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# **Financialisation, distribution & the macroeconomic regimes before & after the crisis - a post-Keynesian view on Denmark, Estonia & Latvia**

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**Financialisation, distribution and the macroeconomic regimes before and after the crisis  
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*Petra Dünhaupt & Eckhard Hein*

**Abstract**

Since the early 1980s, financialisation has become an increasingly important trend in developed capitalist countries, with different beginnings, speed and intensities in different countries. Rising inequality has been a major feature of this trend. Shares of wages in national income have declined and personal income inequality has increased. Against this background unsustainable demand and growth regimes have developed and dominated the major economies before the crisis: the 'debt-led private demand boom' and the 'export-led mercantilist' regime. The current paper applies this post-Keynesian approach on the macroeconomics of finance-dominated capitalism to three Baltic Sea countries, Denmark, Estonia and Latvia, both for the pre-crisis and the post-crisis period. First, the macroeconomics of finance-dominated capitalism are briefly reiterated. Second, the financialisation-distribution nexus is examined for the three countries. Third, macroeconomic demand and growth regimes are analysed, both before and after the crisis.

**Keywords:** Finance-dominated capitalism, financialisation, distribution, financial and economic crisis, Kaleckian theory of distribution

**JEL Codes:** D31, D33, D43, F40, F43, G01

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## 1 Introduction

Since the early 1980s, financialisation has become an increasingly prominent feature in developed capitalist countries, with different beginnings, speed and intensities in different countries.<sup>1</sup> The features of financialisation in general, and the macroeconomics of finance dominated capitalism in particular have been analysed theoretically and empirically in several studies,<sup>2</sup> as recently reviewed in the papers by Sawyer (2013/2014) and van der Zwan (2014), and in the books by Guttmann (2016), Hein (2012), and Palley (2013), among others. Initially, the focus of empirical studies has been on the US as the model country for financialisation, but the analysis has increasingly shed some light on many other developed and also a few less developed capitalist economies in the course of the recent decade or so (see the chapters in Hein et al. 2016 for example). In the current paper we add to the empirical literature on the macroeconomics of financialisation, focusing in a comparative way on three Baltic Sea countries, Denmark, Estonia and Latvia, which, maybe with the exception of Estonia (Juuse and Kattel 2013, Juuse 2016), have not been in the focus of the analysis so far. We believe that these three small open economies are interesting cases, with Denmark representing a coordinated market economy with a social-democratic welfare state and Estonia and Latvia representing two post-socialist countries pursuing a liberal type of capitalist reproduction.

In our study we will examine the periods before and after the Great Financial Crisis and the Great Recession of 2007-09. Since Estonia and Latvia have gone through the transition from state socialist to modern capitalist economies through the early 1990s, our analysis will cover the period from 1995 (1996 for Latvia) until 2016.

In this study we will apply a post-Keynesian approach on the macroeconomics of finance-dominated capitalism, as exposed in Hein (2012) for example, to these countries. According to this approach, financialisation may affect macroeconomic performance through four channels, a) the distribution of income, b) investment in the capital stock, c) private consumption and d) the current and the capital account. In Section 2 we will therefore briefly reiterate these channels and the main empirical findings in previous studies on broad sets of countries. Furthermore, we will outline the typology of macroeconomic regimes under the conditions of financialisation which may and have emerged, a) the export-led mercantilist regime, b) the weakly export-led regime, c) the domestic demand-led regime and d) the debt-led private demand boom regime. Since the distribution channel of financialisation is fundamental to our approach, Section 3 will be devoted to the distributional effects of financialisation in our three countries. We will apply a Kaleckian approach to the determination of income shares, which has highlighted three important channels for the distributional effects of financialisation, a) a shift in

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<sup>1</sup> We follow Epstein's (2005: 3) widely quoted definition of financialisation as 'increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies'.

<sup>2</sup> The terms 'financialisation' and 'finance-dominated capitalism' are used interchangeably in this paper.

the sectoral composition of the economy, b) an increase in overhead costs, i.e. management salaries and rising profit claims of the rentiers, and c) weakened trade union bargaining power. Against this distributional background, in Section 4 we will then turn towards the macroeconomic regimes and we will briefly analyse which kind of regime has dominated in the countries before and after the crisis. Section 5 will then briefly summarise and conclude.

## **2 On the macroeconomics of finance-dominated capitalism**

From a post-Keynesian macroeconomic perspective, finance-dominated capitalism or financialisation may affect macroeconomic development through four channels, as has been described in several contributions (see for example Hein 2012, 2014, Chapter 10; Dodig et al. 2016). The country-specific stances of these characteristics may then give rise to different macroeconomic regimes, as we will explain further below.

1. With regard to distribution, financialisation has been conducive to redistribution in favour of profits and high incomes. In several countries a rising gross profit share, including retained profits, dividends and interest payments, and thus a falling labour income share, on the one hand, and rising inequality of wages and top management salaries and thus of personal or household incomes, on the other hand, has been observed. Hein (2015) has recently reviewed the evidence for a set of developed capitalist economies since the early 1980s. He has found empirical support for falling labour income shares and increasing inequality in the personal/household distribution of market incomes with only a few exceptions, increasing inequality in the personal/household distribution of disposable income in most of the countries, and an increase in the income share of the very top incomes, particularly in the US and the UK, but also in several other countries for which data is available, with rising top management salaries as one of the major driving forces. Reviewing the empirical literature on the determinants of functional income distribution against the background of the Kaleckian theory of income distribution, Hein (2015) has argued that features of finance-dominated capitalism have contributed to the falling labour income share since the early 1980s through three main channels: the falling bargaining power of trade unions, rising profit claims imposed in particular by increasingly powerful rentiers, and a change in the sectoral composition of the economy in favour of the financial corporate sector at the expense of the non-financial corporate sector or the public sector with higher labour income shares. In Hein et al. (2017a, 2017b, 2018) the relative importance of these factors has been analysed for six countries: France, Germany, Spain, Sweden, the UK and the US.

2. Regarding investment in the capital stock, financialisation has meant increasing shareholder power vis-à-vis firms and workers, the demand for an increasing rate of return on equity held by rentiers, and an alignment of management with shareholders' interests through short-run performance related pay schemes, such as bonuses, stock option programmes, and so on. On the one hand, this has imposed short-termism on management and has caused a decrease in management's animal spirits with respect to real investment in the capital stock and

long-run growth of the firm and increasing preference for financial investment, generating high profits in the short run. On the other hand, it has drained internal means of finance available for real investment purposes from non-financial corporations, through increasing dividend payments and share buybacks in order to boost stock prices and thus shareholder value. These 'preference' and 'internal means of finance' channels should each have partially negative effects on firms' real investment in capital stock. Econometric evidence for these two channels has been supplied by Stockhammer (2004), van Treeck (2008), Orhangazi (2008), Onaran et al. (2011), Davis (2018) and Tori and Onaran (2017a, 2017b, 2018) confirming a depressing effect of increasing shareholder value orientation on investment in capital stock, in particular for the US but also for other economies, like the UK, France and other Western European countries, as well as some emerging market and developing economies.

3. Regarding consumption, financialisation has generated an increasing potential for wealth-based and debt-financed consumption in several countries. This has created the potential to compensate for the depressing demand effects of financialisation, which have been imposed on the economy via re-distribution and depressed income financed consumption and the depressing impact of shareholder value orientation on real investment. Stock market and housing price booms have each increased notional wealth against which households were willing to borrow in order to increase or maintain consumption. Changing financial norms, new financial instruments (credit card debt, home equity lending), deterioration of creditworthiness standards, triggered by securitisation of mortgage debt and 'originate and distribute' strategies of commercial banks, made credit increasingly available to low income, low wealth households, in particular. On the one hand, this potentially allowed for consumption to rise faster than median income and thus to stabilise aggregate demand. On the other hand, it also generated increasing debt-income ratios of private households. Several studies have shown that financial and housing wealth was a significant determinant of consumption before the crisis, particularly in the US, but also in countries like the UK, France, Italy, Japan and Canada (Boone and Girouard 2002, Ludvigson and Steindl 1999, Mehra 2001, Onaran et al. 2011). Furthermore, Barba and Pivetti (2009), Cynamon and Fazzari (2008, 2013), Guttman and Plihon (2010), van Treeck and Sturn (2012), and van Treeck (2014) have presented extensive case studies on wealth-based and debt-financed consumption, with a focus on the US. However, Kim (2013, 2016) in two studies on the US has found that although new credit to households will boost aggregate demand and output in the short run, the effects of household debt variables on output and growth turn negative in the long run. This indicates contradictory effects of the flow of new credit and the stock of debt on consumption.

4. The liberalisation of international capital markets and capital accounts has provided the conditions for rising and persistent current account imbalances at the global, but also at the regional levels, in particular within the Eurozone, as has been analysed by several authors, including Hein (2012, Chapter 6, 2014, Chapter 10), Hein and Mundt (2012), Stockhammer (2010, 2012, 2015), UNCTAD (2009) and van Treeck and Sturn (2012).

Under the conditions of the dominance of finance, different demand and growth regimes may emerge, as has been analysed by the authors mentioned in the previous paragraph, using different terminologies. Considering the growth contributions of the main demand aggregates (private consumption, public consumption, investment, net exports) and the sectoral financial balances of the main macroeconomic sectors (private household sector, financial and non-financial corporate sectors, government sector, external sector), four types of regimes can be distinguished: a) the export-led mercantilist regime, b) the weakly export-led regime, c) the domestic demand-led regime and d) the debt-led private demand boom regime.

a) The export-led mercantilist regime is characterised by positive financial balances of the domestic sectors as a whole, and hence negative financial balances of the external sector, and thus, current account surpluses. The growth contributions of domestic demand are relatively rather small or even negative in certain years, and growth is mainly driven by positive contributions of the balance of goods and services and hence rising net exports.

b) Hein and Mundt (2012) have also considered a weakly export-led type, which is characterised by positive financial balances of the domestic sectors as a whole, negative financial balances of the external sector, and hence current account surpluses, positive growth contributions of domestic demand, but negative growth contributions of external demand, and hence falling export surpluses. In the current paper we will also consider countries with positive growth contributions of the balance of goods and services but still negative net exports and negative current accounts, i.e. positive financial balances of their respective external sectors, to be weakly export led.

c) The domestic demand-led regime is characterised by positive financial balances of the private household sector. Here it is usually the government and, to a certain degree, the corporate sector, running deficits. The external sector is roughly balanced or in surplus. The domestic demand-led countries are thus usually running balanced or negative current accounts in the medium to long run. We have positive growth contributions of domestic demand without a clear dominance of private consumption, and of credit-financed consumption in particular, and slightly negative or positive growth contributions of the balance of goods and services on average over some medium run.

d) The debt-led private demand boom regime is characterised by negative financial balances of the private sector as a whole. In particular, the private household sector in this regime shows only slightly positive or negative financial balances, which means that major parts of the private household sector have negative saving rates out of current income, and are hence running deficits, financed by increasing their stock of debt and/or reducing their stock of assets. These private household deficits are accelerated by corporate deficits in several countries and thus we have deficits of the private domestic sectors as a whole. The external sector has positive financial balances, which means that debt-led private demand boom countries are usually running current account deficits. We have high growth contributions of private domestic demand, financed by credit to a considerable extent, and negative growth contributions of the

balance of goods and services, driving the current account into deficit in the medium to long run. The extreme form of the debt-led private demand boom regime is the debt-led consumption boom regime, in which the private household sector is running deficits and private consumption demand is the main contributor to GDP growth (Hein 2012, Chapter 6). However, the broader concept of a debt-led private demand boom regime also includes deficit financed expenditures by the non-corporate and the corporate business sectors for private investment purposes. This broader category also takes into account that in the national accounts the private household sector contains non-corporate business, and thus, depending on the institutional structure of the respective economy, private household deficits to a larger extent may in fact be business deficits.

