



This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800



FESSUD

FINANCIALISATION, ECONOMY, SOCIETY AND SUSTAINABLE DEVELOPMENT

Working Paper Series

No 124

The Changing Impact of Finance on Development

Bruno Bonizzi

ISSN 2052-8035

The Changing Impact of Finance on Development

Bruno Bonizzi

Affiliations of authors: SOAS, University of London

Abstract This paper summarises the literature on the impact that the developments in the financial sector over the past three decades have had on the economic development of developing and emerging countries. It covers both the conventional economic theories, including the “financial repression” paradigm and the concept of “financial development, as well as the growing literature on “financialisation” in the context of developing and emerging economies. Moreover the paper summarises the literature on the international aspects of finance and their relation to development, covering themes such as capital account liberalisation and financial globalisation from both a mainstream and alternative perspective. It concludes by trying to give an encompassing synthesis of the literature developments.

Key words: financial development, financialisation, financial globalisation

Date of publication as FESSUD Working Paper: January 2016

Journal of Economic Literature classification B50, O16, F30

Contact details: b_bonizzi@soas.ac.uk

Acknowledgments:

The research leading to these results has received funding from the European Union Seventh Framework Programme (FP7/2007-2013) under grant agreement n° 266800.



This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800



I am grateful to Jan Toporowski, Annina Kaltenbrunner, Jeff Powell and Judith Tyson for their help during my work on this paper.

Website: www.fessud.eu

Introduction

Developing countries have not been immune to the rise of finance over the past thirty years. In several countries outside the core-industrialised economies finance has become more important, so that financial issues have become key concerns in policy and theoretical debates. In particular, in the context of developing countries, the role of finance is considered in relation to the most pressing economic issue: its impact on growth and development.

Under pressure from the International Monetary Fund and the World Bank, several developing countries have directly pursued policies of financial liberalisation, by both deregulating their own financial system and by opening it to foreign investments. These policies are informed by theoretical viewpoints suggesting the positive impact of the financial sector on development. However frequent episodes of financial crises have led to growing concerns about the role of a fully liberalised financial sector, which may breed instability and thus effectively offsetting any potentially positive impact of finance on growth.

While the traditional literature in financial economics largely accepts the positive relationship between finance and development, a burgeoning theoretical literature on financialisation seeks to critically assess the nexus between the growing role of finance and socio-economic development. By analysing the relationship of finance with the rest of the economy, financialisation scholars try to explain the rise of finance in a more critical way by pointing out its potentially negative impact on development.

1. More and freer finance for growth: financial liberalisation and financial development

During the post-war era, many developing countries had highly regulated financial systems. Measures such as interest-rate caps, heavy intervention in the banking sectors and directed credit were common throughout the developing world. Such measures however

came under severe criticism during the 1970s in the influential works of McKinnon (1973) and Shaw (1973).

McKinnon (1973) put forward a different view of the relation between finance and economic development. The underlying idea is that an expansion of the real money stock leads to an expansion of investment and therefore growth. In many developing countries, however, the real money stock is often found to be too low. This is due to low interest rates generated by policies of financial repression, which, combined with very high inflation, lead to shrinking levels of deposit money.

This situation is further worsened by conventional policies to reduce inflation by reducing aggregate demand. In fact, such policies fail precisely because they focus on reducing the nominal stock of money M , disregarding the real stock of money M/P . McKinnon argued that other countries (such as South Korea) successfully curtailed inflation, by expanding the demand for cash balances rather than reducing its supply.

Financial liberalisation policies can therefore contribute to alleviate to growth by increasing deposits. Disagreements between Shaw and McKinnon appear in the precise mechanism through which deposits generate higher investment. While for Shaw financial liberalisation improves the quality and quantity of financial intermediation, McKinnon puts forwards a peculiar argument according to which, in developing countries, investment is mostly self-financed, and therefore requires prior accumulation of cash (i.e. money and physical capital are complementary rather than alternative assets). Therefore higher interest rates help accumulating the necessary savings that enable investments outlays. Despite this disagreement, McKinnon and Shaw's arguments in favour for financial liberalisation stand out as essentially a case for a free-floating interest rates, which would enable to both expand the real monetary base, and to allocate it more efficiently, especially by extending credit to hitherto marginalised sectors, such as agriculture and small and medium enterprises. Fry, (1978) has summarised these theories through a simple loanable funds graph, where interest rates caps result in non-price credit rationing. Removing such constraint allows the reaching of the equilibrium real-interest rate, both extending the loanable funds supply and letting prices (i.e. the interest rate) reflect fundamental values.

As a result of this work and the increasing difficulties of debt management in developing countries, culminating in the international debt crisis of 1982, financial liberalisation gained prominence as a development policy. The IMF and World Bank actively promoted liberalisation of the financial sector as part of structural adjustment programs. Many developing and semi-industrialised countries liberalised their financial sector during the early 1980's, so that most of them were effectively wholly liberalised by the early 90's (Williamson and Mahar, 1998).

At the same time when financial liberalisation policies were being implemented, the McKinnon-Shaw paradigm was assessed both theoretically and empirically. This gave rise some controversy about its validity. Firstly, it is not clear whether higher interest rates or just financial liberalisation in general actually increase savings. As a matter of fact, standard theory predicts that with regards to such a relation, income and substitution effects work in opposing directions (Dornbusch and Reynoso, 1989)¹. On the empirical side, while early studies may have found supportive evidence², there is widespread agreement that the effect of interest rates on the amount of savings is at least ambiguous (Bandiera et al., 2000).

A second empirical issue is the extent to which financial liberalisation increases the likelihood of financial crises. In a classic paper Diaz-Alejandro (1985) argues that financial liberalisation was at the core of the financial crisis in Southern Cone countries in the early 1980s.

Thirdly, on the more theoretical side, the financial liberalisation paradigm does not take into account market failures. Stiglitz (1994) has forcefully argued that credit rationing can occur in financial markets as a result of informational asymmetries between borrowers and lenders. Financial liberalisation therefore does not necessarily improve the quality and quantity of credit available. To the contrary, state intervention is necessary to correct some of the market failures. Such state intervention could in some cases include policies of "mild"

¹ An increase in interest rates increases the cost-opportunity of current consumption relative to future income thus leading to higher saving, but at the same time reduces the amount of current saving required to satisfy higher future consumption.

²See Balassa (1989) and Thornton 1991) for literature surveys.

financial repression such as directed credit and interest rates cap (as long as the real interest rate is positive).

The financial liberalisation literature has evolved by taking into account most of these criticisms. On the policy side, the growing consensus highlighted the importance of *pre-conditions* and *sequencing* for successful liberalisation strategies. The former is explained by Fry (1997) in relation to the failures of financial liberalisation policies in some countries. “The basic problem lies in the perverse reaction to higher interest rates by insolvent (or non-profit-motivated) economic agents” (p. 758), who essentially borrow more as interest rates grow. This clearly indicates a malfunctioning financial system, where the institutional setting is unable to prevent such distress borrowers from crowding out the good ones. Therefore, in order to avoid such adverse selection, financial liberalization policies must be adopted after five preconditions are in place (p. 759): prudential regulation and supervision of commercial banks, price stability, fiscal discipline, competition in the banking sector and a tax system that does not penalise financial intermediation.

The overall process of financial liberalisation should therefore be implemented only gradually (Demirgüç-Kunt and Detragiache, 1998; World Bank, 1991). The “correct” sequence starts with ensuring the abovementioned conditions are met and promoting liberalisation in the “real economy”. Then the goal is to foster the development of the financial sector, including gradual opening to foreign competition. Only when the financial sector development is sufficiently developed can the final stages of liberalisation can be undertaken: full interest rate liberalisation, removal of any left restrictions on foreign institution entry and finally capital account liberalisation.

On the theoretical side the financial liberalisation paradigm has come to accept the ambiguity on the interest rate impact. Higher interest rates in fact increase growth mainly through the improved efficiency channel and in a non-linear fashion: the relationship between interest rate and growth is more adequately represented by an inverted U-shape curve (De Gregorio and Guidotti, 1995; Fry, 1997).

More fundamentally though, the early 1990s saw the advance of a new literature on *financial development*. This literature seeks to give a comprehensive account of the effects

of financial intermediation on economic growth, beyond the negative effect of distortions in the credit market, which are the focus of McKinnon and Shaw's financial repression paradigm. The macroeconomic literature found its root in the contemporary development of the endogenous growth theory, where financial intermediation plays an important role in increasing the equilibrium rate of growth (Bencivenga and Smith, 1991; Pagano, 1993; King and Levine, 1993). Pagano (1993) explains concisely the three channels through which finance can enhance growth: firstly it can increase the fraction of saving that is turned into investment – it contributed to reduce the share of it that is “lost” in the process; secondly, it can improve the efficiency of allocation thereby increasing productivity of capital; finally it can increase the saving rate. It follows then that financial repression is still seen as damaging, as it reduces the efficiency of resources allocation: financial liberalisation may be a good way to spur financial development (R. G. King and Levine, 1993).

These contentions have been empirically tested. In a seminal paper King and Levine, (1993) assess the effect of financial development on growth. Rather than “monetary growth”, as it was typical of the earlier financial liberalisation literature, explanatory variables are measures of financial intermediation such as the ratio of private credit to total credit or the size of total bank liabilities to GDP. They find that financial development has a strong positive impact on both current and future growth. More specifically, later studies (Beck et al., 2000) suggest that financial development affects growth primarily through improvements in total factor productivity, rather than increased savings and physical capital accumulation.

Partially building on this literature, the World Bank economist Ross Levine and his colleagues (Levine, 1997; 1999; Levine et al., 2000) have further dissected the issue of financial intermediation. The focus here is on explaining precisely the channels through which finance can improve growth, by examining the functioning of the financial system. There are five main functions that the financial system has in this sense (Levine, 1997): facilitating exchange, mobilising saving, facilitating risk management, allocating resources and exerting corporate control. According to this view, what matters for growth is that the financial sector works efficiently in the provision of such services, regardless of the precise financial structure (e.g. bank-based or market-based financial systems).

These new developments allowed financial development scholars to overcome some of the limitations of the original financial liberalisation paradigm. First of all, this approach explicitly addresses the asymmetric information that pervades financial markets. Financial intermediaries exist precisely to overcome informational problems and market failures. Secondly, it addresses the issue of causality between financial development and growth, which was raised by scholars especially in relation to the use of cross-country regressions that cannot, unlike time-series techniques, properly detect that causal relationship (Demetriades and Hussein, 1996; Arestis and Demetriades, 1997). By stressing the theoretical importance and empirically testing the importance of financial intermediation as an engine of growth, scholars seem to find a consensus view in that financial development is in fact driving growth rather than the other way around. In Levine's words, "while subject to ample qualifications and countervailing views noted throughout this article, the preponderance of evidence suggests that both financial intermediaries and markets matter for growth even when controlling for potential simultaneity bias" (Levine, 2005, p. 921).

In sum, the financial development paradigm seems to find a good case for financial development as a way to promote growth. It substantially improves the case of "more finance for growth" as a development policy, than the financial liberalisation paradigm. It also, in accordance with the post-Washington consensus, recognized the possibility of market failures and suggested policies to cope with it.

2. Ownership, access and micro-finance

Having established the broad relation between financial intermediation development and economic growth, the financial development literature has evolved into two main directions. One direction seeks to qualify the impact of financial development, by examining more aspects of development than simply GDP growth. A second direction, directly stemming from the previous works of Levine (1997; 1999), focuses on the causes and the processes through which financial development can be successful, with a major focus on institutions and regulatory arrangements. These two literatures are clearly interrelated, for instance when

it comes to examine the relationship between different types of financial sector arrangements and poverty, and will therefore be examined together.

Having established the impact of financial development on GDP growth, the literature turned to assess its impact on broader development indicators, such as poverty and inequality. As Jalilian and Kirkpatrick (2002) write, financial development can reduce poverty in two main ways: aggregate GDP growth and income distribution. The first channel is closely related to the renowned paper by Dollar and Kraay (2002), who claim that “growth is good for the poor”, and several institutional determinants of growth, including financial development, benefit growth in a non-discriminatory way for the poor. Honohan (2004) adds a second channel to this framework, by finding some suggestive evidence that financial development “is more likely to reduce poverty than the average pro-growth initiative”. More comprehensive evidence in this direction can be found in a later paper (Beck et al., 2007), according to which financial development “disproportionately boosts the income of the poor”, as it increases aggregate income growth while at the same time reducing income inequality. Dehejia and Gatti (2005) confirm the pro-poor nature of financial development by showing its positive impact in reducing child labour, which they consider as a key “indirect” indicator of poverty.

The debate on the distributional impact of financial development was also enriched by the introduction of the concept of *access to finance*. Access to finance refers to the distributional aspect of financial development. If the extension of financial services does not reach the more disadvantaged parts of society then it may fail to spur “pro-poor” growth and lowering inequalities. Ensuring the diffusion of access to finance is therefore key to successful financial development policies.

This is theoretically grounded in the theory of market failures, such as the mentioned issue of “credit rationing” (Stiglitz and Weiss, 1981). Two are the primary obstacles to widespread access: “the poor and start-up companies alike have a lack of collateral and (b) fixed costs, including those of information acquisition, monitoring, collection, and enforcement that can be prohibitive for small financial contracts and transactions” (Caprio

and Honohan, 2001, p. 65). The literature focuses mostly on two potentially excluded sectors from financial services: poor households and small-and-medium enterprises (SME).

