

Financialization, Income Inequality and the Role of Institutions in the Developing and Emerging Economies

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ABSTRACT

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An extensive literature in Sociology highlights a strong positive association between financialization and income inequality. Using a panel dataset of developing and emerging economies, this paper investigates the relationship between financial activities and the extent of income inequality. The analysis reveals a direct link between the two, showing that financialization tends to exacerbate inequality. However, the presence of higher-quality institutions can significantly moderate—and, in some cases, reduce—the distributional effects of financialization. Additionally, rising female labor force participation and the rapid growth of the service sector are found to be significant drivers of social stratification in these economies. The interaction of financialization with both service sector employment and female labor participation shows a significant positive association with income inequality, suggesting that finance's tendency to amplify elite incomes intensifies the inequality effects of the transition to a service-oriented economy. Importantly, these interactions are significantly moderated when institutional quality is accounted for, underscoring the critical role of resilient institutions in mitigating the inequality-enhancing effects of financial development.

Keywords: Financialization, Income Inequality, Female Labour, Service Sector, Growth

INTRODUCTION

In the last two decades economies around the world have undergone a major structural change. In general, the trends which have been dominant across a cross-section of countries is the rise of income inequality and rapid financialization of the economy. There is a plethora of studies which shows that the financialization has contributed to increase in the income inequality in the advanced countries. Over the years scholars like Kus (2012), Lin & Tomaskovic-Devey (2013), Hyde, Vachon, & Wallace (2017) and many others have shown that financialization had led to the increase in income inequality in the OECD countries. Study by Kwon & Roberts (2015) showcase those interactions of financialization with service employment, female labour participation, and knowledge employment return significant positive associations with income inequality in the context of the advanced industrial societies. However, not many studies have been done in the context of the developing and emerging economies (DEE).

At a time when DEE set to contribute 60% of the world GDP by 2030¹ and 47% of world trade in 2008², thus global growth in the next decade or so is mostly expected to come from these DEE. So, it's critical to study the shifting dynamics in the context of the DEE too. We make an attempt to bridge this research gap and our paper shades light on these three areas.

1. Has financialization impacted the income inequality in DEE?

¹ OECD Report titled 'Economy: Developing countries set to account for nearly 60% of world GDP by 2030, according to new estimates', 2010

² WTO Report titled 'Trade and development, 2008

2. Can financial development exacerbate the distributional effects of growing service sector and female labour participation in the economy?
3. Can better quality Institutions in the DEE mute the amplifying effect of financialization on income inequality?

Income inequality is the main area of contention among the policy-makers of the DEE. The reason it's a pivotal issue and is thoroughly debated because the perilous effects of income inequality are even more pronounced in the DEEs which has weaker institutions. On average after adjusting for the population size, the income inequality increased by 11 percent in developing countries between 1990 and 2010³. According to the UNDP, a significant majority of households in developing countries more than 75 percent of the population are living in societies where income is more unequally distributed than it was in the. A number of studies also evidence that beyond a certain threshold, inequality harms growth and poverty reduction, the quality of relations in the public and political spheres of life and individuals' sense of fulfilment and self-worth. Several studies assert that growing inequality may, in turn, result in lowered rates of economic growth Rajan & Zingales (1998). Such a result may be the consequence of limited opportunities among relatively poor population groups to accumulate human capital, leading to relatively low rates of economic growth.

A plethora of studies have shown that the financialization has contributed to rising income inequality in the advanced economies but virtually no studies were done in the context of the developing and emerging economies despite the fact that income inequality disproportionately affects the DEEs. This paper tries to see the effect of the financialization on income inequality in such economies as the DEEs transition into a 'new economy'.

