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Financialisation in post-apartheid South Africa

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Thesis submitted for the degree of PhD
2017

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Abstract

The thesis explores the internationalisation and financialisation of the South African economy in the post-apartheid period grounded in a Marxist political-economy framework that understands financialisation as part of a structural transformation in mature capitalism. It elucidates this in terms of shifting property relations in concert with the internationalisation of the circuits of capital. Financialisation is viewed as entailing the intensive and extensive penetration of finance into ever more spheres of political, economic, and social life, and the remaking of relationships between capitals, capital and the state, and capital, the state and households, with the local political economy and global integration playing key roles.

The historic trajectory of the South African economy – and the development of the financial system therein – is understood through the lens of the Minerals-Energy Complex (MEC). Liberalisation and reregulation are shown to be critical developments in post-apartheid monetary policy. Together, these deeply affect South Africa's global financial integration, subjecting the South African economy to new external vulnerabilities. The South African financial sector undergoes important shifts, with banking increasingly geared towards short-term financial market intermediation and lending to households. At the same time financial investors come to play an increasingly important role in market dynamics.

Far-reaching change is visible in the productive sector with restructuring, internationalisation, quasi-privatisation, and Black Economic Empowerment altering patterns of ownership. Non-financial corporations are increasingly engaged in short-term financial-market activity and shareholder payouts boom, with deleterious affects for capital accumulation. The underlying structure of the economy however has strong continuities with the past and a financialised MEC emerges. Finally, households have, highly unevenly, been integrated into financial markets structuring the nature of social reproduction with broader processes of financialisation retarding employment and raising inequality. Through this all, social and economic relations are remade with financialisation constituting a central feature of South Africa's post-apartheid transformation.

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Acronyms and abbreviations

AAC	Anglo American Corporation
ANC	African National Congress
BEE	Black Economic Empowerment
B-BBEE	Broad-Based Black Economic Empowerment
BIS	Bank of International Settlements
Bn	Billions
BRICS	Brazil, Russia, India, China and South Africa
COSATU	Congress of South African Trade Unions
DTECs	Developing countries, transitional economies and emerging markets
EBITDA	Earnings before interest, taxation, depreciation and amortisation
EME	Emerging market economy
EVA TM	Economic Value Added
FCS	Fixed capital stock
FDI	Foreign direct investment
FLISP	Finance Linked Individual Subsidy Programme
FSC	Financial Services Charter
GDP	Gross domestic product
GEAR	Growth, Employment and Redistribution Plan
GEPF	Government Employees Pension Fund
GVA	Gross value added
GVC	Global value chain
IDC	Industrial Development Corporation
IDT	Independent Development Trust
IMF	International Monetary Fund
JSE	Johannesburg Stock Exchange
M&A	Mergers and acquisitions
MDM	Mass Democratic Movement
MEC	Minerals-Energy Complex
MFI	Microfinance institution
Mn	Millions
MVA	Market value added
NCD	Negotiated certificate of deposit

NCF	Net fixed capital
NCR	National Credit Regulator
NFC	Non-financial corporation
NGO	Non-governmental organisation
NHF	National Housing Forum
NHFC	National Housing Finance Corporation
NP	Nationalist Party
OECD	Organisation for Economic Co-operation and Development
OTC	Over the counter
PALMS	Post-Apartheid Labour Market Series
PGM	Platinum group metal
PIC	Public Investment Corporation
PNB	<i>Permodalan Nasional Berhad</i> – National Equity Corporation (Malaysia)
R	Rands
R&D	Research and development
RBH	Royal Bafokeng Holdings
RDP	Reconstruction and Development Plan
ROE	Return on equity
SACP	South African Communist Party
SARB	South African Reserve Bank
SME	Small and medium enterprise
SOE	State owned enterprise
TNC	Transnational corporations
Tn	Trillions
UF	Urban Foundation
UNCTAD	United Nations Conference on Trade and Development
US	United States
USD / \$	United States' Dollar
VLC	Very large company

1 INTRODUCTION

The demise of apartheid, and the end of international isolation, allowed for the fuller integration of the South African economy into global markets; this has brought far-reaching change. Given that integration was premised on the existing local economic structure and system of accumulation, strong underlying continuities with the past also remain. One prominent change has been the growing weight of finance within the economy, a phenomenon observed globally with the onset of neoliberalism. The ‘financialisation’ literature that emerged from heterodox political economy in the late 1990s and early 2000s is particularly useful for conceptualising this expansion of finance. This literature understands financialisation as more complex than just the growth of the financial sector, in varying ways relating financialisation to a broader restructuring of the real and financial economies. In the developing country context the literature has come to stress global integration, and the interaction between this and the local political economy in the course of financialisation. This thesis contributes to this literature through a South African case study, with this introduction sketching our understanding of financialisation and the South Africa economy, and explaining the theoretical and empirical tools and approaches selected.

1.1 Financialisation

Financialisation is understood here, as Fine (2013a) argues, to refer to both the intensive and extensive penetration of finance into multiple fields of economic, social, and political life. This has altered the social and economic relationships between sections of (local and international) capital, capital and the state and households, and the state and households. As we propose in Chapter 3, this does not entail the straightforward dominance of one section of capital (financial institutions or ‘rentiers’) over another (productive enterprises)¹ but rather the intensification of the dominance of the logic of financial markets, with economic and social reproduction reshaped in far-reaching ways.