With respect to households the literature intertwines with the issue of microfinance. Microfinance refers to the provision of financial services to the poor by specialised institutions. Microfinance was first developed by Muhammed Yunus, during the 70's. The original microfinance model was essentially the provision of uncollateralised-loan to otherwise "unbankable" borrowers with small investment projects. Yunus' institution, the Grameen Bank, overcame the credit risk problem by developing a system of collective borrowing: the loans were made to a group of people, who were jointly responsible for the repayment.

The success of the Grameen Bank led to the widespread development of the microfinance movement. The microfinance "promise" that led to its rapid diffusion was that it would bring about poverty alleviation while at the same time being profitable for lenders, attracting increasing amounts of funds by both donors and investors. This "win-win" narrative has been questioned as such (Morduch, 1999; Morduch, 2000) and was empirically invalidated by cross-country studies (Cull et al., 2009): profitable microfinance experiences are very often associated with commercial bank funding and on lending to individual borrowers, rather than groups, while the "social" microfinance experiences funded mostly by NGOs tend to be more highly reliant on subsidies.

The access to finance and financial development literature draws on the theories and experiences of microfinance, confirming its overall sobering impact on development. In a World Bank report on the issue of access to finance (Demirgüç-Kunt et al., 2008) the impact of microfinance on welfare is reported to be unclear, while many of the projects are still highly subsidised. Additionally, while much of microfinance is focused on credit to finance small entrepreneurial projects, loans are not primarily given out for investment projects but to finance daily expenses. According to the report, these findings are indicative of the poor's need of access to finance: the poor are not only and not primarily lacking access to credit to finance productive activities, but suffer from a generalised lack of access to financial services. Moreover in many countries the "unbanked" and/or the "underbanked" are not only

the poor but also a substantial part of the middle-class. Therefore, it is through the overall development of the financial sector that finance positively impacts the poor rather than through direct expansion of credit to them. The goal should be to expand financial access for all, rather than simply target the poor:

“As a result, the development community has shifted its attention to building inclusive financial systems focusing not only on specialized microcredit institutions, but on an array of other financial institutions, such as postal savings banks, consumer credit institutions, and, most important, the banking system. This broader approach can lead to overall financial system efficiency and outreach to the whole population.” (Demirgüç-Kunt et al., 2008, p. 137).

The lack of access to finance by SMEs is also seen a constraint to development. Barriers to financial access by firms can occur and have a highly negative impact on competition, growth and innovation. SMEs and new firms, by relying almost entirely on external finance for their investment, are the most negatively affected by the lack of financial access. It is therefore considered important to improve their access to finance. Once again, financial development in general is seen as beneficial for the SMEs. However policies aiming to improve specific financial practices, such as factoring and leasing, can be a successful short-term way to improve access to financial services to SMEs (Beck and Demirguc-Kunt, 2006).

The other direction in which the financial development literature has expanded is to better understand how the process financial intermediation can be successful. In the early literature on financial development, as Honohan (2004) argues, there are limitations concerning its measurement and assessment: the concept of financial development, in Levine's (1997) formulation, is more than the expansion of banking activities, and refers to the development of the functions of the financial sector. Thereby what is needed “some measure of the quantity and quality of financial services that households, firms, and governments received in total”.

Honohan (2004) proposes some measures based on the quality of the financial system infrastructure, including the legal and the regulatory environment. This clearly echoes some of the preconditions for financial liberalisation. Additionally the literature is concerned in

understanding how the legal environment affects financial development, and finds that countries with “superior” regulatory and accounting practices do in fact experience a higher level of financial development, and consequently growth. Levine (1999) does in fact use the law and regulatory environment as an instrumental variable and finds financial development-enhancing practices are positively correlated with growth.

A list of determinants of successful financial development can be found in a later paper by Demirgüç-Kunt and Levine (2008), where these are seen as “policy foundations for financial development”. Two elements in such lists stand out as novel with respect to past literature on the “preconditions” for financial liberalisation: ownership and access to finance. The latter has already been discussed as part of the debate of the distributional impact of financial development, but is also found to be a precondition of successful financial development: broadening the access to finance is crucial to ensure that the expansion of the financial sector is beneficial for the country as a whole.

The other element, the ownership structure, is also considered to have an impact on financial development and growth more in general. The literature first of all considers the impact of government ownership of financial intermediaries directly. Influential empirical works (La Porta et al., 2002; Barth et al., 2004) find that that overall the relationship seems to be negative. As Demirgüç-Kunt and Levine (2008) put it:

“evidence shows that government ownership of banks everywhere, but especially in developing countries, leads to lower levels of financial development, more concentrated lending, and lower economic growth, and greater systemic fragility”.

Furthermore, not only the financial sector itself must be privately owned, but the overall regulatory system should work in a way that it empowers the private sector. According to this “private empowerment view” (Demirgüç-Kunt and Levine, 2008) of regulation, government intervention should be aimed at allowing the private sector overcoming transaction costs and informational asymmetries. Importantly, while the outcomes are certainly improved in countries with “better” legal systems, private empowering regulations work even in developing countries (p. 44). To the contrary, safety nets such as deposit

insurance are particularly damaging in those countries, by creating incentives for moral hazard problems.

Very similar results are found with respect to foreign ownership of banks. Once again, the case was again firstly made by Levine (1996) and is particularly concerned with the case of advanced countries banks expanding into developing countries. The argument is relatively straightforward: foreign banks from developed countries possess superior techniques that allow them to better perform the five fundamental functions of financial intermediation (Levine, 1997, see above). Foreign banks can therefore contribute to financial development by both exerting their functions more efficiently than local banks and stimulating such functional improvement within the existing domestic financial sector. These contentions were tested by Claessens et al. (2001), who find consistent evidence that foreign banks entry increases bank efficiency, by reducing profits, non-interest income and overhead costs of the banking sector.

In sum the literature consensus on the issue of ownership is very well summarised by Clarke et al. (2005) in their abstract:

“Bank privatization usually improves bank efficiency, gains are greater when the government fully relinquishes control, when banks are privatized to strategic investors, when foreign banks are allowed to participate in the privatization process and when the government does not restrict competition”

In conclusion, the literature on financial development, once firmly established as a key theme in the (especially World Bank) development debate has been refined and enriched during the past fifteen years or so. Financial development is deemed beneficial for the poor, by both spurring “distribution-neutral” growth that can lift people out of poverty and reducing economic inequalities. Policies should ensure that the development fosters the access to finance for all the hitherto excluded parts of society and SMEs. Microfinance can help to improve the access to finance of the poor, but is unable alone to generate the needed growth to lift the masses out of poverty. In order to be effective as a pro-poor growth engine financial development needs the right legal and regulatory infrastructure, but also needs to be free-market oriented, favouring private over public banks in general and foreign banks in

particular. The government should regulate the system in a private-sector empowering fashion, and must work to ensure financial development proceeds on the right track to deliver its developmental benefits.

3. Domestic financialisation in developing and emerging countries

The mainstream theoretical and policy debate has focused heavily on the establishment of a positive causal relation between finance and development. Such an analysis, while bringing finance to the fore, does not however move much beyond a standard neoclassical analysis: financial markets are assessed in terms of their important and efficiency in bringing their service to the economy, i.e. how much and how well they channel saving to investment. However many alternative schools of thought present a more complex view of the relation between finance and the “real economy”. Some of the most prominent “heterodox” traditions, such as Post-Keynesian, Institutional, Marxian and Regulationist economics and political economy, have paid attention to the rise of finance in the economy, by pointing out its historical evolution and its consequences. Many have referred to this rise as “financialisation”, which has been over the past few years subject of a rapidly developing literature. Most of the literature has assessed the impact of an evolving financial sector on advanced economies. However, some contributions focus on the peculiar features of financialisation in developing and emerging economies. Assessing this literature may therefore give important insights, although very different from the mainstream debates, when it comes to analyse the changing impact of finance on development.

The literature on financialisation on developing countries is relatively new, and to the best knowledge of the author, there is not yet a systematic review of it. The review that follows analyse the key themes raised by the literature. It will first analyse the conceptual issues about financialisation in developing countries, particularly its role in the evolution of the political economy of such countries. It will then proceed to address the key empirical facts that have been associated with financialisation in developing countries, by such as the impacts on the various sectors of the economy.

3.1 Financialisation in the developing countries political economy

Financialisation is almost everywhere defined in the words of Epstein, (2005) as:

“the increasing importance of financial markets, financial motives, financial institutions, and financial elites in the operation of the economy and its governing institutions, both at the national and international levels”.

This very broad definition has allowed many different theoretical approaches to address the issue. In the context of developing countries authors have adopted three approaches to financialisation, more or less fitting in the schools of thought of the Theory of the Regulation, Marxist political economy or post-Keynesian economics. Of course the boundaries are sometimes blurred since the regulation school has much in common with both Marxist and post-Keynesian concepts. However, the approaches often emphasise different aspects and conceptualisation of the process of financialisation.

Perhaps the school of thought that has more directly addressed the specificity of developing countries in their approach to financialization is the regulationist school. More or less explicitly, authors seek to explain different aspects of a financialised regime of accumulation. Much like the move from “Fordist” to finance-led patterns of accumulation that occurred in many advanced economies (e.g. Boyer, 2000), many developing countries have experience a shift from different forms of “peripheral Fordism” to locally-specific forms of financialisation of their economy (Becker et al., 2010).

A key element of regulationist theories is that a regime of accumulation needs a “mode of regulation”, a set of institutions and policies, to make the economic and social reproduction feasible. Therefore the policy shifts occurred in developing countries in parallel to their increasing financialisation are a central focus of analysis. Since the late 70's, many developing countries have followed the policy advices of financial liberalisation and financial development proponents. Moreover these policies fit into the broader context of the transition in economic policy towards more market-friendly development strategies and a shift in macroeconomic policies, propagated by the World Bank and the IMF during the

Washington Consensus era. These changes have deeply affected the role of the financial sector in the economy and the political economy of these countries.

Financialisation is therefore not a linear process and assumes different forms in developing countries vis-à-vis advanced economies, as well as country-specific forms. A first big distinction, which is made by Becker et al., (2010), is between “financialization between the take-off of a second circuit of ... securities, and financialization based on interest-bearing capital and, thus, on high interest rates”. The first type of financialisation, which has its core in the inflation of financial assets price, is the most common form, and is typical of advanced Anglo-Saxon countries. However financialization through interest income rates may be of particular relevance for many developing countries, since inflation and the need to encourage capital inflows (or discourage capital flights) has often induced these countries to adopt high-interest rates policies.

Post-Keynesian approaches points to the rise of financial profits and incomes as one the key process of financialisation (Stockhammer, 2004). In the context of emerging markets, Demir (2007) points to the rise of “rentier” capitalism, primarily through the financialisation of firms income, and its negative consequences for productive investment and growth. There is however a distinctive lack of explicitly post-Keynesian literature on the issue of financialisation in developing countries.

Marxists accounts of financialisation emphasise similar aspects. Ashman et al., (2011), situate the process of financialisation within Marx's between interest-bearing versus other forms of capital, and between accumulation of real versus fictitious capital.

“The neoliberal period has witnessed both the subordination of real accumulation to fictitious capital – with the expansion of speculative assets at the expense of real investment – and the integration of real accumulation into the realm of interest-bearing capital, resulting in financialised accumulation of a systemic nature.” (p. 176)

Ideological and policy shifts that empower private capital, such as privatisation and the deterioration of public provision of services and goods, have further strengthened the power of finance over the economy and the social and political structure of developing countries.

Neoliberalism is therefore tightly linked to financialisation (Fine, 2010), although perhaps by coincidence of interests rather than necessarily by explicit design.

Also includible within the tradition of Marxist political economy is Jeff Powell's concept of "subordinate financialisation" (Powell, 2013), which refers to the Marxist concepts of imperialism. The distinctiveness of financialisation in peripheral countries is its subordinate nature, i.e. the extent to which it is "shaped by imperial relations between states" (p. 3). Thus peripheral countries are subject to similar shifts experienced by core countries, but at the same times these are mediated by their subordinate position, which shapes the form in which financialisation takes place. For example, the global shift to market-based finance by firms, in peripheral countries presents the additional feature of firms turning "disproportionately to foreign capital, allowing the extraction of a share of the domestically-generated surplus" (p. 19).

Marxists approaches however differ markedly from both Post-Keyensian and regulationist approach in their emphasis of power and class relations. As Marois (2011) argues, there is a need to move beyond institutions and policy and uncover the underlying structural political dimensions. This leads Marxist scholars to refute the concept of a "rentier class". As Ashman et al. (2011) argue, the shift of the balance of power from labour to capital and from real to interest-bearing capitalists is different from arguing that financialisation simply marks the return of the rentier.

These disagreements are reflected by the different emphases that these approaches put in the historical accounts of the rise of financialisation. For those who work within a regulationist framework it is central to evaluate the evolution of the "monetary and financial regime", in relation to the rise of finance-led accumulation regimes. The case of Brazil is paradigmatic in this sense. While the country implemented Washington Consensus policies more slowly and partially than other Latin American countries, already in the 1980's the country's monetary and financial regime were conducive of a peculiar kind of financialization based on a dual-currency system. Alongside the state-issued currency that was continuously eroded by inflation an alternative currency, endogenously issued by the financial sector backed by public debt and indexed to inflation, allowed the accumulation of wealth by private

financial institutions (Araújo et al., 2012; Paulani, 2010). When privatisation and liberalisation policies as well as monetary and price stability came about in the early 90's, financial accumulation was primarily driven by very high interest rates³. The expansion of internally held public debt, also due to the state intervention to counteract the 1999 financial crisis, marks the internal financialisation of the country, with a redistribution of income from the middle-class towards financial capital (Becker et al., 2010).