REVIEW OF EXISTING LITERATURE

Literature on financialization in emerging and developing countries gradually developed within the context of Latin American countries, parts of emerging Europe, South Africa and a few East Asian countries. Much of the research on EME financialization offers longitudinal analysis but there are few cross-country comparisons (Karwowski & Stockhammer, 2017). The first sort of financialization, had its core within the inflation of monetary assets price, is that the commonest form in advanced Anglo-Saxon countries (Bonizzi, 2013). However, for the developing economies the financialization through interest income is of particular relevance, since inflation and therefore the got to encourage capital inflows has often induced these countries to adopt high-interest rates policies (Bonizzi, 2013). Post-Keynesian approaches point to the increase of monetary profits and incomes together of the key processes of financialization (Stockhammer, 2004). According to the literature, financialization's distributional effect is defined by its tendency to augment the income of top earners in the national economy (Lin & Tomaskovic-Devey, 2013), (Nau, 2013), (Piketty, 2014), (Volscho & Kelly, 2012). Furthermore, a separate line of empirical research reveals that a number of characteristics of the new economy, from the growth of service and knowledge employment (Kwon, 2014) to the increasing returns to a college education (Acemoglu & Autor, 2011), (Liu & Grusky, 2013) are important determinants of income inequality over the past few decades.

Thus, drawing on these divergent fields of research, the main purpose of this study is to explore whether financialization augments the positive association between measures of the new economy and income inequality in the Developing and Emerging Economies (DEE). Specifically, we contribute to this literature by addressing some major shortcomings. First, although a number of works examine the longitudinal analysis of financialization in EME, virtually no studies explore the potential impact of financialization on income inequality in the context of the DEEs. We add to this line of research by testing whether the financialization has contributed to income inequality over the past two decades or so. Second, as the DEEs like the advanced economies transition into a "new economy", we provide a more nuanced exploration by studying whether the distributional consequences of the new economy are amplified by financialization. Third, we assess the distributional effect of financialization after having controlled for the institutional quality. To test finance's potential moderating effect, we compile a panel data set of 17 DEEs from 1994 to 2019. Specifically, we produce interactions of financialization with indicators of the new economy to explore

³UNDP report titled 'Humanity Divided: Confronting Inequality in Developing Countries, 2015'

whether the inequality-producing effect of the transition to the new economy is enhanced at higher levels of financial activity.

METHODS

In this study we conducted a panel data analysis to determine the impact of financialization on income inequality in DEE using data from 17 countries over a period of 25 years (1994-2019). The units of observation of dependent and independent variables are the country-years. The paper intends to test the following five hypotheses.

H₁: Financialization is positively associated with Income Inequality.

H₂: Financialization amplifies income inequality despite strong institutions.

H₃: Financial development amplifies the positive effect of service employment on income inequality.

H₄: Financial development amplifies the positive effect of female labour participation on income inequality.

H₅: Financial development amplifies the positive effect of female labour participation on income inequality even after having controlled for institutional quality.

a) Sample Countries: Our country sample consists of 17 DEEs. The term developing and emerging economies is not well defined in the literature, loosely referring to the middle-income economies that are undergoing economic transformation, for instance, from planned to free-market economy (Kvint, 2009). The choice of our sample was guided by the financialization literature (Karwowski & Stockhammer, 2017) but at the same time is also restricted by data availability. The literature has identified economies in Latin America as financialized, especially Argentina (Ciblis & Allami, 2013), Brazil (Rossi & J., 2013) and Mexico (Powell J. , 2013). Emerging Europe is another geographical focus of financialization research. Here we have included Central European (CE) countries such as the Czech Republic, Hungary, Poland, as well as Russia (Gabor, 2012) and Turkey (Akyüz & Boratav, 2005), (Karacimen, 2014). These three economies together with Russia are collectively referred to as the Emerging Europe in our sample.

From the African continent only, South Africa was considered since there are few signs of financialization among other African economies (Ashman, Mohamed, & Newman, 2013.). Finally, from emerging Asia the following countries are part of the sample alongside China: the East Asian economies of China's Hong Kong, Indonesia, Malaysia (Rethel, 2010), Singapore (Daniels, 2015.), South Korea and Thailand as well as India. For this study Hong Kong SAR is particularly important. This city has been in the analytical focus of research on global financial centres (Wójcik & Burger, 2010), (Li & Sheikh Dawood, 2016). Additionally, Hong Kong became an autonomous region of the People's Republic of China in 1997. This tightened the links between this city and the other large Chinese financial centre, Shanghai. Thus, a discussion of financialization dimensions emergent in China also necessitates the analysis of Hong Kong's financial structures. These countries are collectively referred to as the Emerging Asia in our sample.

