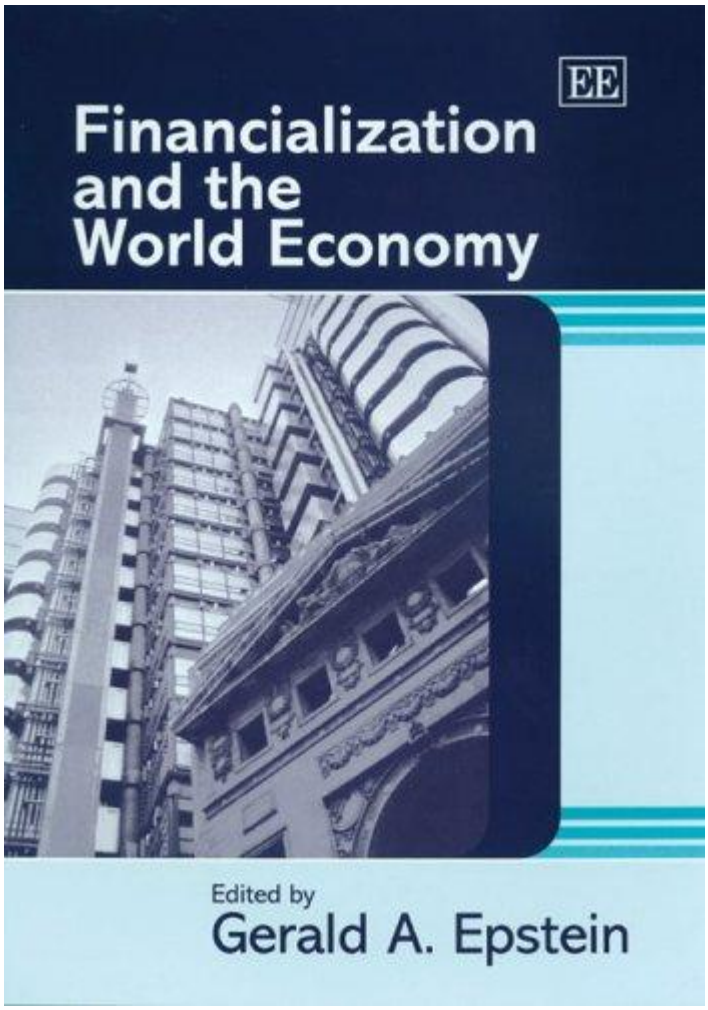

1. Introduction: Financialization and the World Economy

Gerald A. Epstein

INTRODUCTION

In the last thirty years, the economies of the world have undergone profound transformations. Some of the dimensions of this altered reality are clear: the role of government has diminished while that of markets has increased; economic transactions between countries have substantially risen; domestic and international financial transactions have grown by leaps and bounds (e.g. Baker, Epstein and Pollin, 1998: chapter 1). In short, this changing landscape has been characterized by the rise of *neoliberalism, globalization,* and *financialization.*

While many books have been written about neoliberalism and globalization, research on the phenomenon of financialization, the subject of this book, is relatively new. In fact, there is not even common agreement about the definition of the term, and even less about its significance. Greta Krippner gives an excellent discussion of the history of the term and the pros and cons of various definitions (Krippner 2004). As she summarizes the

discussion, some writers use the term 'financialization' to mean the ascendancy of 'shareholder value' as a mode of corporate governance; some use it to refer to the growing dominance of capital market financial systems over bank-based financial systems; some follow Hilferding's lead and use the term 'financialization' to refer to the increasing political and economic power of a particular class grouping: the rentier class; for some financialization represents the explosion of financial trading with a myriad of new financial instruments; finally, for Krippner herself, the term refers to a 'pattern of accumulation in which profit making occurs increasingly through financial channels rather than through trade and commodity production' (Krippner 2004: 14).

All these definitions capture some aspect of the phenomenon we have called financialization. So here we will cast the net widely and define financialization quite broadly: for us, financialization means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies.

