

Inaugural Speech

Globalisation and Financialisation: Implications for Developing Countries

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The concept of concentration and centralization of production in Marx's *Capital* was further developed by Baran and Sweezy in their *Monopoly Capital*, in which they described advanced capitalism as an economic and social order dominated by giant, monopolistic (or oligopolistic) corporations. Surplus (value) could be expected to rise in this system as genuine price competition is avoided, together with continually rising productivity. But chronic lack of effective demand became the main economic constraint at this monopoly stage of capitalist development. Expected profits on new investments, under conditions of low effective demand turned out to be weak, and corporations tended to refrain from carrying out new investments. With the presence of idle plant and equipment business would be deterred from investing in still more, capacity. As real wages were rising less than productivity wage-based consumption too would be chronically weak relative to society's capacity to produce. Under monopoly capital the long-term growth trend would therefore, be sluggish, characterized by a wide, and even widening, underemployment gap. The normal state of the economy at monopoly capital stage, Baran and Sweezy argued, was stagnation or an underlying trend of slow growth. Economic stagnation, in this sense, was not meant technological or consumer-product stagnation. Continuing development of production technology only increased the productive potential of the system, intensifying its over-accumulation tendency.

In the first half of the 1970s capitalism fell into a crisis of inflation combined with stagnation. This situation was called one of stagflation – a term newly coined and added to the language during this period. As inflation was interpreted as the real culprit, there were attempts at economic restructuring aimed basically at keeping inflation under control. This is what systems of thinking called monetarism, supply-side economics, neo-liberalism and so on focussed on. The Age of Hayek replaced the Age of Keynes. Using debt as leverage, a period of neoliberal globalization was ushered in over the third world as well. As Sweezy argued in 1997 there were important underlying trends in the history of capitalism since the mid-1970s: (1) the slowing down of the overall rate of growth; (2) the worldwide proliferation of monopolistic (or oligopolistic) multinational corporations; (3) the financialisation of the capital accumulation process and (4) globalization as a phenomenon, reflecting the new transformation of imperialism.

Financialisation, as a term came up in political economy discourse, as mentioned, in the mid-1990s but became more widely used since the onset of the global financial crisis in 2007. It has its roots primarily in heterodox economics and Marxist political economy, but is being adopted also by the orthodoxy. The idea of dominance of finance capital in mature stages of capitalist development is found in earlier writings. In its broadest sense financialisation refers to the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the global economy and domestic and international activities of individual economies.

There are several ways in which financialisation can be understood. First, it refers to the astonishing expansion and proliferation of financial markets over the past thirty years, during which the ratio of global financial assets to global GDP has been estimated to have risen three times, from 1.5 to 4.5. Second, financialisation has been associated with the expansion of speculative assets at the expense of mobilising and allocating resources for investment in real activity. Third, financialisation has been understood as both the expansion and the proliferation of a bewildering range of seemingly infinite supply of exotic and opaque financial instruments and services – futures, options, derivatives and so on. Fourth, at a systemic level, financialisation involves the dominance of finance over industry – the shift in the centre of gravity of the capitalist economy from production to finance. Profits of financial companies in the US are estimated to have jumped from below 5 per cent of total corporate profits after tax in 1982 to 41 per cent in 2007.

Corporations and wealthy investors have surpluses at their disposal. In order to preserve and expand this money capital in the face of declining investment opportunities in the real economy, it is poured into speculation using a variety of assets. Financial institutions facilitated this through creation of needed financial instruments. This “casino economy” continued over decades, interrupted by credit crunches, and central banks intervening at these times of crisis as lenders of last resort. The more the central banks were effective at preventing the financial system from collapsing, the more they set things up for bigger crises down the line.

Even non-financial corporations have been caught up in the process of financialisation. They have come to be increasingly valued on the basis of the performance of their shares on financial markets rather than on productive criteria. These companies have started deriving greater profitability from their financial, as opposed to their productive, activities. This is reflective of a shift in corporate governance and restructuring in the US, UK and parts of Europe in the 1980s and 1990s to what has become known as the ‘shareholder value movement’. The idea is that, left to the manager, resources may be inefficiently allocated or guided by motives of personal advancement. Companies should therefore ‘maximise shareholder value’ since a higher return to shareholders

represents a manifestation of greater efficiency in allocation of resources. In addition, managers' interests should be aligned with those of shareholders by the latter being remunerated through share and stock options. A shift in firms' decisions on capital allocation from a principle of 'retain and invest' to 'downsize and distribute' has also been noted. These developments have come with lower rates of investment by firms and, at the same time, with higher debt ratios of firms. In other words, firms often have taken out loans to buy back shares to increase shareholder value. All this produced an increased short-termism in the management of even non-financial corporations.

Financialisation however, could not alter the underlying problem of stagnation within production. Growth of finance relative to the real economy led to financial bubbles that threatened to burst. If these became too big, they could overwhelm central banks and the treasury departments producing serious debt deflation – a concept developed by Irvin Fisher as long ago as 1933 to develop an explanation of depressions.

