

THIRD WORLD *Economics*

TRENDS & ANALYSIS

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Developing countries confronted with financial vulnerability

The recent Chinese stock market plunge which roiled markets around the world has highlighted the pitfalls of the deep interlinkages in the globally connected financial system. As developing economies become ever more integrated with international financial markets, new channels have opened up for the transmission of financial shocks which can in turn impact adversely on the real economy.

- The era of financial vulnerability – p2

Also in this issue:

Africa's boom is over

*A universal basic income
p7 considered*

p10

FDI myths and realities

p8 The rise of financialization

p12

Contents

CURRENT REPORTS

- 2 The era of financial vulnerability
- 4 Development aid on the decline, warns new study
- 5 Philip Morris v. Australia: A big win for public health

OPINION

- 7 Africa's boom is over
- 8 FDI myths and realities
- 9 Controlling capital
- 10 A universal basic income considered

ANALYSIS

- 12 The rise of financialization

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The era of financial vulnerability

The crash in stock markets in China and around the world shows up how developing countries are increasingly vulnerable to financial events or shocks, including outflows of foreign funds.

by Martin Khor

The year 2016 started with a big bang, but the kind we would rather avoid. The Chinese stock market plunged for several days, causing panic around the world, with the markets also falling in many countries, East and West.

This is another wake-up call to alert us that finance has become interconnected, indeed much too interconnected, globally.

In particular, many developing countries have been drawn into the web of the global financial system in manifold ways, and that has made them more vulnerable to adverse developments and shocks.

We are now in an era of financial vulnerability, which in turn easily turns into vulnerability in the real economy of GDP growth, trade and jobs.

An immediate issue is whether the rout in China's stock market will affect its real economy, in which case there will be serious effects.

One view is that it would contribute to a "hard landing", as the Chinese economy already has many problems.

Another view, more realistic in my opinion, is that the spillover to the real economy will not be significant. A paper by the Brookings-Tsinghua Centre shows that the interconnection between the stock market and the economy is limited in China.

In the US, half the population own stocks and corporations rely heavily on funds raised in the stock market, but in China less than 7% of urban Chinese invest in the stock market and corporations rely much less than American companies on the stock market to raise funds.

Nevertheless, China's economy is expected to slow down in 2016. Besides this, other factors also add to a pessimistic outlook for developing countries.

These include the continuing weak conditions in Europe and Japan, which may offset the United States' more steady recovery; the expected interest rate rises in the US, which will draw portfolio funds out from developing countries; and the weakening of commodity

prices.

Already many developing countries are suffering on the trade front. In Malaysia, for example, exports in November 2015 grew only 6.3% from a year earlier. More worryingly, Malaysia's industrial production grew by only 1.8% in November from a year earlier.

Other Asian countries fared worse. Korea's exports for the whole of 2015 fell 8%; Taiwan's 2015 exports are expected to fall 10%; and Singapore's manufacturing sector declined 6% in the most recent quarter.

China's exports in December fell 1.4% from a year earlier but imports fell more, by 7.6%, which is bad news for other countries as China has less demand for their exports.

Financial fragility

But of equal if not more concern is how, in the financial area, emerging economies have in new ways become more dependent and vulnerable in recent years.

In particular, foreign presence in these countries' domestic credit, bond, equity and property markets has reached unprecedentedly high levels, and thus new channels have emerged for the transmission of financial shocks from global boom-bust cycles, according to a South Centre paper by its chief economist Yilmaz Akyüz (www.southcentre.int/research-paper-60-january-2015/).

During a boom, there is a rush by yield-seeking investors to place their global funds in emerging economies. But when perceptions or conditions change, the same funds can exit quickly, often leaving acute problems or even crises in their wake.

Malaysia is among the vulnerable countries. Firstly, the fall in the prices of oil (which on 12 January reached a new low of below \$30 a barrel) and other commodities has affected export earnings. The balance-of-payments current account used to enjoy a huge surplus, but this has been shrinking.

In 2010-13 there were very high inflows of foreign funds into Malaysia, averaging over 10% of GDP. But by 2015 there was a sharp reversal, with foreign funds flowing out from the equity and bond markets.

Malaysia is vulnerable to large outflows as foreigners in recent years have built up a strong presence in the domestic bond and equity markets. Foreign holdings of bonds (public and private) peaked at RM257 billion in July 2014. And the share of foreign holdings in the stock market was 23.5% at the end of 2014, indicating a foreign-holding value then of around RM400 billion.

Many billions of ringgit of foreign-owned bond and equity funds have left the country in the past couple of years, especially in 2015.

Due partly to this, Malaysia's foreign reserves have fallen from \$130 billion in September 2014 to \$95.3 billion at end-December 2015. Although the present reserves are adequate to cover imports

and short-term external debt, they are also vulnerable to further outflows of foreign-owned funds in equities and bonds.

Debt held by locals is also high compared to other countries, according to another paper by Akyüz. Debt by households was estimated at 86% of GDP in the first quarter of 2015 by Merrill Lynch. Public debt is near 55% of GDP (compared to an average 40% for developing countries covered in a McKinsey report). And corporate debt is estimated to be about 90-96% of GDP.

The overall local debt is thus very high, probably exceeding 200% of GDP, one of the highest ratios among developing countries. Thus, the country has financial vulnerabilities on both the external and domestic fronts.

What the country faces is part of a trend among emerging economies that is likely to last for some time. Many other countries are in far worse shape than Malaysia.

In an article in the week of 11 January, Martin Wolf of the *Financial Times* highlighted the important shift in perception by investors regarding the prospects for emerging economies, which has resulted in capital flowing out.

Global investors withdrew \$52 billion from emerging-market equity and bond funds in the third quarter of 2015, the largest quarterly outflow on record. The most important reason for this is the realization of the deteriorating performance of the emerging economies, according to Wolf.

Thus, developing countries are in for a tough time in 2016. Of course the vulnerabilities may not translate into actual adverse effects if global or local conditions improve. But it is better to prepare for the probable difficulties ahead. □

Martin Khor is Executive Director of the South Centre, an intergovernmental policy think-tank of developing countries, and former Director of the Third World Network. This article was first published in The Star (Malaysia) (18 January 2016).

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Development aid on the decline, warns new study

Development aid budgets in Europe are being diverted to cover the costs of hosting refugees.

by Thalif Deen

UNITED NATIONS: UN Secretary-General Ban Ki-moon expressed fears in November that increases in humanitarian aid to thousands of refugees entering Europe could result in sharp cuts in development aid by Western donors.

Confirming those fears, a new report by CONCORD, the European confederation of non-governmental organizations (NGOs) representing all 28 European Union (EU) members, points out that aid budgets are increasingly being used to cover refugee and asylum seekers' costs: the Netherlands at 145%; Italy 107%; Cyprus 65%; and Portugal 38%.

And despite repeated promises, the EU as a whole did not deliver on its commitment to spend 0.7% of gross national income (GNI) as official development assistance (ODA) by 2015.

More worryingly, says the report, there is an emerging trend in EU countries to divert aid budgets from sustainable development to domestic costs associated with hosting refugees and asylum seekers.

Luxembourg, Poland and Bulgaria have already decided not to report refugee costs as ODA, contrary to Spain, Malta and Hungary.

Falling short

The report, the tenth CONCORD AidWatch report and titled "Looking to the future, don't forget the past – aid beyond 2015," finds that the EU as a group remains well short of the 0.7% target, having spent 0.42% of its GNI on aid, with only four of 28 member states meeting the target. The four are Luxembourg, Sweden, Denmark and the UK.

According to CONCORD, the largest increases in EU aid were in the EU13 countries, namely Romania (65% increase), Croatia (41%), Estonia (21%), Hungary (13%) and Malta (13%). Significant increases were also recorded in Germany (14%), Finland (14%), the UK (9%) and Sweden (7%), although aid is expected to contract significantly in Finland in 2015.

Major cuts were recorded in other countries, including Lithuania (21%), Spain (20%), Portugal (14%), France (8%) and Poland (7%). Of these countries, Spain, Portugal and France are a source of serious concern, because they have continued on a downward trend for the last few years.

Asked about declining aid, the UN Secretary-General told reporters at a press briefing in Finland in December he appreciates the difficulties and challenges facing many European countries. "At the same time, I commend such compassionate leadership and generous support for many refugees who are seeking better opportunities and safety.