b) Dependent Variable of Interest: Previous studies of financialization and income inequality tend to concentrate on the overall distribution of national income by using the Gini coefficient (Kus, 2012), (Nikoloski, 2012). We used annual GINI indices provided by (Solt, 2014) to measure income inequality, our dependent variable. Solt's data is the only available comprehensive data set that offers standardized GINI coefficients on a yearly basis. We are interested in the distribution of disposable income therefore we use net GINI indices instead of gross GINI indices. While the latter measures the inequality in terms of distribution of market income, the latter also takes into effect transfers and taxation, which impact overall level of income inequality. Even though in DEE countries this distinction is not important. As (Solt, 2014)notes, although in the developing world where effective policies to redistribute income are rare, gross and net income inequality trends tend to be very closely related, this is not the case in advanced countries. Depending on the degree to which taxes are progressive and the extent to which government transfers income to poorer members of society, redistribution varies greatly across advanced countries and to a lesser extent over time, affecting the level of disparity in disposable incomes. Hence, the correlation between gross and net income inequality happens to be considerably lower in advanced nations compared to developing countries.

c) Independent Variable of Interest

Financialization Measures: Unfortunately, there is no gold standard to calculate financialization. Thus, financialization is calculated in the literature via a range of variables such as composite indices that capture various financial activities (e.g., (Kus, 2012)).

There are some aspects of the financialization debate that we will not be able to cover in our empirical analysis either due to data limitations or the macro economic angle of this analysis. First, as the financialization literature is inspired by heterodox economics approaches where income distribution plays a key role in determining macroeconomic outcomes, there has been a keen interest in the distributional implications of financialization. Jayadev (2007) and Stockhammer (2015) provided econometric evidence that financial globalisation has had negative impact on the wage share in panel analyses that include advanced economies as well as DEEs.

Second, post-Keynesians have developed a typology of demand regimes that includes wage-led as well as profit-led regimes (Bhaduri & Marglin, 1990), which has been extended to include debt-driven and export-driven growth models (Lavoie & Stockhammer, 2013). Hein & Mundt (2013) applied this framework empirically to the G20 countries and classify Mexico as having a debt-led consumption boom, India, South Africa and Turkey as domestic demand-led economies and China, Indonesia and Korea as strongly export-led mercantilist and Argentina, Brazil and Russia as weakly export-led economies.

Third, the shareholder value motivation, first observed among rich country corporates, has also been increasingly impressed onto DEE businesses. For the US, Lazonick & O'Sullivan (2000) analysed how financialization has changed firm management's goals towards maximising shareholder value in the form of increased dividend payments and share buybacks. (Stockhammer E. , 2004) provided econometric evidence for several advanced economies that increased financial activities of firms had a negative impact on real investment. Authors writing in the Marxist tradition argued that NFCs have also been under pressure to generate financial profits (Krippner G. R., 2005). In the context of DEEs, integration in global financial markets and competition with foreign NFCs have put pressure on domestic NFCs to generate financial profits. For Argentina, Mexico and Turkey, (Demir, 2007) (Demir F. , 2009) provided firm-level evidence, showing that NFCs in these countries increasingly undertake financial and short-term, often speculative, investment. (Farhi & Zanchetta Borghi, 2009) argued that international financial integration exposes NFCs in EMEs to global competition, pressuring these companies to generate short-term (often speculative) financial profits.

Fourth, one of the interesting features of the financialization debate is that it recognises the endogeneity of the aims (in neoclassical terminology: preferences) of the actors. One stream of the research, thus, has investigated how the perception of households and individuals change in the course of financialization. Within a Cultural Political Economy approach and building on Foucauldian analysis, (Langley, 2008) has pointed out that subjectivities change due to increasing involvement with financial market and internalise a financial self-discipline.

To summarise, consistent with (Karwowski & Stockhammer, 2017) , we also have identified six financialization interpretations for EMEs based on the literature, which can be operationalised empirically for our sample of 17 countries.