Similar experiences, where the mode of regulation promoted financialisation, have been shared by other countries. The experience of Mexico has been one of recurrent financial crises followed by state intervention in favour of the financial sector, coupled with high-interest rates and economic policies that slowly moved the economy towards a finance-led regime (Correa et al., 2012). Particularly, and contrary to Brazil, Mexico followed more closely the policy suggestions of the Washington Consensus in the field of financial liberalisation. The banking sector for instance was extensively privatised and opened to foreign competition, whereas in Brazil state-owned banks and in particular the development bank BNDES, continue to play an important of the domestic financial sector.

The importance of post-crisis IMF-led reforms towards financial liberalisation has been typical of East-Asian countries as well. In South Korea, a vast program of banking and financial liberalisation was undertaken in the aftermath of the East Asian financial crisis (Crotty and Lee, 2002; Kalinowski and Cho, 2009). In Malaysia the move towards financialisation has also been propelled by policies after the 1998 crisis, but these of a more "selective" scope: as Rethel (2010) argues, "the state remained the gatekeeper of Malaysian capitalism", in actively promoting some financial practices that drove the economy to a more finance-led accumulation regime. The role of the State within the country's political economy during the financialisation process thus remains a key variable of analysis.

Marxist scholars emphasise the more structural global and national economic factors. The rise of financialisation is both the result of national shifts of class power towards capital in general and financial capital in particular. Therefore Marxists scholars have sought assess

³ Araújo et al., (2012) calculate that holding government bills at the Selic rate from January 1991 till January 1999 would increase the capital sevenfold.

what processes may lead to such political shifts. In developing countries, as Ashman et al. (2011, p. 189) “there is the added twist of both creating financial elites and strengthening their roles.” Such creation may intertwine with other political objectives, such as the creation of a black political elite in South Africa (Ashman et al., 2011) or a local-Malay entrepreneurial class in Malaysia (Rethel, 2010). Similarly, the changes of the “world market”, a key Marxist concept, are also pointed out as a structural element that gave rise to financialisation, and subordinate financialisation in particular (Powell, 2013).

Another factor affecting the balance of political power towards finance has been the recurrence of financial crises: as Marois, (2011) argues, the recoveries from the crisis in Mexico and Turkey have reinforced the leading role of finance and banks interest in the national political economy. Global factors also play a key role. Indeed some Marxist scholars have explicitly argued that the rise of financialisation in developing countries is the result of the international power of the US, principally through the rise of the US dollar as quasi world money (Painceira, 2009; Lapavitsas, 2009). This view also taken up by Powell (2013), who considers this an important element shaping the subordinate character of financialisation in peripheral countries. These will be discussed in section 5.

6.2 Financialisation in developing countries: key empirical facts

Authors have pointed several empirical facts associated with financialisation. These can be grouped into the changes affecting the different main sectors of the economy, firms, households and banks, as well as some peculiar trends of developing countries such as the expansion of foreign banks, microfinance, and the financialisation of commodity markets.

A key theme is the implication of financialisation for non-financial firms' investment. A common observation is that firms increasingly engage in financial rather than productive investment. This a key research issue in the work of Firat Demir (Demir, 2007; Demir, 2009a; Demir, 2009b): using micro-level data for Argentinean, Mexican and Turkish firms, he finds that financial liberalisation policies do not significantly contribute to reduce capital market imperfections, while on the other hand the availability of financial investment as well as the differential return between financial and non-financial investment have a negative effect on

productive investment and positive on financial investment. The increasing importance of financial activities, including derivatives speculation, for non-financial corporations is testified by several different studies (Correa et al., 2012; Farhi and Borghi, 2009; Rossi, 2011). Additionally firms' productive investment may be reduced as a result of the increasing attention to the creation of "shareholder value". As a result of financial liberalisation in South Korea, "the pressure from foreign and domestic financial investors led to costly efforts by Korean corporations to increase shareholder value and to defend themselves against possible hostile takeovers, which impeded productive investment." (Kalinowski and Cho, 2009). Moreover there is evidence that shareholder orientation in South Korea has decreased not only productive investment but investment in Research and Development, with potentially more damaging long-term effects (Seo et al., 2012). Karwowski (2012) presents evidence that South African firms are "over-capitalised", that is they hold financial assets way in excess of what they need for their productive activities, so that firms have become the largest holders of bank deposits. Finally, Powell (2013) uses panel-data regression on Mexican firms to find evidence that increased market-financing is positively correlated with liquid asset holdings, thus showing that financialisation of firms is a proceeds on both side of the balance sheet at the same time. Emblematic of this is the reported engagement of Mexican firms with carry-trade operations (Powell, 2013, chap. 8).

At the macro-level the combined availability of high-return short-term financial investments and the pressure from financial investors have led in many developing countries to a reduction in productive investments, which have fell as a share of GDP (Araújo et al., 2012; Demir, 2009b; Kalinowski and Cho, 2009; Shin, 2012; Tan, 2013). Furthermore, figures for Brazil suggests that the actual drop in manufacturing within the non-corporate sector is even higher, as manufacturing contribution to GDP dropped by 50% since 1980, while lower-quality and natural-resource intensive have grown at the expenses of labour-intensive production (Araújo et al., 2012). This clearly has negative impacts for employment and wages. In Mexico for instance, (Correa et al., 2012), real minimum wages have declined constantly since the 1980's so that half of the working force is now working in the informal sector. Furthermore it has reinforced income inequality, where richer families that can obtain

financially related income have seen an increase in earnings in spite of the downward trend in wages. Similarly, in South Korea (Kalinowski and Cho, 2009), since the late 90's about half of the working force is employed with contracts lasting one year or less. In this sense, as Araújo et al. (2012) argue, "financialization becomes an even bigger structural obstacle, since it causes functional re-concentration of incomes in favour of the holders of capital without necessarily inducing them to raise the level of productive investment, a basic factor in the generation of employment and income".

Changes in the financial sector itself also constitute a central theme of the financialisation literature. A transition to more market-based financial systems is a theme for many countries that traditionally relied on more or less directed-credit through the banking sector. While, as said, in the case of Brazil financialisation is generally understood to have expanded to the rise of high-interest rates "rents", in Asian countries the expansion of capital markets may signal financialisation through asset prices (i.e. "fictitious capital" according to the terminology of Becker et al. (2010)). Lee (2012) finds that the expansion of financialisation in East-Asia can be seen in the rise of three patterns: the expansion of the stock-markets, fuelled by regional integration and capital account liberalisation; the changing role of banks, which now engage in different kinds of activities, such as securitisation, trading and insurance; the rise of institutional investors, especially mutual funds and sovereign wealth funds. Rethel (2010) further specifies some of these patterns for the case of Malaysia. Policy efforts were aimed at developing local capital markets, especially bond markets, which poses challenge in terms of credit allocation, since "the expansion of bond finance further entrenches a two-tiered industrial structure in Malaysia, which privileges bigger corporations, often linked to the government, to the disadvantage of SMEs" that do not have access to capital markets (p. 496). At the same time banks have reoriented their activities towards trading and fee-generating business. Paradigmatic is the case of Cagmas, a state-led financial institution set up to facilitate the availability of affordable housing, which slowly turned into the biggest securitization provider in the country.

Banks also reoriented their business towards by allocating an increasing proportion of credit to households. Examples of studies testifying this phenomenon are Ergunes (2009) for

the Case of Turkey, Chang (2010) Cho (2010) for South Korea, Rethel (2010) for Malaysia, dos Santos, (2011; 2013) and Paineira (2012) for Brazil, dos Santos, (2011; 2013) for Mexico, Turkey and Poland, Becker et al. (2010) for Slovakia, Ashman et al. (2011) and Karwowski (2012) for South Africa and Gabor (2010) for Eastern Europe. All these studies document that credit to household expanded quite dramatically over the past decade, often from very low or negligible levels.

This has had consequences for households' income, a growing proportion of which is used to repay interest on loans: in Turkey for example the household-debt to income increased from 7.5 % in 2002 to 29.5% in 2007, while interest payments as a percentage of income increased from 2.1% to 4.6% in the same period (Ergunes, 2009). As a result, the cyclical expansions and contractions of household credit often created an additional layer of financial instability as well as an additional crisis transmission channel. For example, in South Korea a credit card boom that eventually burst in 2003 resulted in widespread defaults of households and, in turn, financial institutions, which were bailed out by the State (Chang, 2010). In South Africa, a consequences of American sub-prime crisis was a domestic credit crunch, that resulted in widespread of defaults and repossessions of both properties and automobiles (Ashman et al., 2011).

In some countries the expansion of household debt had a very important "functional" role, in the management of the business cycle, much like it had in Anglo-Saxon capitalism. In Slovakia, for example, the expansion of household debt over the past decade has sustained aggregate demand in a situation of low wages (Becker et al., 2010). Similarly, in Malaysia credit to households was a central element in the government efforts to promote a consumption-led recover after the 1998 crisis (Rethel, 2010). Moreover, household lending becomes a key mechanism in social reproduction: "never has access to finance been so decisive for both social mobility and entrepreneurial success. Indeed, credit has become increasingly important to access basic public goods such as education and health care" (p. 498). Unequal access to credit can thus exacerbate existing social and economic inequalities.

In addition to the expansion of household lending, "mass-based financialisation" has also resulted in the increasing participation of (especially middle-class) households into the

active managements of their financial and housing assets. This issue seems to be particularly relevant for East Asia, where the post-crisis reforms pushed those countries towards a more “Anglo-Saxon” type of financial system. The documented expansion of institutional investors in East Asia is in an aspect of this (Lee, 2012). Once again the metamorphosis of existing Malaysian institutions into channels of financialisation stands out as a paradigmatic case (Rethel, 2010). Investment trusts, which were originally implemented as a vehicle to spread diffused ownership within the local Malay population (*bumiputeras*) as part of the policies to promote the rise of a local entrepreneurial class, have become the primary institutional investors in the country, aside from state pension funds. The gradual opening to non-*bumiputeras* as well as the diversification into different asset types indicates the shift in intentions of these funds “from a concern with the (ethnic) redistribution of corporate ownership to a more general mandate to promote portfolio investment and to inculcate a (low risk) investment culture that draws more and more people into the market.” (p. 502).

Housing and real estate have risen in many countries, a fact that is often the counterpart of the increasing household debt. In South Africa for example, property prices increased by 389% between 1997 and 2008 (Ashman et al., 2011). In South Korea the extension of credit to households after the credit card bubble in 2003 was predominantly in the form of mortgages, sustained by a steady increase in house prices (Chang, 2010; Cho, 2010). The already mentioned Cagmas in Malaysia has been at the centre of the parallel expansion of homeownership and mortgages, as well as a securitisation provider, all of which is clearly reminiscent of the renowned US institutions Fannie Mae and Freddie Mac (Rethel, 2010).

Social policy reforms are however not confined to countries that actively pursued (indebted) consumption-led strategies. The penetration of finance into an ampler range of social policy is in this sense a global trajectory that goes somewhat beyond pure economic policies. Privatisation of pensions and insurance, for instance, has occurred in Mexico (Correa et al., 2012). Perhaps the most famous case is that of Chile, which was a pioneer in privatising its retirement system through the creation of pension funds. Such schemes have provided a very direct way in which finance has penetrated in the life of many Chileans. First of all, the very highly concentrated sector, both in terms of ownership – often by foreign

financial institutions – and in terms of investment, has over its all existence proved to be very costly for pensioners, with about one third of contributions kept by fund management and owners in fees and commissions (Sumaria, 2010). Moreover, the financial crisis has put a lot of stress on the funds, so that old-age income security is at risk, which has led to pension reforms by the Chilean government (Riesco, 2009).

A very important development in the financial sector is the expansion of foreign banks into the domestic market. The policy push above reviewed was, in general successful, so that in many countries foreign banks have come to occupy an important place in the domestic financial sector. Several studies reveal that foreign banks have come to play a substantial and in some cases a leading role in Mexico (Correa et al., 2012), Turkey (Ergunes, 2009), Eastern Europe (Cetkovic, 2011), South Korea (Cho, 2010), Philippines Mexico and Brazil (Lapavitsas and dos Santos, 2008). In a couple of works considering the issue, dos Santos highlights evidence suggesting that foreign banks are often key agencies in transmitting “financialised” practices, i.e. they obtain high profits through non-credit activities, such as trading and fees and commissions, as well as through aggressive household lending. In Brazil and Mexico, for example, foreign banks have led the way in driving the expansion of credit card lending and mortgages, with other banks quickly adapting to the new tendencies (dos Santos, 2011; 2013). Analogous trends can be found in South Korea (Cho, 2010). In Eastern Europe foreign banks have taken the lead in the expansion of foreign currency household loans and the rise of speculative activities (dos Santos, 2011; Gabor, 2010). Additionally foreign banks have been key in channelling the effects of the global financial crisis into emerging markets. Foreign banks were at the core of the increasing borrowing from abroad in South Korea in the pre-crisis years, generating substantial external vulnerabilities that turned into serious financial distress during the crisis (Cho, 2010). In Mexico on the other hand, foreign banks responded to the crisis in the US by repatriating profits to cover losses, and further reducing credit availability, thus directly contributing to the crisis transmission (Correa et al., 2012).