"While I appreciate such difficulties, I ask the rich countries, the European countries, to increase their financial support and generous support for all these migrants and refugees, rather than diverting their already earmarked development aid."

Ban said he realizes there is a limit to resources. "So inevitably, they may have to temporarily divert and use this development money for humanitarian purposes but in the longer term, if this kind of trend continues, it will only perpetuate this bad balancing between humanitarian and development."

If development doesn't move on, it will create more jobless people, it will create more frustration and then, they may have to flee their homes again for better opportunities, he warned.

"So I think you have to address this in a balanced and comprehensive way – that is my earnest appeal to many European countries."

Asked specifically about Finland, he said it was one of the biggest donors in the world and one of the leaders of the world for the development agenda and empowerment, and for peace and human rights. "It is a model member state and I asked many other member states to emulate from that shining example," he added.

Meanwhile, the CONCORD report says EU aid is still seen by many as a tool

to drive policy change or liberalization in partner countries – much aid remains directly tied or comes with a "suggested" policy agenda.

The study said development aid commitments by EU countries are also at risk of being "greenwashed" to meet climate finance promises to poorer nations and that these existing aid commitments could be relabelled to qualify as climate finance. Also, the growing costs of climate change should not replace existing development priorities.

Need for ambitious financing

The UN's post-2015 development agenda, which was adopted by world leaders last September, will require ambitious financing from all actors.

"What's been lacking to date is real action from most – though certainly not all – of the donor community to meet their own commitments and promises on aid, which we've seen again this year as the EU misses its own 2015 target to deliver on the 0.7% promise.

"Aid will remain a vital development source for years to come – it is focused on reaching the hardest to reach, which is vital for the leave no one behind agenda and is more flexible, predictable and accountable.

"To ensure the new development framework delivers as expected, the EU should reach the 0.7% target by 2020 in line with the commitment made [at the Financing for Development Conference in July] in Addis [Ababa, Ethiopia]," said Amy Dodd, CONCORD AidWatch Chair and Director of the UK Aid Network.

Jessica Poh-Janrell from CONCORD Sweden said: "We recognize the urgent nature of the current refugee crisis, but remain convinced that aid should be used to support development in third countries."

The world's poorest should not foot the bill for the refugee costs in Europe. Aid is essential to prevent more people having to flee their homes. Continuing investing in fighting poverty and inequality in developing countries is ultimately the most sustainable way of dealing with the crisis in the long term, she added.

In November Ban appealed to the international community not to forsake its longstanding commitment for development assistance to the world's poorer

nations. His appeal followed a UN pledging conference on 10 November which reported a “dramatic decline” in donor commitments: from \$560 million in 2014 to \$77 million in the most recent pledges, largely covering 2015.

Asked if the Secretary-General’s appeal was the result of the decline in commitments, UN Deputy Spokesman Farhan Haq told Inter Press Service (IPS): “It’s in response to many factors, including concerns expressed by some states about maintaining aid levels.”

The Secretary-General said re-

sources for one area should not come at the expense of another. Redirecting critical funding away from development aid at this pivotal time could perpetuate challenges that the global community has committed to address, he warned.

“Reducing development assistance to finance the cost of refugee flows is counter-productive and will cause a vicious circle detrimental to health, education and opportunities for a better life at home for millions of vulnerable people in every corner of the world,” Ban declared. (IPS) □

Philip Morris v. Australia: A big win for public health

Australia has warded off a legal challenge by tobacco giant Philip Morris against the country’s landmark “plain packaging” laws aimed at curbing cigarette consumption. But the broader danger posed by international treaties which enable corporations to contest such public interest measures remains.

by Kavaljit Singh

Tobacco giant Philip Morris lost a major international legal battle to reverse Australia’s tobacco plain packaging laws using the Australia-Hong Kong Investment Promotion and Protection Agreement (IPPA) of 1993. On 17 December, a three-member arbitral tribunal at the Permanent Court of Arbitration (PCA) issued an Award on Jurisdiction and Admissibility in connection with the case between Philip Morris Asia Limited and Australia.

The full text of the tribunal’s award is yet to be made public but media reports confirm that the tribunal unanimously supported Australia’s position that Philip Morris had no jurisdiction to bring the case against Australia. In other words, Australia’s plain packaging laws banning all branding from cigarette packets will remain in force.

In 2011, Australia enacted the Tobacco Plain Packaging Act and enforced the Tobacco Plain Packaging Regulations which prohibit the display of brand trademarks, logos and designs on cigarette packets. Under these rules, the cigarette packets should follow standardized packaging (for instance, brand names can be displayed only in certain standard styles and at a particular place) and graphic health warnings should be

prominently displayed on the packets. The tobacco companies lost a case against plain packaging legislation in the domestic courts of Australia in August 2012.

Invoking the Australia-Hong Kong IPPA

Australia’s IPPA with Hong Kong provides the investor-state dispute settlement (ISDS) mechanism under which foreign investors can sue host states directly and seek monetary compensation if they claim that their profits have been hurt due to the introduction of policy or regulatory measures.

In 2011, Philip Morris Asia Limited (Hong Kong) initiated an ISDS claim under the UNCITRAL Arbitration Rules (2010). The arbitration hearings began in early 2015 in Singapore.

Philip Morris challenged Australia’s plain packaging laws on the grounds that the ban on trademarks breached the investment protection obligations listed under the Australia-Hong Kong IPPA. Relying primarily on the “fair and equitable treatment” (FET) provision, the company argued that the plain packaging laws constitute an expropriation of its intellectual property rights and there-

fore it should be compensated for the loss suffered due to compliance with these laws. The company also demanded that the enforcement of these laws be suspended.

On its part, the Australian government claimed that plain packaging rules were implemented for a legitimate public purpose to protect public health by reducing tobacco consumption, particularly among the youth.

The government maintained that plain packaging measures would help in reducing the appeal of tobacco products whereas mandated graphic health warnings would educate consumers about the harmful effects of smoking. According to official estimates, smoking alone kills 15,000 Australians each year and exacts a toll of more than A\$30 billion in social and economic costs.

While stressing that the full effects of anti-tobacco measures will be seen over the long term, the Australian authorities provided statistics to prove that the total consumption of tobacco and cigarettes has declined in the country with the introduction of these measures in 2012.

Australia is the first country in the world to implement tobacco plain packaging laws. It is important to note that plain packaging laws are consistent with the World Health Organization (WHO)’s Framework Convention on Tobacco Control (FCTC). Adopted in 2003, the FCTC is the world’s first global public health treaty to address the challenges posed by the growing tobacco epidemic.

Treaty shopping

In its response to the arbitration case, the Australian government raised procedural objections and sought the dismissal of the case on procedural grounds. In particular, the government raised objections to the manner in which Philip Morris restructured itself when its Australian subsidiary (Philip Morris Australia) became wholly owned by Philip Morris Asia Limited (Hong Kong) in February 2011. The Australian authorities argued that the rearranging of the company’s assets was conducted to enable it to claim to be a Hong Kong company so as to cover itself under the framework of the Australia-Hong Kong IPPA. Since this agreement has ISDS provisions, the company saw an opportunity to pursue a claim against the Aus-

tralian government, which had announced in April 2010 that it would introduce plain packaging laws by 2012.

The Australian government claimed that the sole intention of the acquisition of the Australian subsidiary was to bring the claim under the Australia-Hong Kong IPPA once the plain packaging laws were announced, and that the company made false statements before the concerned authorities at the time of the acquisition. The government contended that the commencement of the arbitration by Philip Morris shortly after the restructuring of assets should be considered an abuse of rights and the company was not entitled to an ISDS claim under the IPPA.

The Australian government further argued that Philip Morris Asia Limited did not carry out the acquisition of shares in Philip Morris Australia as per the norms provided under Article 1 of the IPPA, which states that an investment must be "admitted by the other Contracting Party [Australia] subject to its law and investment policies applicable from time to time."

What next?

The unanimous decision by the arbitral tribunal upholding the tobacco control measures has been welcomed by public health experts and civil society groups throughout the world. Needless to say, a win by Philip Morris could have resulted in billions of dollars of cost to Australian taxpayers besides a possible reversal of the plain packaging regime.

Unofficial estimates suggest that the Australian government might have spent anywhere between A\$30 million and A\$50 million in defending this case. At the time of writing, there is no communication from the Australian authorities on how much public money has been spent on the defence. Nor is there any confirmation as to whether Philip Morris would be asked to reimburse the costs incurred by the government.

