

# A bailout for working families?

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**Most accounts of the current financial crisis depict an acute period of excess in the midst of a credit and asset bubble.** Framing the crisis in this way legitimises government and central bank efforts to provide technical fixes that seek to restore 'stability and confidence' in financial markets.

The governments of the 'Anglo-American' economies at the heart of the crisis, the United States and the United Kingdom, have shown a surprising willingness to abandon long held principles of fiscal restraint, independent central banking and rules-based economic policymaking in favour of discretionary political interventions to stem the financial crisis. These include coordinated liquidity injections, nationalisation, asset buyback schemes, the mass selling of government bonds and quantitative easing. As it turns out, confidence and stability are neither objective standards nor something that can be measured, but a general feeling among investors and creditors that must be cultivated at great cost. These measures may have been necessary to prevent systemic financial collapse, but the long term consequences will most likely be borne by the average working family.

This article argues that policies for economic recovery need to focus on the financial crisis facing working households as much, or even more than, the problems in the financial services industry as a whole. Anglo-American households are now hugely indebted, are bearing the brunt of the economic downturn and, most likely, will disproportionately pay for the costs of recovery. Continuing to ignore the precarious financial instability of households takes for granted the socio-political importance of household consumption and its central role as the bedrock of economic growth. Taking issue with Anglo-American household indebtedness is not new, since debt levels have been consistently increasing for decades; but the recent credit and asset bubble has seriously compounded the problem and jeopardised the financial security of many working families.

For some, current household debt levels reflect households' lack of financial sophistication or education as they were too easily duped into taking on more debt than they could afford. For others the recent expansion in household borrowing is the product of rational responses to economic *stimuli* as households chose to take on more debts when nominal interest rates were low in order to benefit from rising property prices. Still others blame indebtedness on the loss of prudence within Anglo-American society as individuals seek to consume whatever they please without any consideration for the limits of income.

This article takes a different perspective by looking at the cumulative effects of two decades of political and economic restructuring combined with the most recent period of financialisation in Anglo-America as the causes of the financial crisis now facing the household sector. More specifically, I argue that slow income growth and the broader 'politics of abandonment' contributed to rising debt levels and financial instability for many working families.

Minimal real income growth, especially compared to rapidly rising debt levels, is an overlooked aspect of most analyses of household indebtedness. For many working families incomes have not kept pace with growing expenditures. In fact many of the staples of middle class life, such as homeownership and education but also cars and vacations, are now funded by ever larger loans. There is also evidence that many households use credit cards to pay for daily expenses such as food and utilities. The causes of stagnant real

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income growth are not straightforward; rather they are the product of interrelated trends such as the economic governance priorities of low inflation and the business community's efforts to constrain wage growth. The Anglo-American governments' longstanding commitment to maintain low inflation by specifically targeting 'wage expectations' curtailed income growth for most working households. During this same time the corporate sector pushed hard against wage concessions even as productivity and profitability increased.

The 'politics of abandonment' refers to the business community and government's changing priorities towards its workforce and citizens over the past two decades. For example, corporate governance priorities, extending out to the private sector at large, have been fixated on permanent restructuring. Even in the boom years the largest and most profitable corporations were continuously shedding jobs and rolling back non-wage benefits to improve shareholder value. Concomitantly government services, at all levels from municipalities to national governments, have been reduced or eliminated for the majority of working families and restricted to the small percentage of households with no other means. The reconfiguring of pensions and education funding and unemployment benefits have contributed to many families' need to borrow heavily in order to maintain what were previously considered middle class entitlements.

To substantiate this claim we begin with a macro picture of the growing scale of household indebtedness in both the US and the UK. In the US households' total debt outstanding doubled after 1999, reaching \$12 trillion in 2007. UK household debt levels tripled over the same period reaching £1.2 trillion. But importantly this figure vastly underestimates debt outstanding because it excludes securitised loans (or those moved off lenders' balance sheets). Significantly, this stock of debt represents an increasing proportion of total GDP output and consumer expenditure, making the financial crisis facing households as important as the one facing Wall Street or The City.

The second section examines how these macro trends translate at the household level. Using the US Survey of Consumer Finances, which has the most accurate and comprehensive data (there is no equivalent in the UK) we see the changing scale of liabilities and slow income growth faced by middle income families over the past two decades.

The final section considers potential ways forward by arguing for political, in addition to technical, reforms to the financial services sector and macroeconomic policymaking.