### **3 Distribution in Denmark, Estonia and Latvia before and after the crisis**

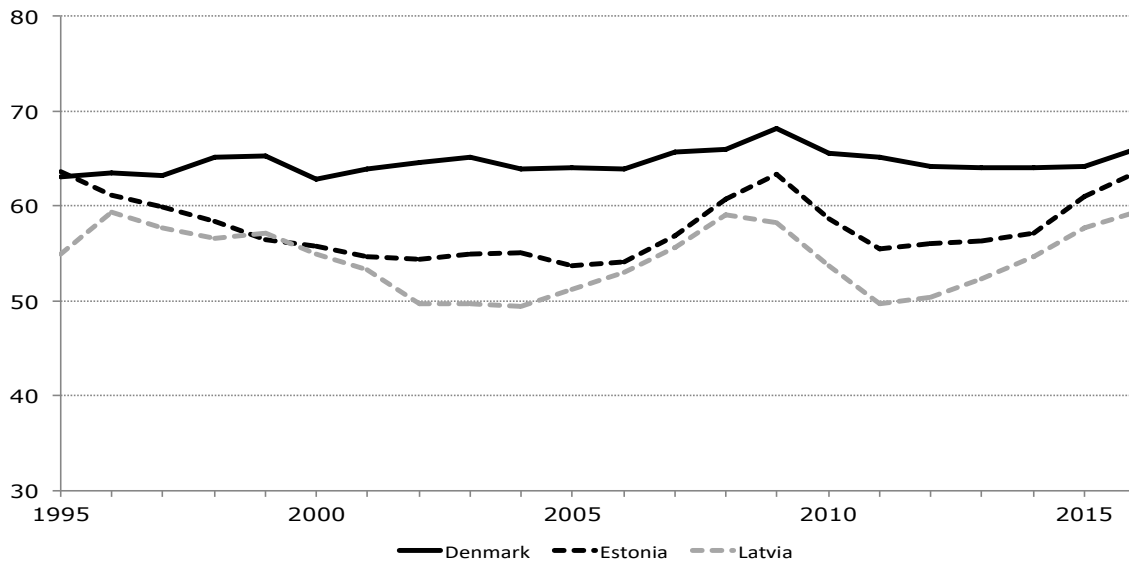
We start our examination of the macroeconomics of finance-dominated capitalism in Denmark, Estonia and Latvia with an analysis of the distribution channel of financialisation, applying the method we have already used in Hein et al. (2017b, 2018) for other countries. The distribution channel of financialisation is fundamental in our approach: Under the conditions of dominance of finance, the redistribution of income from labour to capital has contributed to severe macroeconomic imbalances both at national and international levels, i.e. rising and unsustainable household debt-income ratios in some countries and severe current account imbalances, and ultimately to the financial and economic crisis of 2007-09 (Hein 2017b).

Figure 3.1 presents the adjusted wage share as a percentage of GDP at factor costs from 1995 until 2016. In Denmark the adjusted wage share was slightly rising until the financial and economic crisis 2007-09, and has seen a slightly falling tendency since then. In Estonia and Latvia, however, the adjusted wage share had a slightly falling trend from 1995 until the financial and economic crisis. After the crisis, the adjusted wage share in these two countries was initially falling but then recovered up to 2016, so that the post-crisis trend seems to be constant.

As indicators for the development of personal income distribution, Figure 3.2 and Figure 3.3 display the Gini coefficients for market and disposable income for the years 1995 until 2015 and 2014, respectively. Before the crisis, the Gini coefficient of market income increased in Estonia and Latvia, and remained constant in Denmark. After the crisis of 2007-09, it increased in all of the three countries considered here. The development of Gini coefficients for disposable income, i.e. after taxes and transfer payments, rather differed between the countries. Before the crisis, there was an increase in Latvia and also in Denmark, where the level of inequality however still remained comparatively low; and a decline in Estonia. After the crisis, the Gini coefficient of disposable income was constant in Denmark and increased in Estonia, while it declined slightly in Latvia.

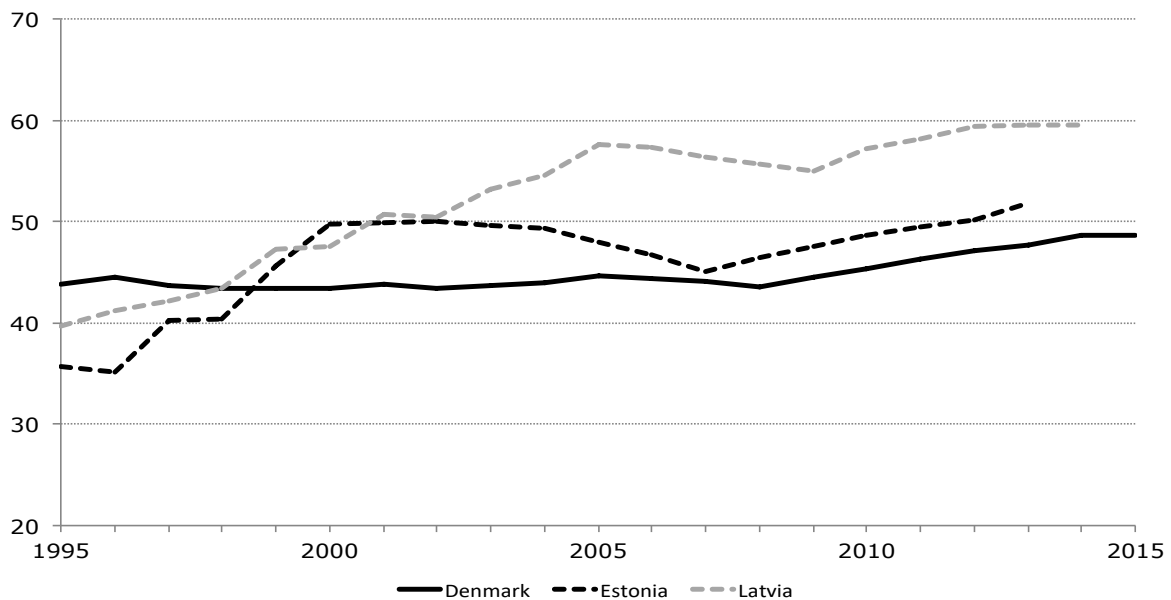


Figure 3.1: Adjusted wage share in Denmark, Estonia and Latvia, 1995-2016  
(percent of GDP at factor costs)



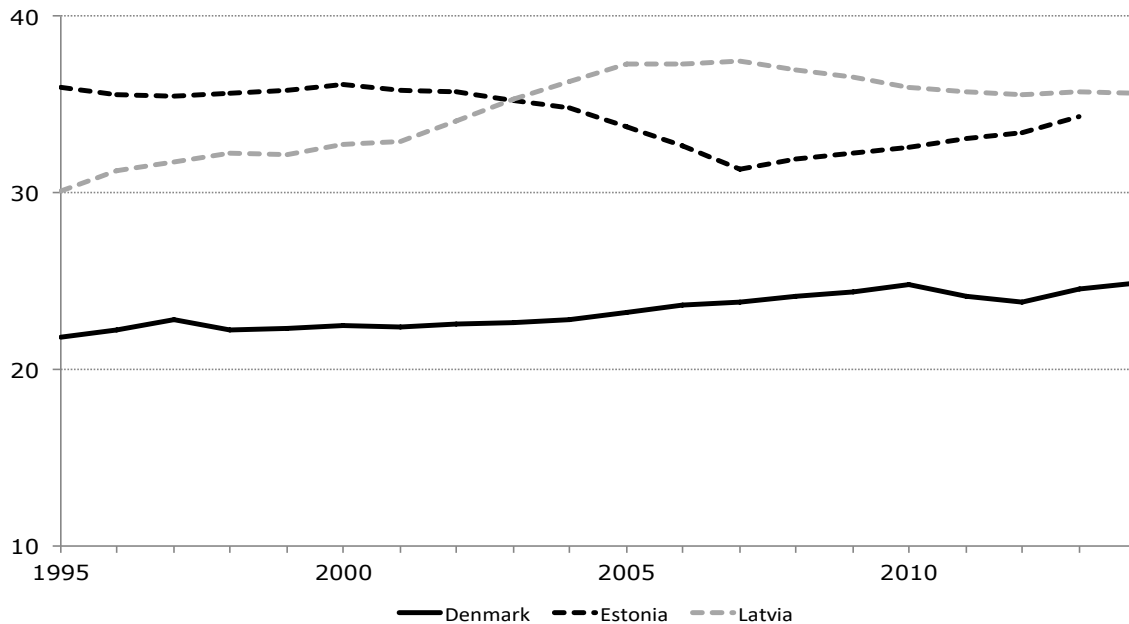
Note: The adjusted wage share is defined as the compensation of employees per employee as a share of GDP at factor costs per person employed. It thus includes the labour income of both dependent and self-employed workers, and GDP at factor costs excludes taxes but includes subsidies and depreciation of the capital stock.  
Source: European Commission (2017), our presentation.

Figure 3.2: Gini coefficient of market income in Denmark, Estonia and Latvia, 1995-2015



Note: The Gini coefficient is based on equivalised (square root scale) household market (pre-tax, pre-transfer) income.  
Source: Solt (2016), our presentation.

Figure 3.3: Gini coefficient of disposable income in Denmark, Estonia and Latvia, 1995-2014



Note: The Gini coefficient is based on equivalised (square root scale) household market (pre-tax, pre-transfer) income.

Source: Solt (2016), our presentation.

Based on the Kaleckian theory of distribution (Kalecki 1954, Part I; Hein 2014, Chapter 5) and drawing on the enormous literature on the characteristics of financialisation, Hein (2015) detected three main channels through which financialisation and neoliberalism might have contributed to the fall in labour income shares which could be observed in many OECD countries since the 1980s and before the financial and economic crisis of 2007-09:

First, financialisation and neoliberalism might contribute to a shift in the sectoral composition of the economy. Since sectoral income shares differ, the overall profit and labour income shares might be affected. Especially a shift from the public sector (where the profit share is zero by definition) and the non-financial corporate sector with higher income shares to the financial sector with lower income share can lead to a decline in the overall labour share.

Second, financialisation might impact overhead costs and profit claims, which in the Kaleckian framework determine the mark-up over unit variable costs and hence the gross profit share, which includes retained earnings, dividends, interest, and rent and management salaries. A rise in management salaries and rising profit claims of rentiers in the form of interest and dividend payments of the corporate sector, and hence rising overhead costs, can contribute to a fall in labour's income share, if the corporate sector successfully passes these costs to labour through raising prices or compressing unit wage costs.

Third, financialisation and neoliberalism might weaken the bargaining power of trade unions, which, in the Kaleckian framework, also affects the mark-up in firms' price setting and thus the gross profit share. Here, several channels are especially important: increasing shareholder value orientation and short-term profitability orientation of the management; sectoral shifts away from the public sector and the non-financial sector with traditionally stronger trade unions towards the financial sector with potentially weaker trade unions; liberalisation and globalisation of international trade and finance; deregulation of labour markets; and downsizing of the government and abandonment of government demand management and full employment policies.

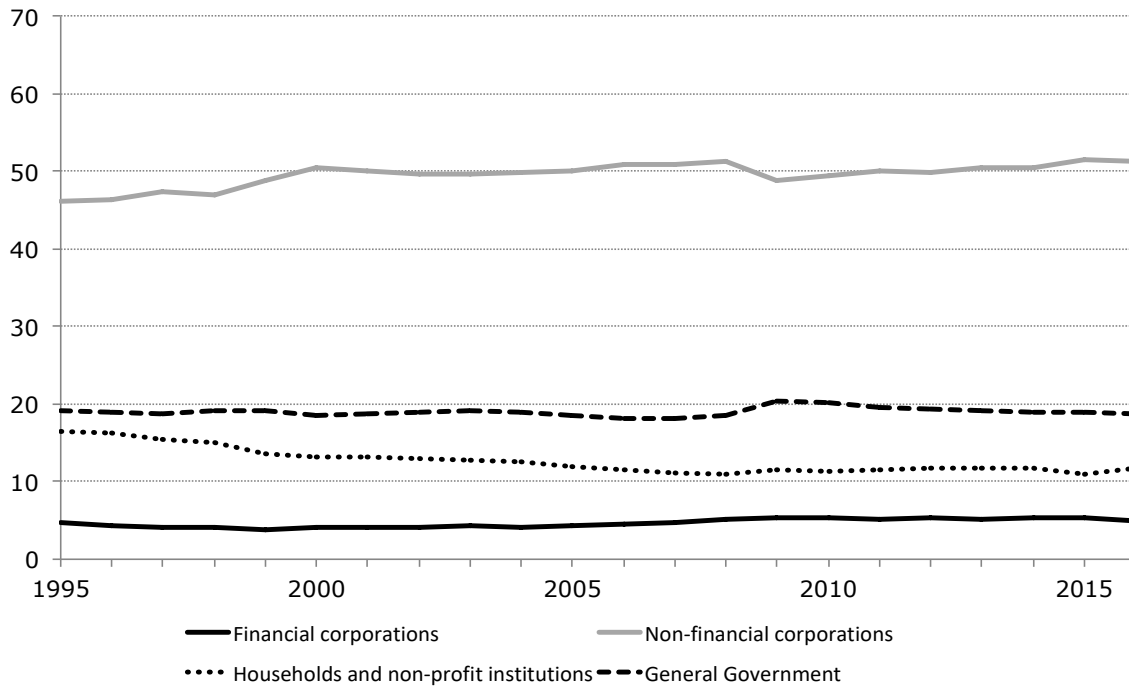
In the empirical literature, as reviewed in Hein (2015) and in Hein et al. (2017a, 2018), it has been shown that these channels indeed contributed to falling labour shares in advanced capitalist economies, but to varying degrees. In the following analysis we distinguish between the pre-crisis and post-crisis period, since it is likely that the crisis of 2007-09 has affected the relationship between financialisation and distribution. We will examine empirical indicators for the three channels mentioned before: the sectoral composition channel, the overhead and gross profit claims channel, and the bargaining power channel for the three countries under investigation.

### **3.1 The sectoral composition channel**

For the sectoral composition channel, we will look at the contributions of the financial corporate, non-financial corporate, household, and government sectors to gross value added of the respective economies, and at the profit shares in the financial and non-financial corporate sectors, in particular. Although the sector definitions are very broad and are not strictly related to price setting power in branches or industries, this will allow us to see whether there has been the expected structural change in favour of the financial sector, whether profit shares in the financial sector have been higher than in the non-financial sectors, and whether any change in the sectoral composition of the economy as such has contributed to a rise in the profit share and hence a fall in the wage share for the economy as a whole.