- (1) Foreign financial inflows can cause financialization.
- (2) Asset price inflation encourages financialization.
- (3) The shift towards a market-based financial system is the origin of financialization.
- (4) NFCs increasingly engage with financial markets, experiencing rising debt burdens.
- (5) High and rising household debt is a sign of the financialization of the household.

The extent of foreign capital inflows present in our sample countries is measured by the stock of foreign liabilities (including portfolio, foreign direct and other financial investment) present as share of GDP. The inclusion of FDI is justified since financialization can take hold of EMEs as domestic NFCs or banks emulate financial practices of foreign companies that are financialised. The data were obtained from the Lane and Milesi-Feretti database (Lane & Milesi-Ferretti, 2011).

Asset price inflation is captured through real house price indices sourced from the Bank of International Settlement (BIS). We focus on house prices rather than other measures of asset prices such as equity prices because of the ease of data availability. When inflationary pressures (i.e. a bubble) in the housing market peaks, house price deflation can be triggered. Hence, it is not merely the high level of house prices that is alarming but more so the large volatility of house prices, the result of inflation combined with deflation of asset prices. Therefore, we consider the coefficient of variation of real house prices. This is a standard measure of volatility for financial investors, expressing the dispersion of prices as percentage of their mean value. The nature of the financial system (i.e. whether it is more bank- or market-based) in the sample countries is assessed using the World Bank's activity indicator. The measure is the ratio of value traded on the domestic stock exchange (expressed as share of GDP) and the share of outstanding credit in total GDP. An activity measure above one is usually interpreted as that the economy is more market-based because the activity in capital markets is stronger relative to bank lending. While the use of this indicator is rather standard in the literature (e.g.(Cihak, et al., 2015)), there are problems with this interpretation: most stock market trading is secondary trading and an increased market value can have little impact on NFC's financial position. Conversely an increase in bank lending can finance speculative activities. The financialization of NFCs is evaluated using data on NFC debt as ratio of GDP. The ratio provides an indication of how much NFCs are exposed to the financial sector through borrowing(Karwowski & Stockhammer, 2017). Due to limited data availability, we cannot obtain figures on debt-to-cash flow ratios for NFCs in our sample countries. The debt-to-GDP ratio for NFCs is a good proxy of NFCs' financial vulnerability given that higher debt ratios will require more resources to be paid off. The data were obtained from the BIS database.

Finally, figures on the level of household debt (as share of GDP), which is a measure of household financialization, were sourced from the BIS. Ideally, household debt should be assessed as share of disposable household income to obtain a picture about the sustainability of this debt. Data availability limits our study once again, only allowing for an analysis of household debt data as share of GDP. These figures are useful, nonetheless, since they give an indication of the size of household debt in relation to aggregate income in the economy, coming close to a Minsky-type analysis.

Our sample is constrained by data availability and our aim to include several financialization measures, both in terms of the time period and the countries included. The period studied runs from 1997, when the East Asian financial crisis hit, to 2015, the most recent year for which data are available. For many EMEs, in particular the Eastern European and Asian countries, this time period is suitable to study the six highlighted financialization interpretations. By contrast, for Latin American countries a longer time period, capturing, for instance, the international financial flows and financial crises in the region since the 1980s would be more desirable.

Financial Development Index: We use financial development index from the IMF database to test whether the financialization conditions the distributive effects of the new economy.

The Financial development index is a compilation of nine indices that summarize how developed financial institutions and financial market share in terms of their depth, access, and efficiency. These indices are then aggregated into an overall index of financial development. We chose financial development index constructed by(Svirydzenka, 2016) as it's an improvement over the former financialization index which used to be either of the two measures of financial depth – the ratio of private credit to GDP or stock market capitalization to GDP.

New Economy Measures: The following independent variables are crucial, as the interaction of these measures with financialization allows for a direct test of the hypotheses. Service employment represents the number of workers employed in the service sector as a percentage of the overall labour force. Female labour participation measures the number of women in the labour force as a percentage of the total workforce. Both the service employment and female participation rates are taken from International Labour Organisation – Statistics (ILO-STAT) database.