### The financialisation of consumption

The concept of financialisation offers an account of present day capitalism in which financial accumulation and innovation are primary drivers of change; and, as a result, individuals, firms, and the macro-economy are increasingly mediated by new relations with financial markets (Parenteau, 2005; Montgomerie, 2008). The advent of 'shareholder value', the rise of institutional investors and other new financial actors in the 'shadow banking system', as well as the arrival of a mass investment culture are elements of Anglo-American financialisation (Froud, Leaver et al, 2007; Pinault, 2007). As such, financialisation is a framework for evaluating more comprehensively how social actors located at the privileged sites of accumulation accrue new political and economic power (Krippner, 2005). With the City and Wall Street at their core, the Anglo-American economies are the epicentre of global financial expansion and crisis. Yet financialisation is an aspiration, rather than a coherent system, as actors and markets attempt to find coherence but often fail.

Financialisation impacted households through transformations in savings and borrowing patterns. Here we focus on the latter, where transformations in household lending trends were based on a confluence of three interrelated developments: (1) unique macroeconomic conditions; (2) the advent of asset-backed securitisation as part of broad based financial market innovation and expansion; and (3) relatedly, the growing sophistica-

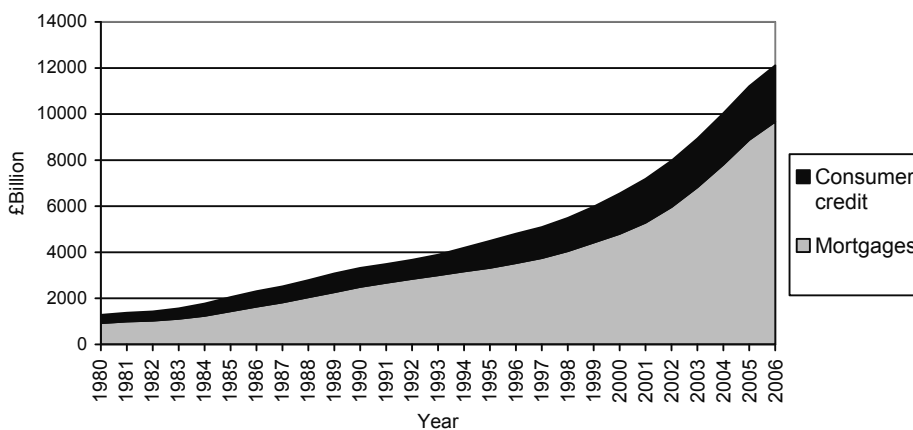
tion of credit scoring techniques. Of course each of these trends has its own unique pattern of development, but it is their culmination in the recent conjuncture that made indebtedness such a pervasive phenomenon.

Benign macroeconomic conditions after 2001 included low inflation and low nominal interest rates, combined with fiscal expansion (to fund the occupations of Iraq and Afghanistan) and foreign investors' insatiable appetite for fixed income bonds or securities (Crotty, 2008). These conditions created a period of excess liquidity and cheap credit as well as rapid ascent in asset prices. This, in turn, fed into household lending directly through Asset-Backed Securitisation (ABS), galvanising low interest rates, excess liquidity and foreign investors' appetites for debt securities into a prolonged housing and consumer boom.

The growing reliance on asset-backed securitisation (in the 'originate and distribute' model) fundamentally transformed the structure of household lending, from the emergence of the universal banking model to the arrival of non-financial institutions and new specialist lenders (Erturk and Solari, 2007). Besides changes in wholesale credit markets, there were also important developments in retail lending practices, as many lenders became mass marketing machines for every manner of financial product. In terms of lending, advances in credit scoring adapted the plethora of digital data sources on individuals into usable quantities which were adapted into risk profiles, used to calibrate loan rates and terms as well as target promotional offers (Langley, 2008).

These developments facilitated an astronomical increase in household debt levels, especially since 2001. Figure 1, from the US Flow of Funds, provides the clearest picture of moderate debt growth, from \$1.2 trillion in 1980 to \$5.9 trillion in 1999; and the subsequent doubling of outstanding debts over the next eight years, reaching \$12 trillion in 2007.