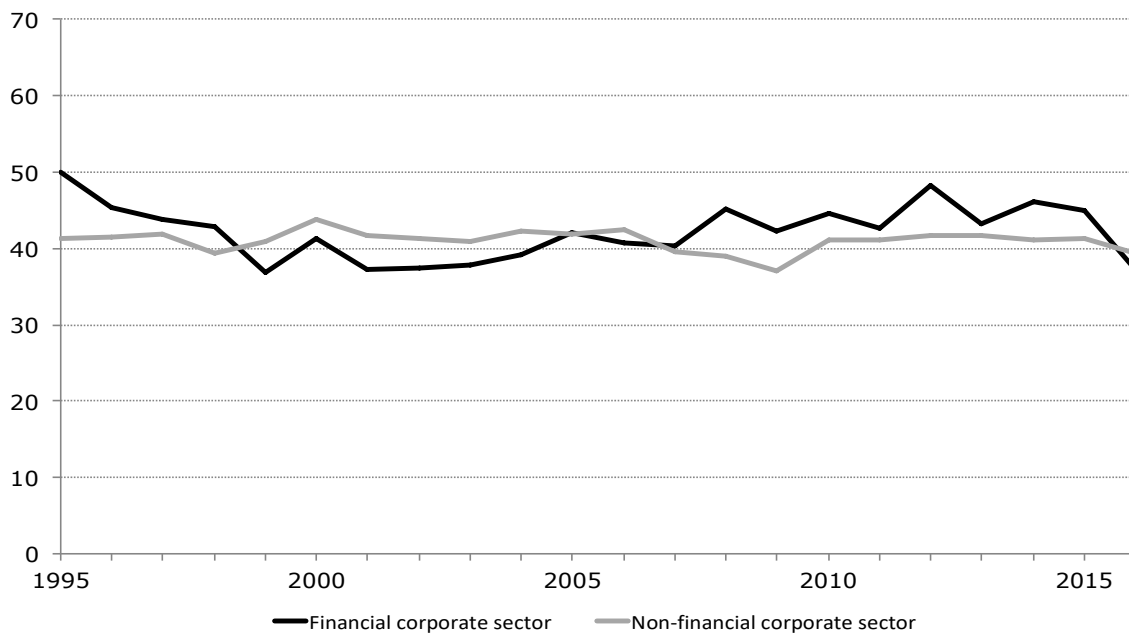
For the case of Denmark, there was no significant shift of the sectoral shares in gross value added towards the financial sector in the period before the crisis, from 1995 until 2008 (Figure 3.4). There was a minor increase in the non-financial sector share at the expense of households. Until the crisis, profit shares of the financial and non-financial corporations evolved similar, with the non-financial corporations' profit share being slightly higher (Figure 3.5). Hence, through the sectoral composition channel, there was no downward pressure of financialisation on the aggregate Danish wage share before the crisis. In the course and after the crisis, in the period from 2009 until 2016, we find a slight increase in the share of financial corporations in value added, as well as in the financial sector profit share relative to the non-financial corporate sector. The sectoral composition channel could thus have contributed to a decline in the adjusted wage share and a rise in the profit share in national income.

Figure 3.4: Sector shares in nominal gross value added, Denmark, 1995-2016 (percent)



Source: OECD (2017), our calculations and presentation.

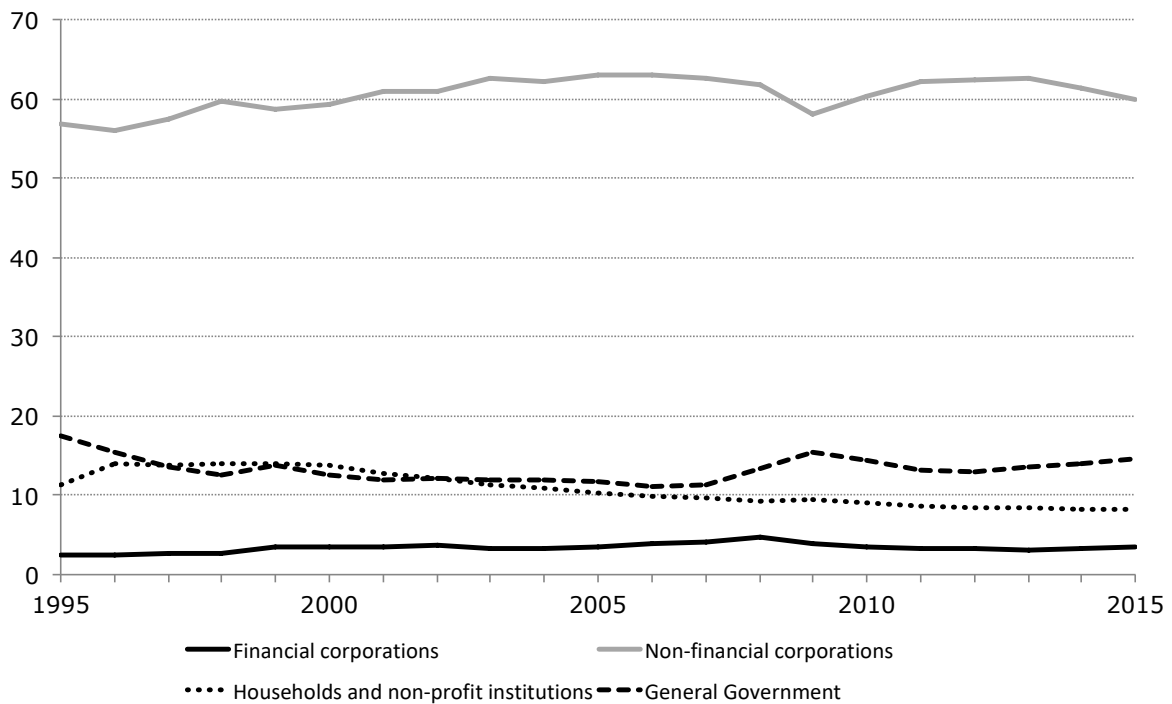
Figure 3.5 Sector gross operating surplus as a share of sector gross value added, Denmark, 1995-2016 (percent)



Source: OECD (2017), our calculations and presentation.

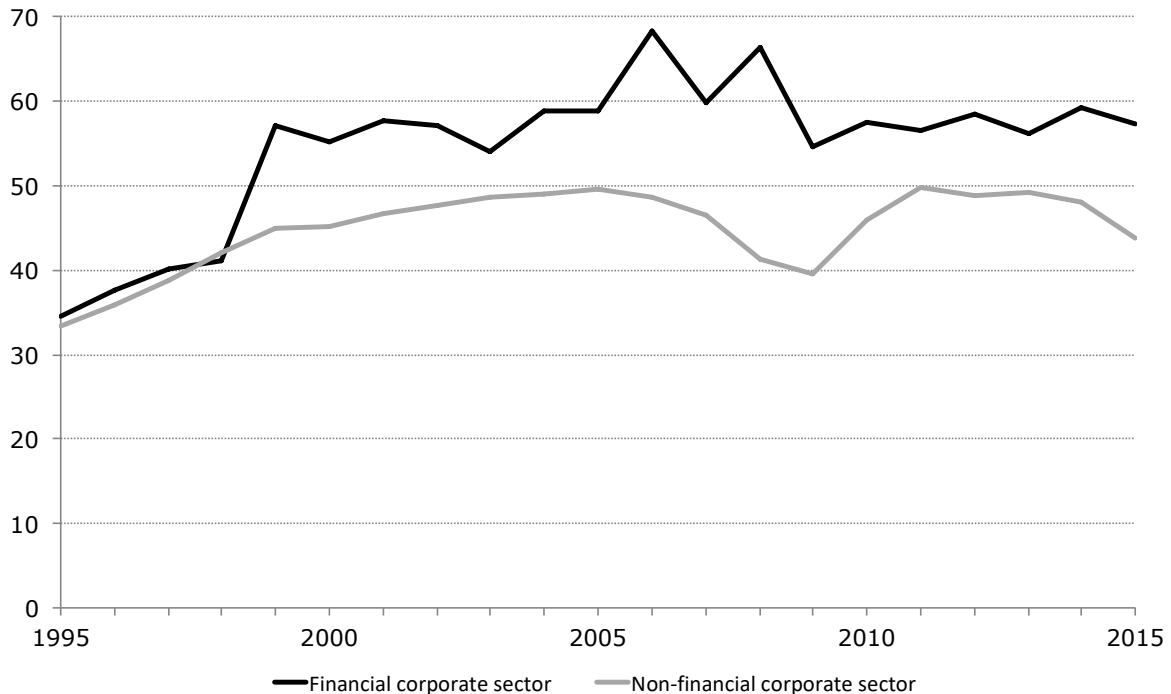
In regard to the Estonian economy, Figure 3.6 illustrates that there was a slightly growing relevance of the financial sector starting in the late 1990 until the crisis. At the same time, the share of the non-financial sector in value added increased, whereas the share of households (i.e. non-corporate business) and the share of the government declined. Simultaneously, the profit share of the financial corporate sector exceeded the profit share of the non-financial corporate sector noticeably (Figure 3.7). The sectoral composition effect in favour of the financial sector thus contributed to the rise of the aggregate profit share in Estonia before the crisis. In the course and after the crisis the share of financial corporations in value added decreased slightly, while the profit share of the financial corporate sector remained fairly constant and above the profit share of the non-financial corporations.

Figure 3.6: Sector shares in nominal gross value added, Estonia, 1995-2015 (percent)



Source: OECD (2017), our calculations and presentation.

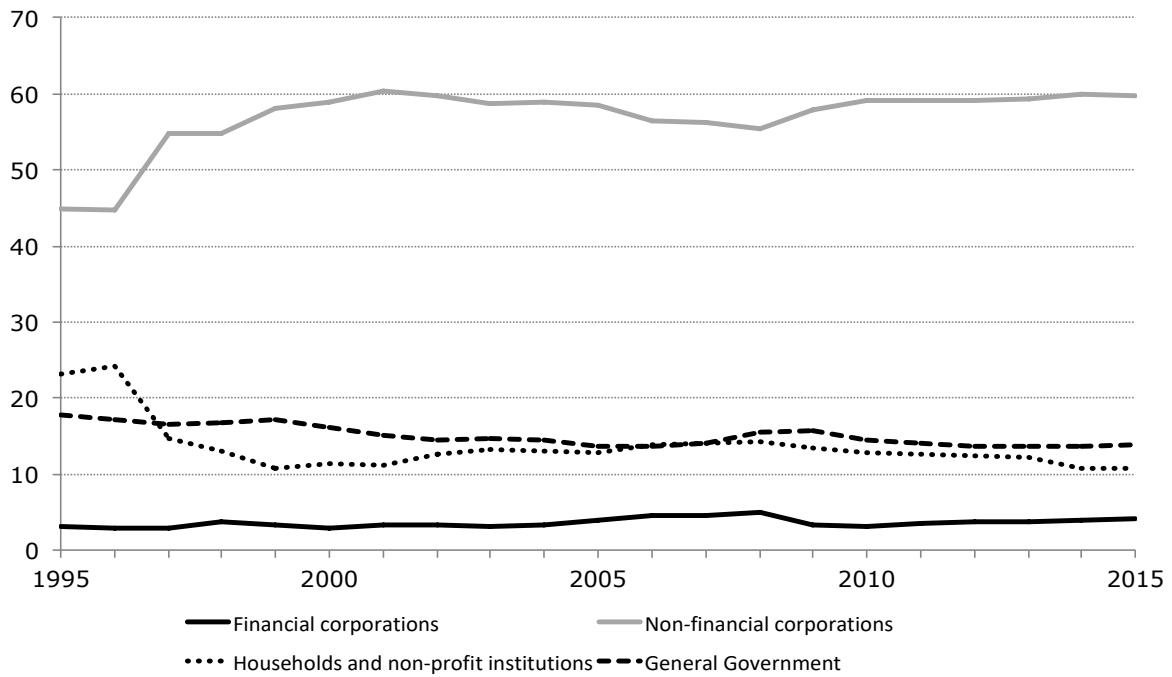
Figure 3.7: Sector gross operating surplus as a share of sector gross value added, Estonia, 1995-2015 (percent)



Source: OECD (2017), our calculations and presentation.

