributed to its own demise in the 1980s. Given all these peculiar circumstances, who were the creditors of the international financial flows?

The SFRY was able to borrow on international financial markets as it was well connected and integrated into them. It was a founding member of the IMF and the World Bank and became a member of the GATT in 1961 (Uvalić 2010, 17). Trade agreements with the European Community were signed in the 1970s, after which economic exchange and financial relations greatly intensified (Uvalić 2010, 18). The major Yugoslav banks maintained offices in the financial centres of the world, and according to one interviewee, their sophistication and expertise was comparatively high (Interviewee 13 2020). After the US cut back its foreign aid in 1964, the SFRY increasingly relied on loans from the World Bank and the IMF to finance medium- and long-term deficits as well as specific investment projects (Dyker 1990, 61). After the aforementioned insolvency in the 1980s, a group of 'friends of Yugoslavia' organised a bailout and further loans, which, however, included restrictive economic policies (Uvalić 2010, 25). Contrary to other socialist countries, Yugoslavia thus enjoyed good relations with the Western world. Due to its geographical location, it was obviously of special interest to both sides of the Iron Curtain. This explains why Yugoslavia was able to borrow both from international financial institutions and on global financial markets despite its meagre economic performance from the end of the 1960s onwards.

[84] Assets denominated in dinars and liabilities in dollars (international borrowings) and in deutschmarks (foreign currency deposits).

Živković (2017, 123) argues that the peripheral financialisation of the SFRY (and later Serbia) and its insolvency is rooted in the acceptance of a price stability focus mandated by international creditors with the aim to duly pay back external debt. However, as shown in this sub-section, the problematic acceptance of foreign currency, first as deposits during continuous periods of high inflation and subsequently during the foreign borrowing spree by banks, created the problems in the first place. If an inflationary growth regime had continued, this would not have changed anything, but only further aggravated the open foreign currency position of the banks. If, however, both sides of the banks' balance sheets had been in dinars, then the Yugoslav model of inflation and negative interest rates could have continued, as Madžar (1992, 92) maintains. On the other hand, the continuous financing of Yugoslavia's deficit by the West had protracted necessary domestic decisions and reforms, which in turn kept the dysfunctional system running and further peripheralised the country (Dyker 1992). If the local banks and the state had not received funds under such favourable conditions, then the political struggle might have led to a more sustainable and regulated financial system. The stabilisation programmes in the 1980s demanded by the IFIs only exacerbated the existing problems because they did not take into account Yugoslavia's model of market socialism, as Bartlett argues (1992). In that sense, and in contrast to Živković's view (2017), both domestic and international factors played a crucial role in creating the roots of the foreign currency debt problem in Yugoslavia and of the international financialisation in Serbia that were to reappear in the 21st century under a new (and at times the same) guise. In the words of a former high-ranking official of the Serbian central bank, "*That's how this FX problem was introduced*" (Interviewee 17 2020).

6.1.2 The FRY– wars, sanctions, overthrow

The historical experiment of the SFRY lasted for around half a century and its demise was already visible in the early 1980s when the Federation could no longer pay back its external debt. The last section argued that some of the roots of international financialisation are to be found in the Yugoslav era. The periods after the Socialist Republic and the Milošević eras ended were mainly characterised by armed conflicts and dictatorships, but also further dissonances in the financial system that at least partly aid us in understanding Serbia's trajectory of international financialisation in the 21st century. This includes periods of hyperinflation and financial fraud that still shape the public image of Serbia's financial sector even today.

The dissolution of the SFRY left Serbia heavily shaken at the end of the 1980s and continued to plague the country during the 1990s as it lost its status as the central republic and Belgrade ceased to be the nucleus of power. Milošević came to power through the so-called 'anti-bureaucratic revolution' around 1990 and was elected president in the same year (Bideleux and Jeffries 2006, 244). However, he chalked up his first real victory back in 1987 at a congress of the Serbian Communist Party, where he won against his mentor Stambolić. In contrast to other states, this meant that an advocate of the old nomenklatura system had come to power and was set the task of embarking on a new epoch (Rüb and Melčić 2007, 327). Not surprisingly, the power structures and relations of the past were kept intact, and the old guard were simply exchanged for a new set of aligned cronies (Bideleux and Jeffries 2006, 324). Due to its hostile behaviour towards the other separating states of Slovenia, Croatia, and Bosnia and Herzegovina, the Federal Republic of Yugoslavia, which contained Serbia and Montenegro, became a pariah state in 1992 (Bideleux and Jeffries 2006, 246).

In the years that followed, the FRY was mainly concerned with its wars, which impoverished a large part of the population while simultaneously enriching the country's criminal organisations. Due in part to the exodus of around 400,000 people in only five years, the economy plummeted, a downfall which was only somewhat softened by remittances. Given these dire facts, it is still a matter of academic and public debate as to how Milošević, with his cruelty towards other ethnicities and nationalistic attitude, remained in power so long; however, his virtuosity in playing with the relationships towards the West but also towards Russia definitely contributed to his political longevity. His success is also attributed to his flexibility, namely his ability to change ideologies and behaviour overnight, from communist to nationalist and from warmonger to peacemaker, with the sole aim of staying in power (Rüb and Melčić 2007, 336). Although the country formally had a pluralist system, in reality there was no discernible separation between the ruling Socialist Party of Serbia (SPS) and the state. Due to its tight control on the media and the police, dissident voices in public or parliament were quickly muffled, rendering the central organ of democracy rather obsolete (Thomas 2000, 422).

While there are numerous accounts of the four wars that Milošević started and fought (see e.g. Melčić 2007), the transition to a market economy moved at an extremely slow pace in Serbia. Privatisation was kick-started in 1991, but most of the deals were revoked three years later (Bideleux and Jeffries 2006, 252). Thereafter, most of the companies that were effectively privatised fell into the hands of friends of the Milošević regime for extremely low prices, though 90% of industrial

assets continued to stay with the state (Bideleux and Jeffries 2006, 259). Serbia's economic development during this period can best be described as agony (Rüb and Melčić 2007, 335), characterised by shortages of goods. The international embargo against the pariah state of Serbia hit large companies especially hard (Thomas 2000, 163). Together with the financing of the Serbs in the separatist regions of Republika Srpksa and Krajina and the influx of a high number of war refugees, this created enormous pressure on state financing because international borrowing was no longer an option. As with the trade of goods, the FRY was also cut off of from international financing, unlike the SFRY, which had extensive access. Similar to other countries, the solution opted for was the printing press, which led to hyper-inflation with rates similar to those in Weimar Germany (Thomas 2000, 165); in the case of Yugoslavia, monthly inflation peaked in January 1994 at 313 million percent (Bogetić, Petrović, and Vujosević 1999, 336).[85] It was attempted to at least temporarily halt the devaluation of prices by introducing a currency board at the end of January 1994, linking the new dinar to the deutschmark, but the board was abandoned despite success due to the dire need for state financing (Barisitz 2008, 52). The price volatility drained especially the middle class and professionals of most of their savings. As a result, many of them emigrated, leaving an intellectual but also a general societal gap.

The banking system during the Milošević regime was still dominated by the main state-owned banks. Alongside them, several private banks were founded, such as Jugoskandik Bank and Dafiment Bank, which closely aligned themselves with the ruling political elite and provided donations to secure votes. Similar to banks in other countries, both entities ran pyramid schemes (Zekić 2005, 114) and went bust, leaving savers with nothing, while politicians and the owners secured their shares prior to closing the banks (Thomas 2000, 166–68). Another form of fraud involved the freezing of foreign exchange accounts in 1991 in the amount of seven billion deutschmarks, which were later found to have been on-lent to failing state companies and therefore embezzled (Barisitz 2008, 52). Businesspeople or wealthy individuals would similarly buy shares in a bank to extend credit to themselves, exacerbating the problem of bad loans (Koyama et al. 2002, 322). With no trust whatsoever in the banking system and in the face of lingering hyperinflation, people resorted to using hard currencies such as deutschmarks in cash for their purchases, or simply engaged in barter. The fear of inflation was a structural characteristic of the population, which explains the flight to and the denomination of prices in hard currency. Due to the failure of the two banks,

[85] A social account of the period of inflation is given in Lyon (1996).

hyperinflation and the seizure of the foreign currency accounts, public trust in the financial sector completely evaporated during the 1990s.

At the beginning of 1997, the political scene started to change in Serbia, at least in Belgrade, preceded by a series of demonstrations by the oppositional forces of the Zajedno ('Together') movement. With the election of Zoran Đinđić as mayor of Belgrade, a politician who was not as close to Milošević as the other political leaders in the country came to hold power in the capital (Thomas 2000, 310). Milošević was actually supposed to resign in the middle of the same year, but he amended the constitution in a way that would secure him another four-year term and which temporarily halted aspirations for an overthrow (Bideleux and Jeffries 2006, 258). Three years later, things would turn out differently. In Kosovo, the continuing Albanian uprising turned violent in the context of suppression at the end of 1998 by the Serbian forces, which once again deployed ethnic cleansing as their main weapon, leading to terror and massacres, with over one million people ultimately being displaced (Schmierer 2007, 476). As is well known, the NATO states intervened and established (relative) peace in the middle of 1999. Surprisingly, this did not lead to a direct overthrow of the system in Serbia. Once again facing the spectre of not being able to run for office, Milošević launched another attempt to change the constitution in order to secure re-election, this time by popular vote instead of via the parliament. To his surprise, his opponent Vojislav Kostunica won the ensuing elections in 2000, marking a structural break in Serbian politics after 13 years. Milošević nevertheless tried to remain in power, but his forces turned against him when faced with the large crowds of the protest movement, which called itself 'Otpor!' (Resistance!). This finally led the beleaguered president to concede defeat in late 2000 (Pavlakovic 2007, 27). One may conclude that all the unresolved issues plaguing the successor states of the SFRY – corruption, ethnic and territorial conflict, to name a few – are most pronounced in Serbia, along with the typical transition problems of all ex-socialist states (Becker and Engelberg 2008, 9). With regard to international financialisation, the dire state of the financial system and domestic currency contributed to eroding trust in the dinar, so that people exclusively resorted to deutschmarks or dollars to make payments and store value.

6.1.3 Interim summary

The end of the Milošević era marks the beginning of the trajectory of international financialisation of Serbia. However, as argued in this section, some of the features of international financialisation

that are discussed in the next sections emerged from mechanisms that took root during the Yugoslav time. Foreign currency use, first as deposits, was institutionalised by the socialist system during the 1960s in order to bolster the balance of payments, which created the original currency mismatches in the financial system. Foreign currency in the form of loans was increasingly attracted by regional banks in order to shore up credit supply and liquidity, in fact more than what was needed for production. Along with the money supply being out of control, this created high rates of inflation in Yugoslavia, contributing to real interest rates being below zero, which completely distorted the incentive system that market(!) socialism was supposed to sustain. But in fact, it was the international financial community and international financial markets that kept the SFRY alive and supplied enough foreign currency credit for its survival. This made the SFRY more dependent on international borrowers and cemented its peripheral status.

After the dissolution of the socialist system and the original Federation, the economic condition of the FRY continued to worsen as industrial output fell by more than half between 1986 and 1998, obviously also related to the different wars. Simultaneously, asset-stripping and hyperinflation eradicated the financial system, which was left with bloated, empty balance sheets. The fraudulent behaviour of some banks further contributed to this development. This led people to exclusively use foreign currency as a means of payment and as a store of value, which they hid at home, coining the term 'u slamarici' or 'under the mattress'. In terms of the political economy, the close of the Milošević era marked the end of political repression and belligerent behaviour for the FRY. However, the early availability of and incentives for foreign currency deposits, the trauma of hyperinflation and the fraudulent banking system are all etched in the (financial) memory of Serbian citizens, a point that was highlighted by all interviewees. These mechanisms hence constitute path dependencies, as they would re-emerge or persist in Serbia throughout the 21st century. All of these factors provide the background of the trajectory of international financialisation that Serbia was to embark on from the turn of the current century onwards.

6.2 Serbia's pre-crisis trajectory of international financialisation

The previous section outlined how the SFYR was intertwined with global financial markets for decades whereas the new Yugoslav Federation attained pariah status in the 1990s. The fall of the Milošević regime marks thus not only the starting point of this analysis but also the beginning of the existence of the country of Serbia as it is known today (apart from the independence of Montenegro and Kosovo). Departing from the description of the stylised facts at the start of this chapter, this section sets out to analyse the first period of international financialisation from the year 2001 until the GFC. As shown earlier, financial inflows in this period derived primarily from cross-border loan activity and other financial inflows, while foreign currency lending surged both in the form of NFC exposures and loans to households.

Before we can delve more deeply into the links between domestic finance and international financial markets, the practices behind these activities must first be unveiled. In order to contextualise this growing interconnection, the first sub-section presents a short outline of the evolution of the banking sector, which was marked by the entrance of foreign, mainly Western banking groups. The second sub-section deals more in detail with the buoyant cross-border loan market, which accounted for a large share of private, volatile financial inflows. The third sub-section traces the as yet uncovered practice of repo trading and its peculiar role in the heyday of the financial mania immediately preceding the GFC. The specific nature and practices of foreign-currency lending are analysed in the fourth sub-section, while the last sub-section sketches the main findings on the pre-GFC trajectory of international financialisation in Serbia.

6.2.1 Banking sector structure and evolution

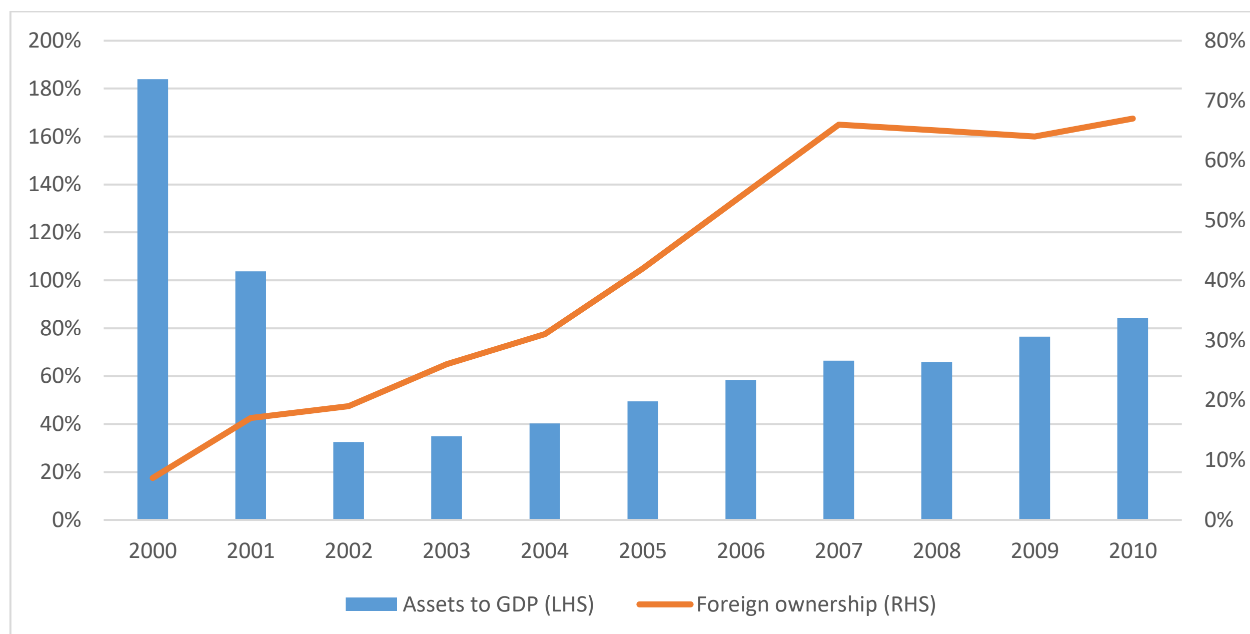
During socialist times, the Serbian financial sector was characterised by a state-owned but federalist banking system, while throughout the 1990s a number of private banks were founded, many of which were revealed to have been engaged in deceptive practices. The new forces in power after the regime change pursued a policy of reform vis-à-vis the financial sector, as will be laid out in this sub-section. A brief overview of the financial sector in Serbia will shed light on some of the mechanisms leading to international financialisation in Serbia.

Following the parliamentary election at the end of 2000, Zoran Đinđić became prime minister of Serbia in 2001. The struggle between the conservative president Kostunica and the liberal Đinđić are emblematic of the everlasting bi-polarity in Serbia between a nationalist and a pro-Western

reformist side that would dominate the political discourse for the next two decades. Despite the partial political stalemate (Ramet 2010b, 295) due to opposing views on different topics (Clewing and Schmitt 2011, 762), Đinđić pushed through a series of reforms before his assassination in 2003. This included the renationalisation of the companies that had been handed over to Milošević's cronies and subsequent re-privatisation, price liberalisation and a heavy reduction of the black market (Bideleux and Jeffries 2006, 296). As the regime left the young democracy with a high burden of external debt, the international community agreed to write-offs of more than USD 5 billion (Bideleux and Jeffries 2006, 322). The dysfunctional banking system was overhauled by closing more than 20 banks, opening up to foreign investors, stabilising the exchange rate and introducing a more formal way of dealing with foreign currency. Despite these economic reforms, which were aligned with the IMF's demands, the power structures and relationships of the regime were not swept away, either in the political institutions or the (real) economic sphere. This was partly due to the tacit approach of Kostunica, who became prime minister after the murder of Đinđić in 2003 (Perović 2008, 124) and who subsequently revoked several of his reforms (Ramet 2010b, 297).

Concerning the banking sector reforms, the four largest banks were shut down overnight and a series of others were closed, which meant that "*there were very few real banks in Serbia at the time*" (Interviewee 20 2020), leaving the banking sector "*effectively non-existent*" (Interviewee 16 2020); meanwhile, many of the remaining banks were state-owned. The reformist political leadership decided to privatise much of the financial sector and open it up to foreign investors. Similar to what transpired in other countries in the region, Western banking groups from Austria, Italy and Greece entered the market mainly by directly acquiring privatised banks. Figure 34 shows both the cleansing of the financial sector, which is visible in terms of financial assets to GDP, and the opening up to foreign investors, illustrated by the share of foreign-owned banks.

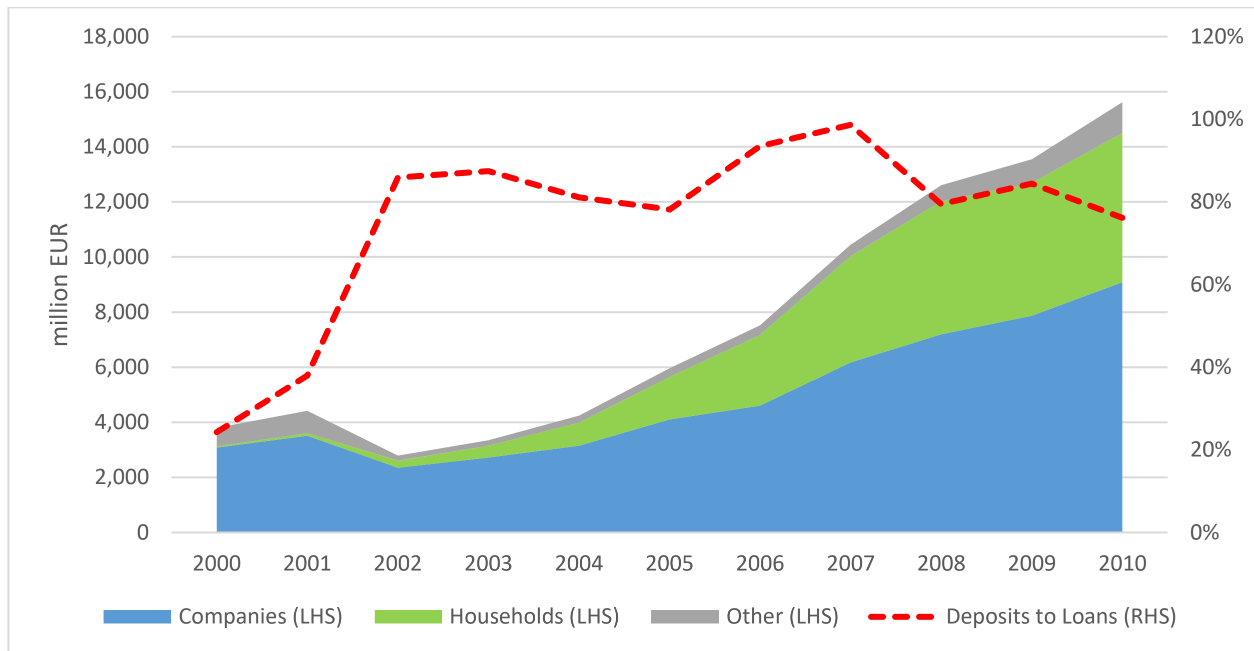
Figure 34: Serbia – Banking sector development



Source: National Bank of Serbia (2020c); Statistical Office of the Republic of Serbia (2019); World Bank (2019d)

Within the first two years of the 2000s, the activity of the entire financial sector had been reduced to a minimum. Thereafter, the banks' assets started to rise again gradually every year, with the exception of 2008, the year of the GFC, bringing a temporary halt to growth. At the same time, foreign ownership in banks increased from near zero to over 60% at the height of the GFC. Concomitantly, the non-bank financial sector developed only slowly, as insurance brokers mainly provided basic insurance for automobiles and houses, and the stock market primarily served the purpose of privatising state-owned companies. On that note, one interviewee commented that the Serbian financial sector is a "*sort of plain vanilla financial sector. There [are] not [a lot] of exotic products. It's still sort of bank-dominated*" (Interviewee 20 2020). In that sense, the non-bank financial sector played a minimal role throughout the first decade of the 21st century in Serbia, also because the central bank assumed regulatory oversight at an early stage (Dimova, Kongsamut, and Vandenbussche 2016, 23). Taking a closer look at the actual activities of the banking sector, it is striking that financial institutions engaged mainly in lending to companies and to a lesser degree to households, as foreshadowed in chapter 4 of this thesis. Figure 35 presents the composition of the total credit portfolio, as well as the deposit-to-loan ratio on the right-hand axis.

Figure 35: Serbia –Banks' loan portfolio



Source: National Bank of Serbia (2020c, 2020g); author's calculation

Credit in Serbia grew rather gradually, even during the GFC. At the beginning of the century, the portfolio mostly consisted of loans to companies, whereas since 2005 loans have increasingly been granted to households as well. Deposits never covered the loan portfolio in Serbia during the first period of analysis, which means that other sources of funding were required by banks. After the early reforms and forced closures in the financial sector in 2001, deposits flowed into the financial sector while credit was obviously much reduced. Overall, the financial sector expanded quite heavily in Serbia up to the GFC, though the divergence between the financial sector and the real economy was smaller than in other countries of the region, as argued in chapter 4 of this thesis.

The foreign banks that entered the Serbian market were mainly part of the same Western banking groups from Austria, Italy and Greece that had already conquered the financial markets in other Eastern and South-Eastern European countries. As the interviewees confirmed, their main motive for entering was the low penetration of financial markets and opportunities for growth (Interviewee 16 2020). In line with these aspirations, they pursued a strategy of opening new branches, disbursing loans, and thereby increasing profits (Interviewee 15 2020). In the case of Serbia, the foreign banks were not only welcomed but actively sought after, as the interviews revealed.

> "The standards were tailored to attract strategic investors. It was not open for domestic, honestly there were no domestic investors who were having the sort of money to invest in banking assets." (Interviewee 16 2020)

As this former high-ranking official from the privatisation agency commented, the ruling party at that time pushed for strategic, foreign investors. It was assumed that they would bring know-how to the market, as Serbia was perceived as being underdeveloped in this sector, which was the typical narrative of the day. However, as revealed in the previous section, the Serbian financial sector was already quite developed in its socialist times, and one interviewee maintained that the operations in the newly foreign-owned banks were actually much simpler than before.[86] This leads one to conclude that the real reason for letting foreign banks enter the local market was to re-establish trust in the financial sector, as most savings were still kept in hard currency 'under the mattress'. At that time, people had more trust in banks with foreign ownership and management due to the "*cronyism*" (Interviewee 19 2020) of the previous periods.[87] This suggests that the reforms were an attempt to cut the former ties between politics and the financial sector that purportedly contributed to the demise of both the Socialist Federal Republic and the Federal Republic of Yugoslavia.

Another reason for welcoming foreign equity investments in the financial sector was that Serbia lacked the necessary financial resources to extend credit in the first place, as visible in the chronically low deposit-to-loan ratio. This is confirmed by a quote from a staff member of the IMF.

> "And I think the government and the NBS at the time would sort of push for this. They understood that the sort of local savings were very low and that you can't really fuel economic growth just based on domestic savings, especially as it was mostly under the mattress. So, both government and NBS had sort of accommodative stands towards this high credit growth." (Interviewee 20 2020)

The early and bold focus of the governing institutions on reforming the banking sector led to the entrance of a high number of foreign banks and increased competition in the financial sector. However, a former minister during that time period laments that the same focus had been lacking in

[86] "*So and as a friend of mine who was the director [of] UniCredit at the time. He said I was doing much more sophisticated business [under] Marshal Tito in Serbia. And when those (inaudible) came, they were not allowed to do this sophisticated banking business anymore.*" (Interviewee 19 2020).

[87] "*[...] there were queues in front of those banks because everybody wanted to deposit money, because they thought, 'This is something new. This is something different, so this is foreign, this is trustworthy.'*" (Interviewee 21 2021)

other sectors (Interviewee 15 2020). In his view, the government shied away from cutting ties in certain important sectors of the real economy as well, which explains why the financial sector developed much faster than the real economy throughout the 2000s. Thus, the new structure of the banking sector resulted out of a deliberate political choice by the first ruling party after the fall of the Milošević dictatorship. Their main aim was to restore trust through severing former ties rather than to bring modern financial practices to Serbia. The domination of the Serbian financial sector by foreign banks already illustrates part of the international financialisation trajectory. But "*[...] financialisation in Serbia is also mixed with something very good that happened with foreign banks coming to Serbia*" (Interviewee 19 2020), as they succeeded in building up trust in the financial sector. However, as the next sub-sections are going to show, not only the presence but also the particular activities of the foreign banks contributed to volatile financial inflows and to connecting domestic debtors to the whims of global financial markets, which exacerbated the repercussions of the GFC.

6.2.2 The dynamics of financial inflows

While the prior section laid bare the evolution of the institutional set-up of the financial sector, this sub-section deals in more detail with international financialisation manifested in volatile financial flows. As shown at the beginning of this chapter, foreign financial inflows increased markedly in the first sub-period from 2002 until 2004 in the form of other financial inflows and then in the second sub-period from 2006 onwards in the form of cross-border loans. In line with the questions posed at the beginning of this chapter, how were these inflows mediated and who were the agents in this process? Was there any kind of regulation and what was the political stance on these inflows? This sub-section attempts to scrutinise the mechanisms behind these financial inflows that contributed to their volatility and to the increasing financial peripherality of the Serbian economy.

Due to data limitations, it is not possible to further discern the composition of the financial inflows in the first sub-period. The balance of payments of the National Bank of Serbia (2020a) reveals an increase in the (rather broad category of) 'medium- and long-term loans'. One former high-level central banker (Interviewee 18 2021) and a bank manager (Interviewee 14 2020) confirmed the assumption that these financial inflows consisted of sub-debt or other types of funding to the newly privatised foreign-owned banks orchestrated by their headquarters.[88] Typically, such loans would

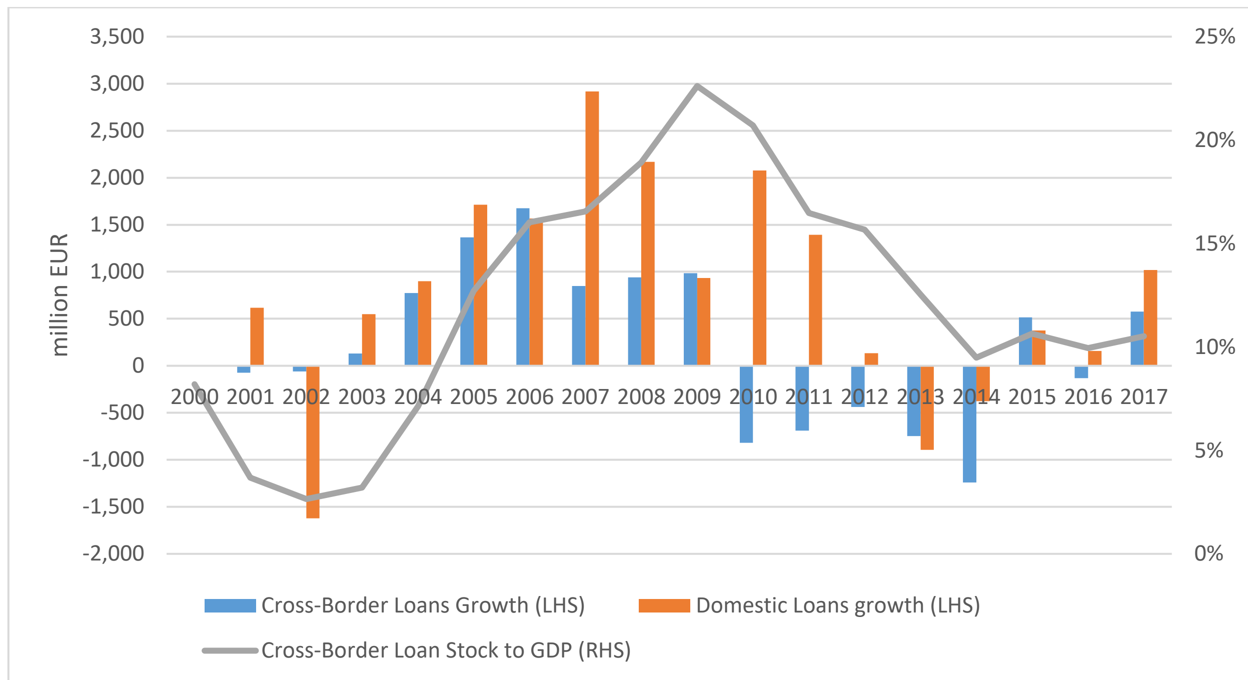
[88] Another former central banker explained the process in the following way: "[At] that time there was no need for cost-sharing between headquarters […] because headquarters got the beautiful 100 plus million euros per year. For all

be expanded with varying maturities but mostly in euros in order to finance the growth ambitions of the subsidiaries. It is striking, however, that the entry of the foreign-owned banks – backed by fresh equity and cheap financing from their headquarters – did not lead to lower interest rates for the final debtor. In that vein, Đukić (2007, 438) finds that both interest and the net interest margin did not shrink after their entry, which leads him to hypothesise about a potential "*tacit agreement between the largest [and foreign-owned] banks in Serbia*" (Đukić 2007, 443). Serbia thus proved to be a profitable investment space for the foreign-owned banking groups. Contrary to the then dominant financial development narrative (dos Santos 2011; Levine 1996; Winkler 2014), the entry of the bolstered foreign banks did not lead to more favourable lending conditions for the real economy.

The second sub-period was markedly driven by an increase in cross-border loans (Marinković 2015, 174) as shown in Figure 32. Cross-border loans were for the most part disbursed by Western European banking groups and their local daughter banks earned a fee for handling the loans. In the case of Serbia, the interviews revealed that the oversight of such financial inflows by the central bank was comparatively tight, just as it was for financial outflows (Interviewee 14 2020). This could go as far as requiring documents to prove the reason for the inflow or the outflow. In that sense, all cross-border loans were registered at and had to be stamped by the central bank (Kojović 2019), which, together with all the other registered in-and outflows, provided the NBS with a coherent picture on the nature of financial inflows in and out of the country. Adding to this, the central bank mandated cross-border loans to be repaid in the form of straight amortisation in contrast to bullet repayments in order to avoid the adverse consequences of sudden outflows of these types of loans (Interviewee 21 2021). In order to grasp the magnitude of cross-border lending in comparison to domestically sourced credit growth, Figure 36 shows both the locally sourced and cross-border financed credit growth in Serbia as well as the relevance of the cross-border loan stock with respect to gross domestic product on the right-hand axis.

of that money, probably they paid, I don't know, 0.5% or 1% in Austria, and they just live beautifully on this huge interest rate difference, how much we pay them for of course country risk, and how much they pay, so to say, to depositors in Austria. So this was a very, very common business." (Interviewee 21 2021)

Figure 36: Serbia – Cross-border loan development



Source: Federal Reserve Bank of St. Louis (2019); Joint External Debt Hub (2019); National Bank of Serbia (2020c); Statistical Office of the Republic of Serbia (2019); author's calculation

At the beginning of the 2000s cross-border loan activity was quite reduced, while the clean-up of the Serbian financial sector is evident in the huge decrease in domestic loans. From 2003 onwards cross-border activities started to pick up and increased for three years with the same nominal value as domestic lending; in 2006 cross-border lending even surpassed domestic credit growth. This trend ends before the GFC in 2007, but cross-border lending remains positive until 2009. Thereafter, the stock of cross-border loans melts away for five consecutive years, coinciding with the recession in Serbia and Europe. More recently, cross-border activity has resumed, but at sharply reduced levels. At the peak of the GFC, the total stock of cross-border loans amounted to nearly 25% of total GDP, which highlights the heavy reliance on the influx of foreign financial capital. As Ćetković (2011, 18) notes, the most prominent counterparty countries of these cross-border loans are Austria, Greece and Italy. Furthermore, he shows that the relevance of the cross-border loan volumes from these three countries is extremely high for Serbia, whereas Serbia is only marginally relevant in terms of credit exposure to the home countries of the banking groups. This fact underscores the peripherality of Serbia with regard to cross-border loans. As to the way these cross-border loans were mediated, one interviewee made the following observation:

> "[…] when companies would approach a local bank and ask for, let's say a loan, they would say, 'Well, this is if you borrow from us, but if you borrow from our parent bank, because they're under a different set of regulations, it can be cheaper.' So you can say that at least [a] substantial portion of these cross-border loans was basically on the advice of local foreign banks, which could've been also prevented by the central bank, but I believe no one was actually fully aware of the amount of these loans taking place […] That's basically the consequence of allowing [a] relatively free flow of capital in and out of the country." (Interviewee 17 2020)

This statement contends that cross-border lending was driven by the headquarters of the foreign banks in order to invest capital on attractive returns. While profit was obviously the primary motivation, the interviewees revealed that a second reason for cross-border activities was the restrictive policies of the central bank enacted from 2005 onwards aimed at taming credit growth. An interview with a former central banker revealed that the central bank faced huge political pressure due to these credit constraining regulations.[89] In fact, starting from late 2004, the NBS launched a series of measures intended to constrain credit growth, foreign currency lending, consumer lending and foreign funding. It also introduced a number of regulations regarding capital adequacy, consumer lending and short-term foreign funding (International Monetary Fund 2006d, 20). In fact, according to the IMF, the NBS was one of the most aggressive central banks in terms of its attempts to curb banks' external debt growth (Vandenbussche, Vogel, and Detragiache 2012, 16). The most pivotal decision of the NBS was to introduce higher risk weights on foreign currency and indexed lending in 2006 together with efforts to tame foreign funding (Vandenbussche, Vogel, and Detragiache 2012, 52). While this reduced the level of the banks' foreign borrowing, it also resulted in banks switching from local lending to direct foreign lending (Interviewee 21 2021).

As the interviews revealed, cross-border loans served as a means to circumvent the restrictions that were put in place by the regulator (Interviewee 13 2020). In a similar vein, other banks engaged in opening SPVs in other countries (preferably in those where they would not face double taxation) in order to continue disbursing loans and not violate the restrictions. According to one interviewee

[89] "So we put such artificial measures in order to control it somehow. But of course, [there was] huge political pressure, 'You are a bureaucrat. You are not a free market representative. You should let people finally get their loans to finally buy their house'" (Interviewee 21 2021).

(Interviewee 13 2020), at least one German and two Greek banks were active in these transactions, which was possible given the legal environment through off-shore SPVs (Mayer, Brown, Rowe & Maw LLP 2007). In retrospect, it can be conceded that the regulatory efforts did indeed change the structure of finance slightly but had little effect on the pace of lending if cross-border lending is factored in (Vandenbussche, Vogel, and Detragiache 2012, 51). As all the operations had to be registered with the central bank, one cannot help but wonder whether the central bank failed to detect – or simply tolerated – the circumvention that heightened international financialisation. One interviewee offered the following view:

> "I think the banking sector lobby was very strong. I think the forces within the national bank, they were not so strong to raise their voice and say OK guys now we are taking over, you cannot do this forever. So then again, the whole prevailing sentiment was very much into the Washington Consensus, grow[th], liberalisation. It's not like we are observing from hindsight, from this perspective obviously this was not sustainable. But at that time it seemed like, you know, everyone was happy. I don't think that the people in the national bank had any different of a feeling that the majority of other optimistic governors of other central banks, everybody was really enjoying the [inaudible] credit growth and pretty much we were going towards becoming a US on a small scale, obviously. And in a different setting. […] We were very happy to have the opportunity to grow even if it's artificial." (Interviewee 16 2020)

The statement summarises the prevailing sentiment at the time. On the one hand, the regulator was wary of the developments and rather active in terms of macroprudential measures. One former central banker even wrote a letter to the Austrian governor pointing out the high influx of foreign capital, but his doubts were dismissed.[90] On the other hand, both politicians and the banking lobby were actively seeking to continue riding the wave, guided by a sentiment of liberalisation and stimulated by the open financial account. Domestic politicians also felt comfortable due to high mandatory reserves and the fact that credit risk was largely carried by foreign banks, as one interview

[90] "*And I remember it was in 2006-2007, I even wrote a letter to the Austrian governor [asking him to] control the inflow of extra foreign currency. They [said], 'Come on guys, this is free movement of capital.' And so basically, they just brushed away the information on this. And of course you [can] also question, 'How can Austrian supervision have a clear view and opinion about the cross-border loans provided to Kruševac and Kragujevac?'*" (Interviewee 21 2021).

with a former minister revealed.[91] However, the regulations put domestically-owned banks at a comparative disadvantage, as they did not have the possibility to grant cross-border loans or would have had a hard time operating with a SPV scheme. As one bank manager commented, "*Local banks did not have [the] opportunity for this*" (Interviewee 13 2020). Adding to this, cross-border lending was exclusively in foreign currency, which, as argued later, increased the susceptibility to exchange rate shocks. The huge influx of foreign flows was also often not used for productive purposes, as a great number of them later ended up in non-performing loans, but in general, "*there was not much objection to money being available even for the shitty projects*" because "*everybody was benefitting from it*" (Interviewee 16 2020). Lastly, cross-border loans created an adverse selection, as the worst loans stayed in the country and the good loan clients were transferred abroad (Gardó 2011, 103). As the statistics display, cross-border loans were not the only inflows that unsustainably fuelled high financial inflows; other flows contributed to this as well. The next section discusses another part of financial inflows that was financially motivated by a monetary instrument of the central bank aimed at sterilising the very same financial inflows.