Regardless of definition, the data presented in this book and elsewhere leave little doubt about the importance of financialization in recent years. Some figures have been widely cited: for example, according to the Bank for International Settlements, the daily volume of foreign exchange transactions amounted to more than 1.9 trillion dollars each day in 2004, in contrast to 570 billion per day in 1989 (www.bis.org/press/p040928.htm; www.bis.org/publ/rpfx02t.pdf). To take another example, Baker, Epstein and Pollin (1998) report that funds raised on international financial markets as a percentage of world exports rose from .5 per cent in 1950 to over 20 per cent in 1996 (Baker, Epstein and Pollin 1998: 10).

The authors in this book broaden and deepen the statistical record on financialization in several ways. James Crotty reports that, for the United States, the profits of financial institutions rose dramatically relative to the profits of non-financial corporations after 1984 (Crotty, Chapter 4). Duménil and Lévy, extending the record to the case of France, point to one reason for the rise of the financial profit rate: the real interest rate more than doubled in France between the 1970s and 1990s (Duménil and Lévy: Chapter 2, Figure 4). They also show that in the cases of the US and France, the returns to holding financial assets, as a share of total disposable income, rose significantly after 1980 (Chapter 2). Duménil and Lévy report that whereas the profit rate of financial corporations was well below that of non-financial corporations (NFCs) in France in the 1970s, by the 1990s, it was well above them (Duménil and Lévy, Chapters 10 and 11). They show that a similar pattern holds for the US as well.

Epstein and Jayadev extend the research to a larger group of Organization for Economic Co-operation and Development (OECD) countries and investigate the share of national income accruing to financial institutions and holders of financial wealth (Epstein and Jayadev, Chapter 3). In a majority of the OECD countries they investigate, this 'rentier share' was significantly higher in the 1980s and 1990s than it had been in the 1970s.

Evidently, then, sometime in the mid- to late 1970s or early 1980s, structural shifts of dramatic proportions took place in a number of countries that led to significant increases in financial transactions, real interest rates, the profitability of financial firms, and the shares of national income accruing to the holders of financial assets. This set of phenomena reflects the processes of financialization in the world economy. These facts in turn raise a number of important questions: What are the dimensions of financialization? What are its implications for economic stability and

growth? For income distribution? For political power and economic policy? What can be done to mitigate the negative impacts of financialization? These are among the questions addressed in this book.

The authors of these chapters represent a number of different views on the nature and implications of financialization. But despite their different analy
tic and policy viewpoints, the authors share at least two common convictions: First, financial phenomena have become increasingly important in much of the world economy. And, second, that some of the effects of financialization – in concert with neo-liberalism and globalization – have been highly detrimental to significant numbers of people around the globe.

This book is divided into five sections. Part One, including this introduction, presents some basic data on the distributional implications of financialization, as well as their determinants. Part Two focuses on financialization in the context of the US economy, with discussions of the relationship between financialization and non-financial corporations (Crotty), financialization and the US stock market bubble (Parenteau) and the evolution of derivative markets (Dodd). Part Three focuses on some international dimensions of financialization, and especially on its relationship to the evolution of the international monetary system. Part Four presents five case studies of financialization and financial crises in emerging markets, all in the 1980s and 1990s: Mexico, Turkey, Argentina, Brazil and South Korea. Part Five offers ideas for policy responses to financialization, including capital controls (Grabel and Felix) and securities transaction taxes (Pollin). There are also policy suggestions in many other chapters, as well.

DISTRIBUTIONAL IMPLICATIONS OF FINANCIALIZATION

As mentioned earlier, at least three processes have simultaneously marked the current era of the world economy: neo-liberalism, globalization and financialization. An interesting question, discussed by some of the authors of this book, is: What is the relationship among these currents? Most of the authors see these as related but somewhat different phenomena, Duménil and Lévy (Chapter 2) take a much more definitive stand:

> Most, if not all, analysts on the left now agree that 'neoliberalism' is the ideological expression of the reassertion of the power of finance….(moreover)…although the return of finance to hegemony was accomplished in close connection with the internationalization of capital and the globalization of markets…it is finance that dictates its forms and contents in the new stage of internationalization…

In short, according to Duménil and Lévy, in the current world economy, finance reigns supreme and neo-liberalism and globalization are themselves expressions of finance. Whether one completely agrees with the claim, the data and analysis presented in their chapter are certainly instructive. Duménil and Lévy argue that this reassertion of financial hegemony since the 1970s, following the demise of finance during the Great Depression, and, then, the

period of strong financial regulation during the heyday of the welfare state, has led to numerous financial crises in the last several decades (see Part Four of this book).