While the PCA is yet to put details of the decision in the public domain, it is widely speculated that Philip Morris may appeal the decision as it has already questioned the outcome based on procedural grounds. In the words of Marc Firestone, Philip Morris International's Senior Vice President and General Counsel: "It is regrettable that the outcome hinged entirely on a procedural issue that Australia chose to advocate instead of confronting head on the merits of

whether plain packaging is legal or even works."

It is difficult to predict the next move by the global tobacco industry, which is facing the heat with the implementation of WHO's FCTC and other measures by several countries. The arguments put forward by the industry against plain packaging measures are not supported by empirical evidence. Therefore, it would indeed be a herculean task to prove that such measures do not yield positive outcomes.

In all likelihood, this verdict may encourage many other countries to implement anti-tobacco measures within their jurisdictions. New Zealand is expected to soon pass the Smoke-free Environments (Tobacco Plain Packaging) Amendment Bill which is currently awaiting Parliament's nod.

Recently France, Ireland and the UK have also announced plans to introduce tobacco plain packaging. France has passed similar legislation which will come into force in mid-2016. In the UK, Philip Morris, British American Tobacco and other big companies have challenged the legality of a move to introduce plain packaging in 2016. The outcome of this legal challenge will be known later in 2016.

Not long ago, Philip Morris had filed a claim against Uruguay when the country attempted to implement similar plain packaging rules on tobacco products. The claim was filed under the Switzerland-Uruguay bilateral investment treaty.

The battle is not over

Despite the tribunal's dismissal of the arbitration case, Australia is facing another legal battle against plain packaging rules at the World Trade Organization (WTO). In 2012, Ukraine, Hondu-

ras, Indonesia, the Dominican Republic and Cuba challenged Australia's plain packaging regime on the grounds that it is inconsistent with the country's obligations under the WTO's Trade-Related Aspects of Intellectual Property Rights (TRIPS) and Technical Barriers to Trade (TBT) Agreements. However, Australia has rejected this claim.

In June 2015, Ukraine decided to drop its legal proceedings against Australia but the other four tobacco-producing countries are still pursuing the case at the WTO and a decision is expected in 2016. It is no secret that big tobacco firms have actively lobbied Honduras to pursue legal action against Australia via the WTO.

The Philip Morris-Australia case has, once again, highlighted that investor-state arbitration has substantial financial implications even if the host state wins the case. Hence, India, Indonesia and other countries that are currently revisiting their investment treaty regimes should have a rethink about the inclusion of the ISDS mechanism in future investment treaties and trade agreements.

The inclusion of the tobacco carve-out in the investment chapter of the recently concluded Trans-Pacific Partnership (TPP) Agreement is viewed by many as a major victory for public health, but the grim fact remains that Australia is a signatory party to more than two dozen agreements (with ISDS obligations) that grant foreign investors the right to challenge tobacco plain packaging and other initiatives to protect public health. □

Kavaljit Singh works with Madhyam, a non-profit organization based in New Delhi devoted to research and public education on economic and developmental issues. This article first appeared on the Madhyam website (www.madhyam.org.in).

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Africa's boom is over

To boost their development prospects, Africa's faltering economies need to turn to industrial policy, but today's trade and investment agreements are restricting their ability to do so.

by Rick Rowden

In recent years, economists and popular publications alike have argued that Africa was on the threshold of an economic boom. Pointing to a decade of high growth and increased foreign investment, this argument held that the continent was finally on track to leave its long years of poverty and under-development behind. Some even said that Africa could become the next global economic powerhouse, following in the footsteps of East Asia.

This view never went entirely unchallenged, of course. In 2013 I argued that Africa's growth would not be real, lasting or beneficial for its people until it was based on industrialization rather than exporting raw commodities. Rather than focusing on the hype of mobile phones and African billionaires, I urged advocates of the "Africa Rising" argument to look at some basic development indicators: Was manufacturing increasing as a percentage of GDP? Were the goods African countries exported becoming more valuable – finished products rather than raw materials? In 2011, a UN report looked into these very questions, and found that most African countries are either stagnating or moving backwards when it comes to industrialization, quite unlike the East Asian experience.

Today, I'm sorry to say, it looks like the skeptics were right. Oil and commodity prices are plunging, China's purchases are slowing, and GDP growth rates across the continent are in steep decline. Reflecting these trends, the International Monetary Fund (IMF) has cut its 2015 projection for growth in sub-Saharan Africa from 4.5% to 3.75%, concluding that the decade-long commodity cycle that had raised African export revenues "seems to have come to an end." With a population boom on the horizon, experts now worry about how the continent will produce enough jobs for its people.

Africa's plight is reflected by developments in its two leading economies, Nigeria and South Africa, which together

account for 55% of the 48 sub-Saharan African nations' GDP and which have both been particularly hard hit by falling mineral and oil prices. Nigeria's growth rate has slumped to 2.4% in the second quarter, the slowest pace in at least five years, while South Africa's economy contracted by an annualized 1.3% as power shortages curbed output. The fall in commodities prices has hit other oil producers too, such as Angola and Ghana, while Zambia, the continent's second-biggest copper producer, has suffered as copper prices have plunged to a six-year low.

Rethinking the use of industrial policy

Without the commodities boom, the actual failure of Africa's development has now been laid bare. In November, *The Economist* finally came around, noting with sudden distress that "many African countries are de-industrializing while they are still poor, raising the worrying prospect that they will miss out on the chance to grow rich by shifting workers from farms to higher-paying factory jobs." But like most free-market champions, it got it wrong when analyzing why Africa has not been industrializing, citing the conventional lack of the "basics" – infrastructure, skills and institutions.

In fact, Africa has had difficulty industrializing because its leaders drank the Kool-Aid of free markets and free trade proffered by the World Bank, the IMF and the best university economics departments over the last 30 years. Of particular harm has been the insistence that African countries forswear the use of industrial policies such as temporary trade protection, subsidized credit, preferential taxes and publicly supported R&D. As a result, African countries have abandoned these key tools, which they could have used to build up their domestic manufacturing sectors.

Free-market advocates told African countries that such "state intervention"

in the economy usually does more harm than good, because governments shouldn't be in the business of trying to "pick winners," and that this is best left to the market. Africans were told to simply privatize, liberalize, deregulate and get the so-called economic fundamentals right. The free market would take care of the rest.

But this advice neglects the actual history of how rich countries themselves have effectively used industrial policies for 400 years, beginning with the UK and Europe and ending with the "four tigers" of East Asia and China. This inconvenient history contradicted free-market maxims and so has been largely stripped from the economics curriculum in most universities. By now, two or three generations of students have unlearned it.

To be fair, critics of industrial policies were correct to cite some historical cases where the policies had badly misfired in developing countries, particularly in Africa and Latin America in the 1960s and 70s. But these critics were often selective in their criticisms, ignoring successful cases and neglecting to explain why they worked so well in the United States, Europe and East Asia while failing so badly in Africa and elsewhere. In Africa and Latin America, industrial policies often failed because they were focused inward on small domestic markets. Companies were often given support based on corruption or nepotism, rather than their efficiency. On the other hand, the successful East Asian countries focused on international markets, and they instilled discipline in companies by cutting off support to those which failed to improve. But this says more about *how* to do industrial policy – not *whether* it should be done.

But a strange thing happened in the wake of the 2008 financial crash and global economic slowdown: industrial policies have made somewhat of a comeback. Harvard's Dani Rodrik said, "industrial policy is back." In 2010 even *The Economist* could not ignore "the global revival of industrial policy." Both the US and the EU have adopted new industrial policies in recent years, and even in Canada industrial policy "need not be taboo," according to a public policy think-tank. The London School of Economics' Robert Wade noted that, by the way, industrial policy never really went away in the rich countries, even if the US refuses to ac-

knowledge its own federal programmes such as the Defense Advanced Research Project Agency (DARPA), the National Institutes of Health (NIH) or the National Institute of Standards and Technology (NIST) as “industrial policy.”

Africans too have taken notice. Recent annual meetings of African finance and development ministers, the African Union and the UN Economic Commission for Africa (ECA) have been raising the issue in a high-profile way. The ECA has begun promoting what it calls “smart protectionism,” suggesting that trade policy in Africa should be “highly selective,” with special treatment for certain sectors to advance national development goals.

