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# Finance, financialization and compressed development: A Schumpeterian perspective

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# Finance, entrepreneurship and economic development

- \* For Schumpeter, credit is necessary for, and precedes entrepreneurship, which drives economic development: ‘Credit is essentially the creation of purchasing power for the purpose of transferring it to the entrepreneur’ (1912: 107)
- \* Minsky synthesises Schumpeter and Keynes: ‘There is not only a price level of current output, but also a price level of capital and financial assets’ (1992: 106) – investment occurs when profits are foreseen in both spheres.
- \* Minsky also notes, however, that the Schumpeterian entrepreneur is active in finance, and not just production: ‘Two new sets of combinations, in production and in finance, drive the evolution of the economy’ (1988: 3).
- \* The relationship between finance and production/real economy, is complex, evolutionary and sometimes highly problematic.

# Cycles and financial instability

- \* In Schumpeter's (1912) schema a primary wave of credit-financed innovation creates a secondary wave – investment rises with imitation, others invest to supply them, consumption expands, and eventually leads to speculation, which becomes causal.
- \* Perez (2003) amplifies this schema and its links with Kondratiev cycles: 'Iruption' of new technology is followed by frenzy, then crash, then government intervention followed by a golden age then stagnation.
- \* Minsky considers firm balance sheets and repayment schedules, distinguishing hedge, speculative and ponzi profiles. When the ponzi stage is reached expansion eventually unravels and works backwards through speculative to hedge profiles – creating 'debt deflation' (cf. Japan, 1990s).

# Four models of structured relations (in the US: Minsky, 1992)

- \* *Commercial capitalism*: financing of goods traded or processed – bill of exchange, production small in scale
- \* *Finance capitalism*: corporation dominant form of ownership, production larger in scale, mechanized – markets for stock and bond flotations under organization of investment banks
- \* *Managerial capitalism*: Important role of government in regulation, supporting mortgages, maintaining aggregate demand hence level of profits, investment largely internally financed – managerial autonomy
- \* *Money manager capitalism*: Blocks of managed money oriented toward ‘the quick turn of the speculator, upon trading profits’ (unlike capital development of the economy under finance capitalism: p.111 – casino, not ephors)

These can co-exist, but represent successive ‘stages’ of capitalist development

# Late developers

- \* In Gerschenkron's (1962) late development thesis, Germany jumped straight into the second of these with universal banks which combined short term banking with long-term credit-mobilier-type finance (cf. Hilferding 1910 fusion of commercial, industrial and banking interests into banker-dominated finance capital which sought to create a 'centralized and privilege dispensing state')
- \* Japan was also quick with financial innovations, but combined market and bank-oriented elements, and zaibatsu and non-zaibatsu organization – a kind of hybrid system in many respects. Cf. Miyajima and Kawamoto, 2014; Patrick, 1971; Okazaki and Okuno-Fujiwara, 1999)
- \* 株式会社亡国論 (高橋, 1930).
- \* Subsequent changes towards managerial capitalism, big government and eventually 'big labour,' with finance restrained. Postwar Bretton Woods institutions and their domestic counterparts.

# 1970s and the re-emergence of finance

- \* Changes in the US competitive landscape (rise of Japan, ‘corporate crisis’ [Galbraith, 2007]), rise of Eurodollar and offshore markets – leading to new financialization.
  
- \* Lapavitsas (2011) emphasizes three inter-related features:
  - 1) large corporations rely less on banks, acquire their own financial capacities (Galbraith links this to the post Volcker shock era in the US)
  - 2) Banks shift from traditional business lending to mediation in open financial markets and transacting with households
  - 3) Households themselves become increasingly oriented towards financial activities (housing loans, ISAs, pensions, insurance...)

# Differences between 'first' and 'second' financialization (Vercelli, 2014)

- \* 'Extrinsic' versus 'intrinsic' power of finance over productive economy (Veblen might disagree)
- \* Bank based versus market based (and bank role changed)
- \* Geographic expansion through imperialism versus expansion into welfare state 'terrain' (health, education, pensions)
- \* Central banks have recently directed their efforts to supporting finance, often at the expense of the real economy

# Developing countries and financialization

- \* In addition to Lapavitsas' 3 features, a fourth: international finance and developing countries.
- \* Kregel (2004) argues that Minsky's repayment profiles apply not just to domestic business firms, but external financing for development as well.
- \* Ponzi profiles in Latin America from late 1970s – crisis triggered by rising US interest rates, exacerbated by de-regulation; cf. also Asian Financial Crisis and others in the 1990s
- \* To avoid such crises developing countries have had to build large external reserves, notably in US treasuries – this has fed financialization in developing countries (and the US housing bubble), as has the acquisition of domestic financial institutions by those from other countries, especially the US (cf. Bonizzi, 2014).
- \* Lapavitsas' three features can be found in developing countries themselves
- \* Inverted U effect of financial deepening on various aspects of growth

# FDI

- \* Equity flows generally seen as more stable than debt, and direct investment more stable than portfolio investment.
- \* However, long-term commitment of FDI increasingly questioned, as is spillover effects, and tax etc revenues
- \* Recent UNCTAD WIRs draw attention to complex structures of FDI and the role of ‘offshore financial centres’ and tax havens. The top 100 MNEs on UNCTAD’s Transnationality Index have
  - ‘on average more than 500 affiliates each, across 50 countries. They have 7 hierarchical levels in their ownership structure (i.e. ownership links to affiliates could potentially cross 6 borders), they have about 20 holding companies owning affiliates across multiple jurisdictions, and they have almost 70 entities in offshore investment hubs’ (UNCTAD, 2016: xiii).
- \* This manifestation of financialization may not be so volatile, but could be more predatory.

# What about China?

Emerging and transition economies may be seen as particularly vulnerable. China maintained controls on capital flows (especially debt), and FDI in the financial sector is low.

However, a large shadow banking sector has grown up. Roughly \$800 billion was invested with (known) private investment fund managers in January 2015 (Nikkei Asian Review 1-7 Aug, 2016, p.58). Some aspects are reminiscent of Japan in the 1920s.

But many innovative companies have secured large funding internationally (unlike Japan); cf. Alibaba, whose NYSE listing in 2014 was the biggest ever IPO (\$25 billion – the shares were actually for a Cayman Islands-registered company to avoid conflict with China's foreign ownership laws)

# China and fintech

- \* Ma founded Taobao in 2003 to compete with eBay. He had to create an online payment system – Alipay – which grew to process over half of china’s online transactions by 2014 – over \$500 billion annually (Tse, 2015).
- \* In 2013 Alibaba launched a consumer finance company called Yu’e Bao. A year after its launch 100 million people had opened accounts, depositing \$93 billion. (Cf. also Baidu and Tencent.)
- \* Such innovations – digital platforms for financial transactions – open up the door for new types of merchants, and allow participants to become producers and sellers as well as consumers. They are agents of the ‘platform economy’ (Parker, van Alstyne and Choudary, 2016).
- \* China is moving quicker in this area than Japan, as a compressed developer, emerging in an age of post managerial capitalism.

# But...

- \* Can it avoid ‘premature de-industrialization,’ ‘middle income trap’ and the downside of flexibilization of employment?
- \* How are these associated with financialization?

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