Importantly and paradoxically, Duménil and Lévy argue that not all classes are injured by these crises. On the contrary, finance benefits handsomely from the same processes that create economic crises and injure so many others. Hence the costs of financial crises are paid by the bulk of the population, while large benefits accrue to finance. Duménil and Lévy provide new and valuable data documenting these trends in the case of

France and the USA, and these issues are further pursued in the case studies on financial crises in emerging markets in Part Four.

In Chapter 3, Epstein and Jayadev present a profile of similar distributional issues in a larger group of countries. They show that rentiers – financial institutions and owners of financial assets – have been able to greatly increase their shares of national income in a variety of OECD countries since the early 1980s. Apart from changes in the nature and operations of financial markets, they identify important government policies that help to account for these significant increases in rentier incomes in these OECD countries. The most important factors include higher real interest rates, partly created by conservative central bank policy in the late 1970s and early 1980s in the USA and the UK, financial liberalization that enhanced the power of financial institutions, and reduction in the power of labor unions and labor more generally, which reduced labor costs and thereby increased the share of national income available to capitalists in general.

FINANCIALIZATION AND THE US ECONOMY

As mentioned before, at least three processes have simultaneously molded the current framework of global capitalism: neoliberalism, globalization and financialization. Crotty (Chapter 4) explores all three with a focus on the evolution of what he considers to be a major driving force in the world economy: the non-financial corporations in the world's core industries. Building on earlier work, Crotty explores the impact of financialization on these crucial institutions in the context of the relatively slow global growth of aggregate demand (apart from China and India).

Using the case of the US economy, Crotty argues that financialization has had a profound and largely negative impact on the operations of US nonfinancial corporations. This is partly reflected in the increasing incomes extracted by financial markets from these corporations; trends identified also by Duménil and Lévy and Epstein and Jayadev. For example, Crotty shows that the payments US NFCs paid out to financial markets more than doubled as a share of their cash flow between the 1960s and the 1970s, on one hand,

and the 1980s and 1990s on the other. As NFCs came under increasing pressure to make payments, they also came under increasing pressure to increase the value of their stock prices. Parenteau (Chapter 5) describes this same phenomenon from the perspective of the financial markets themselves (see more below).

Financial markets' demands for more income and more rapidly growing stock prices occurred at the same time as stagnant economic growth and increased product market competition made it increasingly difficult to earn profits. Crotty calls this the 'neoliberal' paradox. Non-financial corporations responded to this pressure in three ways, none of them healthy for the average citizen: 1) they cut wages and benefits to workers; 2) they engaged in fraud and deception to increase apparent profits and 3) they moved into financial operations to increase profits.

Hence, Crotty argues that financialization in conjunction with neoliberalism and globalization has had a significantly negative impact on the prospects for economic prosperity.

In Chapter 5, Parenteau, an economist and financial market participant, presents a brilliant analysis of the causes of the 1990s' financial bubble, calling it: 'financialization in the extreme'. Parenteau details the key institutional changes, motives and incentives in the financial markets that, together, created this destructive bubble. Among the most interesting aspects of Parenteau's chapter is the way it details the institutional and motivational mechanisms that create herding behavior and how this behavior, in turn,

leads to the creation of an equity bubble. By detailing the specific institutions and incentives that caused such destructive herding behavior, Parenteu gives us a rare insight into the process of financialization. According to Parenteau, among the key factors leading to the bubble were these: 1) the inherent nature of financial markets that, as Keynes and Minsky have taught us, lead to speculation, herding and instability; 2) the increasing importance of the privatization of the US saving system, which led individual investors to search for higher returns and take on riskier investments, increasing susceptibility to rumors and misinformation; 3) the increasing role of institutional investors and the role of mutual funds and benchmarks that increased the concentration of information and incentives for herding; 4) the 'Greenspan Put', by which the Fed placed a floor under equities and 5) the rise to power of a faction of financial capital, what Parenteau refers to as Wall Street Finance, who were able to influence regulatory and central bank policy to keep the bubble going.