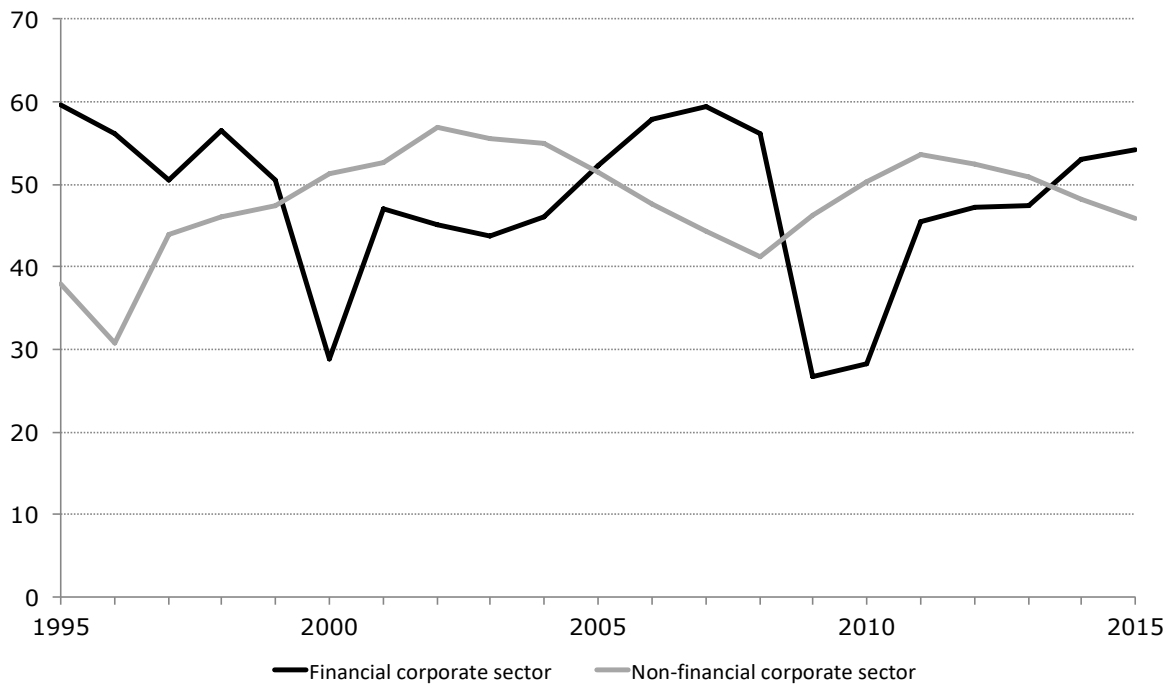
Regarding the relevance of the sector composition channel in Latvia before the crisis, there was a modest increase of the financial corporate sector share in gross value added (Figure 3.8). The contribution of households and the government sector to value added declined while non-financial corporations saw an increase. At the same time, profit shares of the financial and non-financial corporate sector fluctuated and were similar on average (Figure 3.9). Hence, the sectoral composition channel did not contribute to the fall in the aggregate adjusted wage share in Latvia before the crisis. After the crisis, Latvia's financial corporations' share in value added increased slightly, and its profit share, after a tremendous decline during the crisis increased again and reached the pre-crisis level. However, the financial sectors' profit share did not exceed the non-financial sectors profit share and hence we can deny any relevance of the sectoral composition channel for the aggregate adjusted wage share after the crisis.

Figure 3.8: Sector shares in nominal gross value added, Latvia, 1995-2015 (percent)



Source: OECD (2017), our calculations and presentation.

Figure 3.9: Sector gross operating surplus as a share of sector gross value added, Latvia, 1995-2015 (percent)



Source: OECD (2017), our calculations and presentation.

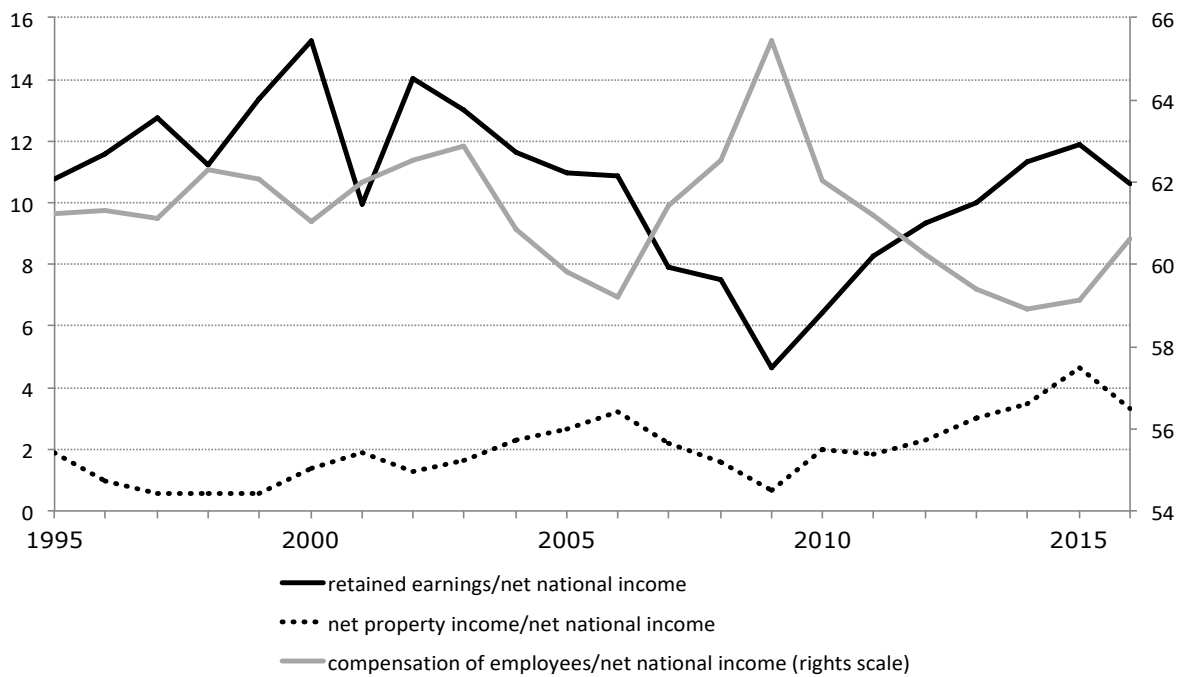
### **3.2 The overhead costs and rentiers' profit claims channel**

For the second channel, the overhead costs and rentiers' profit claims channel, we will more closely examine the functional distribution of national income and distinguish the different components of aggregate profits in order to see whether a rise in the profit share benefitted firms in terms of retained earnings or rather rentiers in terms of distributed profits, dividends, and interest in particular. In turn, this will allow us to infer whether rising income claims of rentiers – and thus overhead costs of firms – came at the expense of workers' income or at the expense of retained earnings under the control of the management of firms. We are thus only examining the distributional effects of changes in financial overheads and rentiers' profit claims on the functional income shares. Our data does not allow us to draw conclusions with respect to the distributional effects of changes in (top-)management salaries as part of overheads, since management salaries are part of compensation of employees in the national accounts and thus of the labour income share to be used below, or the adjusted wage share as shown before.

From 1995 until the crisis, Denmark experienced a slightly rising trend in net property income in net national income, while the share of retained earnings in net national income declined and the share of wages in net national income remained relatively constant (Figure 3.10). The decomposition of rentiers' income, which is depicted in Figure 3.11, shows a modest rise in dividend income and property income attributed to insurance holders. Net interest income remained constant on a negative level until 2006, when it started to decline even further. Hence, there was only little pressure via the financial overheads/rentiers' profits claim channel, even though dividend and insurance incomes were slightly rising. Since the crisis, the share of retained earnings and the rentier share increased, while the share of wages declined. Therefore, it seems that the financial overheads/rentiers' profit claims channel has contributed to the fall in the aggregate adjusted wage share after the crisis.

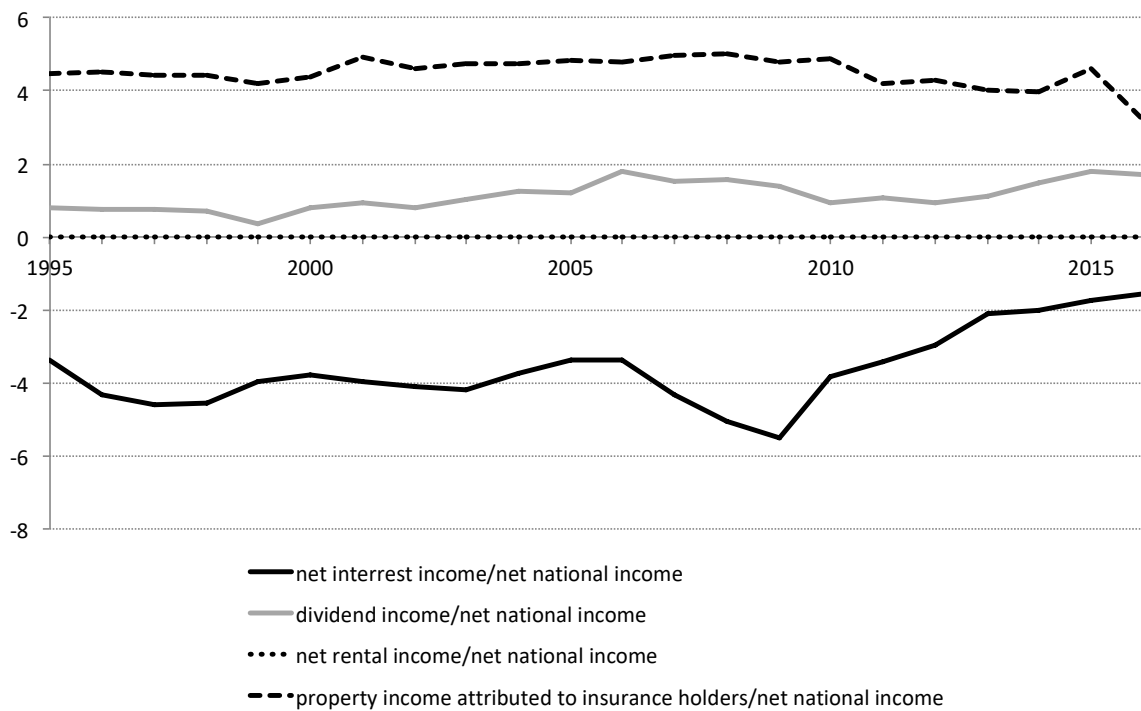


Figure 3.10: Income shares in net national income, Denmark, 1995-2016 (percent)



Source: OECD (2017), our calculations and presentation.

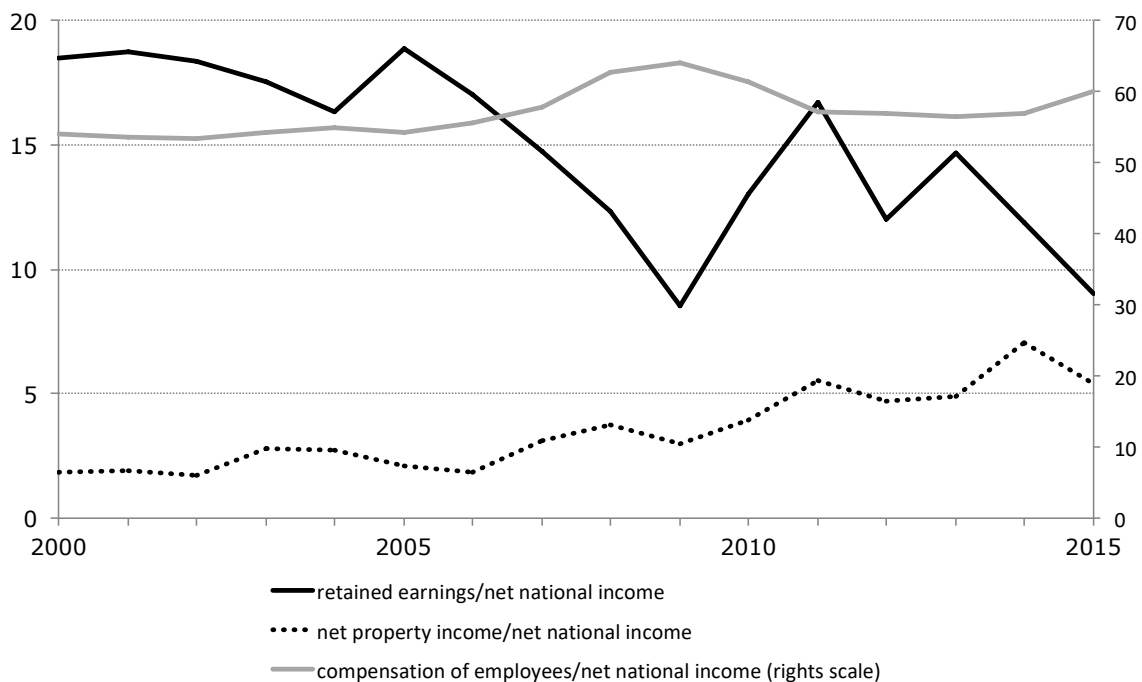
Figure 3.11: Components of rentiers' income as a share in net national income, Denmark, 1995-2015 (percent)



Source: OECD (2017), our calculations and presentation.