6.2.3 The vicious repo circle

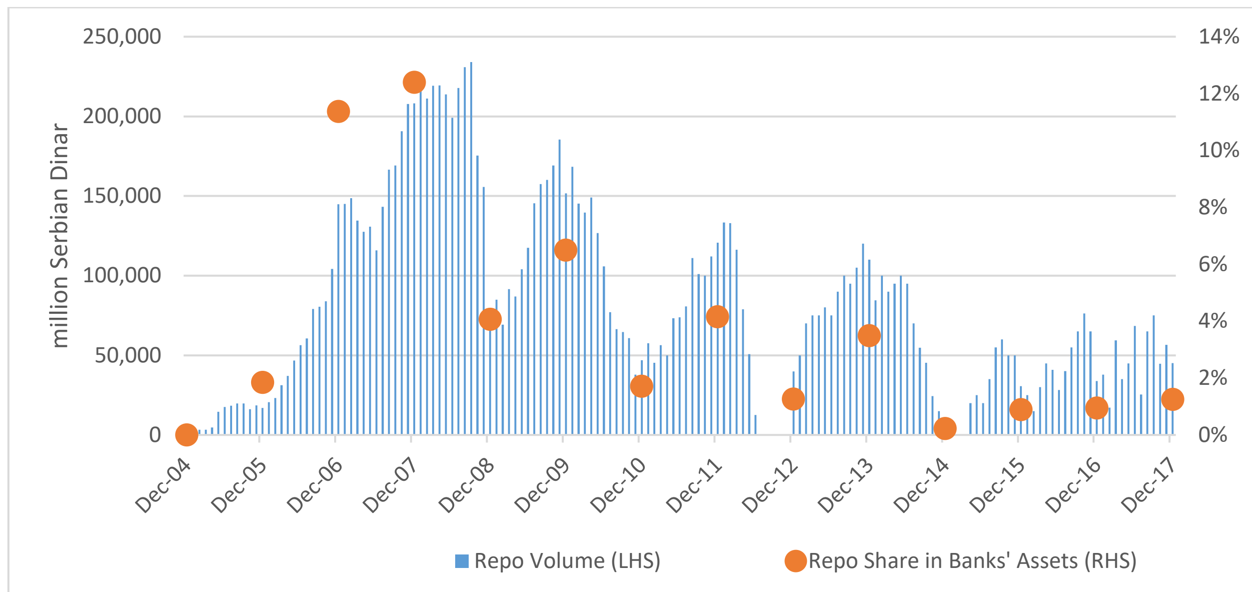
The previous sub-section showed how financial inflows were in part driven by both foreign funding from banks and cross-border and SPV loans as a reaction by the banks to regulatory efforts. All three processes account for a significant part of the high financial inflows, i.e. provide explanatory mechanisms for international financialisation. However, the interviewees revealed that starting from 2005, another factor contributed significantly to financial inflows that ultimately proved to be even more short-term in nature than the loans that were extended by banks. The aim of this sub-section is to highlight how well-intended actions taken by the central bank to control the money supply actually led to the opposite effect in that speculative financial capital from abroad ended up being channelled to Serbia. The investors who took part in these activities were able to profit relatively risk-free from these operations, whereas they quickly withdrew in the face of crisis.

[91] "*If some additional money came to the country to our companies, it was good for us and this was the problem of those foreign banks who did this the risky way. And from the point of view of the Minister of Economy, I didn't have any problem if a company takes some money from strangers for some growth in Serbia. This was good for the economy and the risk was not ours, but mostly the risk was for the foreign banks*" (Interviewee 18 2021).

At the beginning of 2005 the NBS amended laws in order to enable repo operations[92] (Zekić 2005, 153) with the intention of controlling the money supply. Faced with huge inflows that were often converted into dinars so as to prop up reserves, the central bank had to deal with the possibility of inflation at the time, with rates already in the double-digit realm. The hyperinflation period described above obviously made the central bank extremely sensitive when it came to the subject of price inflation. In the early 2000s, this consideration even led it at times to conduct a real deflationary policy (Marinković 2015, 175) in order to quell any fears of inflation. However, at the end of 2004, inflation and real negative interest rates in dinars were just around the corner (International Monetary Fund 2005b, 70), which intensified the fixation on repo operations as a means to steer interest rates on dinars more directly and increase confidence in the currency. In a similar vein, the International Monetary Fund (2006c, 42) advised that "*repo operations can be strengthened*". Throughout the period from 2005 to 2009, the NBS thus deployed this facility as the main means of controlling interest rates, inflation and the exchange rate, the latter jointly with its foreign currency transactions. Figure 37 highlights the extent of the repo transactions on the Serbian financial market, which was particularly pronounced in the last few years before the GFC. On the left-hand axis, the amount of repo transactions is depicted in millions of Serbian dinars and the right-hand axis shows the percentage of the repo volume to GDP.

[92] "*Repos involve the sale and repurchase of an asset*" (Gabor 2017, 968). In the case of Serbia, this involved for example the purchase of a central bank bill in dinars, which would be redeemed with interest after a certain period of time.

Figure 37: Serbia – The repo market



Source: National Bank of Serbia (2020c, 2020k)

From the beginning of 2005 repo transactions grew steadily and accelerated to full speed in 2006. After a temporary decrease, the total amount of repo claims on the central bank started mounting once again until their peak in September 2008. Their volume even rose to around 12% of total bank assets in the years 2006 and 2007. After the outbreak of the GFC, repo transactions sharply decreased until early 2009. After a temporary increase until November 2009, the repo volume dwindled in the subsequent years and operations ceased for most of 2012. While the volume experienced ups and downs thereafter, it never attained pre-crisis levels in terms of size and share in bank assets. According to the interviewees, the meltdown of the repo transactions after the crisis can be explained through their replacement by state securities later on (Interviewee 13 2020) and is dealt with in the section after next.

The central bank chose repo operations as an open market tool to tackle the issue of inflation. One interviewee (Interviewee 21 2021) also revealed that the central bank intended to use the repos to foster the use of domestic currency. It was envisioned that alongside the central bank bills, the government would also issue domestic currency bonds. The repos were also designed to be purchased by the general public and to increase trust in the domestic currency through the high profit rates on the instruments (Interviewee 21 2021). In hindsight, it is obvious that it did not work

properly, as the government did not participate[93], the public rarely purchased the instruments, and inflation rates did not decrease substantially. The yields on repos were in fact only slightly higher than the inflation rate, but given the appreciating or stable real exchange rate of the time, this made the repos appealing for international investors (though this would have been the case for any individual in Serbia with euro savings). In addition, they were eligible as secondary liquidity reserves for banks, which made them even more attractive (Marinković 2015, 177). This led to a misalignment of yields, which created a vicious circle in that ever more capital was attracted from outside the country and subsequently had to be sterilised again. The vicious circle (Marinković 2015, 177) is highlighted in the following statement by a former high-ranking central bank official.

> "They were very much concerned with wiping out [the] so-called surplus of liquidity in the system. And the irony here is that when the foreign currency comes into the system, it generates an additional amount of local currency, and then you got to take it out, not to fuel inflation, right? So the idea was to keep the money base [from] being driven substantially to higher levels. But I think that the remedy was the wrong one. The remedy was, in my view, not to allow this money to come into the system at all, if it's short-term speculative money." (Interviewee 17 2020)

The statement describes how the repo operations allowed a never-ending stream of capital to be drawn into the domestic financial market so that purchasers could profit from low-risk, high-yield investments on the two-week papers (Kujundzić and Otašević 2012, 4). "*Hot money did come*" (Interviewee 21 2021), according to one central banker active at that time. Similar to cross-border lending, the very same banks were not only active in the repo operations on their own books, but also invited foreign investors to participate in the game (Bungin, Filipović, and Matović 2012, 224), since the banks had limits on their foreign funding. In this way, "*classical institutional investors*" (Interviewee 13 2020) with some risk appetite were aided in opening accounts at custodian banks in Serbia and then investing in these repo operations. "*It was Hypo Alpe Adria Bank […] but also other foreign banks, Raiffeisen, Unicredit, almost all of them. […] [The m]other bank […] was channelling these investors to local markets […] They were taking a fixed fee out of this and*

[93] The same interviewee lamented that "*Until 2007 or 2008, the Serbian government did not even issue a single treasury bond in Serbia in local currency, because the Serbian government was thinking just like the Serbian private individual, meaning, 'If I have to pay [an] interest rate [of] 5% in euros, it's still cheaper than pay[ing] 10% in Serbian dinars then.'*" (Interviewee 21 2021).

the risk was of course on investors" (Interviewee 13 2020). As outlined in the interviews and secondary literature, the crux of the problem lay in the rather uncontrolled capital and financial account and in the fixed or appreciating exchange rate that guaranteed returns for speculative investors. Regarding the latter, the central bank made sure of this by massively intervening on the foreign exchange market, at times accounting for almost 84.5% of daily interbank turnover (Marinković 2015, 182). On this point, a bank manager commented that "[…] *[w]ith interventions [by the central bank], this was decreasing the risk for potential investors*" (Interviewee 13 2020) and created a profitable instrument for banks and their investor community.

What was the outcome of this process? Clearly, "*this was [...] fuelling speculative gains without any substantial or significant contribution to the overall economic activity of the country*" (Interviewee 17 2020), which led to an increase in the country's overall external debt. The high repo rates also contributed to high interest rates on the local credit market (Đukić 2007, 441; Živković 2015, 52), putting an additional burden on entrepreneurs. Adding to this, the short-term nature of these operations enabled the investors to quickly withdraw their capital in view of headwinds, which is indeed what happened in the GFC, as shown in Figure 37. This sudden exit exerted pressure on the exchange rate, which only in late 2008 depreciated by around 20% (National Bank of Serbia 2020g). The repo operations also were a "*fairly expensive mechanism for them, which probably means it was a very profitable mechanism for the other side*" (Interviewee 20 2020).[94]

Why did the central bank continue to pursue this strategy despite knowing about the problems? The NBS was in the process of gradually switching from a crawling peg to an inflation-targeting regime (Josifidis 2009: 205), as mandated by the IMF, which meant that it decided to follow whatever policy was necessary to keep inflation under control. While it remains doubtful that inflation could be controlled in an environment where the largest part of the financial sector is denominated in euros, the NBS nevertheless continued to intervene on the foreign currency market in order to prevent the dinar from depreciating, which created distorted expectations. It seems as though the Serbian central bank was attempting to master the Mundell-Fleming trilemma[95] at any cost. Lastly, the excess demand on the repos can also be attributed to the expansionary, pro-cyclical fiscal policy

[94] While it is not possible to scrutinise the exact losses through the annual reports of the central bank, simply multiplying the repo volume in 2007 by the interest rate of around 10% (International Monetary Fund 2009, 15) would result in a loss of more than EUR 200 million for the central bank.

[95] The trilemma or impossible trinity model postulates that out of the policy options 'free capital flow', 'fixed exchange rate' and 'sovereign monetary policy', it is only possible to have two at the same time (Friedman 2019, 27; Mundell 1961).

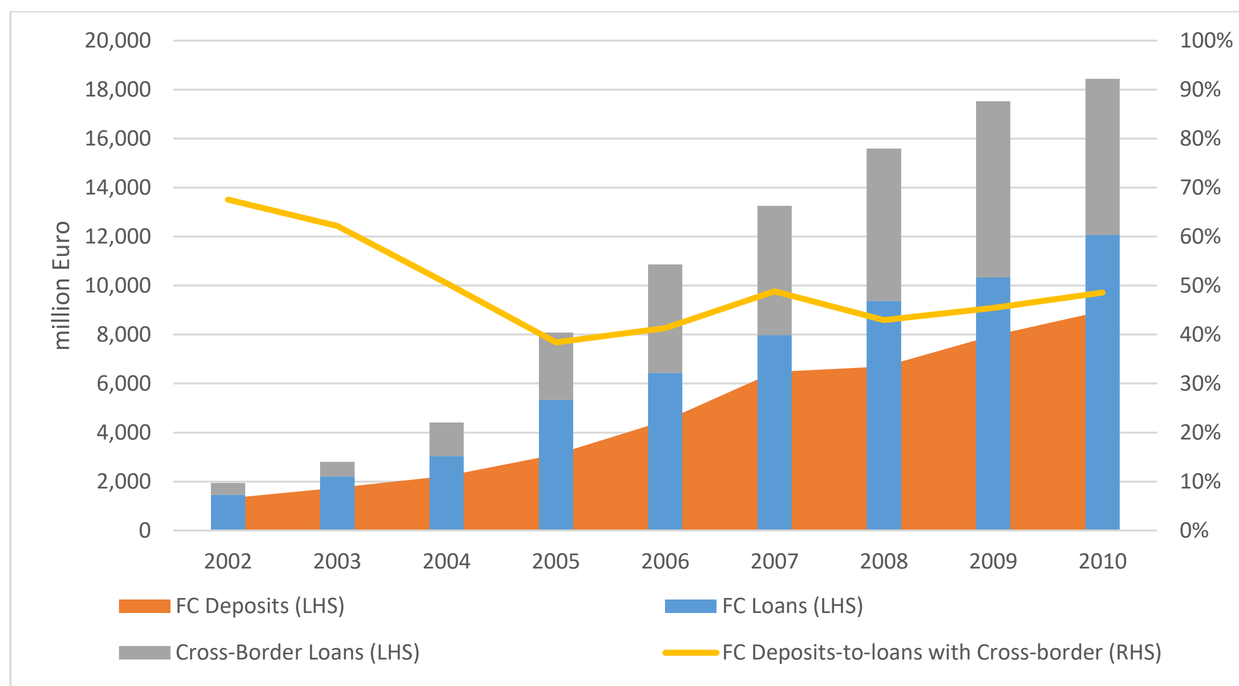
at that time, including pension increases and ‘hand money’ at the end of political tenure (Marinković 2015, 178). In sum, while the well-intentioned repo operations missed their target to a large extent, they increased short-term, carry trade activity resulting in losses for the central bank and heightened the fragility of the financial system. These unintended consequences intensified international financialisation in Serbia.

6.2.4 Foreign currency lending

Next to foreign inflows as a main constituent of international financialisation, foreign currency loans were found to be comparatively high in Serbia, as such loans surged both in household and company lending before the crisis. They reached their peak in 2006, accounting for nearly 90% of all loans in foreign currency, while thereafter such loans to households steadily decreased. Foreign currency loans to companies saw a small dip before the GFC and then remained on an elevated level. This calls for an explanation of the subject matter, with special emphasis on the practices, mechanisms and reasons that led to this high degree of financialisation, which is dealt with in this sub-section. In addition, the decrease in foreign currency loans starting from the year 2006 as shown in Figure 33 is also in need of explanation, as it coincides with a period of heightened financial activity as discussed in the preceding sub-sections.

At the beginning of this section (see Figure 35) it was already argued that deposits in Serbia were not enough to cover loans, which necessitated an influx of capital from abroad. Typically, this sort of finance was in foreign currency, which explains the general increase in foreign currency loans from the perspective of the banks. The banks were not eager to take on the foreign currency mismatch and simply passed the risk on to the debtors (Chailloux, Ohnsorge, and Vavra, 7). A former central banker revealed that for this reason even the World Bank and the IMF advocated for foreign currency loans at the turn of the century (Interviewee 18 2021). In order to visualise the mismatch in foreign currency on the asset and liability side of the banks, Figure 38 depicts domestic foreign currency loans and deposits as well as cross-border loans, which also usually take the form of foreign currency loans. The right-hand axis shows the deposit-to-loan ratio, including cross-border loans, which indicates the extent to which savings in foreign currency in Serbia could cover all loans that were extended.

Figure 38: Serbia – Loans and deposits in foreign currency



Source: Federal Reserve Bank of St. Louis (2019); Joint External Debt Hub (2019); National Bank of Serbia (2020c, 2020g, 2020j); author's calculation

The figure reveals that in the pre-GFC period, a substantial gap between deposits and loans in foreign currency existed (around 50%) if we consider the international dimension of the Serbian financial sector, which is the magnitude of cross-border loans. It can also be seen how cross-border loans exacerbated the disparity between loans and deposits, as in the early 2000s the match between the two had been more balanced. In order to repay their loans in foreign currency, the debtors would thus need to mobilise these funds from elsewhere, be it from foreign trade, remittances, the central bank or the government. The figure also indirectly highlights that foreign currency loans for companies (the usual recipients of cross-border loans) did not decrease but rather shifted from domestic sources of finance to foreign sources. However, the foreign-currency-denominated cross-border loans do not form a regular part of the official statistics of foreign currency loans, as a personal communication of the author with the central bank revealed.[96] As argued here, they need to be included when assessing the increasing interconnectedness between local debtors and global financial markets.

[96] The e-mail communication is available upon request.

In line with the question from the beginning of this chapter, what were the reasons for foreign currency lending? Was it only profit-seeking global capital unleashed and mediated by foreign banks, or are there other factors that could contribute to our understanding of international financialisation in Serbia? While the elaborations above describe and clarify part of the statistics, the reasons for and mechanisms explaining foreign currency lending and the general use of foreign currency are dealt with in the first part of this sub-section. The second part of this sub-section part exposes the peculiar development of foreign currency lending to the most vulnerable sector of the economy, i.e. households, with emphasis on the Serbian mortgage market, up to the GFC.

6.2.3.1 Why go for the euro?

> "It is not the toxic assets such as ABSs that were the risk for our financial sector stability during the crisis, it was the sheer quantity of FX-indexed or -denominated loans to households and businesses who were often unhedged against FX risks." (Marković 2010, 1)

This statement by the vice-governor of the NBS in 2010 reveals the burden that the extent of foreign currency lending has placed on the population of Serbia, apart from magnifying the existing processes of international financialisation. As the first section of this chapter argued, foreign currency loans for companies and households were forbidden by the central bank in the SFRY. In 1993, however, it was made legal to index loans (Opaćić, Perišić, and Gluscević 2016, 138). The change at the beginning of the 1990s happened when banks were faced with hyperinflation and saw their assets shrink day by day (Interviewee 20 2020). Through this legal amendment, banks could now link their outstanding loans to price developments in the domestic currency, but also to those in other currencies. The idea behind the change was to enable banks to link their claims to inflation, so that debtors were not invited to take out an unlimited amount of loans, which would soon no longer be worth anything during that period of inflation in the 1990s. As the law survived the change of regime, it was then used to disburse foreign-currency-indexed dinar loans, and as of now, such loans constitute the bulk of domestic foreign currency loans in Serbia. In these loans, payments are made in Serbian dinars, while the claim itself is contracted in foreign currency. For that reason, any change of the exchange rate directly affects the principal to be repaid in dinars by the debtor.

One central reason for contracting a foreign currency loan in view of the potential downsides mentioned by all of the interviewees and indeed discussed in a range of the publications on this issue is the pervasiveness of the use of foreign currency as a means of payment and store of value in Serbia. Many wages and prices (e.g. rent or other types of payments) are set in euros (Chailloux, Ohnsorge, and Vavra, 1) and people tend to save exclusively in euros instead of Serbian dinars, not only in bank accounts but also in cash (Stix 2013, 4089). Other reasons for foreign currency use include the omnipresent memory of hyperinflation (Ostojić and Mastilo 2013, 56); low institutional credibility, translating into mistrust in the financial sector (Dvorsky, Scheiber, and Stix 2008, 85); and the relative volatility of inflation and nominal depreciation (the so-called 'minimum variance portfolio', MVP) (Urošević and Rajković 2017, 31) leading to an overall low level of confidence in the local currency in Serbia (Windischbauer 2016, 24f). One interviewee summarised this characteristic by saying that "*it's a cultural thing*" (Interviewee 16 2020). However, besides these rather perceptive reasons for the use of foreign currency in general, a range of political and regulatory decisions have also served to reinforce the practice.

In terms of regulation, banks were allowed to keep their paid-in capital in euros. As equity is shown on the liability side, this obviously has an effect on the asset side as well. This was only changed in around 2006, which helped to increase overall dinar assets, according to one bank manager (Interviewee 13 2020). However, if we look at the statistical figures presented above (especially Figure 36), it becomes clear that if cross-border loans and the SPV financing are taken into account, this increase in dinar assets was only halfway material. Another factor was the legally permitted option of paying rent and other bills in foreign currency, which contributed to the use of euros in daily life. The deposit insurance that was instated in 2005 also covers foreign currency deposits (International Monetary Fund 2010c, 14), which puts savers in this currency on equal footing with those who save in domestic currency in terms of the security of their funds (Chailloux, Ohnsorge, and Vavra, 6). Subsidies and start-up financing in euros directly contributes to foreign currency lending as well as the presence of foreign banks in general, as they tend to report their figures and source their funding in foreign currency (Chailloux, Ohnsorge, and Vavra, 6).

> "Well, I would say that as for many problems that we are seeing in our country and in our region, it was both [the] doing of the locals and a little bit of the foreigners. The locals in my view we have to blame for the increase in FX-denominated lending, because at the beginning of [the] 2000s, it was actually integrated

> into [the] legal system. It was allowed to pay for real estate previously in deutschmarks, now in euros. It was allowed to pay rent in euros, and a lot of indexation was going on and still is going on." (Interviewee 17 2020)

This statement by a former central bank official reveals that besides the psychological reasons for the use of foreign currency, legal and regulatory factors also played a decisive role. While this describes both the impact of policy and the motivation by banks that led to increasing foreign currency use, the interviewees indicated two other crucial factors that made these loans so attractive for borrowers. First, the interest rates on euros were simply much lower than those on dinars given the high inflationary environment, high repo rates and potential risk premium on dinar loans. This made it financially attractive for borrowers to take a loan in euros rather than in Serbian dinars (Interviewee 13 2020), even when accounting for slight changes in the exchange rate. Secondly, the euro/dinar exchange rate was relatively stable throughout the early 2000s (National Bank of Serbia 2020g), which eased borrowers' and debtors' concerns about this type of risk (Interviewee 14 2020). Thus, with regard to foreign currency loans, debtors enjoyed lower interest rates on their loans and banks benefitted from foreign currency loans if they had access to cheap financing from abroad (Interviewee 15 2020; Interviewee 17 2020). As long as the exchange rate did not devalue heavily, this proved to be a favourable mechanism for the government and central bank to keep everyone happy, leading one interviewee to comment that "[…] *whatever the mechanism for this growth to be recorded, it was sort of welcomed*" (Interviewee 16 2020). Furthermore, the central bank was in a fairly comfortable position, according to a former central banker (Interviewee 18 2021), since it had amassed a high amount of foreign currency reserves to fend off any foreign-currency-induced pressure. In any case, the exchange rate policy of the central bank played and continues to play a crucial role in steering people's expectations and thus ultimately their decision as to whether to take out a loan denominated in dinars or euros. So, given the forceful impact of the policy on foreign currency lending and ultimately international financialisation, it is only natural to ask: What determined the exchange rate policy over the years in Serbia?

At the beginning of the 2000s the NBS conducted a nominal peg and anchor and then switched to a crawling peg coupled with slight depreciation from 2003 until 2006 (Josifidis, Allegret, and Pucar 2009, 205), which in reality was a tightly managed exchange rate (Chailloux, Ohnsorge, and Vavra, 10). An NBS governor allegedly even commented that a quasi currency board existed in 2005 (Zekić 2005, 207). However, several high-ranking former central bankers (Interviewee 17 2020;

Interviewee 18 2021; Interviewee 21 2021) explained that the managed peg was initially chosen to create stability but also some flexibility in the medium term. In the short run, the central bank attempted to keep the exchange rate stable until 2006 for two reasons. First, it did not want to stir up past fears of devaluation and hyperinflation, which haunt Serbia's collective memory. Second, it did not want society to feel the balance sheet mismatches that existed in the Serbian financial sector due to the existing foreign currency risk (Chailloux, Ohnsorge, and Vavra, 6).

After 2006, the inflation-targeting regime, with its more liberal stance towards the exchange rate (Interviewee 21 2021), worsened the international position as the currency appreciated, which reassured debtors when they were considering a foreign currency loan. Instead of exchange rate stability, the central bank focused on inflation targeting (Kujundzić and Otašević 2012, 3) in line with monetarist appeals. The appreciation attracted more foreign funds (Marinković 2015, 179), which, as shown above, exacerbated the problem at hand due to the emerging repo operations. While others argue that the fiscal policy has to be seen as the culprit for the ineffectiveness of the change of regime (Dragutinović 2008), it is clear that in an environment of real appreciation, it would make even more sense for any borrower to take a loan in foreign currency. In sum, several factors contributed to foreign currency lending during that time period: creditors enjoyed comparatively low interest rates, (foreign) banks benefitted from attractive margins while passing on foreign currency risk, and the central bank regulation and government policy proved to be conducive to keeping foreign currency lending at a high level. The interplay between domestic and external interests and motives thus heightened international financialisation in Serbia. As this section focused on foreign currency lending in general, the next section will consider mortgage lending, as this is one of the few sectors exclusively served by foreign currency loans.

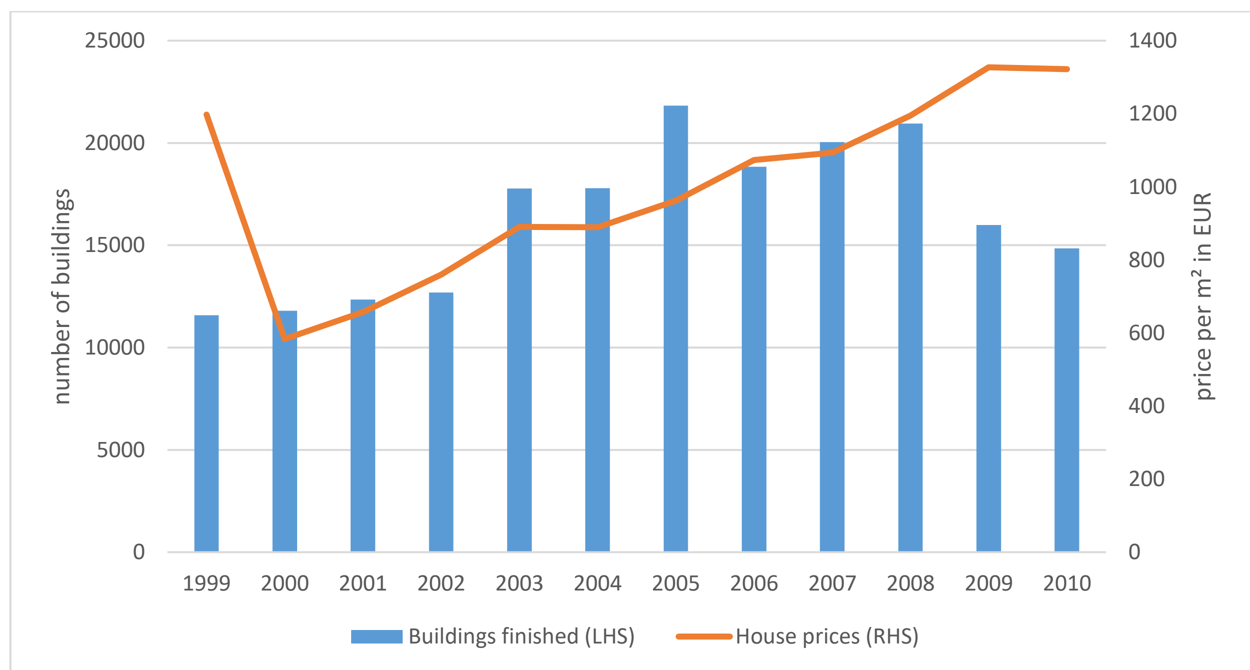
6.2.3.2 Housing market and Swiss franc loans

Household lending in Serbia developed at a moderate pace before the crisis compared to other countries in the region (see chapter 4). However, the mortgage market came to be characterised by an exclusive focus on foreign currency, which connected domestic homeowners with global exchange rates and interest rate dynamics, and is dealt with in this sub-section. How did this market develop in Serbia? In 2004, a novel mortgage law was passed and a credit bureau was established, enabling mortgages to be registered starting in 2005 (Gospavić et al. 2013, 86, 94; Roy 2008, 140). Since then, the loans have been extended exclusively in euros or other foreign currencies (Šoškić

et al. 2011, 255). Particularly striking in the case of Serbia, as for a number of other Eastern European countries, is the fact that a great share of these loans were denominated not in euros but in Swiss francs, a currency to which few Serbs have any connection, let alone savings. This particular characteristic poses yet another instance of international financialisation, as not only the loan itself is denoted in a foreign currency that is otherwise completely absent from the domestic financial sector, but also as the 'global' interconnects with the housing of domestic citizens.

During much of the socialist era, most people lived in socially owned houses. Housing privatisation (to tenants) started in the 1980s and really took off in the 1990s, causing overall home ownership rates to soar above 90% at the turn of the century, albeit with little construction activity (Šoškić et al. 2011, 247). It was not until the middle of the 2000s that the housing market revived and (re-)construction started. Figure 39 presents a snapshot of completed buildings and house price developments in the Serbian housing market.

Figure 39: Serbia – Snapshot of the housing market



Source: Statistical Office of the Republic of Serbia (2019)

The number of completed buildings (left-hand axis) decreased during the war periods but started to surge in 2003 and peaked in 2005. The years of the GFC brought the number of completed buildings down to levels known from the pre-war times of the 1990s, however. After the shock devaluation around the turn of the century, house prices grew steadily even throughout the GFC

due to the existing stock of houses with intransparent housing rights (Šoškić et al. 2011, 262). This led one interviewee to comment that "*I wouldn't say mortgage boom, I would say boom in real estate prices*" (Interviewee 17 2020), albeit definitely not an exponential one. Concurrent with the introduction of legislative changes to enable mortgage lending in 2005, so that the population could either upgrade their existing houses or move into new ones, the government introduced a national mortgage insurance corporation (NMIC) that covers three-quarters of a potential defaulted loan in order to decrease the interest rates. By 2010, the NMIC already covered around 80% of the total mortgage loans outstanding (National Bank of Serbia 2020f; Šoškić et al. 2011, 259). While the insurance scheme was well-intentioned, with the aim of enabling people to purchase new homes, it did not differentiate between domestic and foreign currency loans nor between euros and francs, which contributed to housing loans being disbursed in foreign currency. While this is yet another example of a policy effort that unintentionally enhanced existing peripheral financial streams, the subsequent surge in Swiss-franc-denominated loans demonstrates an even more extreme form of international financialisation.

The promotion of these loans started in 2005, when the first bank, Hypovereinsbank (now Unicredit), started offering such mortgage products at extremely attractive rates to potential borrowers (Pavlović 2017). As was common in Serbia, the loans were denominated in dinars but indexed to the Swiss franc. Several banks swiftly followed suit, mainly those that had parent banks abroad with access to cheap international financial market refinancing. According to one interviewee (Interviewee 19 2020), even the EBRD allegedly offered cheap Swiss franc financing to Western banking groups in Eastern Europe, which would provide a striking example of an international organisation for development promoting questionable loan products and increasing peripherality. By 2008, more than EUR 1 billion of total mortgage loans had already been disbursed in Swiss francs, making up more than 60% of total mortgage loans (National Bank of Serbia 2020e). Thus, apart from the general mortgage lending spree in foreign currency, Swiss-franc-denominated loans probably represented the most extreme example of foreign currency lending in Serbia before the GFC. While the loans were equally or much more prominent in other countries (Brown et al. 2011; Yeşin 2013), in Serbia more than 30,000 people took out loans from banks in a currency to which they had little or no relationship at all. The majority of these loans were indeed dedicated to mortgage finance, but they were sometimes also disbursed as microfinance loans (Janićijević and Petković 2014, 137).

The repayment of the Swiss franc loans finally turned problematic after the GFC, when the Serbian dinar depreciated against the Swiss franc in 2010 by 31% (before the peg of the franc to the euro) and again in 2015 (after the end of the peg) by 12% (author's calculation based on National Bank of Serbia 2020g). The repayment amount of these loans thus increased from 2008 until 2017 by 71% based on the differences in exchange rates, which ultimately proved to be a heavy burden for the borrowers, including years of looming foreclosure, court proceedings and personal tragedies as documented in Opaćić, Perišić, and Gluscević (2016, 139) and Pavlović (2017). Finally, in 2019, the Serbian state enacted a forced currency conversion of the loans into euros – the last country in Eastern Europe to do so (Vidahazy and Yeşin 2020, 216, 225, 231) – but this only provided partial relief to the remaining borrowers who were still servicing their debt. On that subject, one interviewee offered the following comment:

> "I think in the end the ones who were able to service the loan for 10 years actually benefitted [from] it. Of course, the ones who lost their homes in the meantime because they were not able to service it are the main losers. I'm also not sure if at the end the banks benefitted at all because as far as I understand all the banks had liabilities in Swiss banks." (Interviewee 20 2020)

While a certain number of debtors benefitted from the favourable interest rate difference, as for example one interviewee reported to be the case for herself (Interviewee 19 2020), a greater number stumbled into difficulties repaying the loans. Did the foreign banks, while obviously having contributed greatly to international financialisation in this case, benefit from the Swiss franc loans in Serbia? The Swiss franc loans were primarily disbursed by Western banking groups from Austria, Italy and Greece (Pavlović 2017). After the showcase by Hypovereinsbank, a number of other parent groups secured funding in Swiss francs for the subsidiary in order to on-lend to Serbian potential borrowers. This was done through concluding swap contracts and commitment lines between euros, as their unit of account, and Swiss francs, which were available for cheap interest rates, at their headquarters (Interviewee 13 2020; Interviewee 21 2021). In doing so, they in fact eliminated the currency risk for the banking group and were able to pass on the Swiss franc funds to their subsidiaries in Eastern and South-Eastern Europe, profiting from this carry trade activity while being additionally secured with the asset behind it, the home of the debtor. Adding to this, the NMIC covered a greater part of potential loss in any case, which leads us to conclude that the

banks should have benefitted from the scheme overall, contrary to the perception of the interviewee.

So what were their mechanisms for disbursing the loans? It was documented that the loans were often targeted at clients who would otherwise not qualify given the repayment rate, which was confirmed by one interviewee,[97] but the banks also actively engaged in converting existing loans in euros to Swiss francs (Opaćić, Perišić, and Gluscević 2016, 140), as the margin on those loans was probably higher. These types of loans were often disbursed by bank employees who themselves could not even understand the implied type of currency risk (Opaćić, Perišić, and Gluscević 2016, 142).

The government even promoted the loans as an opportunity to build or acquire one's own home (Pavlović 2017). One interviewee confirmed this by stating that "[…] *weirdly, we had a minister, the acting finance minister at the time who was also advertising the loans, saying it was really great*" (Interviewee 20 2020). What is striking is that the central bank was well aware of the practice (Interviewee 14 2020) but did not do much about it. Although the governor of the central bank publicly warned against such types of loans and the foreign currency risk they entail (Interviewee 13 2020; Interviewee 19 2020), the very same institution argued that in principle it was the borrower's responsibility stemming from potential currency differentials (Opaćić, Perišić, and Gluscević 2016, 138). Nevertheless, one former central banker revealed that the political pressure was too high to forbid the practice of disbursing Swiss franc loans.[98] Also, the central bank unofficially advised the NMIC to differentiate at least between euro and Swiss franc loans, which was rejected by the then head of the institution.[99] In that sense, domestic politics thwarted the containment of the dangerous practice of granting loans in a foreign currency that was far from the reality of Serbian households.

As such, the Swiss franc disaster in Serbia proves to be a striking instance of international financialisation, as it entailed the subjugation of Serbian home seekers not only to international currency

[97] "*They were giving the interest rate.... Yeah, for 5.3%. The interest rate for the credit in euros was 9.4. So I took the credit [at] these rates. But 5 and 9 are very different. I could never afford to have a credit with such a high interest rate of 9 and something. I really did benefit [from] it*." (Interviewee 19 2020).

[98] "*I told guys, 'Okay, I understand I cannot prohibit it [Swiss franc loans] because you would hang me up, but you cannot shut my mouth, yeah?'*" (Interviewee 21 2021).

[99] "*We wrote a letter telling them, 'Can you please charge a higher premium for Swiss-franc-denominated loans compared to the euro-denominated loans?' And [they] just refused*" (Interviewee 21 2021).

markets, but also to the financial engineering of Western banking groups that managed to hedge themselves from any currency risk. The politics of the government and to some extent of the central bank proved conducive in this regard. The former fervently advertised the cheap loans as a means to satisfy the demand of the population for new homes, while the latter either did not view the subject matter as being within its mandate or faced too much "*opposition*" (Interviewee 17 2020) from the banks involved in these practices.

6.2.5 Interim summary

This section outlined the trajectory of international financialisation in Serbia and revealed a range of factors that contributed to it. The banking sector in Serbia experienced drastic changes at the turn of the century, which included the closure of several large financial institutions and the arrival of a number of international banking groups, driven by the political will of the time. Financial liberalisation and the entry of foreign banks served to assuage public distrust of the domestic banking system, which had robbed the population of its savings in the 20th century and aided in asset-stripping in the 1990s. Financial inflows, the first indicator of international financialisation under review here, were mainly explained through a surge in foreign funding provided to foreign-owned banks by their headquarters, motivated by growth aspirations in a novel market in the early 2000s. Starting from around 2005, the central bank became wary of the high speed of asset growth and enacted a series of reforms to tame it. In reaction to this, foreign-owned banks devised external SPVs and cross-border loan facilities in order to continue with excessive lending and to circumvent regulations. While both practices account for a large part of financial inflows, they simultaneously fostered the dependence of the domestic economy on the continuous inflow of foreign finance.

Contrary to the mainstream development narrative (Levine 1997), the increased availability of finance did not lead to better conditions for the real economy. Due to a tight regime of control of financial in- and outflows, the central bank should have been aware of the magnitude, but the prevailing positive sentiment towards the Washington Consensus and an open financial account, combined with a desire for high growth and abetted by a strong bank lobby, as disclosed by the interviews, resulted in no further actions being taken to reduce the continuous arrival of foreign funds. On the contrary, the central bank created a vicious circle of foreign financial inflows by enabling two-week repo operations. Although the practice was initially instituted to sterilise and control domestic currency volumes, the attractive returns and low risk on the back of a stable exchange rate invited foreign investors to earn fast profits with benign risk. In this way, even more inflows

were drawn into the country, which swiftly exited at the onset of the GFC, proving a striking instance of international financialisation.

Foreign currency lending, the second indicator of international financialisation under discussion, reached skyrocketing figures before the GFC that were mainly driven by financial funding inflows, as local deposits could not cover asset growth. The exchange rate policy hence proved conducive in this regard, as politicians and the central bank desired to keep the rate stable so as not to endanger public trust in domestic savings, which were often kept in euros due to the traumatic experience with the local currency in the past. Hence, foreign currency loans served as a temporal fix for the desire for credit, as availability of the domestic currency was restrained. Policy initiatives frequently did not differentiate between currencies, which further nurtured the use of foreign currency, especially in the real estate market. In this realm, Swiss franc loans came to account for a large part of the domestic mortgage market, as was the case in other Eastern European markets, which drove a substantial number of homeowners into default after currency adjustments following the GFC. Overall, domestic as well as external factors were uncovered as explanatory mechanisms for the trajectory of international financialisation, which was to provoke a serious backlash during the GFC, as outlined in the next section.

6.3 The repercussions of Serbia's international financialisation in times of crisis

The last section focused on laying bare the trajectory of international financialisation in Serbia from the period of the regime change until the GFC. This section briefly reiterates the impact of the GFC and then explains how the developments in the 2000s that were described in the previous section exacerbated these negative effects. Similarly to other countries in the region, the GFC arrived in Serbia with some delay. While in 2008, Serbia was still recording GDP growth of more than 5%, output turned negative in 2009, i.e. slightly below -3%, and unemployment rose to nearly 20% in 2010 (Gardó 2011, 86). Industrial production even decreased by more than 10% in 2009 and foreign direct investment, as well as other capital inflows, dried up (Upchurch and Marinković 2011a, 243). As private demand contracted, the balance of payments became much more positive, aided by increased remittances from abroad (Sanfey 2010, 9) and by re-started exports in 2010. All this contributed to the fact that Serbia was initially much less directly hit by the GFC than other countries in the region (Petrović 2010, 115), but since then the Serbian economy has been characterised by relative stagnation. To illustrate this, between 2009 and 2014 GDP fell by 0.1% on average per year, while by 2016 more than a quarter of the population was at risk of poverty (Bartlett 2019, 147–48). Thus, while the immediate effect of the crisis was not as dire as in other countries, Serbia was not able to resume a path of growth after the GFC.

Apart from macroeconomic fundamentals, the first signs of the looming economic contraction were already visible at the beginning of 2008, when foreign banks withdrew funds from their affiliates in Serbia (Marinković 2015, 171). Together with the news of a financial crisis, this led to a massive run on foreign currency savings, reducing these deposits by 20% or EUR 1 billion in Serbia (International Monetary Fund 2010b, 16). At the same time, the funds invested in the favourable repos of the NBS decreased by two thirds within a couple of months, as illustrated in Figure 37. While long-term foreign direct investment might have been expected to come to a standstill (though not to go into reverse), the sudden flight of short-term liquidity that took place, both in the form of parent bank lending and repo speculation funds, reveals the peculiar nature of the previous trajectory. International financialisation heightens a country's susceptibility to the vagaries of international financial markets, and this is exactly what happened in Serbia in 2008. Not only did this endanger the stability of the banking sector given the capital flight and the subsequent bank run, but it also caused a sudden devaluation of the dinar by more than 25%. Although it was argued to have been managed by the NBS (Petrović 2010, 115), the swift devaluation caused problems for

debtors with loans in foreign currency. The central bank, however, ultimately succeeded in stabilising the exchange rate by using up most of its foreign reserves and availing itself of a stand-by agreement with the IMF for around EUR 3 billion (Gardó 2011, 87), and the withdrawn deposits gradually returned by the end of 2009 (Sanfey 2010, 12). Yet the GFC exposed the vulnerabilities brought about by the trajectory of international financialisation during the 2000s.