We situate financialisation as a key element within the structural transformation of mature capitalism. We propose, in Chapter 2, that this transformation arises out of both contingent historical circumstances – in the second half of the twentieth century with

¹ This is not to say that it is not powerfully shaped by contestation between capitals – capitals of different

the 1970s and 1980s representing an important turning point – and long-term trends within capitalist development. The latter have involved quantitative and qualitative shifts in property relations – whereby financial claims have come to mediate social relations and property ownership – and the internationalisation of the circuits of capital, which has placed new demands upon the financial system.

In the first instance, financialisation has been functional for capitalist accumulation and the reassertion of profitability under neoliberalism, albeit disproportionately benefitting the few. However, it has brought with it its own instabilities and internal contradictions, often undermining productive investment with deleterious effects for the long-term sustainability of capital accumulation and large segments of society.

Financialisation has originated at the capitalist core and much of the literature has focused thereupon (reviewed in Chapter 3). However, a growing series of (predominately country-specific) studies have focused on financialisation in the periphery (see Bonizzi 2013a, Kaltenbrunner and Karacimen 2016, for reviews). In these locales, the terms upon which global integration has occurred play an important role in structuring the extent and nature of financialisation. Financialisation is thus variegated, shaped by both the character of global integration and the local political economy (Fine 2013b); exploring this literature is the subject of Chapter 4.

1.2 A political economy approach

This thesis proceeds, as may already be clear, on the basis of a political economy approach, rooted in Marxist political economy and the materialist theoretical grounding thereof. Such an approach offers both insights into the specific dynamics of the financial system not found in mainstream economic theory, and a broader methodological and conceptual framework within which to approach social and economic analysis.

In brief, mainstream analysis of credit relations is premised on the microeconomic interaction between individuals approaching each other as borrower and lender, with asymmetric information between the two (and possibly adverse selection problems) which banks step in to solve while transforming short-term deposits into long-term loans (Leland and Pyle 1977, Diamond and Dybvig 1983, Boyd and Prescott 1986,

Sharpe 1990). Problematically, the financial system is theorised separately, underpinned within financial economics by notions of potentially perfect markets and rational investment behaviour (Fama 1970, Jensen 1978, Krugman 2009). Further, the connection between the financial and real economies is poorly theorised (Goodhart 2009), leading to the treatment of monetary and fiscal policy as independent from one another.

The mainstream analysis therefore fails to provide a *systemic* account of finance or meaningfully probe the social relations between borrower and lender; as Lapavitsas (2014, p. 106) notes: “Mainstream economics does not offer a theoretical approach to finance as a system – as an ordered set of relations that contain regular interactions connected to production and circulation of goods and services.” This is in large part because, unlike political economy approaches, it does not typically search for systemic integrity or relate the specific to the whole, rather “all structural constraints on human behavior are abandoned in favour of a purely atomistic and instrumentally rational portrayal of human agency” (Powell 2013a, p. 28). By contrast, Marx’s methodological mix of inductive and deductive method, abstraction, and the dialectical process (Ollman 2003, Fine and Saad-Filho 2004) explains concrete phenomena via the processes and relations within which they are embedded, while stressing the interdependence of particular relations with all other relations (the, not fully knowable, ‘whole’ or ‘totality’).

Regarding finance, this approach argues that: “The emergence of a financial system is ultimately derivative of relations characteristic of the spheres of production, exchange and distribution of goods and services [in general].” (Lapavitsas 2014, p. 107). Financial activity is therefore situated within the a broader context of capitalist accumulation, structured by the forces and relations of production – while maintaining the primacy of production as the site for the creation of surplus value and exploitation (Marx 1970, 1977). In this manner the importance of understanding economic life in terms of social relations – property and value relations – which are established, maintained, and continually undergoing a process of restructuring, is clear; it is particular reconfigurations of these, that defines financialisation. This framework allows us to distinguish the essential features of financialisation, and its contradictions, while exploring these in a context-specific manner that both reflects broader patterns, processes, and relations while advancing our understanding of their on-going evolution.

This said, the financial economy is not dealt with in a complete and systematic manner by Marx (with Volume III of *Capital*, collated by Engels, offering a critical repository). Some Marxist scholars have drawn on Marx's work in grounding their analysis of financialisation, while others have contextualised their analysis within Marxist political economy without necessarily detailed reference to Marx's exposition of the financial economy. We draw on these insights while making (often tacit) use of the broader methodological framework, as well as providing modest theoretical innovation.