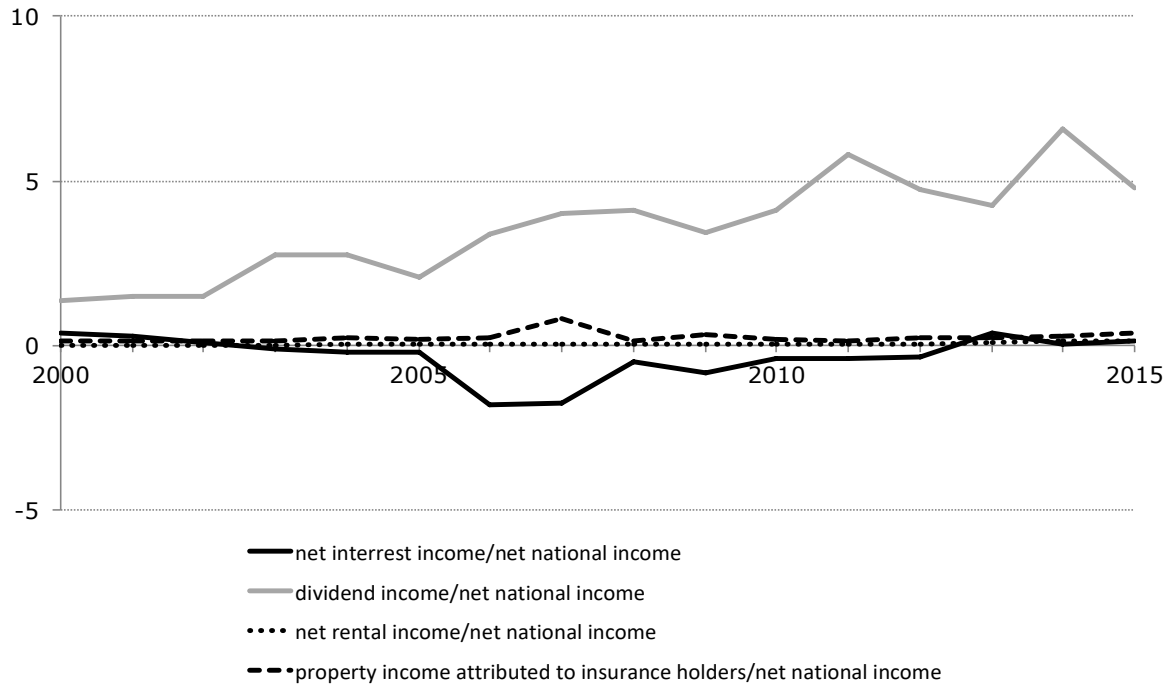
In the case of Estonia, the share of net property income in net national income and the share of wages increased slightly before the crisis, while the share of retained earnings declined (Figure 3.12). The decomposition of the rentier share, which is shown in Figure 3.13, shows a clear upward trend in dividend income, which was only partly compensated by a drop in net interest income. We can deduce that the financial overheads and rentiers' profit claim channel contributed to the decline of the aggregate adjusted wage share before the crisis. In the course of and after the crisis, the share of wages remained fairly constant. The rentier share increased, while the share of retained earnings declined. Hence, financial overheads still put pressure on the aggregate adjusted wage share.

Figure 3.12: Income shares in net national income, Estonia, 1995-2015 (percent)



Source: OECD (2017), our calculations and presentation.

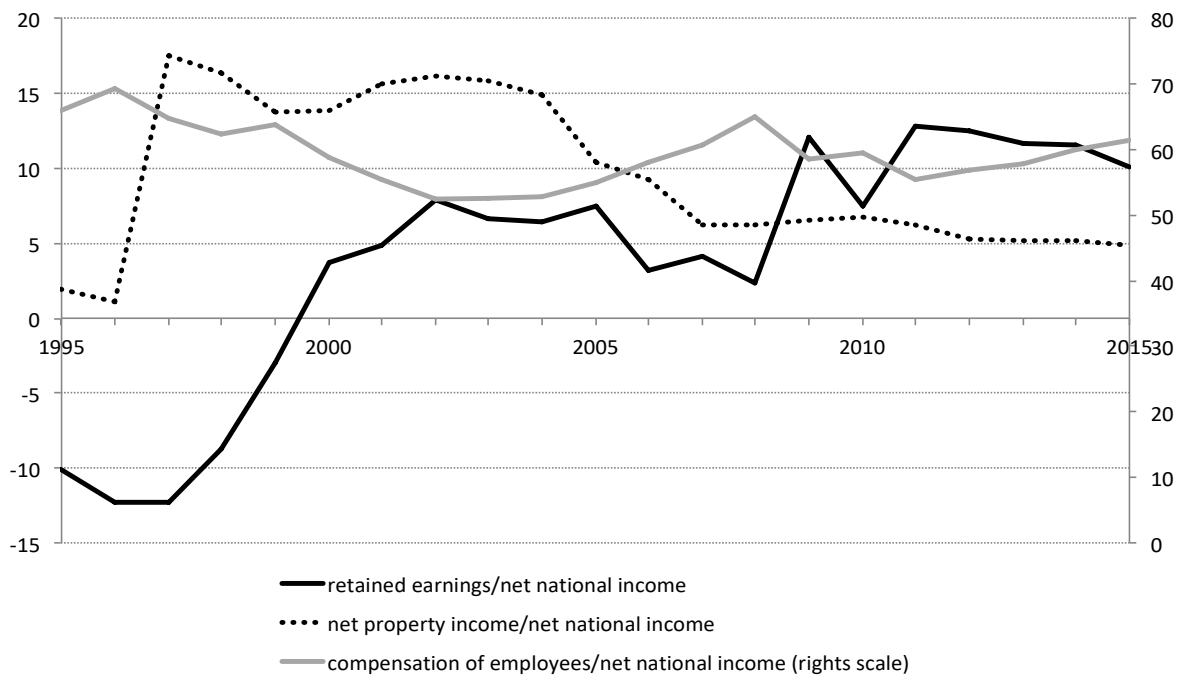
Figure 3.13: Components of rentiers' income as a share in net national income, Estonia, 1995-2015 (percent)



Source: OECD (2017), our calculations and presentation.

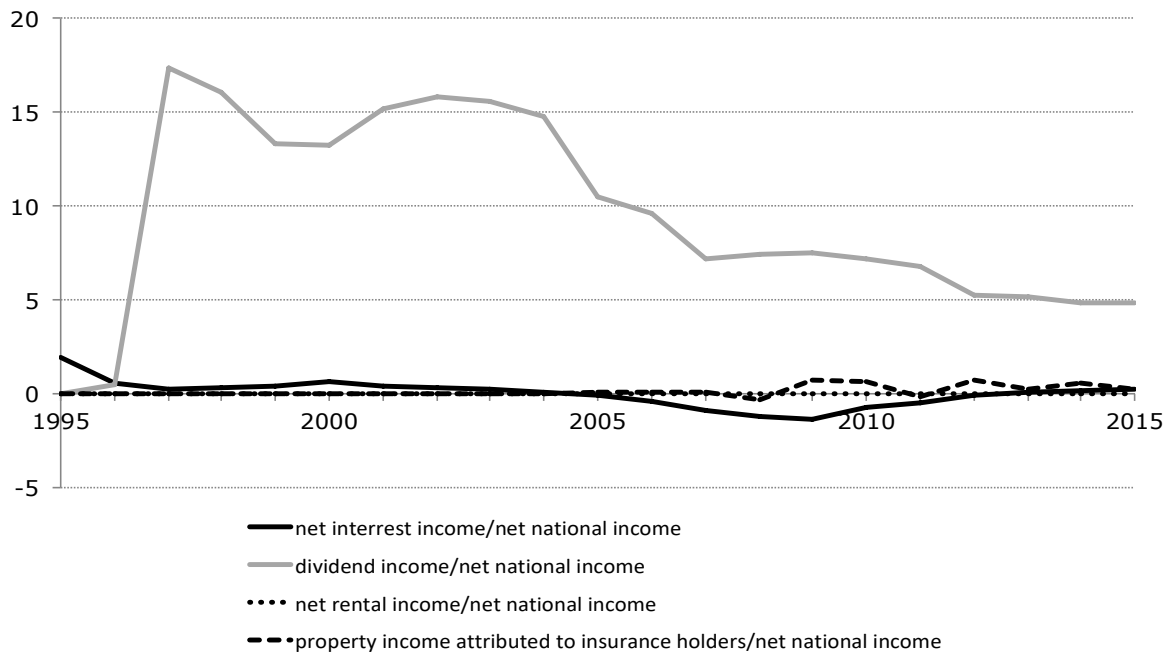
Latvia experienced a tremendous decline in the share of net property income in net national income from 1997 until the crisis (Figure 3.14), which was largely mirrored by the share of dividend income, combined with a simultaneous decline in the share of net interest income (Figure 3.15). At the same time, the share of wages remained fairly stable and the share of retained earnings increased. The trends that we have observed before the crisis persisted during the course and after the crisis. Therefore, we can conclude that the financial overheads/rentiers' profit claims channel was of no relevance in Latvia before or after the crisis.

Figure 3.14: Income shares in net national income, Latvia, 1995-2015 (percent)



Source: OECD (2017), our calculations and presentation.

Figure 3.15: Components of rentiers' income as a share in net national income, Latvia, 1995-2015 (percent)



Source: OECD (2017), our calculations and presentation.

### 3.3 The bargaining power channel

For the third channel, the bargaining power channel, we will assess several determinants of workers' and trade unions' bargaining power, which have been found to significantly affect functional income distribution in recent (panel) econometric work. A first set will be directly related to the labour market, i.e. unemployment rates, union density, wage bargaining coverage, employment protection, and unemployment benefits which should each be positively related to workers' and trade unions' bargaining power. In this context we will also look at the development of trade openness to assess international competition among workers and the 'threat effect' of firms to outsource and relocate production, which should negatively affect workers' bargaining power at national levels. Recently it has been argued that household indebtedness should negatively affect workers' bargaining power, because the cost of job loss will rise if workers need labour income to borrow and to service debt in order to sustain their level of consumption (Barba and Pivetti 2009, Kim, Lima and Setterfield 2017).

In regard to the bargaining power channel at the economy wide level, for the case of Denmark, we find only very small deterioration of labour market indicators before the crisis. On the positive side, the unemployment rate declined. However, the union density rate, and the bargaining coverage rate decreased (Table 3.1). Strictness of employment protection for regular and temporary contracts was slightly downsized. Trade openness of the Danish economy increased until the crisis, which supposedly put pressure on workers' income claims. The same holds true for the household debt to GDP ratio, which in the period 2005-2009 reached a very high level of 210 percent. After the crisis, the overall bargaining power of workers and trade unions deteriorated. Unemployment increased, union density fell, unemployment benefits have declined, and household debt-GDP ratios and trade openness have increased.

Even before the crisis, in Estonia and Latvia workers' and trade unions' bargaining power was comparatively low. The reasons for this are historical and are based, amongst other things, on negative associations with the Communist past. Individualism was preferred over trade unions. Moreover, both countries experienced a deindustrialisation of its heavy industries in which trade unions were traditionally strong. Especially labour intensive light industries have become established in the Baltic States that are organised in small organisational units, and hence structurally inhibit the collective organisation of labour (Gonser 2010). These developments are also reflected in the data. Table 3.2 summarises indicators for workers' and trade unions' bargaining power for the case of Estonia. Before the crisis, the unemployment rate was on a downward trend, but the union density rate deteriorated considerably, and the already relatively low bargaining coverage rate declined further to only 25 percent in 2005-2009. Household indebtedness increased tremendously up to the crisis, while the initially very high indicator of trade openness declined. Taken together, there was a decline in workers' and trade unions' bargaining power before the crisis. After the crisis, this trend prevailed, even though employment protection slightly improved and household debt-to GDP ratios were constant.

Also in Latvia, unemployment declined before the crisis (Table 3.3). The union density rate fell to a very low level in 2005-2009. Household indebtedness more than doubled in the early 2000s, and there was also an increase in trade openness, which supposedly put pressure on workers' bargaining power. In the course and after the crisis, there was a significant rise in unemployment and union density and bargaining coverage declined even further. Trade openness increased by 25 percentage points and there was also a rise in the household debt-to-GDP ratio.

According to Gosner (2010), the further decline in trade union membership at the enterprise level in Estonia and Latvia after the crisis mainly resulted from membership cancellations due to redundancies and financial hardship. Apart from the decline in trade union membership, there was also a destabilisation and deinstitutionalisation of collective bargaining structures, which have manifested themselves in a decline of conclusions of collective agreements, the non-conclusion of sector level agreements, and the intermission of minimum wage bargaining.

Table 3.1: Indicators for workers' and trade unions' bargaining power: Denmark

	1995-1999	2000-2004	2005-2009	2010-2013
Unemployment rate (percent)	5.86	4.72	4.38	7.4
<i>Trade Unions</i>				
Union density rate: union membership as a percentage of wage and salary earners in employment	75.34	72.16	68.21	66.83
Bargaining (or union) coverage: employees covered by collective (wage) bargaining agreements as a percentage of all wage and salary earners, adjusted for occupations and sectors without right for bargaining	85	85	82.3	83.5
<i>Employment protection (index 0 to 6)</i>				
Strictness of employment protection - individual dismissals (regular contracts)	2.13	2.13	2.13	2.18
Strictness of employment protection - collective dismissals (additional restrictions)		3.63	3.03	2.88
Strictness of employment protection - temporary contracts	1.38	1.38	1.38	
<i>Unemployment benefits</i>				
Net replacement rate summary measure of benefit entitlements (excl. social assistance and housing benefits) (percent of previous net income)		65	64	40
Net replacement rate summary measure of benefit entitlements (incl. social assistance and housing benefits) (percent of previous net income)		79	76	68
Households' debt (percent of GDP)	143.8	168.12	210.14	220.43
Trade openness (percent of GDP)	70.43	82.92	96.28	100.41
Notes: Averages were calculated for the 5 year periods indicated. Sometimes data was not available for all years in the 5 year periods. Household sector debt is the stock of liabilities held Households and Non-Profit institutions serving households. The instruments that are taken into account to compile private sector debt are Debt securities and Loans. Data are presented in consolidated terms, i.e. do not taking into account transactions within the same sector. Trade openness is calculated as the sum of exports and imports of goods and services as a share of GDP.				
Sources: European Commission (2018), OECD (2018), Visser (2015), World Bank (2018), our calculations and presentation.				