Further repercussions of the sudden devaluation of the dinar were felt primarily by the debtors in foreign currency, especially corporate clients. Total non-performing loans rose from 5.3% at the end of 2008 (National Bank of Serbia 2008, 9) to more than 20% in 2012, one of the highest rates in Eastern Europe (International Monetary Fund 2013, 35). During the fallout of the GFC, corporate loans made up around 88% of all non-performing loans, which stifled economic recovery (National Bank of Serbia 2013, 14). Obviously, corporate clients suffered primarily due to the economic downturn, but the fact that the National Bank enacted a regulation after the crisis that required banks to carry out a mandatory FX risk assessment in their loan decisions (Interviewee 14 2020) contributed to a number of firms defaulting on their loans due to the sudden devaluation. Jović (2016, 152–53) provides empiric evidence that foreign currency risk did indeed later translate into credit risk, i.e. non-performing loans, in Serbia. As one IMF staff member commented, "*What happened after 2008/9/10 after the dinar depreciated strongly was that many companies went bankrupt because of the loan[s] in euros*" (Interviewee 20 2020). Another contributing factor with regard to the high share of non-performing loans among legal entities in Serbia was that cross-border loan volumes were comparatively high. This created an adverse selection problem, in that the high-quality clients were transferred to the headquarters in Vienna and Milan, while the lower-quality clients remained in the portfolios of their Serbian affiliates (International Monetary Fund 2010b, 9). Relatively speaking, the 'export' of good loan clients thus worsened the overall standing of the Serbian financial sector. As discussed in the previous section, the outstanding principal of housing loans disbursed in foreign currency suddenly increased as well, which was even more damaging for debtors with Swiss franc loans. In that sense, international financialisation manifested in foreign currency loans transmitted the financial turmoil to Serbia through a rise in Euribor and aggravated corporate and household cash flow due to the plunge of the exchange rate.

Along with draining foreign reserves to stabilise the volatility of the exchange rate, the National Bank of Serbia enacted a series of regulatory changes in order to counteract the crisis. While already more versatile than its Western European counterparts in the run-up to the crisis, the NBS

changed the composition of mandatory reserves between euros and dinars. The decision helped banks to maintain liquidity in foreign currency (Marinković 2015, 175), which probably contributed to fending off the pressure on the local currency later on. The NBS also offered swap facilities to the banks in 2009, which, however, were seldom used. Additionally, the central bank cancelled the reserve requirements for new foreign borrowing from the end of 2008 until the beginning of 2010 (Gardó 2011, 90). The measures aided in relaxing credit conditions and were further spurred by loosening down payment requirements for household lending and offering a free-of-charge conversion from foreign currency loans to dinar loans. In view of the effects of the GFC, the NBS thus released most of the brakes that it had previously applied in order to curb the excessive lending growth from 2005 until 2008. However, this may also explain why the share of total foreign currency loans for companies at least temporarily first decreased and then increased amid the crisis, as described at the beginning of this chapter.

Another factor that allegedly contributed to the stabilisation of the financial system during the GFC was the Vienna agreement. Epstein (2014b) documents why the Vienna Initiative was a necessity for the banking groups exposed to Eastern Europe given their sizeable equity investments in the face of liquidity pressures at the height of the GFC. Contrary to a few other countries in the region that opted out of the agreement, Serbia was one of the few non-EU countries to take part in it (Epstein 2014b, 856). Joined by the National Bank of Serbia under the auspices of the IMF, the Vienna Initiative is argued to have helped Serbia in smoothing the credit crunch and restoring confidence in the foreign-owned banks in the country (Marinković 2015). However, in exchange for the agreement, which entailed maintaining the pre-crisis foreign liability levels, Serbia had to accept IMF assistance and conditionality programmes (Epstein 2014b, 856). Adding to this, the National Bank of Serbia arranged access to dinar and foreign currency liquidity arrangements for the banks in early 2009 (Marinković 2015, 188). An overall positive result was the re-established confidence in South-Eastern European financial markets. In order to comply with the IMF's conditions, Serbia had to implement a wide range of austerity policies that might have exacerbated the effects of the crisis. Accepting a framework between banking groups and international financial institutions also further cemented Serbia's status as a peripheral country dependent on foreign capital. Contrary to the agreement, in reality the foreign banks subsequently gradually reduced their exposure, as argued in Bartlett (2019, 152) and in the next section. While there are a couple of publications by Epstein (2014a, 2014b, 2017) on the subject matter, one interviewee argued that in the case of Serbia, the agreement did not help to clean up the financial sector overall.

> “[The] only [one] who had [a] serious problem at this time was Hypo [Alpe Adria][100] and mainly this Vienna agreement was made for Hypo. I am exaggerating but the banks who had a very bad portfolio like Hypo, Volks[bank][101] and many of them were really Austrian and some of them were Greek banks. They are rotten inside. […] All this money that was put in the sector during the crisis, I don’t see any results.” (Interviewee 15 2020)

Thus, while the banks had difficult times due to increasing non-performing loans, they did not face outright losses in the GFC, as they could rely on other sources of profit. Due to an increase in pensions amid elections in 2008 (Interviewee 18 2021)[102], the government was faced with mounting debt. Together with a small rescue package, this ultimately proved to be a heavy burden for state finances, as government revenues relied mainly on import duties and other consumption-oriented incomes. This necessitated the state to increase the issuance of government securities that later were to replace the repo auctions described above. While the mechanics of state financing in relation to international financialisation are discussed in the next section, local banks participated to a great extent in buying government bonds at attractive rates. As one interviewee confirmed, “*[…] [h]ow the banks survived? In the period of the crisis they were buying state bonds […]*” (Interviewee 15 2020). The necessity of the state to fend off the repercussions of the crisis and to finance its budget due to extraordinary structural expense increases helped the domestic banking system to weather the financial crisis and avoid having to recognise excessive losses.

Summarising the developments around the GFC in Serbia, the so-called ‘*external imbalances’* according to the IMF (Bakker and Klingen 2012, 137), identified in the preceding section as international financialisation in a multitude of forms, greatly intensified the fallout of the GFC. Financial inflows decreased and dried up, putting a drain on credit growth and the exchange rate. The hot money inflow to repo operations swiftly exited, which accelerated the pace of this development. With regard to the real economy, this pushed companies and mortgage loan debtors into default due to the rising foreign currency repayments.

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[100] Hypo Alpe Adria was an Austrian Banking group that later turned out to be at the centre of a massive financial scandal (Peitsmeier and Seiser 2013). The bank was quite active in Serbia and was later acquired by a US hedge fund and the EBRD (Reiserer 2020).
[101] Volksbank HVB was an Austrian banking group that also imploded in the financial crisis, with its Eastern European subsidiary banks later acquired by the Russian Sberbank (Moser 2016).
[102] The interviewee revealed that the pension increase was a precondition of a smaller party to form a government coalition.

6.4 Serbia`s trajectory of international financialisation after the crisis

The previous two sections recounted how international financialisation evolved in the first decade of the 21st century in its two most pronounced forms and outlined the explanatory mechanisms behind these developments. The increasing degree of financialisation also heightened the susceptibility to ruptures in global financial markets, which indeed materialised in the GFC of 2008 and the years thereafter, as highlighted in the last section. Referring back to the initial statistical analysis, this section scrutinises the post-crisis phase in more detail. It was shown that after the crisis, private financial inflows (Figure 32) decreased and oscillated near zero. This was both driven by a continuous decrease in cross-border loans and the drying up of other inflows, both of which call for explanations. External government debt surged between 2009 and 2011, while portfolio investments constituted the bulk of financial inflows between 2011 and 2013 according to the statistics published by the International Monetary Fund (2015). Reiterating the questions from the beginning of this chapter, what was the nature and the influence of these public financial inflows? What led to the increase in portfolio investments? Overall, the development of private financial inflows prompts us to ask whether we witnessed a period of de-financialisation after the GFC, and if so, what were the mechanisms leading to it? With regard to foreign currency loans (Figure 33), a general decrease was noted after the crisis that was primarily driven by a decreasing share of foreign currency loans to the household sector, while this type of lending remained at the same level for companies. Was it a deliberate decision to decrease the susceptibility of household debt to international financial markets or were there other reasons for it? While for households it thus needs to be analysed whether we can speak of de-financialisation in this regard, the stagnating share of foreign currency loans for companies requires further scrutiny, as it led to the transmission of the GFC to Serbia, as shown in the section above.

In order to shed light on the explanatory mechanisms that contributed to these developments, this post-crisis section first takes an in-depth look at the structure of financial inflows and reveals that there was a shift from international private to public financialisation. The second sub-section deals with the issue of foreign currency lending after the crisis in light of the dedicated dinarisation strategy carried out by the Serbian central bank. The last sub-section delves more deeply into household lending and traces the rise of dinar-denominated fast cash loans that decreased international financialisation but increased household indebtedness.

6.4.1 International financial flows – from private to public

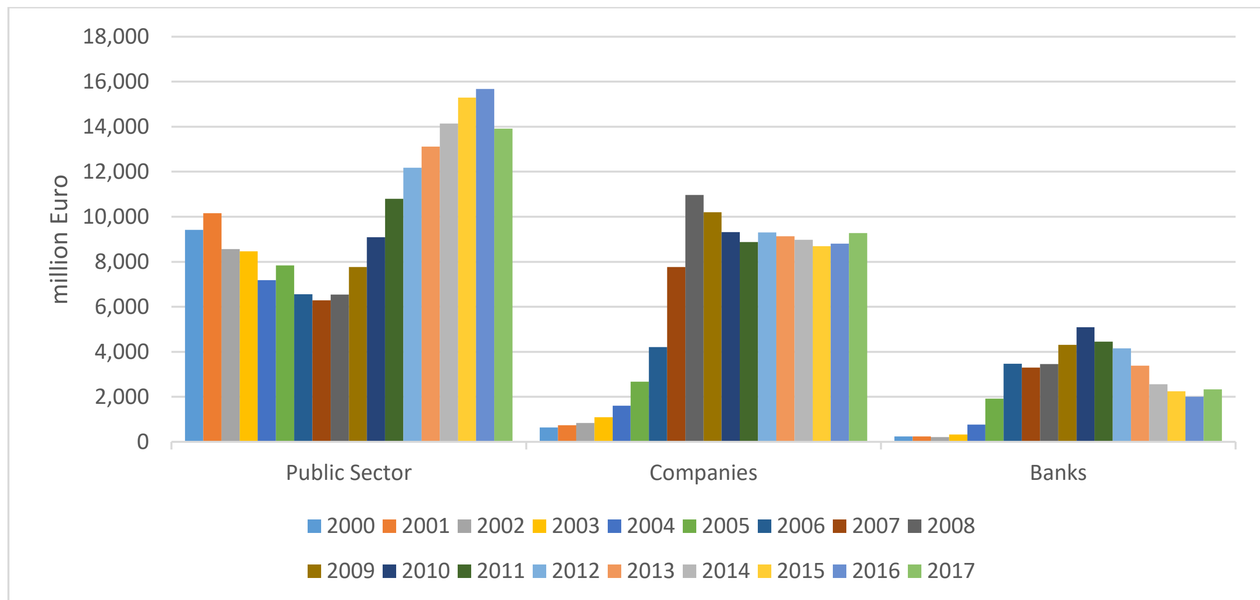
This section reviews the post-crisis trajectory of international financial flows and analyses the extent to which we can speak of international financialisation or de-financialisation in the post-crisis phase. A closer look at the statistics published by the International Monetary Fund (2015) and a cross-check against the data of the National Bank of Serbia (2020b) by the author has revealed a flaw in the IMF's data that has an impact on the assessment of the nature of private financial inflows to Serbia after the crisis. The portfolio investments in the year 2011 until 2013 in the amount of roughly EUR 1.6 billion per annum (around EUR 500 million in 2014) were not of a private nature (as shown in the data from the International Monetary Fund (2015)[103]) but in reality constituted debt securities that were issued by the '*general government*'[104] (National Bank of Serbia 2020b), i.e. the state.[105] This means that from 2009 until 2013, financial inflows in Serbia were to a very large degree composed of public debt increases that compensated for the extant current account deficit. This poses a puzzle with regard to our concept, as it focuses on private financial inflows, which had dried up. On the other hand, it seems as if public financial inflows had been partly compensating for this private decrease, as shown in Figure 40, which presents the composition of Serbia's external debt. The private sector greatly expanded its foreign exposures before the crisis, while after the crisis, the state of Serbia increased its external debt position year on year up to 2016.

[103] This refers to the data for Serbia for the respective years in the sheet PrivInexDi (Private inflows excluding direct investments), which should aggregate the different components of private financial inflows.

[104] This refers to item "3.2.B.2.3" of the Balance of Payment statistics for the years 2011, 2012 and 2013 (National Bank of Serbia 2020b). A cross-check was also performed for the rest of the data. Other differences were marginal, however.

[105] In a personal communication between the author and the NBS, the central bank claimed to be responsible for producing the data, hence this data is used for this section.

Figure 40: Serbia – Composition of external debt



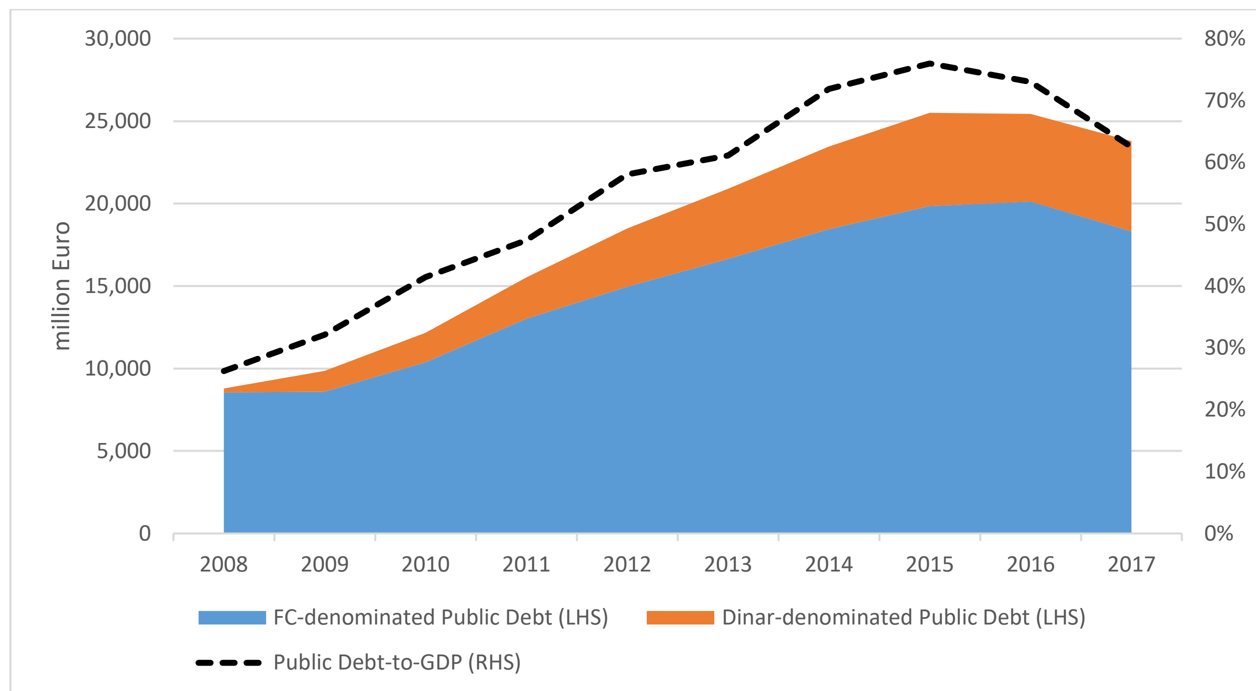
Source: National Bank of Serbia (2020h)

The previous section described the mechanism through which the headquarters of foreign banks reduced their debt exposure to Serbia and how their local affiliates increasingly engaged in buying state bonds, while overall credit activity halted with negative consequences for the real economy (Interviewee 18 2021). On the sluggish behaviour of the banks, one interviewee commented that "*it was more the case that you couldn't find enough good borrowers in the local market*" (Interviewee 17 2020). However, the high rates of NPLs in the banking sector suggest that the necessary clean-up after the excessive growth did not occur because banks did not want to recognise the losses right away. Thus, the additional income through the government securities now replacing the repo operations from before kept them afloat.[106] At the same time, external debt held by companies decreased and then stagnated, possibly also due to one-off large FDIs with accompanying debt inflows, which stabilised overall external debt. While for the private sector we could speak of reduced international financialisation, the statistics prompt us to take a closer look at the state finances, as they seem to have compensated for the drop in private financial inflows, while the actors benefitting from this, i.e. global financial markets and (foreign-owned) banks, might be the same as in the period before.

[106] "*I saw whenever you look into the profit of the banks like P&L, a lot of their profits are coming from the repo operations before and now from deals with the government, especially if you are a big one. I know a friend of mine at Deutsche Bank and for him this is a golden age now*" (Interviewee 15 2020).

While the indebtedness of the state was a major issue for the last 30 years of the 20th century in Serbia, public debt (to gross domestic production) had been at very low levels during the 2000s. However, the gradually mounting government expenses during the pre-GFC period were financed by increasing tax income derived from imports as well as consumption-related revenues. Another important revenue source was the income from the privatisations of state-owned enterprises. Hence, the existing public debt stock was rather small, financed externally and deriving from previous time periods, although part of it was written off after the change of regime in the early 2000s. After the GFC, as in other countries in Europe, public debt increased in the face of recession and mounting social expenses as well as counter-cyclical measures. As argued in the last section, the substantial increase of pensions was a main driver of this trend. The interviews, however, indicated that the mechanism for financing the debt shows specific traits of international financialisation, despite their non-private nature. While private financial inflows dried up after the crisis, the state essentially stepped in to finance the still chronically deficient balance of payments through the use of novel financial instruments and foreign currency financing. This is illustrated in Figure 41, which depicts the development of the public debt stock in Serbia decomposed into domestic and foreign currency on the left-hand axis in millions of euros and the debt-to-GDP ratio in percent on the right-hand axis.

Figure 41: Serbia – Public debt currency composition



Source: Lane and Milesi-Ferretti (2017); Ministry of Finance of the Republic of Serbia - Public Debt Administration (2020); author's calculation

While other economies in Europe devised major programmes to boost the economy during the GFC, the Serbian government followed a wait-and-see strategy, as evidenced in the rather flat public debt stock between 2008 and 2009. Around the bursting of the crisis in 2008, public sector wages were increased and a trade agreement was concluded with the EU that contained a reduction of import taxes, both leading to structural increases in public debt in the following years (Andrić, Arsić, and Nojković 2016, 50) along with the already discussed pension increase. Other countercyclical measures were not devised, and instead, austerity policies were put into place during 2009 and 2010 in the face of rising fiscal deficits and the conclusion of agreements with the IMF in 2009. These contained the freezing of public sector wage adjustments until the end of 2010 (Andrić, Arsić, and Nojković 2016, 50) and the introduction of a maximum threshold for total public debt of 45% in 2010 (Begović, Marinković, and Paunović 2017, 8; Radonjić, Đurašković, and Radović 2020, 56).

Despite the proclamations by the various governments in favour of debt consolidation, relative public debt gradually increased year on year until 2017, and at the same time the stagnating domestic output contributed to an equally increasing debt-to-GDP level (albeit from low levels during the 2000s). The continuous mounting of public debt also alluded to the fact that from the end of

2010 consolidation efforts were reversed and the government started to conduct more counter-cyclical policies, which even led to the suspension of the IMF's Stand-By Arrangement (Bartlett and Prica 2017a, 836). However, some of the counter-cyclical efforts were directed at spending tax revenue on subsidies and loans to loss-making state-owned enterprises as well as other gifts to secure votes for elections (Bajec 2018, 82). A new government formed in 2012 proclaimed a more liberal agenda but continued to engage in deficit financing in areas that did not to help Serbia get back on track with growth. Adding to this, a local bank scandal, the so-called Agrobanka affair, necessitated the state to bail out four partly state-owned banks for more than EUR 600 million in 2012 (B92 2012; ekapija 2013). Supposedly, the money was embezzled through granting loans to friends and family of local politicians. A 'new'[107] government that was formed in 2014 changed the course of fiscal spending and launched a consolidation programme at the end of 2014, lauded and supported by the IMF from 2015 onwards (Andrić and Minović 2018, 251; Bartlett 2019, 149). The programme entailed a reduction of public sector wages and pensions, which succeeded in lowering the primary fiscal deficit and in finally achieving a surplus in 2017.

While the public debt cycle mirrors that of other especially peripheral European (Bartlett and Prica 2017b) and Western Balkan countries (Bartlett and Prica 2017a), the fact that a large part of this debt was financed in foreign currency and increasingly through marketable securities was specific to Serbia. During much of the 2000s, public debt was also mainly funded in foreign currency, while the debt-to-GDP ratio continuously decreased due to various write-offs by the London and Paris Club of debtors, as well as through the privatisation of state-owned companies (Stojanović and Stanković 2015, 31). This changed after the crisis when the Serbian Ministry of Finance increasingly placed local currency securities in the domestic market and foreign currency securities ('Eurobonds') on global financial markets. According to the Ministry's statistics (Ministry of Finance of the Republic of Serbia - Public Debt Administration 2020) these securities were first issued with short maturities in the form of T-Bills and then from 2011 increasingly with longer maturities of up to 10 years in the form of bonds. In this way, the Ministry of Finance managed to increase the overall maturity of its debt portfolio (International Monetary Fund 2019, 19) and to increase the share of local-currency-denominated government debt, which reduced the susceptibility to exchange rate fluctuations. One of the reasons for changing the mechanics of state financing was the

[107] The Serbian Progressive Party, which had received the highest vote in previous elections, was now led by Aleksandar Vučić and formed a new coalition with a slightly amended party constellation.

relative ease of finding investors on the international bond market as compared to direct investors (Interviewee 18 2021). Another rationale for switching to marketable securities was "[…] *the motivation that we were given was that we don't want to depend on [the] IMF"* (Interviewee 19 2020). The trade-off for the reduced dependency on the IMF was that Serbia had to pay more on its publicly traded securities. One could argue that the shift in the mechanisms of government financing was devised in order to decrease dependency on this multilateral organisation and replace it with increased financing on more anonymous global financial markets alongside with some special deals with China, Russia and Saudi Arabia (Interviewee 15 2020). In this regard, one could contend that Serbia was able to diversify its existing peripheral status towards multiple cores or semi-peripheries.

However, two factors relativise the improvement in the structure of public finance and are relevant in the context of international financialisation. First, during the same time period public debt was also raised in foreign currency, which grew in volume even more than local currency debt, as can be seen in Figure 41. Second, although part of the foreign currency debt was also attracted on the domestic market, the overall share of debt held externally versus internally did not change drastically from 2001 until 2017 (around 60% held by non-resident investors[108]). Thus, while domestic and local currency funding contributed to reducing the effects of international financialisation, it partly obfuscates the fact that the increasing volumes of foreign currency and external public debt heightened Serbia's dependencies on international debt flows and on exchange rate developments, particularly in euros and dollars. Hence, Serbian policymakers fell prey to the 'original sin' (Eichengreen, Hausmann, and Panizza 2005), i.e. indebting the state in foreign currency in the pre- and post-crisis phase. As one interviewee confided, this happened despite the attempts of the central bank to create domestic-currency-denominated securities such as the aforementioned repo operations (Interviewee 21 2021).

In sum, private financial inflows dried up completely in the post-crisis phase and highlight the flipside of international financialisation. The state stepped in through increasingly financing itself on global financial markets and from different multilateral or non-Western government sources. The former was achieved through marketable securities, which now form a prominent part of government debt. However, the overall amount of local currency government debt was increased,

[108] According to the statistics published by the Ministry of Finance of the Republic of Serbia - Public Debt Administration (2020).

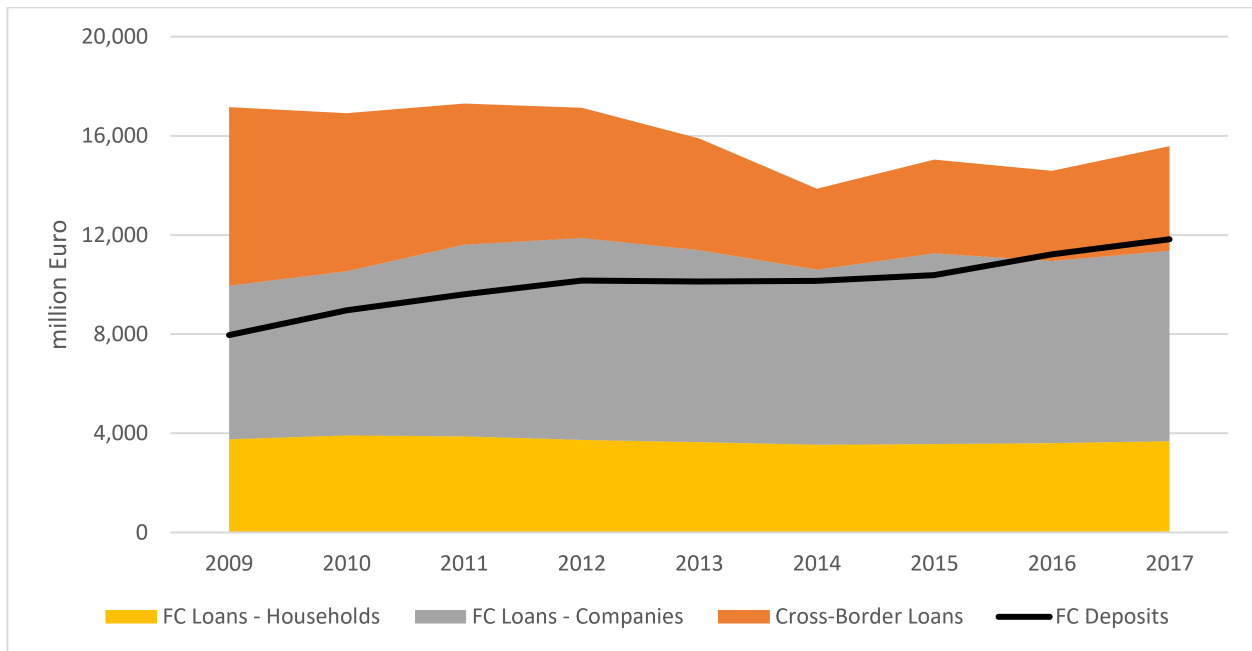
which helped domestic banks to beef up their profit and loss statements. In that sense, one can rather speak of a decrease of or a switch from international financialisation to state financialisation (instead of de-financialisation) (Lagna 2015; Mikuš 2020), since there was no deliberate decision to decrease private financial inflows or to incentivise more long-term foreign investments in productive sectors instead of volatile short-term financial flows. In this regard, the exchange rate policy of the central bank played a crucial role that will be covered in the next sub-section, which deals with the persisting stock of foreign currency company lending.

6.4.2 Foreign currency lending in the post-crisis phase

As detailed in the previous sub-section, public debt sourced from global financial markets replaced private financial inflows in the post-crisis phase. At the same time, banks reduced their foreign funding and simultaneously melted down their cross-border loan portfolio. While this decreased the susceptibility of the economy to these short-term financial inflows, foreign currency lending, our second indicator of international financialisation, remained persistent in the case of the companies, i.e. the real economy. This sub-section takes a closer look at why this type of lending prevailed in company financing despite the fact that it had led to a rise in default cases during the GFC.

Since the GFC, the share of foreign currency lending to companies has oscillated between 70% and 80%, whereas the share of this type of household lending has decreased, which is dealt with in the next sub-section. As section 7.2.4 shows, a crucial point with regard to such lending is the availability of foreign currency deposits in the economy. Figure 42 depicts foreign currency lending to companies (composed of foreign currency loans to NFCs and cross-border loans) and to households as well as foreign currency deposits for the post-crisis phase.

Figure 42: Serbia – Foreign currency lending after the GFC



Source: Federal Reserve Bank of St. Louis (2019); Joint External Debt Hub (2019); National Bank of Serbia (2020c, 2020d, 2020e, 2020g); author's calculation

The figure highlights how the discrepancy between foreign currency deposits and loans was large before the crisis, especially if we consider the massive amount of cross-border loans. After the crisis, cross-border lending decreased until its nadir in 2014. Domestically mediated foreign currency loans increased until 2012 and then started to decrease mildly before stagnating for the remaining years of the analysis. At the same time, foreign currency savings register continuous, albeit moderate growth. Starting in 2016, domestic foreign currency funding exceeds domestic foreign currency lending. This already points to one possible explanation for the persistently high share of foreign currency lending to companies in that there was an increasing amount of domestic foreign currency available that needed to be mediated and disbursed by local banks. This also needs to be seen in the context of generally stagnant credit activity between in 2012 and 2016 (domestic local currency and foreign currency lending) as shown in Figure 36. It was only in 2017 that credit to the real economy returned to the levels of 2011. Thus, one interviewee offered the following explanation as to why banks did not disburse more loans in the local currency, which would have decreased the susceptibility to international financial markets.

> "The banks, when they are basically offering a client a loan in dinars, they're financing this loan from FX-denominated liabilities very frequently. And therefore, this type of loan then in dinars is quite expensive, because they need to put [it] in the[ir] structure, […], they need to put in the risk premium for the FX risk. So, I would say the root of the problem is how to increase dinar-denominated liabilities in the banking system, and then things will be much easier. You can shift these dinar-denominated liabilities then into dinar-denominated assets, which would be more attractive, cheaper, and so on." (Interviewee 17 2020)

The quote unveils another mechanism that contributes to foreign currency lending, which is the more attractive interest rates on these types of loans. These are driven on the one hand by the increased availability of domestic foreign currency but also by the persistently high interest rates on dinars, to which banks would need to add both a foreign exchange risk premium (if they finance a dinar loan with foreign currency deposits) and a domestic currency risk premium.[109] Thus, the financialisation trajectory in Serbia in terms of foreign currency lending needs to be seen in the light of an extremely high domestic availability of foreign currency deposits, which might not be the case in other emerging economies and potentially mitigates the negative effects.[110]

The weak development both of local currency lending and local currency savings was already striking in the pre-GFC period, but it became even more startling in the post-crisis phase, as in 2010 the central bank entered into a dialogue about the topic with a broader audience (Marković 2010). In 2012, the NBS concluded a memorandum of dinarisation of the financial system together with the government (National Bank of Serbia 2012). The dinarisation strategy included a wide range of measures, in terms of both laws and regulations, that primarily banks but also other agents in the financial sector need to adhere to. The memorandum even foresaw the quarterly publication of a report on the status of dinarisation by the central bank and the commitment to the memorandum

[109] Accounting for inflation, country risk, etc. On the dinar risk premium, one interviewee commented that "*[…] this is something that, if you see the members of the government or the parliament, and they look to you like [the] Monty Python show, [this is] how high the risk premium is"* (Interviewee 19 2020).

[110] On the aggregate level, foreign currency deposits in Serbia had finally superseded foreign currency loans in 2017 (National Bank of Serbia 2020j). In comparison to other countries, the availability of foreign currency deposits is comparatively high in Serbia (Chailloux, Ohnsorge, and Vavra, 2), which, together with the high reserves of the central bank, theoretically enable Serbia to repay its debt in foreign currency. However, on the individual level, borrowers might still fail to clear their debt in foreign currency, especially when the exchange rate plummets.

itself was renewed in December 2018 (National Bank of Serbia 2018). A range of arguments discussed in this sub-section are indeed taken up in the publication and followed up with statistics.

Yet while the list of specific regulations is extensive, a brief look at the statistics concerning the share of foreign currency lending to companies reveals that at least in this regard the strategy has not been successful. A former central bank manager who directly participated in the drafting of the document commented that as of today *"[n]othing has been basically done [...][because] there wasn't really at least [a] mid-term initiative on the side of the government institutions to promote this"* (Interviewee 17 2020). The very same sentiment was expressed by a bank manager who opined that "*I do not think they were successful in doing this*" (Interviewee 14 2020). Besides a failure to implement further small-scale incentives and technical changes geared towards the use of local currency (Interviewee 17 2020), another issue raised by the interviewees is the communication of the government (Interviewee 14 2020). In public statements on various issues, the government often refers to euros instead of dinars (e.g. the minimum wage (Interviewee 15 2020)), which conveys the image that even for the government the euro is the reference currency.[111] Also, public advertisements and the prices of various types of products are frequently denominated in euros, which reinforces the omnipresence of foreign currency. Thus, while the government and new management of the central bank profess to be on track with dinarisation, as expressed in their renewed commitment to it (National Bank of Serbia 2018), former central bankers and financial sector actors view this issue more critically. Though the central bank gives the impression of being halfway dedicated to reaching longer-term targets in that direction, the government does not seem to be keen on placing its focus on reducing the dependency on foreign currency movements, as can be discerned from its style of communication and particularly from its will to maintain a stable exchange rate, as the interviewees argued (Interviewee 20 2020).

What influence does the exchange rate have on foreign currency lending? The dinar-euro exchange rate is omnipresent in Serbia as most people receive incomes and make payments in dinars but save in euros. During the post-crisis phase, the exchange rate underwent two developments (National Bank of Serbia 2020g). Between 2008 and 2012 it devaluated by 28% and then stabilised from 2014 onwards, leading one interviewee to comment that "*we don't say that it's fixed, but it's fixed*"

[111] "*So basically the government by itself, when they talk about budgets, when they talk about big money, they always talk about euros. They never talk about dinars. And if they themsel[ves] don't believe and don't trust, the whole thing just makes no sense then*." (Interviewee 21 2021).

(Interviewee 17 2020). The implicit fixing of the exchange rate on the back of meagre financial in- and outflows as well as high central bank reserves led companies to opt for foreign currency lending, as these interest rates were lower and they expected that their repayments would not increase dramatically due to changes in the exchange rate. As one IMF staff member commented, *"[...] Because companies see the dinar as stable, they see euro borrowing as cheap*" (Interviewee 20 2020). So why would the central bank act in a way that stabilises the exchange rate? In order to understand this mechanism, it is vital to recognise that in Serbia the head of the NBS is appointed by the ruling party. Prior to the current reign of the Serbian Progressive Party of Aleksandar Vučić, the central bank was governed by rather unpolitical and more technical experts (Interviewee 19 2020). Since 2012 it has been led by Jorgovanka Tabaković, who is also deputy president of the same party as President Vučić. The influence of the government becomes visible when looking at recent statements by the central bank governor[112], which was confirmed by the interviewees (Interviewee 13 2020). Though such tight connections between the government and the central bank is nothing new, in Serbia the central bank's actions with regard to the exchange rate seem to be subjugated to the policy and aims of the ruling party. "*With this they are keeping social stability*" (Interviewee 14 2020) contended one interviewee. Another interviewee offered the following reasons for a fixed exchange rate:

> "The interests, the main interest of the government is that this fixed exchange rate is very good for them because they're repaying less and less debt in foreign currency with this appreciating exchange rate, it is fixed, not appreciating. […] The other reasons are the importers, which benefit from appreciation. And the importers are tycoons, are people with money […]. So those are the people who really do benefit, the importers and the state." (Interviewee 19 2020)

Importers benefitted from stable or appreciating exchange rates because their purchasing power remained the same. At the same time, they were also close supporters of the regime. The stable exchange rate helped the government to more easily repay debt in foreign currency, which had

[112] "*With the institution that I am heading, we will do our best to ensure that President Vučić has full support in the preservation of Serbia's stability in any sense, including financially, which is both his and our key goal*" (National Bank of Serbia 2020l)

increased in volume in the very same time period, as shown in the previous sub-section. Another interviewee goes even further by making the following argument:

> "The only thing that the political structure in Serbia is now interested in, is to keep the fixed exchange rate, because that is something that the voters prefer. […] if you analyse all of the […] agents in the social system, you can hardly find anyone that has an immediate interest to have a weak currency […] Even the central bank doesn't like depreciation of the currency, because it's much harder to control inflation." (Interviewee 17 2020)

Neither the state nor the importers had an interest in devaluing the currency. As pensions and public wages such as those for doctors were denominated in dinars, these interest groups would also have been against a weaker currency, as prices would have quickly adjusted in that case and "*[…] people are perceiving the movement [of the] exchange rate like inflation*" (Interviewee 17 2020). Thus, another swift devaluation of the currency, as was the case in the GFC, "*can cause a potential government change"* (Interviewee 14 2020). The only two interest groups in favour of a weaker currency in Serbia would have been exporters and, strikingly, the IMF (Interviewee 17 2020; Interviewee 20 2020).[113] One interviewee (Interviewee 15 2020) maintained that although banks would have favoured more local currency lending (probably due to higher yields), a devaluation would have led to a depreciation of the local-currency-denominated equity of foreign-owned banks, so it could hardly be in their interest. Thus, all other domestic interest groups apart from exporters benefitted from the fixed exchange rate, which ultimately fostered foreign currency lending and in the longer run weakened the competitiveness of the Serbian economy as well as reduced the independence and power of the central bank. In sum, this peculiar alliance in favour of a stable exchange rate together with the lower interest rates were the two mechanisms through which foreign currency lending was so persistent in company financing in Serbia in the post-crisis phase. While in the pre-GFC phase, international investors and banking groups drove international financialisation, the post-crisis period exhibited a novel set of interests that indirectly maintained but did not heighten the degree of international financialisation.

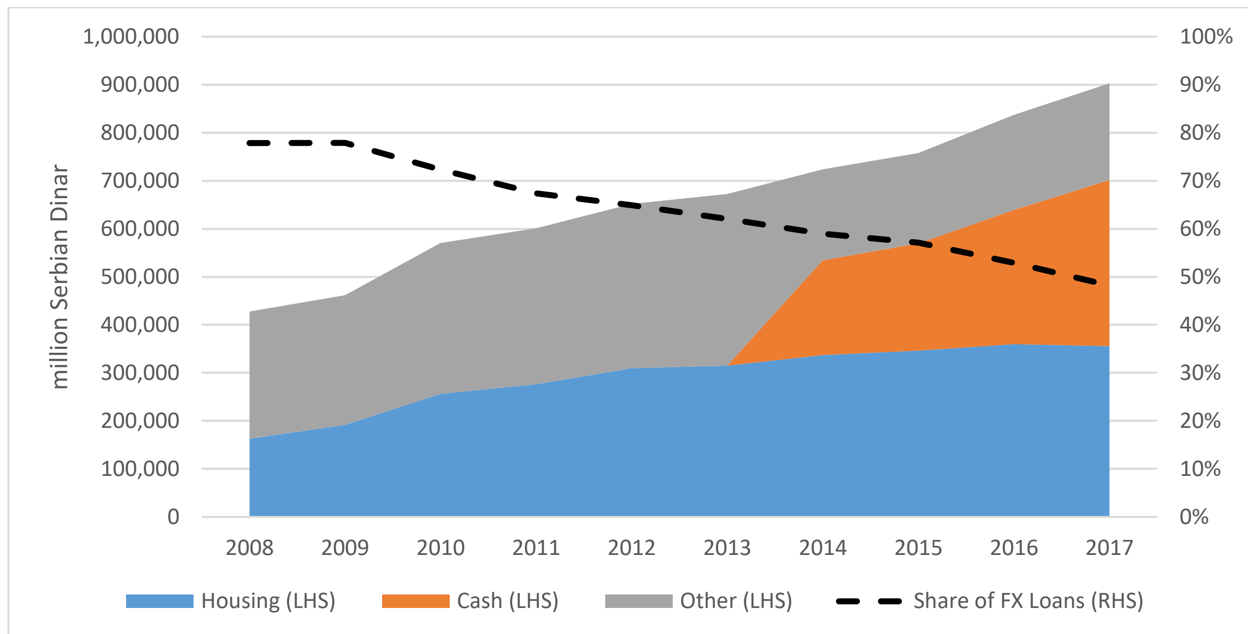
[113] "*The only ones that are sometimes reminding us that we should basically be using more dinars in all aspects in the financial system, is the IMF*." (Interviewee 17 2020).

6.4.3 Stagnation and fast cash loans

Foreign currency lending to companies remained at the same share since the GFC due to a variety of reasons, as elaborated in the previous sub-section. This sub-section scrutinises the development of foreign currency lending to households. The share of this type of lending continuously dropped after the crisis, so one could argue that the degree of international financialisation decreased. To reiterate the questions from the beginning of this chapter, can we detect deliberate political or regulatory decisions that led to a possible de-financialisation or could other explanatory mechanisms account for this?