Institutional Quality: The scientific literature of the last 30 years unceasingly underlines the relation between institutions and a country's level of development from different perspectives (economic, political, psycho-sociological etc.). Empirical studies found significant statistical correlations between various elements of the institutional framework and the different economic performances of countries. In other words, the presence of adequate or high-quality institutions is a necessary condition for economic growth. High quality institutions are being recognized as those consistent with free trade, limited government, secure and enforced private-property rights, a sound legal

environment and a stable monetary system (Corey, 2009). All these elements are components of an overall country's economic freedom.

In liberal tradition, since Adam Smith, economic freedom has proven to be the best path to prosperity and progress and a measure of a country's institutional structure. Consequently, there have been many attempts to quantify the degree of a country's economic freedom. The difficulty of providing an exact measure derives from the fact that freedom is rather qualitative than quantitative. That is why, nowadays, we have a heterogeneous range of indicators which aim at quantifying economic freedom. However, they share several similarities since most of them include in their methodology the core elements of economic freedom: secure private property rights, rule of law, freedom of trade, limited government.

However, using the data provided by different freedom indices provided by Fraeser Institute, Heritage Foundation and Freedom House, numerous researchers have empirically proven the benefits of economic freedom and, through it, the importance of institutional quality. For instance, to mention only a few of the most recent ones, (Feldman, 2007) proves that economic freedom is likely to reduce unemployment. (Bjornskov & Foss, 2008) used Fraser Institute Economic Freedom Index to explain cross-country differences in the level of entrepreneurship (a core element of a market economy) and found out that the size of government is negatively correlated and sound money is positively correlated with entrepreneurial activity. (Faria & Montesinos, 2009) found a "robust association between economic freedom and prosperity".

The list of studies on this subject is much longer. Many researchers have devoted their time and efforts to the issue of economic freedom and its aspects. To summarise, what all of these studies point out is the fact that economic freedom, measured in different ways, can be a good predictor for a country's institutional framework and it certainly creates the premises for economic growth and development.

d) Control Variables: The cluster of Control variables represents two covariates. *Savings rate* represents the proportion of Gross savings is to GDP. The data is collected from the World Bank Database. The other is *Population* of the countries. The same is also collected from the World Bank Database.

RESULTS

Table-1 presents the regression models of financialization measures, institutional quality and income inequality. Model-I shows the results for hypothesis-1 which is the association of the financialization measures with the income inequality. Consistent with Hypothesis-1, the results for Model-I indicates that certain financial activities share a significant and positive association with the income inequality.

Table – 1

**Panel Autoregressive Distributed Lag results for Financialization,
Institutional Quality with Income Inequality**

	Model – I	Model - II
Long Run Variables		
Household debt	-0.47***	-0.11***
NFC debt	-0.01	-0.04***
Stock market	0.12***	0.02***
Credit growth	0.09***	0.07***
International Investment Position	-0.11	-1.28***
Institutional Quality	---	-0.41
Savings Rate	-0.04	0.26
Population	8.33***	0.04

Short Run Variables		
ECT	-0.07	-0.05
Household debt	-0.06**	-0.01
NFC debt	0.01	-0.01
Stock market to GDP	0.01	0.01
Credit growth	-0.04	-0.05
International Investment		
Position	1.50	1.86
Institutional Quality	--	-0.15
Savings Rate	0.01	0.02
Population	1.86*	2.02*
Constant	2.34	0.95

Note: ***, ** and * indicate the significance at the 1%, 5% and 10% levels respectively

The Pooled Mean group estimation results indicate the long-run association of the financialization with the income inequality in the developing countries. Both the market-based financialization and bank based financialization has a highly significant positive association with the income inequality. Thus, the results confirm that disproportionate credit growth or unbalanced financial market growth has adverse long-run effects on the economy. On the other hand, household financialization can significantly reduce the income inequality both in the long run as well as in the short run. This result is consistent with (Sun, 2018) findings in their paper “Quantifying the Effects of Financialization and Leverage in China”. This result is also in line with the notion that expansion of household financialization leads to increased access to financial services thus effectively reducing income inequality. Financial globalisation remains a non-significant predictor both in the long run and short run. Nevertheless, the results show strong overall support for hypothesis-1, given that the financialization is significant predictor of income inequality and returns a robust association in three of four models.