1.3 South Africa's system of accumulation: towards a financialised MEC

A political economy approach also informs our understanding of South Africa's growth path, or system of accumulation. In this regard, we make use of Fine and Rustomjee's (1996) notion of the Minerals-Energy Complex (MEC), which is discussed in depth in Chapter 5. In brief, the MEC tacitly approaches the evolution of South Africa's economy via an analysis of the forces and relations of production. On the one hand, the economic structure is heavily shaped by its early reliance on mineral extraction and the related manufacturing subsectors that arose, as well as the institutional expression of these – massive conglomerates. On the other hand, this imposed certain relations where dominant English capital – controlling most of mining, industry, and finance – and Afrikaner capital – later supported by the apartheid regime – tussled for control and influence, while white labour was bolstered and black labour subjugated. Further, the MEC also captures the relations between mining, industrial, and finance capital, which became heavily intertwined in supporting a mineral-centric and capital-intensive growth path with a prominent role for the financial sector.

Our focus here is on the post-apartheid period (from 1994 onwards) but both the structure of the economy as well as a changing policy environment from the 1980s onwards (also reviewed in Chapter 5) mean that continuities exist, although, critically, financial liberalisation accelerates dramatically from 1995 (interrogated in Chapters 6 and 7). We shall argue, predominately in Chapter 9, that, in the post-apartheid period, a financialised form of the MEC emerges, although nascent forms of financialisation date back to the 1980s.

This entails a transformation in certain aspects of the forces and relations of production. The economy undergoes widespread liberalisation and internationalisation during which time the conglomerates are unbundled and restructured with significant offshoring. As productive and financial capital become heavily inserted into global markets (often internationalising in tandem) and the weight of financial ownership in the economy grows, new imperatives are brought to bear altering the relationship between them. At the same time, their engagement with credit and financial markets re-orientates them towards short-term financial instruments, both assets and liabilities.

Concomitantly, international financial capital exerts enormous influence over the domestic economy, predominately via the changing nature of capital flows and the trading of South African (mostly rand-denominated) financial assets, with destabilising consequences. The financial sector expands in tandem, with the contribution of finance and insurance services to gross value added increasing from an average of 3% in the 1970s and 1980s to an average of 7% from 2000 onwards. Increased liquidity stimulated high levels of onward lending, informing a rise in household debt and domestic asset markets. These patterns of banking lending result in a partial fall in lending to non-financial corporates and concomitant lacklustre investment in the real economy, the latter strongly determined by large distributions to shareholders. In the course of these processes households are drawn, highly unevenly, into financial markets, with the rich benefiting and the poor majority finding themselves financially vulnerable.

All of the above is facilitated by state actions, often congruent with a policy agenda predating democracy, and in this way the underlying continuity with the past becomes clear. Further, it is the traditionally dominant sections of capital, at the heart of the MEC, that drive the agenda of liberalisation and internationalisation, while pushing privatisation and co-opting the new black elite into their ranks; the latter's success comes to rely heavily on financial market appreciation. At the same time, the structure of the economy – the rise in the tertiary sector and partial decline in the primary sector notwithstanding – endures. Economic power remains in the hands of the mining, industrial, and financial institutions that formed the apartheid-era conglomerates, with the linkages between sectors at the heart of the MEC remaining strong. Non-MEC manufacturing subsectors continue to flounder as the cold winds of international competition compound their traditional peripheral position in the economic pecking

order. Capital intensity increases and monopolisation remains prominent. At the same time, productive capital is drawn into financial markets as described above. The financialised MEC is the confluence of these trends.

1.4 A note on methodology and data sources

The analysis undertaken, underpinned by these methodological approaches, relies heavily on statistical data (particularly chapters 7 through 10), although these data are complemented by secondary sources. The statistical data are drawn from a, sometimes bewildering, array of sources, and more detail is provided in the appendix. Most highly utilised are the South African Reserve Bank's (SARB) macroeconomic time series data associated with the Quarterly Bulletins (SARB 2014, 2015a, 2015b, 2016a), banking sector balance sheet and income statement datasets (SARB 2015c, 2016b, 2016c, 2016d), and flow-of-funds data (SARB 2015d), the first two accessed via the prominent Quantec databank. The Quarterly Bulletin data were accessed over a number of years, meaning different years are reflected in the references, with some series running up until the end of 2014, 2015, or 2016; where possible earlier datasets were updated to reflect more current data. The flow-of-funds data (available yearly from 1970 and quarterly from 1992) was provided directly by the SARB, with the dataset ending in the first quarter of 2015 used throughout.

South African firm level data are also used. The leading local provider of such is INET BFA, which provided, via email in 2015, aggregate balance sheet data for all listed Johannesburg Stock Exchange (JSE) companies from 1988 to 2014 (INet BFA 2015). As this dataset has not been checked against individual company records it is used sparingly; research on financialisation using company-level data is needed. The other prominent local datasets used come from Quantec directly (input-output analysis) (Quantec 2016), Statistics South Africa (Stats SA 2016), the National Credit Regulator (NCR 2016a, 2016b), the JSE (2016), PALMS (Kerr and Wittenberg 2013), and the Absa's Housing Price Index (Absa 2015, 2016). Internationally, the IMF's International Financial Statistics (IMF 2015a, 2016a), World Economic Outlook (IMF 2016b), Coordinate Portfolio Investment Survey (2015b), and Balance of Payments (IMF 2016c) data are also used, as are data from Bloomberg (2016), the World Bank (2015a, 2016a), UNCTAD (2016a), and the Bank of International Settlements (BIS 2016a). Limited use is made of a number of other datasets and referenced accordingly, as are data extracted

from secondary sources. All secondary sources are referenced as per standard academic conventions.

