

FESSUD

FINANCIALISATION, ECONOMY, SOCIETY AND SUSTAINABLE DEVELOPMENT

Working Paper Series

No 146

International and Domestic Financialisation in Middle
Income Countries:
The Brazilian Experience

Annina Kaltenbrunner and Juan Pablo Paineira,

International and Domestic Financialisation in Middle Income Countries: The Brazilian Experience

Authors: Annina Kaltenbrunner¹ and Juan Pablo Paineira²

Affiliations of authors: 1 Leeds University Business School

2 Central Bank of Brazil

Abstract: This paper analyses the recent changes in financial practices and relations in emerging capitalist economies (ECEs) on the basis of using the example of Brazil. It argues that in ECEs these financial transformations, which are akin to those observed in Core Capitalist Economies (CCEs) summarised under the heading of financialisation, are fundamentally shaped by their integration into a financialised and structured world economy. Moreover, this integration takes place in a subordinated way. The paper draws on the multidisciplinary framework of international currency hierarchies in order to analyse this subordinated financial integration and tendency toward financialisation. It shows how the existence of a hierarchic international monetary system has changed the financial behaviour of domestic economic agents as well as the structure of the domestic financial system. In doing so, the paper focuses on two specific channels. The first channel highlights the phenomenon of reserve accumulation and the changing behaviour of domestic banks. The second channel concerns the ECEs' sustained external vulnerability and the impact of such vulnerability on the operations of Brazilian firms. The paper shows that not only have these financial transformations been shaped by ECEs' subordinated financial integration, but also that these financialisation tendencies have contributed to cementing existing hierarchies and deepening uneven economic development.

Key words: Financialisation; Currency Hierarchy; Reserve Accumulation; External Vulnerability; Brazil



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



Date of publication as FESSUD working paper: February, 2016

Journal of Economic Literature classification: F32; F56; E52

Contact details: a.kaltenbrunner@leeds.ac.uk; jppainceira@gmail.com

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.

Website: www.fessud.eu

1. Introduction

This paper analyses the financialisation process in Emerging Capitalist Economies (ECEs) with a focus on the example of Brazil. It argues that in these countries financialisation is fundamentally shaped by their integration into a financialised and structured international monetary and financial system. Moreover, this integration takes place in a subordinated way.¹ Put differently, it is their international financialisation that drives domestic financialisation, which is mediated through their subordinated position in the international economy.

The paper attempts to make four contributions to the literature on financialisation.

First, while there is by now an extensive literature on financialisation in Core Capitalist Economies (CCEs), there is still very little systematic analysis of the distinctive nature of financialisation in ECEs. A growing number of papers shows the variegated nature of financialisation in ECEs (Araujo et al., 2012, Demir, 2008, Demir, 2009, Ergüneş, 2012, Ertürk, 2003, Gabor, 2013, Paineira, 2008, Powell, 2013, Rethel, 2010, Bonizzi, 2013, Correa et al., 2012, Doucette and Seo, 2011, Karacimen, 2014, Levy-Orlik, 2012)². Most of these contributions attempt to map financialisation phenomena encountered in CCEs *onto* ECEs. However, there is very little systematic analysis as to how financialisation in ECEs might differ in important ways. This paper seeks to fill this gap. Rather than inquiring into distinct financialisation phenomena, it examines the distinctive nature of the financialisation *process* in these countries.

Second, by emphasising the driving role of the international economy, the paper responds to recent calls for an integration of the analyses of financialisation with that of financial globalisation and cross-border capital flows (Christophers, 2012, French et al., 2011, Montgomerie, 2008). Christophers (2012) shows the potentially fundamental changes an international perspective makes in the analysis of financialisation. Moreover, we follow up on Christophers' implicit message that researchers need to take into account not only international networks of value but also what position countries assume in these networks.³ We also stress the bi-directional nature of this relationship. Whereas international

integration shapes domestic financialisation, it is this same domestic financialisation that, in turn, facilitates and exacerbates international financialisation.

Third, the analytical framework we draw on to analyse ECEs' subordinated financialisation is the hierarchic structure of the international monetary system. In this sense, we also provide an explicit monetary foundation for the analysis of financialisation – an effort that has been conspicuously missing from large parts of the literature on financialisation (Christophers, 2015).⁴ Finally, the paper presents more detail on the thesis that financialisation cements and exacerbates uneven development (Pike and Pollard, 2010). Whereas the role of international integration in exacerbating spatial differences has traditionally been analysed in the context of the real economy, namely, processes of trade and foreign direct investment, we extend this literature to the new reality of financialised international markets.

To illustrate our arguments we present two channels through which Brazil's international financial integration and its subordinated nature have shaped domestic financialisation. The first is the phenomenon of reserve accumulation and the financialisation of banks. The second is Brazil's continued vulnerability to large and sudden capital and exchange rate movements (largely independent of domestic economic conditions), which have promoted the financialisation of Brazilian Non-financial corporations (NFCs).

Following this introduction, section 2 discusses in more detail the literatures with which we are engaging. Section 3 describes the international financialisation of Brazil. Section 4 details how this international financialisation and its subordinated nature have conditioned the domestic financialisation phenomena in Brazil. Section 5 concludes with some directions for future research.

2. Financialisation, World Money and the International Financial System

There is by now an extensive literature on financialisation in CCEs. The phenomena investigated include the increased holdings of financial assets by non-financial corporations (NFCs) (Orhangazi, 2008, Stockhammer, 2004), the importance of shareholder value

(Lazonick and O'Sullivan, 2000), the rising involvement of households in predatory debt relations (Aalbers, 2008, Montgomerie, 2009, Dymski, 2010), the changing income pattern of banks from deposits and lending to fees and commissions (Erturk and Solari, 2007), and the financialisation of everyday life (Langley, 2008). Moreover, authors have pointed to the importance of the variegated nature of these phenomena (Engelen et al., 2010, Lapavitsas and Powell, 2013).

This analysis of financialisation has traditionally taken place within the canvas of the nation state. This applies to both the characteristic elements of financialisation and the factors which have given rise to them. As to the former, there is surprisingly little analysis of the international aspect of financialisation. International financialisation is most frequently associated with financial globalization, which in turn is equated to a rise in international cross-border flows (Stockhammer, 2010).⁵ As to the latter, the sources of financialisation have been firmly embedded in national economic developments.

One strand of explanation traces this condition back to the stagnation of late capitalism. These accounts locate financialization in the falling rate of profit and the consequent contraction of demand which required a series of financial activities for the continuance of the system (Magdoff and Sweezy, 1972, Magdoff and Sweezy, 1987, Brenner, 2004, Arrighi, 1994, Foster and Magdoff, 2008). Other explanations emphasize the determining role of government policies which have unleashed the forces of finance, which has led in turn to an unprecedented increase in financial markets and financial actors (Duménil and Lévy, 2004, Aglietta and Breton, 2001, Boyer, 2000, Crotty, 2005, Stockhammer, 2004, Orhangazi, 2008). However, as shown by Christophers (2012), an accurate understanding of financialisation can be gained only through addressing the international nature of capitalist finance. He writes: "It is surely the case, therefore, that any identification of fundamental structural shifts in capitalism, such as "financialisation", must be framed at the international scale – or, at the very least, must critically interrogate the full array of international capital flows in which individual "national economies" such as the US are embedded" (p. 279).⁶

Christophers' analysis echoes earlier calls by Montgomerie (2008), Guttman (2008) and French et al. (2011), who note the absence of an explicit consideration of the role of the

international financial system and the global financial networks for financialisation phenomena. As French, Leyshon et al. (2011) point out: "...prioritizing the nation state as container of economic activity fails to adequately take into account the central part played by the emergence in the 1980s of a new international financial system founded upon disintermediated and securitized financial capitalism run mainly through New York and London..." (p.11).

For Guttmann (2008) financial globalisation is a "powerful force remaking the world into something more than just the sum of its parts". Indeed, as Montgomerie (2008) makes very clear, once we consider the global financial networks within and through which financialisation takes place, relations of power and inequality--that is, the conditions under which inclusion in these networks takes place--gain centre stage. She writes: "....the US and the UK are powerful global financial centres which occupy a unique place within the global economy. What happens in Anglo-American financial markets has profound ramifications for the rest of the world, a point not often considered in the financialisation literature.For instance, different political and institutional complexes allow global finance to proliferate through unequal relations between new emerging markets and well-established global financial centres" (p. 248).

Compared to the analysis of financialisation in CCEs, the analysis of such a trend in ECEs is still relatively limited. A small yet growing literature points to financialisation phenomena that are similar to those observed in CCEs. For example, Rethel (2010), Powell (2013), and Akkemik and Özen (2014) show the increased involvement of ECE NFCs with financial markets. Gabor (2010) and Karacimen (2015) point to the increased integration of ECE households into credit markets through consumption and/or housing loans. Finally, a few authors have noted the changing behaviour of ECE banks, which have increasingly generated funding through market activities rather than deposits (Painceira, 2011, dos Santos, 2009). This literature remains largely grounded in the analysis of financialisation in CCEs, attempting to map phenomena encountered in the Anglo-Saxon core onto ECEs. There is very little systematic analysis of the distinctive nature of financialisation both between and across ECEs. Moreover, few papers inquire into the determinants of these processes⁷. Although,

several papers note the driving role of ECEs' insertion into the global economy, there is no explicit and systematic consideration of how this (asymmetric and subordinated) insertion interplays with domestic financialisation phenomena (though Powell (2013) is an exception). ECEs' asymmetric and subordinated international integration, which constrains national strategies of development and self-determination, has traditionally been analysed in the context of trade relations and foreign direct investment. For example, Latin American structuralists highlighted ECEs' declining terms of trade, technological lagging and dependence on capital intensive imports, processes that caused systemic vulnerabilities and imposed constraints on the periphery (Fischer, 2015).

These "real" economic relations have been complemented by the growth in international financial markets and ECEs' integration into them. However, ECEs' financial integration – just as their real integration – has been characterised by relations of dependency, subordination and hierarchies. As highlighted by structuralists, "peripherals' vulnerabilities and constraints are historical, in that they necessarily change and evolve over time in synergy with change and evolution in the centres" (Fischer 2015, p. 704). Surprisingly, there is very little research which updates the insights by structuralists and dependency theorists to confront the new reality of financialised and globalised financial markets.