Even amongst the poorer strata of society, financialisation makes its way through the expansion of microfinance. Microfinance itself has been increasingly “financialised” by

linking in to the global capital markets. According to (Aitken, 2010), microfinance “has recently become a site of financialization, that is an object transformed into an ‘investable asset’ capable of generating financial profits for investors”. This refers to the rise of microfinance investment funds (MIFs), through which it is possible to invest in institutions directly providing micro-credit, or, more commonly to purchase a securitised microloan-backed asset (Aitken, 2013). Such funds have attracted a rising amount of flows from investors, initially as a way “socially-concerned investments”, but subsequently turned into purely financially driven allocations (Tyson, 2011). In fact, such funds are seen as a way to diversify portfolios, since MIFs present low correlations with other assets (Aitken, 2010). In this context it is not surprising to see a shift in microfinance practices towards commercialisation, as Tyson (2012) documents: firstly, the growth of microfinance has been remarkable⁴; secondly, microfinance institutions themselves have changed nature, as the sector is becoming dominated by regulated fully-fledged financial institutions as opposed to NGO’s and credit-unions; thirdly, the activities of microfinance institutions have moved away from credit for investment in productive activities towards consumption lending and other financial services, and away from group lending to individual lending. These moves made the microfinance extremely profitable, so that vast investments poured into MFI’s. As a result microfinance institutions actively turned themselves into financial institutions through IPOs such as the one of the renowned institution Compartamos in Mexico, which was vastly oversubscribed (Aitken, 2010; Aitken, 2013). Such processes, while making microfinance more self-sustainable, have made it highly unstable and destabilising. In India the high potential yield have essentially generated a bubble-like phenomenon of expansion and contraction as soon as the first defaults set in (Wichterich, 2012). Additionally, the aggressive credit extension have generated situations of over-indebtedness and serious financial distress, to the extent that it generated over 200 thousands suicide among farmers (Wichterich, 2012). Even where situations are less tragic, it seems that microfinance, as a result of growing financialisation, fails to alleviate poverty substantially.

⁴ For example, the number of microfinance institutions grew from 618 in 1998 to 3552 in 2008.

Finally, financialisation has affected developing countries indirectly, through its impact on commodities. Commodity prices have exhibited a typical boom-bust trajectory over the 2002-2007 period (Akyüz, 2012). There is considerable evidence that such price instability was driven by financial investors, who rapidly included commodity futures and even “real” commodities as an asset class into their portfolio, attracted by their low return correlation with the standard financial assets (Wray, 2008; Tang and Xiong, 2010; Ventimiglia, 2012). The impacts of such cycles affected developing countries considerably. While it has had a positive impact on the current account of commodity exporters, it has generated some sort of “Dutch disease” phenomenon where production and investment in commodity sectors crowd out investment in other sectors (Araújo et al., 2012; Nissanke, 2010). Moreover, as Newman (2009) reports for the case of coffee, the increasing financialization of commodity may reinforce the already existing inequalities in the production chain.

In conclusion, the literature on financialisation and development is extremely vast and wide-ranging. Authors have outlined several different phenomena, that characterise the process, and contextualised them in the political economy of different countries.

6.3 Summary

To summarise here are the main points that the financialisation literature points out:

- An increasing proportion of income is in the form of financial “rents”. This is either interest income, resulting from very high-interest rates, or asset price inflation. Theoretical debate exist as to whether this is the result of the rise of the “rentier” class, or the product of more structural shifts, such as the evolution of class relations.
- The State and other public institutions present an important degree of diversity across different countries with respect to their intervention or passiveness in the take off of financial development. While everywhere financialisation is facilitated by policy changes such as privatisation and reduced welfare provision, in some countries state policy is directly aimed at creating a “finance-led” regime of accumulation, whereas in others seems to be a more “unplanned” consequences of liberalisation policies coupled with increasing foreign influence. Specific country changes in the mode of

regulations and/or changes in power and class relations may account for such diversity.

- Non-financial corporations engage with financial markets more directly. They hold more income-generating liquid assets, and sometimes even speculate in the derivatives market. At the same time their reliance to bank credit has weakened. In some countries the pressure to create shareholder value by distributing dividends has increased.
- Decreasing investments have often exacerbated existing inequalities and fostered employment insecurity.
- In some countries capital markets have expanded dramatically. In many of them this is the result of both capital account opening and the rise of domestic institutional investors.
- Banks have re-oriented themselves towards non-lending activities, such as fee-generating businesses and trading, and increased their credit allocation to households. In many countries this has been the result of the increasing competition pressures from foreign banks entry.
- Households have increased their borrowing for both consumption and housing needs. This is often mirrored by a rise in the value of their property and financial assets. Nevertheless their borrowing needs often are the result of social security shifts.
- Microfinance is increasingly “financialised”, through the increasing commercialisation, as a result of the pressure of financial investors. Moreover it has created situation of financial instability and distress in some countries.

All these points refer to the “domestic” financialisation of developing and emerging countries. However in many cases the literature refers to the issues of capital account liberalisation and its consequences for capital flows and exchange rates as a key theme for financialisation. The aspects of “international financialisation” deserve further treatment and will be considered in the next two sections.

4. Financial globalisation

A particular aspect of financial liberalisation refers to the opening of the capital account to external investors. The case for liberalising the capital account can be made on standard neoclassical economics grounds.

In a standard neoclassical model with diminishing marginal returns to capital, investment takes place until returns to capital equal the equilibrium-borrowing rate of interest. In the open-economy, this means that capital should flow to developing countries, where it is relatively scarcer and therefore yields higher returns.

Such a situation is viewed positively for at least two reasons. The first is that, by flowing to poorer countries, it allows a more efficient allocation of capital. Capital scarce economies should import it from abroad, running current account deficits, to finance productive investments at lower costs than it could have otherwise borrowed domestically, while capital richer economies lend their capital, earning a higher return than the one obtainable from domestic investment. Capital flows liberalisation can in this sense be seen as promoting economic development, as developing countries achieve higher growth rates by importing capital from abroad.

Secondly, the increased allocation efficiency is welfare enhancing since it allows international risk diversification. As investors allocate a part of their portfolio to foreign assets, they can achieve higher risk-adjusted returns. From the point of view of countries as a whole, this results in lower volatility of consumption and income, since international investments effectively represent an “insurance” against country-specific risks.

A further reason supporting capital account liberalisation is the disciplining force of international finance on domestic economic policy. As Obstfeld, (1998) argues, “unsound policies - for example, excessive government borrowing or inadequate bank regulation - would spark speculative capital outflows and higher domestic interest rates”.

Until the late 90's this represented a consensus. In a famous speech, the IMF deputy managing director Stanley Fischer (1998) argued that the risks of liberalisation, which could be seen in the early signs of the East Asian crisis, were far outweighed by the benefits. This

represented a significant push that eventually led include liberalisation of the capital account in the IMF Articles of Agreement.

Just a few months later, this unanimous consensus towards liberalisation policies was heavily shaken by the devastating impacts of the financial crises that occurred in several emerging economies. Prominent economists (Bhagwati, 1998; Rodrik, 1998; Stiglitz, 2000) argued that full openness to capital flows was clearly at the core of the crisis, since it allowed capital to flow into this countries creating risky external exposures as well as exacerbating domestic financial fragilities. These views contend that arguments in favour of full liberalisation do not exhibit a serious understanding of financial markets. Financial markets, much more than goods markets, are characterised by informational asymmetries and other imperfections, which make them highly unstable and prone to sudden changes. Phenomena such as contagion and herd behaviour clearly signal the imperfection of international financial markets (Kaminsky et al., 2003).

Still, the policy consensus was only mildly affected by these crises. While conceding that financial markets are characterised by imperfections, which may make markets overreact, the structural causes of the crises were to be found in problems with the fundamentals. The most common explanation was based on the notion of “moral hazard”⁵ (Corsetti et al., 1999; Eichengreen and Hausmann, 1999; Krugman, 2000; McKinnon and Pill, 1998; Mishkin, 1999). According to this theory, emerging markets, particularly the Asian ones, were characterised by implicit or explicit guarantees that encouraged excessive borrowing. Some authors found the sources of such guarantees in the state measures related to industrial policy (Corsetti et al., 1999), such as subsidies to corporations or credit incentives to financial institutions, or due to “cronyism” and corruption (Krugman, 2000), which lead to excessive lending and investment in unprofitable projects. McKinnon and Pill (1998) highlighted the role deposit insurance, which created an incentive for banks to engage in very risky activities. At the international level a pegged exchange rate (Mishkin, 1999; Eichengreen and Hausmann, 1999) as well as the implicit government or IMF bailout (Corsetti et al., 1999; McKinnon and Pill, 1998) can create the incentive for excessive cross-border lending. Whatever the specific

⁵ See Chang, (2000) for a more extensive review and critique of these views.

form that moral hazard took, the distortions created by it eventually lead to the inevitable crisis:

“When indeed things went wrong and a series of domestic and external shocks revealed the low profitability of past investments, the shaky foundations of investment strategies in the region emerged, and currency and financial crises appeared inextricably intertwined.”
(Corsetti et al., 1999)

Capital flows in this sense make things worse, but they are symptom rather than the cause of the crisis (Mishkin, 1999). The solution to the moral hazard problems is therefore to eliminate the guarantees that allow it, hence the push for further liberalisation in the economy that often came along with IMF bailouts.

Another potential explanation of the crises was the so called “original sin hypothesis” (Eichengreen and Hausmann, 1999). Governments and firms in emerging and developing countries, because of the structural underdevelopment of their financial markets and/or the history of high inflation and depreciation, find themselves unable to borrow in their own currency, sometimes even domestically. This has the consequence to make their financial systems unstable, due to the resulting persistent currency mismatches in their economic units’ balance sheets. The authors propose two alternative solutions to the problems originated by the “original sin”. The first one is to erase the problem of mismatches by allowing the full dollarisation of the economy. The second one is to achieve “redemption”, by allowing the domestic development of financial markets before completely opening to foreign investment.

What the “original sin” and moral hazard based explanations have in common is the acceptance of capital account openness as a given policy. Emerging markets need to strengthen their regulatory system, eliminate moral hazard incentives and seek redemption from their original sin, but should not seriously consider restrictions on capital movements. As Eichengreen, (2001, pp. 359-360) puts it:

“officials and their advisors may differ on precisely when and how to liberalize international financial transactions so as to best insure that capital inflows are channelled

in productive directions, in other words, but there is little support for refusing to liberalize [...] for reversing previous liberalization measures”

What matters is therefore the appropriate sequencing of liberalization that can allow emerging economies to reap the benefits of capital flows (Eichengreen and Mussa, 1998).

A series of puzzling facts regarding the patterns of capital flows during their renewed expansion since the early 2000's, cast new questions about the costs and benefits of financial globalisation.

First of all, the rapidly growing literature that sought to validate that claims of beneficial impacts of free capital movements on growth, was more or less unsuccessful. A paper written by several IMF economists (Edison et al., 2004) was able to find some mild evidence of these benefits, but claims that these results are still much debated in the literature. In a later vast survey of the literature Kose et al. (2006, p. 28), while considering promising studies with different types of flows or micro-level data, state that “it is difficult to find robust causal evidence that financial integration boosts growth”.

Second, the actual capital flows patterns in the 2000's presented some paradoxical features. Capital flows to developing have long been affected by the “Lucas paradox” (Lucas, 1990), which showed and sought the explain the fact that capital did not flow to developing countries in any level close to the predictions of standard neoclassical models. In the 2000's, however, not only capital did not flow significantly to developing countries, it flowed persistently “uphill” from developing to advanced countries. Moreover Prasad et al. (2007) document a *positive* correlation between current accounts and growth. In other words countries that do receive capital flows seem to grow less than countries that do not receive them. This “allocation puzzle” was analysed in detail by Gourinchas and Jeanne (2007): a standard neoclassical growth model would predict that flows should be directed to countries with higher productivity gains and consequently higher investments rates, but in empirical terms the opposite seems to be the case.

Thirdly, by looking at the data more closely, it is clear that such “uphill movement” of flows is linked to the issue of foreign exchange reserves accumulation in emerging and developing countries. The explosion of such reserves offset is at the core of the 2000's phase of financial

globalisation. Central banks in developing countries have accumulated reserves, mostly in dollar denominated short-term assets that often had to offset a surplus in both the current and the private capital account. The magnitude of such phenomenon is another puzzle for standard theories. Most of the literature (Aizenman and Lee, 2007; Jeanne, 2007; Obstfeld et al., 2008; Jeanne and Rancière, 2011) has focused in understanding whether reserves are accumulated for precautionary reasons – to prevent or be able to face the effects of a financial crisis – or mercantilist reasons – as a result of the intervention on the currency market to keep the exchange rate “artificially” low. There seems to be more support for the “precautionary” motive, but not even Obstfeld et al. (2008), which deploy an array of different indicators of financial stability, including the possibility of capital flights after a crisis, are able to fully explain the high levels of reserves in the mid 2000’s.

Fourthly, emerging and developing countries international macroeconomic policy did not seem to conform to the standard prescriptions. After the East Asian crisis, (soft) pegged exchange rate regimes were blamed as a source of moral hazard, and similarly full dollarisation or pure free float as policy prescriptions against the troubles of original sin. This “bipolar” view was in fact very prominent amongst international economists after the crisis:

“there has been a hollowing out of the middle of the distribution of exchange rate regimes in a bipolar direction, with the share of both hard pegs and floating gaining at the expense of soft pegs” (Fischer, 2001, p. 22).

This prediction did not come true. The dissolution of the currency board in Argentina in 2001, clearly posed some challenges to the sustainability of hard pegs. On the other hand, as Calvo and Reinhart (2002) report, emerging and developing countries that officially declared to let their currencies float very often did not, and maintained an unofficial “soft peg” or at least a managed floating exchange rate regime. They understand this as a “fear of floating”, which they mainly attribute to the lack of credibility of emerging countries financial authorities coupled with high pass-through rates⁶. Another widely accepted explanation is linked to the hypothesis of “original sin” (Eichengreen and Hausmann, 1999; McKinnon and Schnabl,

⁶ The link between the exchange rates and domestic price levels.

