Financialisation: Tackling the Other Virus

Jomo Kwame Sundaram
IDEAS
Malaysia

Michael Lim Mah Hui
Third World Network
Malaysia

The 1971 Bretton Woods (BW) system collapse opened the way for financial globalisation and transnational financialisation. Before the 1980s, most economies had similar shares of trade and financial openness, but cross-border financial transactions have been increasingly unrelated to trade since then.

Although COVID-19 recessions have rather different causes and manifestations from the financially driven crises of recent decades, financialisation continues to constrain, shape and thus stunt government responses with deep short-, medium- and long-term consequences.

It is thus necessary to revisit and contain the virus of financialisation that has been wreaking long-term havoc in developing, especially emerging market, economies. No one is working on a vaccine against financialisation, though many influences have been infecting us. After all, financialisation is touted as the miracle cure-all to the major economic problems of our times, rather than seen as the insidious threat it poses to the real economy.

Financialisation

Global financialisation has spread, deepened and morphed with a changing cast of banks, institutional investors, asset managers, investment funds and other shadow banks. Transborder financialisation has thus been transforming national finance and economies.

The changing preferences of financial market investors have been reshaping the uneven spread of market finance across assets, borders, currencies and regulatory regimes. To preserve and enhance their value, new financial asset classes and relationships have been created.

Within borders, banks and shadow banks are lending to households, companies and one another, while national frontiers do not matter for securities and derivative markets, often financed via wholesale money markets.

Over the last four decades, the scope, size and concentration of finance has grown and changed as mainly national regulatory authorities try to keep up with recent financial innovations and their typically transnational consequences.

Managing Discontents

Financialisation has involved reorganising finance, the economy and even aspects of society, to enable investors to get more from financial market investments, effectively undermining sustainable growth, full employment and fairer wealth distribution. The following measures should help slow financialisation and limit some of its adverse effects:

Strengthen international financial regulation

While financialisation has become transnational, financial regulation remains largely national, albeit with some transborder effects of the most powerful, such as US tax rules and Fed requirements. Transnational finance has often successfully taken advantage of loopholes and 'arbitrage' to great profit.

Multilateral cooperation to strengthen effective and equitable regulation will be difficult to secure as voting power in the only multilateral institution, the IMF, remains heavily biased against developing countries.

Strengthen national capital-account management

Transnational financialisation has made developing countries more vulnerable to transnational finance and its rent-gouging practices, while also causing greater instability and limiting policy space for development.

Although the IMF's article 6 guarantees the national right to capital-account management, all too many national authorities in developing countries, especially emerging markets, have been deterred from exercising their rights effectively.

Improve national regulation of finance

Improving the effective, equitable and progressive national regulation of finance, particularly market-based finance, remains challenging, especially in emerging-market economies where typically divergent, if not contradictory, banking and capital-market interests seek to influence reforms differently in their own specific interests.

Strengthen Bank Regulation

There were few banking crises from the 1930s to the 1970s after banking was strictly regulated following the 1929 Crash. With financial deregulation from the 1980s, major financial and currency crises have become more frequent. More effective regulation and supervision are urgently needed, not only of banks but also of 'shadow banks', which account for a large and growing share of transnational finance.

Make Finance Accountable

Instead of improving regulations to achieve these objectives, the growth and greater influence of finance have led to regulatory capture, with reforms enabling—not hindering—financialisation, including its adverse consequences. Political financing reforms are also urgently needed to limit the influence of finance in politics.

Promote Collective, not Asset-based Welfare

Financialisation has been enabled by the reduced role of government. Nationalising or renationalising pension funds and improved government 'social provisioning' of health, education and infrastructure would reduce the power and influence of institutional investors and asset managers.

Ensure that Finance Serves the Real Economy

The original and primary role of finance—to provide credit to accelerate productive investments and to finance trade—has been increasingly eclipsed by financial institutions, including banks, which have been engaging in securities and derivatives trading and other types of financial speculation.

Such trading and speculative activities must be subjected to much higher and more appropriate regulatory and capital requirements, with commercial or retail banking insulated from investment or merchant banking activities—for example, insulating Main Street from Wall Street, or High Street from the City of London, instead of the recent trend towards 'universal' banking.

Promote patient banking, not short-termist profiteering

National financial authorities should introduce appropriate incentives and disincentives to encourage banks to finance productive investments and trading activities, and deter them from pursuing higher short-term profits, especially those created from daily changes in securities and derivatives prices.

This can be achieved with appropriate regulations and deterrent taxes on securities and derivatives financing transactions. An alternative framework for banking and finance should promote long-term investment over short-term speculation—for example, by introducing an incremental capital gains tax where the rate is higher the shorter the holding period.

Ensure Equitable Financial Inclusion

While financial exclusion has deprived many of the needy of affordable credit, new modes of financial inclusion which truly enhance their welfare must be enabled and promoted.

Financial inclusion has often extended exploitative and abusive financial services to those previously excluded. In some emerging-market economies, for example, levels of personal and household debt have risen rapidly, largely due to inclusive finance initiatives.

New Financial Technologies

Financial houses are profitably using new digital technologies to capture higher rents. While technological innovations can advance financial inclusion and other progressive development and welfare goals, thus far they have largely served financial rent-gouging and other such exploitive and regressive purposes.

For example, while Big Data has been used to track, anticipate and stop the spread of infectious diseases, it has also been more commonly abused for commercial and political purposes.

National regulators must be vigilant of ostensibly philanthropic foundations and businesses that actively promote 'fintech' in developing countries without sufficient transparency, let alone consideration of its mixed purposes, implications and potential.

Minimise Tax Avoidance

Besides curtailing and penalising tax avoidance practices at the national level, tax accountants, lawyers and others who greatly enable and facilitate tax evasion and related abuses should be much more effectively deterred.

Strengthen Multilateral Cooperation to Equitably Enhance National Fiscal Capacities

Governments must cooperate better multilaterally to more effectively and equitably tax transnational corporations and high net worth individuals. Such cooperation should effectively check illicit financial flows with strict regulations to deter private banking, banking secrecy, tax havens and other international facilitation of tax evasion.

Existing initiatives need to be far more inclusive of, sensitive to and supportive of developing-country governments. OECD-led initiatives previously excluded developing countries, but their recent inclusion, while an advance, remains biased against them.

Originally published 9 July 2020

Remembering Thandika's timeless article -
"Running while others walk: Knowledge and the Challenge of Africa's Development"-
In this article Thandika centers African universities at the core of the continent's development efforts.
By this Thandika meant that if Africa will have to run, the university will have to sprint.

Read the article here – https://bit.ly/3F3xdFV

Souvenons-nous de l'article intemporel de Thandika -
« Courir pendant que d'autres marchent : le savoir et le défi du développement de l'Afrique ».
Dans cet article, Thandika place les universités africaines au cœur des efforts de développement du continent.
Thandika voulait dire par là que si l'Afrique doit courir, l'université doit sprinter.

Lisez-le ici – https://bit.ly/3F3xdFV