In order to analyse these subordinated international financial relations, we draw on the analytical framework of international currency hierarchies. The notion that different sovereigns' currencies have a varying status in the international monetary system is a core concept in International Political Economy (IPE). For example, Susan Strange (1971) distinguishes between top, master, negotiated and neutral currencies. Whereas the top currency is the uncontested leader of the international monetary system due to its economic attractiveness, master and negotiated currencies maintain an internationally prominent role either through direct coercion (e.g., through colonial relations), financial or political inducements. Neutral currencies are economically attractive but do not have the means to become top currencies (Strange, 1971, Helleiner, 2008, Otero-Iglesias and Steinberg, 2013) In a similar vein, Cohen (1998) distinguishes seven currency categories (top, patrician, elite, plebeian, permeated, quasi and pseudo) depending on their international use and influence.

The determinants of a currency's international monetary position vary in this IPE literature. Whereas market (or economic) based approaches highlight the attractiveness of a currency for private economic actors through its stability of domestic value (primarily due to sound macroeconomic fundamentals) and liquidity and transactional networks (Helleiner, 2008, Helleiner and Kirshner, 2009), instrumental and geopolitical approaches stress the economic and political decisions of foreign governments (Minh, 2012). Institutional approaches (e.g. Eichengreen, 2010) place the spotlight on the willingness and ability of a currency's issuer to safeguard its market based attractiveness.

The IPE literature also shows the "exorbitant privilege" and freedom of action that accompanies a currency's position on the top of the hierarchy. The country with the top currency can defer external adjustment and afford external disequilibria which "...anywhere else, elicit a withering "disciplinary" response from international financial markets" (Kirshner, 2008: 424). This position is accompanied by an unrivalled macroeconomic policy space, which is extended by a lack of alternatives and grants the top currency latent value stability (Cohen, 2006, McNamara, 2008).⁸

Interestingly, though, while there is an extensive discussion on the advantages (and costs) of being the top currency, very little is said about the implications of being on the lower level of the hierarchy. Although some of the advantages of the top currency might represent analogous disadvantages for currencies at the lower end of the hierarchy, this condition does not necessarily need to be case. Issuers of subordinated currencies might face their own constraints (or indeed advantages) which cannot be necessarily inferred from the peculiar conditions of the top currency.⁹

Moreover, there is little discussion on the implications that a currencies' position in the international monetary hierarchy has for the structure of a country's economy. Whereas it offers rich insights into how the structural characteristics of an economy influence currency status, there is little analysis on the reverse question. For our purpose this analysis is of particular interest with regards to financial market structure. Whereas the literature places considerable emphasis on the importance of deep and liquid financial markets in order to support the currency's internationalization (and also its reserve currency status) (Kenen,

2009, IMF (International Monetary Fund), 2011), there is little analysis of how this reserve currency status affects economic agents' financial relations.¹⁰

Some more discussion on ECEs' position in the international currency hierarchy and the implications of this position for macroeconomic policy, capital accumulation and financial structure can be found in the Post Keynesian literature (Herr, 1992, Herr and Hübner, 2005, Prates and Andrade, 2013, De Conti et al., 2014, Kaltenbrunner, 2015, Dow, 1999, Fritz, 2002, Fritz et al., 2014). Referring explicitly to Keynes' analysis of money in a closed economy, these authors believe that currencies' differential position in the international monetary system is determined by economic actors' assessment of their international liquidity premium relative to other currencies. As in the market-based approach of IPE, Post Keynesians assert that the international liquidity premium is determined by currencies' ability to act as international stores of value and units of account.¹¹

These differences in currencies' international liquidity premia, in turn, have crucial implications for monetary policy autonomy, external vulnerability and financial structure. As in Keynes' closed economy, "money rules the roost". This implies that monetary conditions in the country with the highest liquidity premium will influence monetary conditions across the globe. The consequent impact will be felt more in those currencies with lower liquidity premia, that is, ECEs currencies. In a similar vein, any change in international liquidity preference can lead to large capital and exchange rate movements that are largely independent of economic conditions as (international) investors seek protection in the currency with the highest liquidity premium. Again, the impact will be felt stronger, the lower a currency's liquidity premium is.

The lower liquidity premium of ECE currencies also requires them to offer higher interest rates in order to maintain investor demand. Thus, in this view, the notorious carry trade is not an aberration from perfectly working markets, but a structural feature of the international monetary system. Finally, in terms of financial structure, Post Keynesians have argued that rather than a result of their inflationary past (as in the "original sin" hypothesis), ECEs' inability to issue domestic currency debt is a direct result of their subordinated position in the international monetary hierarchy.

These peculiar features of ECEs' monetary dynamics, in turn, have crucial implications for capital accumulation and financial structure, which in turn perpetuate their monetary subordination. Whereas the high interest rates weigh on domestic investment demand and growth, the capital flow and exchange rate volatility further undermine the ability of ECE currencies to perform international monetary functions. The prevalence of foreign currency debt has a similar affect, since any change in the exchange rate will increase ECEs' real debt burden. This result might not only lead to short-term solvency and liquidity concerns, but also require the future generation of foreign exchange and with it a devalued exchange rate, which would further weigh, in turn, on these currencies' international liquidity premia (Keynes' transfer problem). Despite the centrality of financialisation and international monetary dynamics in Post Keynesian economics, these two topics have not yet been linked.¹² Although analysed very little in the Marxist literature, the concept of the hierarchy of currencies can be understood through the category of world money in this literature¹³. World-money is a necessary development in the evolution of money in the global capitalist market (Itoh and Lapavitsas, 1999, Marx, 1967). According to (Marx, 1976: 242), world money "serves as the universal means of payment, as the universal means of purchase, and as the absolute social materialisation of wealth as such." Countries hoard an internationally acceptable means of payment in order to be able to participate and compete in international markets (trade and capital markets). The more capitalist accumulation spreads across the world economy, the more countries need to have access to the world's money reserves (or international reserves as a proxy). Consequently, there is a connection between the hoarding of world money, mediated by the international financial system, and domestic financial conditions¹⁴. In this regard, world money is a necessary development for (and of) international capital accumulation.

In this vein, world money supports the world market, and provides the organising impetus for the institutional structure that the world market lacks when it is compared to domestic markets. For the same reason, world money crystallises tensions present in the world market, and becomes the focus of global crises. For instance, it is well known that the financial crises of the 1990s in ECEs manifested themselves as problems of liquidity or

solvency in world money. In this sense, given that they cannot issue world money, ECEs assume a subordinated role in relation to international finance¹⁵. In order to grasp the subordinated role of these economies in the international monetary system, it is necessary to discuss further the concept of the world market.

The world market is structurally different from the domestic market. The world market is the universal sphere of circulation of capital --of finance in particular-- in which there is a relation and interaction between national markets and the place where financial crises happen in the era of financialisation. This market has fewer homogenising mechanisms of law, institutional practice, custom and regulation than the domestic market and it also incorporates relations of power and national exploitation (Lapavitsas, 2006). Consequently, the role of money in the world market has a pronounced weight, significance and meaning.

The 2007-8 crisis became a global financial crisis, for example, due to the connection between financial operations (monetary and credit transactions) undertaken within the US financial system and the global financial system. These operations were denominated in the US dollar, which has the property of being quasi-world money¹⁶. This role of the dollar as world money creates a direct link between the issuer country's domestic sphere and the international financial sphere.

In addition, in contrast to the gold regime—when gold was the world money and global capitalist crises were characterized by sudden swings in gold hoards-- in the contemporary international financial system, holdings of world money have a more complex role. Gold (commodity money) has been restricted to a hoard of last resort, while the US dollar functions as quasi-world-money. One of the main challenges for political economy has been, in fact, to fully explain the role of the US dollar as world-money (Itoh, 2006).

The role of the US dollar as quasi-world money becomes apparent when comparing the flows of the US dollar during the period of crisis, moving mainly to developing countries, and gold flows in the previous international monetary arrangement. In both instances, the demand for protection against wealth loss led to a sudden rise in the demand for dollar or dollar-denominated assets and gold, respectively.

Consequently, in times of crisis the contradiction between the monetary system and the credit system is revealed as the demand for money (as money, not as capital) increases. In Marx's words "in times of squeeze, when credit contracts or ceases entirely, money suddenly stands as the only means of payment and true existence of value in absolute opposition to all other commodities" Marx (1972, p. 516). In the present international monetary arrangement, however, there is a rise in the demand for dollar denominated assets (credit-money), mainly for US public debt securities. Therefore, differently from movements in the gold era, when there was no clear group of beneficiaries in the international monetary system, the current arrangement has mainly one country as the issuer of world money.¹⁷ Thus the fact that world money is being issued by a sovereign state has considerable implications for the working of the international economy and, more importantly, has served to sustain the hierarchical nature of the international monetary system.

3. Defining Financialisation

The proliferation of the concept of financialisation and its increased "fuzziness" have led several authors to question the usefulness of the term (Michell and Toporowski, 2013, Christophers, 2015). For example, Christophers (2015) points to five limitations of the term 'financialisation', including doubts about its actual novelty and applicability to countries beyond the Anglo-Saxon heartland. Despite these shortcomings, we still believe that financialisation offers a useful analytical tool in providing a general benchmark against which variegation and its determinants can be investigated. The term highlights the continuously changing role of finance in economic and indeed in social life, whose manifestations, specificities and contradictions can be investigated in specific institutional, macroeconomic, spatial and social settings.

However, we do agree with Christophers that there is a compelling need for greater analytical and empirical precision about the concept of financialisation. In this paper, we use the interpretation of Lapavitsas (2014). He defines financialisation as the structural changes

in financial relations, practices and needs of key economic agents: banks, households, and non-financial corporations (NFCs). These changes are the outcome of alterations in real capital accumulation, which by themselves have promoted restructuring of production itself. The empirical phenomena that Lapavitsas observes in Core Capitalist Economies (CCEs), though in clearly variegated forms, (Lapavitsas and Powell, 2013) are: the increased incorporation of households into predatory credit relations through consumption credits and mortgages; the increased reliance of banks on fees and income from trading rather than from (productive) lending; the rise in bank funding from markets rather than deposit taking (including the phenomenal rise in repo markets); and the surging involvement of (large) NFCs with financial markets. In terms of balance sheets, on the asset side, this trend includes the increased holdings of financial assets. On the liability side, it refers to the fact that market funding has replaced bank funding.