1.5 Structure of the thesis

This thesis has eleven chapters that can be divided into three parts. The first part is Chapters 2 through 4 and contains our theoretical grounding and literature reviews. Chapter 2 interrogates the notion of financialisation as a structural transformation locating it within a Marxist political economy framework, focusing on the evolution of the credit and financial systems, shifting property relations, and the expansions of the circuits of capital in the context of the world market. Chapter 3 analyses competing understandings of the evolution of the relationship between financial and productive capital entailed by financialisation, and the place of the state and households, drawing heavily on literature pertaining to the capitalist core. Chapter 4 details the financialisation literature centred on developing countries with a particular focus on international financial integration, as well as country case-study evidence on the relations between capitals, the state, and households in the course of financialisation in these locales. Together these literature reviews are used as ‘signposts’ against which we can partially judge the extent and nature of financialisation in South Africa.

Part two contains Chapters 5 and 6 and begins our analysis of the South African case. The former explains the MEC and the evolution of the financial sector, and related policy, therein. Chapter 6 then charts the evolution of post-apartheid monetary policy and the relationship between such policy and financialisation in South Africa. Part three, Chapter 7 through 10, deepens the empirical analysis of our case study. Chapter 7 focuses on South Africa’s global financial integration – with a particular stress on capital flows and the international trading of South African assets – and the manner in which the South African economy has been embedded in hierarchical international relations and the vulnerabilities this brings. The local financial sector is explored in Chapter 8 which looks at the general expansion of the sector, the structure and behaviour of the banking system and whether this has altered, as well as the growing prominence of large financial market investors.

Chapter 9 is concerned with the productive sector and offers an account of the transformations that occurred after the end of apartheid – corporate restructuring,

internationalisation, partial privatisation, and Black Economic Empowerment. It then brings these themes, and the analyses of the previous chapters, together, to unpack changes in the operations and priorities of non-financial corporations, the consequences for capital accumulation, the relationship between productive and financial capital, and the emergence of the financialised MEC. Finally, Chapter 10 examines the consequences of financialisation for households. It probes the (uneven) integration of households into financial markets, the financialisation of service provisioning through the case study of public housing, and the consequences of financialisation for employment and distribution.

The South African financialisation literature has grown since this project was conceived and begun; some of this is drawn upon here (see Ashman *et al.* 2011a, 2011b, Bond 2012, 2015, Newman 2012, 2014, Ashman and Fine 2013, Ashman, Fine, *et al.* 2013, Mohamed 2014, Rodrigues Teles Sampaio 2014, Isaacs 2016b, 2016a). This thesis contributes in both its detail and comprehensive nature. Theoretically, it provides a theoretical and historical account of financialisation, with novel elements, that is often absent or cursory in much (but not all) of the financialisation literature. On this foundation, it draws on the existing literature to build a picture of the concrete nature of financialisation as part of a structural transformation.

In the South African case study, it tackles financialisation in a multi-faceted manner that provides detailed evidence of the intensive and extensive penetration of finance resulting in the expansion and intensification of the dominance of the logic of financial markets over economic, political, and social life. In the conclusion (Chapter 11), we provided a provisional drawing together of the relationships between the myriad processes and relations, the parts and the whole, in a way that paints a systemic picture connected to the underlying logic of the South African economy and its historical trajectory. In this manner, and in its empirical detail, the thesis moves the literature forward while pointing to avenues for future investigation.

2 THE CAPITALIST CREDIT SYSTEM AND STRUCTURAL TRANSFORMATION

2.1 Introduction

We noted in the introductory chapter that financialisation is understood here as a central feature within the structural transformation of mature capitalism, involving the expansion and intensification of the dominance of the logic of financial markets over economic, political, and social life. This has altered the inter- and intra-social and economic relations between capital, labour, and the state. We also noted that it arises out of both long-term trends within capitalist development and contingent historical circumstances over the course of the second half of the twentieth century, with the 1970s and 1980s representing an important turning point. On this basis, this chapter lays a theoretical and historical foundation for our analysis, often absent from the literature. More specifically we grapple with the issue of *structural transformation*, from a Marxist perspective, in an attempt to understand how the seeds for this structural transformation are present within capitalist development.

We do not attempt, in this chapter, to characterise what the implications of this structural transformation are, or how different facets of the economy are transformed in the concrete (this we do in future chapters). Rather we wish to root these in longer-term tendencies within capitalist development and particular historical developments. We approach this through two prisms or propositions: shifting property relations and the world market. For the former we propose that quantitative and qualitative shifts in property relations have occurred, whereby financial claims have predominately come to mediate property ownership in place of more direct forms of ownership. This has had important consequences for capitalist accumulation and the distribution of the social surplus. For the latter we propose that the increased internationalisation of the circuits of capital has placed new demands on the financial sector and called forth new modes of financial intermediation, while placing financial markets at the heart of social and economic reproduction. Both of these phenomena are rooted in the historic evolution of the capitalist credit system with which we begin our analysis.