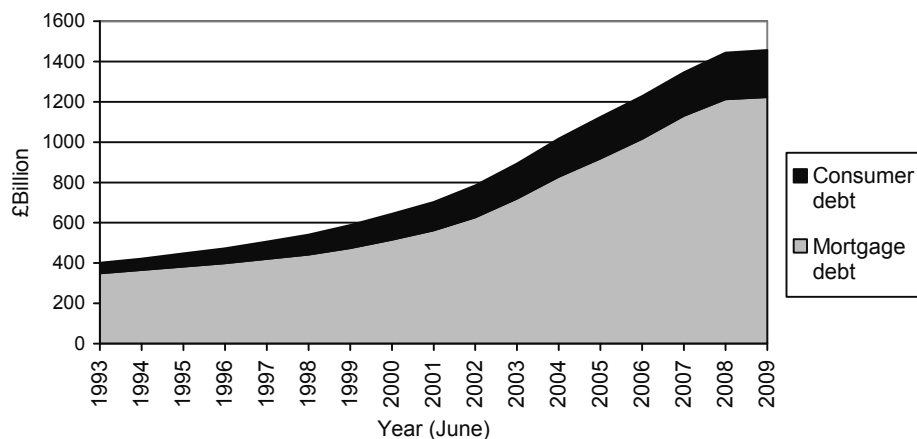
Figure 1: United States flow of funds – household liabilities by type



(Source Flow of Funds, Table 1153: home mortgages (FL153165105.Q) and consumer credit (FL153166000.Q))

A similar picture emerges in the UK, although the data only begins in 1993, where total amount outstanding of mortgage (secured) and consumer (unsecured) loans was £588 billion in 1999 and nearly tripled to £1.2 trillion in 2008. It is important to note that the UK figures only include loans on lenders' balance sheets, meaning they exclude securitisation and, as a result, significantly underestimate the true amount of debt held by the household sector.

Figure 2: United Kingdom, amounts outstanding of lending to individuals



(Source: Bank of England, Amounts outstanding of total sterling net lending to individuals (in billions), (SA) series: LPQVTKX and LPQVZRI)

This staggering rate of growth demonstrates a new dependence on debt to access homeownership and fuel consumption. Importantly, Anglo-American households' growing indebtedness fuelled a prolonged economic expansion in both the US and UK, especially since 2001. As such, the term 'financialisation of consumption' is not simply about individuals' closer connections to capital markets; rather, it refers to how debt-led consumption bolstered financialised expansion.

Table 1 illustrates this by comparing the total amount of outstanding debts (Figures 1 and 2 as a proportion of GDP and household consumption expenditure. Although we are not comparing like for like, Table 1 demonstrates that total household debt outstanding is equivalent to 92 per cent of US GDP and 100 per cent of UK GDP (note total debts excludes securitised loans) in 2008. Therefore, households' total debt outstanding is approximately equal to the total GDP output of both Anglo-American economies. Using an expenditure measure of GDP, household or personal consumption, total debt outstanding is 131 per cent in the US and 162 per cent in the UK in 2008. This means that the total stock of household debt in both the US and UK is larger than households' total expenditure in the economy.

Table 1: Total debts as proportion of GDP and household expenditure

Total mortgage & consumer debt	United States		United Kingdom	
	as % of GDP	as % of Personal Consumption Expenditure	as % of GDP	as % of Household Final Consumption
<b>1990</b>	58	88	n/a	n/a
<b>1995</b>	62	92	61	100
<b>2000</b>	68	99	66	105
<b>2005</b>	92	132	90	144
<b>2008</b>	92	131	100	162

(Sources: United States, Bureau of Economic Analysis: Gross Domestic Product (Table 1.2.5) and Personal Consumption Expenditures by Major Type of Product (Table 2.3.5); United Kingdom: Office for National Statistics Gross Domestic Product at market prices CP SA (series YBHA) and Household final consumption expenditure CP SA (series ABJQ))

As the bedrock of the Anglo-American economies, household consumption is the single largest segment of domestic growth. In 1989, Personal Consumption Expenditure (PCE) was 65.5 per cent of US GDP, compared to all gross domestic investment which was only 16.5 per cent, demonstrating the relative importance of consumer expenditure on durable goods, consumer products, and services to the American economy as a whole. In 2008, Personal Consumption Expenditure grew to 70.5 per cent of GDP, while gross domestic investment declined to 15.5 per cent. Similarly, in the UK Household Final Consumption (HFC) is also the largest component of GDP. In 1989, Household Financial Consumption was 60 per cent of GDP and total fixed capital investment was 21 per cent. By 2009, HFC rose slightly to 62 per cent and total investment declined substantially to 15.8 per cent.