Table 3.2: Indicators for workers' and trade unions' bargaining power: Estonia

	1995-1999	2000-2004	2005-2009	2010-2013
Unemployment rate (percent)	10.22	11.6	7.5	11.9
<i>Trade Unions</i>				
Union density rate: union membership as a percentage of wage and salary earners in employment	26.09	13.26	8.08	7.04
Bargaining (or union) coverage: employees covered by collective (wage) bargaining agreements as a percentage of all wage and salary earners, adjusted for occupations and sectors without right for bargaining		28	24.7	23
<i>Employment protection (index 0 to 6)</i>				
Strictness of employment protection - individual dismissals (regular contracts)			2.74	1.81
Strictness of employment protection - collective dismissals (additional restrictions)			1.75	2.88
Strictness of employment protection - temporary contracts			1.88	2.16
<i>Unemployment benefits</i>				
Net replacement rate summary measure of benefit entitlements (excl. social assistance and housing benefits) (percent of previous net income)			24	24
Net replacement rate summary measure of benefit entitlements (incl. social assistance and housing benefits) (percent of previous net income)			39	42
Households' debt (percent of GDP)	45.36	68.76	124.7	123.63
Trade openness (percent of GDP)	146.86	126.29	132.7	161.84
Notes: Averages were calculated for the 5 year periods indicated. Sometimes data was not available for all years in the 5 year periods. Household sector debt is the stock of liabilities held Households and Non-Profit institutions serving households. The instruments that are taken into account to compile private sector debt are Debt securities and Loans. Data are presented in consolidated terms, i.e. do not taking into account transactions within the same sector. Trade openness is calculated as the sum of exports and imports of goods and services as a share of GDP.				
Sources: European Commission (2018), OECD (2018), Visser (2015), World Bank (2018), our calculations and presentation.				



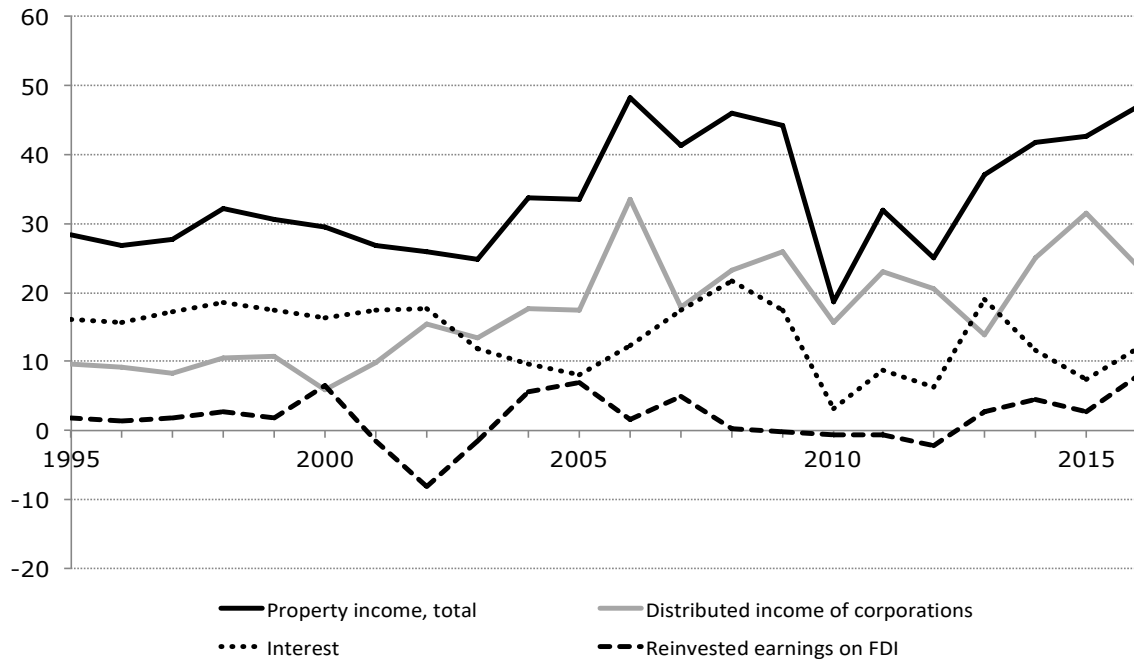
Table 3.3 Indicators for workers' and trade unions' bargaining power: Latvia

	1995-1999	2000-2004	2005-2009	2010-2013
Unemployment rate (percent)	14.14	13.12	9.64	15.65
<i>Trade Unions</i>				
Union density rate: union membership as a percentage of wage and salary earners in employment	27.4	20.23	16.21	13.9
Bargaining (or union) coverage: employees covered by collective (wage) bargaining agreements as a percentage of all wage and salary earners, adjusted for occupations and sectors without right for bargaining		18	18.3	16.2
<i>Employment protection (index 0 to 6)</i>				
Strictness of employment protection - individual dismissals (regular contracts)				2.69
Strictness of employment protection - collective dismissals (additional restrictions)				3.75
Strictness of employment protection - temporary contracts				0.88
<i>Unemployment benefits</i>				
Net replacement rate summary measure of benefit entitlements (excl. social assistance and housing benefits) (percent of previous net income)			24	24
Net replacement rate summary measure of benefit entitlements (incl. social assistance and housing benefits) (percent of previous net income)			46	48
Households' debt (percent of GDP)	24.16	52.34	102.16	109.9
Trade openness (percent of GDP)	84.52	86	95.24	120.09
Notes: Averages were calculated for the 5 year periods indicated. Sometimes data was not available for all years in the 5 year periods. Household sector debt is the stock of liabilities held Households and Non-Profit institutions serving households. The instruments that are taken into account to compile private sector debt are Debt securities and Loans. Data are presented in consolidated terms, i.e. do not taking into account transactions within the same sector. Trade openness is calculated as the sum of exports and imports of goods and services as a share of GDP. Sources: European Commission (2018), OECD (2018), Visser (2015), World Bank (2018), our calculations and presentation.				

Finally, we will look at the bargaining power of workers at the non-financial corporate level, in particular. This should be affected by the managers' interest in the maximisation of short-term profits in favour of shareholder value as opposed to the long-term growth of the firm. This strategy implies to 'downsize and distribute' instead of 'retain and invest' (Lazonick and O'Sullivan 2000), boosting share prices and/or paying out profits to shareholders by means of squeezing workers and by financial investments instead of real investments in the capital stock of the firm. In terms of indicators, we examine the relevance of property income received in relation to the operating surplus of non-financial corporations to assess the relevance of financial vs. real investments, and we use property income paid in relation to the operating surplus to identify the distributional pressure imposed by shareholders on management and on labour. A high relevance of received financial profits and of dividend payments will each be interpreted as indicating a high shareholder value orientation of management, which should be detrimental to workers' bargaining power and hence the wage share at the corporate level.

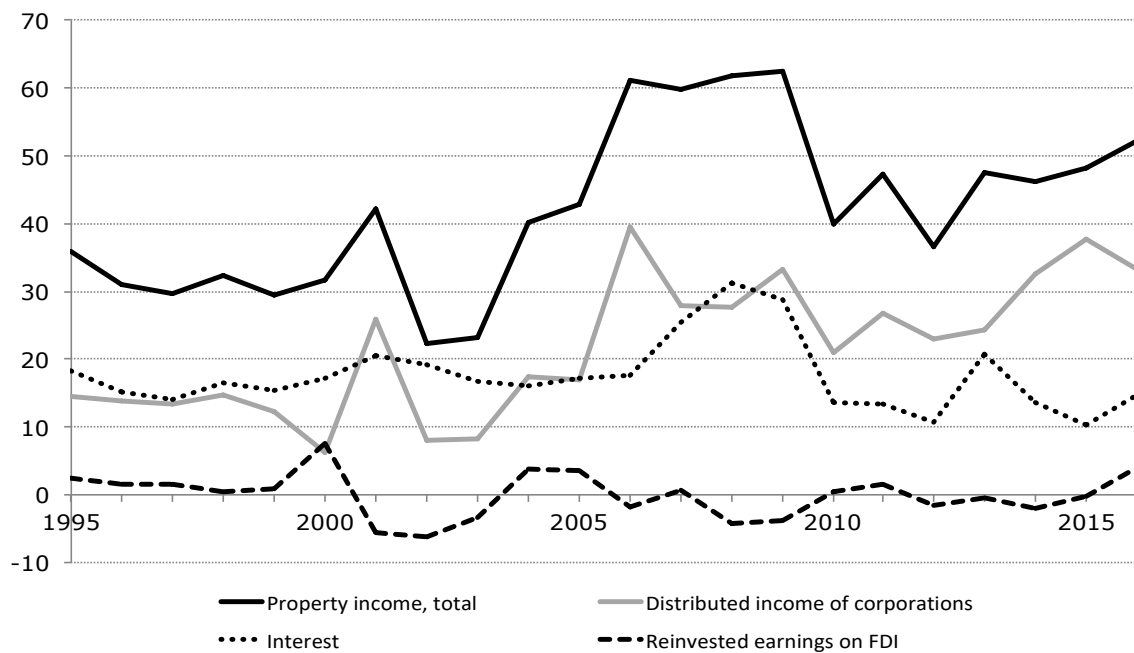
In Danish non-financial corporations the total property income received in relation to the gross operating surplus evolved relatively stable until 2005, when it started to increase until the crisis by almost 20 percentage points. This remarkable increase was largely driven by an increase in distributed income of corporations, i.e. dividends (Figure 3.16). Looking at the second indicator of increasing shareholder value orientation of management – the growing relevance of profits distributed to shareholders – Figure 3.17 shows that between 2003 and 2007, property income paid as a share of gross operating surplus increased by almost 40 percentage points. Again, this increase was largely driven by an increase in the pay-out of distributed income of corporations. Hence, at the corporate level, there was a rise in shareholder value orientation of the management, which undermined workers bargaining power. After the crisis, Denmark experienced a renewed increase in shareholder value pressure at the non-financial corporate level.

Figure 3.16: Property income received by non-financial corporations, Denmark, 1995-2015, (percent of sector gross operating surplus)



Source: OECD (2017), our calculations and presentation.

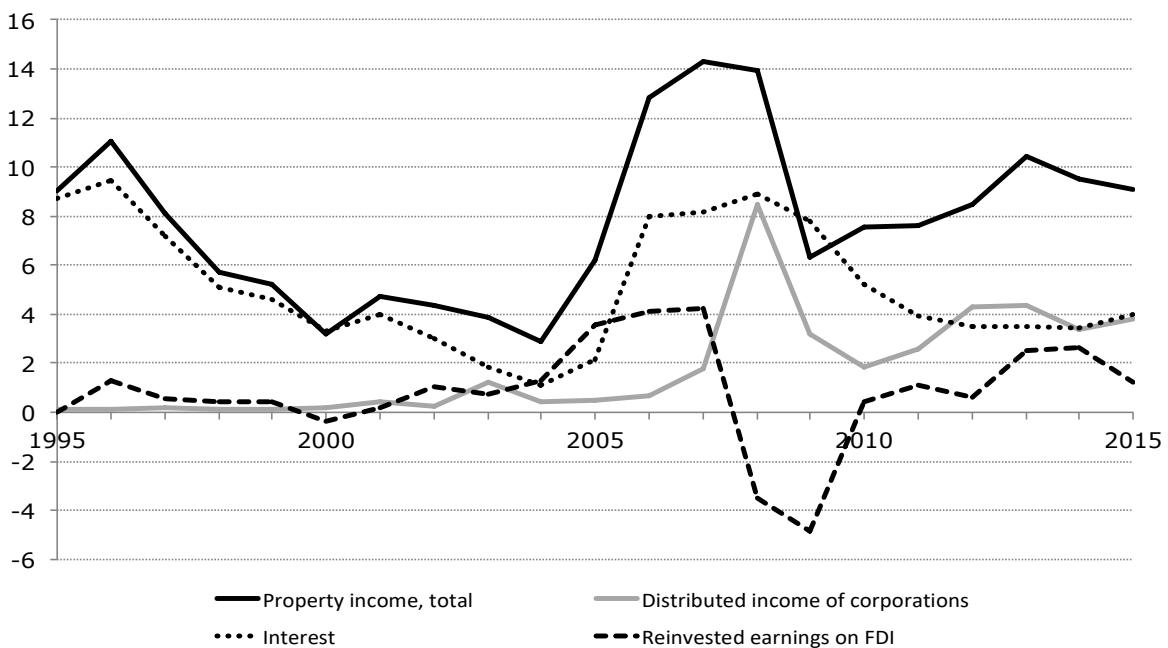
Figure 3.17: Property income paid by non-financial corporations, Denmark, 1995-2015, (percent of sector gross operating surplus)



Source: OECD (2017), our calculations and presentation.