2004): due to liability dollarisation and the inability to hedge it in forward exchange markets, emerging countries authorities, reminiscent of devastating impacts of depreciation in the late 90's, try to smooth as much as possible exchange rates movements. If the fear of sharp depreciation can be devastating, emerging countries' central banks do not seem to accept appreciation much more: as Levy-Yeyati and Sturzenegger (2007) show, intervention on currency markets is more often to curtail excessive appreciation than the other way around.

In sum the experience of developing and emerging markets after the late 90's crises can be summarised as follows. Private capital flows have restarted to flow into these countries to unprecedented levels so that their integration in the global financial markets, while small compared to the explosion of cross-border holdings among advanced countries, has been growing, particularly in the form of equity liabilities (Lane and Milesi-Ferretti, 2007). Such a situation is however not totally in line with the theories and policy analysis of international macroeconomists. The dramatic rise in foreign exchange reserves shows the high perceived risks by government and central banks in emerging markets that, afraid to simply let their currency freely float, heavily intervene to smooth exchange rate movements, and at the same time accumulate reserves that allow them to build up a buffer of safety against financial crisis. As Aizenman et al. (2010) show, most emerging markets seem to have adopted a policy stance of moderate financial integration, while at the same time maintaining a certain degree of monetary policy independence and exchange rate stability⁷. To make this stance credible and sustainable, and therefore less crisis-prone, central banks have accumulated foreign exchange reserves.

This gives rise to the "paradoxical" net flows of funds from these countries to advanced countries. The results of this are the renowned "global imbalances", which have been heavily debated over the past decade⁸, with emerging markets showing big current account surpluses mirrored by deficits in advanced countries, chiefly the US. This situation clearly comes at a high cost for emerging and developing countries, given the return spreads

⁷ This, according to the so-called "macroeconomic trilemma" would be impossible or unsustainable.

⁸ See for instance Blanchard and Milesi-Ferretti (2009), Obstfeld and Rogoff (2009) and Caballero et al. (2008).

between their domestic assets and their reserves assets, typically short-term US bills. Yet there is not only evidence that this has not substantially affected their growth, but also that countries that seem to adopt this stance grow faster than countries that do not.

Nevertheless, the consensus among financial globalisation, at least up to 2008, still regarded it as positive. The argument is that, despite the acknowledgment that capital flows entail considerable risks and their direct contribution to growth seems to be at best weak, financial globalisation brings considerable “collateral benefits” that may eventually lead to growth. There are three types of such benefits (Kose et al., 2006). The first is financial development: capital flows deepen financial markets and foreign banks may develop the financial sector infrastructure, thus leading to an overall improvement in the domestic financial system. The second is the benefits that foreign investors may bring to the system of corporate governance, which would reduce the cost of capital for domestic firms, as well as public governance, such as reducing corruption and enhancing transparency. Finally, the mentioned positive impact of integration on macroeconomic policy remains an important argument in favour of free capital movements.

However, there need to be some pre-existing minimum thresholds in order to make capital flows beneficial. This result can already be found in some of the empirical literature on capital account liberalisation and growth, “the benefits of capital account liberalization are only fully realized if this policy change occurs in the presence of adequate institutions and sound macroeconomic policies” (Klein and Olivei, 2008, p. 874). When reviewing the relevant literature, Kose et al. (2006, p. 39) list “financial sector development, overall institutional quality, the macroeconomic policy framework and trade integration”. These thresholds clearly echo both the “sequencing” approach to capital account liberalisation and the “preconditions” for financial liberalisation and financial development mentioned in section 1 and 2. Furthermore it would seem that some of the collateral benefits and the required thresholds present some bi-directional links. A minimum level financial development, for example, is a requirement for financial globalisation to be successful, but in turn financial globalisation itself improves financial development.

It is indeed on the lack of financial development that many authors have focused. The lack of financial development is a primary cause of the high savings rate in those countries, even though not all developing countries do (Gourinchas and Jeanne, 2007; Prasad et al., 2007): shallow capital markets impede savings to be channelled efficiently, and the possibility for households to smooth consumption by borrowing against future income. Therefore, by growing faster, financially underdeveloped countries may actually see an increase in their saving rate, which would then be channelled to foreign countries.

In this sense, paradoxically, more financial globalization would appear to be a solution for its own current distortions. Much of the literature on global imbalances does in fact blame underdeveloped financial markets in developing and emerging countries, for their high savings rates (Blanchard and Milesi-Ferretti, 2009). This view is emblematically represented by Ben Bernanke's (2005) global savings glut theory, which stated that over-saving in developing countries, especially in China, was the main culprit of global imbalances⁹. By spurring financial development, financial globalization can contribute to reduce these imbalances, and promote growth.

The critical voices on the issue of financial globalisation were somehow vindicated by the scale of the global financial crisis in 2008. As Ruziev (2012, p. 81) argues, "the fact the most recent global turmoil originated in the United States [...] with 'state of art' supervisory and regulatory frameworks, casts serious doubt on the feasibility of ever establishing a supervisory and regulatory structure that is capable of preventing financial crises". Several renowned economists, including some of those previously supporting financial globalisation, came to have a much more sceptical view of free capital movements. Obstfeld (2009) for example claims that, while the risks of financial globalisation were made once again evident by the global financial crisis, both direct and indirect benefits remain yet to be proved. Similarly, Jeanne et al. (2012), using meta-regression techniques and therefore producing an econometric test of the whole literature, find no significant benefits of free capital movements on growth, both in the short and the long run.

⁹ As well as a concurring cause of the US housing bubble.

On a more theoretically grounded level, Rodrik and Subramanian (2009) offer a sharp critique of supportive views of financial integration, including those based on “collateral benefits”. The authors criticise what they perceive to be the key underlying assumption of these views, the supposedly savings constraint to growth in developing countries. They argue that in developing countries, the binding constraint is not so much the availability of finance at reasonable costs, but rather the opportunities for profitable investment. From this viewpoint, opening the capital account does not increase investment, since it does not change domestic returns to capital. On the contrary, capital inflows may further reduce investment, since they induce and appreciation of the real exchange rate.

There is therefore a gradual movement, within the theoretical and policy consensus, towards the views of those who had assumed a more critical position towards open capital accounts. Prasad and Rajan (2008), for instance, advocate for a “pragmatic” approach to minimise the costs of financial opening, which is already a fact in many emerging markets.

The safer situation of emerging countries did not in fact prevent another episode of capital outflows and sharp depreciation of their currency, although it arguably was the reason why they were not as deeply affected compared to advanced countries, let alone to their own situation ten years earlier. As capital flows recovered again after 2009, the weakness of the links between flows and fundamentals was evident, while much blame was directed at the FED’s quantitative easing policies. It is on the basis that the IMF has opened the way for some forms of capital controls (Ostry et al., 2011). Indeed the IMF (2012) official position on capital account management opens the way, although very limited and subject to several conditions, for capital account management:

“For countries that have to manage the macroeconomic and financial stability risks associated with inflow surges or disruptive outflows, a key role needs to be played by macroeconomic policies, including monetary, fiscal, and exchange rate management, as well as by sound financial supervision and regulation and strong institutions. In certain circumstances, capital flow management measures can be useful. They should not, however, substitute for warranted macroeconomic adjustment.”

5. Critical views on financial globalisation

Alongside the development of the consensus views on financial globalisation, the heterodox traditions of economics have also assessed capital flows and their impact on emerging and developing economies. This section will review such contributions by firstly looking at models of Minskyan boom-bust cycles in the context of emerging markets crisis. It will proceed to analyse the heterodox criticisms of the mainstream foreign capital-growth nexus, and present alternative views. Then it will analyse the implication of such alternative theories for global imbalances and the rise of foreign exchange reserves. Finally, it will look at the theory of currency hierarchies and its relation to capital flows.

Much like in the mainstream, a first line of inquiry has sought to analyse emerging markets currency and financial crises, following the events in the late 1990s. The typical “boom and bust” dynamics of such crises, coupled with the progressive deterioration of balance sheets makes Hyman Minsky’s “financial instability hypothesis” a particularly suitable framework of analysis. The literature applying the FIH in the context of emerging markets crises is extremely vast (Taylor, 1998; Kregel, 1998; Palma, 1998; Dymski et al., 1999; De Paula and Alves, 2000; Arestis and Glickman, 2002; Schroeder, 2002; Grabel, 2003; Cruz et al., 2006; Onaran, 2007; Frenkel and Rapetti, 2009). All these papers present a similar story of the emerging countries crisis, where capital flows are an additional element of financial instability. Domestic financial liberalisation reforms, which usually precede the beginning of a boom phase, have the effect of rising interest rates and generally making domestic returns attractive for investors. Once the capital account is liberalised, the high return spread induces both domestic and foreign players to finance themselves in foreign currency to invest in domestic currency assets. As capital flows grow, the liquidity in financial markets flourishes and asset prices increase, which in turn attract more capital flows in a positive-feedback fashion. At the same time capital flows appreciate the real-exchange rate, which slowly deteriorate the country’s current account and external financial position. The boom also starts to make the balance sheets of many economic units in the country more and more fragile. Awareness of the country’s deteriorating fundamentals and currency

overvaluation spreads, and investors start to limit their exposures. This in turn slows the boom, which further deteriorates the financial structure of more economic units. At some point, either a domestic economic event – such as the failure of a major financial institution – or policy shock – such as the sudden relinquishment of an exchange rate peg by the central bank – or the decision of foreign investors to speculate against the currency, spreads the panic: capital flows suddenly stop and turn negative. Financial fragility becomes a widespread financial crash as the currency depreciates, generating extremely serious issues for all borrowers in foreign currencies, and in turn for the whole economy.

These views present a powerful narrative against the predominant “moral hazard” view of emerging countries crisis. As Palma (1998) claims, “over-lending” and “over-borrowing” may be reinforced by distortions in incentives and regulations, but are essentially endogenous components of a free-market economy. The *endogenous* character of the crisis is presented as the key distinguishing element of Minskyan approaches to emerging markets crises vis-à-vis standard approaches. Arestis and Glickman (2002, p. 255) vividly makes this point:

“[...] whilst there may be some common ground, the differences are crucial. The most striking of these relates to the question of whether the source of the Asian crisis was endogenous or exogenous and the related issue of the coincidence or otherwise of financial liberalisation and financial crisis. A further crucial difference is that whilst [the conventional views] hold one group of actors or another, lenders borrowers or the authorities, our Minskyan thesis incorporates all of them into an endogenous interpretation of the crisis. We may conclude therefore that ours is more general approach.”

Capital account liberalisation is therefore criticised as a policy move that favours the rise of a boom-bust cycle in emerging countries. And conversely, capital account management is advocated as a way to avoid or limit the effects of the crises¹⁰.

The heterodox criticism towards free capital movements was however not only confined within the issue financial crises. The conventional understanding of the finance-growth

¹⁰ See Grabel (2003) for a comprehensive review and assesment of such policy proposals.

nexus, upon which all the various strands of financial liberalisation policies are based upon, was criticised heavily by Niskanen and Stein (2003). The authors consider these views, according to which the financial system is there to channel funds from units in deficits to units in surplus and any problems arising within it are due to various forms of informational problems, as static and impoverished. They contrast them with a view, based on the works of Keynes, Minsky and Schumpeter, where finance is a central component of capitalist accumulation and endogenously creates the potential for instability, since uncertainty is pervasive and generates systemic risks, as opposed to idiosyncratic risks created by moral hazard. Therefore instead of adopting a “plumbing” approach that simply aims to correct the distortions of an otherwise sound system, countries should seek to reform the “architecture” of their financial system. This entails a vast reorientation of institutions that together enable financial circuits to better intersect with circuits of production, in direct contrast to policies of financial and capital account liberalisation, which favoured short-term profit orientation and risk-taking in financial markets and discouraged productive investment.

In this sense the traditional balance of payment distinctions between debt and direct investment flows becomes less important, as no type of capital flows does by definition end up within the productive side of the economy. Indeed, some authors have argued that FDI, which even critics of financial globalisation such as Stiglitz (2000) considered positively, can be as ineffective to spur growth and just as dangerous a form of external exposure as short-term capital flows (Singh, 2003).

A systematic theoretical critique of the foreign capital-growth link was made by Bresser-Pereira, 2002 and Bresser-Pereira and Gala (2009) and in a very recent paper by Arestis and Resende (2015). Running a current account deficit does not bring an acceleration of accumulation, since in general it will appreciate the real exchange rate, increasing income and domestic consumption. In this sense foreign saving will simply replace the decline of domestic saving, and foreign debt is essentially financing consumption rather than investment. Only if investment opportunities that make the marginal propensity to consume fall, will income from foreign capital flows be spent in investment, and thus contribute to a sustainable high-growth pattern. This condition is found to be rare though, such that the low

growth of Brazil since the 90's is attributed precisely to the policy shift in favour of foreign-savings growth strategy (Bresser-Pereira, 2002).

This argument is very similar to the critique of financial globalisation by Rodrik and Subramanian (2009), on the basis of the investment-constraint vs saving-constraint argument. An important difference though is that Rodrik and Subramanian's analysis is based on a loanable funds model: in the saving-constrained economy, capital flows increase the supply of "investable resources", thereby reducing the interest rate and spurring investment. Developing countries are investment-constrained not because of a fundamental demand-constraint on growth, but because there are some institutional weaknesses or because there are large learning externalities in investment. To the contrary, the primary purpose of Arestis and Resende (2015) is to show that the FISF (finance-investment-saving-finance) circuit, which relies on the traditional Keynesian proposition that investment drives saving is valid even in the open-economy. In open-economy with non zero-elasticity of import and export to the exchange rate, when the exchange rate appreciates, exports decrease and imports increase. If domestic investment – i.e. the demand for capital goods - stays at the same level, there will be at least a partial part of capital goods imported that is not matched by exports. This gap, which is reflected by the current account deficit, increases saving in the other country. Investment therefore determines saving even in the open economy but it may not necessarily generate domestic saving: it may generate saving abroad. The real exchange rate becomes in this sense a distributional variable between domestic and foreign saving.