As indicated above, the international dimension of financialisation has been far less explored and has frequently been equated to financial globalization.¹⁸ In this paper we define international financialisation as both a quantitative and qualitative change in the size and nature of international financial relations. Just as financialisation is more than just a quantitative increase in the size of the financial sector, international financialisation is more than just a rise in international capital flows. These capital flows have changed their form and have become more complex and varied, and have penetrated new economic and social areas.

As an illustration, Figure 1 shows the unprecedented increase in short-term capital flows to Brazil over the last decade.

Insert Figure 1 here

In Brazil, cumulative 12-months short-term capital flows surged from an outflow of US\$8bn at the beginning of 2000 to more than US\$60bn and US\$50bn at the end of 2007 and 2010 respectively. Brazil's total stock of outstanding short-term external liabilities reached US\$679 billion, or 46.1 % of GDP in June 2008 just before the failure of Lehman Brothers.

This condition compares to a stock of only 28% of GDP before the Brazilian crisis in 1999. Brazil's stock of short-term external liabilities stood at US\$883 billion or 39.7% of GDP in March 2011, before a further worsening of the Eurozone crisis.

In addition, these flows of capital experienced important qualitative changes. On the investor side, traditional ECE investors (such as banks and dedicated funds) have been complemented with a wide range of others actors, such as institutional investors (pension, mutual and insurance funds) and new types of mutual fund investors such as exchange-traded funds and macro hedge funds (Yuk, 2012, Jones, 2012, Aron et al., 2010). Given the enormous size of these financial investors, even a small reallocation of their portfolio shares can have a huge impact on capital flows to ECEs. Moreover, these different actors have diverse investment strategies and funding patterns, substantially increasing the complexity of foreign investment in the Brazilian economy.

On the asset side, these investors have become exposed to an increasingly complex set of domestic currency assets, including domestic currency sovereign bonds, equities, derivatives and the currency itself as in the notorious carry-trade phenomenon. For example, foreign investors' participation in the Brazilian stock market increased from below 25% at the end of 2003 to 37% in the first quarter of 2006. After a sharp drop in the first quarter of 2010, their participation recovered again to more than 50% at the end of 2014. Thus, over the last decade, foreign capital has permeated entirely new areas of Brazil's economic and, indeed, social life and by doing so – as the next section shows – fundamentally changed the country's economic and financial structure.

4. From International to Domestic Financialisation

4.1. Reserve Accumulation and the Financialisation of Banks and Households

Arguably one of the most substantial changes in international financial relations since the millennium is the vast accumulation of foreign exchange reserves by ECEs. The total stock of foreign exchange reserves in ECEs increased from US\$0.5 trillion in 2000 to US\$8.1 trillion

in 2014. Figure 2 shows the surge in foreign exchange reserves in Brazil, which increased from US\$50 billion in 2004 to US\$364 billion in 2014.

Insert Figure 2 here

Reserve accumulation can be considered a direct outcome of both ECEs' international financialisation and their subordinated nature. The trends in Brazil shown above illustrate that international capital flows to ECEs have far surpassed previous waves of international capital movements. The total capital inflows to ECEs increased from US\$200 billion in 2000 to US\$1.1 trillion in 2014 (IIF, 2015). Independent of their current account position, ECEs have been net recipients of capital inflows and, as a consequence such trends have often led to a substantial excess of foreign exchange for these countries.¹⁹ Rather than letting this excess be “absorbed” in the domestic economy, ECE central banks have accumulated a “war-chest” of foreign exchange reserves in order to protect themselves against sudden stops or future capital outflows²⁰. Being at the lower rungs of the international monetary hierarchy means that ECEs have to be prepared to face large and sudden flights into currencies with higher liquidity premia or into “world money”. Thus, extensive reserve accumulation is a necessary precaution to satisfy this demand and avoid an excessive impact on the domestic economy. However, this reserve accumulation has had crucial implications for the structure and behaviour of the domestic banking system. Table 1 presents a summary of the argument.

Insert Table 1 here

In order to control the possible macroeconomic effects of the monetary expansion from its foreign exchange purchases, the Brazilian central bank has engaged in extensive monetary sterilisation operations²¹. That is, it has undertaken a large amount of repurchase agreements (repos), through domestic public debt securities, with the domestic banking system in order to drain the excess of bank reserves. As can be seen in Table 1, the outstanding stock of repos increased from R\$58 billion in 2004 to R\$858 billion in 2014.

Through their portfolio management techniques, banks could then use these short-term assets to issue their own (short-term) liabilities.²² In other words, (Brazilian) banks used the sterilisation bonds to expand their own balance sheets. This additional borrowing, in turn, was used to inflate the asset side of their portfolio through, in particular, lending to consumption and households. Given the short-term nature of this borrowing, banks' assets also remained relatively short-term, leading to a displacement of long-term (risky) loans to the productive sector by short-term (less risky) household lending. This trend contributed to rising household financialisation.

Figure 3 shows the main four types of assets in the Brazilian banking system.

Insert Figure 3 here

One can observe the relatively strong increase in banks' inter-financial positions and other credits.²³ Inter-financial positions, which are essentially central banking repos, started to grow faster around the beginning of 2006 – the same time that short-term portfolio flows experienced their first substantial surge to Brazil. In addition, overall credit operations saw a continuous increase. The rise in credit operations is, in principle, beneficial to capital accumulation. Traditionally, the increase in banking credit is positively related to lending operations to the productive sector since companies are the main demanders of credit. However, as we will see below, the structure of bank credit has changed substantially over recent years.

Banks used these very liquid (and interest bearing!) assets to “leverage” and increase their own funding, thus expanding their balance sheets. Figure 4 shows the rise in banks' time deposits relative to other deposit categories.

Insert Figure 4 here

Time deposits are mainly composed of certificates of banking deposits. These certificates are securities issued by banks that can be classified as banks' own liabilities. All deposits

are banking liabilities in as much as banks have obligations to depositors. However, only liabilities issued by banks, such as certificates of deposit or financial debentures, can be considered as banks' own liabilities, because their issuance is primarily determined by the bank's portfolio decisions (while the other liabilities are to a large extent decided by the creditors or clients of the banks). Figure 4 shows that these deposits rose concurrent to the rise in capital inflows and the central bank repos on banks' balance sheets.

Finally, Figure 5 illustrates how the changing pattern in banks' funding influenced their credit allocations. It shows the dramatic switch in credit allocation from "productive" lending to industry to more short-term consumption and housing funding.

Insert Figure 5 here

As indicated above, banks' increased lending to households was intimately linked to their changing funding structure. As their liabilities became more short-term, banks tried to match the maturity of their funding with their asset positions. Household credit, which usually has a shorter maturity than manufacturing credit, allowed them to do so.²⁴ Over recent years, the stagnation in consumption credit has been more than compensated by real estate lending, primarily through providing mortgages to households.

Whereas Brazil's subordinated international financial integration has had crucial implications for its domestic financial structure, it was these same changes in the domestic financial system that further facilitated the international aspect of financialisation. More concretely, the short-term financial assets on domestic bank balance sheets reduced their risk to act as counterparties to foreign investors, thus stimulating further capital inflows. Repos allowed banks to easily access central bank liquidity through open market operations, thus reducing their balance sheet risk in times of market turmoil.²⁵

Finally, there are two important mechanisms through which the processes described above have exacerbated uneven development and cemented ECEs' subordinated international (monetary) position. First, reserve accumulation implies a constant resource transfer from developing countries to developed countries. Whereas ECE central banks hold low-yielding,

safe and liquid CCE sovereign bonds, foreign capital flows generate substantial returns which are repatriated abroad (Painceira, 2008). Indeed, as Yu (2013) shows for the case of China, the government is actually quite limited in how it can use these reserves given the need of the Bank of China to match, as much as possible, the reserve assets on its balance sheet with the domestic liabilities that it used to purchase these reserves, in addition to the domestic liabilities (i.e. bonds) issued to sterilize the monetary effects of these purchases. Second, the substitution of productive loans by household loans adversely affects capital accumulation, negatively weighing on ECEs' growth potential.

4.2. New Forms of External Vulnerability and Financialisation of Non-Financial Corporations (NFCs)

The second manifestation of ECEs' subordinated integration into the international economy is their vulnerability to large and sudden capital and exchange rate movements largely independent of domestic economic fundamentals. As seen above, this external vulnerability has traditionally been analysed in the context of ECEs' inability to borrow in their domestic currency, which made international investors wary, in turn, about their ability to repay their outstanding external obligations.

For neoclassical theorists this "original sin" was the result of misguided economic policies which caused information asymmetries and moral hazard (Krugman, 1998, MacKinnon and Pill, 1998), and/or weak domestic institutions (Burger and Warnock, 2006). Therefore, the maintenance of sound economic fundamentals, the development of credible domestic institutions, and the retreat of the state from the market more generally should reduce ECEs' external vulnerability. At the same time, the switch from foreign to domestic currency debt, a high level of foreign exchange reserves and the development of domestic financial markets were thought to help stabilize international capital flows (Caballero et al., 2004, Goldstein and Turner, 2004).

Figure 1 showed earlier that this has not been the case. In addition to their massive surge, capital flows have been characterized by extreme volatility over recent years. Kaltenbrunner and Painceira (2015) show that this trend has taken place irrespective of Brazil's sound

fundamentals and its position as net currency creditor (both through the accumulation of foreign exchange reserves and the switch from foreign currency to domestic currency debt). Instead it has been largely shaped by conditions on international financial markets.²⁶

Short-term capital flows picked up at the beginning of 2003 as liquidity returned to international financial markets, surged in the first stage of the international financial crisis when international investors “diversified” into high yielding and liquid ECEs assets, and contracted dramatically as the failure of Lehman Brothers led to a global liquidity crunch. Similar patterns have repeated themselves during the Eurozone crisis, as initial uncertainty led to return chasing and diversification into ECEs, followed by an abrupt contraction as conditions on developed markets (Europe) worsened. These dynamics were exacerbated by extraordinary loose monetary conditions in the CCEs, which pushed international investors to seek higher returns in alternative asset classes. The effects of external factors are particularly visible in the last capital flow cycle, as the first “tapering” announcements by the FED in May/June 2013 led to a renewed withdrawal of funds from ECEs (Eichengreen and Gupta, 2013, Prachi et al., 2014).²⁷

The consequences of these capital movements were large and caused volatile exchange rate movements. Figure 6 shows the Brazilian Real and the VIX, an indicator of international market conditions.