As the second section of this chapter and the comparison of financialisation in chapter 4 showed, household lending developed at a much more moderate pace in Serbia than in any other country in SEE. In the pre-GFC phase, this was due to a very critical stance towards consumer lending by the central bank governor Radovan Jelašić (Interviewee 19 2020), who also warned against Swiss-franc-denominated mortgage loans (Jelašić and TV Pink 2007). However, as was shown, precisely this type and other foreign currency mortgage loans began to grow at a swift pace until the GFC, marking a striking instance of international financialisation. After the GFC, total loans to households picked up the pace starting in 2010, while at the same time lending to companies stagnated, as shown in the last section. In this regard, Figure 43 summarises the decomposition of household loans in Serbia during the post-crisis phase with the loan categories on the left-hand axis in millions of dinars and the share of foreign currency loans on the right-hand axis denoted in percent.

Figure 43: Serbia – Household loans decomposition



Source: National Bank of Serbia (2020e, 2020f)

The graph illustrates how housing loans increased only gradually after the crisis. As they are almost exclusively disbursed in euros, the increase can to a large extent even be attributed to the depreciating exchange rate of the Serbian dinar to the euro at the beginning of the period. Concurrently, other loans in this category increased. Since the National Bank started recording cash loans in 2014, it is evident that this category contributed the most to the increase in overall loans to households. Given that mortgage loans are mainly disbursed in foreign currency, the decreasing share of foreign currency loans to households can thus be solely attributed to the increase in Serbian dinar-denominated cash loans. Hence, the declining degree of international financialisation with regards to the indicator of foreign currency loans (to households) after the crisis can be explained through a rather constant foreign-currency-denominated mortgage loan stock and at the same time through increasing local currency consumer loans. In order to understand the decreasing degree of international financialisation, the driving forces behind the increase in cash loans and the reasons why foreign currency mortgage loans did not resume the level of growth they enjoyed in the pre-GFC phase need to be further investigated.

According to the interviewees, the key to understanding both the increase in Serbian dinar-denominated cash loans and the rather stagnating foreign-currency-denominated mortgage lending are the regulations that followed the dinarisation strategy (Interviewee 13 2020; Interviewee 14 2020). In

2011, a newly enacted regulation allowed foreign-currency-denominated lending to households with a down payment of only 30% of the loan amount, while the maximum loan-to-value (LTV) ratio was set at 80% (Dimova, Kongsamut, and Vandenbussche 2016, 81). With regard to lending to households, this made Serbian dinar-denominated loans more attractive than foreign currency lending. While prior to the crisis tight regulations to protect households against indebtedness existed, "*after the crisis, this regulation was liberalised, we [no longer had a] limit of debt to payment capacity*" (Interviewee 13 2020). Furthermore, during the GFC, the limit on the maximum ratio of household lending to equity of banks (which was set at 150%) was cancelled (Dimova, Kongsamut, and Vandenbussche 2016, 80), freeing up funds for retail lending. Hence, both currency- and household-lending-related regulations were modified in a way that made them conducive to Serbian dinar consumer lending (but not mortgage loans). As banks still had to grapple with the unresolved high share of NPLs in the corporate sector and were not willing to engage further in that area of lending, dinar-denominated loans seemed to be a vital option for "*banks […] looking for profit. They see opportunity, especially now with the very stable currency that you can even lend in dinars*" (Interviewee 15 2020). On why the regulations were released in this direction, a bank manager commented, "*I think it was pushed by banks […] and [the] central bank felt relaxed*" (Interviewee 13 2020). Contrary to the corporate sector, where companies chose foreign currency loans for their longer-term investments due to the low interest rate and stable currency, for households it was quite the opposite, as they received their incomes almost exclusively in dinars and were ready to accept a higher interest rate for shorter maturity loans, which was aided by the high speed of credit decision-making.

> "But I think the horizon of these loans is such that nobody's really seeing any dangers of the currency sliding into devaluation or anything else and there is no risk of that contracting. […] Yeah, because of the short term. Wherever there is a long-term consideration, for example the housing loans for the citizens, it is always euro-denominated and tends to be with a foreign exchange clause." (Interviewee 16 2020)

This quote by a manager of an auditing company in Serbia summarises how the government's exchange rate policy (explained in the previous sub-section) aided banks in their decision to engage in these fast cash Serbian dinar-denominated loans. At a time when austerity policies were in place, regulations on consumer lending were thus loosened for the banking sector by the National Bank

of Serbia, thereby breaking with the pre-crisis stance. As for why the central bank released the brakes on household lending, one interviewee contended that "*They [central bank] also wanted to boost […] consumption*" (Interviewee 13 2020). At the same time, this came in handy for the Vučić government as a means to stimulate consumer spending during a time of generally stagnant economic activity (Interviewee 15 2020).[114] In sum, international financialisation decreased partly due to deliberate decisions to limit foreign currency lending, but also due to relaxations of regulations on consumer lending and an accommodating stance on the part of the central bank and government in this regard. The trade-off for the decrease of international financialisation was thus an increase in household financialisation, which was, however, not very pronounced (as described in chapter 4.1), at least compared with other countries in the sample. Nonetheless, the decreasing degree of international financialisation can in part be attributed to considerations at the central bank (dinarisation strategy) about the susceptibility of foreign currency lending to sudden movements on global financial markets and exchange rates (Interviewee 17 2020).

[114] Though it is beyond the temporal scope of this thesis, the central bank enacted tighter regulations on consumer loans in 2019 (Interviewee 14 2020).

6.5 Chapter summary

This case study revealed how up to the GFC, foreign funding and currency as well as cross-border loans and repos contributed to the trajectory of international financialisation in Serbia. Thereafter, government debt financing surged and household indebtedness increased, while at the same time the degree of international financialisation decreased. The corporate sector suffered greatly from the fallout of the GFC and remains financially strongly dependent on exchange rate movements. In the first section of this chapter, it was argued that certain roots of financialisation could already be found in the SFRY. The use of foreign currency began with the introduction of 'gastarbeiter' deposit accounts in the 1960s. Although they initially served as a means to receive hard currency to settle capital import liabilities, these types of deposits were subsequently made available for the whole population at the same conditions as local currency accounts. This 'primal sin' (as it was termed by one of the interviewees) would subsequently contribute heavily to the demise of the Socialist Federation, as banks were increasingly faced with balance sheet mismatches that were aggravated through their borrowings on global financial markets in foreign currency and unsustainable domestic lending activities. The peripheral position of the SFRY was heralded by the continuous receipt of loans from the IMF and other Western financial institutions which ultimately kept the dysfunctional system alive, and by the forced enactment of structural adjustment programmes in the 1980s before its ultimate dissolution at the end of that decade.

During the Milošević regime financial inflows obviously ceased but the use of foreign currency was further entrenched due to hyperinflation and domestic bank scandals. After the changes at the beginning of the century, the financial system was overhauled by closing the four largest banks and by privatising the remaining financial institutions. In these operations, foreign buyers were clearly favoured over domestic ones based on the argument that Serbia lacked the necessary deposits to fund future development. The affiliates of Western banking groups that entered the market were hungry for growth and financed it with funding from their headquarters, which explains the early international financialisation in Serbia. As this was not enough, in the middle of the 2000s they commenced with cross-border lending, which grew at the same pace as domestic lending. Together with the practice of external lending through an SPV, these two methods also constituted handy tools to circumvent the newly enacted central bank regulation to tame the credit surge. The most striking instance of international financialisation was revealed in repo practices that started around

2005, which provided a low-risk, high-yield opportunity for banks and foreign investors. The massive amount of foreign finance arriving in the country was welcomed by domestic politicians, either motivated by the financial development narrative or simply by the prospect of positive voter turnout in the next election. Foreign currency lending became widespread throughout the company and household segments in Serbia, which was shown to have the highest level of this penetration across SEE. Several factors were revealed to have contributed to it, including the presence of foreign banks, longer-term savings exclusively in foreign currency, the relatively stable exchange rate and lower interest rates. Adding to this, the issue was not treated in a serious way by either the government or the central bank, which meant that nothing stood in the way of the increasing degree of international financialisation. Swiss francs disbursed for mortgage loans proved to be even more disastrous for domestic house owners due to the well-known exchange rate dynamics that unfolded later, as was the case in other Eastern European countries.

The GFC hit Serbia with some time lag but then effected a longer period of stagnation characterised by sluggish growth and a high share of corporate non-performing loans. Though a complete run on the banking system could be averted, the sudden depreciation of the dinar caused a number of debtors to default on their loan repayments due to foreign currency clauses. The Vienna Initiative orchestrated by international financial institutions and banking groups managed to restore trust in the local affiliates, including in Serbia, but failed to spur lending in times of crisis. Instead of cleaning up the books and injecting fresh capital into the economy, banks relied on income from increasing government bond portfolios to keep their profitability levels afloat. Together with the Vienna Initiative and IMF Stand-By Arrangements, Serbia had to enact austerity policies with little room for manoeuvre as funds were squandered on unsustainable pension increases to secure votes for elections. The GFC brought the downside of continuous and substantial reliance on foreign funds and currency to the fore and cemented the peripheral financialisation of Serbia.

The period after the crisis was marked by a decreasing degree of international financialisation as public financial inflows replaced private financial inflows. Increasingly, government debt was financed through the issuance of marketable securities in both local and foreign currency to domestic banks and international investors. While this increased their incomes, the evolving autonomous state financing reduced the dependency on the IMF with the aid of a series of deals with various non-Western states. In that sense, financial inflows substituted for financialisation of the state. Foreign currency lending in the corporate realm persisted throughout the post-crisis period as euros

were amply available and interest rates were much more favourable for such loans. The stable exchange rate contributed to this development, which was achieved by way of interventions undertaken by the central bank. The ruling party pressed for this strategy to preserve social peace, knowing that it would be favoured by the various interest groups in the country, including civil servants, pensioners, and tycoon importers. With regard to household lending, foreign currency loans decreased continuously due to the dinarisation strategy issued by the central bank. The paper entailed a range of regulations favouring the use of local currency. According to the interviewees, however, the current ruling government and the new central bank governor have done little to promote the use of the domestic currency as a store of value or unit of account. Still, foreign currency loans decreased due to the related amendments in regulations for banks, which rendered short-term consumer loans a profitable area of investment. Chapter 4 revealed that household indebtedness in Serbia increased to a moderate extent compared to other countries, but one could still argue that international financialisation was exchanged for household financialisation.

Besides providing a detailed description of the trajectory of international financialisation, this case study on Serbia confirmed a range of explanatory mechanisms leading to it (described in chapter 3) and identified other, mostly domestic factors. The liberalisation of the capital and financial account following the regime change obviously made it possible in the first place to receive such a high influx of foreign finance. Despite the fact that the flows in and out of the country were meticulously registered by the central bank, the sheer magnitude, at times over 20% of GDP, makes it difficult to understand why the regulator and policy-makers did not undertake further steps to reduce or moderate the reliance on and growing interconnectedness with global finance. Certainly, the influence of international financial institutions and foreign banks played a role in this regard and contributed to a general positive sentiment with regard to Washington Consensus policies, the financial development narrative and unabated growth. While the central bank might have averted a more extreme development, domestic politicians capitalised on the trajectory in order to gain the laurels for the short-lived and at times artificial growth. Certain domestic subsidy projects also contributed to the propagation of foreign currency lending, such as the national mortgage insurance scheme.

At the same time, the exchange rate policy of the central bank proved to be conducive both for financial inflows and foreign currency lending. The desired stability in light of bad historical memories not only reduced the competitiveness of Serbian exports but also secured the value of the

foreign financial inflows as well as reassured borrowers about their foreign currency exposure. High interest rates on the local currencies made their foreign currency counterparts even more attractive. The repo facilities devised by the central bank similar to those in other Eastern European countries to sterilise inflows produced the opposite result, highlighting how the central bank's desire to maintain price stability dwarfed any concern about huge public losses. This type of inflow further deepened the peripherality of the Serbian economy. Contrary to the expectations, corporates seldom issued bonds on global financial markets and mainly engaged in cross-border lending. Specific tax reforms that would favour the trajectory of international financialisation were likewise not identified. Also, it should be maintained that the influence of global finance and international financial institutions was revealed to be less pronounced in Serbia than is probably the case in other countries. This results from nationalism rather than a specific agenda for productive, real economy growth as well as from the pervasiveness of domestic tycoons in Serbia's 'wild capitalism' (Upchurch and Marinković 2011b).

The literature reviewed here underscores the fact that Serbia is not novel territory for financialisation research, yet certain gaps were identified. With regard to the roots of international financialisation in Serbia, Becker et al. (2010, 237) mention the abundance of liquidity provided by the Western world to the SFRY, funds that were gratefully received by Serbian enterprises via banks in the form of foreign currency loans according to Živković (2017, 122). This certainly instituted the peripherality of the Socialist Federation, but both accounts fail to highlight the importance of the problematic creation of foreign currency deposits first for workers abroad and then for every citizen at the same interest rates as local currency, thereby producing the original currency mismatch. The unproductive use of foreign currency borrowings in the SFRY likewise remains unmentioned, which has contributed to the meagre competitiveness of Yugoslav products and to sluggish capital investments, leading to failing receipts of foreign currency through export.

The institutional set-up of the financial sector (foreign banks) and growth model (consumption and imports) built on peripheral financialisation is sketchily described in Ćetković (2011, 21), Bartlett and Prica (2017b, 127) and Becker et al. (2010, 237). Yet all three fail to point out how foreign institutions were openly invited into the country because the population's trust in the domestic financial sector was shattered, and hence how it served as a fix for the structural problem of society's distrust. The decisive role of monetary policy in safeguarding the exchange rate and reducing inflation is rightly acknowledged as one of the key explanatory mechanisms leading to peripheral

financialisation in the four relevant publications. Besides the overt benefit for foreign finance, this chapter has demonstrated how this was also motivated domestically, both before and after the crisis. Moreover, this case study has elucidated the motives behind cross-border lending and foreign currency lending in general, highlighting the conducive role of national politics and institutions. The peculiar practice of repo operations that was exposed by Gabor (2013) for the case of Romania was pinpointed as one of the striking instances of peripheral financialisation in Serbia as well and is completely novel to the study on financialisation in Serbia, as are the considerations for the post-crisis period.

Contrary to the expectations voiced by Becker et al. (2010, 242) that the crisis might lead to the promotion of peripheral financialisation, the fourth section of this chapter exposed a decreasing degree of international financialisation after the GFC, which was traded for state financialisation and household financialisation. Hence, the expectations can be rejected in hindsight. Certainly, the evolving nationalism and autocratic rule in Serbia in the second decade of the 21st century contributed to the reduced dependence on foreign finance and on the IMF, but democracy lost out. Viewing it from the opposite angle, the high degree of international financialisation in the run-up to the GFC had brought about vulnerabilities for the country, which then materialised in negative effects during the GFC. The resulting negative sentiments continued to reverberate in the post-GFC phase, causing similar resentments as in Poland and in Hungary. Yet the new arrangements of the ruling elite, coupled with state financialisation, again appear to be a temporal fix for the chronic, structural problems of de-industrialisation, low competitiveness, inequality and clientelist market structures.

7 Case study: Household and NFC financialisation in Croatia

As outlined in chapter 4, Croatia exhibited the most extreme degree of financialisation among households and NFCs across SEE. Hence, this chapter deals with analysing the trajectory and explanatory mechanisms of both cases from the turn of the century until 2017.[115] As argued in section 3.5, household financialisation, understood as indebtedness, is considered to be primarily driven by depressed wages, inequality and an increasing retail focus on the part of banks, which is aided when a central bank pursues a policy of price stability and when novel automated credit scoring techniques are applied. The erosion of the welfare state, especially the pension system and other forms of social provisioning, leads to an increase of financial assets in households, essentially turning everyone into a financial investor regardless of their degree of financial literacy, while such assets are subject to the volatility of global financial markets.

In turn, the financialisation of NFCs can be chiefly explained through an increasing focus on short-term shareholder value maximisation and through policies that ease the requirements for accessing finance on open or international financial markets as opposed to the traditional bank lending channel. Adding to this, NFCs are increasingly listing themselves on stock markets to tap into the large pool of institutional investors, which tends to control companies through the use of performance-based salary schemes. Furthermore, NFCs are deriving more and more of their income from financial sources, which is coupled with declining capital investments and slowing innovation. Figure 44 summarises the trajectory on both levels of financialisation in Croatia, depicting the indicators of debt to income (of households) and stock market capitalisation to GDP (for NFCs) that were used in the comparison in chapter 4.

[115] In contrast to the other case studies, it was not possible for the author to conduct interviews and field trips due to the corona pandemic.

Figure 44: Croatia – Household and NFC financialisation

Source: Eurostat (2019d); World Bank (2019b)

Household indebtedness in Croatia started with already comparatively high values in 2002 and then doubled to 60% until the GFC in 2008. Thereafter, the degree of household financialisation remained stable and started to decrease in 2015. Why was household indebtedness already high at the turn of the century? How did it increase so quickly up until the GFC struck, and what were the mechanisms behind it? What were the reasons for the stagnating degree of financialisation after the GFC and for the decrease observed in the last years of analysis?

The development of NFC financialisation has been far more cyclical than that of households. Commencing at already moderate levels, it did not start surging heavily until 2005 up to 2008. Then, stock market capitalisation decreased at an equally rapid pace, but remained at an elevated level after the GFC, one that was significantly higher than that of surrounding countries. What were the drivers behind the increasing degree of financialisation? Why did it fall so dramatically after the crisis? Even if we attribute the spike to stock market hysteresis, why did its capitalisation remain at a much more elevated level than before the build-up of the crisis? Had there been a structural change towards market-based finance, and if so, what were the reasons for it?

To answer these questions, it is necessary to take a deeper look at the trajectory of each indicator of financialisation. As for household financialisation, the intricate types of debt as well as the regulatory and political environment need to be studied in more detail next to the relevant financial

intermediaries. The same holds for the company level, which requires an inquiry into the institutional evolution of the stock market, the main participants and the political environment. Based on an assessment of a more fine-grained statistical analysis, the relevant actors and the political economic background, it becomes possible to scrutinise the main explanatory mechanisms and corroborate them with the ones that were laid out in chapter 3. To achieve this objective, however, it is necessary to revisit the history of Croatia, which once formed part of the Socialist Federal Republic of Yugoslavia but then relatively quickly exited the federation at the beginning of the 1990s.

Chapter 1 summarised the existing publications on financialisation in Croatia. These studies cover the overall political economy with emphasis on household financialisation (Rodik and Zitko 2015) and Swiss franc lending (Rodik 2015), state financialisation (Mikuš 2019b, 2020) and household financialisation from an anthropological perspective (Mikuš 2019a). This chapter does not attempt to replicate the existing scholarship, but instead follows the concept laid out in chapter 3, making use of the findings in the existing publications when suitable and adding to the findings from these publications. In particular, it was shown that the studies failed to apply a coherent concept of financialisation and do not cover the period after the GFC. Furthermore, the issue of the financialisation of NFCs was not researched in these publications.

To fill this gap, section 7.1 contextualises household and company financialisation historically and institutionally by reviewing the SFRY era and the early years of independence in the 1990s. In particular, the Croatian banking system crisis, in which the state stepped in and saved ailing banks, is identified as a key historical event that would shape the later trajectory of financialisation. Section 7.2 deals with the pre-GFC trajectory of financialisation. After a brief review of the institutional setting of the financial sector, the processes and explanatory mechanisms of household financialisation are identified. The analysis distinguishes between the forms of debt, social classes of debtors, inequality and lastly financial assets in the form of privatised pensions on the basis of the conceptual elaborations from chapter 3. The section then delves more deeply into the emergence and development of the stock market in Croatia and finds that state policies played an instrumental role in the financialisation of NFCs. It then analyses corporate financialisation by investigating the activities, assets and debt strategies of Croatian enterprises. Section 7.3 sheds light on the repercussions of the GFC in Croatia, especially those that were caused or exacerbated by the financialisation of households and companies. Section 7.4 analyses the post-crisis trajectory and finds that both levels of financialisation saw a decrease, which was partly driven by the fact

that economic stagnation and corporate defaults were already looming. Only privatised pensions proliferated and mark a special case of the financialisation of households. The last section summarises the findings and contrasts them with the respective literature.

7.1 Starting point: NFC and household financialisation in historical perspective

This section discusses the starting point of our analysis and puts it into its historical-institutional context. Both forms of financialisation already exhibited elevated degrees at the turn of the century that proved to be higher than those of other countries in SEE. Stock market capitalisation stood at around 10% of GDP and the debt-to-income ratio already hovered around 30%. Are we able to detect any processes of financialisation prior to the 21st century? Were there specific explanatory mechanisms either leading to or conducive to the financialisation trajectory? This section shows that hardly any mechanisms set in motion during the SFRY era can explain the trajectory of financialisation on both levels, while during the 1990s the privatisation of companies and the liberalisation of the pension system contributed to the ensuing financialisation of NFCs. At the same time, the seeds for the subsequent consumer lending spree were sown by an unsustainable banking sector.

The market economy and financial sector played a much greater role in the SFRY, of which Croatia was a part, than in other former socialist or communist states in Eastern Europe. Section 6.1.1 provided a summary of the political economy of the SFRY and laid bare the infiltration of foreign currency in the region. The country's financial system can be characterised as bank- and federation-based. There were a few instances of bonds or promissory notes issued by corporations, but these proved to be a means of raising funds to cover up unsustainable business activities. Also, foreign currency bonds were issued locally at attractive interest rates and served to secure jobs in the issuing enterprise for the investors (Baučić 1976, 95). Stock markets were not active and companies mainly resorted to banks or other companies for financing apart from these few instances of debt issuance.

Households during this era mainly engaged with financial institutions in order to save or conduct transactions. Loans for housing were seldom disbursed and came with extremely low or even negative interest rates. At the same time, interest rates on savings were onerous if they were held in foreign currency. The introduction of foreign currency accounts and their subsequent availability to the public laid the foundation for the pervasiveness of foreign currency in the republics of Yugoslavia. Likewise, borrowing in foreign currency by (regional) banks during the 1970s and 1980s

was as widespread in Serbia as it was in Croatia. The appropriated foreign currency (deposits) by the National Bank of Yugoslavia in Belgrade during the SFRY would become the object of struggle after Croatia declared independence, as they were not reimbursed and dubbed 'frozen foreign savings deposits' (Barisitz 2000, 101; Čučković 1995, 78).

In sum, we can hardly detect any kind of mechanisms in the SFRY era that would aid in explaining the trajectory of the levels of financialisation in Croatia during the 21st century apart from the issue of foreign currency. The next two sections take a more in-depth look at possible explanatory mechanisms during the 1990s. This decade was characterised by the autocratic rule of Tudjman and the widespread crony capitalist system that was built up in Croatia, which burdened the public debt and welfare system. The second sub-section in this starting point analysis deals with the Croatian banking crisis in 1998, which proved to be a turning point for the country in that it foreshadowed a change of political rule and the privatisation of the financial system to foreign investors.

7.1.1 Gradual transition and the Tudjman rule

This section describes the political economy of Croatia at the beginning of the 1990s in light of the dissolution of the socialist system. The depiction of the transition process provides the background for the analysis of mechanisms for the emerging financialisation, with special reference to the topics of privatisation policies and government rescue packages for the financial sector. With regard to the dissolution of the SFRY, the Croatian independence efforts around 1990 were preceded not only by the so-called 'anti-bureaucratic reform', similar to the other republics, but also by a domestic democratic revolution stemming from liberal intellectuals that sped up the transition process around 1990 (Kasapović 2007, 453). Adding to this, Croatia already featured a market economy with worker's self-management of firms and significant devolution of power. Hence, the country was already on the verge of adopting capitalism and democracy at the end of the 1980s, which – on a side note – leads Bohle and Greskovits (2012, 194) to speak of Croatia as an '*originally capable state'*.

In the political realm, the first free multi-party elections in Croatia were held in 1990, out of which a nationalist anti-communist party, the Croatian Democratic Union (HDZ), came to power. The other relevant parties included the Croatian Social Liberal Party (HSLS) and the League of Communists (SDP) (Bartlett 2004, 33–35), both of which were to become more important later on, when the majority of the HDZ dissolved. Subsequently, Croatia declared independence in 1991

under stark protest from the Serbs (Clewing and Schmitt 2011, 742). The first years under President Franjo Tudjman, who was to become the dominant political figure in Croatia for at least ten years, were increasingly characterised by a nationalist tone and mobilisation, the so-called 'ethnic collectivism' (Bideleux and Jeffries 2006, 230). The struggle quickly escalated into a regional war, which lasted until 1995.[116] With regard to the transition process, Tudjman's reign was notable in its attempt to completely wipe out communism (Kasapović 2007, 454), which leads some authors to claim that the elites were replaced entirely (Clewing and Schmitt 2011, 755). On the other hand, the new government was in dire need of administrative resources, which implied new jobs in the old workplace for many bureaucrats of the old regime (Kasapović 2007, 454). The overarching theme of the Tudjman era, however, was to form and foster national identity and reconciliation, leading to a benign number of prosecutions for former deeds. Nevertheless, during the second half of the 1990s, the young democracy developed further into an autocratic regime under Tudjman. Public protest was heavily suppressed and the enrichment of peers started to become the norm (Crampton 2002, 290). This even led to a pariah status for the country from 1997 to 1999 until Tudjman died (Bideleux and Jeffries 2006, 208). Although the elections held during that time were essentially free, the ruling HDZ managed to keep its majority throughout the 1990s, also by means of granting voting rights to Croats living outside of the country, a special gift to the separatist Croats living in Bosnia, the majority of whom voted for the HDZ (Kasapović 2007, 456). The death of Franjo Tudjman just before the elections in late 1999 heralded the dawn of a political change that was preceded by several contributing developments, mainly in the economic realm.

In terms of economic development, Croatia was grappling with recession and inflation in the early 1990s, which reached astronomically high figures. Output fell by more than one third in the early years of independence (Bartlett 2004, 89) and inequality surged (Bičanić and Franičević 2003, 20). Inflation was caused by the central bank, which bought up the foreign reserves of citizens and enterprises by issuing new money (Bartlett 2004, 92). (The Croatian National Bank (HNB) was in dire need of hard currency due to the seizure of foreign currency by the Yugoslav central bank.) Although a new currency, the dinar, was introduced after the declaration of independence, inflation

[116] In comparison to Bosnia, Croatia did not suffer that much in terms of war damage, but actually benefitted significantly with respect to territory, securing the whole Adriatic coastline except for the Bosnian enclave of Neum (Clewing and Schmitt 2011, 755). During the war, the Croatian government supported the Croatian separatists in Bosnia and heavily engaged in its own ethnic cleansing operations against the Serb minority (Bideleux and Jeffries 2006, 208). When peace was restored, Croatia was admitted to the Council of Europe in 1996, a first step towards its accession to Europe, which was to become a dominant theme in Croatian politics and international relations.

was only tamed after the currency was renamed 'kuna', establishing a managed float and subsequently pegging it to the deutschmark (Bideleux and Jeffries 2006, 213).[117] Alongside achieving price and exchange rate stability, the government enacted stabilisation policies in the same year of 1993, backed by the IMF, which aided the authoritarian government with support and loans (Bičanić and Franičević 2003, 23). Economic stability and the steady – even appreciating – exchange rate produced growth in the following years in conjunction with decreasing competitiveness, low exports and surging imports. Hence, a difficult transition process, along with nationalism, the introduction of a fixed exchange rate regime and an import- and consumption-oriented growth model, and reliance on receipts from tourism (Bohle and Greskovits 2012, 207) constitute the main hallmarks of the political economy of Croatia during the 1990s that were to be carried forward into the 21st century.

Turning to the level of NFCs, the privatisation process of companies in Croatia was not undertaken through one consistent process, but can rather be described as '*hybrid*' and full of '*compromises*' (Franičević 1999, 8). While the actions of the responsible institutions and politicians might have been well intended, reality would prove them wrong (Bičanić 2001, 162). Privatised firms often landed in the hands of domestic tycoons or the Tudjman family (Bideleux and Jeffries 2006, 215), leading the relevant literature to label Croatia as a country steeped in 'crony' (Bičanić and Franičević 2003, 11) or 'political capitalism' (Cvijanović and Redžepagić 2011). When companies failed to privatise or were bankrupted, they were taken over by the state or by one of the larger banks, which were themselves owned by the state. This leads Franičević and Kraft (1997, 675) to speak of an 'étatisation', as in the middle of the 1990s more firms were state-owned than during the SFRY era. Lovrinović, Primorac, and Lovrinović (2016, 162) illustrate the corrupted privatisation process by noting that the supervisory board of the privatisation fund held only one meeting in six years, which casts doubt on the accountability of the institution. Thus, despite the comparatively fast privatisation process and the simultaneous founding of a large number of new firms, the microeconomy became largely dominated by loss-making state corporations and those of the peers of the ruling party under Tudjman. Most of the firms were privatised by virtue of being listed on the stock market and were then either acquired by new shareholders, banks, the state or the public privatisation fund. This specific mechanism of privatisation for companies explains why Croatia

[117] The nationalistic tone of the government once again comes to the fore here, since 'kuna' was also the name of the currency introduced by the Nazi-allied fascist Ustaša movement in 1940s Croatia.

started at comparatively higher values of company financialisation than other countries in the region. However, the increased market capitalisation during the 1990s did not foreshadow the ascent of shareholder value capitalism in Croatia nor a shift towards a market-based financial system, but was a mechanism to organise the disentanglement of formerly socially owned enterprises.

7.1.2 The banking crisis of 1998 and end of the Tudjman reign

Reconstruction, investment and consumption led to a period of sustained growth from 1995 to 1997, which was heralded as an economic wonder and improved the international recognition of Croatia. However, the achieved growth partly rested on the consumption of goods that were imported, which, given a liberalised trade policy, increasingly worsened the country's balance of trade position (Bartlett 2004, 102). The accumulated profit was short-lived since it derived largely from tycoons who engaged in asset-stripping and short-term deals instead of investing in productivity-enhancing assets (Bartlett 2004, 110). Simultaneously, in 1997 a banking crisis produced by extremely high levels of non-performing loans was on the way. Indeed, more than half of the assets of the banking sector had already been non-earning in the middle of the 1990s (Franičević and Kraft 1997, 680). Over the years, in fact, the state had already spent USD 7 billion on the rehabilitation of loans. The costs derived, among other sources, from two government bond issues launched in the early 1990s to save a series of banks (Šonje and Vujčić 1999, 10) and from a round of bail-outs in 1994 that was conducted with the help of loans from the World Bank (Bartlett 2004, 115).

Contrary to expectations, lending to loss-making companies continued and lending to households increased, whereas it was not reallocated to incumbent firms (Kraft and Jankov 2005, 107–11). In 1998 and 1999, a large part of the debt stock finally turned sour. This triggered a series of collapses of small and medium-sized banks in the country. In the process, the central bank's supervisory power was enhanced, enabling it to subsequently close some banks (Jovančević 2002, 255) and enforce their sale to international investors later on. The total cost of the rescue packages to the banking system is estimated at around 30% of GDP (Bičanić 2001, 172; Jankov 2000, 17), making Croatia's banking crisis one of the most expensive in recent history (Šonje and Vujčić 1999, 11). The continuous aid furnished by the state to the banking sector explains why the degree of household financialisation was already at higher values at the turn of the century than in the other countries in the region. The packages enabled the banks to stall recognising their losses on, and writing off, their defaulted consumer loans, and allowed them to continue disbursing such loans. Most

other countries were equally shaken by the financial crisis during and at the end of the 1990s, which in most cases wiped out banking assets. Croatia proved different in this regard due to the continuous support it received from the government at the expense of mounting public debt.

The banking and ensuing balance of payments crisis caused the economy to shrink for the first time since the war. Together with the death of Tudjman just prior to the parliamentary elections of 1999, this caused public opinion vis-à-vis the government to sour. While the economic crisis was the trigger, long-term structural factors for this radical change include, among other elements, the mounting inequality and aspirations to shift towards modernity at the expense of traditionalism and towards less polarisation of centre-periphery relations within the country. The high voter turnout marked a victory for the centre-left coalition led by the HLSL and the SDP under the leadership of Ivica Račan (Kasapović 2007, 458). The subsequent presidential election was won by the opposition, leaving the HDZ with nothing after more than ten years of rule. The six-party coalition embarked on a path of structural legislative changes, including constitutional changes regarding elections and a reduction of the powers of the president (Bartlett 2004, 59), the autonomy of the provinces and an overhaul of the executive forces. Croatia's pariah status was ended due to the forceful declaration of termination of support for the Bosnian HDZ. The regime change and the victory of reformist forces altered the country's relationship to the EU and other Western institutions, which was underlined by public opinion clearly favouring this direction. The year 2000 thus marks a structural break in the political economy of Croatia and justifies the choice of the starting point of analysis. Struggles over the issue of war criminals paralysed some of the new government's reforms, especially with regard to reducing the public sector, tackling unemployment and increasing the productivity of the Croatian economy (Bartlett 2004, 61). With respect to the latter issue, opinions within the coalition diverged between devaluation and cutting taxes (Bartlett 2004, 119), while the banking sector was largely privatised by 2001 and the majority of financial institutions were acquired by foreign banks by 2003 (Bideleux and Jeffries 2006, 229).

The unsuccessful attempt at economic recovery coupled with political struggles led to parliamentary elections in 2003, which were won by the reformed HDZ, leading a minority government. These and subsequent political changes in the government occurred while general stability prevailed, with nationalism featuring much less prominently than before (Clewing and Schmitt 2011, 757). While Tudjman's rule prevented Croatia from rapidly evolving into a full-functioning democracy, the post-Tudjman era was strongly characterised by the will of the public to accede to the

EU as quickly as possible, but also by recurring corruption scandals (Ramet 2010a, 270). As such, Croatia stands out with regard to the intensity of its desire to move towards the EU compared to its neighbours.

7.1.3 Interim summary

The analysis of the starting point revealed that only a few of the mechanisms set in motion during the SFRY and in the 1990s aid in explaining the trajectory of household and NFC financialisation. The introduction of foreign currency accounts in the SFRY planted the seeds for the high share of foreign currency loans in the 21st century, which is a specific characteristic of Croatian household financialisation. Housing loans existed in the SFRY, but they formed only a small part of the overall credit activity of banks, as most people were living in socially owned houses. The apartments and houses were handed over or sold for little money to the tenants during the transformation, which explains the high home-ownership ratio not only in Croatia but in Eastern Europe in general. With regard to NFCs, the analysis exposed that there were a couple of bond issues by socialist companies, but these merely served personal interests and thus constituted neither a turn towards market-based financing nor a shift towards other financialised practices.

During the 1990s, former socialist firms often landed in the hands of either tycoons, banks or the state. This contributed to the volume of privatisations through the stock market, the preferred means of ownership transferral by the state, which also owned the majority of banks. This specific type of transition policy in Croatia explains the increasing degree of NFC financialisation and comparatively high starting point. A liberal licensing regime and the generally lax oversight by the central bank enabled buoyant credit granting to loss-making companies by banks, which perpetuated unsustainable and corrupt corporate practices. The government chose to bail out such banks at several points in time during the 1990s, which led to mounting government expenses. Due to the overall liberal stance of regulation in the banking sector, household lending likewise commenced and flourished early on in Croatia. A great many banks were saved in the latest banking crisis of 1998 and 1999, which explains the high degree of household financialisation at the starting point of the analysis, as they did not have to write off their already sizeable defaulted consumer loan portfolio and could continue to disburse this type of loans.

7.2 Croatia's pre-crisis financialisation trajectory

This section analyses the trajectory of household and NFC financialisation from the turn of the century until the GFC, drawing on the elaborations of the previous section. The set-up and evolution of the financial sector discussed in the first sub-section serves as a further basis for the evaluation of financialisation on both levels. Specifically, it reveals certain conducive drivers of bank behaviour, such as a diverted focus of domestic banks on household lending due to cross-border lending to NFCs as well as to regulatory efforts to curb lending.

Household financialisation is scrutinised from the liability and asset side in sections 7.2.2 and section 7.2.3, respectively. On the liability side, indebtedness increased first for more affluent households, while financial institutions later trained their sights on lower-income households given the banks' high risk and growth appetite. Key explanatory factors are found in the absence of a credit bureau, which would have transparently registered the debts of every citizen, as well as in the introduction of cheap Swiss franc housing loans, which were marketed at attractive rates to normally ineligible credit applicants. On the asset side, households' financial assets started surging at the turn of the century as the pension system saw a major neoliberal transformation, including mandatory private pension funds run by international banking and insurance groups.

The financialisation of NFCs is assessed and explained in view of its relation to stock market activity (section 7.2.4) and of the relevance of financial income (section 7.2.5). Apart from the privatisation through the stock market in the 1990s, stock market activity received another major boost through mandatory listings of firms due to the need for domestic investment opportunities by the privatised pension funds. This geared companies further towards shareholder value maximisation principles, while a few larger corporates even listed on international stock markets. NFCs received a stagnant and even decreasing share of their income through financial activities despite increasing financial assets, which suggests that these assets are held for other reasons than for developing novel, financialised revenue streams.

7.2.1 Evolution of the financial sector

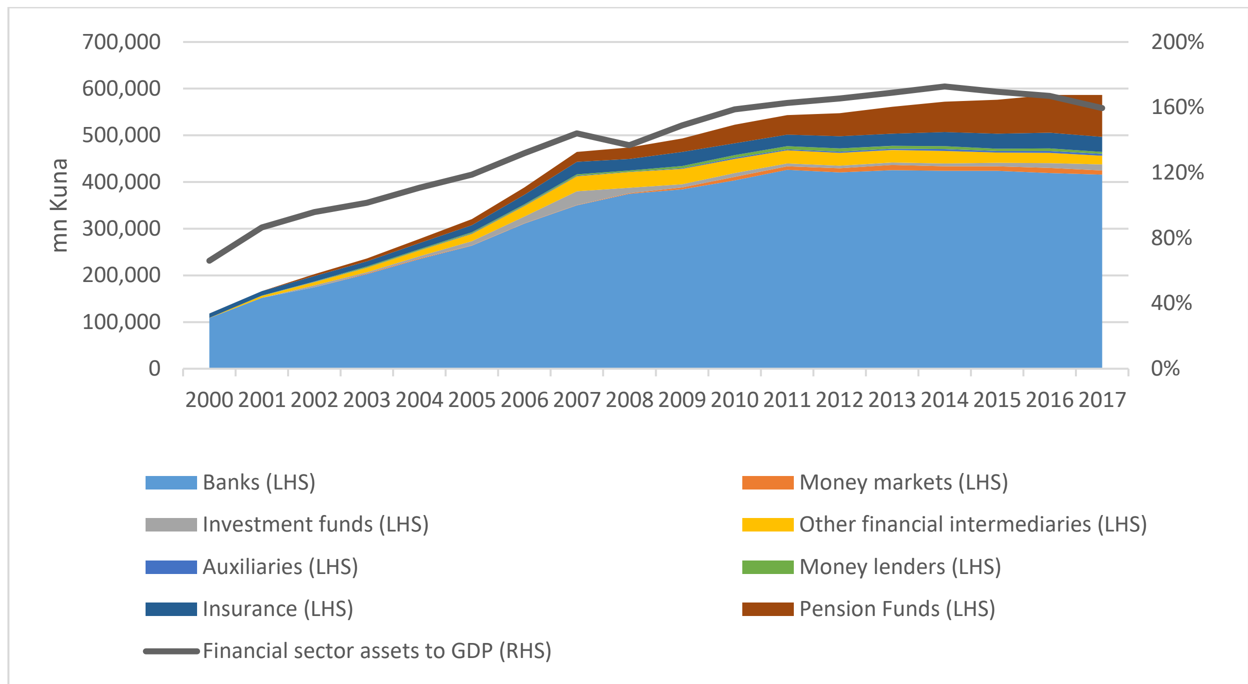
This section provides a synopsis of the development of the financial sector in Croatia before the GFC, thereby providing context for the further investigation of household and company financialisation. Specifically, this sub-section sketches out the traits within the evolution of the financial sector that aid in understanding the asset and liability side of households and firms. As shown in

the last section, the banking sector underwent dramatic developments during the 1990s, starting with insolvency, inflation, and a liberal licensing policy (Reininger and Walko 2005, 111). Although the system was stabilised in the middle of the 1990s through continuous interventions, the end of that decade saw the failure of one of the largest banks, Dubrovačka Banka, which preceded a serious banking crisis. This led to the temporary management of more than 10 banks by the central bank (Barisitz 2000, 112). While the direct costs for saving most of these banks and for reimbursing deposits amounted to around 5% of GDP (Barisitz 2000, 112), the total fiscal expenditures during the 1990s for maintaining the solvency of the banking system are estimated at around 31% of GDP (Jankov 2000, 17). Hence, Croatian policymakers opted to rescue the ailing banking sector, which was characterised by widespread related-party lending[118] at the expense of government debt. The extensive support to the financial system, even to non-systemic banks, during the 1990s is a peculiarity of the Croatian trajectory, as other countries in the region opted to close down such institutions.