Model-II indicates the association of the financialization with the income inequality after having controlled for the Institutional quality. The model reveals some interesting results. First, after having controlled for the income inequality the positive association of the expansion of financial market led financialization with income inequality comes down by a staggering 82% and the positive association of the bank-led financialization with income inequality tanks by 23%. Secondly the financial globalisation, which in Model-I was statistically insignificant in the Model-I, now after having controlled for institutional quality has a highly statistically significant negative association with the income inequality. Thus, indicating that stronger institutions will provide the countries with capabilities that will help in making the financial globalisation work for the masses. Thirdly, along with financial globalisation, the Non-financial corporation financialization also has negative association with the income inequality. These initial findings are largely consistent with previous research showing that financial activities increase the incomes of elite earners at the expense of middle- and low-income earners (Nau, 2013)(Tomaskovic-Devey D. a.-H., 2011.)(Volscho & Kelly, 2012). Thus, the results indicate stronger institutions can be used to counter the financialization’s tendency to exacerbate income inequality.

Yet the question remains: Does financialization condition the connection between the new economy measures and income inequality? We contend that the tendency of finance to expand the income of top earners augments the distributional impact of the new economy indicators. The remainder of the analysis is dedicated to testing this main hypothesis.

Table-2 presents the regression models of financial development, measures of the new economy, institutional quality and income inequality. In other words, Table-2 reports regression models that test whether the inequality-producing effect of the new economy measures is conditioned by financialization. Model-III indicates the results for the association of the new economy measures with income inequality as the DEE transition into the “new economy”. The regressions in the model-III also show that the new economy measures are robustly coupled with income inequality. Over the Long run the female participation rate has a significant positive association with income inequality.

Table – 2

**Panel Autoregressive Distributed Lag results for the Financial Development
and New Economy with Income Inequality.**

	Model –III	Model - IV	Model - V
Long Run Variables			
Financial development Index	-	-9.89 ***	-8.15
Institutional Quality	-	-	-3.40
Female Participation	0.93***	0.83***	-0.11
Service sector	0.08*	0.17***	-0.02
Savings Rate	-	-0.08*	0.00
Population	-	-	-
Short Run Variables			
ECT	0.10	-0.07	-0.40***
Financial development Index	-	-4.68	-1.75
Institutional Quality	-	-	-0.24
Female Participation	0.23	0.22	0.37
Service sector	0.14	0.05	0.00
Savings Rate	0.79	0.04	0.04
Population	-	-	-
Constant	-	-0.65	-4.71

Note: ***, ** and * indicate the significance at the 1%, 5% and 10% levels respectively.

The service sector too in the long-run has a statistically significant positive association with the income inequality. According to the results in Model-IV, the interaction of financial development and service employment returns a highly significant positive and robust connection with the income inequality. Financial development index's interaction with female labour participation returns positive and significant associations with the dependent variable, as well. The point that is noteworthy as both the results indicates that financial development conditions the association of the new economy variables with income inequality in the long run rather than in the short-run.

Three observations are of note from these findings as a whole. First, consistent with hypothesis-3 and 4, it is of interest to note that financialization increases the inequality producing effect of service and knowledge employment, albeit at opposite ends of the income distribution. Interpreted intuitively, this may mean that finance's effect on inequality is partially determined by whether a given country is experiencing a larger transfer of workers to the service sector. That is, if a growing proportion of the national labour force and, by extension, the middle of the income distribution is migrating toward high-paid service employment, financialization is likely to exacerbate the differentials. However, if more of the labour force is entering the low-paid services, financial activities are also likely to augment the differentials.

Second, consistent with hypothesis 4, the evidence shows that the interaction of financialization and female labour participation increases income inequality. To this end, it is important to keep in mind that measures such as service sector employment allow for a clearer delineation between higher- and lower-paid occupations, making it easier to

isolate the specific way in which high, middle, and low earners are affected by changes in the sectoral composition of employment. However, female labour participation affects employment across a larger cross section of sectors, which, by extension, means that this covariate affects a wider spectrum of the income distribution. Thus it is not surprising that finance augments female labour participation's impact on inequality.