Insert Figure 6 here

The Brazilian Real (BRL) appreciated from nearly R\$3.6 at the beginning of 2003 to close to R\$1.5 to the US Dollar in August 2008, but it then lost about 60% again until the beginning of December 2008 during the worst of the international financial crisis. The BRL had regained most of this loss by mid-2011, but depreciated again, by 16%, during the worsening of the Eurozone crisis in September 2011. In the middle of 2013, as the first signs of the US monetary policy normalization (Fed tapering) appeared, the BRL started to depreciate. By the end the last quarter of 2014, the sharp drop in commodity prices, mainly in oil prices, exerted additional pressures on ECEs’ currencies, and on the BRL in particular. Moreover,

uncertainties with regard to the Brazilian presidential election and the implementation of economic policy during Dilma Rousseff's second administration have added pressure on the BRL in the last quarter of this year.

Brazil's continued external vulnerability is the result of its international financialisation and the subordinated nature this financialisation has taken. On the one hand, the massive stock of foreign capital in the Brazilian economy (relative to the size of the domestic market) means that any change in international market conditions and reallocation of international portfolios will have repercussions on the Brazilian economy. On the other hand, the nature of these foreign investments continues to be shaped by Brazil's subordinated position in the international monetary and financial system.

Although denominated in domestic currency (in an apparent move away from the ECEs' original sin), these investments have remained very short-term and concentrated in high yielding and volatile asset classes. For example, although lengthening, the average maturity of Brazil's domestic public debt was at approximately 4.3 years in 2014. This maturity structure was undercut only by Saudi Arabia and Turkey. Taking into account the Brazilian Central Bank's monetary sterilisation operations (repos) with Treasury bonds, the average maturity drops even lower, namely, to 2.7 years. Stock market and derivatives investments are inherently more short-term as their main revenue comes from trading and securing the consequent capital gain. This pattern has been supported by an extremely short maturity. By the end of 2014, 85% of trading volume in US\$ futures contracts was concentrated in the period of the first maturity (up to one month) while most of the trading in the interest rate futures (around 65%) was taking place with maturities of up to 2 years. The short-term nature of these transactions allows quick and easy resale in the case of a changing international liquidity premium, whereas the accompanying high yield is necessary to compensate for ECE currencies' lower liquidity premium.²⁸

Moreover, the majority of these investments remain funded in CCE currencies, most prominently the US\$.²⁹ Due to its position on the top of the international currency hierarchy, the US\$ remains the world's most important funding currency. Its high international liquidity premium allows US agents to offer low interest rates and secures the stability of its value

during periods of rising uncertainty or of crisis. At the same time, the US's deep and liquid financial markets offer a wide range of instruments. The US dollar's role as the main funding currency means that any problem in international liquidity conditions, and, as a result, in funding constraints, will lead to rising demand for the world money. Investment currencies such as the Brazilian Real are subject, in turn, to latent depreciation pressures as any deterioration in international market conditions will result in selling pressures.

This vulnerability to large and often unpredictable capital and exchange rate movements fundamentally shapes economic agents' relations with financial markets. Over recent years, (large) Brazilian NFCs have become very active on (international) financial markets, both on the asset and the liability side of their balance sheets. To protect themselves against adverse exchange rate movements, exporting NFCs have started to operate on the local derivatives market to hedge their (expected) export revenues or shortfalls. Enticed by potential gains on the exchange rates, these NFC operations have turned speculative in some cases, leading to substantial losses and near bankruptcies during the international financial crisis (Farhi and Borghi, 2009).

On the liability side, Brazilian NFCs have ratcheted up their foreign currency borrowing on offshore markets. The Bank for International Settlements (BIS) shows that these external liabilities were partly related to carry trade operations. Brazilian NFCs borrowed offshore in US\$ in order to invest in domestic currency assets, thus taking advantage of favourable exchange rate movements (Bruno and Shin, 2015).³⁰ Again, it is important to note that these financial operations of Brazilian companies were important to supporting the international aspect of financialisation. The positions of NFCs acted as counterparties to the operations of financial actors, either domestic or foreign, allowing the latter to further expand their positions.³¹

Finally, the operations of NFCs provide the clearest examples of how financialisation potentially cements and exacerbates uneven development. Demir (2008) shows for Argentina, Mexico and Turkey that financial investments have crowded out real investments, thereby reducing capital accumulation. In a similar vein, NFCs' losses during financial market turmoil will negatively impact growth. However, even if certain fractions of domestic

productive capital can take advantage of increased financial penetration, others might not be able to. In that sense, financialisation might lead to a bifurcation in the NFCs world, with large, savvy firms being able to take advantage of new financial opportunities, whereas smaller and medium sized enterprises lack the expertise and financial resources to effectively “play” the game (Powell, 2013). This contrast echoes arguments that financial disintermediation (that is, the move from bank to capital-market financing) will exacerbate the unevenness of credit and lead to heightened dynamics of inclusion and exclusion (Rethel, 2010, French and Leyshon, 2004, Boyer, 2007).

Putting aside these “real” implications, financialisation also arguably cements existing international currency hierarchies and the ECEs’ subordinated position within them. Whereas the US\$ role as the world’s most important funding currency grants the greenback’s value stability, the opposite is the case for financialised investment currencies facing latent depreciation pressures and the likely large and sudden loss of value during periods of market turmoil. These latent depreciation pressures make (international) investors reluctant to commit longer term funds to these currencies or indeed to use them as a funding currency, cementing their subordinated position in the international monetary hierarchy.

5. Conclusions

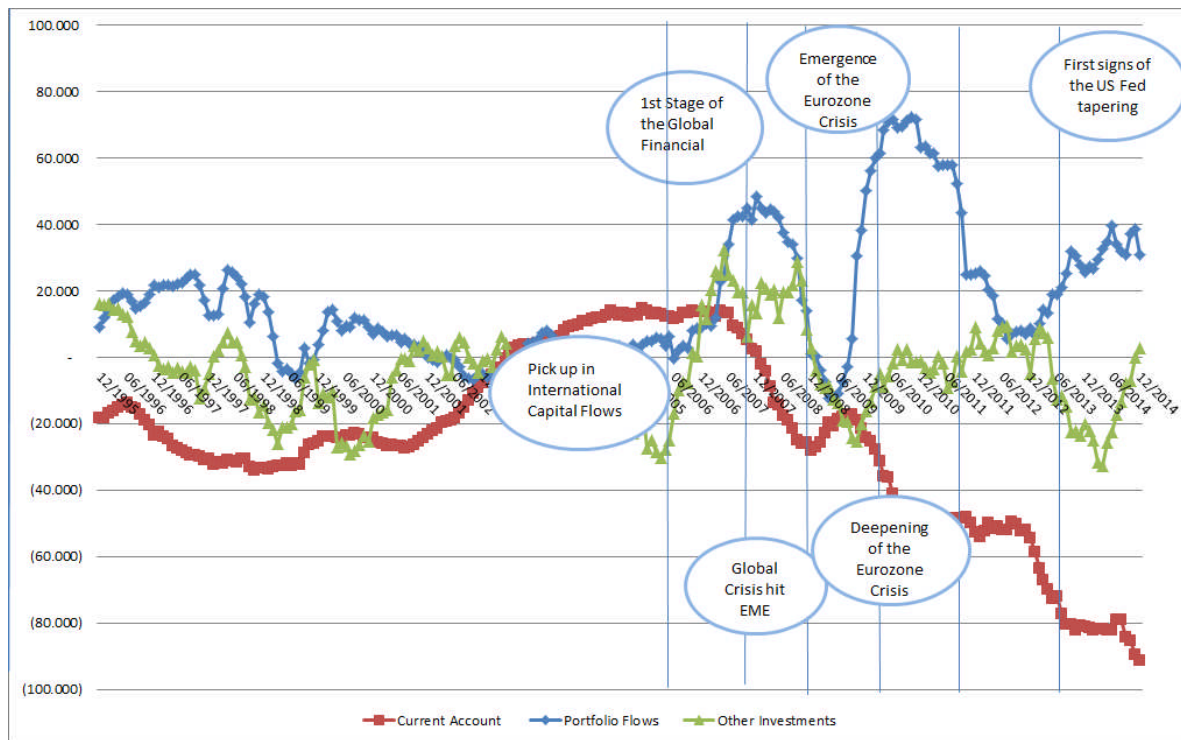
This paper has argued that ECEs’ financialisation is fundamentally shaped by their integration into the world economy and the subordinated nature that this integration has taken. To illustrate its argument, the paper presented two channels. The first channel was that of reserve accumulation and the financialisation of banks and households, and the second channel was that of the ECEs’ continued external vulnerability, which has served to intensify the financialisation of NFCs. The interdisciplinary analytical framework underlying this analysis has been the concept of international currency hierarchies, which is central to International Political Economy, Post Keynesian and Marxist political economy.

In carrying out such an analysis, the paper has attempted to make several contributions to the literature on financialisation. First, it has presented insights into the distinct nature and processes of financialisation outside the Anglo-Saxon core. Rather than focusing on variegated manifestations, it has emphasised instead the differential processes and mechanisms through which financialisation has developed. Second, the paper has extended analyses of the connection between financialisation and cross-border capital flows. In contrast to existing work, it has focused on the “demanders” of capital and the implications of international financialisation have for domestic financial and economic structures. Third, by emphasising the close connection between international monetary constellations and financialisation, it has firmly embedded the analysis within a critical analysis of money, a contribution that has been conspicuously missing from the analysis of financialisation. Finally, and perhaps most importantly, it has shown that not only is financialisation fundamentally shaped by ECEs’ subordinated position within the international financial economy, but financialisation itself cements this position and exacerbates uneven development. This works both through the “real” implications that financialisation has and by the self-reinforcing processes within financial markets themselves.