Erosion of policy space

But if industrial policy is making a comeback, it’s not likely to be so easy for those in Africa. Many African countries have foolishly signed on to World Trade Organization (WTO) rules that have clearly restricted their “policy space” for using such policies. And while WTO rules still afford them some limited provisions, this is not the case under a raft of other, newer and further-reaching regional free trade agreements and bilateral investment treaties promoted by rich countries over the last 15 years. And even more are on the way: Some of the biggest deals on the immediate horizon are the Trans-Pacific Partnership (TPP), the Trade in Services Agreement (TiSA) and the EU’s free trade deals with several African regions, known as Economic Partnership Agreements.

So, even as we are seeing a renewed appreciation of industrial policy, trade negotiators from the rich countries are twisting arms, cajoling developing countries into signing new treaties and agreements that will restrict their use of industrial policies. Many developing-country leaders either buckle under such pressure or willingly sign on in the hope that they can export more of their primary commodities into rich-country markets in the short term, even if this means foregoing long-term industrialization.

Given this situation, the logical conclusion is still seldom spoken in polite company: African leaders who are serious about pursuing industrialization will have to backtrack, renegotiate and redesign their previous international trade commitments, and refuse to sign new ones that put them at a disadvantage. Offending more powerful trading partners and big foreign investors would likely invite serious short-term conse-

quences, including lawsuits, threats to cut off foreign aid and trade preferences, and possibly lower foreign investment. But the longer-term consequences of not doing so may be far worse.

In Johannesburg, I recently asked the Chairperson of the African Union, Nkosazana Clarice Dlamini-Zuma, how Africa could expect to industrialize if it signs on to the EU’s Economic Partner-

ship Agreements. Her reply: “We’re going to have to renegotiate some of them.”

Rick Rowden is a doctoral candidate in economics at Jawaharlal Nehru University in New Delhi. Previously he worked as an inter-regional advisor for the United Nations Conference on Trade and Development (UNCTAD) in Geneva and as a senior policy analyst for ActionAid. The above article is reproduced from ForeignPolicy.com.

FDI myths and realities

To derive benefits from inflows of foreign direct investment, developing countries need policy flexibility to manage such flows – flexibility that is fast being undermined by a slew of bilateral investment treaties.

by Yilmaz Akyüz

Foreign direct investment (FDI) is perhaps one of the most ambiguous and least understood concepts in international economics. Common debate on FDI is confounded by several myths regarding its nature and impact on capital accumulation, technological progress, industrialization and growth in emerging and developing economies.

It is often portrayed as a long-term, stable, cross-border flow of capital that adds to productive capacity, helps meet balance-of-payments shortfalls, transfers technology and management skills, and links domestic firms with wider global markets.

However, none of these is an intrinsic quality of FDI. First, FDI is more about transfer and exercise of control than movement of capital. Contrary to widespread perception, it does not always involve flows of financial capital (movements of funds through foreign exchange markets) or real capital (imports of machinery and equipment for the installation of productive capacity). A large proportion of FDI does not entail cross-border capital flows but is financed from incomes generated on the existing stock of investment in host countries. Equity and loans from parent companies account for a relatively small part of recorded FDI and an even smaller part of total foreign assets controlled by transnational corporations.

Second, only the so-called greenfield investment makes a direct contribution to productive capacity and involves cross-border movement of capital goods. But it is not easy to identify from reported statistics what proportion of FDI consists of such investment as opposed to transfer of ownership of existing firms

(mergers and acquisitions). Furthermore, even when FDI is in bricks and mortar, it may not add to aggregate gross fixed capital formation because it may crowd out domestic investors.

Third, what is commonly known and reported as FDI may contain speculative components and create destabilizing impulses, including those due to the operation of transnational banks in host countries, which need to be controlled and managed as any other form of international capital flows.

Fourth, the immediate contribution of FDI to the balance of payments may be positive, since it is only partly absorbed by imports of capital goods required to install production capacity. But its longer-term impact is often negative because of high import content of foreign firms and profit remittances. This is true even in countries highly successful in attracting export-oriented FDI.

Finally, superior technology and management skills of transnational corporations create an opportunity for the diffusion of technology and ideas. However, the competitive advantage these firms have over newcomers in developing countries can also drive them out of business. They can help integrate developing countries into global production networks, but participation in such networks also carries the risk of getting locked into low-value-added activities.

These do not mean that FDI does not offer any benefits to developing and emerging countries. Rather, policy in host countries plays a key role in determining the impact of FDI in these areas.

(continued on page 11)

Controlling capital

Combating inequality demands restrictions on the flow of capital across borders.

by Jesse Griffiths

There is a date that marks the rise of global inequality. The rich have always held their grip on the levers of power, but the transformation of our economies, institutions and societies to align with the interest of a small group of the ultra-wealthy started on 15 August 1971.

This is a symbolic date, of course, but an important one. It marks the “Nixon shock” – the day the US President unilaterally announced that dollars were no longer convertible into gold, effectively ending the Bretton Woods system of international monetary cooperation that had helped ensure the longest and most equitable sustained period of global growth in human history.

The breakdown of global cooperation that followed opened up space for neoliberal ideas to elbow the Keynesian paradigm out of the way and, marshalled by the international financial institutions under the banner of the “Washington Consensus,” achieve global domination. The best symbol of how this new world order differed from the post-war consensus was that the chains that had tightly bound capital to national boundaries were smashed. The Bretton Woods system required cross-border flows of finance to be heavily regulated by governments, in order for them to manage their exchange rates within tight bounds. The new system, built on a concept of exchange rate flexibility, explicitly required the reverse: governments should not attempt to control, restrict or influence the “free” movement of capital.

The rise of the wealth and power of the super-rich has many causes, of course, but this idea is at the fulcrum of this shift. The rich no longer have to engage with the societies from which their wealth derives when trying to influence public policy – they can simply move, or threaten to move, their assets overseas. The rise of tax havens, the liberalization of the financial sector, the race to the bottom on the regulation of multinationals, the erosion of labour rights around the world: these all make sense if the objective is to allow wealth – and the super-rich that control an eye-watering share of this wealth – to decide where

best to reside, how best to be (or not to be) taxed, and what obligations may (or may not) be owed to the workers, citizens and customers by whom that wealth was built.

The high point of this march to “free” capital from the obligation to consider its impacts on society arrived in the 1990s when the International Monetary Fund (IMF) tried – and failed – to make it effectively illegal for governments to place any restrictions on the movement of finance across borders.

Now it is time to rout this march, to tame capital once more, and put it back in the service of the public good. The fronts on which we must fight are many, but the fight is already happening. The damaging financial sector liberalization of recent decades must be reversed. This means not just changing the nature of banks – so that large, high-profile banks can never again take extravagant risks and so that financial institutions invest rather than speculate – but also recognizing that ownership matters too. The privatization of the mutually owned financial sector in Britain, the US and elsewhere at the end of the last century helped destroy institutions that helped stabilize economies and stand up for a vision of finance rooted in the needs and priorities of ordinary people. The results of this process of financial liberalization blossomed into the global financial crisis that began in 2007, the worst since the Great Depression that started in 1929.

The weakening of the power of public institutions to intervene and make sure that finance serves the public interest must also be reversed, and new institutions created to prevent future crises. An obvious place to start is with reviewing existing trade and investment agreements and removing the damaging limitations they place on governments’ abilities to regulate cross-border investments. A new institution to fairly and quickly resolve sovereign debt crises – currently being negotiated at the UN – would be a major improvement, allowing debtors to negotiate debt reduction on fair terms with creditors, rather than repeat the Greek tragedy of years of counter-productive and emaciating aus-

terity policies.

We should not be afraid to restate the case for public finance and investment, not just in schools, hospitals and clean water, but also in transforming our infrastructure to speed us to a climate-resilient future. This means, of course, that we have to end the tax dodging that costs our treasuries hundreds of billions per year, close down tax havens and start to cooperate, not compete, internationally to ensure multinationals and the super-rich actually pay their taxes. Progressive taxes, such as a global wealth tax, would be the best symbol of our new desire to end the march of inequality and bring the plutocrats back down to earth. Redistribution is the flipside of that coin. The gaping chasm between not just the super-rich and the rest of us, but also between rich countries and poor countries, continues to demand large global transfers – not “aid” but investment in our shared future prosperity.