At the turn of the century, most of the banking sector was privatised and sold off to foreign Western banking groups (Kraft 2004, 156) that would dominate the Croatian financial sector for the next 20 years. With regard to the market structure, Figure 45 depicts the decomposition of financial assets of the Croatian financial sector on the left-hand axis and total financial sector assets to GDP on the right-hand axis. As can be seen from the share of the banking sector in financial assets, the Croatian financial sector can be characterised as rather bank-based despite the fact that the non-bank financial sector has increasingly gained in relevance over time.

[118] Related-party lending means granting loans to people or firms connected to the owners or managers of a bank, which is often subject to abuses if the arm's length principle is not obeyed.

Figure 45: Croatia – Financial sector asset breakdown



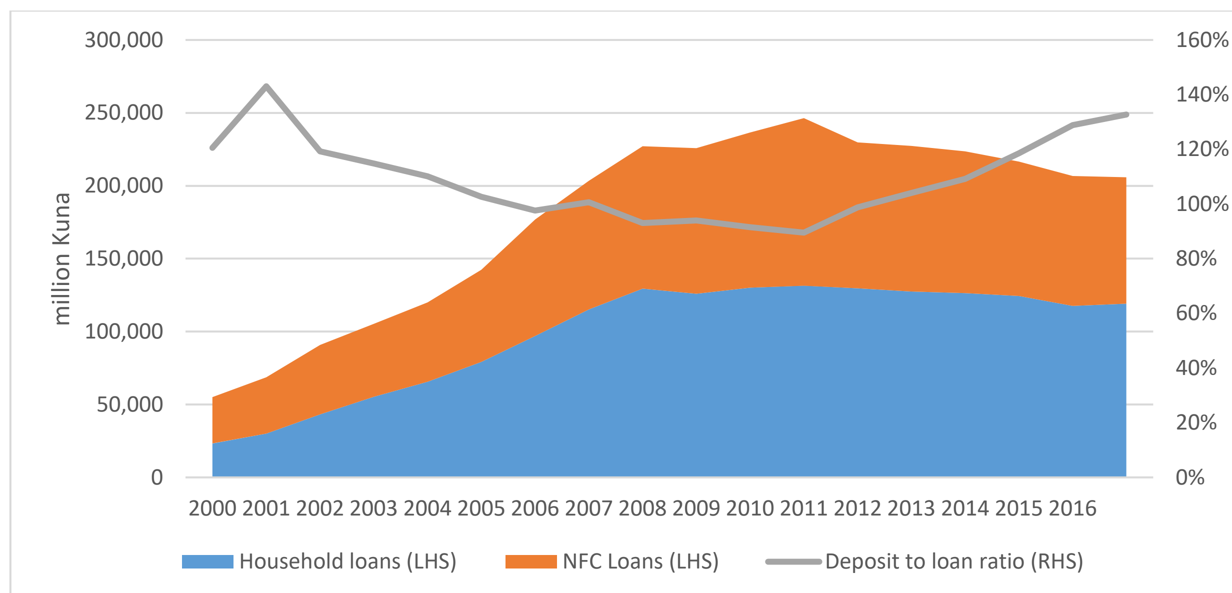
Source: Croatian National Bank (2020a, 2020b); author's calculation

The effect of government rescue packages is visible in that the financial crisis at the end of the 1990s did not have a major impact on the size of the financial assets of banks. The share of financial assets to GDP already hovered at more than 50% and did not drop significantly. After the foreign take-over of the banking sector at the turn of the century, assets grew strongly until the advent of the GFC in 2008. The crisis put only a temporary halt to the increase of financial assets, but banking sector assets have been stagnating since 2011. At the same time, the financial sector diversified in that the relevance of pension funds, insurances and other financial intermediaries has been mounting steadily. While both financial intermediaries and insurances stagnated after the GFC, the relevance of pension funds, i.e. financial assets pertaining to individual households, continuously increased. This presents a notable thread to follow with respect to household financialisation, as financial assets of private pension funds steadily increased starting in 2002. Overall, the relevance of the financial sector vis-à-vis the real economy in Croatia was already quite pronounced during the 1990s and financial assets doubled compared to GDP within only seven years after the turn of the century (as depicted in Figure 45).

The financial sector in Croatia has been rather liquid over the years except for the heydays of financial mania shortly before the GFC. This is visible in the deposit-to-loan ratio on the right-hand axis of Figure 46, which also shows the split between company and household lending of banks on

the left-hand axis. Due to large write-offs at the end of the 1990s and regained trust in the financial sector at the turn of the century, deposits flowed into the financial sector, providing the initial funds that were needed for growth. The increase in loans was most pronounced in household lending, whose share grew to around 60% until the GFC and then remained at that level throughout the next decade.

Figure 46: Croatia – Banking sector decomposition



Source: Croatian National Bank (2020c, 2020d)

Lending to companies increased at a slower pace than household lending before the GFC and decreased from then on. While this already pinpoints the looming stagnation that Croatia was to embark upon in the second decade of the 2000s, the development of household lending is all the more striking and indeed was even higher than in the other member states that joined the EU during the 2000s (Reininger and Walko 2005, 113). The growth in credit was driven by foreign banks, which had been drawn to Croatia due to attractive margins and the low level of penetration (Kraft 2004, 158). As their activity intensified, the regulator became wary of the developments, enacted credit ceilings and tightened reserve requirements by 2003 in order to tame credit growth (Gardó 2008, 63). The so-called 'credit growth reserve' mandated banks to buy central bank bills in twice the volume of loan portfolio growth, which exceeded 4% per quarter (Kraft and Galac 2011, 2). For foreign banks it was nonetheless still attractive to gather funding from their parent institutions to finance their credit appetite and pay for the 'reserve' (Reininger and Walko 2005, 120). As this regulation did not fully live up to its promises (as seen in Figure 46), marginal reserve requirements

were enacted in 2004 on increases in foreign liabilities. Both regulations made foreign-funded finance much more expensive, but the Western-owned affiliates devised other strategies to circumvent the regulations, similar to what transpired in other countries.

The typical circumvention by Western banks consisted of cross-border loans (Gardó 2008, 63). In the year 2000, such loans amounted to a benign USD 3 billion. In the following years, cross-border loans rose eleven-fold to USD 33 billion in 2008, leading them to account for roughly 50% of GDP (Joint External Debt Hub 2019). The volume of the cross-border loans even exceeded that of the total domestic corporate portfolio.[119] Smaller or local banks that did not have this technique at their disposal could not partake in the spoils (Kraft and Galac 2011, 10). Such cross-border loans are usually disbursed only to NFCs, which aids in explaining why the domestic corporate portfolio did not develop as rapidly as its domestic household counterpart. The other main evasion technique consisted of devising other forms of credit, such as leasing or loans issued by credit houses or by bank-affiliated companies (Reininger and Walko 2005, 120). The regulator reacted by curtailing this method of (domestic) circumvention through mandating the consolidation of affiliated companies in the credit growth calculations for limit breaches (Gardó 2008, 70). This evasion technique explains why the financial assets of financial intermediaries and leasing companies (see Figure 45) continued to rise up until the GFC of 2008.

The bold measures by the central bank explain part of the focus on household lending by Croatian foreign-owned banks since their headquarters mostly dealt with lending to businesses. The range of efforts by the HNB and their effect on domestic banking activities, which were outlined in this sub-section, are conveniently overlooked in the accounts of financialisation on Croatia (Cvijanović and Kešeljević 2015; Rodik 2015; Rodik and Zitko 2015). On the other hand, it seems as if NFCs were indirectly pushed out of the 'normal' banking system and left to the whims of either foreign or non-bank financial institutions to slake the banks' thirst for credit. Besides the problem that this credit portfolio escaped regulatory oversight, Croatian businesses were now dependent on the decision-making process in the banks' headquarters in Austria and Italy. Thus, the developments in the Croatian financial sector had a decisive effect on the financialisation of both households (increased focus) and companies (decreased focus, cross-border lending). One explanatory mechanism is found in the well-meant counter-cyclical regulatory changes that were thwarted by the open

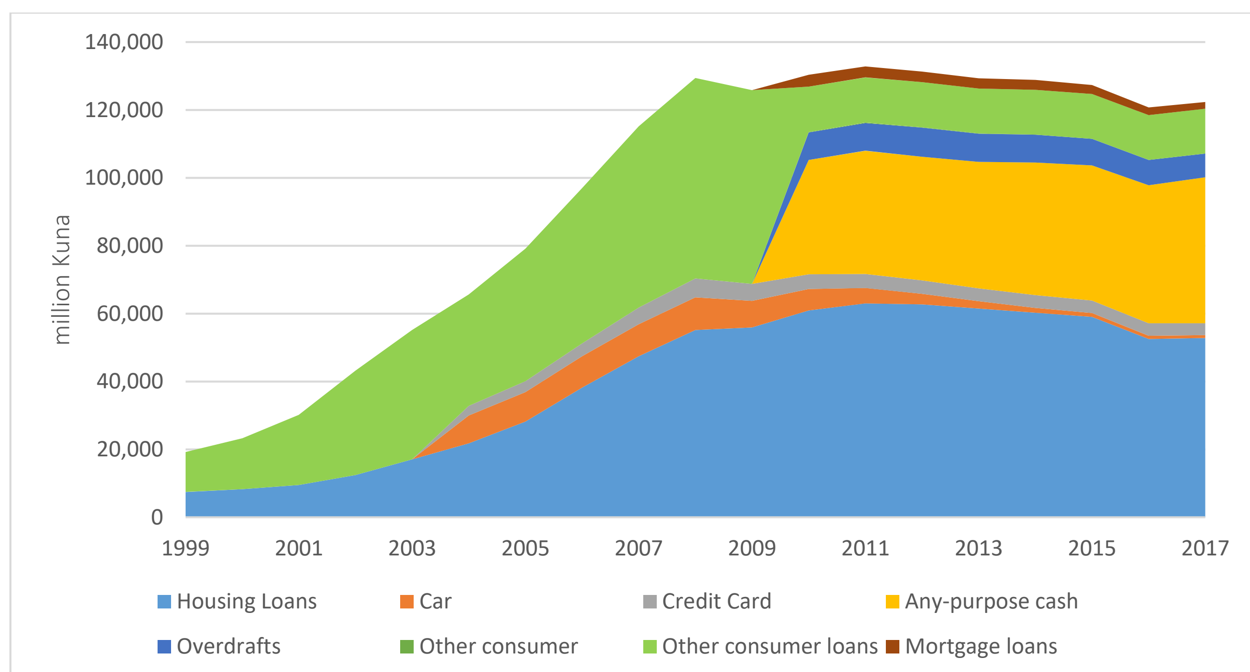
[119] Such cross-border loans are not registered on the central bank aggregated bank balance sheet statistics as loans. Typically, they enter the statistics as financial inflows in the balance of payments.

capital and financial account and by the growth and profit imperative of the mainly foreign banking sector. The next section analyses lending to households more in detail and tracks the trajectory of personal indebtedness in Croatia.

7.2.2 Household financialisation in Croatia: The liability side

During the first decade of the 21st century, household financialisation measured by debt to income grew distinctly in Croatia, doubling in a very short period of time. This section delves more deeply into the growing proliferation of credit relations in Croatian households, describing the development of the debt and the income component and carving out potential explanatory mechanisms. The already substantial debt-to-income ratio at the turn of the century and the starting point of this analysis was explained through a rather established financial sector and relations as well as through the continuous rescue packages devised by the central bank and the Tudjman government in order to keep troubled banks alive. After the change of regime and the privatisation of the financial sector, lending to households surged markedly and increased six-fold in the pre-GFC period as depicted in Figure 47, which provides us with a picture of the type of loans disbursed.

Figure 47: Croatia – Household loans breakdown



Source: Croatian National Bank (2016a, 2020d, 2020f)

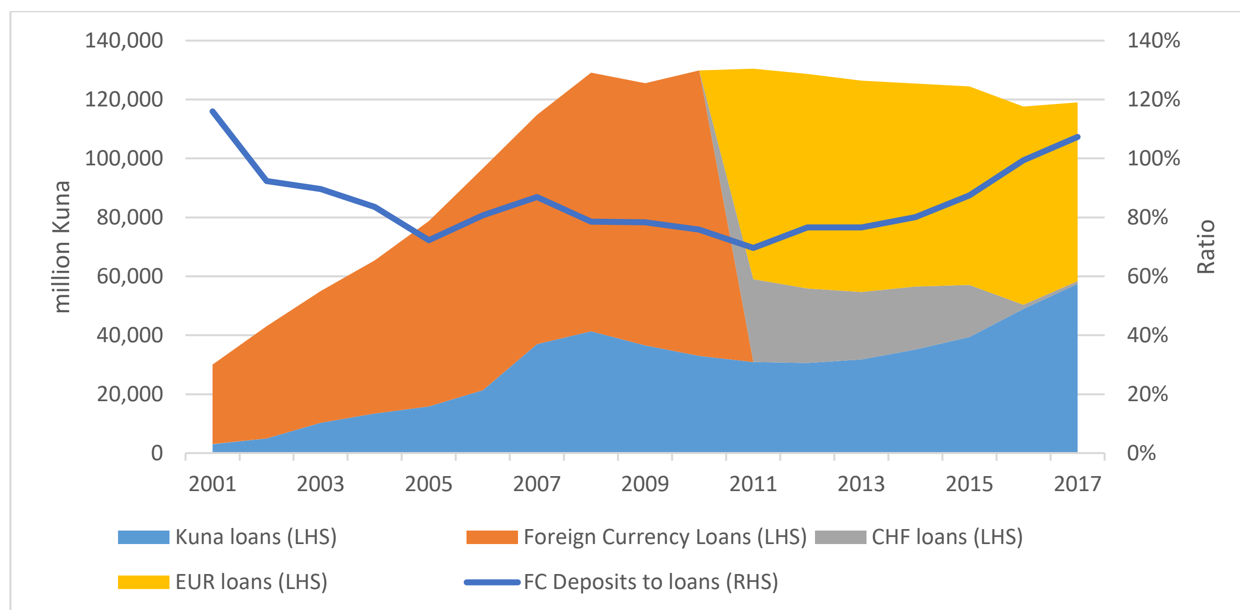
The chart denotes the composition of household lending by banks in Croatia.[120] Within household loans, not only housing but also consumer loans for any purpose contributed to the increase before the GFC, while car and credit card loans accounted for the rest of the surge. After the crisis, loans to households remained fairly stagnant at a share of roughly 60% of the overall credit portfolio, as shown in Figure 46. Overall, the housing loan category grew faster than other loans to households up until the GFC, when it reached a share of around half of the 'retail' portfolio. After the crisis, the share of housing loans slowly declined.

Clearly, a proliferation of credit to households can be observed, which accounts for the increase in the debt-to-income ratio, thereby intensifying financial relations with households. As argued in the previous sections, one of the reasons for this is to be found in the steady transfer of NFC lending to the parent companies of foreign banks during the pre-GFC phase. The relegation of domestic banks to corporate loan intermediaries triggered a shift of focus to the retail segment, thereby confirming one of the explanatory mechanisms of household financialisation.

Similar to other countries in the region, household lending in Croatia took a specific form in that a great number of these loans were disbursed in foreign currency, as discussed by Rodik and Zitko (2015, 61). While their focus is more on Swiss franc (CHF) housing loans, which is dealt with in section 7.2.2.2, euro-denominated lending was equally pervasive. Section 4.2 describes how foreign currency lending in Croatia was the second highest in the region. The extent of foreign currency loans to households in Croatia is shown in Figure 48, which decomposes the domestic loan portfolio into different currencies and displays the foreign currency deposit-to-loan ratio on the right-hand axis.

[120] The decomposition in the chart depended upon the availability of data at different points in time. The emerging categories can solely be attributed to this and not to sudden increases of loan categories.

Figure 48: Croatia – Foreign currency household lending decomposition[121]



Source: Croatian National Bank (2016a, 2020c, 2020e, 2020f); authors calculation

The ratio of foreign currency loans to household loans increased at a much faster pace than local currency loans until 2006. From 2006 until 2008, however, local currency loans surged, possibly due to regulatory efforts by the central bank, though a great number of them were of a short-term nature. However, this demonstrates that the regulations did at least have a certain effect, which is not mentioned in the studies on household financialisation in Croatia – instead, they unanimously lament the central bank's inability to deal with the rising volume of foreign currency lending (Rodik and Zitko 2015). After the crisis, the share of foreign currency lending increased again, mainly due to maturing short-term kuna loans. In the last years of the analysis, local currency loans gathered steam, which is dealt with in the post-crisis section. The foreign currency deposits of the banking sector were not sufficient to finance lending in the pre-GFC phase, as is evident in the decreasing foreign currency deposit-to-loan ratio. This is one of the factors that triggered the influx of foreign finance in the pre-GFC phase, which was possible in the first place due to the open capital and financial account as well as to the currency regime, which was geared towards maintaining an unofficial currency board (Vidakovic and Radošević 2014, 6). Other connected reasons related to monetary policy include the focus on price stability and the high interest rates on domestic currency to control inflation rates. These policies and others served to put domestic debtors at the mercy of

[121] The decomposition in the figure depended upon the availability of data at different points in time. The split between euros and Swiss francs (CHF) can be solely attributed to this and not to sudden increases of loan categories.

the global financial interest rate and exchange rate movements. The increasing foreign currency share created a self-perpetuating pressure on the central bank to maintain the peg, as otherwise a depreciation of local currency would have caused major defaults. Hence, household indebtedness in Croatia is interconnected with international financialisation, although the increasing share of foreign currency deposits to loans mitigates the dependence on currency movements.

While this describes much of the trajectory of household indebtedness, in his original anthropological contribution, Mikuš (2019a, 302) argues that a fair share of the household debt boom in Croatia took an even higher-risk and predatory form because Austrian cooperative banks disbursed home 'equity loans' (Mikuš 2019a, 297), which soon turned non-performing, to more than 3,000 people in Croatia. Thus, adding to the rapid pace of domestic household lending, foreign banks were even granting loans to Croatian households directly. While this certainly accounts for an expropriation through debt in line with the theoretical concept of household financialisation, Mikuš (2019a) contends that this practice occurred in parallel to the expansion of cross-border lending and marks an instance of peripheral financialisation. However, in doing so, he confuses the issue, as this was rather an instance of malpractice and money laundering (Gepp 2014) by one regional Austrian bank. The overall strategy of cross-border lending pursued by Western banking groups consisted of lending exclusively to companies (Puhr, Schwaiger, and Sigmund 2009, 117). In contrast, the practice mentioned by Mikuš (2019a) took the form of direct loans that were channelled through Croatian credit intermediaries (not through the Croatian Raiffeisen subsidiary bank), preying on the gullibility of financially distressed people who owned real estate property. Yet the intransparent institutional environment in Croatia regarding (household) consumer protection in the mid-2000s (Buchen et al. 2016, 13) and the overall Austrian-fuelled lending spree prepared the fertile ground on which such fraud was able to thrive. The next sub-section takes a more granular look at household indebtedness in Croatia before the GFC both on the income and on the debt side of this indicator of household financialisation. The second sub-section reviews the peculiar practice of Swiss franc lending and the developments in the real estate sector that account for a major part of household financialisation in Croatia.

7.2.2.1 Income and inequality

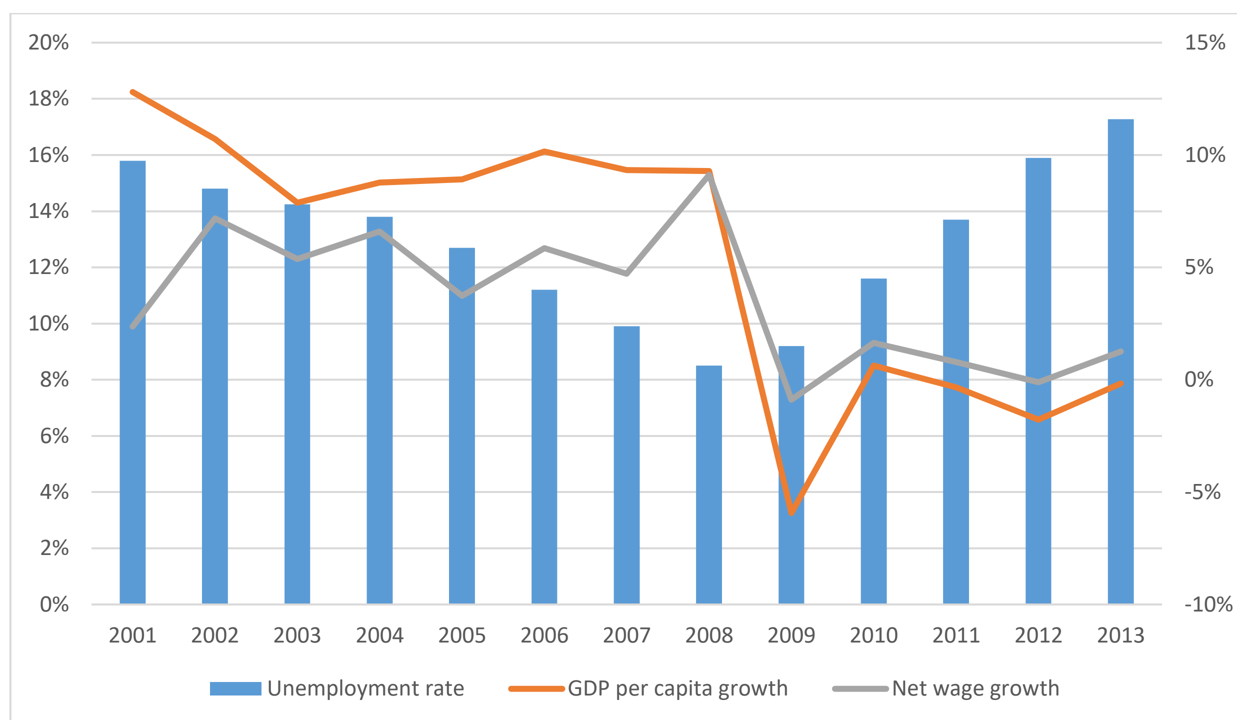
This sub-section sets forth the trajectory of household financialisation in Croatia and discusses its explanatory mechanisms, among which income inequality and wage depression are two of the main hypotheses to be analysed, as argued in chapter 3.5. Sustained inequality creates a desire among

lower-income households to artificially boost consumption or assets through taking loans in order to emulate the capitalist class's status, while depressed wages drive households to engage in debt in order to keep up with price level changes. Income inequality and the emergence of a clientelist class at the expense of the worker was already a political topic in Croatia during the 1990s. Nationalism had served as a temporal fix to obfuscate the fact that a large part of the population was left out of the distribution of privatised assets, which mostly landed in the hands of a few. With the change of regime, nationalistic appeals were replaced with the hope for EU accession and growth through liberalisation, while at the same time clientelist structures persisted in Croatia's capitalism, as argued by Cvijanović and Redžepagić (2011). Debt-fuelled consumption served as the means for creating a temporary illusion of sudden wealth through household lending.

To whom were household loans disbursed? In their empirical study on household debt in Croatia, Herceg and Šošić (2011, 208) show that people with debt tended to be more affluent (i.e. income, education, age) than those without debt. This aligns with Kraft (2007, 351), who demonstrates that between 1999 and 2004, a great share of the debt was taken by households with higher income. We can therefore conclude that a financialisation of the elite took place during the early 2000s. Bejaković (2016, 51) further maintains that between 2003 and 2006, around one third of the population had debt and that this share did not change within the time period. Since overall debt levels were rising, this points to an intensification of credit relations with wealthier households. Once increasing amounts of debt had been disbursed and the debt appetite of wealthier households was satisfied, financial institutions turned towards lower income categories, as contended by Rodik and Zitko (2015, 66). Again, it was shown empirically by Herceg and Šošić (2011, 199) how the amount of debt in lower-income households increased. This leads Filipovic (2017; 201) to even speak of a 'democratisation' of credit in Croatia in the run-up to the GFC.

One of the main explanatory mechanisms for household financialisation, especially for populist financialisation (see section 3.5), are depressed wages and increasing inequality. The unequal distribution of wealth during the 1990s continued at the turn of the century, as inequality in terms of income increased mildly (Nestić 2005). The 2000s were characterised by economic growth and increasing wages, as exhibited in Figure 49, while at the same time unemployment was reduced. The graph highlights that wages were not depressed in Croatia, as they registered continuous growth throughout the pre-GFC phase, yet they did not rise as much as total productivity increased.

Figure 49: Croatia – Income and unemployment



Source: Croatian Bureau of Statistics (2020), Croatian National Bank (2020b)

Figure 49 depicts the development of unemployment on the left-hand axis and GDP per capita as well as net wage growth on the right-hand axis. It attempts to capture the development of wage income and its participation in growth as more fine-grained data (i.e. the Gini index or comparable inequality indicators) are not available. During the 2000s, unemployment continuously decreases and drops below 10% shortly before the outbreak of the GFC, which underscores the fact that the growth succeeded in providing formal employment. However, the GFC triggered dismissals and bankruptcies, leading unemployment levels to revert to even higher levels than at the starting point of the analysis. During the period prior to the crisis, GDP grew steadily at levels of around 10% per year. At the same time, net wages rose, but at lower levels than GDP except for the year of the crisis. From this we may conclude that wages did increase but comparatively lost out. Thus, wages were not depressed but rather suppressed. The increased income of the population can explain the increase in levels of indebtedness only to a small extent (Herceg and Šošić 2011, 199), while the rest of the rise is attributable to the higher appetite for risk by banks and for debt by households.

So what were other drivers of household indebtedness apart from the unequal distribution of assets and income? From a mainstream financial point of view, Kraft (2007) argues that Croatia's economy still had ample room to catch up and banks were motivated by the interest rate gap as well as

by low inflation to finance households. Likewise, the structurally weak real economy and business environment diverted banks' attention to households at the expense of the former. Adding to this argument, Herceg and Šošić (2011, 199) highlight that the increase in household lending, especially in the lower-income segment in the run-up to the GFC, can be attributed to the banks' more lenient lending standards. The opening of borders and focus on EU accession shifted the consumer mindset and allowed the narrative of mass consumption to proliferate in Croatia. Household debt was in part able to flourish because people did not possess the requisite financial literacy to evaluate risks, according to Bejaković (2016, 46). The legal introduction of currency clauses in the middle of the 1990s enabled a large part of this debt to be in foreign currency (Koški 2012).

Importantly, Croatia also lacked a sound institutional environment for bank lending in general. It was only in 2007 that a credit registry bureau went into operation there, enabling banks to view and evaluate the liabilities and repayment capacity of a debtor. As Croatia was one of the last countries in Eastern Europe to create such an institution, Simovic et al. (2011, 113) contend that the absence of a credit registry is pivotal for explaining the rising household indebtedness levels when compared to other countries in the region, such as Serbia. The lack of a centralised database rendered it difficult for banks and the regulator to check whether a person or firm already had loan exposures at another institution when a credit decision was made. The credit registry was initially only operational for households and not for businesses, which reinforces the image of a lack of focus on creating sound conditions for the real economy. Adding to this, the central bank shied away from imposing loan-to-value or payment-to-income thresholds for consumer and household lending for the reason that credit risk was not in jeopardy due to other regulations and that 'social' considerations mattered more (Kraft and Galac 2011, 17). Thus, even the central bank indirectly welcomed the spread of consumer lending in Croatia to satisfy the population's demand for credit. Hence, a range of factors contributed to the increasing degree of household financialisation, which first took the form of elite financialisation and intensification and then shifted to populist, expansive financialisation shortly before the sobering up forced by the GFC. The fallout turned out to be even more grave for those households that indebted themselves in foreign currency and more specifically in Swiss francs, which is dealt with in the next sub-section.

7.2.2.2 Swiss mortgaging on the Adriatic Coast

As the previous sub-sections revealed, a substantial part of the financialisation of households in the pre-GFC phase derived from housing loans. Therefore, and in line with the conceptual elaborations

from chapter 3.5, this sub-section deals more closely with the development of the Croatian housing market and the indebtedness of households in foreign currency, including Swiss francs, which proved to be toxic in hindsight. As shown in the introduction to this section on household financialisation, housing loans rose continuously up to the GFC, starting from around the year 2002. The Croatian housing finance market has indeed been dominated by foreign currency loans in the 21st century, which make up more than 90% of the loan book (Croatian National Bank 2020d). It is only in the last two years of the analysis that this changed course slightly in the direction of local currency loans, which is dealt with in the post-crisis section of this chapter.

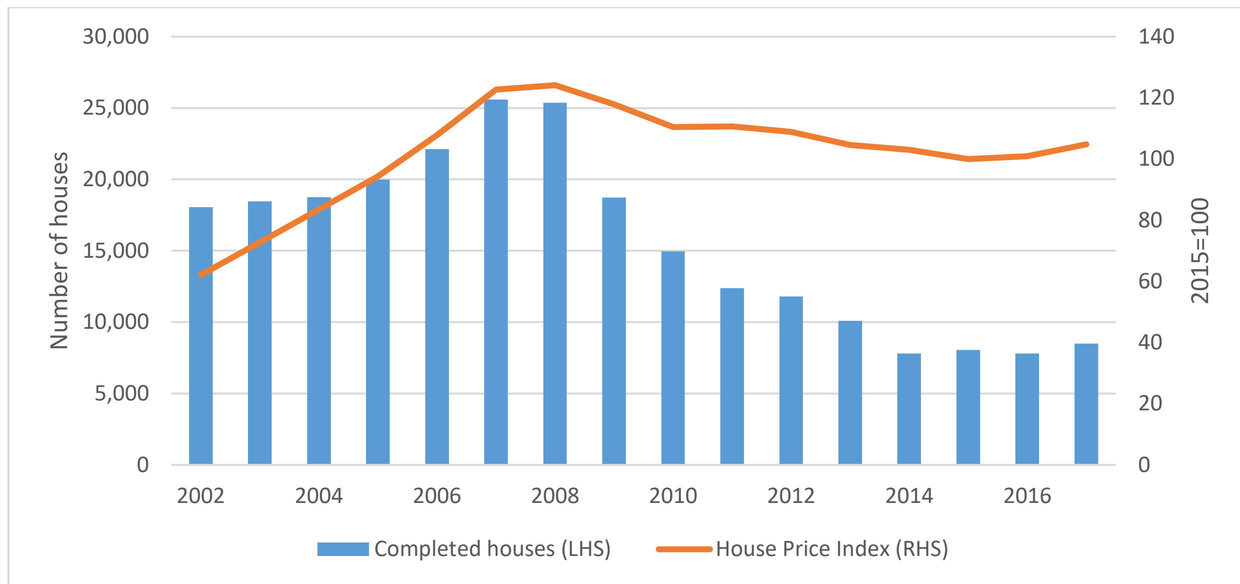
During the 2000s, roughly 40% of all housing loans were disbursed in Swiss francs (Croatian National Bank 2020f) and mostly at variable interest rates. Similar to other Eastern European countries (Bohle 2014), Swiss-franc-denominated housing loans were introduced in Croatia around the year 2003, primarily by Austrian banks (Rodik and Zitko 2015, 62), and were frequently marketed at much more attractive rates than their euro- or kuna-denominated alternatives. As most debtors received their income in local currency but contracted the loan in a foreign currency with which they had no affiliation whatsoever (contrary to the euro), Swiss franc loans were sometimes dubbed the 'small men's carry trade' (Vidaházy and Yeşin 2020, 224). Rodik and Zitko (2015) depict how these Swiss-franc-denominated loans constitute a peculiar instance of financialisation in that they not only increased the indebtedness of the individual household but also transferred the exchange rate risk to the debtor (as banks typically hedged against their currency risk). Furthermore, banks often did not inform the client properly about the risk involved or about the terms and conditions, which allowed them to unilaterally alter the interest rates (Rodik 2015, 65). The financial institutions also assigned special personal advisers to housing loan seekers. These employees were tasked with creating a friendly rapport between the parties, while the very same bank employees were incentivised by salary bonuses to nudge clients towards Swiss franc loans (Rodik 2015, 74). All of these measures contributed to a proliferation of household (housing) finance in Croatia, as this type of loan was typically taken by clients who otherwise would not have qualified for a housing loan, thereby expanding the reach of finance into virgin territory.

The practice created devastating personal tragedies as disposable incomes diminished when the exchange rate of the Swiss franc suddenly shot up around 2011. The appreciation of the Swiss franc caused more than two thirds of the respondents surveyed by Rodik (2015, 70) to slide into risk of foreclosure, and overall non-performing loans in Swiss francs doubled to more than 10% in 2011

compared to the previous years (Croatian National Bank 2016b). Indeed, Tomas Žiković, Žiković, and Arbula Blecich (2015, 12) provide empirical proof that the increase in non-performing loans to households can be directly attributed to the change in the exchange rate. Due to the obfuscation of the risks involved, the practice of pushing these housing loans was even deemed to be an instance of 'mis-selling' financial products in a study commissioned by the EU ECON committee (Zunzunegui 2018). In this context, it needs to be noted that both the Croatian government and the Croatian National Bank (2015) took the matter into their own hands and retroactively converted all Swiss franc loans into euro loans at the beginning of 2016 (Fischer and Yeşin 2019, 12; Vidaházy and Yeşin 2020, 225). In doing so, they unilaterally shifted the costs to banks and several Western banking groups filed for arbitration at the International Centre of Investment Disputes (2017). Policymakers thus responded to the public's discontent over the 'unethical' practice (Zunzunegui 2018, 9), but it remains unclear why it was allowed or at least tolerated in the first place. During the 2000s, the central bank issued rather tepid warnings about the dangers (Rodik 2015, 66) and resorted to risk weight increases on foreign currency lending to unhedged borrowers (Vandenbussche, Vogel, and Detragiache 2012, 17), but it did not take any further action. The Swiss franc housing loans unlocked a new group of potential borrowers for banks and served as a temporal fix to satisfy the growing demands of the lower and middle classes to participate in the growth bubble. The proliferation of Swiss franc loans thus explains one part of household financialisation in Croatia.

Nevertheless, the Swiss franc mortgage disaster needs to be seen in the context of the Croatian real estate market. Similar to other states in SEE, Croatia had a legacy of socialist-era, run-down apartments that were privatised and sold to their tenants after the declaration of independence (Bartlett 2004, 139). Hence, Croatia has historically featured one of the highest home-ownership rates across Europe, with a ratio of around 90% over the years (Eurostat 2020). As with other countries in the region, this firmly anchors Croatia in the familial variety of residential capitalism (Fernandez and Aalbers 2016, 7). The war across the Balkans, however, damaged the living spaces of the affected regions, creating further pressure to renovate and build new dwellings at the turn of century. At the same time, Croatia resumed its status of an attractive tourist destination, which contributed to the demand for real estate. Specific to Croatia and to the region is that real estate is also seen as a safe haven for unofficially earned income (given the lingering existence of the grey market) and rental income is often omitted from tax returns (Tica 2004, 649). Both supply and demand factors determine the development of completed houses and house prices, which is depicted in Figure 50.

Figure 50: Croatia – The housing market



Source: Croatian Chamber of Economy (2018, 13); Croatian National Bank (2020g)

The figure shows a continuous increase of completed buildings up to the GFC with a corresponding increase in house prices, which almost doubled during the same period. Thereafter, construction activity slowed down markedly, while prices tended to stagnate. As the home-ownership ratio remained constant for Croatia (Eurostat 2020), the boom before the crisis and the high supply furnished by the construction sector was able to meet the demand for new houses, albeit at the expense of indebting a part of the population in a way that would later make it difficult for them to repay their loans. Still, with regard to housing loans, we can speak of an expansion rather than an intensification of credit (Van Gunten and Navot 2018), as most borrowers wished to have a home to live in rather than to artificially boost their income, e.g. through mortgaging their existing house to receive a loan (apart from the home equity loans mentioned earlier). The house price surge, however, required them to take on debt that was greater than they would have incurred in the case of a more moderate development. The growth in the real estate market and related financial activities increased the degree of elite household financialisation, as most of the housing loans were disbursed to the younger generation, who were in the kind of chiefly full-time and legal employment commonly held by the middle strata of society. At the same time, the housing boom displaced the export-oriented part of the real economy. Tkalec and Vizek (2014, 28) show how the real estate mania in Croatia in the pre-GFC phase contributed to the absorption of production factors in the construction sector and created price distortions to the disadvantage of the export sector. As the

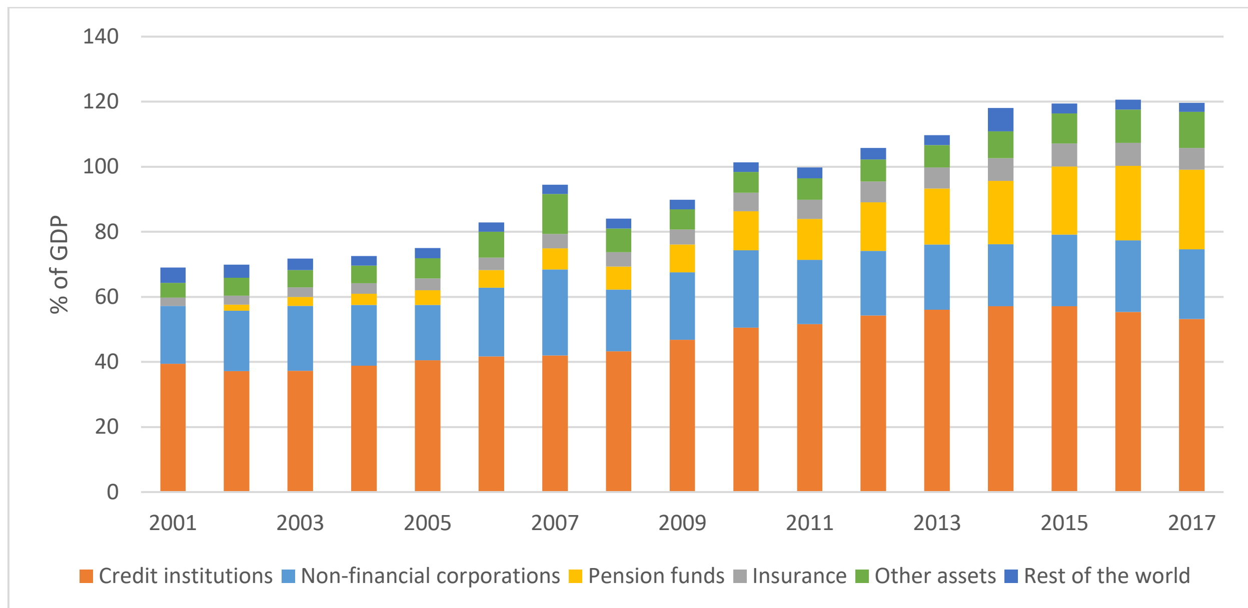
authors argue, both effects led to decreased international competitiveness. Hence, the 'democratisation' of housing finance in Croatia, also through the means of Swiss mortgaging, served as a temporal fix for the structural underdevelopment of the manufacturing and agricultural sectors as well as for the sustained inequality in the country. In that sense, housing financialisation increased the relevance of finance vis-à-vis the real economy and explains part of the malaise that Croatia went through after the GFC.

7.2.3 Household financialisation in Croatia: The asset side

While the last sub-section outlined the trajectory of the liability side of household financialisation and discussed the explanatory mechanisms, this sub-section turns to the asset side of household financialisation in line with the conceptual elaborations from chapter 3.5. Specifically, this sub-section reviews the development of the financial assets of households and then addresses a notable welfare system change in Croatia that not only fostered the financialisation of households but also laid the cornerstone for the financialisation of NFCs. This indicator for the level of household financialisation was not available in the comparison in chapter 4, but data is available for Croatia.