These are surely not the only prisms through which an understanding of financialisation as part of a structural transformation can be approached. Nor do we claim that they

provide a complete framework through which every dimension of financialisation can be understood. They do however contribute to the literature on these issues. Analysis within the literature of the transformation which financialisation entails, even when based on nuanced theoretical grounds and given some historical context, does not always consider underlying tendencies within capitalism that support the advent of financialisation, or sometimes does so only in passing. By way of contrast, classic theories of imperialism (Lenin, Hilferding, Luxemburg and others) sought to do just this. For example, with some diversity, these stressed the concentration and centralisation of capital as long-term tendencies giving rise to ‘capital associations’ which, together with states, sought to divide the world into imperial state-controlled markets and spheres of lending.

Our objective is more modest. We do not build a new theory of imperialism with financialisation at its centre; such a task is beyond the scope of this project. We do however propose that these two secular tendencies within capitalism – shifting property relations and the expansion of the circuits of capital within the world market – assist us in framing an understanding of financialisation. We do so for two reasons – mostly as this can contribute generally towards a broader theorisation of the underlying dynamics which give rise to financialisation and more narrowly as this provides a basis for our ensuing analysis. This is particularly true regarding the world market as global transformations exert a significant influence on financialisation in developing countries. The link between this more abstract theory and the analysis of financialisation in South Africa is worth noting now as it is not always explicit in future chapters. By drawing out two underlying tendencies within capitalist development, we help to explain what precipitates financialisation as part of a structural transformation.

We begin this chapter, in Section 2.2, by briefly reviewing existing approaches which draw links between financialisation and structural transformation. We then turn to a lengthier explication of the underlying logic of capitalist credit and financial relations in Section 2.3. This provides a basis upon which we can understand the role of finance in the economy, as well as how the development of the financial system – logically and historically – entails shifting property relations. Theorising the transformation in property relations as part of a structural transformation in mature capitalism is tackled in Section 2.4. That section also provides a theoretical framework for approaching the

world market and how this relates to financialisation and structural transformation, while Section 2.5 deals with concrete historical developments relating to the nexus between internationalisation and financialisation. In Section 2.6 we briefly relate our preceding analysis to the rise of neoliberalism and in Section 2.7 we conclude.

2.2 Structural transformation in the existing literature

While much of the financialisation literature focuses on its evolving nature or present dynamics (reviewed in Chapters 3 and 4) there are some approaches that position financialisation as part of a broader structural transformation. Many of these have stressed financialisation as involving a ‘flight into finance’ as a result of stagnating production; this has four main strands. First, The *Monthly Review School* (Paul Sweezy, Harry Magdoff, and Paul Baran) argue that monopolies generate an ever-expanding surplus leading to the over-expansion of productive capacity and that one way capital seeks to counteract insufficient demand and the inability to absorb the surplus, is by seeking refuge in the sphere of circulation, especially in the speculative activities of finance (Magdoff and Sweezy 1985, 1987, Lapavistas 2010, Shaikh 1978).² Second, Giovanni Arrighi (2010) – in an account based on four long-term ‘systemic cycles of accumulation’ over six centuries – also poses that, for the prevailing global ‘hegemon,’ a flight into finance occurs again on the basis of a crisis of over-accumulation, but in this theory due to increased competition in product markets not monopolisation. This leads to a transition between hegemons. Third, the Regulationists view the ‘finance-dominated’ regime as part of a transition from Fordism to post-Fordism with the decline in productive accumulation and the demise of the capital-labour compromise captured under the Fordist growth regime (for example Aglietta 2008). Fourth, a number of Marxists explain the onset of financialisation as rooted in the crises of the 1970s, with the tendency for the rate of profit to fall taking centre stage (Brenner 2003, 2005, Duménil and Lévy 2005, Shaikh 2011). Some of these, for instance Samir Amin (2004) in line with the *Monthly Review* school, argue that falling profit rates at the end of the post-war period did not lead to an acute crisis (as Marx suggested) but to over-accumulation, stagnation, and a flight into finance.³

² This view, now focused on international oligopolies, has been maintained most strongly by Foster (2010, 2015) and Foster and Magdoff (2009).

³ Others who approach financialisation on the basis of over-accumulation/overproduction include: David Harvey (2003, 2005) who argues that a dearth of profitable investment opportunities creates the need for

Despite notable strengths, for instance the prescience and foresight of the *Monthly Review School* in perceiving the rise of finance early on, each of these suffer from particular historical and theoretical weaknesses. The *Monthly Review School*, for instance, does not logically substantiate why monopolies would persist in over-expansion in the face of insufficient demand (Shaikh 1978, p. 230). For Arrighi the place of ‘financial expansions’, as cause or effect, during hegemonic transitions is left hanging, as are the reasons why some leading capitalist organisations are able to retreat into the financial realm and others not, and why financial markets ensure a higher rate of return when profits in the real sector are depressed (Orhangazi 2008a, p. 46, see Pollin 1996 for a critique). For the Regulationists, neither the crisis of Fordism nor the characteristics of post-Fordism are sufficiently clearly defined (as covered in detail in Brenner and Glick 1991, Mavroudeas 2012) and hence the broader context within which financialisation fits is uncertain. Other approaches that centre on crisis, while capturing an important turning point in the 1970s, miss the functional aspects of finance’s growth – the important role it plays in oiling the wheels of the ‘real’ economy – as well as the manner in which capitalist accumulation has managed to recover from the crises of the 1970s and the critical role that finance played within that.⁴ A potentially dangerous consequence of this, as Lapavistas (2014, p. 17) notes, is that we may “lapse into treating finance as a parasitical or speculative set of activities, thus assigning to financialisation a purely pathological character that would be misleading”.