In short, a close reading of Parenteau's chapter gives a wonderful account of the anatomy and evolution of financialization in the creation and promotion of the 1990s' equity bubble in the US.

Focusing on derivatives markets, Dodd (Chapter 6) pursues some of the themes introduced by Parenteau. Dodd describes the rapid growth in the use

of derivatives in recent years and, more importantly, the 'public interest concerns' associated with them. Among these are the following: derivatives make risk-taking cheaper and more available; they can be used to 'outflank' laws and regulations; they can distort the price discovery process; they can be used to manipulate accounting rules. In short, while they have their benefits, they can also facilitate many 'unproductive' and 'inefficient' activities. To reduce these activities and social costs, Dodd outlines a regulatory policy agenda, arguing that 'carefully designed prudential regulatory measures can substantially improve the safety and soundness – in addition to the efficiency – of financial markets'. Dodd says that there are 'three pillars' of prudential regulation applicable to any market or instrument, including derivatives: registration and reporting requirements, capital and collateral requirements, and orderly market rules. Dodd makes clear that these policies will not eliminate the problems caused by derivatives markets, but, he believes, they will significantly reduce them.

FINANCIALIZATION AND THE INTERNATIONAL MONETARY SYSTEM

In Chapter 7, Blecker shows that financialization of the international economy has far-reaching implications even for phenomena that might at first seem far removed from the realm of finance: trade theory and trade policy. Blecker argues that financialization vitiates the validity of the traditional mainstream separation of the study of international economics into the relatively distinct disciplines of 'international trade' and 'international finance'. And more important, it invalidates the famous and widely believed theory of comparative advantage, which lies at the core of the case for 'free trade' as the socially best trade policy. These are surprising and extremely important claims about the impact of financialization on international trade theory and policy.

Standard arguments for free trade rest on the idea that markets will automatically set exchange rates (or income levels) that will establish full employment and balanced trade. Only with balanced trade will countries be buying just those products in which they have a comparative disadvantage and exporting only products in which they have a comparative advantage. On the other hand, if a country runs a trade deficit, it will be importing some

goods in which it actually has a comparative advantage and should be exporting. Some workers will lose their jobs in these industries and face unemployment or will have to work in another industry: in either case, they will not be working in their most productive employment according to the standard theory.

We can link the argument with financialization as follows: financial speculation that causes a misalignment of exchange rates and thereby leads a country to run a trade deficit (or surplus, for that matter) will, therefore, have a profound impact on trade, and invalidate the theory of comparative advantage. In this world, a more relevant theory of trade would be based on the idea of 'competitive advantage': trade is actually based on relative costs not necessarily implying an optimal allocation of resources. In a world characterized by financial liberalization leading to misaligned exchange rates, Blecker states that 'trade liberalization does not necessarily lead to a globally efficient allocation of resources'. And one cannot neatly separate trade from financial and macroeconomic considerations as mainstream economics erroneously claims. It is important to note that Blecker argues that these conclusions follow directly from much mainstream economic research itself.

In the policy realm, Blecker concludes that exchange rates need to be managed. But the policy implications are certainly broader than this. In the absence of financial and macroeconomic policy that maintains appropriate exchange rates and employment levels, 'free trade' cannot necessarily be assumed to be the best policy. Capital controls, and other more significant reforms, may be necessary to deliver appropriate exchange rates and high levels of good quality employment.