Indeed a criticism that applies to the conventional approaches to financial globalisation is their reliance on loanable funds theory. Real interest rates at the global level are assumed to be determined as the equilibrium between the global supply and demand for loanable funds (Perraton, 2012). In a very influential paper Borio and Disyatat (2011) criticise the conventional excess savings view of global imbalances. They argue that such view confuses saving, which is unspent income, with financing, a cash-flow concept indicating a flow of funds. In the open-economy context this is reflected by confusion between net and gross flows: net flows are simply the financial counterpart of trade and income factors, while gross flows are all flows of funds moving across borders. Current account data do not necessarily

provide any indication about how investment is financed, nor is it conversely warranted to connect any specific gross flow to the current account.

Bibow (2010, p.6) makes a very similar point in his criticism of global imbalances:

“Simply put, in the context of monetary production economies the supposed excess saving (or: saving glut) can only arise together with the corresponding excess spending being done by someone else, somewhere.”

Such excess spending arose in the US, which experienced by a consumer-led boom, driven by the expansion of private-credit especially in the form of mortgage. These phenomena have been fuelled by financial innovation and encouraged by the expansionary monetary policy of the Federal Reserve. The resulting “global dollar glut” spilled over to other countries in the world. Most of it however returned to the US in the form of reserves accumulation.

In another paper Bibow (2008) considers the desirability of such arrangements from the point of view of developing countries. While undoubtedly this accumulation has costs and may be sometimes related to some form of mercantilist strategy, it raises more fundamental doubts about capital account openness. Notwithstanding the weak relations between foreign capital flows and growth, the current pattern of these flows, which are simply recycled into low yield US assets, is of little benefit for these countries. While this seems somewhat preferable to the risky building up of current account deficits that preceded the late 90's crises, it is nonetheless a very distorted system, where developing countries essentially play the role of providers of high-return assets for foreign rentiers. It is preferable in this sense to have a comprehensive system of capital account management. Even the supposed “collateral benefits” could be achieved by allowing only selective range of long-term capital flows that match the needs of the country, and importing selective services that could improve the efficiency of the country.

The accumulation of foreign exchange reserves is the focus of scholars working in the Marxist political economy tradition (Painceira, 2009; Lapavitsas, 2009). Developing countries in the era of financialisation have accumulated vast reserves, either to maintain their trade competitiveness or to shield themselves from financial crises. The role of the US dollar as “quasi-world money”, that is the ultimate means of payment to settle international

transactions, makes the purchase of safe US public debt securities the easiest way to accumulate reserves. These analyses underline the exploitative character of such an accumulation:

“Issuing quasi-world-money has become an international mechanism for the rich to extract value from the poor in the context of financialisation and free capital flows. In this sense, reserve accumulation is an exploitative process, a form of tribute accruing passively to the issuer of quasi-world money.” (Painceira, 2009, p. 21)

Reserve accumulation is also seen as a key channel of transmission between international finance and domestic financialisation. The central banks operations reserve accumulation and subsequent sterilisation have created a pool of domestic liquidity for domestic banks, which enabled the expansion of their balance sheets (Painceira, 2010; Painceira, 2012). Gabor (2010) analyses the situation of Eastern European countries, and highlights the role of central banks sterilisation bonds in creating the pool of liquidity that banks used to engage in a range of risky, such as foreign currency lending to households, or effectively speculative activities, including carry trade and currency arbitrage. This situation made the central banks actions to face the post-2008 crisis more difficult, since liquidity provision could have the conflicting effects of providing relief to the financial system and creating incentives for currency speculations in an already unstable environment.

Furthermore, the new configuration of financial globalisation, with more sound “fundamentals” and reserve accumulation by emerging markets, does not seem to have reduced the cyclicity of capital flows. As Akyüz (2012) shows, since 2002 the positive relation between capital flows, asset prices and exchange rates in emerging markets has kept intact, with an even closer co-movement across different countries: equity markets boomed and real exchange rates towards the dollar appreciated considerably between 2000 and 2008 and crashed together in the aftermath of the Lehman Brothers collapse, only to recover in a new boom since 2009. The much more solid structure of these economies, such as the current account surpluses or small deficits, “sound” fiscal situations, the much smaller incidence of currency mismatches and substantial levels of foreign exchange

reserves, has avoided the catastrophic consequences of previous crisis, but could not prevent the sudden stop in capital flows, asset price deflation and sharp currency devaluation.

Brazil's situation during the crisis is emblematic. As Kaltenbrunner (2010) and Paineira and Kaltenbrunner (2009) show, despite solid fundamentals the country experienced one of the world's largest currency depreciation. The rapid integration of the country has made the Brazilian Real one of the most traded emerging currencies, turning it into a financial asset itself. The external vulnerabilities, given by a large stock of liabilities to foreign investors, were key in determining the seriousness of the crisis. In this sense capital flow themselves, regardless of their precise form, create a vulnerability to foreign-driven shocks.

The underlying reasons for this can be found in the theory of currency hierarchies (Terzi, 2005; Kaltenbrunner, 2011; Andrade and Prates, 2013). Accordingly, exchange rates can be understood on the basis of Keynes' theory of the own rate of interest: internationally each currency has a different liquidity premium, based on its role in the international financial system. This points to a hierarchy between currencies that, better fulfilling their role internationally, have a higher liquidity premium, and currencies that have lower liquidity premia, and therefore have to compensate this with higher returns or holding gains. A currency's position in the hierarchy depends on the ability to use it as a store of value. Kaltenbrunner (2011) adds to this view, by arguing that a currency's liquidity premium depends on its capability to be used to face liabilities. This depends on mainly two factors: the first is the external stock of liabilities, the second is the ability of the country's issuing the currency to meet the commitments through the foreign exchange productivity and the "institutional" liquidity of its financial markets. In such a situation, capital flows emerging markets are doomed to be characterised by boom-bust cycles, since investment in their assets will by definition occur in a phase of lower liquidity preference and higher return seeking (Biancareli, 2009; Biancareli, 2011). Once again, the policy implication of such an analysis would point towards the possibility of capital controls that may reduce the exposure of emerging countries and thus allow them to reduce the negative effects that their lower position in the hierarchy in which they are relegated by the asymmetries of global financial system. This theories are in clear contrast with mainstream theories of financial

globalisation: while both theories point out the weaker position of developing countries in the global financial system, a deeper and more liquid financial system as a result of foreign capital is a source of potential instability, as opposed to a potential way to overcome the “original sin”.

In conclusion the different heterodox schools have pointed out many different features about capital flows and financial globalisation that differ from the conventional understanding.

Firstly, the financial and currency crises of the late 1990s that affected many developing and emerging countries are not (only) caused by moral hazard problems, but rather the normal endogenous results of a Minskyan boom-and-bust cycle, driven by capital flows following the liberalisation of the current account.

Secondly, the finance and growth nexus upon which the supportive views of capital account liberalisation are based is flawed, since again it does not accurately represent the endogenous links between finance and the real economy. Moreover it is generally based on a loanable fund analysis, which sees savings as a requirement for and determinants of investment, rather than the other way around. Foreign flows, including FDI, are not a requirement for investment.

Thirdly, the issue of foreign reserve accumulation and global imbalances is not wholly understood by conventional theories, which recognise the costs but essentially rationalise the phenomenon. In contrast, heterodox scholars have emphasised the extremely inefficient and exploitative nature of such arrangements, which rely on the premises that capital flows must be accepted, despite the evidence that they do not contribute at all to development, especially in the current situation.

Fourthly, the crisis and related boom and bust cycle have further shown that strong fundamentals do not shield emerging countries from instability. Rather it points towards the structural hierarchical nature of the current international financial system.

Overall the literature seem to be pointing towards a radical reform of the international financial system, with capital controls and institutional reforms that limit capital flows, and ensure that finance best serve the needs of development.

Unsurprisingly the new IMF stance towards capital controls is seen by many as “too moderate” and insufficient to face the problems of modern financial globalisation (Fritz and Prates, 2013; Akyüz, 2012; Gallagher and Ocampo, 2013).

6. Conclusion

This paper has reviewed several strands of literature on the changing impacts of finance in developing and emerging countries, particularly in relation to their evolution of the past three decades.

The rising importance of finance in the past twenty years has affected developing and emerging countries. The first big push for finance came with the financial repression school, according to which a heavily regulated financial system was the primary cause of low saving and therefore low growth in developing countries. The more recent concept of “financial development” further pushed the cause of more finance as a determinant of growth, and even pro-poor growth. As a result policies were implemented to liberalise the financial markets and promote its development, including the entrance of foreign financial institutions and policies to promote financial inclusion of the more marginalised strata of societies.

At the international level, capital account liberalisation was promoted, on the basis of similar arguments, i.e. that foreign savings could promote growth and welfare gains for developing countries. However the recurrence of crises and the scant evidence of the growth benefits of financial openness have cast doubt about its desirability. The global financial crisis has further confirmed these doubts, so that even the IMF now opens to the possibility of capital controls. Nevertheless, the consensus view maintains that such measures should be limited in scope and time, since eventually financial globalisation retains its beneficial impact, although possibly through indirect channels.

Heterodox scholars have put forward a more critical outlook of both trends. At the domestic level, the supposed beneficial impact of financial development are contrasted with theories and evidence of the increasing “financialisation” in many of such countries. While different authors have pointed out different aspects, most of them ultimately point out

negative impacts on economic development and inequalities, with finance often flourishing at the expense of other more productive sectors and the resulting negative impacts on employment and productivity.

Moreover many authors argue that capital account liberalisation is clearly destabilising, irrespective of prudential regulations and sequencing, as demonstrated by the role it had in contributing to the several financial and currency crises experienced by developing and emerging countries. On the other hand, the scarcity of evidence of positive impacts of capital flows on growth should not come as a surprise, since the basic loanable fund model upon which the arguments about such positive impacts are based, is unable to adequately describe the modern global financial system. Moreover the conventional views overlook the asymmetric and hierarchical nature of the current global financial system. In such a situation, there is little reason for developing countries to have a fully open capital account, and therefore capital controls must be a permanent policy tool rather than a temporary measure.

In conclusion, the current configuration of finance domestically and internationally has failed to deliver substantial benefits for developing countries. The contrast between conventional and “heterodox” views rests on the precise causes of such failure. While conventional views points to imperfections and policy distortions, heterodox scholars point to the inherent and endogenous nature of such problems in a capitalist economy. Given the severity of the recent financial crisis, and the apparent impossibility for mainstream macroeconomics to account for it, it is possible to argue that the latter views may be more well suited to explain the failures of modern finance, and possibly to fix it to promote development for all.

Bibliography

Aitken, R. (2010) 'Ambiguous Incorporations: Microfinance and Global Governmentality', *Global Networks*, **10**, 223–243.

Aitken, R. (2013) 'The Financialization of Micro-Credit', *Development and Change*, **44**, 473–499.

- Aizenman, J., Chinn, M. D. and Ito, H. (2010) 'The Emerging Global Financial Architecture: Tracing and Evaluating New Patterns of the Trilemma Configuration', *Journal of International Money and Finance*, **29**, 615–641.
- Aizenman, J. and Lee, J. (2007) 'International Reserves: Precautionary Versus Mercantilist Views, Theory and Evidence', *Open Economies Review*, **18**, 191–214.
- Akyüz, Y. (2012) 'The Boom in Capital Flows to Developing Countries : Will It Go Bust Again?', *Ekonomi-tek - International Economics Journal*, **1**, 63–96.
- Andrade, R. P. and Prates, D. M. (2013) 'Exchange Rate Dynamics in a Peripheral Monetary Economy', *Journal of Post Keynesian Economics*, **35**, 399–416.
- Araújo, E., Bruno, M. and Pimentel, D. (2012) 'Financialization against Industrialization: A Regulationist Approach of the Brazilian Paradox', *Revue de la régulation. Capitalisme, institutions, pouvoirs*.
- Arestis, P. and Demetriades, P. (1997) 'Financial Development and Economic Growth: Assessing the Evidence', *The Economic Journal*, **107**, 783–799.
- Arestis, P. and Glickman, M. (2002) 'Financial Crisis in Southeast Asia: Dispelling Illusion the Minskyan Way', *Cambridge Journal of Economics*, **26**, 237–260.
- Arestis, P. and Resende, M. F. da C. (2015) 'Fiscal Policy and the Substitution Between National and Foreign Savings'. *Journal of Post Keynesian Economics*, **37**, 436–458
- Ashman, S., Fine, B. and Newman, S. (2011) 'The Crisis in South Africa: Neoliberalism, Financialization and Uneven and Combined Development', *Socialist Register*, **47**.
- Balassa, B. (1989) *The Effects of Interest Rates on Savings in Developing Countries*, Policy Research Working Paper Series, The World Bank.
- Bandiera, O., Caprio, G., Honohan, P. and Schiantarelli, F. (2000) 'Does Financial Reform Raise or Reduce Saving?', *Review of Economics and Statistics*, **82**, 239–263.
- Barth, J. R., Caprio Jr., G. and Levine, R. (2004) 'Bank Regulation and Supervision: What Works Best?', *Journal of Financial Intermediation*, **13**, 205–248.
- Beck, T. and Demirgüç-Kunt, A. (2006) 'Small and Medium-Size Enterprises: Access to Finance as a Growth Constraint', *Journal of Banking & Finance*, **30**, 2931–2943.
- Beck, T., Demirgüç-Kunt, A. and Levine, R. (2007) 'Finance, Inequality and the Poor', *Journal of Economic Growth*, **12**, 27–49.
- Beck, T., Levine, R. and Loayza, N. (2000) 'Finance and the Sources of Growth', *Journal of Financial Economics*, **58**, 261–300.