Finally, the battle for control of the corridors of power matters. Placing democratic principles at the heart of powerful institutions must be at the core of all our demands, for example to end the one-dollar-one-vote system of the IMF and World Bank, to give developing countries real influence over these powerful institutions. It is not enough to try to match the armies of lobbyists, lawyers and accountants that the plutocrats can muster. The mechanisms of politics should be exposed to the transparent daylight of democratic scrutiny, with the days of policy decisions made in private members’ clubs ended. This means adopting a transparency charter based on the right to information, applicable to all international institutions, as well as transforming the G20 club into a United Nations economic council where all countries have a say, and ending the role of the many undemocratic or unrepresentative institutions – such as the OECD (a rich-country club) or the International Accounting Standards Board (a private company) – in global rule setting.

There is a date that marks the beginning of the march of global inequality. The fight to rout that march and put in place a new world order, based on equity and shared prosperity for ourselves, future generations and the planet itself, has begun on many fronts.

We must win every one. □

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A universal basic income considered

A basic income for all could lift millions out of poverty – and change how we think about inequality, writes *Ralph Callebert*.

The idea of a basic income for every person has been popping up regularly in recent years.

Economists, think-tanks, activists and politicians from different stripes have toyed with the idea of governments giving every citizen or resident a minimum income off which to live. This cash transfer could either replace or supplement existing welfare payments.

Pilot projects and feasibility studies have been run or are under way in the Netherlands, India, Canada, Finland, France and elsewhere. Even in the US, the idea finds support. Alaska, for example, already divides its oil revenues among its residents.

Most arguments in favour of or against basic income have focused on its feasibility, simplicity, promotion of personal independence or effectiveness at reaching those who fall through the cracks of the welfare state. However, the most important advantage of basic income may not be in its practical application but rather in how it could change the way we think and talk about poverty and inequality.

Benefits of a basic income

Giving every resident an unconditional grant, regardless of whether you are a billionaire or destitute, is a significant departure from our existing welfare state. The latter offers only limited and conditional support when working is not an option.

Support for a basic income comes from very disparate political and ideological circles.

Some libertarians like basic income because it promises a leaner state without a large bureaucracy checking people's eligibility and policing their behaviour. Others see it as enabling entrepreneurialism – the poor helping themselves.

On the left, many see basic income as an opportunity to plug numerous holes in the social safety net or even to free people from "wage slavery." For feminists, basic income is a successor to the old demand for wages for housework.

Pilot projects suggest that simply giving money to the poor could successfully tackle poverty. In Namibia, pov-

erty, crime and unemployment went down, as school attendance went up. In India, basic income recipients were more likely to start small businesses.

Jobs are no longer sole answer to poverty

When discussing inequality, we usually focus on employment and production. Yet, much of the world's population has no realistic prospects of employment, and we already produce more than what is sustainable.

Basic income, however, separates survival from employment or production.

Our current answers to poverty and inequality stem from Fordism, the New Deal and social democracy. They centre on wage labour: get more people into jobs, protect them in the workplace, pay better wages and use taxes on wages to fund a limited system of social security and welfare.

It would seem that to get people out of poverty, you have to get them into jobs. Politicians across the spectrum agree. Is there a politician who does not promise more jobs?

In my own research on labour in Africa, however, I have found that wage labour is only a small part of a larger picture.

In most of the Global South, whole generations are growing up without realistic prospects for employment. We cannot develop the world solely by getting people into jobs, encouraging them to start small businesses or teaching them how to farm (as if they didn't already know). The painful reality is that most people's labour is no longer needed by increasingly efficient global chains of production.

In economic speak, a large portion of the world's population is surplus to the needs of capital. They have no land, no resources and no one to whom they can sell their labour.

Thus, to believe that jobs or economic growth is going to address this crisis of global poverty seems naive.

The example of South Africa is telling. In a comparatively rich country where youth unemployment runs at more than 60%, pensions, childcare and disability grants are for many house-

holds the most important source of income. Yet many slip through the cracks of this limited welfare state.

As a healthy adult male, you stand little chance of either receiving a government benefit or finding decent employment, as economic growth has been largely jobless. For an adult without children, disability is the only access to these crucial grants.

In the early 2000s, a movement emerged in support of a very modest Basic Income Grant (BIG) of 100 rand (less than \$12 in 2002) per month. Significantly, this campaign received the support of the government-appointed Taylor Committee. Its report concluded that a BIG was likely fiscally sustainable and would lift as many as six million people out of poverty. It argued that this result could not be achieved by expanding existing welfare programmes. However, the proposal was dismissed by the ruling African National Congress (ANC), which continued to see employment as the only solution to poverty and inequality.

Not surprisingly, basic income campaigns have been prominent in countries with high socioeconomic inequality, like South Africa. These countries have both significant resources and a need for redistribution. In neighbouring Namibia, another country with extreme inequality, a similar campaign has received growing support.

Furthermore, as the Club of Rome already realized in 1972, the productivist bias of our usual answers to inequality – grow more, produce more and grow the economy so that people can consume more – is ultimately unsustainable. Surely, in a world already characterized by overproduction and overconsumption, producing and consuming more cannot be the answer. Yet, these seem to be the answers with which we are stuck: grow, grow, grow.

Give a man a fish

To move beyond these defunct politics, we may need to think about distribution rather than production, a point powerfully argued by anthropologist James Ferguson. For Ferguson, giving a man a fish might be more useful than teaching him to fish.

The problem of global inequality is not that we do not produce enough to provide for the world's population. It is about the distribution of resources. This is why the idea of a basic income is so important: it discards the assumption

that in order to get the income you need to survive, you should be employed or at least engaged in productive labour. Assumptions of this kind are untenable when for so many there are no realistic prospects for employment.

This does not mean that basic income is a panacea. There are too many potential problems to list here. Yet, to give just a few examples: those countries whose populations would need it most might be least able to afford such schemes. And, basic income grants that are small enough to be politically acceptable may actually further impoverish the poorest if basic income replaces other grants.

Moreover, if people get money merely because they are citizens or residents of a country – shareholders in the wealth of that country – these claims become very susceptible to nationalist and xenophobic exclusion. Indeed, during recurrent episodes of xenophobic violence in South Africa, many explained their dislike of foreigners by accusing them of receiving welfare grants and public housing that should be going to South Africans.

Despite these problems, it is important to start experimenting with alternatives and to start thinking about distribution rather than production. After all, the welfare system that we have now also resulted from longstanding debates, experiments that were once considered unrealistic, ad hoc improvements and partial victories. □

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(continued from page 8)

A laissez faire approach could not yield much benefit. It may in fact do more harm than good.

Successful examples are found not necessarily among countries that attracted more FDI, but among those which used it in the context of national industrial policy designed to shape the evolution of specific industries through interventions. This means that developing countries need adequate policy space vis-à-vis FDI and transnational corporations if they are to benefit from it.

Liberalization of FDI regimes

Still, the past two decades have seen a rapid liberalization of FDI regimes and erosion of policy space in emerging and developing countries vis-à-vis transnational corporations. This is partly due to the commitments undertaken in the World Trade Organization as part of the Agreement on Trade-Related Investment Measures.

However, many of the more serious constraints are in practice self-inflicted through unilateral liberalization or bilateral investment treaties signed with more advanced economies – a process that appears to be going ahead with full force, with the universe of investment agreements reaching 3,262 at the end of 2014.

Unlike earlier bilateral treaties, recent agreements give significant leverage to international investors. They often include rights to establishment, the national-treatment and the most-favoured-nation clauses, broad definitions of investment and investors, fair and equitable treatment, protection from expro-

priation, free transfers of capital and prohibition of performance requirements.

Furthermore, the reach of bilateral investment treaties has extended rapidly thanks to the use of so-called special purpose entities which allow transnational corporations from countries without a bilateral treaty with the destination country to make the investment through an affiliate incorporated in a third-party state with a bilateral treaty with the destination country.

Many bilateral investment treaties include provisions that free foreign investors from the obligation of having to exhaust local legal remedies in disputes with host countries before seeking international arbitration. This, together with lack of clarity in treaty provisions, has resulted in the emergence of arbitral tribunals as lawmakers in international investment which tend to provide expansive interpretations of investment provisions in favour of investors, thereby constraining policy further and inflicting costs on host countries.