Chapter 8 gives some historical perspective to the evolution of recent financialization in the international realm. Edwin Dickens provides a new and enlightening historical account of a key moment in the creation of financialization of the world economy: the rise of the Eurodollar market and the breakdown of the Bretton Woods System in the late 1960s and early 1970s. Dickens' story is a complex interaction of powerful forces that helped to foster capital mobility and financialization: 1) competition between US and UK banks; 2) the need of the USA to finance its war in Vietnam, and, more generally, the 'Costs of Empire', as Dickens puts it and 3) the reemerging political power of financial institutions, as is also emphasized by Duménil and Lévy and Epstein and Jayadev.

These forces propelled the financialization process – innovation driven by financial competition, benefits accruing to the state from such processes, and the increasing power of financial elites that resulted –are all laid out clearly by Dickens in the micro history of this important historical moment. Dickens concludes on a point that is in concert with Crotty's analysis: the result of this international financialization has been a deflationary bias in the international monetary system, a problem that Keynes and White were deeply worried about at the dawn of the Bretton Woods system.

This international monetary system, based on the creation of liabilities and aggregate demand by the USA as importer of last resort, is not sustainable, according to Jane D'Arista. Among other reasons, the USA must continue to

run up large international debts that will eventually undermine confidence in the US dollar. The main alternatives to this proposed by mainstream economists – currency blocs and further dollarization – will only increase the degree of instability. D'Arista proposes taking a leaf from Keynes' book: an

international clearing system that can, as she puts it, provide the basis for an 'open international trading system in an institutional framework that promotes more egalitarian participation by all countries in the global economy'. These policy ideas – more managed exchange rates (Blecker) and an international clearing system (D'Arista) will be taken up more when we discuss policy alternatives in connection with Part Five below.

FINANCIALIZATION AND CRISES

Part Four contains a series of five case studies describing the spread of financialization to emerging markets and its relationship with economic crises. These studies detail the propagation mechanisms of financialization at the economic, institutional and ideological levels. And they describe the farreaching and often negative consequences of financialization and associated crises.

Sarah Babb's chapter (Chapter 10) is a fascinating account of the relationship between the ideological spread of financialization and the real economic forces that sustain and promote that ideology in developing countries. Her chapter is a case study of the spread of neoliberal ideas in universities and policy institutions in Mexico, but the tale she spins is of much broader applicability.

Babb asks a simple yet profound question: Why are so many economists in developing countries trained in US neoclassical economics departments? One possible explanation, of course, is that those departments give the 'best' training in some objective sense of the term. Babb shows, however, that there is a strong ideological reason in connection with the legitimation function such economists play: when countries become more dependent on attracting foreign finance (Babb calls this resource dependence) governments decide they need to enhance their 'credibility' with foreign creditors by hiring more economists trained in the mainstream US departments, and later, in the home country. Hence, according to Babb, the creation and employment of neoclassical economic expertise has its material basis in the perceived need to attract finance in the neoliberal era.

Babb traces this trend in the case of Mexico during and after the Mexican debt crisis of 1982. The need to attract foreign expertise harkens back to the days of the famous 'money doctor' Edwin Walter Kemmerer, who 'forded tropical rivers and crossed Andean mountain ranges to bring the gospel of the gold standard and responsible central banking to Latin American countries'.

As Kemmerer himself observed, 'a country that appoints American financial advisors and follows their advice in reorganizing its finances, along what American investors consider to be the most successful lines, increases its chances of appealing to the American investor and obtaining from him capital on favorable terms'.

This in turn might help to explain the paradox identified by Blecker at the theoretical level: the widespread belief in standard neoclassical theory of trade and finance, despite its demonstrated incoherence.

FINANCIALIZATION AND ECONOMIC CRISES: CASE STUDIES OF 'EMERGING MARKETS'

The remaining chapters in Part Four detail ways in which this project of financialization has worked itself out in concrete cases of Turkey, Argentina, Brazil and South Korea. Yilmaz Akyüz and Korkut Boratav present the case of Turkey. At the turn of the 21st century, Turkey was in 'urgent need of stabilization', according to Akyüz and Boratav, 'in order to halt run-away inflation, unsustainable public debt accumulation and increasing financial fragility, resulting, they argue, from irresponsible policies and a lack of fiscal discipline since the early 1980s'. But the 'stabilization program' launched in

1998 with the support and guidance of the International Monetary Fund (IMF) failed to fundamentally improve matters, and, in fact, plunged the economy into an unprecedented recession. Though observers commonly blame the Turkish government policies for the crisis, Akyüz and Boratav argue that the primary culprits included serious shortcomings in the design of the program and failed crisis interventions which 'appears to have drawn no useful lessons from recent crises in emerging markets'.