- Becker, J., Jager, J., Leubolt, B. and Weissenbacher, R. (2010) 'Peripheral Financialization and Vulnerability to Crisis: A Regulationist Perspective', *Competition and Change*, **14**, 225–247.
- Bencivenga, V. R. and Smith, B. D. (1991) 'Financial Intermediation and Endogenous Growth', *The Review of Economic Studies*, **58**, 195–209.
- Bernanke, B. S. (2005) 'The Global Saving Glut and the U.S. Current Account Deficit', *Speech*.
- Bhagwati, J. (1998) 'The Capital Myth: The Difference between Trade in Widgets and Dollars', *Foreign Affairs*, **77**, 7–12.
- Biancareli, A. M. (2009) 'International Liquidity Cycles to Developing Countries in the Financial Globalization Era'. In *XI Reunión de Economía Mundial*, Huelva.
- Biancareli, A. M. (2011) 'Brazil, Developing Economies and Private International Capital Flows: The (new) Challenges in the Post-Crisis Scenario'. In *15th conference of the Research Network Macroeconomics and Macroeconomic Policies (FMM): 'From crisis to growth?*, Berlin.
- Bibow, J. (2008) 'Insuring Against Private Capital Flows: Is It Worth the Premium? What Are the Alternatives?', *International Journal of Political Economy*, **37**, 5–30.
- Bibow, J. (2010) *Bretton Woods 2 Is Dead, Long Live Bretton Woods 3?*, Economics Working Paper Archive, Levy Economics Institute, The.
- Blanchard, O. J. and Milesi-Ferretti, G. M. (2009) *Global Imbalances: In Midstream?*, IMF staff position note, International Monetary Fund.
- Borio, C. and Disyatat, P. (2011) *Global Imbalances and the Financial Crisis: Link or No Link?*, BIS Working Paper, Bank for International Settlements.
- Boyer, R. (2000) 'Is a Finance-Led Growth Regime a Viable Alternative to Fordism? A Preliminary Analysis', *Economy and Society*, **29**, 111–145.
- Bresser-Pereira, L. C. (2002) 'Brazil's Quasi-Stagnation and the Growth Cum Foreign Savings Strategy', *International Journal of Political Economy*, **32**, 76–102.
- Bresser-Pereira, L. C. and Gala, P. (2009) 'Why Foreign Savings Fail to Cause Growth', *International Journal of Political Economy*, **38**, 58–76.
- Caballero, R. J., Farhi, E. and Gourinchas, P.-O. (2006) *An Equilibrium Model of*, Working Paper, National Bureau of Economic Research.
- Caballero, R. J., Farhi, E. and Gourinchas, P.-O. (2008) 'An Equilibrium Model of "Global Imbalances" and Low Interest Rates', *The American Economic Review*, **98**, 358–393.

- Calvo, G. A. and Reinhart, C. M. (2002) 'Fear of Floating', *The Quarterly Journal of Economics*, **117**, 379–408.
- Caprio, G. and Honohan, P. (2001) *Finance for Growth: Policy Choices in a Volatile World*, World Bank Publications.
- Cetkovic, P. (2011) *Credit Growth and Instability in Balkan Countries: The Role of Foreign Banks*, Discussion Paper, Research on Money and Finance, SOAS.
- Chang, H.-J. (2000) 'The Hazard of Moral Hazard: Untangling the Asian Crisis', *World Development*, **28**, 775–788.
- Chang, K.-S. (2010) 'Proletarianizing the Financial Crisis: Jobless Industrial Restructuring and Financialized Poverty in Post-Crisis South Korea'. In *First International Conference in Political Economy*, IIPPE.
- Cho, H. (2010) *South Korea's Experience with Banking Sector Liberalisation*, Research Report, SOMO.
- Claessens, S., Demirgüç-Kunt, A. and Huizinga, H. (2001) 'How Does Foreign Entry Affect Domestic Banking Markets?', *Journal of Banking & Finance*, **25**, 891–911.
- Clarke, G. R. G., Cull, R. and Shirley, M. M. (2005) 'Bank Privatization in Developing Countries: A Summary of Lessons and Findings', *Journal of Banking & Finance*, **29**, 1905–1930.
- Correa, E., Vidal, G. and Marshall, W. (2012) 'Financialization in Mexico: Trajectory and Limits', *Journal of Post Keynesian Economics*, **35**, 255–275.
- Corsetti, G., Pesenti, P. and Roubini, N. (1999) 'Paper Tigers?: A Model of the Asian Crisis', *European Economic Review*, **43**, 1211–1236.
- Crotty, J. and Lee, K.-K. (2002) 'A Political-economic Analysis of the Failure of Neo-liberal Restructuring in Post-crisis Korea', *Cambridge Journal of Economics*, **26**, 667–678.
- Cruz, M., Amann, E. and Walters, B. (2006) 'Expectations, the Business Cycle and the Mexican Peso Crisis', *Cambridge Journal of Economics*, **30**, 701–722.
- Cull, R., Demirgüç-Kunt, A. and Morduch, J. (2009) 'Microfinance Meets the Market', *The Journal of Economic Perspectives*, **23**, 167–192.
- Dehejia, R. H. and Gatti, R. (2005) 'Child Labor: The Role of Financial Development and Income Variability across Countries', *Economic Development and Cultural Change*, **53**, 913–932.

- Demetriades, P. O. and Hussein, K. A. (1996) 'Does Financial Development Cause Economic Growth? Time-Series Evidence from 16 Countries', *Journal of Development Economics*, **51**, 387–411.
- Demir, F. (2007) 'The Rise of Rentier Capitalism and the Financialization of Real Sectors in Developing Countries', *Review of Radical Political Economics*, **39**, 351–359.
- Demir, F. (2009a) 'Capital Market Imperfections and Financialization of Real Sectors in Emerging Markets: Private Investment and Cash Flow Relationship Revisited', *World Development*, **37**, 953–964.
- Demir, F. (2009b) 'Financial Liberalization, Private Investment and Portfolio Choice: Financialization of Real Sectors in Emerging Markets', *Journal of Development Economics*, **88**, 314–324.
- Demirgüç-Kunt, A., Beck, T. and Honohan, P. (2008) *Finance for All?: Policies and Pitfalls in Expanding Access*, World Bank Publications.
- Demirgüç-Kunt, A. and Detragiache, E. (1998) *Financial Liberalization and Financial Fragility*, Policy Research Working Paper Series, The World Bank.
- Demirgüç-Kunt, A. and Levine, R. (2008) *Finance, Financial Sector Policies, and Long-Run Growth*, Policy Research Working Paper Series, The World Bank.
- Diaz-Alejandro, C. (1985) 'Good-Bye Financial Repression, Hello Financial Crash', *Journal of Development Economics*, **19**, 1–24.
- Dollar, D. and Kraay, A. (2002) 'Growth Is Good for the Poor', *Journal of Economic Growth*, **7**, 195–225.
- Dornbusch, R. and Reynoso, A. (1989) *Financial Factors in Economic Development*, Working Paper, National Bureau of Economic Research.
- Dymski, G. A. (1999) *Asset Bubbles and Minsky Crises in East Asia: A Spatialized Minsky Approach*, Research paper, Department of Economics, University of California-Riverside.
- Edison, H. J., Klein, M. W., Ricci, L. A. and Sløk, T. (2004) 'Capital Account Liberalization and Economic Performance: Survey and Synthesis', *IMF Staff Papers*, **51**, 220–256.
- Eichengreen, B. (2001) 'Capital Account Liberalization: What Do Cross-Country Studies Tell Us?', *The World Bank Economic Review*, **15**, 341–365.
- Eichengreen, B. and Hausmann, R. (1999) *Exchange Rates and Financial Fragility*, Working Paper, National Bureau of Economic Research.

- Eichengreen, B. and Mussa, M. (1998) 'Capital Account Liberalization and the IMF', *Finance and Development*, **35**.
- Epstein, G. A. (2005) 'Introduction: Financialization and the World Economy'. In Epstein, G. A. (ed) *Financialization And The World Economy*, Edward Elgar Publishing, pp. 3–16.
- Ergunes, N. (2009) *Global Integration of the Turkish Economy in the Era of Financialisation*, Discussion Paper, Research on Money and Finance, SOAS.
- Farhi, M. and Borghi, R. A. Z. (2009) 'Operations with Financial Derivatives of Corporations from Emerging Economies', *Estudos Avançados*, **23**, 169–188.
- Fine, B. (2010) 'Neoliberalism as Financialisation'. In Saad-Filho, A. and Yalman, G. L. (eds) *Economic transitions to neoliberalism in middle-income countries: policy dilemmas, economic crises, forms of resistance*, London; New York, Routledge, pp. 11–23.
- Fischer, S. (1998) 'Capital Account Liberalization and the Role of the IMF'. In *Should the IMF Pursue Capital-Account Convertibility?*, Princeton University.
- Fischer, S. (2001) 'Is the Bipolar View Correct?', *The Journal of Economic Perspectives*, **15**, 3–24.
- Frenkel, R. and Rapetti, M. (2009) 'A Developing Country View of the Current Global Crisis: What Should Not Be Forgotten and What Should Be Done', *Cambridge Journal of Economics*, **33**, 685–702.
- Fritz, B. and Prates, D. M. (2013) *The New IMF Approach to Capital Account Management and Its Blind Spots*, Desigualdades.net working paper series.
- Fry, M. J. (1978) 'Money and Capital or Financial Deepening in Economic Development?', *Journal of Money, Credit and Banking*, **10**, 464–475.
- Fry, M. J. (1997) 'In Favour of Financial Liberalisation', *The Economic Journal*, **107**, 754–770.
- Gabor, D. (2010) '(De)financialization and Crisis in Eastern Europe', *Competition and Change*, **14**, 248–270.
- Gallagher, K. P. and Ocampo, A. (2013) 'Gallagher and Ocampo: A Critique of the IMF's New View on Capital Controls', accessed at <http://us5.campaign-archive2.com/?u=74907371d448da77287940e4d&id=4414225578&e=2387854313> on September 27, 2013.
- Gourinchas, P.-O. and Jeanne, O. (2007) *Capital Flows to Developing Countries: The Allocation Puzzle*, Working Paper, National Bureau of Economic Research.

- Grabel, I. (2003) 'Averting Crisis? Assessing Measures to Manage Financial Integration in Emerging Economies', *Cambridge Journal of Economics*, **27**, 317–336.
- De Gregorio, J. and Guidotti, P. E. (1995) 'Financial Development and Economic Growth', *World Development*, **23**, 433–448.
- Honohan, P. (2004) *Financial Development, Growth, and Poverty: How Close Are the Links?*, Policy Research Working Paper Series, The World Bank.
- IMF (2012) *The Liberalization and Management of Capital Flows - An Institutional View*, IMF policy paper, International Monetary Fund.
- Jalilian, H. and Kirkpatrick, C. (2002) 'Financial Development and Poverty Reduction in Developing Countries', *International Journal of Finance & Economics*, **7**, 97–108.
- Jeanne, O. (2007) 'International Reserves in Emerging Market Countries: Too Much of a Good Thing?', *Brookings Papers on Economic Activity*, **2007**, 1–55.
- Jeanne, O. and Rancière, R. (2011) 'The Optimal Level of International Reserves For Emerging Market Countries: A New Formula and Some Applications*', *The Economic Journal*, **121**, 905–930.
- Jeanne, O., Subramanian, A. and Williamson, J. (2012) *Who Needs to Open the Capital Account?*, Peterson Institute.
- Kalinowski, T. and Cho, H. (2009) 'The Political Economy of Financial Liberalization in South Korea: State, Big Business, and Foreign Investors', *Asian Survey*, **49**, 221–242.
- Kaltenbrunner, A. (2010) 'International Financialization and Depreciation: The Brazilian Real in the International Financial Crisis', *Competition and Change*, **14**, 296–323.
- Kaltenbrunner, A. (2011) *Currency Internationalisation and Exchange Rate Dynamics in Emerging Markets: A Post Keynesian Analysis of Brazil*, PhD, SOAS, University of London.
- Kaminsky, G. L., Reinhart, C. and Vegh, C. A. (2003) *The Unholy Trinity of Financial Contagion*, Working Paper, National Bureau of Economic Research.
- Karwowski, E. (2012) 'Financial Operations of South African Listed Firms: Growth and Financial Stability in an Emerging Market Setting'. In *Conference paper n. 6, III Conferencia internacional do IESE*, Mozambique.
- King, R. G. and Levine, R. (1993) 'Finance, Entrepreneurship and Growth', *Journal of Monetary Economics*, **32**, 513–542.
- King, Robert G. and Levine, R. (1993) 'Finance and Growth: Schumpeter Might Be Right', *The Quarterly Journal of Economics*, **108**, 717–737.