Other approaches to the structural transformation which gives rise to financialisation, not premised exclusively on a flight into finance, do exist. Duménil and Lévy (2004, 2005, 2011), for instance, situate the ‘rise of finance’ in class terms. For them financialisation comes about due to a class alliance between the upper section of the capitalist and managerial classes, under the leadership of the former with technical change playing an important role. Despite notable insights, they naturalise the dominance of finance as a (if not the) normal state of capitalist accumulation (Duménil

a spatial and temporal reshuffling of the processes of production and accumulation; and Peter Gowan (2003, 2009) who sees the ‘Dollar-Wall-Street’ regime – which makes governments, banks, and industrial companies dependent on American finance – as arising on this basis.

⁴ Those that postulate long-term stagnation also ignore the recovery of profit rates (see Basu and Vasudevan 2012, p. 2 for a review).

and Lévy 2004, pp. 15–16) without providing a theoretical basis for why this is so, while postulating a relatively straightforward takeover of the state by finance.

Duménil and Lévy thus refer to this as the “reestablishment of the domination of finance after a period of retreat” (2004, p. 156), with reference to the strong influence of finance in the late nineteenth and early twentieth centuries. While finance played a leading role during that period, by our definition, we do not consider it an earlier period of financialisation. The nature of finance during that period was different – for example, large banks rather than financial markets dominated – as was finance’s role within capitalist accumulation – for instance, the role of financial market in mediating transnational production was not as pronounced. Further, it is argued here that both the extent and intensity with which financial markets have dominated economic production and social reproduction is quantitatively and qualitatively new.

Non-Marxist approaches also (to varying degrees) discuss financialisation as part of a structural transformation. The post-Keynesian literature, while broad and varied (as explored in the next chapter), sees the transformation as driven by ‘rentier’ interests and occurring due to changes in state regulation rather than rooted in underlying capitalist tendencies (for example Crotty 2005, Epstein and Jayadev 2005, Parenteau 2005). Others within this school have argued that Minsky’s (1974) financial instability hypothesis can be adapted to explain a secular (or medium-term) rise in the weight of the financial sector (Palley 2011, Wray 2011). We argue in the next chapter that these are limited based on their emphasis on the rentier. Lazonick (2010, 2011) and others situate the transition to financialisation as part of a breakdown in prevailing business models rather than a crisis in accumulation. There is much to recommend the empirical analysis (drawn on in the next chapter) but too little attention is paid to the restructuring of the financial sector itself and the transition described is not placed within a broader theory of capitalist development.

Our manner of approaching structural transformation does overlap with other contributions to the literature. Fine (2007, 2009a, 2010a) specifically roots financialisation within a Marxist political economy of finance and its evolution (as we do, albeit with different emphasis); Lapavistas (2011, 2014) also does so but with an opposing interpretation to Fine. A distinct strength of Fine’s (2009b, 2009c, 2010b)

analysis is the relationship between transformations in accumulation and a broader restructuring of social and economic life, linking financialisation and neoliberalism (see Section 2.6). Lapavistas (2014) refers to financialisation as representing a period change in capitalism “entailing a systemic transformation” and explains this in light of changes in the operations of nonfinancial enterprises, banks, and households. He points to the secular tendency within capitalism towards the concentration and centralisation of capital in large monopolistic capitals and discusses the importance of the remaking of monetary relations, underpinned by a Marxist theory of world money (see Section 2.5). Panitch and Gindin (2009) also offer a framing which overlaps with ours. They place particular importance on the role of the state with specific emphasis on American imperialism in facilitating the restructuring. They also stress the importance of the world market – although with emphasis on finance in its own right, and the relationship between finance and trade, and less emphasis on the internationalisation of production. Duménil and Lévy (2005) mention the importance of internationalised production but only in passing, while Powell (2013a, 2013b) places direct emphasis on this in the context of the world market.

This brief review of the literature is not exhaustive nor does it give a full account of each of these approaches (many of which are reviewed with regard to the concrete dynamics of financialisation in the next chapter). It serves rather to note dominant views of financialisation as part of a structural transformation, in contrast to which the approach taken here can be viewed. We switch tracks now and begin our analysis, as noted, with an interrogation of credit relations and the development of the financial system under capitalism; both because this contextualises our propositions and because it lays a basis for understanding finance.