In December 1999, the Turkish government adapted an exchange ratebased stabilization program to bring down inflation and limit an excessive process of public debt accumulation. After an initial period of success, there was a massive attack on the Turkish lira and a rapid exit of capital. The currency was floated, the currency depreciated excessively, interest rates rose sharply and the economy contracted at an unprecedented rate.

Some of the problems encountered by Turkey were typical problems. Exchange rate-based stabilization policies often lead to overvalued exchange rates, relying on capital inflows to finance growing external deficits. The consequent build-up of debt makes the economy financially vulnerable, which often leads to a flight of currency and a collapse of the currency. This boom-bust cycle in so-called stabilization policies tries to use financial markets – both internal and external – to stabilize the economy. But, instead, the highly liquid and speculative nature of these markets often leads to financial vulnerability and economic disaster.

In the Turkish case, particular Turkish institutions and processes made the situation worse. In a telling example of the interaction between financialization and crisis, they describe how the banking sector was heavily dependent for their earning on high spreads between deposit rates and T-bills associated with rapid inflation. So, an attempt to rapidly reduce inflation, which reduced T-bill rates faster than deposit rates, placed the Turkish banking sector in jeopardy. In short, a financially based stabilization policy that does not sufficiently understand the specific dynamics of the financial sector is vulnerable to failure.

More generally, however, Akyüz and Boratav attribute the failure of the stabilization program to a stubborn adherence by the IMF and local policy makers to a flawed model of financial orthodoxy based on the ideas described by Blecker (Chapter 7) and Babb (Chapter 10) and further elaborated by O'Connell (Chapter 12) Crotty and Lee (Chapter 14) and Felix (Chapter 16). Despite previous experiences with the failures of similar polices and actual economic crises, the IMF and Turkish authorities evidently refused to learn from these failures.

The fundamental problem – and one which runs through the discussions of many of this book's chapters, is the unwillingness of economists and policy makers to confront the central problem created by financialization: speculative and excessively liquid financial flows that create debt-laden balance sheets, overly short-term perspectives, volatility and mispricing of important asset prices, including exchange rates, and subsequent misallocation of resources and unstable economic growth. The reason why policy makers have been unwilling to confront these problems probably stem from some of the forces identified by the authors of these chapters:

1. The resource dependence of developing countries' development models that make them depend on economic theories and models that support financialization, neoliberalism and globalization.
2. The power of financial elites that benefit handsomely from these policies despite these costs to many others.
3. The unwillingness of most economists themselves to honestly face the

profound problems associated with these theories and policies.
Akyüz and Boratav propose several important policy improvements that they believe could truly help stabilize countries with serious debt problems, such as Turkey. Keynes noted that inflating away 'rentiers'' claims or a 'capital levy' on rentiers to reduce the burden of the debt are feasible policies, but Akyüz and Boratov point out that 'for obvious reasons neither …accelerated inflation nor a capital levy nor any other measure that would place a sizeable burden on the rentier class can be successfully applied with the capital account is fully open and the currency is fully convertible'. Of