It is this later aspect of financialisation that we argue needs more attention in the future literature on financialisation. Rather than making dichotomous general statements about the relationship between finance and the “real” economy, we need more in-depth empirical investigations into the specific implications of financialisation for different segments of society. For example, who wins and who loses? And why? And what are the factors that determine such outcomes? Answers to these questions will certainly change over time and space. Some of them will no doubt escape empirical investigation. But all of them are crucial for moving the debate on financialisation forward.

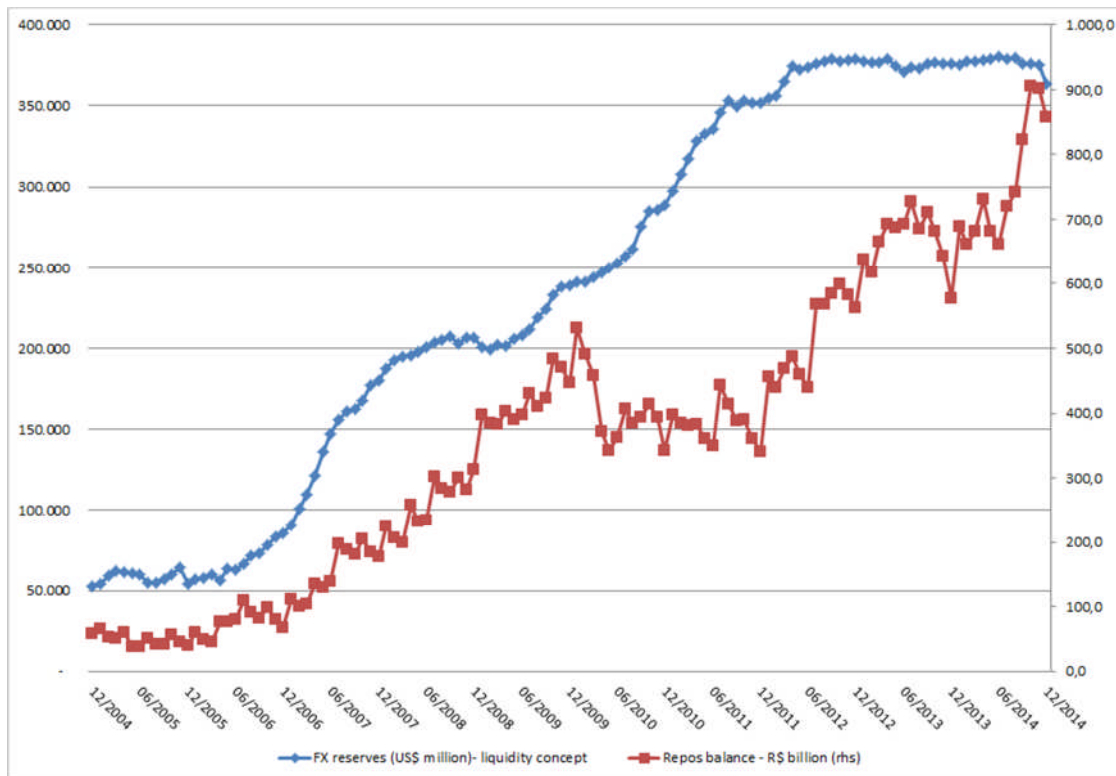
Graphs and Figures

Figure 1: Net Short-Term Capital Flows and Current Account Balance (US\$ millions)



Source: BCB (2015)

Figure 2: Foreign Reserves and Monetary Sterilization Operations (repos)



Source: BCB (2015a) and BCB (2015b)

Table 1: From Reserve Accumulation to Domestic Financialisation

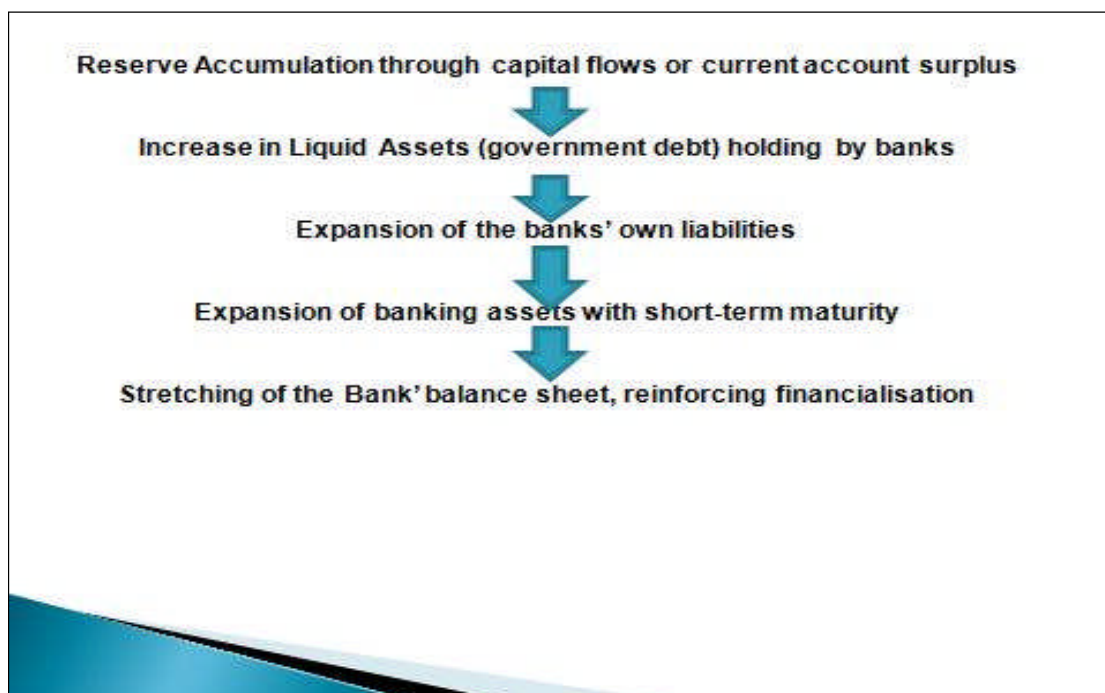
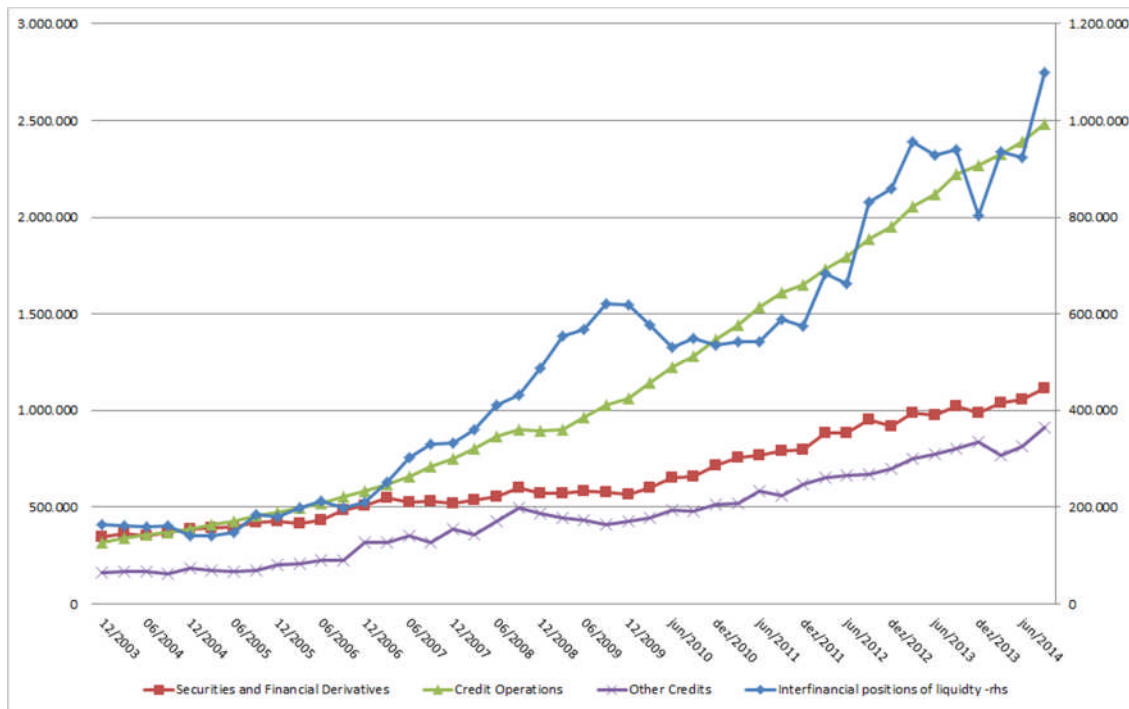


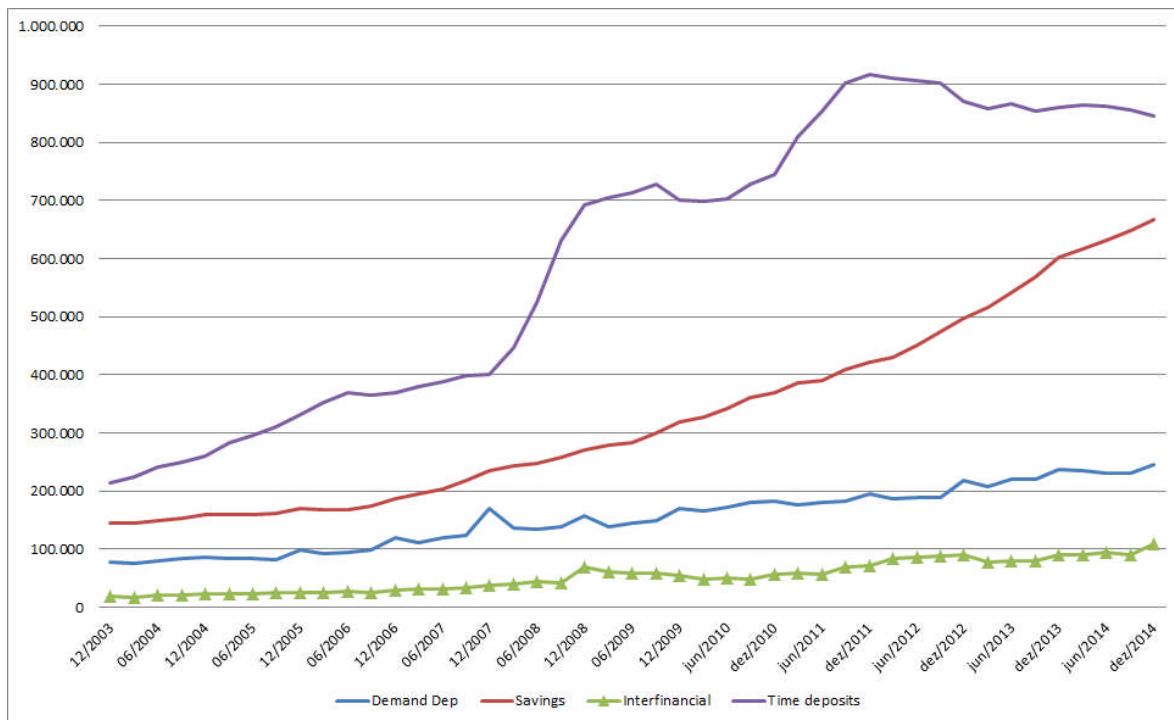
Figure 3: Brazilian Banking System – Main Assets (R\$ million)