Only a few developing countries signing such bilateral treaties with advanced countries have significant outward FDI. Therefore, in the large majority of cases there is no reciprocity in deriving benefits from the rights and protection granted to foreign investors. Rather, most developing countries sign them on expectations that they would attract more FDI by providing foreign investors guarantees and protection, thereby accelerating growth and development. However, there is no clear evidence that bilateral investment treaties have a strong impact on the direction of FDI inflows. (IPS) □

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(continued from page 16)

or enterprise of their choosing, is also a means of bypassing large financial institutions. However, the growing popularity of these schemes puts them at risk of corporate takeover; in this sense, it is worth investigating how different platforms operate before jumping on the bandwagon.

There are also a number of different campaigns aimed at addressing the problems wrought by financialization. Most of these campaigns focus on lobbying governments to regulate specific aspects of the financial industry. For example, the US “Stop Gambling on Hunger” and the European campaign against “Food Speculation” (which combines the work of a number of civil society organizations and NGOs) have been pressuring for the introduction of new rules to roll back the financialization of agricultural commodity markets. The latter campaign contributed to the European Union’s decision to

impose position limits, capping the number of contracts on agricultural commodities that any one financial trader or group of traders can hold. Unfortunately, opposition to the regulations, especially from the UK government, watered down the agreement and left key loopholes open. There are also multiple campaigns for implementing or strengthening more general financial transaction or “Tobin” taxes, aimed at stifling speculation.

We have outlined just a few channels through which financialization is being challenged. Throughout history people have responded to coercion in creative and unexpected ways. Just as financialization is a recent historical phenomenon, so resistance to it has just begun. □

The above is extracted from “Financialization: A Primer”, published by Transnational Institute (October 2015) and written by Frances Thomson and Sahil Dutta. The full report with references is available on the Transnational Institute’s website (www.tni.org).

The rise of financialization

Financialization has drawn into its expanding orbit non-financial firms and the average household, with detrimental impact on production, employment and inequality. The following extract from a Transnational Institute publication on financialization explores the consequences of this phenomenon, the factors behind its ascendancy, and how it can be resisted.

Financialization is a relatively new term which covers such a range of phenomena that it is difficult to define precisely. The most-cited definition, from Gerald Epstein, states: "financialization means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies".

How does financialization change the wider economy?

Financialization is a shift in the way wealth is accumulated. Whereas in the past profits were mostly derived from the mass production and sale of goods, in our financialized era a large proportion of profits comes from the buying and selling of financial securities and the interest payments they accrue.

A study conducted by the International Labour Organization (ILO) covering 17 different countries found that the portion of profits represented by the financial sector rose to over 40% in 2005.

Although the financial sector's share in US domestic profits fell drastically during the first few years of the Great Recession, by 2010 it had recovered to almost 30%.

Financialized accumulation profoundly affects how the economy works. If companies can make more from trading financial assets than manufacturing products, they may choose not to invest in new technology or they may spend on expanding their finance department to the detriment of other areas. In other words, financialization has been shown to negatively impact on "real" investment. The trend is clear: where higher profits can be made through financial speculation, productive investment tends to decline.

Meanwhile, households have become increasingly reliant on credit in the face of declining or stagnating real wages and employment instability. Debt is now a major source of funding for people's everyday spending, especially in countries like the US and the UK. In the past, productivity increases were tied to wage growth, which allowed for rises in spending and thus demand and growth. Over the last few decades, in contrast, demand (and hence growth) has become increasingly reliant on greater indebtedness.

Debt is not only used to sustain consumption but also to fund financial investment and speculation. Many countries' tax codes encourage companies to increase their indebtedness by allowing interest repayments to be counted as a cost, reducing overall profits that are taxed. Many companies raise finance from debt rather than by issuing shares, because this allows them to maintain high profits per share, which helps keep share prices up. Both financial and non-financial firms have become increasingly reliant on credit for financial investments; this trend is especially evident in the US but is also

matched in the UK, Japan and Ireland.

A number of studies have shown that debt-led growth, in addition to being inherently unstable and hence prone to crisis, is also ineffective in the long run. Debt-led growth, however, is just one side of the story. For while financialization has led countries such as the US and the UK to offset falling income levels with increased debt, others, such as Germany or China, have attempted to resolve similar demand problems by means of increased exports.

It is sometimes argued that financialization in the Global North simply reflects the shifting of production and manufacturing activities to other parts of the world (in the Global South), which leaves predominantly financial functions in the multinational corporation's "home country". However, Krippner found that US multinationals' profits from foreign financial activities have increased relative to profits from overseas production. In other words, US companies appear to be bringing their "financialized" practices with them to other countries. In sum, corporations are reaping profits not only from relocating production but also increasingly from a boom in financial activities overseas. In both cases, the benefits to countries in the Global South are limited, which has contributed to the "persistence of the North-South divide".

How are non-financial firms changing in the context of financialization?

As Demir puts it, many non-financial companies have themselves "metamorphosed" into "financial rentiers". A retail giant like Tesco may choose to buy up large parcels of land, speculating that rising prices mean it can sell the land later for a profit, without ever building a new outlet. Similarly, Sainsbury's, another UK supermarket chain, now offers insurance and banking services to its customers. Such is the involvement of large (ostensibly non-financial) corporations in finance that many have their own departments specialized in financial activities. For example, in the case of Enron, financial assets were so central in the business strategy that the company building had its own trading floor.

Krippner shows that since the 1950s, US non-financial firms, particularly manufacturing companies, have increasingly relied on financial income streams. According to another study, US non-financial firms' financial returns (as measured by "interest and dividend income as a percentage of internal funds") grew from 20% for most of the 1960s to a high of over 50% from the late 1980s on into the early 2000s. Around the same period, US non-financial corporations began to invest more in financial assets (like stocks and bonds) than they did in their own non-financial assets (like machinery). Their proportion of financial assets relative to "real assets" increased from around 30% in the 1970s to over 100% in the early 2000s.

Various case studies – examining coffee traders, oil companies, agribusiness and auto-assembly firms – provide concrete evidence of the “financialization of non-financial firms” from across the world.

Lapavistas argues that the financialization of corporations ties in closely to their reduced reliance on banks for credit and their pursuit of profit from unused funds. In other words, corporations sought ways to both lend and borrow money, and engaging in financial markets directly offered “lower costs” and more “flexibility” than going through banks. Gradually, non-financial firms developed financial “skills” and “acquired functions that previously belonged to financial institutions”. As discussed below, the financialization of non-financial companies also relates to the imposition of shareholder value principles and the short-term profitability of financial relative to real investments.

How does financialization impact on employment and income inequality?

The effects of financialization on investment extend to employment. Businesses, of course, invest not just in equipment but also in their staff. Whereas in the past new job opportunities and expansion of productive activity would have been an indication of economic well-being, in the era of financialization share prices often rise following the announcement of job cuts and physical capital downsizing. For example, in May 2014 Hewlett-Packard’s stock prices rose more than 6% the day after it announced that it would cut between 11,000 and 16,000 jobs. Furthermore, many businesses transfer the burden of capital market demands onto their workers, slashing wages and adding, in different ways, to the growing precariousness of employment.

Real wage growth has been stagnating or declining in countries such as the US and the UK over the last 30 or so years. At the same time, managers and CEOs within the productive sector and top-level financial sector employees have seen their pay packets swell, in large part due to stock option pay and bonuses – contributing to growing income inequality.

If the impacts are negative for labour when finance is “doing well”, they are even worse when it isn’t. Workers were the group worst affected by the global economic crisis. Not only did unemployment grow across the Global North, but wealth inequality also continued to rise. Thus, in contrast to the Great Depression when inequality fell because of declining asset values held by a minority elite, in the contemporary Great Recession asset prices recovered relatively quickly (in part due to the help of government bailouts) and the wealthy got by relatively unscathed.

The increasing importance of the financial sector overall, combined with the growing reliance of non-financial firms on financial income relative to productive activities, seems to have made capital less dependent on labour for profits and thus further tilted the balance of class power. Still, it is important not to make overly simplistic generalizations. Drawing on evidence from the German automobile industry, Kadler and Sperling show, for example, the continued importance of collective bargaining and trade unionism in influencing key decisions within some globalized and financialized firms.

What is shareholder value and what is its role in financialization?

One of the most important aspects of financialization is also one of the least well understood: shareholder value governance. Over the last 40 years non-financial companies have become obsessed with their share prices, and seem to dedicate more resources to improving their share price than they do to improving the products or services they sell. To do so, firms sell off divisions that are less profitable, fire staff, outsource services and often spend vast sums buying their own shares.