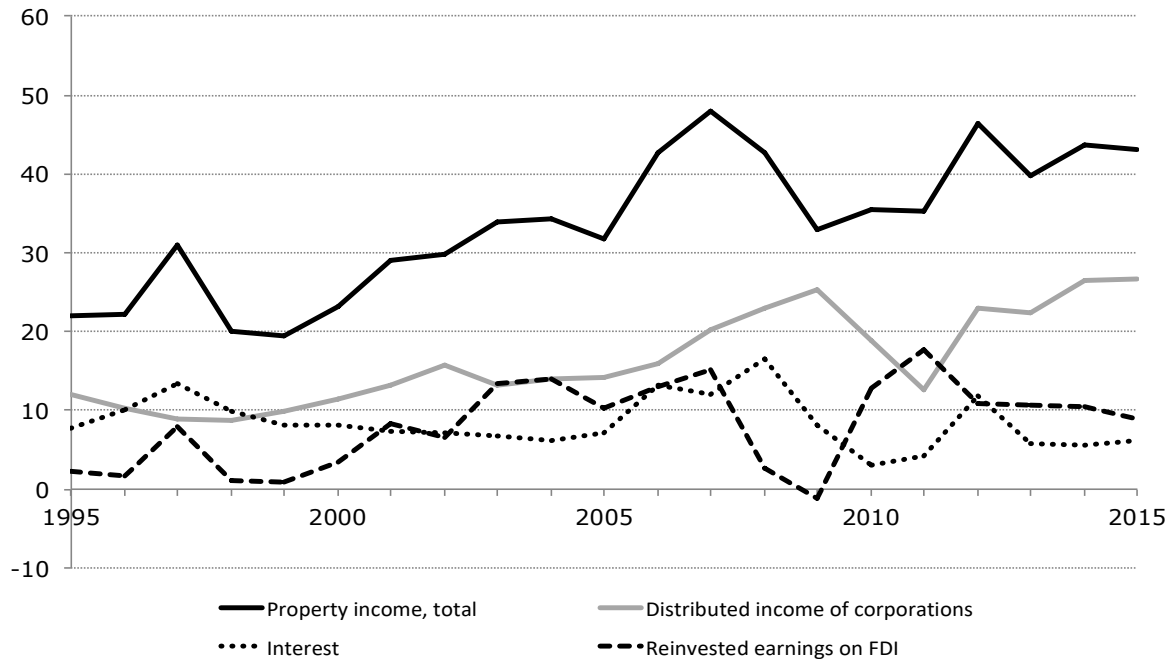
In the case of Estonia, distributed property income received as a share of gross operating surplus of non-financial corporations declined from the mid 1990s until 2004, when until the crisis it increased tremendously. (Figure 3.18). The property incomes distributed in relation to the operating surplus increased, driven in particular by rising dividend payments to shareholders (Figure 3.19). After the crisis, Estonia experienced a modest increase in shareholder value pressure at the non-financial corporate level.

*Figure 3.18: Property income received by non-financial corporations, Estonia, 1995-2015, (percent of sector gross operating surplus)*



Source: OECD (2017), our calculations and presentation.

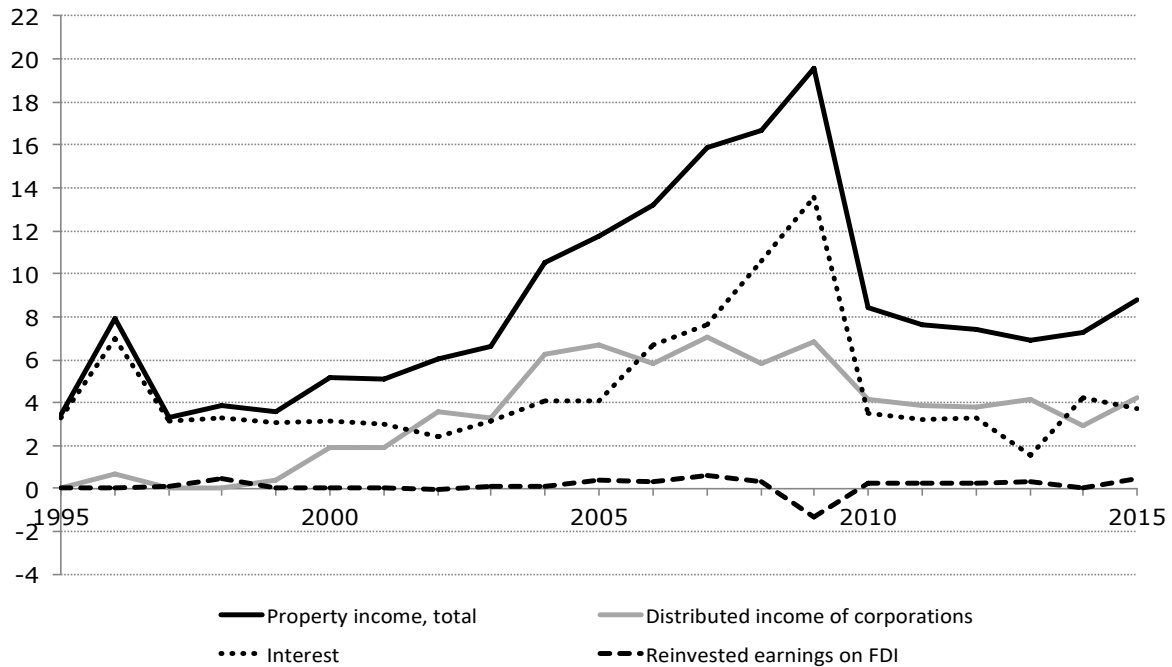
Figure 3.19: Property income paid by non-financial corporations, Estonia, 1995-2015, (percent of sector gross operating surplus)



Source: OECD (2017), our calculations and presentation.

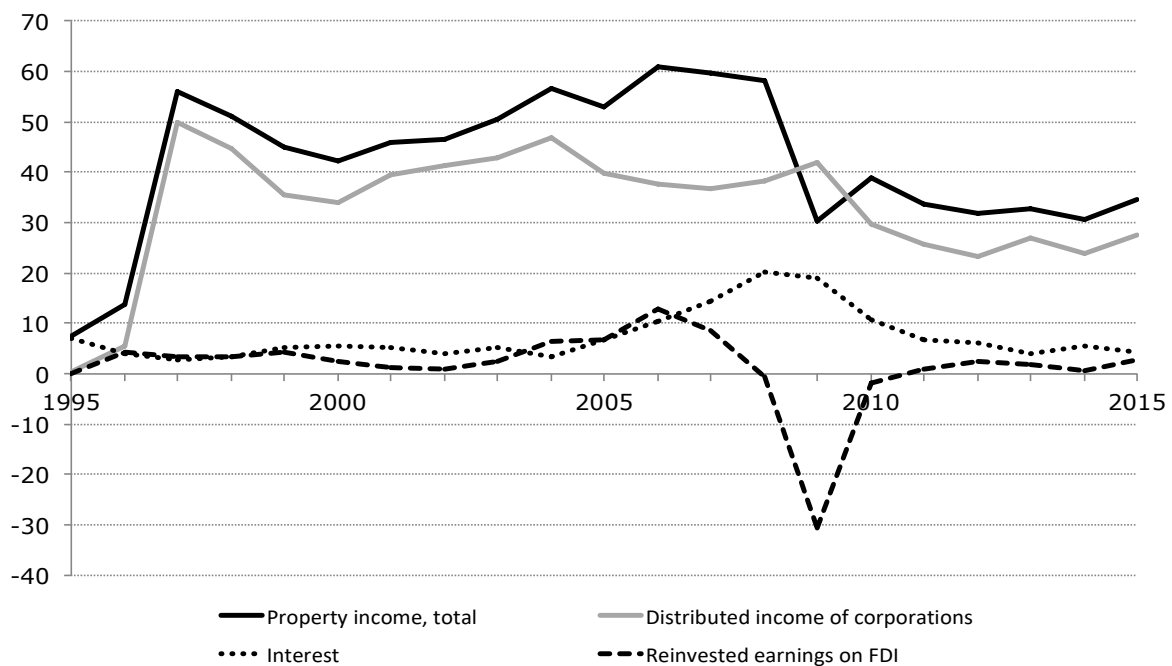
In Latvia, up to the crisis, there was a massive rise in property incomes received relative to the operating surplus, which indicates an increasing relevance of financial investments as compared to investments in the real capital stock of the firm (Figure 3.20). The property income distributed in relation to the operating surplus also increased before the crisis. This increase was, to a large extent, driven by rising dividend payments to shareholders (Figure 3.21). Hence, it can be concluded that there was a rise in shareholder value orientation. In the course of the crisis, the pressure has fallen and remained constant since then.

Figure 3.20: Property income received by non-financial corporations, Latvia, 1995-2015, (percent of sector gross operating surplus)



Source: OECD (2017), our calculations and presentation.

Figure 3.21: Property income paid by non-financial corporations, Latvia, 1995-2015, (percent of sector gross operating surplus)



Source: OECD (2017), our calculations and presentation.

### 3.4 Patterns of distribution trends before and after the crisis

Table 3.4 provides a summary of the country-specific results and connects them to the possible theoretical channels of influence of financialisation on functional income distribution following the Kaleckian theoretical approach outlined before.

Let us first consider the period from the mid 1990s until the crisis. Denmark saw a tendency of the adjusted wage share to increase, while Estonia and Latvia experienced a decline. The Gini coefficient of market income was constant in Denmark and increased in Estonia and Latvia. However, the Gini coefficient of disposable income, i.e. after taxes and transfer payments, saw an increasing trend in Denmark and Latvia, and declined in Estonia.

			Denmark	Estonia	Latvia
<b>Distribution trends</b>	Adjusted wage share	Before	+	–	–
		After	–	0	0
	Gini coefficients	Before	0/+	+/-	+
		After	+/0	+	+/-
<b>Potential channels for the effects of financialisation</b>	Sectoral composition	Before	0	+	0
		After	+	0	0
	Financial overheads	Before	0/+	+	–
		After	+	+	0
	Bargaining power overall	Before	0/-	–	–
		After	–	–	–
	Bargaining power at corporate level	Before	–	–	–
		After	–	0/-	0

Notes: + tendency to increase, – tendency to decrease, 0 no tendency, 0/-, 0/+, +/- ambiguous tendencies for different indicators.  
 Before: early 1990s until the crisis 2007-9. After: after the crisis 2007-9.  
 Source: Authors' presentation.

The examination of the potential channels for the effects of financialisation on functional income shares provides mixed results. In the case of Denmark, there was no change in the sectoral composition of the economy towards a financial sector with higher profit shares and only a minimal rise in financial overheads and rentiers' profit claims. And there was only a slight decline in workers' and trade unions bargaining power. Overall, there was some pressure of financialisation on the wage share, which, however, was not very pronounced. The wage share could thus even slightly rise and Gini coefficients could remain broadly stable.

For Estonia and Latvia, with falling wage shares in the pre-crisis period, we can however establish a relationship between financialisation and functional income distribution. Estonia saw a change in the sectoral composition of the economy towards the financial corporate sector

with a higher profit share, whereas in Latvia, the fall in the wage share cannot be attributed to a change in the sectoral composition. Moreover, only in Estonia have we found a rise in financial overheads and rentiers' profit claims, whereas in Latvia financial overheads and rentiers' profit claims were falling before the crisis. For Estonia and Latvia the fall in workers' and trade unions' bargaining power, both at the overall and corporate level, is a major explanation for the fall in the wage share before the crisis.

For the period since the crisis, the empirical indicators suggest that there were some effects of financialisation on functional income shares in the case of Denmark. The sectoral composition channel, the financial overheads and rentiers' profit claims channel and the workers' and trade unions' bargaining power channel contributed to a decline of the aggregate adjusted wage share. For Estonia and Latvia, which experienced stagnating trends of the wage share in the post-crisis period, the indicators for financialisation pressure on wages show mixed results, i.e. financial overheads have been putting pressure on the wage share in Estonia but not in Latvia, and workers' bargaining power has been weakened at the overall level but seems to have recovered at the corporate level in both countries.

#### **4 The macroeconomic regimes before and after the crisis**

Against this rather diverse background of distributional trends before and after the crisis, we can now examine the demand and growth regimes which have dominated in our three countries before (1995/6 – 2008) and during and after the crisis (2009 – 2016). We will apply the typology outlined in Section 2 above: a) the export-led mercantilist regime, b) the weakly export-led regime, c) the domestic demand-led regime and d) the debt-led private demand boom regime. Empirically, the demand and growth regimes can be distinguished by considering first the financial balances of the main macroeconomic sectors: the private sector, with the private household sector, the financial, and non-financial corporate sectors as sub-sectors; the government sector; and the external sector. Second, the growth contributions of the main demand aggregates are of interest. These are the growth contributions of private consumption, public consumption, as well as private and public investment, which sum up to the growth contribution of domestic demand, and then the growth contribution of the balance of goods and services, i.e. of net exports. The sectoral financial balances of a country should sum up to zero, apart from statistical discrepancies, because a positive financial balance of one sector needs a respective negative financial balance of another sector – a creditor needs a debtor and vice versa. And the growth contributions of the demand aggregates should sum up to real GDP growth of the respective country, although we have to bear in mind that the latter also includes the changes in inventories which explains slight deviations.