- Klein, M. W. and Olivei, G. P. (2008) 'Capital Account Liberalization, Financial Depth, and Economic Growth', *Journal of International Money and Finance*, **27**, 861–875.
- Kose, M. A., Prasad, E., Rogoff, K. S. and Wei, S.-J. (2006) *Financial Globalization: A Reappraisal*, Working Paper, National Bureau of Economic Research.
- Kregel, J. A. (1998) *Yes, 'It' Did Happen Again - A Minsky Crisis Happened in Asia*, Macroeconomics, EconWPA.
- Krugman, P. (2000) *Fire-Sale FDI*, NBER Chapters, National Bureau of Economic Research.
- Lane, P. R. and Milesi-Ferretti, G. M. (2007) 'The External Wealth of Nations Mark II: Revised and Extended Estimates of Foreign Assets and Liabilities, 1970-2004', *Journal of International Economics*, **73**, 223–250.
- Lapavitsas, C. (2009) *Financialisation Embroils Developing Countries*, Discussion Paper, Research on Money and Finance, SOAS.
- Lapavitsas, C. and dos Santos, P. L. (2008) 'Globalization and Contemporary Banking: On the Impact of New Technology', *Contributions to Political Economy*, **27**, 31–56.
- Lee, J.-Y. (2012) *Financialization and Transformation of the East Asian Economies*, IIPPE Financialisation Working Paper.
- Levine, R. (1996) 'Foreign Bank, Financial Development, and Economic Growth.' In *International Financial Markets: Harmonization versus Competition*, Washington D.C., AEI.
- Levine, R. (1997) 'Financial Development and Economic Growth: Views and Agenda', *Journal of Economic Literature*, **35**, 688–726.
- Levine, R. (1999) 'Law, Finance, and Economic Growth', *Journal of Financial Intermediation*, **8**, 8–35.
- Levine, R. (2005) 'Chapter 12 Finance and Growth: Theory and Evidence'. In Philippe Aghion and Steven N. Durlauf (ed) *Handbook of Economic Growth*, Elsevier, pp. 865–934.
- Levine, R., Loayza, N. and Beck, T. (2000) 'Financial Intermediation and Growth: Causality and Causes', *Journal of Monetary Economics*, **46**, 31–77.
- Levy-Yeyati, E. and Sturzenegger, F. (2007) *Fear of Appreciation*, Policy Research Working Paper Series, The World Bank.
- Lucas, R. E. (1990) 'Why Doesn't Capital Flow from Rich to Poor Countries?', *The American Economic Review*, **80**, 92–96.

- Marois, T. (2011) 'Emerging Market Bank Rescues in an Era of Finance-Led Neoliberalism: A Comparison of Mexico and Turkey', *Review of International Political Economy*, **18**, 168–196.
- McKinnon, R. I. (1973) *Money and Capital in Economic Development*, Brookings Institution Press.
- McKinnon, R. I. and Pill, H. (1998) 'International Overborrowing: A Decomposition of Credit and Currency Risks', *World Development*, **26**, 1267–1282.
- McKinnon, R. and Schnabl, G. (2004) 'The East Asian Dollar Standard, Fear of Floating, and Original Sin', *Review of Development Economics*, **8**, 331–360.
- Mishkin, F. S. (1999) 'Lessons from the Asian Crisis', *Journal of International Money and Finance*, **18**, 709–723.
- Morduch, J. (1999) 'The Microfinance Promise', *Journal of Economic Literature*, **37**, 1569–1614.
- Morduch, J. (2000) 'The Microfinance Schism', *World Development*, **28**, 617–629.
- Newman, S. A. (2009) 'Financialization and Changes in the Social Relations along Commodity Chains: The Case of Coffee', *Review of Radical Political Economics*, **41**, 539–559.
- Nissanke, M. (2010) 'Commodity Markets and Excess Volatility: Sources and Strategies to Reduce Adverse Development Impacts'. In *Conference 'Promoting Beneficial Global Financial and market synergies', Common fund for commodity*.
- Nissanke, M. and Stein, H. (2003) 'Financial Globalization and Economic Development: Toward an Institutional Foundation', *Eastern Economic Journal*, **29**, 287–308.
- Obstfeld, M. (1998) *The Global Capital Market: Benefactor or Menace?*, Working Paper, National Bureau of Economic Research.
- Obstfeld, M. (2009) 'International Finance and Growth in Developing Countries: What Have We Learned?', *IMF Staff Papers*, **56**, 63–111.
- Obstfeld, M. and Rogoff, K. (2009) 'Global Imbalances and the Financial Crisis: Products of Common Causes', *Proceedings*, 131–172.
- Obstfeld, M., Shambaugh, J. C. and Taylor, A. M. (2008) *Financial Stability, the Trilemma, and International Reserves*, Working Paper, National Bureau of Economic Research.
- Onaran, O. (2007) 'Capital Flows, Turbulences, and Distribution: The Case of Turkey', *European Journal of Economics and Economic Policies: Intervention*, **4**, 353–374.

- Ostry, J. D., Ghosh, A. R., Chamon, M. and Qureshi, M. S. (2011) 'Capital Controls: When and Why?', *IMF Economic Review*, **59**, 562–580.
- Pagano, M. (1993) 'Financial Markets and Growth: An Overview', *European Economic Review*, **37**, 613–622.
- Painceira, J. P. (2009) *Developing Countries in the Era of Financialisation: From Deficit Accumulation to Reserve Accumulation*, Discussion Paper, Research on Money and Finance.
- Painceira, J. P. (2010) 'The Financial Crisis of 2007-09 and Emerging Countries: The Political Economy Analysis of Central Banks in the Brazilian and Korean Economies', *Competition and Change*, **14**, 271–295.
- Painceira, J. P. (2012) *Financialisation, Reserve Accumulation and Central Bank in Emerging Economies: Banks in Brazil and Korea*, Discussion Paper, Research on Money and Finance.
- Painceira, J. P. and Kaltenbrunner, A. (2009) *New Forms of External Vulnerability: Brazil in the Global Financial Crisis*, Discussion Paper, Research on Money and Finance.
- Palma, G. (1998) 'Three and a Half Cycles of "mania, Panic, and [asymmetric] Crash": East Asia and Latin America Compared', *Cambridge Journal of Economics*, **22**, 789–808.
- De Paula, L. F. R. and Alves, A. J. (2000) 'External Financial Fragility and the 1998-1999 Brazilian Currency Crisis', *Journal of Post Keynesian Economics*, **22**, 589–617.
- Paulani, L. M. (2010) 'Brazil in the Crisis of the Finance-Led Regime of Accumulation', *Review of Radical Political Economics*, **42**, 363–372.
- Perraton, J. (2012) 'Globalization'. In Toporowski, J. and Michell, J. (eds) *Handbook of Critical Issues in Finance*, Edward Elgar Pub, pp. 139–144.
- La Porta, R., Lopez-de-Silanes, F. and Shleifer, A. (2002) 'Government Ownership of Banks', *The Journal of Finance*, **57**, 265–301.
- Powell, J. (2013) *Subordinate Financialisation: A Study of Mexico and Its Non-Financial Corporations*, PhD, London, SOAS, University of London.
- Prasad, E. S. and Rajan, R. G. (2008) 'A Pragmatic Approach to Capital Account Liberalization', *The Journal of Economic Perspectives*, **22**, 149–172.
- Prasad, E. S., Rajan, R. G. and Subramanian, A. (2007) *Foreign Capital and Economic Growth*, Working Paper, National Bureau of Economic Research.
- Rethel, L. (2010) 'Financialisation and the Malaysian Political Economy', *Globalizations*, **7**, 489–506.

- Riesco, M. (2009) 'The End of Privatized Pensions in Latin America', *Global Social Policy*, **9**, 273–280.
- Rodrik, D. (1998) 'Who Needs Capital-Account Convertibility?' In *Should the IMF Pursue Capital-Account Convertibility?*, Princeton University.
- Rodrik, D. and Subramanian, A. (2009) 'Why Did Financial Globalization Disappoint?', *IMF Staff Papers*, **56**, 112–138.
- Rossi, J. L. J. (2011) *Hedge or Speculation? Evidence of the Use of Derivatives by Brazilian Firms during the Financial Crisis*, Ibmec Working Paper, Insper Working Paper, Insper Instituto de Ensino e Pesquisa.
- Ruziev, K. (2012) 'Emerging Markets'. In Toporowski, J. and Michell, J. (eds) *Handbook of Critical Issues in Finance*, Edward Elgar Pub, pp. 77–84.
- Dos Santos, P. L. (2011) 'A Policy Wrapped in "Analysis"— The World Bank's Case for Foreign Banks'. In Bayliss, K., Fine, B., and Van Waeyenberge, E. (eds) *The Political Economy of Development: The World Bank, Neoliberalism and Development Research*, London, Pluto.
- Dos Santos, P. L. (2013) 'A Cause for Policy Concern: The Expansion of Household Credit in Middle-Income Economies', *International Review of Applied Economics*, **27**, 316–338.
- Schroeder, S. K. (2002) *A Minskian Analysis of Financial Crisis in Developing Countries*, SCEPA Working Paper, Schwartz Center for Economic Policy Analysis (SCEPA), The New School.
- Seo, H. J., Kim, H. S. and Kim, Y. C. (2012) 'Financialization and the Slowdown in Korean Firms' R&D Investment*', *Asian Economic Papers*, **11**, 35–49.
- Shaw, E. S. (1973) *Financial Deepening in Economic Development*, New York, Oxford University Press.
- Shin, H. Y. (2012) *Essays on the Causes and Consequences of the Asian Financial Crisis--- Financialization, Stagnant Corporate Investment, and Alternative Measures of the Asian Labor Markets*, Ph.D., Ann Arbor, United States.
- Singh, A. (2003) 'Capital Account Liberalization, Free Long-Term Capital Flows, Financial Crises and Economic Development', *Eastern Economic Journal*, **29**, 191–216.
- Stiglitz, J. E. (1994) 'The Role of the State in Financial Markets'. In *Proceedings of the World Bank Annual Conference on Development Economics*, World Bank.
- Stiglitz, J. E. (2000) 'Capital Market Liberalization, Economic Growth, and Instability', *World Development*, **28**, 1075–1086.

- Stiglitz, J. E. and Weiss, A. (1981) 'Credit Rationing in Markets with Imperfect Information', *The American Economic Review*, **71**, 393–410.
- Stockhammer, E. (2004) 'Financialisation and the Slowdown of Accumulation', *Cambridge Journal of Economics*, **28**, 719–741.
- Sumaria, S. (2010) *Social Insecurity: The Financialisation of Healthcare and Pensions in Developing Countries*, Bretton Woods Project.
- Tan, J. (2013) 'Running out of Steam? Manufacturing in Malaysia', *Cambridge Journal of Economics*, bet032.
- Tang, K. and Xiong, W. (2010) *Index Investment and Financialization of Commodities*, Working Paper, National Bureau of Economic Research.
- Taylor, L. (1998) 'Capital Market Crises: Liberalisation, Fixed Exchange Rates and Market-Driven Destabilisation', *Cambridge Journal of Economics*, **22**, 663–676.
- Terzi, A. (2005) *International Financial Instability in a World of Currencies Hierarchy*, DISCE - Quaderni dell'Istituto di Economia e Finanza, Università Cattolica del Sacro Cuore, Dipartimenti e Istituti di Scienze Economiche (DISCE).
- Thornton, J. (1991) 'The financial repression paradigm: a survey of empirical research / la repression financière: une etude des resultats empiriques', *Savings and Development*, **15**, 5–18.
- Tyson, J. (2011) 'The Financialisation of Microfinance'. In *14th Berlin Roundtables on Transnationality*, Irmgard Coninx Foundation.
- Tyson, J. (2012) 'Microfinance'. In Toporowski, J. and Michell, J. (eds) *Handbook of Critical Issues in Finance*, Edward Elgar Pub, pp. 225–236.
- Ventimiglia, L. (2012) 'Commodity Markets'. In Toporowski, J. and Michell, J. (eds) *Handbook of Critical Issues in Finance*, Edward Elgar Pub, pp. 49–55.
- Wichterich, C. (2012) 'The Other Financial Crisis: Growth and Crash of the Microfinance Sector in India', *Development*, **55**, 406–412.
- Williamson, J. and Mahar, M. (1998) *A Survey of Financial Liberalization*, International Finance Section, Dept. of Economics, Princeton University.
- World Bank (1991) 'World Development Report 1989: Financial Systems and Development. Oxford University Press, New York for The World Bank 1989; 155 Pp. plus Tables', *Public Administration and Development*, **11**, 187–188.

Wray, L. R. (2008) *The Commodities Market Bubble: Money Manager Capitalism and the Financialization of Commodities*, Economics Public Policy Brief Archive, Levy Economics Institute, The.

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

THE ABSTRACT OF THE PROJECT IS:

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

THE PARTNERS IN THE CONSORTIUM ARE:

| Participant Number | Participant organisation name | Country |
|---------------------------|--|----------------|
| 1 (Coordinator) | University of Leeds | UK |
| 2 | University of Siena | Italy |
| 3 | School of Oriental and African Studies | UK |
| 4 | Fondation Nationale des Sciences Politiques | France |
| 5 | Pour la Solidarite, Brussels | Belgium |
| 6 | Poznan University of Economics | Poland |
| 7 | Tallin University of Technology | Estonia |
| 8 | Berlin School of Economics and Law | Germany |
| 9 | Centre for Social Studies, University of Coimbra | Portugal |
| 10 | University of Pannonia, Veszprem | Hungary |
| 11 | National and Kapodistrian University of Athens | Greece |
| 12 | Middle East Technical University, Ankara | Turkey |
| 13 | Lund University | Sweden |
| 14 | University of Witwatersrand | South Africa |
| 15 | University of the Basque Country, Bilbao | Spain |



This project has received funding from the European Union's Seventh Framework Programme for research, technological development and demonstration under grant agreement no 266800



The views expressed during the execution of the FESSUD project, in whatever form and or by whatever medium, are the sole responsibility of the authors. The European Union is not liable for any use that may be made of the information contained therein.

Published in Leeds, U.K. on behalf of the FESSUD project.