Many argue that shareholders – investors on financial markets – have used the stock markets to force companies to prioritize shareholder returns above all other concerns; this is often called “shareholder value maximization”. If shareholders felt managers were not delivering high enough returns, they would sell the equity and take their money to a company that did. This market pressure is supposedly exacerbated by the fact that ownership of corporate stocks is concentrated in a few hands. If a big institutional investor decided to sell all the shares it owned, share prices could tumble. In this way the stock market supposedly left managers with no choice but to obsess over share prices.

However, the reality is that the big institutional funds, bar a few isolated incidents, have actually been unable to force their will on non-financial companies. More often than not, it’s easier for them to go along with management’s decisions than to challenge them. So rather than shareholders forcing managers to make share price the main priority, it is the managers of non-financial companies themselves that have led the change.

In a financialized environment where lots of debt can be raised very quickly (thanks to securitization), it is far easier to acquire companies, restructure them and sell off divisions than it is to try and build long-term plans and improve productivity. In today’s age, many corporations’ main priority is to be able to borrow money quickly and easily, and a high share price is a good route to creditworthiness. The chase for high share prices and sound creditworthiness has made financial criteria – and financial experts and accountants – central to the strategies companies adopt. Accountants, not engineers, now decide what’s best for industrial companies.

To compound matters, managers have tied their own salaries to share prices by paying themselves partly through stock options. So when share prices increase, so do their own salaries.

The increase in share prices has also been boosted by general demand on the stock markets. This new demand is a result of the massive inflow of funds from households drawn into financial investment through pension plans or special saving schemes. Thus, as Froud et al. point out, “with financialization, stock prices are driven by the pressure of middle class savings bidding for a limited supply of securities”. This has made the underpinnings of recent shareholder gains extremely unstable. The authors even liken the operation of the US and UK financial markets to a giant Ponzi scheme, with the income of existing shareholders largely depending on the continual entrance of new players.

Overall, it is clear that financial markets have an enormous impact on corporate behaviour. In the race to increase

share prices, many corporate managers have begun to mimic financial market conduct – changing the disposition of the company towards “short-termism”. Non-financial firms have chosen to seek new profit channels through financial activities, restructuring (e.g., outsourcing, takeovers and mergers) and financial engineering (e.g., share buybacks or tax dodges), instead of investing in new products or to improve productivity.

How does financialization affect the “average” household?

A lot of people have become more dependent on financial products for their wants and needs. Though use of credit by households is not a new phenomenon, household financial activities have changed both quantitatively and qualitatively. Individuals may be involved in financial markets through their insurance cover (health, home, car, life, unemployment), their pension plans, their savings schemes, their student loans, mortgages and different consumer borrowing options such as overdrafts, short-term loans and credit cards. The reliance on loans, especially, has become habitual in many countries, the normality of credit card usage being an obvious example. Increasing use of and access to credit is sometimes treated as a symptom of affluence; however, it can also be viewed as the result of social pressures for maintaining or increasing consumption whilst facing stagnating or falling real wages.

As Montgomerie has described, retail banking innovations have integrated individuals and households into capital market networks whether they know it or not. For example, by securitizing credit card and mortgage debt and selling these securities on international markets, retail banks brought consumers and households into direct contact with investment banking. This made consumer debt a very profitable and apparently secure activity and allowed for an increase in the credit available.

Households engage in financial markets not only as debtors but also as investors. Since the 1980s and 1990s, many governments have been pushing reforms encouraging (for example, with tax incentives) the adoption of private “individual retirement plans”. There has been a drift away from “pay as you go” or PAYG (where retirees or pensioners are paid with taxes and contributions from people currently working) towards “partially funded” or “fully funded” (in which contributions are invested in a fund, later used to pay benefits) systems. As such, retirement savings have been channelled into financial institutions. Even those countries (e.g., France) that maintain relatively large public pension systems have been gradually changing from PAYG to investing state funds in financial markets.

At the same time, within companies, there has also been a shift from “defined benefit” to “defined contribution” type plans, which has implied the transfer of risk from employer to employee. Under defined benefit plans, the employer or company provides pensions for its employees. It bears the financial risks and has to pay its workers as promised even when its investments don’t perform as expected. With defined contribution plans, in contrast, individuals hold their own accounts that incur gains or losses depending on investment performance. In sum, pension reform has converted many workers into investors with a direct stake in the performance

of stocks and bonds.

All in all, through debt, pension and other types of savings, households have become more closely involved in financial markets. This implies a cultural transformation in which households are supposed to adopt a “finance rationality”. In making decisions about which pension plan to choose, the type of savings scheme to invest in, between variable and fixed interest rate loans, and so forth, the individual or family is expected to act as a rational financial actor, analyzing and calculating the costs and benefits of different options. In short, he or she should behave as any other investor. Above all, the individual worker or household should allegedly assume financial risks and take responsibility for his or her own future.

Indeed, the mounting reliance of households on financial markets is the corollary of a total or partial withdrawal of state provisions such as pensions and other types of social security, subsidized housing, health and education. It is about “the transfer of risk and responsibility from the collective to the individual”. With this in mind, many governments and institutions have been aggressively advocating “financial literacy” for everyone. Neoliberal discourse calls this “financial empowerment”. However, the result has been to “naturalize ideas about self-reliance and to depoliticize more specific questions about the privatization of risk”.

How did financialization become so dominant?

Financialization is not something that simply occurred. Political decisions or non-decisions permitted the process of financialization to take off and continue apace. Although deregulation responded, in part, to “regulatory arbitrage” and loopholes that some corporations were already taking advantage of, policies at national and international level also actively encouraged activities and changes that buttressed financialization. Finally, non-action, such as the refusal to intervene in financial activities that are potentially destabilizing, has been at least as important as active policy reform.

Neoliberal policy, in particular, bolstered financialization. The focus in the last few decades on maintaining low inflation, as opposed to the post-war Keynesian-era macroeconomic goal of maintaining full employment, has particularly benefited the financial sector because inflation erodes the value of financial assets. Of course, inflation affects everyone; it eats away at savings and makes salaries lose their purchasing power, but the priority it has been given, the goals that have been set and the methods (austerity or interest rate hikes) by which it has been contained, skew benefits to the financial sector.

A rise in interest rates, for example, worsens debt loads (for governments, companies and households) and can contribute to a stifling of growth as a result of increasing credit costs. Yet at the same time, high interest rates tend to benefit the financial sector and may encourage investors to flock to financial assets at the expense of long-term productive investment in the “real” economy.

The relation between financial gain and interest rates, however, is not straightforward. It is important to note that it was extremely low interest rates that initially fuelled the financial bubble in the US. Financial institutions took advantage of low federal funds rates by leveraging their investments. This is reflected in the high levels of debt taken on by these firms during the boom.

Some governments have become resigned to such economic policies, arguing that they have little choice in the matter. Once financial liberalization has taken place and capital is unshackled from its chains, national policy autonomy is limited to an extent. On the one hand, the ability to tap into private financial sources depends on “creditworthiness” as assessed by international institutions and rating agencies. On the other hand, countries that don’t comply with investor interests are punished by “capital flight” where investors take their money out of a country to pursue greater returns elsewhere.

There are, however, significant differences between countries in this regard, depending on global political economic positioning and power. Some governments are more restrained by capital market valuations than others, while how countries respond to these pressures depends upon outcomes of conflicts and negotiations between different actors within specific contexts. Examining the case of Argentina, Jimenez observes that neoliberal restructuring in the 1990s “reflected an alliance of political power between the state and transnational financial power at the expense of industry”. Financialization, she argues, was imposed by a particular coalition of interest groups who intended to encourage a finance-led growth regime in the Argentine economy. This created a boom in the mid-nineties followed by a bust in 2001.

Many economists celebrate the restrictions imposed on public policy through capital mobility; Thomas Friedman, for example, calls this the “golden straitjacket”. From this point of view, capital mobility serves as a “disciplinary instrument” forcing governments to adopt the “appropriate” monetary and fiscal policies such as balanced budgets (which may require harsh austerity measures), low inflation, generous tax codes and deregulated financial markets. Ironically, rules of fiscal austerity do not apply in the event of a financial crisis in which the government is expected to bail out private investors and institutions. Thus market discipline dictates not the desired amount of government spending but the desired form: budgets which include funds for health, education or social security, for example, are seen as objectionable, whilst in the case of a financial crisis the government is expected to empty its purse.