Financialisation is about the appropriation of surplus, accelerating the concentration of wealth in the hands of what is now popularly known as 'the one percent'. As Ben Fine argued on the basis of a review of critical literature, financialisation widens its influence, both directly and indirectly, to cover both economic and social policy. It places more aspects of economic and social life at the risk of volatility from financial instability.

The processes involved in financialisation have their corresponding impacts on developing countries, thus adversely influencing their prospects for real sustainable development. The main purpose of this talk is to raise some of the more important elements in the influence of financialisation on developing countries.

Stagnation and financialisation at the centre of the capitalist world economy are structurally related to new openings for export-driven industrialization in the low-wage periphery. This allowed some degree of industrialization in the periphery – export oriented industry at lower levels in the global value chain of certain products (e.g. clothing). But the long term impacts of these export-oriented industrialisation episodes in developing countries after the 1970s have not been very promising in terms of sustainability. The available empirical research on this is limited. But some analysts use this limited evidence to argue that, contrary to what globalisation protagonists predicted, financialisation tendencies appear not to be permitting those developing countries which commenced export oriented industry at lower levels in the value chain to gradually engage in up-stream (higher value added) activities of the value chain. These countries are therefore not moving on to a level of sustainable industrial and economic development (as NICs in East Asia did in the 1960s and 1970s). Such upgrading prospects have all but disappeared in the process of financialisation of global capitalism. This happened through structural changes that have taken place in the strategies of lead

firms in the capitalist centres of the world which coordinate and control supply chains and suppliers in developing countries.

Increased concentration of lead firms in value chains (e.g. coffee and clothing) that are open to developing countries has led to a growing asymmetry in power between buyers in the centre and sellers in the periphery. This has allowed for the shift in the distribution of income/value-added from developing country producers towards lead firms. Women working in the clothing industry have been disproportionately affected as a result of more stringent demands of buyers (both in terms of price and flexibility). This has spurred the reconfiguration of subcontracting into more tenuous and arms-length relations and more precarious labour contracts. In the case of coffee, financialisation has meant more volatile prices for coffee and weakened bargaining power for coffee producers and marketing firms in producing countries. This was exacerbated by the dismantling of the national coffee marketing boards as part of structural adjustment policies (in Uganda). Faced with more volatile prices, local middlemen have little alternative but to buy as low as possible from the farmer in order to buffer against sudden falls in the world price. This means that farmers receive a low farm-gate price regardless of whether world markets are going up or not.

In the wake of the global financial crisis, it has become evident that countries and regions that have avoided the worst effects have been those which have shielded themselves from the processes of financialisation, and where a strong manufacturing base has been developed and maintained (China and Germany being prime examples). But in the period after the 1980s the bulk of the developing countries did not succeed in achieving such levels of sustainable industrialisation except for a few large countries like Brazil, China and India. But monopolistic organisations in the spheres of finance, technology, communications, strategic natural resources and military power continue to hold onto the reins of power in the global economy keeping the developing world under their economic control.

There are certain international dimensions of financialisation showing its impacts on developing economies. International financial liberalization was promoted on the promise of generating (foreign) investment-based growth. Financial globalization, it was argued, would allow capital to be allocated to its most efficient use. In particular it would benefit developing countries. These ideas were behind IMF programmes of neo-liberalism imposed on developing countries. However, financial globalization has failed to live up to expectations as on average, capital has been flowing 'uphill', i.e. from poor to rich countries.

The liberalization of international capital flows has led also to increased volatility of exchange rates, often culminating in violent exchange rate crises. Financial

globalization and liberalization seems to have led, also to long-lasting international imbalances. As a consequence of financial globalisation, exchange rate movements are increasingly determined by capital flows rather than by economic fundamentals such as current account positions. Indeed episodes of massive capital inflows followed by sudden and sharp capital flow reversals – swings of capital inflows (‘capital flow bonanza’) followed by capital flow reversals – resulting in exchange rate crises have been a common feature particularly in emerging and developing countries.

At the same time, the whole era of neoliberal financialisation has been tied to the third world debt crisis, leading to new financial dependencies. Even China and India, despite their huge economic advances, have not been able to break out of the imperial systems of foreign exchange and financial control, which leave them often passively responding to initiatives determined primarily within “the triad” of the United States, Europe, and Japan. Emerging economies are now massive dollar creditors, yet the U.S. economy lies outside their control and continues to dictate the terms, reinforcing their reliance on exports and external outlets as safe havens for their surplus from exports. Financialisation, with its attendant problems, is growing apace in Asia as well.

Financialisation also has had profound effects on income distribution through the following channels: (a) rise in ‘rentier income’, i.e. interest and dividend income as well as capital gains; (b) rise of incomes in the financial sector, most notably in the form of bonuses; (c) shifting of the power balance between capital and labour leading to a decline in wage shares. The adverse impacts growing relative inequalities create on social and political stability and peace do not augur well for sustainable development of these countries.