Source: BCB (2015)

Notes: The banking data analysed includes the whole banking system, except the development banks

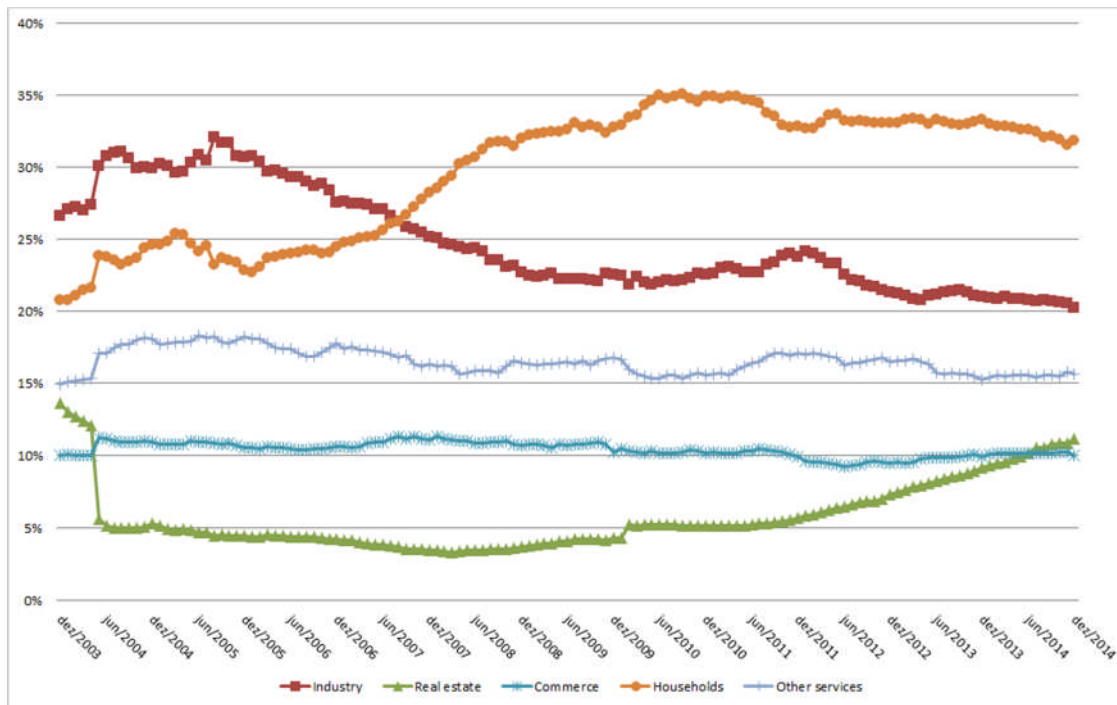
Figure 4: Types of Banking Deposits (R\$ million)



Source: BCB (2015)

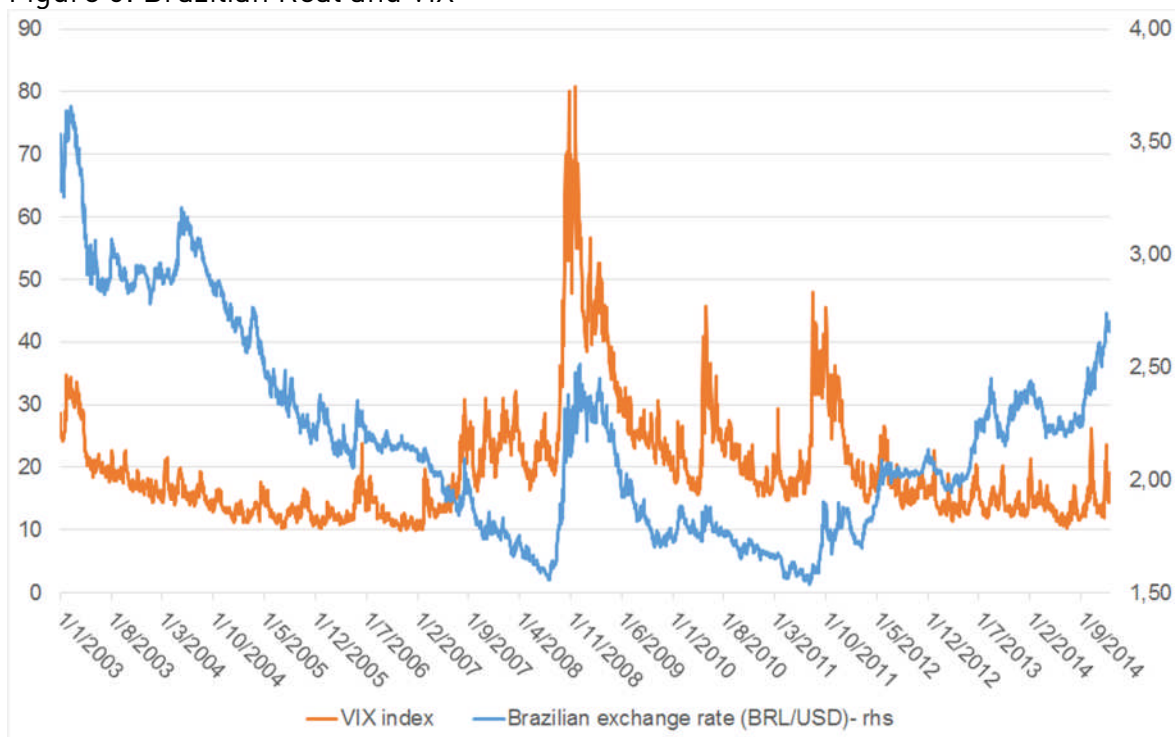
Notes: Banking deposits are the main item of Brazilian banks' liabilities (around 1.8 trillion R\$ at the end of 2014). The other categories are repo obligations (approx. 1.4 trillion R\$ at end of 2014), other obligations (essentially various types of obligations and obligations in the foreign currency portfolio (FX loans are not included); approx. 1 trillion R\$ at end of 2014) and obligations with loans and transfers (essentially FX loans and Governmental transfers; standing at just over 660 billion R\$ at the end of 2014).

Figure 5: Brazilian Financial System – Credit Allocation – Main Items (%)



Source: BCB (2015)

Figure 6: Brazilian Real and VIX



Source: Bloomberg

References:

- AALBERS, M. B. 2008. The Financialization of Home and the Mortgage Market Crisis. *Competition & Change*, 12, 148-166.
- AGLIETTA, M. & BRETON, R. 2001. Financial Systems, Corporate Control and Capital Accumulation. *Economy and Society*, 30, 433-466.
- AKKEMIK, K. A. & ÖZEN, Ş. 2014. Macroeconomic and institutional determinants of financialisation of non-financial firms: Case study of Turkey. *Socio-Economic Review*, 12, 71-98.
- ARAUJO, E., BRUNO, M. & PIMENTEL, D. 2012. Financialisation against Industrialisation: A Regulationist Approach to the Brazilian Paradox *Revue de la Regulation*.
- ARON, J., LEAPE, J. & THOMAS, L. 2010. Portfolio and Capital Markets in South Africa. *Paper presented at the CSAE Conference 2010 Economic Development in Africa, 21 – 23 March, Oxford*.
- ARRIGHI, G. 1994. *The long twentieth Century: Money, Power, and the Origins of our Times*, Verso.
- BONIZZI, B. 2013. Financialization in Developing and Emerging Countries. *International Journal of Political Economy*, 42, 83-107.
- BOYER, R. 2000. Is a Finance-Led Growth Regime a viable Alternative to Fordism? A preliminary Analysis. *Economy and Society*, 29, 111-145.
- BOYER, R. 2007. Assessing the impact of fair value upon financial crises. *Socio-economic review*, 5, 779-807.
- BRENNER, R. 2004. New Boom or new Bubble. *New Left Review*, 25, 57-102.
- BRUNO, V. & SHIN, H. S. 2015. Global dollar credit and carry trades: a firm-level analysis. *BIS Working Paper*, 51.
- BURGER, J. D. & WARNOCK, F. E. 2006. Local Currency Bond Markets. *NBER Working Paper*, 12552.
- CABALLERO, R., COWAN, K. & KEARNS, J. 2004. Fear of Sudden Stops: Lessons from Australia and Chile. *NBER Working Paper*, 10519.