In Model-V, the evidence shows that the interaction of financial development interaction with female labour participation and service sector is significantly moderated after having controlled for the institutional quality. The results are intuitive in the sense that it shows the higher quality institutions are an imperative if we want the financial development to work for the masses.

Finally, it is interesting that among the control variables both the savings rate and the population growth maintain a more or less significant association in all the models. Both the savings rate and population growth are positively associated with income inequality in the short run.

In closing, we found support for the contention that financialization increases social stratification in advanced industrial societies (hypothesis 1). Specifically, market-based financialization and bank based financialization has a highly significant, long-run positive association with the income inequality. In contrast, Household financialization can significantly reduce the income inequality both in the long run as well as in the short run. Secondly we find support for the contention that the effect of financialization is moderated after having controlled for institutional quality. Especially Financial globalisation returns a highly significant, long-run negative association with inequality after having controlled for institutional quality. Similarly, even Non-financial sector financialization can significantly contribute to reducing income inequality, in the long-run if stronger institutions are put in place (hypothesis 2).

We also provide empirical evidence in support for the contention that financial development does amplify the long-run distributional effect of service employment (hypothesis 3) and female labour participation (hypothesis 4).

Lastly, we find statistical evidence that shows financial development no longer conditions distributional effect of the service sector and female participation, once high-quality institutions are put in place. (Hypothesis 5)

In short, financialization increases the income inequality and also increases the inequality-producing effect of the transition to the new economy. But the effect of the financialization on income inequality is significantly moderated by high-quality institutions.

CONCLUSION

The pivotal role played by the developing economies makes it critical to understand how the DEEs will fare in the modern financialised world. It is commonly acknowledged that the DEE societies underwent a drastic shift in recent decades. In addition, these trends were occurring during a time when financial activities were contributing to the growth of an increasingly bifurcated distribution of national income in many DEE countries.

Interestingly, while there is an explicit recognition that the rise of the new economy and financial activity are intrinsically intertwined, virtually no studies explore how financialization affects the new economy's connection to income inequality.

As DEE countries are still in their developmental stages, the quality of Institutions play a vital role in determining what type of development they will have and the type of economies it will eventually mature into.

We contribute to this literature by presenting the argument that the finance-based activities is a significant predictor of income inequality in the DEEs and also augment the inequality-producing effect of the indicators of the new economy. But the distributional effect of financial development is moderated if the DEE countries have high quality resilient institutions.

To test this contention, we compiled a panel data set of 17 DEE countries from 1994 to 2019. According to the analysis, financialization increases income inequality in all DEE countries. In the long-run both the market-based financialization and bank based financialization has a highly significant positive association with the income inequality. While household financialization can significantly reduce the income inequality both in the long run as well as in the short run. But the higher-quality institutions can significantly moderate and in certain cases reduce the

distributional effect of financialization. Furthermore, many new economy measures were found to share a robust positive link with the dependent variables. Yet more important for the purposes of the current investigation, the interactions of financialization with service employment and female labour participation were found to share a significant positive association with income inequality in the long run. Thus, indicating financial development amplifies the distributing effects of the service sector and female participation. The evidence shows that the interaction of financial development interaction with female labour participation and service sector is significantly moderated after having controlled for the institutional quality.

In closing, the growing importance of financial activity in the operation of DEE countries changed the way firms traditionally operated during the postwar period. Increasingly beholden to their shareholders, executives implemented a range of labour-saving strategies to augment returns for investors. However, far less attention has been given to the way financialization augments the connection between rise of the new economy and income inequality.

In this study, we show that the distributional effect of the changing composition of labour in the new economy increases at higher levels of financial activity. It should be interesting to see whether these trends continue in the years to come or whether labour will be able to push for stronger regulations over the distributional consequences of financialization.

Thus a key take-away from this paper for policy-makers of DEE would be that as DEEs mostly face “subordinate financialization” or “peripheral financialization” spear-headed by the advanced economies (particularly the United States) and financialization can’t be controlled or avoided at the DEE levels, what the policy-makers of the DEE can do is that strengthen their own domestic financial institutions so that they can make most out of it, as we move towards a more financially integrated global society.

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