The financial institution bailouts imposed by the US and various European governments following the 2008 crisis are a good example. In autumn 2008 the US Congress passed the Troubled Asset Relief Program or TARP which provided up to \$700 billion for buying up or insuring “troubled” financial assets. For Palley, the purpose was not necessarily to save investors from incurring losses but to prevent a wider crisis, since under financialization the fortunes of the broader economy depend on the financial system.

Despite the US government’s injection of cash, the financial system remained reticent to lend and the “credit crunch” dragged on. At the same time, financial institutions quickly recovered profitability and were not so reticent about paying out large “rewards” to their top employees.

How have political and economic interests promoted financialization?

Notwithstanding those examples where regulators’ choices were (apparently) constrained, there are countless cases from across the world that clearly point to political and eco-

nomical interests as the ultimate determinants in financially biased policymaking. Pension reform is a good example. In many countries an ageing population is said to pose an imminent risk of a pension crisis. There are many different possible solutions to this problem, but un-coincidentally most governments have veered in the same direction: a closer integration of the pension system with global financial markets. Put simply, more and more people’s retirement savings are now invested in capital markets.

This has three main impacts favourable to financial firms. First, it provides them with new income and profit channels. Second, in contributing to demand for financial assets, it encourages asset price inflation that props up finance-led accumulation. Third, the growing number of individuals with a stake in the financial markets facilitates support for policies that end up benefitting large financial firms. Financialized pension regimes help to cultivate a culture of finance among the population that normalizes the finance-dominated society in which we live.

One of the countries with the worst fame for its politicians pandering to financial sector interests is the US. Apart from the extensive congressional lobbying by big banks and the huge sums financiers “donate” to political campaigns, there is a “revolving door” between Wall Street and Washington in which individuals move between positions as politicians and regulators and high-end jobs in the financial sector.

In 2004, the US Securities and Exchange Commission (SEC) heeded to the largest investment banks’ lobby for an exemption from the established “net capital rule”. The regulation required brokers to maintain a certain level of liquid asset reserves relative to their liabilities, ensuring their ability to meet payments even under unforeseen circumstances of severe investment losses. In effect, the regulation limited the amount of debt the brokers could take on and thus restricted their participation in lucrative leveraging strategies; it also tied up money in reserves that could otherwise be used for different profiteering ventures. From the investment bank’s perspective, then, this was something worth lobbying about. The exemption was eventually applied to big investor banks with assets of more than \$5 billion. In exchange for being released from these rules, the banks promised to allow the commission access to their books, but the SEC basically left them to self-regulate. These decisions were later questioned in light of the 2008 crisis and the enormous amount of taxpayer money spent on bailing out large investment banks. It is worth noting that one of the big investment banks pressuring for this change was Goldman Sachs, which at the time was headed by Henry Paulson, who in 2006 became Treasury Secretary of the US. In 2008, Paulson supported the government move to use public money to cover private financial losses, including those of Goldman Sachs.

In most countries, gestures of reform since the financial crisis have been meagre – at best. Without a significant change in power dynamics, it is unlikely that governments will do much to halt the financialization process. Indeed, financial institutions’ profitability recovered not long after the financial meltdown, and some of these profits were quickly put to work lobbying congress to block reforms considered detrimental to their interests.

What is “financial democracy” and why is it problematic?

The growing involvement of “ordinary” people in finan-

cial markets is sometimes celebrated as the dawn of a “financial” or “investor” democracy. Wealth is supposedly constantly redistributed from corporations to the millions of worker-shareowners. Policies that favour Wall Street or the City now allegedly represent the public good instead of a narrow minority.

Yet only a small percentage of the population is able to invest enough savings for financial gains to be truly relevant. The impression made by the statistic of more than half of North Americans having a “stake in” the financial markets quickly deflates when considering that 40% of stockowners hold only “negligible” amounts in shares: “70 per cent of US households still own few or no stocks.” In sum, most people do not benefit in a significant way from rising share prices or increasing dividend payments. Furthermore, the notion of financial democracy distracts from the fact that the sector is actually highly concentrated. If before the crisis many institutions were considered “too big to fail”, this only worsened with restructurings: as of 2009 just five investment banks controlled 37% of financial assets in the US.

Still, the mere impression of financial democracy, regardless of the fact that it is not backed by the figures, consolidates the hegemony of finance: “As investors, many workers now appear to have a direct material interest in neoliberal policies such as capital mobility, price stability, low capital-gains tax and shareholder value.” In reality the losses suffered by the majority under these policies are more than the measly gains obtained from them.

The financial democracy thesis is also questionable given that workers and large corporations are clearly un-equals in the finance game. Most big firms cannot easily be taken advantage of by financial institutions, given they have a similar level of power and information access, but individuals often use finance to meet basic needs and may have few alternatives. For example, a company may take out credit as part of a calculated leveraging strategy (i.e., in order to multiply gains), whilst an individual may have little option but to take on a student loan or even use a credit card to pay for groceries when his or her derisory salary runs out. Furthermore, workers continue to be mere consumers of financial products, while large firms have the capacity not only to buy in the financial markets but also to sell. Finally, “limited liability” gives corporations exceptional power compared to the household: unlike with workers, the homes of shareholders are not expropriated in order to pay the debts of an insolvent company. There is clear evidence of this inequality when considering the outcome of the Great Recession: a lot of families lost homes and jobs, while the state used public funds to rescue many companies.

For Bryan, Martin and Rafferty, far from constituting a “financial democracy”, financialization can be likened to an “enclosure” of the household: “the realm of reproduction and domesticity” has been converted into “a scene for further accumulation”. In many cases, households are forced to work more (e.g., additional employment or overtime) in order to sustain growing levels of debt. As argued by Lapavistas, there is an “evident contradiction at the core of this phenomenon”: the growing reliance of banks on extracting profit from workers’ income corresponds with stagnating real wages – in essence, it is not a sustainable strategy as eventually workers

may not be able to meet debt payments, which can lead to wider economic crisis, as in the 2007-08 housing market crash.

Despite hopes that greater financial inclusion and literacy could foster wealth creation (by channelling idle savings directly into capital markets) that filters to all rungs of society, and could even provide a mechanism for people (as equity holders) to hold large companies to account, the practice has turned out quite differently. Instead, “financial democracy” has meant the money of the many fuelling the profits of the few.

How can financialization be resisted?

Financialization has imposed new pressures on everyday life and made old pressures worse. But it has also opened up new possibilities for resistance.

One is debt itself. Just as striking coalminers once used their access to the engine of the economy – coal – to flip the balance of power and demand better conditions, so now debtors can use their access to credit by declaring a debt strike. A refusal to accept unfair quantities of debt lumbered on people in financialized economies can force creditors to back down or change their terms of payment. In early 2015, a group of 15 students in the US refused to pay back the student loans they took out to attend the for-profit Corinthian colleges. Outstanding student debt in America is over \$1 trillion and organizations like Strike Debt and the Debt Collective hope to organize mass refusals to help counter the debt-laden financialized norms they live under. Refusing repayment and demanding a write-off of debt is not unfamiliar and has a long history. Anthropologist David Graeber’s thorough history, *Debt: The first 5000 years*, shows how debt jubilees have been common since the debt slates were wiped clean in ancient Mesopotamia.

Another route of resistance is the attempt by campaigners to foster solidarity and a sense of collective identity among debtors. Rolling Jubilee, a collective that grew out of Occupy Wall Street, is using the financial markets to this end. It is organizing debt jubilees by collecting donations to buy distressed personal debt (money that banks have given up trying to collect) at discount on the secondary debt market. Instead of allowing it to fall into the hands of debt collectors, the group steps in, buys the debt and writes it off. Those who have had their outstanding loans cleared are then encouraged to donate to keep it moving. Because the debt is worth much less than the value of the initial loan, they are able to buy up large quantities. By March 2015 Rolling Jubilee had raised over \$70,000 to abolish almost \$32 million of distressed debt. They hope that such actions will make even more radical debt strikes possible.

Another way of exercising pressure on large banks is by simply “moving your money” to smaller institutions with different operating logics. The Move Your Money campaign created a “Bank Ranking Scorecard” which ranks UK banks and building societies according to criteria including “honesty, customer service, culture, impact on the real economy and ethics” in order to help consumers decide which institution to hold an account with. Crowdfunding and peer-to-peer lending, in which individuals lend or donate directly to the project

(continued on page 11)