As argued in chapter 3, we can speak of household financialisation on the asset side if households' financial assets increase, primarily if households tend to hold marketable financial assets that nurture the role of the individual as a financial object and investor. Figure 51 shows the development of the financial assets of Croatian households over the entire period under analysis. Since the turn of the century, these assets have almost doubled in percent to GDP.

Figure 51: Croatia – Decomposition of financial assets of households



Source: Croatian National Bank (2019a, 19)

The decomposition of financial assets (stocks) by the Croatian National Bank (HNB) derives from reviewing every kind of financial transaction between institutional sectors (i.e. households, NFCs, etc.). The overall increase is notably driven by financial assets held in credit institutions that first and foremost represent regular deposits. While the next sub-section discusses the development of the stock market in more detail, company-related financial assets (i.e. shares, loans or bonds) held by households increased only marginally over the entire period, yet a temporary spike is visible in the year 2007, just prior to the GFC. While insurances grew slightly as well, pension funds surged markedly from zero in 2001 to 24.4% of GDP in 2017. Thus, on the asset side, household financialisation is not very pronounced in Croatia (concerning shares, bonds, etc.); only pension funds registered a structural increase in the 21st century. The claims on these funds constituted the driving force behind the growth of the financial assets held by households in Croatia both before and after the GFC. Hence, the remainder of this sub-section analyses the trajectory of the pension system and shows why the welfare reform represents an explanatory mechanism leading to the financialisation of households in Croatia.

Similar to other former socialist Eastern European countries, Croatia introduced a reform of its pension system around the turn of the century (Orenstein 2005). While it formerly featured a sort of Bismarckian pay-as-you-go (PAYG) pension system (Stubbs 2009, 130), the late HDZ government drafted a three-pillar system at the end of the 1990s that was later implemented by the centre-

left government in 2002. How did this reform come about? After the war and around the banking crisis of 1998, Croatia was experiencing mounting social expenses connected to an impending pension crisis (Bičanić and Franičević 2003, 18). The distress in public finances was exacerbated by a court ruling that swept away a political decision to cap the rise in pensions dating from 1993 and which required a repayment of this old 'pensioners debt' (Stubbs 2019, 112). A series of factors are discussed in the literature that explain the volume of expenses, such as an ageing population, unemployment, a high number of war-affected people, and early retirement buyouts (Anušíc, O'Keefe, and Maďzarevíc-Šujster 2003, 10–18; Bejaković 2019, 237). While the matter was likewise debated at a series of domestic conferences, the World Bank and the IMF pressured the country to place the problem higher on the agenda. The World Bank wanted Croatia to adopt a Chilean-style radical privatisation of the pension system (Guardiancich 2013, 59) and even seconded an employee to the country to become the national coordinator of the pension reform (Orenstein 2005, 195). Contrary to the response in other countries, the demand received harsh criticism in Croatia and instead an Argentinian model combining public and private funds was introduced (Stubbs and Zrinščak 2009, 130). In this way, domestic politicians devised their own interpretation of the recommendations of the international financial institutions[122] in order to serve their own interests, which primarily lay in shielding party supporters from major cuts. The exemptions included existing pensioners, along with homeland war combatants and their families. Whereas other countries in the region unilaterally applied the neoliberal reforms, in Croatia they were domestically mediated and discussed but then concocted in a way that served clientelist interests (Guardiancich 2013, 57; Stubbs and Lendvai-Bainton 2020, 544).

The Pension Insurance Act entailed two major changes. First, retirement ages were raised and certain benefits were eliminated, which triggered fierce objections among the affected people (Vidović and Pauković 2011, 97).[123] Second, the new act foresaw the overhaul of the first pillar (PAYG), which would then resemble that of a German-style points system (Anušíc, O'Keefe, and Maďzarevíc-Šujster 2003, 24–26; Guardiancich 2013, 58). The newly added mandatory private pillar (Pillar II) and voluntary private pillar (Pillar III) were to work in a pre-funded manner, making it a typical three-pillar system and thus part of the global neoliberal agenda of economic reform

[122] "*The bank's recommendations were only partly followed*" (Guardiancich 2013, 59).
[123] However, due to the existing favourable options, early retirement was still widespread until further changes in 2011 (Tica 2018, 75).

(Orenstein 2005, 181). In that way, people would increasingly save for their own retirement benefits. While the changes to the retirement ages had already been passed in 1998 (Bejaković 2019, 238), the move towards a multi-pillar reform, which was worked out in 1999, was delayed until 2002, when it was implemented by the new Social Democratic Party (Vidović and Pauković 2011, 98). However, the old PAYG system continued to co-exist with the new multi-pillar system (Guardiancich 2007, 96). Similar to its predecessors, the new reformist government was faced with the same high expenses for the pension system and ongoing pressure from the World Bank. It also exhibited a sort of blind faith in any kind of privatisation process, which moreover would demonstrate its willingness to move towards the EU (Stubbs and Zrinščak 2009, 131). The pressure on public finances was apparent in the 24% of GDP spent on social protection measures in 2003 and 2004, a level that exceeded that of the EU and other countries in SEE (European Union 2006, 7). Most of the expenditures went towards pensions and health care (Stubbs and Zrinščak 2009, 128), with little spent on social welfare or child allowances.

The implementation of the multi-pillar pension system necessitated the creation of private pension funds that had to register with and be approved by the regulator.[124] Regulatory oversight was later merged into and assumed by the Croatian Financial Services Supervisory Agency (HANFA) (Bejaković 2011, 62). Despite the modest salary contribution of five percent (Guardiancich 2013, 59), the privately owned pension funds would necessarily grow into large institutional investors in Croatia over time, mediating a substantial share of the country's pensions. Initially, seven funds were licensed, but after a couple of years four of them represented the majority of the market. These four are run by the largest banks in the country, namely Raiffeisen, Erste Sparkasse, Intesa SanPaolo (Privredna Banka) and Unicredit (Zagrebacka Banka) together with Allianz (Anušíc, O'Keefe, and Maďzarevíc-Šujster 2003, 58). Thus, only a handful of asset managers (Draženović, Hodžić, and Maradin 2019, 86) operated in an oligopolistic market structure (Guardiancich 2013, 68) that featured rather high management fees. The private funds were mandated to invest at least half of their portfolio in domestic government bonds, a small amount in foreign assets and a sizeable sum in domestic stocks. The latter proviso necessitated the existence of a sufficient number of listed shares and companies.

[124] At the inception of the reform, the regulating institution was the Central Registry of Insured Persons (REGOS) (Guardiancich 2013, 62).

While scholars initially deemed Pillar II to be marginal, by 2010 its assets already amounted to around 11% of GDP (Guardiancich 2013, 70). Ignoring warnings from the International Labour Organization about similar reform failures in Latin America (Vidović and Pauković 2011, 103), the pension funds registered sizeable losses during the GFC (Draženović, Hodžić, and Maradin 2019, 86). Also, it is argued that the new system failed to contribute to more equity in the pension system and featured low first pillar contributions (Kasek, Laursen, and Skrok 2008, 8), which led to a meagre minimum pension if one did not qualify as a privileged or disabled pensioner (Bejaković 2019, 236).[125] Thus, the Croatian pension reform somehow lowered government expenses but not as much as expected given the high number of exceptions. According to Bohle and Greskovits (2012, 254), it produced a "*pathological welfare state [that] sets the country apart from the neoliberal model*" (Bohle and Greskovits 2012, 254).

Aside from the discussions about its effectiveness, the mandatory Pillar II transformed each contributor to the scheme into a financial investor subject to the developments of domestic and global financial markets. Moreover, the foreign-owned banking groups were able to siphon off their share in the financial investments (paradoxically the majority of it in government bonds). In that way, the pension reform led to a financialisation of households that was even deepened after the crisis when a subsequent amendment to the reform produced fund categories with different risk profiles to choose from (Draženović, Hodžić, and Maradin 2019, 86), helping to create the image of the pension contributor as a financial asset manager. As the next sub-section will show, the funds required domestic financial assets to invest in, so the government sought to increase stock market capitalisation through mandatory listing, which explains part of the financialisation of NFCs in Croatia. Besides the domestic amendments to the pension recommendations, the neoliberal reform agenda based on the recipe of the World Bank (1994) (Guardiancich 2007, 96) induced a financialisation trajectory in Croatia, confirming the explanatory mechanisms from chapter 3. Though household financialisation on the asset side did not intensify greatly overall, financial assets held as pension claims rose steadily throughout the analysed period due to the welfare reform described here.

[125] The share of privileged or disabled pensioners was around one quarter.

7.2.4 The institutionalisation of the stock market: Tepid financialisation of NFCs

This section delves into the development of the Croatian stock market and picks up the thread of necessary domestic shares as a prerequisite for pension funds, as reported in the preceding sub-section. The transformation towards a privatised pension system in Croatia is closely linked with the evolution of the domestic stock market, whose roots go back even further in time. According to the conceptualisation of financialisation, stock markets were argued to gear NFCs towards shareholder value maximisation, which shortens their time horizon and alters their business behaviour and their corporate governance. Croatia was shown to have been the country with the highest stock market capitalisation in SEE, raising the question of whether and why financialisation occurred to the highest degree in this country. What explains the already well-established stock market activity in the 1990s, and which factors led to the surge during the 2000s? To what extent can we actually speak of a financialisation of Croatian companies? This section takes a more in-depth look at the trajectory of NFC financialisation with respect not only to a potential transformation towards a market-based financial system, but also in terms of the explanatory mechanisms that lie behind the inception of capital markets in a former socialist country. It will be argued that the high stock capitalisation of Croatian NFCs is not so closely related to financialisation.

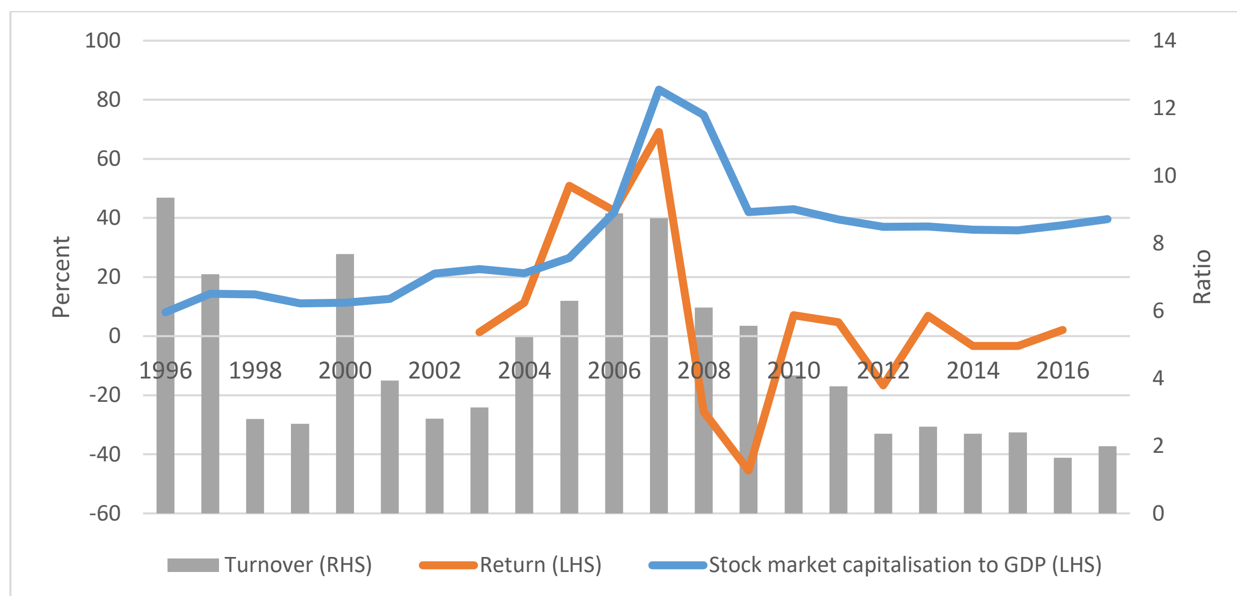
The onset of capital markets in Croatia was strongly linked with endeavours to privatise state-owned companies. After its independence, Croatia initiated the privatisation of former socialist firms by offering their shares at discount rates to former management and employees, mostly on a case-by-case basis (Čučković 1995, 76). In a seminal article on the privatisation process on Croatia, Franičević (1999, 8) refers to this form of privatisation as 'hybrid' because it had to bridge expectations deriving from former workers' self-management, dire state finances and rent-capturing interests of the ruling party. At the end of this process, around 40% of all shares of state-owned enterprises were held by individuals, 32% by the Croatian Privatisation Fund (CPF) and 16% by another state fund (Bartlett 2004, 105). Following the end of the war and the signing of the Dayton Agreement, privatisation took a novel turn in that stock option vouchers were distributed to a range of people adversely affected by the war and to those with frozen foreign currency deposits (Čučković 1995, 78), which they could now hand over to so-called privatisation investment funds.[126] These privately owned fund management companies would then exchange the vouchers

[126] It is argued that the privatisation process in Croatia contributed to increasing inequality and the creation of a new elite with close ties to the ruling party at that time (Čučković 1995, 87).

for shares held by the CPF (Bartlett 2004, 105). Around seven such companies collected the shares from the CPF and then started trading the share portfolio (around USD 400 million) on the stock market (Bartlett 2004, 106), which was expected to contribute to capital market development in the late 1990s (Franičević 1999, 16). The shares that were acquired by the workers before and distributed to various interest groups were often traded over the counter (OTC) (Grubišić Šeba 2017, 42) but also partly on the stock exchange. The early privatisation through the issuance of shares and through vouchers, as well as the obligation to trade the share portfolio of the privatisation investment funds, contributed to the early development of capital markets in a country that had just taken its first steps in a capitalist economy.

Apart from the regulatory obligation of the public and private funds to sell their shares on the Zagreb Stock Exchange (Franičević 1999, 10), only part of the available shares were traded on the bourse, which contributed to the volatile turnover in the late 1990s. Hence, the efforts to establish liquid capital markets were not successful, as the stock market mainly seemed to fulfil the role of transferring initial ownership rights during the transition from a socialist to a capitalist economy. Nevertheless, more than two dozen large corporations were listed on the exchange, which contributed to its noticeable capitalisation level early on. In that sense, the roots of the financialisation of NFCs with respect to market-based finance in Croatia are to be found in its transition to capitalism. This is evident insofar as capital markets were devised to transfer ownership and later received more attention and aid from policymakers who required public and private funds to list shares. After the inception of capital markets in Croatia and the crisis of 1998, the privatisation of the financial sector in terms of the remaining state-owned companies sped up. However, this did not always take place over the stock market and when it did, firms were swiftly de-listed from it. The new owners were often larger international conglomerates that saw no sense in letting their shares float on the domestic stock exchange, especially if they held all of the shares. The erratic development of stock market turnover can be seen in Figure 52, which denotes the key indicators of the stock market development starting from the middle of the 1990s until the end of the period under analysis.

Figure 52: Croatia – Stock market key indicators



Source: World Bank (2019b)

Figure 52 depicts stock market capitalisation to GDP and average return on shares in percent on the left-hand axis as well as turnover, i.e. the ratio of the volume of shares traded divided by capitalisation, on the right-hand axis. As noted in chapter 4, Croatia has the highest level of stock market capitalisation in SEE, on average only slightly lower than that of Germany but higher than e.g. in Poland or Austria (World Bank 2019b). At the inception of the stock market, turnover was fairly high given the low capitalisation of firms and the high number of shareholders owing to the privatisations. While spiking temporarily in 2000, turnover reached its climax in the two years preceding the crisis. Not surprisingly, these are also the years with the highest returns and capitalisation increases. After the crisis, capitalisation decreased but remained stable at 40%. At the same time, both returns and turnover plummeted. Returns were barely zero while stock market activity froze, especially when compared to the previous decade. Both returns and turnover behaved in a volatile manner, which is explained either through the privatisations or stock market hysteresis preceding the GFC. Stock market capitalisation increased more gradually and exhibited a typical bubble trajectory around the GFC, before settling at a higher value.

After the initial phase of transfer of ownership that coincided with the end of the war and stabilisation programmes, the stock market ceased to play an important role at the beginning of the century. This could be due to the fact that for example one of the largest banks, Zagrebačka Banka, floated a quarter of its shares on the London Stock Exchange (Barisitz 2000, 107). Two of the

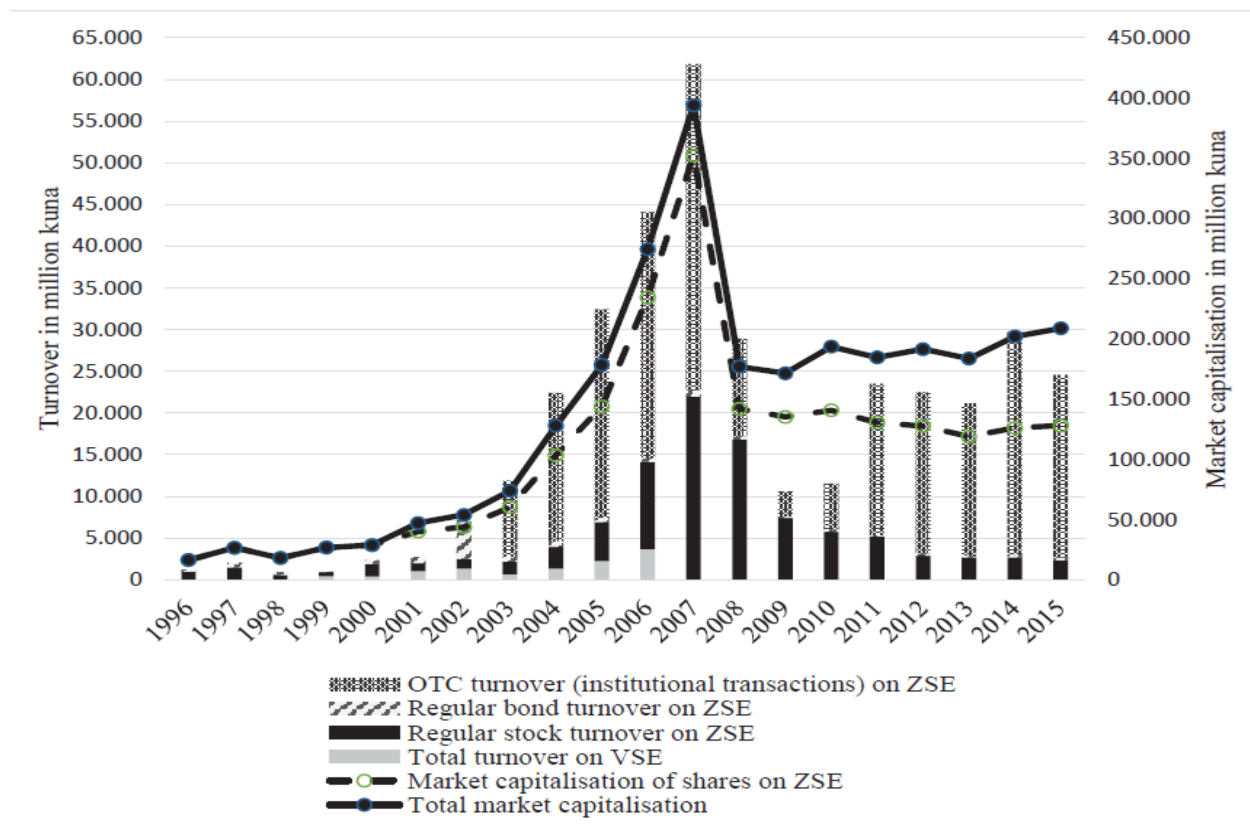
largest Croatian firms, Pliva (pharmaceuticals) and Podravka (foodstuffs), also raised funds on the same foreign stock exchange (Grubišić Šeba 2017, 51). Another explanation revolves around a change in the taxation policy, which required tax payments on dividends and capital gains from 2001 onwards.[127] The amendment was introduced by the new centre-left government in 2001 (Grubišić Šeba 2017, 55). The early engagement of large corporates in international stock exchanges is noteworthy when it comes to the financialisation of NFCs in emerging economies. Possibly due to the illiquidity of domestic capital markets, they turned to international bourses in order to raise funds, providing key evidence of the financialisation of these large corporates as they, in turn, needed to align their governance structures and business behaviour towards the needs of cautious but hungry global financial capital.

Turning back to Croatia, a number of decisive changes occurred at the beginning of the 21st century in the domestic stock market environment. The previous sub-section described how the pension reform foresaw the mandatory investment of private pension funds in domestic stocks (Bartlett 2004, 132). Investment in foreign securities was capped at 15% (Fund 2002, 22) and a minimum of 50% of funds had to be invested in government securities (International Monetary Fund 2008, 20). The regulation brought about a continuous pouring of funds into the domestic capital market, mainly channelled into government securities and the shares of a few large Croatian corporations (such as Podravka and Pliva). Due to the scarce supply of credible investments, the government mandated firms of a certain size or with a given number of shareholders to list on the Zagreb Stock Exchange in 2003 (Grubišić Šeba 2017, 42) in the hope that more firms would offer their shares to the public. Moreover, large state-owned companies such as the telecommunications and the gas and oil company were privatised over the stock market (Čučković, Jurlin, and Vučković 2011), contributing both to capitalisation and turnover (Grubišić Šeba 2017, 46) during the HDZ government from 2003 until 2011. The privatisation of these large utility providers as well as the change of the welfare system need to be seen in the light of structural neoliberal reforms after the fall of the Tudjman regime as well as unsustainable government expenses, despite the fact that the marketisation of these state assets did not bring the expected revenues (Bartlett 2004, 124). All these regulatory changes led an increasing number of companies to divert their attention to their stock market activities, which entailed mandatory regular reporting as well as a focus on short-run profit maximisation.

[127] There was none before (International Monetary Fund 2000, 48).

The years shortly before the crisis were characterised by a domestic stock market mania that even the IMF termed '*herd behaviour*' (International Monetary Fund 2008, 19). New firms listed on the stock exchange, but a great number of them traded with benign volumes of free-floating shares, leading to price volatilities (International Monetary Fund 2008, 19). The surge was so extreme that it was even on a par with the mayhem on the stock markets in Western Europe. Horvath and Petrovski (2013, 5, 11) found that the co-movement of stock market indices aligned to that of their Western European counterparts in the years prior to the GFC and that stock market capitalisation was nearing the maturity of that found in Central Eastern European countries, such as Hungary. The spike becomes visible once again in Figure 53, which illustrates turnover and market capitalisation levels.

Figure 53: Croatia – Stock market turnover breakdown



Source: Grubišić Šeba (2017, 48)

Figure 53 highlights the main components of stock market turnover on the right-hand axis while market capitalisation is denoted on the right-hand axis. It can be seen that over-the-counter (OTC) transactions (including institutional transactions) constituted the bulk of the dealings that took place

over the stock exchange. Regular stock market turnover only gained momentum from 2006 until the GFC of 2008, aided by the fact that the Varadzin Stock Exchange (VSE) was merged into the Zagreb Stock Exchange (ZSE) (Buljat, Ivanovic, and Baresa 2015, 230). As the graph indicates, bond turnover, a further sign of the transition towards market-based finance, played a minimal role. Indeed, it was shown by Sprčić and Wilson (2007, 77) that the corporate debt market in Croatia was limited to a few issues by large corporations. The bonds were sold to institutional investors, mainly pension funds, and held until maturity, i.e. they were not actively traded on the secondary market (Sprčić and Wilson 2007, 77). By the same token, fresh capital raised on the stock market by *non-financial* firms only amounted up to EUR 27.5 million (Grubišić Šeba 2013, 130) through the initial public offerings of seven firms, out of which two were privatisation-related (from 2006 until 2008) (Grubišić Šeba 2015, 1084). The share of *non-financial* corporations in all activities to raise public funds (offerings and private placements with prospectus) on the stock market hence only amounted to roughly 20%. The relatively limited involvement of the real economy in these transactions indicates that the stock market was rather used by the financial sector (Grubišić Šeba 2015, 1085). In a similar vein, survey research shows that firms tended to finance through banks or leasing companies (Grubišić Šeba 2013, 139). However, in terms of corporate governance, the mandatory listing necessitated companies to create a stock market prospectus and provide data on shares issued. Adding to this, the exposition to the stock market led a number of Croatian NFCs to adjust their management remuneration policies, i.e. to make rewards contingent on short-term business results (Grubišić Šeba 2015, 1089).[128] While only a few of the explanatory mechanisms for NFC financialisation can be confirmed, the mandatory listing certainly had an effect on the companies' business behaviour.

In sum, the Croatian capital markets mainly served the function of ownership transfer and consolidation given that few companies raised equity or financing through them and essentially regarded their listing as an advertisement (Grubišić Šeba 2017, 50–52). The run-up to the GFC triggered a short-lived stock market mania that quickly ceased at the first signs of negative news. The increased demand just prior to the GFC was further fuelled by a change in regulation that allowed the mandatory private pension funds to allocate up to 15% of their investments to riskier, non-tier-one Croatian assets (Iorgova and Ong 2008, 19). The comparatively high stock market capitalisation

[128] Grubišić Šeba (2015, 1089) conducted a survey of Croatian chief financial officers and found that out of his sample, 30% of respondents confirmed that this happened after listing their shares.

levels can thus be seen as a direct consequence of the mandatory listing requirements (Grubišić Šeba 2013, 130) as well as of the political will around the turn of the century. However, while it did not lead either to a transition towards a market-based economy or to a shift in the financing policies of Croatian non-financial firms, it had a definite effect on their renumeration policy.

With regard to NFC financialisation, up until the crisis there had been a certain trajectory towards market-based finance that transformed the workings of NFCs. This was driven by the idea of establishing domestic capital markets as well as by the need to provide domestic investment assets for the newly private pension funds through the mandatory listing regulation. Yet the relevant studies in this field on Croatia have observed that despite these political actions, a major transformation did not occur because the GFC put an end to this emerging trajectory. In that sense, the findings on the financialisation of Croatian NFCs through the stock market are rather mixed apart from the very few large corporates that occasionally engaged in global capital markets early on.

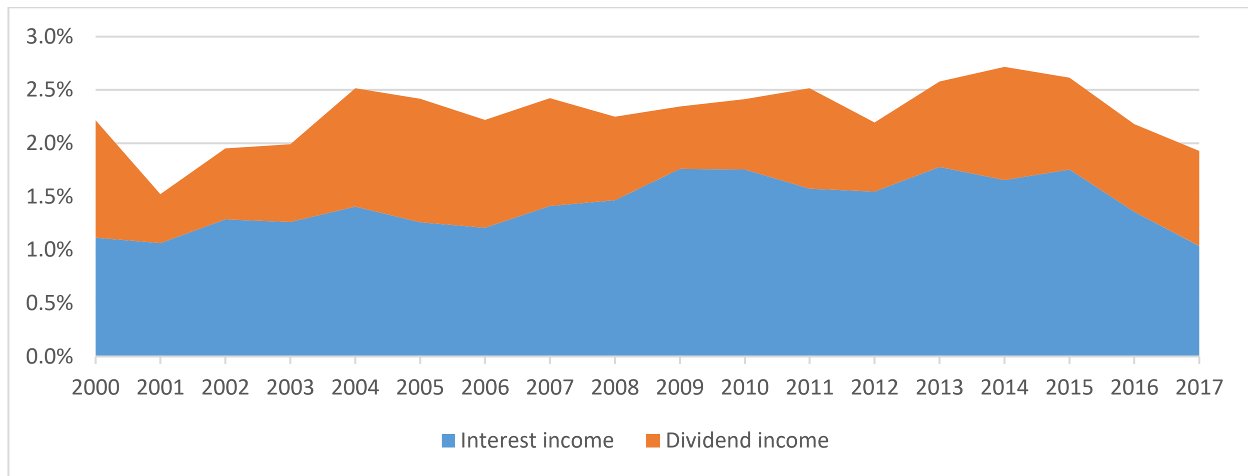
7.2.5 The relevance of financial income for Croatian NFCs

This section takes a closer look at the second indicator of NFC financialisation, that is the increasing holdings of financial assets and the increasing share of financial income at the expense of 'regular' income. In the comparative chapter of this thesis (chapter 4), the analysis of this indicator of financialisation was limited by data availability. However, as this data is partly available for Croatia, it is employed in this section in order to determine whether there has been a shift towards the 'financial' in Croatian companies and which mechanisms explain this shift.

As outlined in chapter 3.5, NFCs are argued to exhibit traits of financialisation when a growing share of their income derives from any kind of financial transaction. This occurs when traditional sources of income become less profitable or because financial income can be received more quickly, which itself is fuelled by short-term performance-based remuneration. Turning to Croatia before the GFC, Figure 54 depicts the share of financial income to total output received.[129] Since 2001, a slightly growing trend is visible that reverses starting from the year 2016.

[129] As no other variable was available for total income in the Eurostat (2021b) non-financial transactions database, the author chose *output* (i.e. the sum of all products) *received* (payments received for the sale of output). Capital gains as in Rabinovich (2019, 746) were not available.

Figure 54: Croatia – NFC financial income to total output



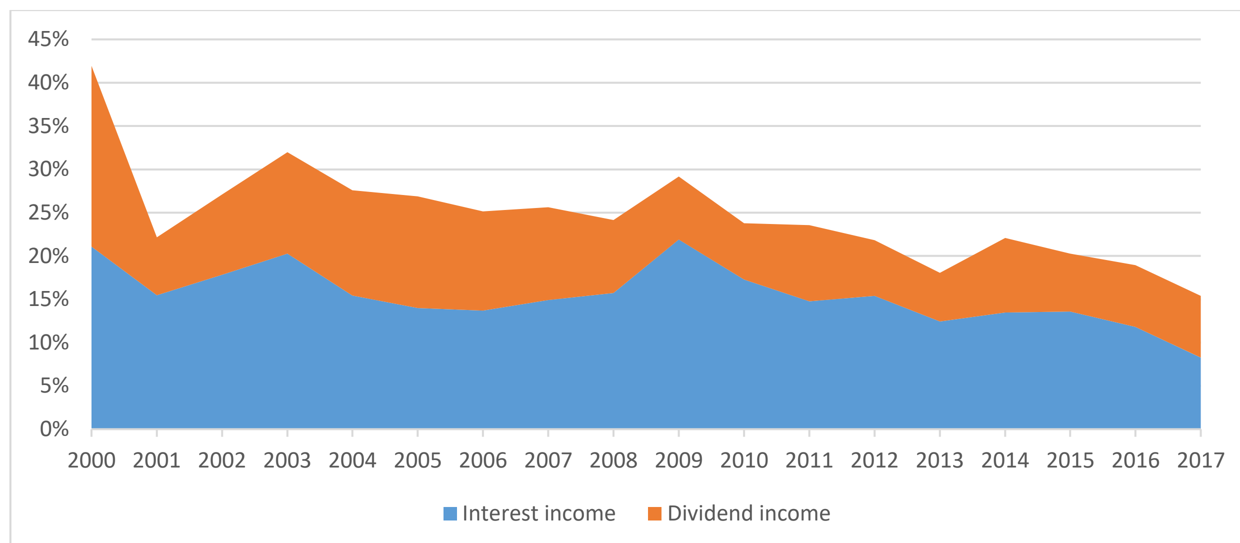
Source: Eurostat (2021b)

For most of the observed period, total financial income oscillated around 2.5% of total income. Strikingly, this is only slightly lower than the average values for firms in the USA, as shown by Rabinovich (2019, 752); however, it should be noted that data sources and classifications make it difficult to compare the cases.[130] This also concerns the denominator of this indicator (output received), which is slightly different from the one deployed in other studies (i.e. total income) and which suggests focusing exclusively on the Croatian trajectory. Until the GFC struck, dividend income had increased markedly, while interest income started rising after the crisis. This might suggest that firms were deriving an increasing part of their income from shares in other companies before the GFC, while interest income could also be generated from inter-company loans, which were widespread during the SFRY. Due to data limitations, however, it is not possible to ascertain whether dividend incomes derived from dividends from affiliated companies or FDI (non-financialised practice) or whether they stemmed from investments on stock markets (financialised practice). The development of the Croatian stock market described in the previous sub-section suggests that firms might have invested part of their income in shares of other companies and derived financial income from it. Such a business strategy would prove to be a case in point for the financialisation of companies in Croatia. Following the methodology of Krippner (2005, 185), who uses the ratio of financial income to cash flow, Figure 55 depicts the ratio of financial income to disposable

[130] The denominator output (used here) is either the same or lower than the turnover or total income used by Rabinovich (2019).

income.[131] Up until the GFC, the share of financial income had been fairly stable, whereas after the GFC it decreased considerably.

Figure 55: Croatia – NFC financial income to disposable income



Source: Eurostat (2021b)

Similar to the previous figure, interest income accounted for a higher share of total financial income than dividend income. Financial income as a share of disposable income averaged around 25% before the GFC, which is distinctly lower than the values in Rabinovich (2019, 752) for the case of the United States, in which he uses cash flow instead of disposable income. Financial income peaked in 2009 due to an increase in interest income. This is certainly related to the overall change in interest rates during the GFC. After the crisis, financial income slowly melted away, but this was also caused by growing disposable income for firms (denominator), while in the previous Figure 54 total output decreased after the GFC and only resumed in 2016. While the findings for the trajectory after the GFC are further discussed in the post-crisis section of this chapter, the pre-GFC trajectory does not show an increasing trend in the share of financial income to disposable income.

Hence, the findings on the share of financial income are mixed. Financial income to total income increased slightly before the GFC and remained stagnant thereafter. With respect to the share of financial income to disposable income, no clear trend is visible. Within financial income, interest income contributed more than dividends, which calls for scrutinising this component more deeply.

[131] Disposable income was used as a proxy for cash flow due to database limitations. (Krippner 2005) uses portfolio income comprising interest, dividends and capital gains. The latter data is not available.

However, due to data limitations[132], no further analysis could be done on the development of this indicator of financialisation. Instead, we turn to financial assets, which may help us identify the assets that generated the financial income. Data on financial assets is available from the Croatian National Bank (2020a), but the total assets of NFCs are not readily available. Remlein and Roška (2018, 14) analyse a small set of listed companies in Croatia (and Poland) and find that financial assets in comparison to total assets grew substantially, from 2% in 2005 to 16% in 2017. This may explain the increasing and later stagnant share of financial income to total income. For the pre-GFC period, financial assets consisted of around 50% in stocks and shares (Remlein and Roška 2018, 15), which further supports the argument that companies were placing an increasing part of their income in tradeable financial assets on the stock market, from which they derived dividends. After the crisis, however, the picture changes: despite the fact that financial assets increase, they instead tend to consist of longer-term and 'other' financial assets (Remlein and Roška 2018, 16).

As the findings in the previous sub-section indicate, NFCs embarked on a trajectory of financialisation shortly before the GFC. This was undoubtedly driven by the regulation of mandatory listings, which institutionalised stock market logic for companies, as well as by the mania on the domestic stock market in 2006 and 2007. After the crisis, financial income decreased while financial assets increased, at least for the small set of listed companies that were analysed in the abovementioned study. This suggests that these financial assets were held for other (accounting or organisational) reasons but do not reflect the continuing financialisation of Croatian NFCs. In sum, prior to the GFC, NFCs started to financialise, while the contribution of financial income to overall income was neither significant nor structurally increasing.

7.2.6 Interim summary

The pre-GFC trajectory of household and NFC financialisation has been shown to be closely linked to the evolution of the financial sector. The Western banks' hunger for expansion led to high growth rates in the lending portfolio, particularly to households. Before the GFC, financial assets even stood at 150% of GDP, even though the central bank enacted a series of measures to tame growth.[133] These measures prompted banks to search for circumvention techniques in the run-up to the GFC, which they found in the shape of cross-border loans, leasing institutions and credit houses. The circumvention mechanisms were mainly employed for companies, which explains the focus of

[132] A lack of finer-grained quantitative or qualitative data.
[133] In the same year, Bulgaria stood at around 80% of financial assets to GDP (see chapter 5).

banks on households. Yet the strong measures by the central bank have gone largely unmentioned in existing accounts of financialisation on Croatia, even though without them the (foreign-funded) lending spree would have been even more pronounced.

The burgeoning household loans were often disbursed in foreign currency, a practice which carried with it an exchange rate risk and which pushed the central bank to uphold its indirect peg to the euro. The analysis on the distribution of debt and income showed that in the first part of the pre-GFC period, loans were extended to the wealthier part of the population, hence suggesting elite financialisation. In the second period, i.e. the run-up to the crisis, debt was increasingly disbursed to lower-income households due to the more lenient lending practices by banks, the low level of financial literacy on the part of the borrowers, the proliferation of debt-based consumerism, and importantly, the belated introduction of a credit registry in Croatia. The debt-fuelled boom was argued not only to have led to household financialisation on the liability side, but also to have served as a temporal fix for welfare demands and for the imbalances created by the clientelist political system.

The problem of foreign currency household debt was aggravated by the mass disbursal of Swiss franc housing loans. These loans were marketed at alluring interest rates and often to sub-prime borrowers, which added to the emerging real estate bubble. When the Swiss franc exchange rate dwindled, the repayments exceeded the income of the borrowers, leading to large-scale defaults on these loans. Neither politicians nor the central bank dealt with the issue at the time, which would later lead to social mobilisation for a resolution of the problem. During the loan disbursal process, clients were revealed to have been misinformed about the potential foreign currency risk and the bonus-related payments for bank employees. The Swiss franc lending spree spurred the financialisation of households and added a novel twist by connecting domestic borrowers to the currency movements on global financial markets.

On the asset side, the pension system was overhauled and the second and third pillars were privatised in 2002, which created the initial conditions for the financialisation of households. The liberalisation of pensions was preceded by lengthy discussions in the 1990s by the late HDZ regime, which had to grapple with skyrocketing social expenditures and demands by the World Bank to join in similar neoliberal welfare undertakings like other countries around the world and in Eastern Europe. The proceeds of the pension savings had to be invested by the privatised funds, which were

all run by companies affiliated to Western banks. The creation of investment profiles further catered to the emerging image of a financialised pensioner or pension saver, while at the same time the well-connected friends of the old system (war veterans, etc.) retained their privileged pensions in the first pillar, which remained to be financed by the state.

The privatisation of pension funds necessitated having domestic stocks to invest in, which was made possible through enacting a mandatory listing of all firms above a certain threshold and privatising a series of state-owned companies through the stock market. The institution of the stock market itself in Croatia was closely linked with the initial ownership transformation after the country declared its independence from the SFRY. The stock market was deployed to transfer ownership to former employees and other interested investors. At the end of this process, a number of firms were acquired by domestic tycoons and friends of the Tudjman regime or bought back by the state through the privatisation fund. The merging of another domestic bourse into the Zagreb Stock Exchange spurred a share price mania shortly before the GFC, while NFCs still largely resorted to banks for their financial needs. The share of financial income in output and disposable income as another indicator of financialisation of the firm in Croatia revealed a fairly stagnant if not decreasing trajectory. However, financial assets in the form of stocks and shares were found to be increasingly held by NFCs in the year 2007, though it was rather the mandatory listing and ensuing focus on short-term shareholder value maximisation that indicated an emerging financialisation of NFCs in Croatia up until the GFC.

7.3 The repercussion of Croatia's financialisation in times of crisis

The preceding section traced the financialisation trajectory of households and NFCs in Croatia prior to the GFC and revealed several explanatory mechanisms. As highlighted in Figure 44, the GFC put an end to the increasing degree of both forms of financialisation. Stock market capitalisation decreased notably and household indebtedness stopped increasing. While the section on the post-crisis trajectory (section 7.4) provides a more in-depth analysis of why both forms of financialisation remained at elevated degrees after the GFC, this section briefly reviews the repercussions of the global financial turmoil on Croatia, with special emphasis on the two levels of financialisation.