On the one hand, this simple data analysis provides some information about the main drivers of growth, and, on the other hand, on how demand is financed. We can thus check whether and to which extent we find indicators for the three other macroeconomic channels of financialisation at work, via investment, consumption and the current and the capital account,



in the countries under investigation. And, of course, we can allocate the countries to the typology of demand-led growth regimes under financialisation. Table 4.1 summarises how we have operationalised the respective criteria for our four potential demand and growth regimes.

<b>Table 4.1: Classification of demand-led growth regimes under financialisation</b>	
<b>Export-led mercantilist (ELM)</b>	<ul style="list-style-type: none"> <li>• positive financial balances of the private sector, and the private household sector,</li> <li>• negative financial balances of the external sector,</li> <li>• positive balance of goods and services,</li> <li>• positive growth contributions of net exports.</li> </ul>
<b>Weakly export-led (WEL)</b>	<p>Either</p> <ul style="list-style-type: none"> <li>• positive financial balances of the private sector,</li> <li>• negative financial balances of the external sector,</li> <li>• positive balance of goods and services,</li> <li>• negative growth contributions of net exports.</li> </ul> <p>Or</p> <ul style="list-style-type: none"> <li>• negative but improving financial balances of domestic sectors,</li> <li>• positive but declining financial balances of external sector,</li> <li>• negative but improving net exports,</li> <li>• positive growth contributions of net exports.</li> </ul>
<b>Domestic demand-led (DDL)</b>	<ul style="list-style-type: none"> <li>• Positive financial balances of the private household sector and positive or balanced financial balances of the private sector as a whole,</li> <li>• balanced or positive financial balances of the external sector,</li> <li>• growth is almost exclusively driven by domestic demand,</li> <li>• around zero growth contribution of net exports.</li> </ul>
<b>Debt-led private demand boom (DLPB)</b>	<ul style="list-style-type: none"> <li>• negative or close to balance financial balances of the private sector,</li> <li>• positive financial balances of the external sector,</li> <li>• significant growth contributions of domestic demand, and private consumption demand in particular,</li> <li>• negative growth contributions of net exports.</li> </ul>
Source: Authors' presentation.	

As we have seen in Section 3, comparing our three countries, Estonia and Latvia have seen more similar developments with respect to income distribution, although the financialisation channels have not played out in exactly the same way, and they can thus be distinguished from Denmark. A similar result holds true for the distributions and growth regimes in these countries, as can be seen in Table 4.2 and as we will explain below.

**Table 4.2: Key macroeconomic variables for Denmark, Estonia and Latvia, average annual values for the period 2000-2008**

	Denmark		Estonia		Latvia	
	1995-2008	2009-2016	1995-2008	2009-2016	1996-2008	2009-2016
Financial balances of external sector as a share of nominal GDP, percent	-2.75	-7.10	9.91	-1.11	11.04	-0.06
Financial balances of public sector as share of nominal GDP, percent	1.16	-1.61	0.54	-0.03	-1.40	-3.25
Financial balance of private sector as a share of nominal GDP, percent	1.65	8.68	-9.82	3.22	-8.96	5.69
- Financial balance of private household sector as a share of nominal GDP, percent	-3.33	0.17	-0.87	1.24	-3.22	-2.55
- Financial balance of the corporate sector as a share of nominal GDP, percent	4.98	8.51	-8.96	1.98	-5.74	8.24
Real GDP growth, percent	2.08	0.50	5.97	0.84	6.55	0.21
Growth contribution of domestic demand including stocks, percentage points	2.32	0.18	7.95	0.25	8.31	-1.08
- Growth contribution of private consumption, percentage points	0.91	0.16	4.09	0.41	3.82	0.54
- Growth contribution of public consumption, percentage points	0.50	0.21	0.49	0.24	0.59	-0.17
- Growth contribution of gross fixed capital formation, percentage points	0.87	-0.09	3.35	-0.74	3.71	-1.47
Growth contribution of the balance of goods and services, percentage points	-0.24	0.32	-1.91	0.81	-1.77	1.29
Net exports of goods and services as a share of nominal GDP, percent	5.21	6.46	-7.23	4.02	-12.59	-2.27
<b>Regime</b>	<b>WEL</b>	<b>ELM</b>	<b>DLPB</b>	<b>ELM</b>	<b>DLPB</b>	<b>ELM</b>
Note: Growth contributions of private consumption, public consumption and growth fixed capital formation may not sum up to growth contribution of domestic demand, because the latter also includes the change in inventories/stocks, DLPB: debt-led private demand boom regime, WEL: weakly export-led regime, ELM: export-led mercantilist regime, Source: European Commission (2017), own calculations						

Denmark, a member of the European Union (EU) since 1973 which refrained from entering the Eurozone, followed a weakly export-led regime in the period before the crisis, from 1995 until 2008 (Table 4.2). Domestic financial balances, both private and public, were positive and the external sector showed a considerable deficit. The current account already displayed a considerable surplus in this period, and balance of goods and services was even more in surplus. Growth contributions of net exports, however, were negative on average of this period, which qualifies Denmark as weakly export-led. Growth was driven by domestic demand, and we observe a relatively high growth contribution of investment in the capital stock and a relatively modest one of private consumption. Depressing effects of financialisation on real investment cannot hence be observed at the macroeconomic level in Denmark. Furthermore, although financial balances of the private household sector were negative,<sup>3</sup> it were the financial surpluses of the corporate sector which made the financial balances of the private sector positive, and the wage share was slightly improving in the pre-crisis period, there was no indication of a consumption boom in Denmark in the pre-crisis period looking at the growth contributions of private consumption.

In the course and after the crisis, in the period from 2009 until 2016, Denmark has then moved towards an export-led mercantilist regime (Table 4.2). In the face of a falling wage share, the private sector financial surpluses have exploded, with surpluses now in the private household sector and in the corporate sector, the government has run deficits on average of this period, mainly due to stabilisation policies by means of government deficits in the course of the crisis. Foreign sector financial deficits and thus Danish current account surpluses have reached extremely high values. The same has been true for net exports of goods and services. Growth has been mainly driven by net exports, and domestic demand has contributed only marginally to meagre average GDP growth, mainly through public consumption. The growth contribution of fixed investment in the capital stock has turned negative.

The regime pattern we find for Estonia and Latvia is quite similar to each other, and can be clearly distinguished from Denmark. Both countries have gone through the transition from state socialism to modern capitalism in the early 1990s, and this has also had an impact on our period of examination, in particular on the pre-crisis period from 1995 until 2008.<sup>4</sup> Furthermore, both countries have become members of the EU in 2004, and they have both introduced the euro after the Great Financial Crisis and the Great Recession, Estonia in 2011 and Latvia in 2014. This means, they have been part of and suffered from the Eurozone's response to the crisis, as we will see below.

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<sup>3</sup> Also household debt-GDP ratios were at a very high and increasing level in this period (see Table 3.1. above). However, these ratios are referring to gross debt and are therefore no safe indicator for the level of net indebtedness.

<sup>4</sup> For more detailed analysis of financialisation processes and of macroeconomic policies leading to the crisis in these countries, see for example Juuse (2016) and Juuse and Kattel (2013) for Estonia, Kazandziska (2015) for Latvia, and Kattel (2010) for the Baltic States.

In the period from 1995 until 2008 both countries showed the features of a debt-led private demand boom regime (Table 4.2). Financial balances of the domestic sectors, and in particular of the private sectors, both private households and corporations, were in deep deficits. The public had a slight surplus in Estonia and a small deficit in Latvia. It was thus the external sector which showed high financial surpluses. The two countries were thus running high current account deficits, with high deficits in the balance of goods and services, in particular in Latvia. Growth contributions of net exports were negative, and the very high growth rates in this period were thus driven by domestic demand. In both countries, growth contributions of private consumption and private investment in capital stock were almost of equal size. Therefore, at the macroeconomic level, there is little incidence of negative financialisation effects on investment in the capital stock, as expected in the post-Keynesian approach outlined in Section 2. On the contrary, the countries have benefited from the opening of the capital account and from large FDI inflows, which have caused several structural problems, i.e. a dual structure of the economy of foreign owned and internationally integrated large corporations with labour intensive production sites in Estonia and Latvia, on the one hand, and domestically owned and oriented non-corporate small and medium-sized enterprises.<sup>5</sup> In the face of rising income inequality and a falling wage share, consumption growth was at least partially financed by private household deficits – gross private household debt-GDP ratios tripled in Estonia (Table 3.2) and quadrupled in Latvia (Table 3.3) in the period before the crisis. Of course, debt-financed consumption booms in these countries, facilitated by financial liberalisation and foreign currency lending, and either driven by the need to maintain basic consumption in the face of stagnating or falling real income or by catching-up consumption patterns for several households, are clear-cut features of finance dominated capitalism, as explained in Section 2.

With the deep crisis 2008/9, which meant the collapse of the ‘debt-led private demand boom’ regime and of ‘foreign savings-led growth’ (Kattel 2010, p. 57), and the following weak recovery, Estonia and Latvia have both switched towards an export-led mercantilist regime in the post-crisis period from 2009 until 2016 (Table 4.2). Since both economies, as a precondition for adopting the euro and then as Eurozone members, were part of and exposed to the deflationary stagnation policies in the Eurozone as a response to the euro crisis starting in 2010 (Hein 2013/14, 2017b), fiscal austerity policies and attempts at internal devaluation were the dominant strategies (Kattel and Raudla 2013). As a result, private sector financial balances have turned positive in both countries. In Estonia this has been true for both subsectors, but in Latvia the private household sector (including non-corporate business) has remained in deficit, which however has been overcompensated by the financial surpluses of the corporate sector. The public sector balances have been almost balanced on average over the post-crisis period in

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<sup>5</sup> For further discussions see Juuse (2016), Kattel (2010) and Kattel and Raudla (2013), for example. Here is not the place to discuss these problems in detail.

Estonia, whereas Latvia accepted much higher public deficits in the crisis years and thus shows considerable government deficits on average over the period, however with a trend towards a balanced budget at the end of the period. As a result of austerity policies, the internal devaluation and modest recovery, financial balances of the external sectors have turned negative and both countries have been running slight current account surpluses on average over the post-crisis period. In Estonia the balance of goods and services even turned significantly positive, whereas Latvia has been less successful in this respect. Growth contributions of net export have been the main drivers of meagre real GDP growth in both countries. Estonia has also seen slight growth contributions of domestic demand, but only due to positive inventory investments, i.e. unsold goods. In Latvia, growth contributions of domestic demand have been negative as a result of austerity policies.

## 5 Conclusions

In the current paper we have applied a post-Keynesian approach on the macroeconomics of finance-dominated capitalism to three Baltic Sea countries, Denmark, Estonia and Latvia, which so far, with the exception of Estonia, have not been in the focus of this type of analysis. The focus has been on the pre-crisis period from the mid-1990s until 2008 and then on the crisis and post-crisis period from 2009 until 2016. After recapitulating the main elements of the post-Keynesian macroeconomics of finance-dominated capitalism, we have first examined the effects of financialisation on income distribution for the three countries. For the pre-crisis period we have found that financialisation effects in favour of the profit share cannot be substantiated empirically for the case of Denmark, where we have observed a rising adjusted wage. For Estonia and Latvia with falling wage shares in the pre-crisis period, however, we could argue that financialisation has contributed to this development, in the case of Estonia through the sectoral composition channel, and the financial overheads and profit claims channel, and in Estonia and Latvia in particular through the workers' and trade unions' bargaining power channel. Interestingly, for the post-crisis period also the Danish case seems to contain some financialisation effects on income distribution, as empirical indicators for the sectoral composition channel, the financial overheads and rentiers' profit claims' channel and the workers' and trade unions' bargaining power channel show. For Estonia and Latvia with stagnating trends of the wage share in the post-crisis period, the indicators for financialisation pressure on wages show mixed results, i.e. financial overheads have been putting pressure on the wage share in Estonia but not in Latvia, and workers' bargaining power has been weakened at the overall level but seems to have recovered at the corporate level in both countries.

Against the background of these findings we have then examined the macroeconomic demand and growth regimes under financialisation in our three countries, again for the pre- and the post-crisis period. For Denmark we have found a weakly export-led regime for the pre-crisis period which has moved towards an export-led mercantilist regime after the crisis. Estonia and Latvia were dominated by a debt-led private demand boom regime with high net inflows of

foreign capital, allowing for deficit financed consumption and investment growth. In the course of and after the crisis these two countries, under the dominance of fiscal austerity policies and internal devaluation, switched towards export-led mercantilist regimes. The three countries have thus followed a tendency, which has been observed at a wider scale, and in particular for the EU and the Eurozone (Dodig et al. 2016, Hein 2017a, 2017b). Of course, if (very) small open economies like Denmark, Estonia or Latvia follow such a 'beggar thy neighbour'-strategy in isolation the damage for the world economy is limited. However, if major countries or currency unions, like the Eurozone as a whole, turn towards an export-led mercantilist regime, this poses major problems for the world economy, creating and contributing to global current account imbalances and the related fragilities. And also for our three small open economies, export-led mercantilist strategies so far have not paid off in terms of strong economic recovery and GDP growth.

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