- CHRISTOPHERS, B. 2012. Anaemic Geographies of Financialisation. *New Political Economy*, 17, 271-291.
- CHRISTOPHERS, B. 2015. The limits to financialization. *Dialogues in Human Geography*, 5, 183-200.
- COHEN, B. J. 1998. *The Geography of Money*, Ithaca, Cornell University Press.
- COHEN, B. J. 2006. The Macrofoundations of Monetary Power. In: ANDREWS, D. M. (ed.) *International Monetary Power*. Ithaca, NY: Cornell University Press
- CORREA, E., VIDAL, G. & MARSHALL, W. 2012. Financialization in Mexico: Trajectory and Limits. *Journal of Post Keynesian Economics*, 35, 255-275.
- CROTTY, J. The Neoliberal Paradox: The Impact of Destructive Product Market Competition and „Modern. Financial Markets on Nonfinancial Corporation Performance in the Neoliberal Era” In, 2005. Citeseer.
- D'ARISTA, J. 2005. The Role of the International Monetary System in Financialization. *Financialization and the world economy*, 220-239.
- DE CONTI, B. 2011. Políticas Cambial e Monetária: os Dilemas enfrentados por Países Emissores de Moedas Periféricas. *Tese de Doutorado, University of Campinas and University of Paris 13*.
- DE CONTI, B. M., PRATES, D. M. & PLIHON, D. 2014. A hierarquia monetária e suas implicações para as taxas de câmbio e de juros e a política econômica dos países periféricos. *Economia e Sociedade* 23, 341-372.
- DEMIR, F. 2008. Financial Liberalization, Private Investment and Portfolio Choice: Financialization of Real Sectors in Emerging Markets. *Journal of Development Economics*, 88, 314-324.
- DEMIR, F. 2009. Capital Market Imperfections and Financialisation of Real Sectors in Emerging Markets: Private Investment and Cash Flow Relationship Revisited. *World Development*, 37, 953-964.
- DOS SANTOS, P. 2009. On the content of banking in contemporary capitalism. *Historical Materialism*, 17, 180-213.

- DOUCETTE, J. & SEO, B. 2011. Limits to Financialization? Locating Financialization within East Asian Exportist Economies. Discussion Paper.
- DOW, S. 1999. International Liquidity Preference and Endogenous Credit *In: DEPRez, J. & HARVEY, J. (eds.) Foundations of International Economics: Post Keynesian Perspectives.* London: Routledge.
- DUMÉNIL, G. & LÉVY, D. 2004. *Capital resurgent: Roots of the Neoliberal Revolution*, Harvard University Press.
- DYMSKI, G. 2010. Why the Subprime Crisis is different: a Minskyian Approach. *Cambridge Journal of Economics*, 34, 239-255.
- EICHENGREEN, B. 2010. *Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System*, Oxford, Oxford University Press.
- EICHENGREEN, B. & GUPTA, P. 2013. Tapering Talk: The Impact of Expectations of reduced Federal Reserve Security Purchases on Emerging Markets. *VOX*, Online Source: Available at: <http://www.voxeu.org/article/fed-tapering-and-emerging-markets>.
- EICHENGREEN, B., HAUSMANN, R. & PANIZZA, U. 2003. The Mystery of Original Sin. *In: EICHENGREEN, B. & HAUSMANN, R. (eds.) Debt Denomination and Financial Instability in Emerging Market Economies.* Chicago: University of Chicago Press.
- ENGELN, E., KONINGS, M. & FERNANDEZ, R. 2010. Geographies of Financialization in Disarray: the Dutch case in Comparative Perspective. *Economic Geography*, 86, 53-73.
- ERGÜNEŞ, N. 2012. Global Integration of Middle-Income Developing Countries in the Era of Financialisation: The Case of Turkey. *Financialisation in Crisis*, 32, 217.
- ERTÜRK, I. 2003. Governance or Financialisation: the Turkish Case. *Competition and Change*, 7, 185-204.
- ERTURK, I. & SOLARI, S. 2007. Banks as Continuous Reinvention. *New Political Economy*, 12, 369-388.
- FARHI, M. & BORGHI, R. A. Z. 2009. Operações com Derivativos Financeiros das Corporações de Economias Emergentes no Ciclo Recente. *Estudos Avançados*, 23, 169-188.

- FISCHER, A. M. 2015. The End of Peripheries? On the Enduring Relevance of Structuralism for Understanding Contemporary Global Development. *Development and Change*, 46, 700-732.
- FOSTER, J. B. & MAGDOFF, F. 2008. Financial Implosion and Stagnation. *Monthly Review*, 60, 1-29.
- FRENCH, S. & LEYSHON, A. 2004. The new, new financial system? Towards a conceptualization of financial reintermediation. *Review of International Political Economy*, 11, 263-288.
- FRENCH, S., LEYSHON, A. & WAINWRIGHT, T. 2011. Financializing Space, Spacing Financialization. *Progress in Human Geography*, July 2011, 1-22.
- FRITZ, B. 2002. *Entwicklung durch wechselkurs-basierte Stabilisierung? Der Fall Brasilien*, Marburg, Metropolis.
- FRITZ, B., PRATES, D. M. & DE PAULA, L. F. 2014. Keynes at the Periphery: Currency hierarchy and challenges for economic policy in emerging economies.
- GABOR, D. 2010. *Central Banking and Financialization. A Romanian Account of how Eastern Europe became Subprime*, Palgrave Macmillan.
- GABOR, D. 2013. The Financialisation of the Romanian Economy: from Central Bank-led to Dependent Financialization. Financialisation, Economy, Society & Sustainable Development (FESSUD) Project.
- GARCIA-ARIAS, J. 2015. International financialization and the systemic approach to international financing for development. *Global Policy*, 6, 24-33.
- GOLDSTEIN, M. & TURNER, P. 2004. *Controlling Currency Mismatches in Emerging Markets*, Washington Institute for International Economics.
- GUTTMANN, R. 2008. A Primer on Finance-Led Capitalism and Its Crisis *Revue de la Regulation*, 3.
- HELLEINER, E. 2008. Political Determinants of International Currencies: What Future for the US Dollar? *Review of International Political Economy*, 15, 354-378.

- HELLEINER, E. & KIRSHNER, J. 2009. The Future of the US Dollar: Wither the Key Currency? . In: HELLEINER, E. & KIRSHNER, J. (eds.) *The Future of the Dollar*. London: Cornell University Press
- HERR, H. 1992. *Geld, Währungswettbewerb und Währungssysteme: Theoretische und Historische Analyse der internationalen Geldwirtschaft*, Frankfurt, Campus Verlag.
- HERR, H. & HÜBNER, K. 2005. *Währung und Unsicherheit in der globalen Ökonomie: Eine geldwirtschaftliche Theorie der Globalisierung*, Berlin, Edition Sigma.
- IIF 2015. Capital Flows to Emerging Markets. *Institute of International Finance*, January
- IMF (INTERNATIONAL MONETARY FUND) 2011. Internationalization of Emerging Market Currencies: A Balance between Risks and Rewards. *IMF Staff Discussion Note*, 11/17.
- ITOH, M. 2006. Political Economy of Money, Credit and Finance in Contemporary Capitalism: Remarks on Lapavitsas and Dymski. *Historical Materialism*, 14, 97-112.
- ITOH, M. & LAPAVITSAS, C. 1999. *Political Economy of Money and Finance*. London: Macmillan.
- JONES, S. 2012. *Macro Funds seek Succour in Emerging Markets*, Online Source: <http://www.ft.com/cms/s/0/406cec70-1ddb-11e2-8e1d-00144feabdc0.html#axzz2AlFqcC3Z> [downloaded 24th October 2012], Financial Times, 24th October 2012.
- KALTENBRUNNER, A. 2010. International Financialization and Depreciation: Brazil in the International Financial Crisis *Competition and Change*, 14, 296-323.
- KALTENBRUNNER, A. 2015. A Post Keynesian Framework of Exchange Rate Determination: A Minskyan Approach. *Journal of Post Keynesian Economics* 38, 426-448.
- KALTENBRUNNER, A. & PAINCEIRA, J. P. 2015. Developing Countries' changing Nature of Financial Integration and New Forms of External Vulnerability: the Brazilian experience. *Cambridge Journal of Economics*, 39, 1281-1306.
- KARACIMEN, E. 2014. Financialization in Turkey: The Case of Consumer Debt. *Journal of Balkan and Near Eastern Studies*, 1-20.

- KARACIMEN, E. 2015. Consumer Credit as an Aspect of Everyday Life of Workers in Developing Countries Evidence from Turkey. *Review of Radical Political Economics*, 0486613415591806.
- KENEN, P. B. 2009. Currency Internationalization: An Overview. *Paper presented at the Bank of Korea and BIS Seminar on Currency Internationalization: Lessons from the Global Financial Crisis and Prospects for the Future in Asia and the Pacific, March 19-20, 2009, Seoul, Korea.*
- KIRSHNER, J. 2008. Dollar Primacy and American Power: What's at Stake? *Review of International Political Economy*, 15, 418-438.
- KRUGMAN, P. 1998. What happened to Asia? www.mit.edu/Krugman [Online].
- LANGLEY, P. 2008. *The Everyday Life of Global Finance: Saving and Borrowing in Anglo-America: Saving and Borrowing in Anglo-America*, Oxford University Press.
- LAPAVITSAS, C. 2006. Relations of Power and Trust in Contemporary Finance. *Historical Materialism*, 14, 129-154.
- LAPAVITSAS, C. 2009. Financialisation embroils developing countries. *Papeles de Europa*, 19.
- LAPAVITSAS, C. 2014. *Profiting Without Producing: How Finance Exploits Us All*, Verso Books.
- LAPAVITSAS, C. & POWELL, J. 2013. Financialisation varied: a comparative Analysis of Advanced Economies. *Cambridge Journal of Regions, Economy and Society*, rst019.
- LAZONICK, W. & O'SULLIVAN, M. 2000. Maximizing Shareholder Value: A New Ideology for Corporate Governance. *Economy and Society*, 29, 13-35.
- LEVY-ORLIK, N. 2012. Effects of financialization on the Structure of Production and Nonfinancial Private Enterprises: the Case of Mexico. *Journal of Post Keynesian Economics*, 35, 235-254.
- MACKINNON, R. & PILL, H. 1998. International Overborrowing: A Decomposition of Credit and Currency Risk. *World Development*, 26, 1267-1282.
- MAGDOFF, H. & SWEEZY, P. 1972. *The Dynamics of U.S. Capitalism*, New York, Monthly Review Press