course, this is precisely one of the reasons why rentier and the IMF advocate for open capital markets.
Instead, Akyüz and Boratav advocate a temporary suspension of convertibility and a standstill on external debt payments as a practical policy option for stabilizing the exchange rate in countries facing international liquidity problems, as well as addressing problems of domestic debt. There are measures that have long been advocated by the United Nations Conference on Trade and Development (UNCTAD), based on Chapter 11 of the US Bankruptcy Code. They point out that at lest temporary restrictions on capital outflows may be necessary to complement such policies (see Grabel: Chapter 15). A third argument would be to lend into arrears to prevent the country from facing a liquidity crisis, and thereby allowing it to restructure. Such a set of policies, they argue, would, in many cases, work much better than orthodox stabilization policies combining free capital markets with austerity macroeconomic policy. But to implement such policies would mean confronting advocates of financialization and their rentier supporters – both at home and abroad.
As O'Connell (Chapter 12) makes clear, Argentina was seen as the great model of neo-liberal restructuring: it instituted free capital mobility; created a currency board and thereby adopted a 'hard peg'; and privatized everything in sight. And as O'Connell makes clear, Argentina represents an important case of financialization run amuck: 'Finance, both external and domestic, is one essential part of the story. Argentina became one of the most highly liberalized financial systems in the world' (Chapter 12).
The origins of this liberalization were common enough. In reaction to high and accelerating inflation, run-down public utilities, and bad quality of many consumption goods, the Argentine public was ripe for a change, and 'reformers' promoted liberalization as a solution to their woes. The main elements of the Argentine 'reforms' that set it apart from other emerging markets included: 1) the currency board system, which started in March 1991 and end at the end of 2001 – under which the Argentine peso was fixed by law to the US dollar and that Central bank could not issue pesos unless they were backed for foreign exchange reserves; 2) a full bi-monetary system, placing in equal status the peso and foreign currencies (mainly the US dollar); 3) a fractional reserve banking system even for foreign bank deposits; 4) full liberalization of domestic financial markets; 5) extreme privatization and 6) highly decentralized fiscal structure, among other elements.
In the Argentine case, the extensive financial liberalization in the face of a currency board that did not allow for a lender of last resort function by the central bank (in local currency) facilitated the build-up of excessive financial fragility without leaving the government the regulatory and stabilizing tools to deal with the financial instability that resulted. On the external side, the

fixed exchange rate in combination with internationally open capital markets allowed the run-up of large debts without the tools to devalue and keep the domestic economy competitive. The end result was a full-blown financial crisis that led to a huge decline in output, employment and incomes. Financialization, liberalization and globalization all combined to bring the Argentine economy to its knees.

More recently, with the adoption of less liberal policies, the Argentine economy has been improving. Thus, far from providing a success story for financialization and neoliberalism in 'emerging markets', the Argentine case is both a poster child for its failures and a testing ground for alternatives to such policies.

Nelson Barbosa-Filho (Chapter 13) presents a model of Brazil that describes the impacts of erratic external capital flows on Brazilian economic growth. His very carefully articulated and highly detailed structuralist model, though built for the case of Brazil, has important implications for many other countries as well. Barbosa shows that capital inflows and outflows have a huge impact on Brazil's current account balance (as Blecker argued in the general case in Chapter 7) and on economic growth. More specifically, Barbosa-Filho's model estimates that fluctuations in Brazil's capital account can explain 6 per cent of the variation in the growth rate of Brazil over the period 1956-2003. Barbosa's work is a clear demonstration of the real impacts of erratic behavior of international financial agents, institutions and markets described throughout the book.

Crotty and Lee (Chapter 14) further develop the themes of the section and use them to illuminate the ongoing crisis in South Korea. As an example of the process and impacts of financialization, South Koreas' recent history is breathtakingly radical and therefore highly instructive. As Crotty and Lee show, the South Korean 'miracle' of the 1960s–1980s, based on a statedirected capitalism, violated virtually every rule of neoliberalism enunciated by neoclassical economics. Foreign investment into and out of South Korea was highly regulated and, in some cases, restricted, domestic finance was bank-based, and credit allocation was closely connected to state industrial policy; high savings rates fostered high levels of domestic investment without dependence on foreign borrowing. Of course, there are many problems with the South Korean model, not the least of which was a violent authoritarianism and excessive power by a small group of South Korean families that controlled the industrial powerhouse chaebol.

By the early 1990s political pressure from both domestic and foreign elites to increase opportunities for financial business and foreign investment, the Korean government liberalized its regulatory system, including control of its financial markets. Soon, South Korean banks and firms borrowed dangerous amounts of capital from abroad, leaving the country vulnerable to financial crises.