Strangely enough, it seems that throughout the period of financialisation-based expansion, consumption grew while private investment declined as a relative proportion of GDP. It may seem paradoxical that under the auspices of financialisation, where unhindered financial market expansion led to record profits, personal consumption grew while private domestic investment declined. The dividends of financialisation appear not to have translated into significant investment in the Anglo-American economies; instead it bolstered debt-led consumption by households.

Perhaps it is not surprising to some that household debt levels grew so precipitously during the recent credit boom. Indeed there have been many warnings from both sides of the Atlantic that household indebtedness is extremely problematic for long term growth.

Yet, so far we have only seen the supply side explanation of rising household indebtedness: benign macroeconomic conditions, low nominal interest rates and rising asset prices all provided the necessary means for debt levels to grow. This fails to account for why households demanded so much credit in the first place. The next section details the cumulative effects of the longer trajectory of economic and political restructuring in the Anglo-American economies that contributed to households' need to borrow. That is, slow income growth and the politics of abandonment fostered a business climate of permanent restructuring, and government rollbacks in social and economic support for the majority of working families.

### **The household's financial crisis**

The importance of rising household indebtedness is not simply about a general loss of prudence, be it by individuals, lenders or the government. Rather, this trend speaks directly to the importance of a large (solvent) middle class in creating the economic expansion and prosperity of the post-war era.

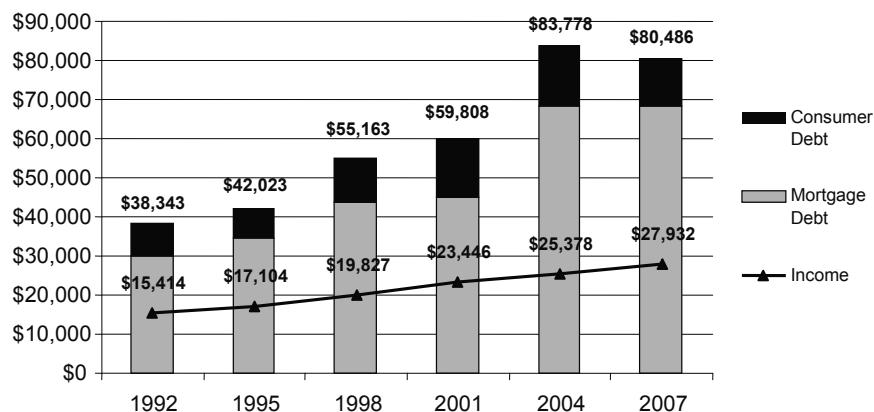
The fact that middle income households are mired in debt speaks volumes about the bigger and more long-term problems facing the Anglo-American economies, alongside the immediate effects of the financial crisis and recession. The past thirty years of economic and political restructuring – call it globalisation, or neo-liberalism, or more recently financialisation – has entailed the stifling of wage growth, receding government services and support, as well as the virtual abdication of social responsibility by the business community.

All of these trends have been well documented elsewhere. For instance, the changing structure of labour markets and flexible employment policies, all aimed at fostering global competitiveness, led to low paid service work replacing well paid jobs in the manufacturing sector (Glyn, 2006). Also, there has been a substantial increase in income inequality in Anglo-America, where the gap between the upper quartile of income earners and the rest grows bigger every year (Conyon and Murphy, 2000; Froud, Johal et al, 2001; Dumenil and Levy, 2004). Moreover, non-wage benefits like pensions, and also health care benefits in the US, have been in terminal decline for the average worker (Lazonick and O'Sullivan, 2000). Add to this the reduction in government support for the majority of working families in favour of benefits for the few with no other means: for example, unemployment benefits

are increasingly difficult to qualify for and below a living wage, meaning households are left to deal with the consequences of restructuring on their own.

So far we have only dealt with general macro-level trends and not considered how these are reflected at the household level. Using the US Survey of Consumer Finances (SCF), which provides the most comprehensive household data with no equivalent in the UK, we see a detailed picture of the changing scale and composition of liabilities for median income families (where 50 per cent of families fall below and above) over the past two decades. This provides an illustration of the outcomes for households that contributed to the rapid escalation of debt outstanding as seen in the figures from Figure 1. As such these figures are for families with debt holdings (rather than 'All Families' which would include renters or those that own their homes outright), in order to roughly match up the macro and household level data.