- MAGDOFF, H. & SWEEZY, P. M. 1987. Capitalism and the Distribution of Income and Wealth. *Monthly Review*, 39, 1-16.
- MARX, K. 1967. *Capital Unabridged, Volume 1, A Critical Analysis of Capitalist Production*, New York, New York International Publishers.
- MARX, K. 1976. *Capital. Volume 1*, London, Penguin.
- MCNAMARA, K. R. 2008. A Rivalry in the Making? The Euro and International Monetary Power. *Review of International Political Economy*, 15, 439-459.
- MICHELL, J. & TOPOROWSKI, J. 2013. Critical observations on financialization and the financial process. *International Journal of Political Economy*, 42, 67-82.
- MINH, L. 2012. Review Essay: Special Drawing Rights, the Dollar, and the Institutional Approach to Reserve Currency Status *Review of International Political Economy*, 19, 341-362.
- MONTGOMERIE, J. 2008. Bridging the critical divide: global finance, financialisation and contemporary capitalism. *Contemporary Politics*, 14, 233-252.
- MONTGOMERIE, J. 2009. The pursuit of (past) happiness? Middle-class indebtedness and American financialisation. *New Political Economy*, 14, 1-24.
- ORHANGAZI, O. 2008. Financialization and capital accumulation in the non-financial corporate sector: A theoretical and empirical investigation of the US economy, 1973-2004. *Cambridge Journal of Economics*, 32, 863-886.
- OTERO-IGLESIAS, M. & STEINBERG, F. 2013. Is the dollar becoming a negotiated currency? Evidence from the emerging markets. *New Political Economy*, 18, 309-336.
- PAINCEIRA, J. P. 2008. Developing Countries in the Era of Financialisation: From Deficit Accumulation to Reserve Accumulation. In: LAPAVITSAS, C. (ed.) *Financialisation in Crisis*. Leiden: Brill.
- PAINCEIRA, J. P. 2011. Central Banking in Middle Income Countries in the Course of Financialisation: A Study with Special Reference to Brazil and Korea. *PHD Dissertation, University of London*.
- PAINCEIRA, J. P. 2012. Financialisation, Reserve Accumulation, and Central Banking in Emerging Economies: Banks in Brazil and Korea. *Research on Money and Finance*

Discussion Papers, 38, Available at:
<http://www.researchonmoneyandfinance.org/index.php/publication/discussion-papers>.

- PIKE, A. & POLLARD, J. 2010. Economic Geographies of Financialization. *Economic Geography*, 86, 29-51.
- POWELL, J. 2013. *Subordinate Financialisation: a Study of Mexico and its Non-Financial Corporations*. SOAS, University of London.
- PRACHI, M., MORIYAMA, K., N'DIAYE, P. & NGUYEN, L. 2014. Impact of Fed Tapering Announcements on Emerging Markets *IMF Working Paper*, 109.
- PRATES, D. M. & ANDRADE, R. 2013. Exchange Rate Dynamics in a Peripheral Monetary Economy. *Journal of Post Keynesian Economics*, 35, 399-416.
- RETHEL, L. 2010. Financialisation and the Malaysian political economy. *Globalizations*, 7, 489-506.
- STOCKHAMMER, E. 2004. Financialisation and the Slowdown of Accumulation. *Cambridge Journal of Economics*, 28, 719-741.
- STOCKHAMMER, E. 2010. Financialization and the Global Economy. *Political Economy Research Institute Working Paper*, 242.
- STRANGE, S. 1971. *Sterling and British Policy: A Political Study of an International Currency in Decline*, London, Oxford University Press
- YU, Y. 2013. Rebalancing the Chinese Economy *Oxford Review of Economic Policy*, 28, 551-68.
- YUK, P. 2012. *The rising of Emerging Markets EFTs*, Online Source: <http://blogs.ft.com/beyond-brics/2012/10/18/the-rise-and-rise-of-emerging-markets-etfs/#axzz2A7uCHIKR> (downloaded 18th October 2012), Financial Times, 18th October 2012.



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



¹ The fact that ECEs' financialisation has taken a subordinated character was first noted by Paineira (2011) and Powell (2013).

² Also see the series of country studies resulting from the FESSUD project.

³ Our analysis differs from that of Christophers. Rather than focusing on the flows of value which constitute a financialised international economy, we concentrate on the implications these international networks of value have for the structure of the economic and financial system in ECEs.

⁴ Indeed, Christophers points out that as the literature on financialisation has grown, that on the critical studies of money has, with a few exceptions, stagnated. In a similar vein, few authors--again with some exceptions (e.g. Lapavistas, 2014)--provide an explicit monetary foundation for their analysis of financialisation. This paper responds to the latter shortcoming and shows how financialisation processes are intimately linked to the reigning (international) monetary order.

⁵ This argument raises, however, a question about the novelty of the process. Several authors have argued that we find ourselves already in a second or third wave of globalization. Moreover, treating financial globalization as a merely quantitative dimension neglects the crucial qualitative changes in financial markets highlighted by the financialisation literature.

⁶ Although our paper addresses the international aspect, it probably falls short of the kind of holistic global analysis envisaged by Christophers. As pointed out above, rather than analysing the global interconnection of supply and demand, this paper sets out how national economic and financial structures are conditioned by their integration into financialised capitalism.

⁷ One exception is Powell (2013) who explicitly enquires into the peculiar nature of financialisation in ECEs. Akkemik and Özen (2014) investigate the determinants of financialisation in Turkey-- without, however, putting too much analytical emphasis on their distinctive nature in ECEs.

⁸ In addition, the literature points to the pure financial gain of issuing the currency at face value at low cost, that is, on the basis of seignorage.

⁹ There is some discussion of ECEs' "original sin", that is, their inability to borrow in their own currency (Eichengreen et al., 2003). Interestingly, though, this claim is not directly linked to the literature on monetary hierarchies.

¹⁰ One exception is Guttmann (2008), who notes that having much of the world's financial capital denominated in U.S. dollar helps the US to maintain more easily the deepest and most liquid financial markets in the world.

¹¹ Post Keynesians' focus on fundamental uncertainty makes them more prone to concentrate on the store of value and unit of account functions of money, rather than that of medium of transactions. As in the IPE literature, the highlighted determinants of currencies' international liquidity premia vary. Whereas Fritz et al. (2014) highlight ECEs' ability to run sustainable current account surpluses, De Conti (2011) and Kaltenbrunner

(2015) stress the important role of market-institutional factors (which include but are not exclusive to the role of the central bank). Kaltenbrunner also highlights the importance of currencies' position in international debtor-creditor relations.

¹² The only exception is D'Arista (2005), who does not focus on ECEs.

¹³ Some exceptions are Paineira (2011) and Powell (2013).

¹⁴ In this paper, the first manifestation of financial subordination of ECEs is linked to the monetary sterilization operations of their central banks and their impacts on the domestic banking system.

¹⁵ At the moment in the crisis when the sudden movement for protection against wealth loss raises the demand for money, the contradiction between monetary and credit systems becomes clear. In the financialisation era, the rise in demand has been mainly for world money and not for domestic currencies.

¹⁶ The term quasi-world money (instead of world money) is used to describe the US dollar because there is no formal agreement, as there was in the era of gold as the store of value. Furthermore, there is no clear mechanism of international adjustment as there was under the gold regime. However, in order to keep matters simple, we use the terms 'world money' and 'quasi-world money' interchangeably in this paper.

¹⁷ In the early 1970s a mutation in the form of world money occurred: the international monetary system was definitely de-linked from gold and this change has created a more unstable system prone to financial bubbles. See McNally (2008).

¹⁸ Exceptions are Lapavistas (2009), Kaltenbrunner (2010), and Garcia-Arias (2015). Except for Kaltenbrunner (who has a more "qualitative" definition), international financialisation is largely equated to a rise in cross-border capital flows.

¹⁹ Reserve accumulation can originate from the current account or capital account or both. For example, China's large current account surplus was an important source of foreign exchange. Despite this surplus, these countries still received large amounts of capital inflows, which further swelled their foreign exchange reserves and exerted pressures on their domestic economy.

²⁰ Another potential reason for reserve accumulation is the attempt to ease pressures on the exchange rate appreciation in order to keep economic competitiveness.

²¹ A pertinent question to ask is whether ECE central banks had to engage in these sterilization operations-- that is, whether financialisation is a policy "choice" or is "forced upon" countries by their subordinated financial integration. We would argue for the latter thesis since in conditions of more integrated global capitalist accumulation, there is a need (imposed by foreign investors) for a more homogeneous macroeconomic setting. In this respect, those ECEs officially following an inflation targeting regime were institutionally bound to reduce potential inflationary pressures from an excessive expansion in the domestic money supply.

²² This analysis of the banks' behaviour dynamic is based on Paineira (2012).

²³ Other credits are mainly foreign exchange credits and “various types of credit operations”, which include credits on taxes and official contributions and credits and securities to receive.

²⁴ Obviously, this change in banks’ funding structure was not the only reason for the increase in consumption lending. Economic growth, the rising real minimum wage and the profitability of these loans also contributed to this trend. However, without expansion of balance sheets through the BCB’s sterilization operations and the shortening of their funding structure, accommodating the rising demand for household credit would have been much more difficult for banks.

²⁵ This also shows the important role that public institutions play in financialisation processes. In many cases it is the ability to hold short-term, relatively low-risk assets, that is, government bonds, which allows financial institutions to grow their balance sheets.

²⁶ This has changed to some extent over the last year where increased domestic uncertainty, both politically and economically, has reduced Brazil’s attractiveness for (international) financial investors.

²⁷ In Brazil, this last cycle of capital flows has been much more pronounced in banking than in portfolio flows. This has been due to two reasons. First, portfolio investors have increasingly hedged their exchange rate risk on the domestic market rather than withdrawing funds. Second, banking flows have been exacerbated by the positions of domestic banks, which have significantly increased their international operations over recent years.

²⁸ It is important to note that these higher yields nowadays include both higher interest rates and returns on the currency itself in the form of exchange rate changes.

²⁹ This is the case both for foreign investors operating in these markets and Brazilian actors borrowing offshore.

³⁰ Another reason that Brazilian NFCs tap international capital markets is closely related to monetary subordination itself. Due to the high interest rates and short-term nature of Brazilian domestic-currency assets, NFCs resort to borrowing on international market in foreign currency.

³¹ When there is “speculative” FX positions undertaken by NFCs, domestic banks most frequently acted as counterparties. In this case, banks would “lose” on the exchange rate but would make significant gains on the interest rate margin by borrowing offshore and lending on to domestic companies. Moreover, domestic banks could square these positions again with foreign investors. In the case of “hedging” positions, it was either banks or indeed foreign investors who took the counterparty, taking advantage of favorable exchange rate movements.

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

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.