What followed was a six-year assault on South Korea's system of economic and financial controls, culminating in the creation of a highly financialized and globalized economic apparatus. As Crotty and Lee argue, such a swift and overwhelming set of changes have never occurred in recent financial history under foreign control outside of the aftermath of a military defeat and occupation. The most striking claim made by Crotty and Lee is that the Kim Dae Jung government deliberately instigated a deep economic recession in order to break the political opposition of labor and other groups. In addition, the IMF and other external forces used the crisis to win the opening of South Korea's economy to foreign investment. As Crotty and Lee write, 'Foreigner wanted a share of the Korean miracle'. And a share

they got, as foreign companies bought large shares in key companies and banks. Perhaps this is yet another example of Dumenil and Levy's claim that finance has gained from financial crisis.

In the South Korean case, the move toward financialization has been dramatic. Domestic banks which for decades support government strategies of industrial policy with long-term directed lending have now been transformed into consumer lending and credit companies operating along Western capitalist lines, thereby starving domestic core firms of credit. In the meantime, core companies are increasingly foreign-owned and interested in short-term profits along the lines described by Crotty (Chapter 4). While domestic and foreign elites have prospered, the economy has mostly stagnated. Crotty and Lee argue that there are viable alternatives to this neoliberal model. A more democratic version of a regulation and planning system was and remains a workable possibility for South Korea. This is an example of an alternative structure for more egalitarian and substantive economic reform that is further addressed in the next section.

POLICY ALTERNATIVES

A comprehensive set of alternative policies to deal with the problems associated with financialization are well beyond the scope of this volume, not least because appropriate economic structures will vary from country to country. But in Part Five, authors present outlines of a battery of policy suggestions which, in conjunction with policy suggestions presented in some of the book's other chapters, offer some important examples.

The case studies contained plenty of vivid and sorry tales in which financial liberalization and open capital markets have contributed to severe economic crises in a variety of developing countries. When 'speculation dominates enterprise' as Keynes put it (see Pollin, Chapter 17), investment is often poorly allocated and society is poorly served.

Grabel (Chapter 15) outlines a host of policies that can ameliorate some of the crisis tendencies resulting from excessive financialization. Grabel identifies the following risks from international capital flows: currency risk, flight risk, fragility risk, contagion risk and sovereignty risk, the latter being the possible loss of economic and political sovereignty, as happened, according to Crotty and Lee, in South Korea.

Grabel then outlines several preventative and ameliorative financial policies, describing the degree to which they can reduce or even eliminate these risks and, in a thought experiment, whether they might have even been able to prevent the Asian financial crisis. The policies include taxes on domestic asset and foreign exchange transactions – so-called Keynes and Tobin taxes – reserve requirements on capital inflows (so-called Chilean regulations), foreign exchange restrictions, and so-called trip-wires and speed bumps, which are early warning systems combined with temporary policies to slow down the excessive inflows and/or outflows of capital. Grabel makes a plausible case that had some of these policies been in place, the Asian financial crisis in some countries could have been mitigated or even avoided altogether.

Felix (Chapter 16) continues in the same vein as Grabel. After summarizing and then criticizing the underlying assumptions of financial liberalization, Felix argues for the importance of capital controls to manage the excesses of international capital mobility.

Whereas the previous two chapters focus on solutions to international financial speculation, Pollin (Chapter 17) details a policy to simultaneously reduce domestic financial instability and to raise tax revenue at the same time. Pollin carefully analyzes the mainstream case against securities

transactions excise taxes (STET) and then outlines a response to them. Of particular concern is the claim that STET will distort incentives. Pollin shows that this concern is highly exaggerated and then presents carefully calibrated calculations of the revenue that can be raised from the tax. Pollin shows that the STET can raise significant amounts of revenue that could be used for socially beneficial activities. Evidently, by taxing the excesses of financialization and channeling the revenue appropriately, governments can help to restore public services and investments which, otherwise, are among financialization's first and most severe casualties.

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