Figure 3: United States - Median income families, average total debt outstanding and income



(Source: Survey of Consumer Finances, Mortgage debt = total value of mortgages, home equity loans and home equity lines of credit secured by primary residence; Consumer Debt = total value of all outstanding loans on credit cards, instalment loans, other lines of credit, vehicle and education loans; Income from all sources Quintile 2, adjusted for inflation using CPI-U)

Figure 3 shows the changing scale of indebtedness for middle income households: we see that over the past two decades, total debts outstanding have more than doubled, while real pre-tax income grew by just 80 per cent over the same period. To put this in context, in 1992 median income families had total debts equal to 2.5 times their income; by 2007, total debts were just under three times income levels.

The US data shows that household indebtedness is not just a product of the recent credit boom. Instead, it suggests that median income households have been on a long trajectory of accumulating ever more debt, which was compounded by the post-2001 credit bubble. More important than the amount of debt is the cost of servicing outstanding loans. In 2007, median income families paid \$11,668 per year in loan repayments, which is an astounding 42 per cent of pre-tax income levels. With such a large proportion of income already diverted to debt repayment there is not much room for further expanding household borrowing; indeed this demonstrates the financial insecurity already faced by the comparatively well off median income families.

This growing scale of indebtedness is matched by an increase in types of household borrowing, demonstrating the degree to which debt has become a necessity in achieving

and maintaining the Anglo-American middle class way of life. There is growing evidence, mainly from the US, that shows households are using debt to finance almost every facet of daily life (Schor, 1998). This is partly because income levels have not kept pace with the growing demands on household expenditures.

The causes of slow income growth are clear: both Anglo-American governments have remained singularly committed to controlling inflation, specifically wage-led inflation (Temple, 2000; Wilkinson, 2000; Hay, 2004). Of course, this policy led to the contradictory outcomes of curtailing wage inflation while allowing asset price inflation to escalate unchecked. The example of homeownership makes the interplay between these policies and household borrowing clearer: homeownership was fuelled by providing loans at ever larger multiples of income and, during the credit boom, this practice further stoked property price increases (Hay, 2009). Not only did the working consensus between 'good' and 'bad' inflation create an unsustainable credit and asset price bubble, it also has long term effects for working families: home ownership is becoming increasingly unaffordable.

This is not just a matter of government policy. In addition the business community as a whole pushed equally hard against wage gains and non-wage benefits. Over the past two decades Anglo-American business culture has been gripped by the logic of permanent restructuring. Outsourcing, downsizing, streamlining, alongside rollbacks to non-executive pension plans, and most importantly health care benefits in the US, have all been justified to make business more competitive or to realise shareholder value (Froud, Haslam et al, 2000; Jackson, 2002; Aglietta, 2008). Even during the boom years, with productivity gains and robust corporate profits, successive rounds of job cuts or outsourcing were commonplace.

The consequence for Anglo-American working families facing this prolonged political and economic restructuring is that debt is being used as a 'plastic safety net' (Wheary and Draut, 2005). In order to cope with job loss, illness, or one off misfortunes like major repairs, many families borrow just to get by (Draut and Silva, 2003).

It seems that the Anglo-American governments' success in curbing public expenditure has simply meant private debt has replaced public debt. For example, reductions in unemployment benefits and capping of pension (or social security) outlays may have helped the national budget, but for households this has meant accessing more debt to maintain their standard of living (Cutler and Waine, 2001; Brewer, Clark et al, 2002). Another example is university education where, in both the US and the UK, loans replaced bursaries and grants for students – making access to credit an important element for gaining access to higher education. Even basic education is affected, as many middle class families are willing to pay premiums to live in a catchment area for a 'good school', which typically means taking on a bigger mortgage (Warren and Tyagi, 2003).

It is through these subtle ways that household indebtedness has accumulated to its current levels. In addition to major expenditures a recent Demos survey in the US found that one third of households reported using credit cards to cover basic living expenses in, on average, four out of the last twelve months (Wheary and Draut, 2005). The demands on middle income families to pay for cars, holidays, childcare and extra-curricular activities, as well as more mundane consumer expenditures like clothing and electronics, mean ever more claims against household incomes (Schor, 1998). It is these trends, not just the unique conditions of the credit bubble, which we must consider when assessing the causes of rising household debt levels.

Therefore, middle income households are spending beyond the limits of income to preserve a standard of living established over a generation ago. Indeed, the post-war expansion made middle income household consumption the backbone of the Anglo-American economies, as well as a strongly held socio-cultural norm which has profound political meaning in defining our way of life. Slow income growth, along with the politics of abandonment, and in particular a business climate of permanent restructuring and govern-

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ment rollbacks in social and economic support for the majority of working families, all contributed to households' growing demand for debt to plug the gap between income and expenditure. Therefore indebtedness cannot be reduced to a single causal relationship; rather it is a product of the cumulative effects of political and economic transformations and socio-cultural factors.