The GFC first hit Croatia through a mild decrease in stock prices in early 2008, while the full blow to the economy commenced at the end of the same year. From 2009 onwards, Croatia registered a continuous decrease of GDP for six consecutive years, rendering it a particularly long period of recession (Bokan et al. 2009, 2; Falck and Schönherr 2016, 11). The growth rate in this recessive time period averaged around -2% of GDP per year (Croatian National Bank 2020b). At the same time, unemployment doubled from around 8.5% to more than 17% and the negative double-digit current account balance slowly turned positive, but this was mainly due to falling imports (Croatian National Bank 2020b). The ruling HDZ government reacted in a rather cautious manner as government revenue crumbled and social transfers surged. Instead of devising a large-scale stimulus package, it implemented some minor cuts in the public budget so as not to breach the conditions set for Croatia's impending accession to the EU (Murgasova and Rahman 2012, 248).[134] According to Šonje (2012, 1), the state's hesitant approach during the GFC served mainly to 'buy time', as the ruling party did not wish to touch the structural budgetary problems of transfers to special recipients and subsidies to loss-making companies. Adding to this, an anti-corruption scandal involving Prime Minister Sanader in 2009 kept the government officials even busier than the GFC itself (Bohle and Greskovits 2012, 254). In 2012 the incoming government led by the SDP introduced more substantial austerity measures, which included a decrease in subsidies (Šonje 2012, 4). Besides the discussed prevailing characteristics of clientelist capitalism in Croatia, which prevented it from having more fiscal leeway in the crisis, the main problem was that the Croatian government did not pursue a consistent crisis strategy. Apart from not devising counter-cyclical measures, it

[134] An overview of the government actions in the immediate aftermath of the crisis can be found in Franičević (2011, 173–74).

pursued neither internal (wage reduction) nor external (depreciation) devaluation, which would have increased its competitiveness (Buchen and Wollmershäuser 2016, 32).

The early signs of an impending financial crisis caused insecurity among the population in Croatia and other countries in the region, and rumours about problems at the parent banks of foreign financial institutions provoked large-scale deposit withdrawals (Bokan et al. 2009, 7). The financial system was fairly stable in the run-up to the crisis, as Croatia featured very high equity requirements and banks were asked to capitalise their profits during the crisis years (Kraft and Galac 2011, 3; Murgasova and Rahman 2012, 249). In order to ease funding in times of liquidity distress and large withdrawals of deposits, the CNB abolished the marginal reserve requirement and reduced the minimum requirement amount of foreign currency claims (foreign liquid assets) (Bokan et al. 2009, 4–5). This helped restore confidence in the stability of the financial system and recoup deposits. During the crisis, the CNB loosened a number of other regulations to further stabilise the liquidity of the financial system and spur credit growth.[135] In doing so, it quickly managed to induce domestic credit growth in 2009, as seen in Figure 46, while the medium-term effects were marginal. Surprisingly, foreign borrowing by financial institutions essentially remained stable, though the funds were now directed towards government bonds (Bokan et al. 2009, 38) while cross-border lending waned. The loss of confidence among depositors as well as international investors caused the kuna to depreciate slightly, which was reinforced by the need for companies and the government to pay back external debt (Gardó 2010, 9). In total, the domestic currency depreciated by around 7% between 2009 and 2015, after which it stabilised (Buchen, Drometer, and Wollmershäuser 2016, 54). The CNB intervened heavily to uphold the managed fixed exchange rate (in view of financial outflows) so as to prevent the foreign currency risk of domestic debtors from materialising (Kotarski and Tkalec 2019, 156). The need for the central bank to intervene so drastically revealed that the stable exchange rate before the crisis was one of the main reasons for the high level of financial inflows, as argued by Murgasova and Rahman (2012, 247).

In the years leading up to the crisis (2006 and 2007), the Croatian stock market had been one of the best ‘performers’ – in the world, even (see Figure 52) – but during the crisis it slumped by 75% from the end of 2007 to the first quarter of 2009 (Gardó 2010, 32). This development resembled that of other Southern European countries (Kotarski and Petak 2019, 13) and consequently credit default swap rates shot up (Murgasova and Rahman 2012, 247). The corporate bond market, which

[135] Gardó (2010, 10) provides an overview of the actions by the CNB.

increased its activities before the crisis (as argued in the preceding section), dried up completely, thereby contributing to the decreasing activity and decapitalisation of the stock market. Due to the falling share prices and returns, the GFC brought about problems for the privatised part of mandatory pension funds. Their profit stagnated in 2008 and the values of assets held[136] by pension funds decreased by around 20% in 2008 (HANFA 37-40). This indirect loss of the mandatory second pillar caused fierce public debate about the stability of the privatised pension system (Vidović and Pauković 2011, 104). Though this drop was significant in the short run, the increasing government debt and interest rates to be paid on public bonds contributed to balancing out the negative effects in the medium run. The swift turnaround was possible because domestic government bonds represented around 70% of the total asset portfolio of the privatised pension funds. However, the GFC exposed how pensions became susceptible to the vagaries of global financial markets, which highlights the causes and effects of household financialisation.

Apart from the stock market, the unsustainable credit surge before the crisis caused bad loans to rise during the GFC. Non-performing loans of households tripled from 2008 to 2014 from 4% to 12% (Buchen, Drometer, and Wollmershäuser 2016, 55), which contributed to a general increase of the risk of poverty (Franičević 2011, 193). Thus, on both the asset and the liability side of household financialisation, the increasing degree before the crisis exacerbated the repercussions of the crisis. Similar to stock prices, the real estate market experienced a price slump as well, which created problems for some housing loan debtors but even more so for banks, as their collateral values were reduced (Gardó 2010, 19). As the stock market no longer proved to be a financing option for companies and the traditional bank lending channel was muted due to loan quality problems, NFCs found it difficult to obtain financing for their business endeavours. The next section discusses the post-crisis financialisation trajectory of Croatia and why it maintained its (reduced) degree of financialisation on the level of both households and NFCs.

[136] This refers to the Croatian MIREX index (Croatian Financial Services Supervisory Agency 2009, 37).

7.4 Post-crisis financialisation trajectory of Croatia

The last section exposed the reverberations of the GFC, which were aggravated by the pre-GFC financialisation trajectory on the level of households and NFCs. This section analyses the post-crisis financialisation trajectory of households and NFCs in Croatia. Shortly before the admission of Croatia to the EU in 2013, a new centre-left government came to power that had to juggle ailing growth rates, the impending accession and skyrocketing government debt. Though the new government gave into the demands of financial markets for debt consolidation, it did not implement severe austerity measures outright, as for example demanded by the IMF, which led Croatia to slide into an Excessive Deficit Procedure directly following its entry into the EU (Lendvai and Stubbs 2015, 457).

Another pattern of the post-crisis financialisation trajectory in Croatia shared with other states in the region consisted of the shift of private to public indebtedness (Kotarski and Petak 2019, 13). While the private sector debt levels stagnated, the public sector grew its debt stock considerably in the first half of the 2010s and only after some time managed to reduce its deficits to more sustainable levels. As the introduction of this chapter already mapped out, the degree of household and NFC financialisation did not intensify but instead remained at roughly the same degree after the crisis and even declined in the last two years of analysis. Thus, the focus of this section is on analysing which mechanisms explain the continuous and lately decreasing degree of financialisation in Croatia. The first sub-section of this section addresses this question for the case of households, while the second sub-section investigates the trajectory of NFCs.

7.4.1 Household financialisation after the crisis

The GFC put an end to the increasing degree of household financialisation in that indebtedness levels did not rise further and even decreased in the last two years of analysis, as shown in Figure 44. Loans to households represented more than half of the total portfolio of the banking sector and remained at the same level throughout the post-crisis period (as presented in Figure 46). According to the data for household indebtedness, for the last two years of analysis, rising income levels and hence the increasing economic activity were the reasons for the decreasing indebtedness. Within the category of household loans, housing and car loans fell while any-purpose cash loans increased in the post-crisis phase (Figure 47, Rosan and Zauder (2020, 16). This suggests that due to the recession, people were taking out loans to make ends meet instead of using finance as a means for

personal investment. This section deals with the post-crisis phase of financialisation and attempts to shed light on the stagnant degree of household financialisation on the liability side and on the development of the asset side, with particular emphasis on the mechanisms that have contributed to it.

During the first decade of the 21st century, Croatia experienced a lending boom that was especially punctuated in the realm of households. While this fuelled their financialisation, the crisis and its repercussions effected a great share of these households to slide at the brink of default. In 2013, one in five citizens was experiencing financial losses or problems with debt repayment (Bejaković 2016, 51) and later in 2016, the risk of over-indebtedness stood even at a staggering 48% (Eurofound 2020, 10), placing Croatia on the second highest rank in the EU after Greece. Besides the lending spree, one of the key reasons for the continuing indebtedness of households has been the missing legal framework for debt resolution. Similar to other countries in the region, Croatia had allowed banks to lend massively to the population while lacking necessary institutions that would support the debtors in case of repayment problems. The adoption of the 2007 Consumer Protection Act brought only minimal protection to debtors, while a long awaited law on personal bankruptcy was only effective starting from 2016 (Bejaković 2016, 53–54). Adding to this, Croatia has been featuring absent or limited debt advisory services (Eurofound 2020, 1). Altogether, this aggravated the situation of over-indebted households and led to a high number of so-called 'blocked accounts'. According to Mikuš (2019a, 306) this procedure was easily enforceable by creditors in Croatia. Hence, adding to the belated introduction of a credit registry for households discussed in an earlier section, consumer protection, debt resolution and advisory were all missing or inadequately implemented in Croatia, which put debtors in problematic situations and exacerbated the effects of the financialisation of households.

The dire situation of debtors and especially of those with Swiss franc loans led to public considerations about the matter, which was reinforced by interest groups that lobbied for the rights of debtors. Figure 48 highlights how Swiss franc loans rose markedly in the 2000s and then decreased throughout the post-crisis trajectory. The depreciation of the Swiss franc led thousands of debtors to slide into personal bankruptcy. This triggered the formation of a rather professionally organised social group that lobbied for a political solution to the Swiss franc problem, as described in Mikuš (2019a, 309) and Rodik (2015). The social groups were successful in that the loans were retroactively converted into euros, which shifted most of the burden onto banks (Kotarski and Tkalec

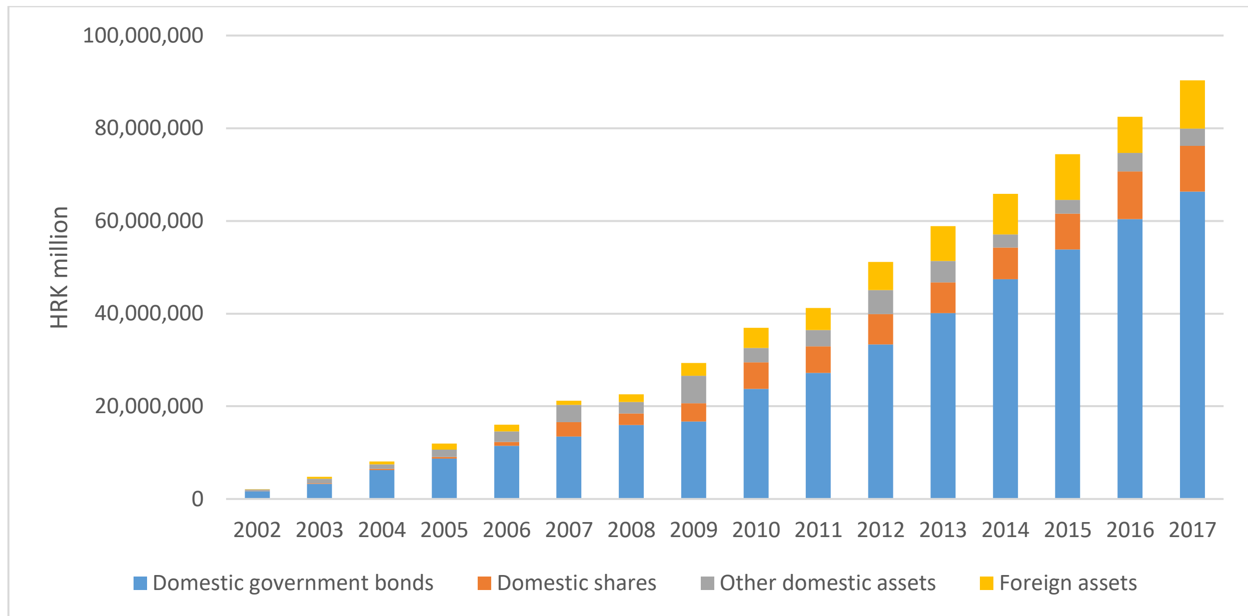
2019, 162). However, the loss did not harm them much, as they were granted eased liquidity requirements by the central bank (Flug and Towe 2020, 5) and were able to again report profits a year later in 2016. The centre-left government jumped on the bandwagon of these political demands as a means to soothe public discontent with the enacted austerity measures (Mikuš 2019a, 310). The debate on the subject even incentivised many people to convert their private loans to local currency loans as they now realised the true impact of foreign currency risk (Kotarski and Tkalec 2019, 163), leading the share of local currency loans to increase (see Figure 48). Although the kuna depreciated from 2009 to 2015 by around 7% (Buchen et al. 2016, 12), the central bank maintained its managed peg policy even against calls by the IMF to let the currency fluctuate more (Flug and Towe 2020, 8). Thus, the fallout from consumer lending and the Swiss franc disaster effected a swap of lending practices.

Concomitantly with the conversion of Swiss franc loans, Croatia enacted a series of debtor protection laws and regulations in the second half of the 2010s. To resolve the problem of blocked accounts, a 'fresh start' programme was introduced (Buchen et al. 2016, 12) to offer defaulted households a way out of the debt trap. At the same time, the central bank tightened lending standards for banks in late 2013 and 2014 with regard to interest rate limitations (Bejaković 2016, 48). The prevailing political sentiment in this respect is underscored by a law that was passed in 2017, nullifying the direct loans from Austrian cooperatives, which would later be abolished by the European Court of Justice (Mikuš 2019a, 305). Together with the other mentioned items, these regulations and laws suggest that the age of financial liberalisation in Croatia, which started with its independence and was reinforced at the turn of the century, had to a certain extent ended around the year 2015. The winding back of untethered lending practices through the enacted regulations and laws explain part of the stagnating and later decreasing household financialisation. They were partly rooted in the social mobilisation and political actions, which hence constitute key explanatory mechanisms. In parallel to the reduced level of household financialisation, inequality also declined in the second decade of the 21st century (measured by the Gini index (Eurostat 2021a)), providing us with another explanatory factor.

While this illustrates the developments on the liability side, on the asset side, household financialisation continued to naturally increase as ever more people joined the mandatory privatised pension scheme. As depicted in Figure 51, the financial assets of households surged primarily due to their holdings in the pension funds. This occurred despite the reduction of government subsidies for the

third (private) pillar as a way to reduce burdened government debt (Lendvai and Stubbs 2015, 458). The private pension funds continued to invest the vast majority of their financial assets in Croatian government bonds, as shown in Figure 56.

Figure 56: Croatia – Pension fund's Pillar II asset breakdown



Source: Croatian Financial Services Supervisory Agency (2021), author's calculation

As argued in the preceding sections, the pension funds only started to invest part of their assets in non-government bonds around 2006, after regulations were relaxed. This decision rebounded negatively when the GFC struck in 2008. Since 2010, government debt represented around two thirds of the total stock of pension fund assets and in the last year of analysis, 2017, they even amounted to nearly three quarters. Hence the privatised and financialised pension system (Mikuš 2020, 1) produced a peculiar state-finance nexus, in which individuals are increasingly saving for their retirement in private pension funds, which offer three different investment categories, but place the majority of their funds in government bonds. In between the process of government financing and saving for retirement, both fund managers and banks designing and underwriting the government bond issuances (Mikuš 2020, 26) retain a certain fee. The privatisation of the pension system certainly helped to structurally decrease the burden on government debt, while the clientelist rewards for war veterans, their families and other friends of the system, as described in the preceding sections, continued to be in place in the first pillar (the PAYG system). In that sense, household financialisation was traded for maintaining a selective pension system that has put a considerable burden on government finances.

In sum, household financialisation on the liability side stagnated and even decreased in the last years of analysis due to high default rates and to social mobilisation against Swiss franc loans, which prompted politicians to put in place a range of measures that would help indebted households and contain aggressive household lending to some extent. Certainly, the reinvigorated economy starting from 2016 helped both the government as well as indebted households decrease their debt levels. On the asset side, household financialisation persisted through a financialised pension system, which aided the government in containing its deficit and shielding its loyal voters with preferential pension claims in the old PAYG Pillar I system.

7.4.2 Financialisation of NFCs after the crisis

Similar to the post-crisis trajectory of household financialisation, the financialisation of NFCs also stagnated and decreased after the crisis. Stock market capitalisation levels fell dramatically during the GFC, as highlighted in Figure 44, and since then have remained at around 40% of GDP. At the same time, financial income of NFCs compared to output remained stagnant and decreased in the last two years of analysis (Figure 54), while financial income to disposable income decreased throughout the post-crisis period (Figure 55). As financial income to total output decreased in the last two years of analysis, in which the economy started growing again (Croatian National Bank 2020b), this points to the fact that the growth model of Croatian NFCs did not rely extensively on income derived from short-term financial deals. Likewise, the size of financial derivatives held by NFCs in Croatia was low throughout the post-crisis phase (Croatian National Bank 2020a) as they tended to hold longer-term financial assets (Remlein and Roška 2018, 14). Hence, in the realm of NFC financialisation, Croatia saw a decreasing degree of financialisation when it comes to financial income and a rather stagnating degree concerning the stock market capitalisation level (which is still substantially higher than in the other countries in the sample). As the research is constrained by data limitations, this section primarily concentrates on the reasons for the stagnating stock market development as an indicator of financialisation.[137]

After the heydays before the GFC and the subsequent fallout, stock market capitalisation rose, plummeted and then this indicator of financialisation remained at a degree that was higher than at the beginning of the 21st century. In the post-crisis phase, stock market turnover fell drastically and continuously while average returns oscillated around zero (Figure 52). The declining turnover was

[137] Primary (interviews) and secondary (literature) data considerations limit the researcher's ability to analyse possible explanatory mechanisms for these indicators of NFC financialisation.

chiefly due to a lack of demand from private investors and the small proportion of companies' shares in free float, as a number of firms sought to acquire their own stocks with the aim of delisting from the market (Grubišić Šeba 2017, 51). The available free float was further reduced by the great demand from institutional investors, mainly pension funds, to hold stocks for a longer term. As described in the preceding sub-section (Figure 56), pension funds increased their assets year on year and invested a portion of them in domestic stocks. Thus, in the post-crisis phase, the stock market served only two functions, namely that of listing large former state-owned enterprises and that of government debt issuance (Grubišić Šeba 2017, 47).

It was already argued that government debt rose markedly during both the crisis and the post-crisis phase. The Croatian state had to spend more on social transfers while also having to deal with reduced tax income due to the continuous recession. This necessitated the issuance of government bonds, which was undertaken on both domestic and international markets. Mikuš (2020, 25f) describes the practice of Croatian government bond issues in detail. The bonds that were issued domestically contributed to stock market capitalisation volume, as the Zagreb Stock Exchange was the natural choice for these placements. Bonds would be placed there to render the securities more tradeable, which is the same practice carried out in other Western countries. However, these government bond issues hardly contributed to, nor do they explain, the financialisation of NFCs.

The tepid stock market trajectory may be further expounded through the developments of two large former state-owned enterprises, the Croatian telecommunications company and the Croatian oil and gas company. Both were privatised around the turn of century and listed on the domestic stock market and the London Stock Exchange in 2006 and 2007 (Čučković, Jurlin, and Vučković 2011). Peculiarly, the remaining free floating shares (the majority of shares were owned by strategic foreign investors and pension funds) were delisted in 2014 from the London Stock Exchange, where the 'global depository receipts'[138] were also made available for trade at the time of the initial public offering in 2006 and 2007 (Grubišić Šeba 2017, 51). The delisting contributed to a certain extent to domestic turnover, but more importantly highlights how Croatian firms sought less finance and equity on global financial markets as there was little interest in their stock. It has been argued that one of the reasons for the continuous domestic appetite for stocks was that demand stemmed from Croatian institutional investors. The privatisation and financialisation of welfare in Croatia, above

[138] Globally tradable bank certificates for shares.

all the pension system, contributed to a domestic pool of capital that was invested in all major Croatian firms that were listed on the domestic stock exchange.

Another factor explaining the modest development of the stock market in the post-crisis phase lay in the government's failure to develop the stock market (Grubišić Šeba 2017, 57). Although international financial institutions such as the ERBD continued to encourage the country to make progress in this area (EBRD 2010), the centre-left government undertook few actions in this regard and enacted a full capital gains tax in 2016 (Grubišić Šeba 2017, 56). Furthermore, the stock market was shaken by the scandal related to Agrokor, one of the region's largest companies, with the trading of its shares suspended in April 2017 (Škrinjarić and Orlović 2019). In sum, the degree of NFC financialisation stagnated and even decreased after the GFC due to a lack of demand for shares traded on the stock market. The government's hesitancy to undertake any actions in this regard and the ongoing delisting of companies from the stock market, which commenced since the mandatory listing of firms in the first decade of the 21st century, further contributed to the stagnation of domestic capital markets. Companies sought finance mainly from domestic banks – if at all – and did not undertake any major bond issuances. The involvement of the privatised pension funds in the domestic capital market suggests that the motive of short-term shareholder value maximisation of Croatian firms was not as predominant as in the pre-GFC phase and indicates the workings of a peculiar form of pension-finance nexus. Hence, the Croatian financial system can still be considered as bank-based, while companies rarely engaged in any kind of financial income generation in the post-crisis phase.

7.5 Chapter summary

This case study on Croatia set out to elucidate the degrees of household and NFC financialisation throughout the last two decades. Overall, the study found that both levels exhibited intensifying degrees of financialisation before the GFC, driven by a combination of neoliberal policies, a lack of consumer protection, country-specific transition policies, regulatory decisions and aggressive bank behaviour, while in the absence of these factors after the GFC, the degree of financialisation stagnated. The comparatively high starting point of the financialisation of NFCs at the turn of the century is explained through the Croatian transition policies, which included the privatisation of NFCs over the stock exchange during the 1990s. Paradoxically, a series of these firms again landed in the hands of state-owned privatisation funds later on. At the same time, banks lent at high rates to consumers and firms alike, which produced a banking crisis in 1997 and 1998. The comparatively high starting point of household financialisation was reasoned by the actions of the government, which decided not to let the dwindling banks go broke but to save them at a high cost, and this shielded banks from writing off their bad consumer loan portfolios. As chapter 4 argues, most other countries in the region featured similar financial crises at the end of the 1990s, but in those cases banks were not saved but either closed or allowed to fail. Another general explanatory mechanism for both financialisation trajectories was expounded in the price stability focus, the HNB's prime concern since the middle of the 1990s, but this needs to be seen in the context of two historical phases of high inflation. At the same time the indirect peg instituted in the 1990s continuously eroded the international competitiveness of Croatian firms but safeguarded banks from a depreciation of their disbursed loans.

Concerning the trajectory of household financialisation, one central mechanism that was confirmed to have brought about higher indebtedness levels consisted in banks focusing on households instead of NFCs. In part this was caused by some larger NFCs listing themselves on foreign stock exchanges, where they received equity and debt and hence reduced their domestic demand for credit. Another reason pertained to the development of the financial sector. By the beginning of the 21st century, the sector was largely overtaken by foreign international banking groups. They exhibited a high-risk appetite and engaged in increasingly lenient credit risk practices, lending first to the wealthier and then to the lower-income segment of the population, which suggests a pattern of "elite financialisation first, popular financialisation second". When the financial-assets-to-GDP ratio crossed the 100% threshold, the central bank became wary of the pace of credit provisioning

and enacted a series of regulations and measures aimed at curbing domestic lending and foreign funding. The international banks found their circumvention techniques in cross-border lending and leasing through non-bank financial institutions chiefly to NFCs, which explains the domestic banks' increasing focus on household lending.

This trajectory of household financialisation was amplified through the disbursal of loans in euros and through the introduction of Swiss-franc-denominated housing loans. While any foreign currency loan necessarily carries a risk for the household and chains it to the movements of global financial markets as well as to the maintenance of the indirect kuna-euro peg, Swiss francs were revealed to be even more toxic due to their detachment from the reality of Croatian households. Regulation to stop this development proved inadequate, and the fallout from the GFC and from the surging exchange rate of the Swiss franc was especially dire for these homeowners. The credit-induced housing bubble on the real estate market was argued to have served as a sort of temporal fix for the still unequal and clientelist system marked by a structural underdevelopment of Croatia's export sector. The lack of a credit bureau and of regulations addressing indebtedness levels were determined to be two pivotal domestic institutional drivers that supported this development. Inequality and wage depression were argued to represent hypothesised explanatory mechanisms for household financialisation. In the case of Croatia, the clientelist system of the 1990s carried a whiff of inequality, although overall wage inequality was not as high as in other countries in the region. Wages did rise, but not as much as GDP growth, so one can speak of suppressed rather than depressed wages.

On the asset side, households saw their financial assets increase due to the privatisation of the pension system in the early 21st century. Orchestrated by international financial institutions, the institutional change was viewed as necessary due to buoyant state finances that resulted from a wide range of privileged pensions for war veterans and people with connections to the old Tudjman system. The privatised pension funds are all run by banks, most of them from the very same Western banking groups that received fees for handling the funds. Through the pooling of pensions savings in investment funds, future pensioners became financial investors with risk categories to choose from and dependent on the movements of and returns on global financial markets. However, one cannot speak of a general retreat of the public welfare state, though its onerous payments were primarily directed to a large group of privileged pensioners, creating a bifurcation in social provisioning.

With regard to the financialisation of NFCs, the stock market was already instituted in the 1990s to privatise companies and to handle the initial ownership transfer that often resulted in ownership concentration. At the same time, some larger Croatian firms even listed on international stock exchanges. Both developments contributed to a growing focus on the international norms of (short-term) shareholder value maximisation. The partial privatisation of the pension system triggered a demand for investment opportunities, which was addressed by a mandatory listing law in 2003 for most Croatian firms and by the privatisation of former state-owned enterprises through the stock market. Hence, the privatisation of welfare not only brought about the financialisation of households but of NFCs in Croatia as well. These developments gave way to a stock market mania on the Croatian exchange. This was seldom accompanied by bond issues from NFCs, however, indicating that the Croatian financial system was only modestly developing towards a market-based system. At the same time, financial income to output and disposable income, another indicator of financialisation, was developing steadily and at non-negligible levels, while financial assets of firms were rising and increasingly held in the form of shares. All these mechanisms and developments contributed to an increasing financialisation of Croatian NFCs in the pre-GFC phase.

The GFC brought recession and unemployment to Croatia at a time of political uncertainty given the lingering corruption allegations against Prime Minister Sanader. Thus, the ruling government bought time and continued to sustain special social recipients and state-owned companies without devising any major counter-cyclical measures. The resulting rising government deficits were only tackled after a governmental change with milder austerity measures. The financial system had to grapple with high default rates on loans, but the central bank maintained financial stability and the kuna-euro peg through its actions. The stock and real estate market suffered a huge blow, which also resulted in losses for the privatised pension funds. The previous financialisation trajectory hence exacerbated the effects of the crisis.

As for the post-crisis trajectory, both household and NFC financialisation stagnated and modestly declined in the last two years of analysis, albeit remaining at elevated degrees. The lack of consumer protection or aid to defaulted borrowers worsened the situation of households with high indebtedness levels. On the back of social and political mobilisation against the Swiss franc loans around 2015, a series of regulations and laws were enacted that would help household borrowers deal with their debt. Swiss franc debt was converted into euros at the expense of banks, which nevertheless suffered only mild losses from the measure. After the crisis, inequality decreased

while the financial assets of households continued to increase, especially in the form of private pensions. Hence, the financialisation of households ebbed on the liability side but increased on the asset side. Stock market capitalisation dwindled after the GFC and then remained stagnant while share turnover consistently decreased. This had to do with the fact that an increasing number of firms delisted from the exchange and firms continued to rely mainly on banks for financing. The only relevant activity on the stock market was government bond issues, which were now much more frequent than before the crisis. Otherwise, the government did not undertake any actions to foster the capital markets. Overall, in the absence of the drivers identified for the pre-GFC trajectory, the degree of financialisation stagnated after the GFC.

A certain amount of research on financialisation in Croatia has already been undertaken, yet this study has added to developing a more complex understanding of the subject matter. Rodik and Zitko (2015) as well as Rodik (2015) have analysed the level of household financialisation in Croatia with a detailed focus on foreign currency loans and more specifically the practice of Swiss franc loans. The analysis presented in this chapter has partly repeated the exercise with a consistent conceptualisation of financialisation but added to it a more in-depth understanding of the housing market and consumer protection (laws, regulations, credit bureau), as well as the banks' heightened focus on consumer lending because company financing was by majority done through cross-border lending. Mikuš (2019a) highlights the countermovement initiated by Croatian debtors after the crisis and the end of the intensifying financialisation trajectory, yet this chapter has exposed how, in around 2015, the government indeed gave in to the demands of their voters by mandating the conversion of Swiss franc loans and enacting other laws and regulations to tame predatory household lending.

With regard to household financialisation, an exploration of the privatisation and financialisation of the pension system has so far been largely absent from the abovementioned studies. Only Mikuš (2019b, 9, 2020, 10) briefly mentions the set-up and evolution of the pension system, but fails to highlight its relevance for the accumulation of financial assets in households as well as fostering the capital market development in Croatia, e.g. through the mandatory listing. Nonetheless, the two studies by Mikuš (2019b, 2020) referred to above complement this chapter by focusing more explicitly on the topic of state financialisation and government debt. An analysis of the financialisation of Croatian NFCs has thus far not been covered in the literature, which otherwise focuses intensively on the high capital inflows, central bank policy and foreign currency loans (Cvijanović

and Kešeljević 2015; Radošević 2015). Yet the actions of the central bank to tame growth and limit foreign funding are not dealt with extensively in the present literature on financialisation in Croatia, which is one of the issues that this chapter addressed in order to deliver a more complete picture. In sum, this chapter has added to the existing research on household financialisation and presented a novel analysis of the financialisation of NFCs. Lastly, the stagnant and decreasing degree of financialisation in the post-crisis phase has not yet been fully addressed in the respective literature and likewise supports the argument that financialisation is not a one-way trajectory but one that is continuously mediated both domestically and externally.

8. Conclusion

This thesis has set out to analyse the degrees and trajectories of financialisation in the countries of SEE and to elucidate its drivers through three case studies. The temporal scope was divided into two periods: from the turn of the 21st century until the GFC in 2008, and from 2009 until 2017. It was found that financialisation in the region has been highly variable, both in terms of differences between countries and also when comparing different levels. For instance, there was not a single country which experienced the highest relative financialisation across all levels. The study confirmed a range of drivers that had been argued to cause financialisation (in peripheral economies), whereas some drivers were either disproven, could not be checked or the results were not straightforward. Next to this general finding, the thesis provides answers to the research sub-questions presented in chapter 3.1:

Key finding to RSQ1: How has the degree of financialisation developed over time in the different countries of SEE?

In the pre-GFC phase, most of the countries in SEE increased their degree of financialisation. After the GFC, the developments diverged: financialisation stagnated on the levels of the household and financial sector, and even decreased for NFCs and international financialisation. Overall, the degrees varied between countries and among the levels of financialisation.

Key finding to RSQ 2: Which countries are the most financialised on each level of financialisation?

On the level of households and NFCs, Croatia exhibits the highest degree of financialisation. Bulgaria displays the highest degree of financial sector financialisation, while Serbia is the country with the highest degree of international financialisation. Albania, Macedonia and, to a certain extent, Bosnia feature consistently low financialisation on all four levels.

Key finding to RSQ3: How are the trajectories of financialisation characterised on the different (extreme case) levels and what caused them?

The trajectory in Bulgaria is characterised by rapid growth of the financial sector, driven by foreign banks, from a low point after a domestic financial crisis in 1997, which eradicated a significant part of the financial sector and deposit base. Other explanations include neoliberal policies, domestic political support and changing consumer mentality. The Croatian trajectory is likewise marked

by high growth in credit to households but from an already higher position, as domestic policy-makers had saved ailing banks during times of a domestic crisis at the end of the 1990s instead of bankrupting them. At the same time, the financialisation of NFCs was instituted by privatisation policies and further fostered through mandatory stock exchange listings. Serbia's international financialisation can be traced even further back to the SFRY, yet the pre-GFC trajectory was mainly driven by foreign funding and repo speculations embedded into assertive political sentiment. Foreign currency lending became attractive due to much lower interest rates and few objections by the regulator, which in turn connected Serbian debtors to the vagaries of international currency markets – a risk that eventually materialised in the GFC.

Key finding RSQ 4: Which conceptual mechanisms help explain the (extreme case) degrees of financialisation and how?

Among the general drivers that are assumed to cause financialisation, it was found that deregulation, asset bubbles, profit maximisation and the privatisation of public goods have been the most prominent. On the different levels of financialisation, the high degrees were mainly explained by foreign banks, their diverted focus on consumer lending, and the liberation of capital controls which was part of the harmonisation of regulatory regimes. The identified drivers were shown to be interwoven with the individual domestic historical contexts, setting in motion causal processes that proved conducive for financialisation.

Apart from the key findings, this conclusion provides a brief summary of the thesis (section 8.1) and presents a regional synthesis (section 8.2) based on the findings. It is shown how the thesis contributes both to the academic discourse on financialisation in SEE (section 8.3) and to financialisation research as such (section 8.4). The last two sections provide an outlook and policy recommendations (section 8.5) as well as closing remarks by the author (8.6).

8.1 Summary of the thesis

The thesis commenced by presenting the criticism about narrow spatial optics of financialisation studies (chapter 1), arguing for an analysis of one of the understudied regions, namely SEE. A review of the state of research identified a gap in the literature: countries have not been compared against each other, nor has there been an in-depth analysis of the drivers. Chapter 2 laid out the theoretical perspectives on the process of financialisation (Marxism, Regulation Theory, Post-

Keynesianism, Institutionalism), which aided in generating a range of drivers for case study research. The same chapter confirmed another commonly cited criticism (Mader, Mertens, and van der Zwan 2020a, 1): as it was found that most of the comparative frameworks did not engage with one another, an argument was made that they feature either inconsistent or under-theorised conceptualisations. Among the few more elaborate models, it was argued that the approaches of Karwowski and Stockhammer (2017) and Karwowski, Shabani, and Stockhammer (2020) serve best for comparative study of financialisation in SEE; nonetheless, this concept does not adequately consider the international facet of the process, and it is argued that this aspect is crucial for peripheral countries.

The research design (chapter 3) limited the scope of the study to six countries in SEE and to the time period from 2000 until 2017. The two-step approach adopted for the study consists of a quantitative comparison of indicators using a modified framework; on this basis, extreme cases analysed via process tracing and through expert interviews were sampled. The comparison of the countries (chapter 4) revealed the extreme cases among the four levels of financialisation and six countries in the region. The different degrees were in part contextualised through the distinct starting points of the countries and how they experienced transition from socialism to capitalism, periods of war and financial crisis in the 1990s or earlier. Compared to other geographical areas, it was shown that the financial sector in Bulgaria was financialised to a degree almost comparable to that of the UK; in contrast, the extreme cases on other levels ranged lower than for other Western European countries, although the pace of change was higher.

As one of the extreme cases, the study on Bulgaria (chapter 5) presented the trajectory of financial sector financialisation beginning with its historical evolution. The Bulgarian financial crisis of 1997 was a decisive factor in radical privatisation and the introduction of the currency board, considering that it was preceded by widespread asset stripping, corruption and hyperinflation. Foreign-owned banking groups introduced consumer lending and performance-based salaries to the market in the early 2000s, catalysing the ensuing lending spree. Concomitantly, a real estate bubble emerged that was fuelled by foreign inflows and sustained by lax credit provisioning, even culminating in the creation of securitised mortgage-backed financial products. The case also highlighted how the central bank imposed ceilings on credit growth as well as the myriad ways financial institutions devised for their circumvention, including cross-border loans and securitisation. These developments had become possible through the liberation of capital controls carried out in an aim to

enable EU accession. When the latter materialised in 2007, the credit growth limits set by the central bank had to be lifted. Though the BNB did not shield borrowers from unsustainable lending practices, and they subsequently bore the costs for the excessive behaviour of banks, it also did not allow Swiss francs to proliferate and it unilaterally stopped the outflow of liquidity through foreign banking groups during the GFC. After the GFC, the degree of financialisation stagnated, as the financial sector had to grapple with a substantial volume of bad loans and the failure of two large domestic banks. Due to tightening equity requirements, financial institutions resorted to expanding activities in the non-bank financial sector through consumer lending, especially to the low-income population, giving rise to a potentially new process of financial sector financialisation.

The Serbian case study (chapter 6) commenced by presenting part of the process of international financialisation as being rooted in the possibility for workers abroad, and later for the general public in the SFRY, to open deposit accounts in foreign currency. Additionally, these accounts were guaranteed by the state and were assigned the same interest rate as local currency deposits. In the early years of the 21st century, after the overthrow of the Milosevic regime, international financialisation taking the form of foreign funding and foreign currency lending was facilitated mainly by the entrance of foreign banking groups which had been explicitly invited into the country. This was a reaction to the scandalous banking practices of the 1990s and hyperinflation, which had led to the closure of six major banks at the end of the decade. This response restored society's trust in the banking system but it also increased the country's reliance on foreign finance, particularly in the form of hot money entering the market as inter-bank loans, cross-border loans and, notably, speculative inflows into repo products. Foreign funding naturally increased the volume of foreign currency loans for households and NFCs. On the eve of the GFC, short-term financial flows swiftly exited the country, most prominently those from repos. The rapid departure put strain on the exchange rate (increasing indebtedness levels) and on financing for the real economy. Despite rather mild initial consequences, the Serbian state took buoyant measures to pump money into the economy and vested interest groups. International financialisation decreased overall throughout the post-GFC phase and was presumably replaced by state financialisation, though foreign currency lending persisted, particularly for NFCs. With support from the leading political party that came to control the central bank's monetary policy, a stable exchange rate in the 2010s contributed to this trend as well.

Croatia's trajectory (chapter 7) was found not to be rooted in the SFYR, and only partly in the transition policies of the 1990s. Significantly, the privatisation of NFCs was undertaken through the stock exchange, increasing its total market value and kicking off an early institutionalisation of capital markets in Croatia. The newly created banks lent heavily to firms and households alike in the 1990s, which culminated in a financial crisis in 1998. The state saved the banks at great expense, which maintained indebtedness levels of real economy debtors. After the rescue, most banks were sold off to foreign investors. Household financialisation was shown to have intensified in the pre-GFC phase: banks had shifted focus to this profitable segment in reaction to regulatory measures that caused NFCs to be almost completely financed by cross-border lending. The financialisation of Croatian households followed a pattern of first elite and then popular financialisation, which was exacerbated by the absence of a credit registry. On the asset side, households were able to increase their financial holdings due to the privatisation of the pension system. Relatedly, privately-run investment funds required domestic assets in which to invest, leading the Croatian state to enact a mandatory listing rule for Croatian NFCs. Croatia was hit by the GFC with some delay, and stagnation necessitated a large uptake of government debt with increasingly financialised practices. As stock market dynamics abated, financialisation of households (except for pension assets) and NFCs decreased in the post-GFC phase. Public discontent with the path of pre-GFC financialisation manifested itself in political mobilisation during the fallout from a Swiss franc housing loan disaster that had over-indebted and displaced Croatian homeowners.

8.2 Region-based synthesis

The findings from the comparative analysis and case studies suggest shared threads in the processes and drivers of financialisation in the region. As a presentation of this aspect was found to be lacking in previous comparative studies, the common factors uncovered in the analysis of trajectories (section 8.2.1) and in the identification of conceptual drivers (section 8.2.2) are reviewed in this section, providing further qualitative complexity to the quantitative analysis undertaken in chapter 4.

8.2.1 Trajectories of financialisation across SEE

One point of divergence in the three case studies was the starting point around the year 2000 and the initial degree of financialisation. Most of the countries (all except BiH) featured a banking or financial crisis at the end of the 1990s. At all levels, Croatia started off with comparatively high degrees of financialisation, particularly as it had saved a large number of banks through additional

government debt. Although the ailing banks' significance was low, a peculiar alliance of war veterans, cronies and peers of the ruling Tudjman party seem to have vowed to stabilise the financial system at the expense of the general public. In the case of Bulgaria, and even more so in Serbia, a number of the largest banks were closed overnight. Most of their balance sheets were in default and the people had kept their savings 'under the mattress'. In Serbia there was implicit public desire for a clear departure (in the financial system) from the former ties of the Milosevic system, while in Bulgaria a new group of central bankers instated a currency board and new regulations to clean the banking system under the auspices of international financial institutions. The dire experience of the Albanian pyramid-scheme-induced crisis certainly factors into the explanation of why the degree of financialisation had been comparatively low in this country. Overall, the findings from the case studies highlight the historical contingency of financialisation processes, which do not commence overnight, but are instead partly rooted in earlier developments.