2.3 Capitalist financial relations

At the broadest level, credit relations, we argue, establish socially-recognised claims between debtor and creditor – financial claims (Petersen 2012).⁵ When the creditor parts

⁵ When discussing commodity exchange Marx stresses the importance of social recognition, he notes: “Commodities cannot themselves go to market and perform exchanges in their own right. We must, therefore, have recourse to their guardians, who are the possessors of commodities. ... The guardians must therefore recognize each other as owners of private property. ... Here the persons exist for one another merely as representatives and hence owners, of commodities.” (Marx 1977, p. 178). The same is

with money they receive in return a socially-recognised claim upon the debtor for future repayment of the principal plus interest on a specified date in the future. The borrower, by definition, is subject to a corresponding socially-recognised obligation. This is definitional and is the case in capitalist as well as pre-capitalist credit relations. Such claims and obligations need not pertain only to the repayment of loans, a financial security for instance represents a claim that the shareholder has upon the company for the payment of dividends (should the company choose to declare them) and a *pro rata* claim upon the assets should the company liquidate. Other financial claims, such as futures trading or credit-default swaps, commit the parties to undertake particular actions on specified dates in the future, or in the advent of specific circumstances. This synthesising framework, while useful in ways we shall develop, does not tell us about the nature of these claims under capitalism, their social content, and how and why they have proliferated; these are the topics tackled here. This lays the foundation for proposing a transformation in property relations based on the extent to which such claims have come to mediate ownership.

While credit relations have long existed, they remained external to the core of social reproduction in pre-capitalist conditions (Itoh and Lapavistas 1999, p. 73). With the growth of merchant activity – trade and in particular long-distance trade – money-dealing took on new importance. The profit derived by the merchant – a portion of which was paid to the money-dealer for the technical trade-facilitating functions performed – accrued on the basis of buying cheap and selling dear. The qualitative difference in capitalist credit relations rests, therefore, in the first instance, on the pre-existing capacity to generate surplus value under conditions of capitalist accumulation and the credit system’s centrality in supporting and accelerating this. As Lapavistas (2014, p. 108) notes, for finance to “become integrated into a system, there must already be regularity in creating and augmenting monetary value in the rest of the economy. ... In short, a system of finance [opposed to ad hoc financial relationships] could only emerge if capitalist relations already permeate economic life. ... [T]he system itself would be based on the social practice of regularly recouping value with increment.”

true of financial transaction where debtor, creditor, and society at large recognise such claims and their corresponding obligation.

The existence of this ‘social practice’ is captured within the circuit of capital, typically given by: $M - C(MP, LP) \dots P \dots - C' - M'$. Here, money (M) – in its role as the purchaser of the means of production (MP) and labour power (LP) – undertakes a new function. It is advanced as capital (as money capital), a commodity whose *raison d'être* (and hence use value) is the expansion of value itself.⁶ Through the circuit new commodities are produced (C') and when sold the capitalist receives money with increment (M'). This circuit of capital can also be viewed as ‘beginning’ and ‘ending’ at different points, thus Marx also notes the circuit of commodity capital, $C - C'$, and productive capital, $P - P'$ (Fine 2012, p. 111). The generation of surplus value, which occurs only within production, is foundational to Marx’s approach to capitalist accumulation, and capitalism develops and expands on this basis (see for instance Marx 1977);⁷ it will not however detain us here and we will proceed taking this as given.

When expanded reproduction and credit relations are considered M is lent to the capitalist enterprise and a portion of M' is used to pay back the original debt. When money is alienated as capital it becomes a commodity *sui generis* that is exchanged between parties; financial relations inherently involve the trading of money or money capital in exchange for financial claims (liabilities).⁸ This can be represented diagrammatically as shown in Figure 2.1, which also highlights various stocks (S) and flows (F) of capital. In this context credit (M) is extended in order to initiate a new circuit of capital or expand an existing one. Credit can also be extended to speed up the circuit. Indeed this played a critical role in the development of capitalist credit as capitalists’ bills of exchange – promissory notes used to facilitate the exchange of goods between capitalist enterprises – were discounted by banks and replaced by banks’ own