### Conclusion

Current plans for economic recovery are focused primarily on creating conditions to restore investor confidence and making more credit available to foster investments which, eventually, will kick-start economic growth. But if private investment declined as a relative proportion of GDP during the prolonged period of cheap credit and booming markets, how could such a utopian vision of recovery ever be possible?

It seems that recovery plans hinge on re-establishing the economic climate that existed before the crisis hit, with households borrowing and spending at the same levels. Such an optimistic view belies the reality faced by many middle income working families who are already sitting on a huge stock of debts with substantial repayment obligations. Add to this the fact that the current financial crisis has decimated working families' investment portfolios, while falling property prices threaten to eliminate housing wealth. It appears that many of the supposed gains of financialisation only existed on paper, while middle income households are now left servicing a mountain of debt. With unemployment rising and the prospects of wage increases as remote as ever there seems to be no other notion of how to boost consumption that does not entail households acquiring even more debt.

I have sought to highlight the point that access to credit is no replacement for real wage growth and adequate social protection. As such, political interventions to stem the current economic downturn need to address the financial instability facing the household sector.

Of course growing household indebtedness could simply be dismissed as hyper-consumerism gone mad, where people spend without any consideration for the limits of income. But this notion ignores the pivotal importance of household consumption in fuelling economic growth and the reality that the Anglo-American households are the consumers of last resort in the global economy. Moreover, consumerism is a powerful socio-cultural norm that has come to define middle class prosperity. These factors influence the prospects for economic recovery as households (and policymakers) face a double bind: curtail spending now to pay down existing debts and risk a further downturn in economic growth, or continue debt-led spending and risk insolvency.

Not only have policymakers failed to acknowledge the current financial crisis facing many working families, but households are now expected to absorb the proscribed tax increases and further reductions in government services to remedy the fiscal deficits incurred to fund the massive bailouts of the financial services industry. For instance, both of the UK's main political parties have already committed themselves to substantial cuts in government services in the near future. As unemployment increases, and business squeezes wage growth further, working families face more of the same conditions that created households' financial insecurity in the first place.

By trying to restore finance-led growth, both Anglo-American governments are only prolonging the erosion of a vibrant, and solvent, household sector. Moreover, if long term recovery requires further reductions social protection and stifling of wage growth, this will only exacerbate the financial crisis already facing most working families. The problem is that the current consensus on reform focuses only on technical fixes to improve the inner workings of financial markets. What is needed is political reform of economic governance priorities, which until now have overwhelmingly privileged financialised growth.

Political reforms to economic governance priorities, for example, would require



rethinking low inflation priorities that have only focused on wage expectations and not asset prices. The past two decades of prioritising the quelling of wage-led inflation, while allowing asset prices to increase unchecked, greatly contributed to our current economic instability. Since low inflation facilitated low nominal interest rates, many households had to borrow ever larger multiples of their income to access the property market in the same way that investors used highly leveraged buy-outs and mergers to cash in on rising asset values.

Continuing to stifle wage growth in order to facilitate low inflation, and thus nominal interest rates, in the belief it will spur investment is nothing more than an attempt to re-establish the conditions of the last credit/asset bubble. Admittedly, incomes policies have long been discredited as tools of macroeconomic governance, but the current financial crisis facing the household sector suggests that household income levels can no longer be ignored in economic policymaking.

Another pressing political issue is whether households should pay for bailing out the financial services industry, either through tax increases, or reduction in services, or both. Populist claims that this amounts to the privatisation of profits and socialisation of losses are not without merit, since there seems to be no effort to consider how the financial services industry will pay for its own bailout over the long term.

A straightforward approach could be to introduce a transaction tax on financial products, such as over-the-counter (OTC) derivatives or stocks purchases. This would be akin to the sales tax or VAT paid by households on the majority of products they purchase in daily life. This would be as viable an option as any to plug the fiscal gap because stocks and OTC derivatives are discreet products exchanged in much the same way as any consumer product. A small transaction tax would not only provide much needed funds to pay back the costs of the bailout, from which all of the financial services industry benefited in some way, it would also serve to quell speculative volatility in these markets in the future. Yet policymakers have no immediate plans to implement such a proposal because it is so far away from the current economic governance priorities to save the financial markets from their own misadventures.

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