As for *financial sector financialisation*, it was shown that the practices cannot be compared to those of financialised hubs in mature economies, a fact which also explains the rather low *fee-to-income ratio* in the region. This is also related to the bank-based financial systems which continue to prevail, as most efforts to create capital markets remained unsuccessful in both the pre- and post-GFC phases. The significance of the financial sector in terms of *employment* cannot be negated in SEE, although its attractiveness declined in the post-GFC phase, as demonstrated in the Bulgarian case study. Vocal criticism against Swiss francs in Croatia, and to a certain extent in Serbia, has contributed to a generally negative public impression of the financial sector in the region. Furthermore, the case studies indicated that the relevance of the financial sector (in terms of *gross value-added*) surged in the region due to exorbitant growth rates in the pre-GFC phase; this trend was sustained by the encouraging attitude of domestic politicians (as demonstrated for Bulgaria and Serbia) and international development institutions that promoted the sector's growth-enabling character.

With regard to *international financialisation*, the indicator for *private financial inflows* was particularly strong in Bulgaria, Croatia and Serbia, and was comparatively low in Albania. The case studies showed that there were two main types of inflows: foreign funding from Western banks' headquarters to their local subsidiaries, and later cross-border loans (and occasionally SPVs). The Serbian case study demonstrated how inflows were welcomed by domestic policymakers, who viewed the funds as necessary for on-lending to domestic borrowers, and hence for growth stimulation. Cross-border loans proliferated from around 2005 onwards, when the central banks in all

three case-study countries limited foreign funding (Serbia and Croatia) or set limits on credit growth (Croatia, Bulgaria). The application of these macroprudential measures is another common feature identified through the present analysis, which is all the more striking when considering that such measures had seldom been employed in Western Europe, and if so, only after the GFC (Dimova, Kongsamut, and Vandenbussche 2016, 5). International financialisation deems such financial inflows to be of a short-term nature, and this became evident during the GFC: Western banking groups suddenly called off certain funding and credit lines, as highlighted in Serbia, triggering a rise in depositor anxiety about the soundness of the financial system. In contrast, the case study for Bulgaria showed how the BNB, in a bold move, simply limited or stopped foreign banks' ability to transfer large amounts of funds back to their headquarters. In Serbia, the central bank mandated that cross-border loans have a minimum maturity, thus preventing funds from flowing out of the country too rapidly. The study on Bulgaria showed that the BNB understood the reliance of foreign banks on their 'second home market' (Epstein 2014b) and therefore did not take part in the Vienna Initiative. Deleveraging cross-border loans had a major impact on domestic credit volume (around 30-50% of GDP), and this was shown to be an under-appreciated development in all three political economies and in the relevant literature.

Foreign currency loans are a widespread phenomenon across SEE. As demonstrated in the case studies, this was due to the fact that most countries experienced phases of hyperinflation in the 1990s or during socialist times. The case study on Serbia indicated that the usage of hard currency was fostered in the times of the SFRY, so this can in turn apply to all other former republics. Both factors pushed people to continue to save and to trade primarily in hard currency even into the 21st century. Due to their focus on price stability, the central banks did not exert significant effort to increase domestic currency supply in order to avoid another period of inflation. Most countries introduced a currency peg to the euro, and only Serbia was shown to exhibit a more 'liberal' approach towards exchange rate management. Although foreign currency loans were argued to link domestic borrowers to the whims of global currency markets, the existence of a peg mitigated the risk for those debtors. Obviously, this 'protection' came at the expense of not having the option to implement independent monetary policy and instead being subjugated to the global currency hierarchy. The dependence on international money markets in the form of Euribor or Libor loan contract clauses is another typical feature of foreign currency loans. The case studies also showed that, after the initial deposit base had been exhausted, most of the necessary funding for lending came

in foreign currency from the headquarters of foreign banking groups. In this way, banks hedged against exposure to exchange rate risk but passed on the burden to borrowers.

The situation was shown to be different for *Swiss franc* loans, although scholars tend to conflate euro- and Swiss franc-denominated loans. Specifically, the case studies indicate that each of the three countries moved in different directions. In Croatia, Swiss franc loans were disbursed widely and contributed to a housing bubble and subsequent major borrower default. The development was less extreme in Serbia, with a lower volume of housing loans and fewer borrowers of this loan type. Here, the head of the central bank warned publicly against Swiss franc loans on multiple occasions but did not forbid them, as this would have contradicted the notion of a 'free market'. Bulgaria stands out here, as its central bank indirectly prohibited the practice before it started spreading. As shown in the case study, the central bank viewed itself to be in a comfortable position since foreign banks were locked into the country through equity commitments. This aspect shows how the actions of the central bank are decisive in shaping the reality of financial markets and the degree of (international) financialisation.

Another shared feature across the region is the comparatively low degree of *non-financial company financialisation*. Croatia was shown to exhibit the highest degree; however, even there the case study revealed that nascent signs of NFC financialisation were detected on the indicator of *stock market capitalisation* but only in the short period before the GFC. The same holds true for *financial income* and assets of Croatian NFCs, which were revealed to be either stagnant or decreasing throughout the period of analysis. Given the fact that Croatia was argued to be the extreme case, we can deduce that NFC financialisation did not occur in SEE to a meaningful extent. Most countries established a stock market in the early 1990s as a channel for ownership transfer, but thereafter it was seldom used except for individual privatisations of state-owned companies or for the issuance of government bonds (Croatia, Macedonia). Firms largely relied on and still rely on banks for their financial needs, and do not engage further on capital markets despite lobbying efforts undertaken by IFIs to develop market-based finance in the region. The other two factors contributing to shallow stock exchange development, as demonstrated in the case studies, are the short supply of innovative financial instruments from banks and lacking impetus in domestic politics. On this basis, due to the absence of these conditions, the degree of NFC financialisation failed to increase in the region.

The trajectories of *household financialisation* can be considered to be rather homogeneous throughout SEE, based on the findings of the case studies and of the comparative analysis. Firstly, banks extended loans to wealthier clients and those with formal jobs, often in international companies. In the years before the GFC, lending standards loosened and lower income borrowers were financed with greater frequency. Central banks in most of the countries refrained from imposing any kind of payment-to-income or loan-to-value rules on disbursement, although such criteria could have prevented the over-indebtedness of households. Generally, for the pre-GFC trajectory, the countries of SEE seem to have featured first elite and then popular financialisation. After the GFC, household financialisation decreased in some countries (Albania, Croatia, Bulgaria) but started increasing in countries like Serbia, Macedonia and Bosnia, serving once again as a temporary fix for the lack of a sustainable growth regime (Bosnia) or for populist policies (Serbia, Macedonia).

Within the trajectories of household and financial sector financialisation, it was demonstrated that shadow banking has emerged as a new way for international banking groups to expand their consumer lending operations (particularly in Bulgaria). During the 2000s, banks began founding their own NBFIs, such as insurance companies, private pension funds or lending vehicles, as means to hide bad portfolios (Croatia, Bulgaria) or reap income from privatised pension schemes (Croatia). In the 2010s, banks increasingly pushed household lending operations into their non-bank affiliates in order to escape tight regulation, to hide bad loans and to save on equity costs. This phenomenon is not unique to Bulgaria but has also been observed in other countries in the region; this could potentially produce a novel type of household financialisation. For the countries of SEE, this marks a distinct instance of financialisation through shadow banking operations.

With regard to the overall trajectory of financialisation in SEE in the post-GFC phase, the degree of financialisation on most levels has remained *stagnant or has decreased* (with the notable exception of household financialisation in some of the countries). The region had suffered a huge blow in the GFC, with protracted recessions in the case of Serbia and Croatia. The reasons for stagnant degree of financialisation ranges from major, unresolved NPLs in banks, banks' altered focus towards government bonds (Bulgaria, Croatia, Serbia) and lacking policy initiative to foster capital markets (Croatia). Nevertheless, major *de-financialisation* policies or policies of financial repression were not devised in the countries of SEE, marking a contrast to the case of Hungary as exposed by Ban and Bohle (2020). The growth model of most countries in the region is highly reliant on the (foreign-owned) banking sector; there is an absence of strong domestic banks that could provide

a conduit for the implementation of national development policy.[139] Most countries are consumption- and import-oriented, leaving them little international political leverage. All countries in SEE feature either direct or indirect currency pegs, limiting the possibility to monetise the government debt that has been mounting considerably in the case of Serbia and Croatia. In these two countries, nationalist overtones have gained momentum in the post-GFC period, and the case studies indicate that this has led to a certain unmaking of liberal financial market rules, at least in Croatia. In Bulgaria, the rather apolitical central bank decided that the costs of the GFC would be borne by borrowers, so it refrained from enacting any stricter rules except higher equity requirements for banks. Although Bulgaria would have had sufficient political leverage, given its strong FDI production sector and sound government budgeting, it did not move to counter financialisation. This was potentially due to the fact that it exited recession relatively quickly after the GFC and had to grapple with the failure of two larger domestic banks.

8.2.2 Explanatory mechanisms for financialisation across SEE

In addition to the trajectories of financialisation discussed in the case studies, which revealed distinct country- and/or region-specific explanatory mechanisms, this thesis has elaborated a range of hypothesised drivers (as set out in chapter 3.5). In the case studies, it was confirmed that the majority of these drivers could explain the degree of financialisation on diverse levels, while it was found that some could not be applied to the countries. This section reviews these drivers and synthesises the findings across the region.

Given its geographic location, the EU has historically been perceived in the region as a beacon of growth, welfare, and the implementation of rule of law. In SEE, Bulgaria joined the EU in 2006 and Croatia in 2013. The remaining countries are, or rather continue to remain, at various stages of accession. The case studies have shown that, in particular, the *open capital and financial account* is regarded a prerequisite for the commencement of the accession process, which has proven decisive to the financialisation of the financial sector. At the same time, the desire for accession has produced a gradual *harmonisation of regulatory regimes*, which has served as a driver for international financialisation. For example, accession to the EU has made it impossible for central banks to enact certain macroprudential regulations (e.g. the credit ceiling in Bulgaria), which has served as an implicit bulwark against further financial sector financialisation. Furthermore, EU regulation

[139] With the exception of two large Bulgarian banks (First Investment Bank and Corporate Commercial Bank)

has made it easier for banks to open branches or subsidiaries in foreign countries with much lower equity requirements and lighter supervision compared to the domestic regulatory requirements for full fledged banks (as shown in the case of Bulgarian NBFIs), which potentially marks a new phase of financialisation. However, aside from this, no major direct influence of the EU has been detected in the case studies with respect to political lobbying and the findings on the influence related to such *trade, monetary and economic agreements* on international financialisation (see non-EU country Serbia) were not clear-cut. The opposite could be observed with regard to IFIs such as the World Bank or the IMF, which kick-started and guided the privatisation of financial and welfare systems. Aspirations of joining the EU made Bulgaria and Croatia particularly attractive in terms of investments and foreign finance, which contributed to financialisation in its various forms. On the other hand, regulations enacted and adopted by the EU in the various countries have contributed to a reduction of overall financialisation, and of household financialisation in particular, in the post-GFC phase. These regulations encompass laws concerning consumer protection and credit risk assessments of indebtedness (Bulgaria, Croatia) and the phasing of performance-based salaries.

Loans in Swiss franc and other foreign currency were shown to be directly linked to the development of the respective real estate markets. Concomitant to the housing lending spree, *asset price bubbles* have been observed in the real estate market in Bulgaria and Croatia and to a much lower degree in Serbia. The housing bubbles have been fuelled by low-interest housing loans and direct foreign investments alongside grey or illicit money channelled into this sector as a means to park these funds in a safe haven. All three countries exhibit extremely high home ownership ratios, placing them in the familial variety of residential capitalism (Fernandez and Aalbers 2016). Young and newly employed individuals looking to buy a home were approached by banks that often employ lax credit risk assessment standards (*focus of banks on retail*), thus leaving the debtor with low amounts of disposable income (as in Bulgaria) or exposing the clients to exchange rate risks (as in Serbia and Croatia with Swiss franc loans). Yet, the relationship of *credit scoring and financial literacy* with household financialisation could only be assumed (Bulgaria) but not definitively established. In Serbia, the government provided subsidies in the form of a national collateral insurance programme (also for Swiss franc loans), which lowered interest rates for potential borrowers; however, it was in the other two countries where the bubble developed a life of its own.

At the end of the 1990s, the dire financial crises in the various countries had spurred a transformation that consisted of privatising the remaining banking sector, mainly to *foreign Western banking groups*, similar to what had already occurred in Central Eastern Europe (Raviv 2008). Since then, the financial sectors of the region have been dominated by foreign banks with percentages ranging from approximately 75% in Serbia to 95% in Albania, across the time period under analysis (World Bank 2019b). Foreign banking groups were primarily seen by domestic politicians as a means to re-establish trust in the domestic financial system (Bulgaria and Serbia), provide the necessary funds for growth (Croatia and Serbia), and introduce banking technology (Bulgaria and Serbia). While most of these affiliated companies were full-fledged banks and not branches (Epstein 2014a), the strategies employed by these institutions were revealed to be similar in nature across the case studies. These strategies were characterised by the introduction of retail banking (Bulgaria), foreign funding (Serbia), and cross-border loans as a circumvention strategy (Bulgaria, Croatia, Serbia). The banking groups, which were mainly Italian and Austrian, implemented *performance-based salaries* (Bulgaria) and *short-term*, at times predatory, *lending practices* (Croatia) that drove up profits and ultimately *shareholder value*. This also hinted towards a shift *from patient to impatient finance*. Seeing as the same banking groups are active in the entire region, their business strategies and practices serve to explain the financialisation on multiple levels in SEE.

The case studies revealed that there have been fierce discussions between (foreign) banks and the central banks upon the enactment of credit and foreign funding ceilings. Nevertheless, all three central banks continued with their agenda. The Bulgarian case demonstrates how the BNB openly opposed the views of foreign banks and the central banks of other countries by not participating in the Vienna Initiative nor in a potential bailout for a subsidiary of a foreign bank. Similarly, as seen in Serbia, central bank officials continued to uphold the limits on foreign funding, despite the constant rhetoric of foreign banks. Yet, the central banks did not enact stricter measures to tame the unsustainable path prior to the GFC and instead largely resorted to macroprudential measures or risk-weights to steer credit volume. The institutions did not enact any major regulations regarding individual credit risk assessment (LTV or PTI rules), as this would have gone against their view of free market norms, which hence proves that *deregulation and financial liberalisation* are in general drivers of financialisation. Moreover, in all three countries assessed, the central banks followed a monetary strategy of *price stability*, despite different currency regimes. These differences made it also difficult to establish a relationship between *subjugation of domestic currency* and international

financialisation. Along with an unachieved improved level of competitiveness in the financial sector, the price stability focus led to *high domestic interest rates and yields*, owing to low levels of inflation and the *sterilisation of inflows* by means of repos. In terms of monetary policy, much of the same applies to the remaining countries in the region.

Although many countries in SEE have a stock exchange, a *shift to market-based banking* could not be detected in the countries in question nor in the remaining countries in the region in the case studies. Though *ownership* is often widely *dispersed*, due to the privatisation policies established in the 1990s, there has not been a general *rise of institutional investors* or an *increased listing of firms* (except in Croatia). *Declining capital investments and hampered innovation* could not be verified in the analysis. In contrast, the *privatisation of welfare* in Eastern Europe has long been a topic of scholarly interest (Appel and Orenstein 2018; Orenstein 2005) and the case studies (Bulgaria and Croatia) revealed a similar transformation based on a blueprint by the World Bank (1994). The privatisation of welfare has contributed to the financialisation of households and of the financial sectors in these countries, as pensions are now accumulated, handled privately, and subject to the uncertainties of global financial markets. As mentioned above, *depressed wages* and *inequality* were not confirmed as contributing to household financialisation at least for the case of Croatia. Yet, in the same case, the privatisation of welfare had implications for the real economy that were more far reaching, as exemplified in the mandatory stock market listing rule for firms, which *eased requirements for open and international market funding*. In the case of Bulgaria, it was revealed that privatised pension funds were invested in *innovative financial products* (REITs), which are reminiscent of mortgage-backed securities but neither pervasive nor large in volume. In addition to Croatia and Bulgaria, North Macedonia also privatised its pension system in 2002 (Appel and Orenstein 2018, 94), which suggests further scrutiny. Apart from welfare policies, the major neoliberal agenda of a flat *tax regime* (Bulgaria) was implemented in Albania and North Macedonia in 2007 and in Bosnia in 2008 (Appel and Orenstein 2018, 94), motivated by the idea of promoting formal income registration and fostering international competitiveness at the expense of progressive tax collection. The case studies have shown that the privatisation of welfare and the introduction of a flat tax do not only constitute yet another feature of neoliberal reform, but also contribute to financialisation on various levels in the region. Table 4 summarizes the findings on the hypothesised drivers (through different colours, which are explained in the legend) that were elaborated in section 3.5.1. The columns denote the different levels of financialisation.

Table 4: SEE: Findings on the hypothesised drivers

General financialisation	Financial sector financialisation	International financialisation	NFC financialisation	Household financialisation
Financial innovation and market-based banking	Favourable tax regime	Harmonisation of regulatory regimes	Increased listing of firms (shift to market-based finance)	Depressed and stagnating wages
Privatisation of public goods	Liberalisation of capital controls	Sterilisation of inflows through central banks	Dispersed ownership and rise of institutional investors	Credit scoring and financial literacy
Short-term profit maximisation and performance-based salaries	From bank-based to market-based financial system	Trade, monetary, and economic agreements	Eased requirements for open and international market funding	Focus of banks on retail and reduced regulation of consumer lending
Asset bubbles	From patient to impatient finance	High domestic yields and interest rates	Shareholder value primacy	Growing inequality
Focus of the central bank on deregulation, financial liberalisation and price stability	Performance-based salaries and higher salaries in financial sector	Foreign-owned banking groups and corporations receiving finance from abroad	Declining capital investments and hampered innovation	Privatisation of welfare system, pension system, and retreat of social provisioning
	High real interest rates	Subjugation of domestic currency		
Legend				
Confirmed	Disconfirmed	Not possible to check	Mixed findings	

Source: Author

8.3 Contribution to academic discourse on financialisation in SEE

This thesis expands the research available on financialisation in SEE in multiple ways. Firstly, it extends the research of Holzner (2017), who provided a comparison of the four regions in Eastern Europe. Chapter 4 in this thesis delves deeper and delivers a comparison of financialisation in the individual SEE countries. Secondly, this thesis is the first to analyse the degree of financialisation in the region on multiple levels (four) and singles out extreme cases for each. This research adds to the contributions of Mikuš (2019c) who examined the level of state financialisation in a similar

manner. Thirdly, in addition to offering comparative insights, this thesis contributes to research on the overall financialisation trajectory of the region and the individual countries and elucidates on the drivers and explanatory mechanisms conducive to the development.

Further, this thesis addresses the gaps identified in the work of Radošević and Cvijanović (2015) in that it provides one single coherent framework for analysis, covers unstudied countries (Albania, Bulgaria, and North Macedonia), and provides more contextualised and multi-faceted case studies in an attempt to eschew one-sided argumentation. With regard to the research conducted by Becker and Ćetković (2015) and Ćetković (2015), this thesis has shown that profit-hungry foreign banks did not only establish themselves and thrive by preying on virgin financial markets, but that domestic political forces actively invited these institutions into the country. Certainly, this had to do with the ideological influence of international development institutions and their propagated finance-growth nexus, but also with the dire bank landscape at the end of the 1990s, in which a large portion of the population was robbed of their savings. Nevertheless, the stability of the financial systems did ensue. At the same time, the growing financial sector aided domestic politicians seeking to remain in power by generating positive voter sentiment. The case studies also uncovered the intricate tactics employed by foreign banks to circumvent regulations, a topic which had not been covered by the literature available. Hence, the in-depth accounts provided in the case studies painted a more complex picture of this explanatory mechanism for financialisation.

The trail of the financialisation of households in post-socialist societies described in Rodik and Zitko (2015) identifies the shift to impatient finance, the lack of regulation, and the real estate boom as drivers for this development in Croatia. In this thesis, the case study on Croatia confirms the assessment by Rodik and Zitko (2015) on the one side, yet provides a deeper assessment of the assumed impatience, which was achieved by laying bare the increasingly more lenient credit risk standards of banks. On the other side, it identifies further drivers such as the general lack of consumer protection and more importantly, the lack of a credit registry. In the case study, this thesis disconfirmed the role of depressed wages as a driver, which is one of the central hypotheses of household financialisation in the literature available. Central bank policy is argued to be conducive to the financialisation of households and NFCs, as argued by Radošević (2015) who views this as a cause for the particular import-oriented growth model observed in Croatia. Although he mentions the belated capital controls of the HNB, he does not properly highlight the series of enacted regu-

lations outlined in this thesis, which have possibly prevented an even greater degree of financialisation. With regard to the financialisation of households in Croatia, this thesis has pointed to the steadily growing financial assets of households, which can be chiefly attributed to the privatised pension system. The institutional change was identified to be driven by the World Bank, but also became necessary owing to the burgeoning state expenses linked with pensions for vested interest groups ('privileged pensions') around the turn of the millennium. Though Mikuš (2020, 10–13) briefly touches on this point in relation to his analysis of state financialisation, this thesis reveals its financialising effect on households. Foreign bank-run pension funds and the possibility to choose from different risk profiles are only two of the aspects of this development.

The case study on Serbia problematised the argumentation brought forth by Živković (2017) in that it revealed how the SFRY paved the way for inflows of foreign currency by making it possible to open state-guaranteed foreign currency deposits at the same interest rate as deposits in domestic currency. While this did not negate the imperialist tactics of the West, which entailed pouring finance into the SFRY in order to increase its dependency, as revealed in detail by Živković (2017) in his contribution, the case study exposes the other side of the coin. Furthermore, the analysis of Serbia uncovered that foreign finance did not drive-up consumer debt to a high extent, owing to the rather conservative stance of the National Bank of Serbia, which provides a counterpoint to the argumentation by Becker et al. (2010, 238). Foreign finance was indeed shown to have led to higher degrees of household indebtedness in other countries in the region, but to a lesser extent in Serbia, which is again an argument for evaluating the countries individually. The trajectory of foreign currency lending and notably the vicious repo cycle described in the case study clearly showed the vulnerability of financial flow reversal (but not as generalised as in Becker et al. (2010) and in Živković (2017)).

This thesis is the first to provide a case study on Bulgaria, a country that has not only been financialised to a substantial degree on the level of the financial sector compared to the region, but also compared to the EU. In this unexplored space, the thesis has shed light on the initial roots of the financialisation trajectory at the end of the 1990s and the evolution of the financial system, which then experienced a strongly increasing relevance vis à vis the real economy, also by way of circumventing macroprudential regulations by the BNB. The analysis of the post-GFC trajectory and its drivers has also revealed a rising shadow banking sector in Bulgaria. The similarities between

the financial sectors in the region suggests that comparable developments have also taken place in other SEE countries.

In addition to information regarding financialisation in SEE, this thesis contributes to research in political science on the region. Compared to the rest of Eastern Europe, SEE has not been subject to major academic interest in the last two decades after the war. Although some research was published in the early 2000s, often related to the positively stated finance-growth nexus (Levine 1997), comparative political economists found the region difficult to analyse or categorise (Bohle and Greskovits 2012), which manifests itself in the term 'cocktail capitalism' (Ban 2013). Speaking to this literature, the study has shed light on certain commonalities, but also divergences in the trajectories of the political economies in the region. The discussion around the role of foreign banks (Epstein 2014a, 2014b; Spendzharova 2014) was enriched in this thesis throughout the different case studies, as they were shown to be one of the core drivers of varying levels of financialisation. On the other hand, the case studies revealed that the transformation of the financial systems in SEE at the end of the 1990s, which led to the influx of foreign banking groups, also brought with it positive results: non-transparency was reduced, access to finance democratised and, most notably, deposits became safe. However, the form of transformation and its governance partially paved the way for the subsequent financialisation processes. Problematising the role of foreign banks when analysing the inflows of capital shed light on the growing external debt levels in the super-periphery of SEE that were highlighted by Bartlett and Prica (2017a). It was shown that these were not side-effects of financialisation as a response to secular stagnation in the core (Bartlett and Prica 2017b), but instead constituted the processes of financialisation within the region, which is comparable to a certain extent to those in more mature economies. Hence, the case studies underpinned the trajectories of financialisation that were only assumed in this particular strand of literature (Bartlett and Prica 2013, 373).

8.4 Contribution to the academic discourse on financialisation

By considering the rationale behind the blind men's approaches to trying to make sense of an elephant (Mader, Mertens, and van der Zwan 2020a, 1), this thesis provides an example of how to overcome the deficiencies of the many studies that fail to disclose the underlying context of their conceptualisation when studying financialisation. Furthermore, these delineations have helped us to develop a series of independent variables that served as hypothesised drivers for the case studies.

Thus, this thesis addresses recent criticisms often made of the incoherent conceptualisation and conflict between independent and dependent variables and vice versa when studying the subject matter (Aalbers 2019, 2). Likewise, the thesis contributes to broadening the spatial optics of financialisation (Christophers 2015) by studying countries on the periphery of the global north (Fernandez and Aalbers 2020).

While these can be seen as more general contributions to the financialisation literature, the thesis has engaged extensively with the existing comparative frameworks of financialisation in order to devise a concept for answering the research question. So far, individual indicators have only been discussed in a small number of contributions (Rabinovich 2019; Van Gunten and Navot 2018) and a critical assessment of comparative financialisation frameworks has been largely absent from the literature so far. This thesis argues that the contribution by Karwowski, Shabani, and Stockhammer (2020) serves best to study financialisation across countries, although certain adjustments have been made to the framework. Specifically, the thesis argues that debt levels themselves (such as for the financial sector or for NFCs) are not an indicator of financialisation but rather an indicator of an approaching financial crisis (Minsky 1992). To expose the growing relevance of the financial vis à vis the real economy, it is arguably better to rely on relative indicators, such as gross value-added or financial income to total income. Although it is not its purpose to provide an in-depth theoretical or conceptual discussion on the topic, the thesis provides an example of how to move the discussions on measuring financialisation forward.

Based on these discussions, the thesis proposes the inclusion of the international level of financialisation into comparative frameworks. The relevance of this has been raised in a series of publications (Bonizzi 2017; Bortz and Kaltenbrunner 2018; Kaltenbrunner 2010) but it has to date not found its way into measurements of financialisation, which makes this another contribution to the literature. In this regard, the case study of Serbia traces the trajectory of international financialisation and has confirmed a range of hypothesised drivers for this level, which has not been studied as extensively as other levels of financialisation. Thereby, it contributes to a deeper understanding of the explanatory mechanisms and reveals certain commonalities to other cases, as e.g. the account on repo activities in Serbia unveiled a similar mechanism as described in Kaltenbrunner (2010) for Brazil.

An empirical examination of the drivers raises questions about some of the hypothesised independent variables in the literature. This relates principally to depressed wages, which were shown to be

not always a driver for household financialisation. The case study of Croatia highlights that the process can also occur amid steadily rising or suppressed wages. A shift to market-based banking could not be detected as a necessary driver for financialisation in the countries of the region, which further adds to our differentiated understanding of financialisation in peripheral countries. However, a series of across-the-board drivers were confirmed (such as privatisation of the welfare system and performance-based salaries) that reinforce the recommendation that they be scrutinised in any in-depth account of financialisation. Apart from the hypothesised drivers, the case studies once again confirm the significance of the domestic context, i.e. how processes of financialisation are enabled, geared and mediated by domestic forces. In analysing explanatory mechanisms, the case studies reveal how the processes of financialisation are in fact often unintended consequences of political actions directed at solving other problems. These findings resonate with those of the country studies on financialisation in peripheral countries (see section 2.3.2) and emphasise the importance of in-depth case studies as part of the research agenda.

This brings us to the topic of the debate on how to denominate the different degrees and trajectories of financialisation. Some authors subscribe to varieties of financialised capitalism (Fernandez and Aalbers 2016, 8) or to the fact that the degrees of financialisation vary (Lapavitsas and Powell 2013), whereas others refer more to variegations of financialisation (Brown, Passarella, and Spencer 2015, 2; Karwowski, Shabani, and Stockhammer 2016, 7; Nölke 2017, 32). No author has picked up this issue in detail (Lapavitsas and Powell 2013, 365) but most scholars concur that the outcomes and trajectories differ in each geographical and institutional setting. A comparable but different discussion can be found in the domain of comparative capitalism research on the Varieties of Capitalism concept (Peck and Theodore 2007). Based on the insights from this thesis, it could be argued that the degrees of financialisation are varied, since the levels and indicators are fixed but the values differ. However, as shown, the trajectories of financialisation in the different countries could be argued as being variegated, which would highlight its contested (May and Nölke 2013, 114) and dynamic character (Jessop 2013, 55–56) marked by spatio-temporal fixes (Harvey 2003, 115). In sum, this thesis primarily provides an empirical extension to the research on financialisation, but at the same time provides a number of recommendations for conceptual improvements and for critical engagement.

8.5 Outlook and implications for research and policy

The findings of this thesis yield insights on the process of financialisation in the countries of the region and contribute to the study of financialisation in general. At the same time, it opens up a series of possible avenues for further academic study and the analyses implicitly suggest possible political implications that would contribute to de-financialisation and a more equitable, sustainable path of growth. Both issues are discussed.

This thesis has undertaken extreme case studies of countries that were shown to exhibit a high degree of financialisation. However, it would be worthwhile studying the countries that were found to feature a lower degree of financialisation, such as Albania or North Macedonia. Besides tracking the individual trajectory of a country, such an examination would also contribute to testing hypothesised drivers of financialisation. If they are disproven, it adds to the robustness of the approach. If they are confirmed, it would also question the assumed relationship between the dependent and independent variables of financialisation. One of the major findings of this thesis reveals that Bulgaria has become highly financialised, but it has not been covered in any literature yet. Since this thesis does not claim to have researched the case in its totality, further investigation could contribute to enhancing our understanding of the financialisation process in this country. However, the case study on Bulgaria did shed light on the emerging practices of banks to operate part of their activities, such as fast-cash, sub-prime consumer lending via NBFIs to evade regulatory supervision. Given that these banks are often part of larger groups suggests that these tactics are also being applied in other countries in Eastern or even Western Europe, which would render it an interesting research topic from a financialisation perspective.

Quantitatively oriented comparative financialisation studies have gained traction in recent years (Karwowski, Shabani, and Stockhammer 2020; Rabinovich 2019; Schwan 2017). However, the contributions have seldom engaged with each other, i.e. critically discussed the levels of financialisation and corresponding indicators. Although this thesis provides one example of how to address the matter, further research should engage in expanding this debate. Once done, we would be able to run further quantitative tests for causality that would help confirm or invalidate independent variables. Nevertheless, this should be understood as a plea for a pure expansion of quantitative testing. Such research could point to potentially fruitful cases for further qualitative in-depth study. This thesis has likewise provided an example of how to combine methods to advance research.

The thesis reveals that in order to avert financialisation, the approach of policymakers – especially the central bank – must be deliberate and strong. In order to limit household financialisation, in particular indebtedness, payment-to-income and loan-to-value ratios were found to be particularly meaningful and should be more rigorously applied in more countries. Limits on credit growth can also hamper the intensification of financialisation, but they need to be well-designed in order to function properly. If these ratios are circumvented by NBFIs or other instruments, such as in Bulgaria, unregulated lending could simply be forbidden (as is the case in Serbia) since it escapes regulatory supervision. As market participants will always try to find ways of bypassing even strong regulations, it is necessary to change the mindset and expectations of people working in the sector, which has already been achieved to some extent by phasing out performance-based salaries. This could be also effected by demanding higher standards for granting loans and including aspects of sustainability as well as a more critical scrutiny of predatory lending practices. Reducing inequality and increasing wages in line with increases in productivity would also lessen the demand for such short-term consumer loans.

Besides discussing the need for stronger and bolder regulations, the thesis explores the ways in which foreign currency loans proliferated in the countries of the region and, at times, suddenly and massively increased indebtedness, since borrowers usually earn their income in the local currency. In order to encourage borrowers to take on debt in domestic currency, it is crucial that both politics and monetary policy actively promote this and that laws are enacted to prevent the usage and advertising of foreign currency loans as much as possible. This should be a prime concern for policymakers as it will reduce the susceptibility of domestic debtors to the vagaries of international currency movements, i.e. it will alleviate the negative effects of international financialisation.

This thesis has found that a prime cause behind the exacerbation of financialisation on multiple levels is the privatisation of public welfare, which itself was a consequence of the three-pillar reform based on ideas propounded by the World Bank (1994) that found its way into a number of countries in Eastern Europe (Appel and Orenstein 2018). Although it might seem difficult to turn back the clock, state-backed systems have the advantage of making pensions less dependent on global financial markets. Moreover, in a state-backed system, people's hard-earned retirement savings would not be skimmed off by privately-run funds that maximise short-term profit. The same applies to housing and social provisions. As another institutional area of interest, the case studies highlight the inadequacies behind the creation of capital markets in the region, which only served

to boost the primacy of shareholder value. Hence, the attention of politicians should instead focus on topics more relevant than the promotion of stock exchanges in SEE.

Lastly, a common feature identified in the case studies is the comparative lack of support for lending to SMEs, as banks apparently prefer to lend to households instead. In doing so, however, these banks are not living up to the promises of their self-subscribed mantra that finance enables growth; this was in vogue before the crisis but is still common today. SEE countries have experienced both financial expansion and financialisation. Yet, the growth was short-lived and unsustainable, as highlighted by the huge increases in government debt after the GFC, especially in Serbia and Croatia. Hence, the relationship should be scrutinised once again, including for the region as a whole. Finance is necessary in a capitalist system, but this thesis has shown that the way in which finance is delivered, regulated, and mediated is instrumental to its ability to have a beneficial impact. If left to its own devices, it tends to relentlessly increase its relevance, while indebting households and diverting companies' attention from investing in sustainable ways of optimising production.

Six years have passed since the initial research endavours of this thesis. Nevertheless, the relevance of financialisation continues to be undiminished. It remains to be seen how the pervasion of financialisation will impact on and shape the political responses in times of crises, given the current challenges such as the COVID-pandemic and increasingly frequent manifestations of climate change. The publication of the handbook of financialisation by Mader, Mertens, and van der Zwan (2020b) has lately further institutionalised this branch of research in political sciences (and other disciplines) and it continues to prove an area of interest that can bring scholars from a wide range of disciplines together. As noted by Fernandez and Aalbers (2020), it is still pertinent to continue working on conceptualisations of financialisation. At the same line, the recent special issue by Schelkle and Bohle (2020) underscores how important the study of variations is for enriching our empirical and conceptual insight into finance and financialisation, thus mirroring the initial work and concluding findings of this thesis.

This thesis was motivated by a wish to offer a more coherent overview of the process of financialisation in the countries of the region. In the opinion of the experts who were interviewed, financialisation has proven to be either a necessary evil or an unintended consequence along the route to other sought-after improvements. Nevertheless, it cannot be left unmentioned that the most pervading motives for financialisation are likely to have been the maximisation of short-term profit for banks or voter turnout for politicians. Extending the time horizon and gearing it towards a

sustainable and – equally important – environmentally positive pathway remains, therefore, one of the greatest challenges we face in reducing financialisation and achieving equitable development, especially in the countries of South Eastern Europe.

Appendix

Declaration

I declare that this thesis has been composed solely by myself and that it has not been submitted, in whole or in part, in any previous application for a degree. Except where stated otherwise by reference or acknowledgment, the work presented is entirely my own.

Marcel Zeitinger, 15.09.2021

Exemplary interview guide

"Financialisation describes the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies"

Bloc 1: Pre-Crisis financialisation in Serbia

1) How do you in general evaluate the relationship between the real economy and the financial sector in Serbia given the statement above?
2) From 2003 until 2010, GDP grew on average 4.6%, while credit increased by 18%. How do you evaluate this? Relatedly, would you say there was a mortgage boom?
3) Euroisation in the form of foreign-currency lending increased to very high values (over 80% of total credit) until the financial crisis. How do you and your institution view this and what were the reasons for it?
4) Regarding the practice of issuing Swiss Franc mortgage loans, how did you evaluate it? Why was it allowed? Who benefitted from it?
5) Who benefitted from foreign currency loans in general? Did anyone promote foreign currency loans and if yes, how? Was there any political discussion on the FX risk associated with these loans? How did the central bank handle them?
6) Regarding the balance of payments, private financial inflows (excluding FDI) accounted for roughly 12% of GDP from 2002 until 2009. How do you explain this?
7) Cross border loans contributed much to the increase and decrease of these financial inflows, how do you and your institution evaluate this? Was there any major discussion on the significance of cross-border loans on the Serbian balance of payments and the credit volume in the country?
8) The Central Bank started the practice of repo auctions in 2005, which amounted up to 12% of total bank assets at the end of 2007. How do you evaluate this? Do you think that international investors or banks exploited this mechanism for short-term, risk-free profit? Do you think this contributed to the flight of capital in the financial crisis?

Bloc 2: Post-Crisis Financialisation

9) After the financial crisis, government debt surged both internally and externally and the ministry of finance switched from loans to T-Bills and Bonds as well as debt in foreign

currency increased, how do you evaluate this? Do you think that banks invested into government bonds at the expense of financing companies?

10) Why did private financial inflows dry out in the post-crisis phase? Would you agree to the statement that, after the crisis, the state has been financing the chronic trade deficit?
11) Household debt increased markedly after the crisis while lending to companies stagnated, how do you evaluate this?
12) After the crisis, lending for companies has still been predominantly in foreign-currency. Why do you think this is so?

Bloc 3: Searching for reasons

13) Do you think that the opening of capital and financial accounts was a reason for the boom and bust in financial inflows and the high level of foreign-currency lending? Which interest groups advocated for it?
14) How do you evaluate the role of monetary policy and the central bank on volatile financial inflows and foreign-currency lending? Did the fixation on the exchange rate in the early years promote these developments? Do you think this has changed after the NBS switched to inflation targeting?
15) What was the role of the government(s) and other public institutions (e.g. tax reforms)?
16) Did we witness an increased focus on short-term profit maximization in the Serbian financial sector? Can you think of any examples, mechanisms etc?
17) How would you evaluate the impact of harmonisation efforts regarding regulatory regime and of trade, monetary, and economic agreements on the topic at hand?
18) Did we witness higher salaries in the financial sphere than elsewhere? How do and did salaries look like and what is their structure? Are they geared towards perpetuating these developments?

List of Interviewees

Interviewee	Case Country	Institution	Position	Date of Interview	Place
Interviewee 1	Bulgaria	Bank	Chairman of Supervisory Board	05.02.2019	Sofia
Interviewee 2	Bulgaria	Bank	Manager	07.02.2019	Sofia
Interviewee 3	Bulgaria	Bank	Manager	28.03.2019	Frankfurt
Interviewee 4	Bulgaria	Bank	Head of Unit	08.02.2019	Sofia
Interviewee 5	Bulgaria	Bulgarian National Bank	Governing Body	23.05.2019	Sofia
Interviewee 6	Bulgaria	NGO	Former politician and central banker	24.05.2019	Sofia
Interviewee 7 and 8	Bulgaria	Bulgarian Association of Banks	Researcher	23.05.2019	Sofia
Interviewee 9	Bulgaria	Bulgarian National Bank	Head of Unit	24.05.2019	Sofia
Interviewee 10	Bulgaria	Bank	Head of Unit	28.02.2020	Sofia
Interviewee 11	Bulgaria	NBFI	Head of Unit	28.02.2020	Sofia
Interviewee 12	Bulgaria	Financial advisory	Manager	28.02.2020	Sofia
Interviewee 13	Serbia	Bank	Manager	02.03.2020	Fürth (Odw.)
Interviewee 14	Serbia	Bank	Manager	03.03.2020	Fürth (Odw.)
Interviewee 15	Serbia	Consulting	Manager	28.07.2020	Skype
Interviewee 16	Serbia	Consulting	Manager	15.09.2020	Skype
Interviewee 17	Serbia	University of Belgrade	Professor	26.08.2020	Skype
Interviewee 18	Serbia	Consulting	Manager	13.01.2021	Skype
Interviewee 19	Serbia	University of Belgrade	Professor	08.09.2020	Skype
Interviewee 20	Serbia	IMF	Staff	27.08.2020	Skype
Interviewee 21	Serbia	Bank	Manager	29.01.2021	Skype/Teams

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