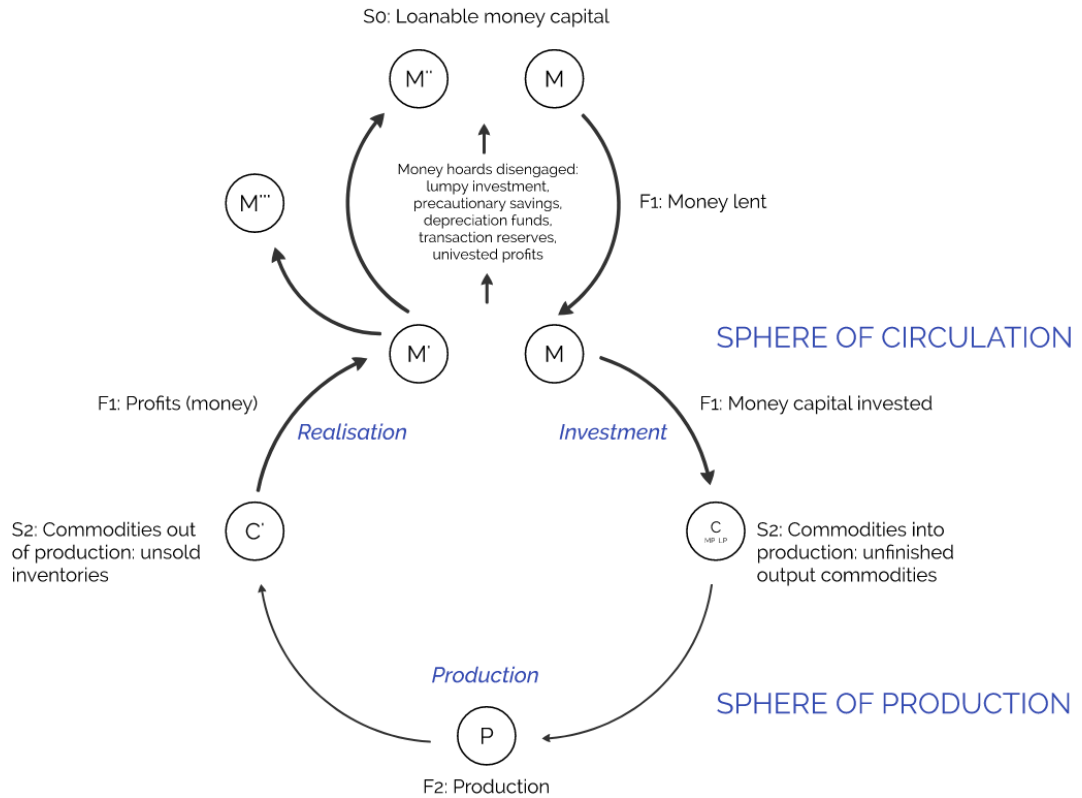
⁶ Money has other functions that exist irrespective (and historically prior) to its advance as capital. Marx lays these out as: a measure of value, medium of circulation, and money proper. The latter function includes money’s role in hoarding (as a store of value), as a means of payment, and as world money. Not all of these are discussed here, see de Brunhoff (1976), Foley (2005), and Vasudevan (2009a).

⁷ ‘Value’ is used by Marx to refer to the ‘socially necessary labour time’ embodied in a commodity (distinct from ‘use value’ – the use to which the commodity can be put – and ‘exchange value’ the quantum for which the commodity can be exchanged). ‘Surplus value’ is used by Marx to refer to the new value created in production by workers in excess of their own labour cost, surplus value is appropriated by the capitalist as profit when the commodity is sold.

⁸ It is worth noting that (contrary to Marx and a number of Marxist scholars, for example Lapavistas 2014) the depositor is no longer the ‘owner’ of the money capital advanced, but the holder of this socially-recognised claim upon the bank. Marx (1981, p. 491) argues that the money capital is merely “placed under the control of the bankers as representatives of the social capital”. Certainly the bank is the “representative of the social capital” but, as property law makes explicit, the bank takes ownership of the money deposits and in exchange issues a bank liability – a claim upon the bank – to the depositor. The bank does not therefore lend out money or money capital belonging to ‘other people’.

liabilities. This placed banks at the heart of credit relations: the discounting and extension of trade credit – which remains in usage today – helped establish the social position of banks so that they could serve as providers of banking or monetary credit.⁹

Figure 2.1 The circuit of capital



The money capital advanced within the circuit (M) can derive from three different sources: first, pre-existing ‘hoards’ of money, which may have accrued on the basis of prior money-dealing and trade operations; second, ‘hoards’ that become temporary idle in the course of capitalist accumulation – depreciation funds for capital investment, ‘turnover’ reserves (disbursements not instantaneously used as input purchases may be gradual), precautionary funds to meet unforeseen payments, and realised but uninvested profits (dos Santos 2011a, p. 8, Lapavitsas 1997, pp. 93–94); and, third, the *ex nibilo*

⁹ Lapavitsas (2014, p. 110) explains the difference between trade and monetary credit in the following terms: “Trade credit is the advance of commodity output against a promise to pay later. In transactions of trade credit, money acts as measure of value (accounting unit of contracts) and as a means of payment that eventually settles transactions; however, the original form of value advanced is commodities. Monetary credit, on the other hand, is the advance of money against the promise to pay later, plus interest. In transactions of monetary credit, money acts as measure of value and as a means of payment, but it also is the original form of value advanced.” It is for this reason that our analysis focuses on monetary credit.

creation of credit primarily by banks. On the back of the social position that the bank establishes – as a party able to make good on its financial commitments – it is able to issue liabilities *ex nihilo*.¹⁰ This is generally ignored in neoclassical economic theory in which investment is purported to arise out of a pre-existing pool of savings. It is however critical to the process of accumulation as “capitalised profits represent a net addition to the total value taking the form of money in the economy” and this necessitates an expansion of the monetary means for expressing value (dos Santos 2011a, p. 11). The creation of credit money steps in to solve this and in doing so establishes the premise for its own repayment: loans create deposits. In doing so the loan creates a whole series of further assets and liabilities as in the course of economic interactions the money is transferred from one account to another; the balance sheet of the credit system as a whole burgeons.

In all cases money thus lent earns its own rate of interest. Marx differentiates between interest-bearing capital, money capital lent on the basis that it makes possible the generation of surplus value, which earns the rate of interest, and other money loaned which would tend to earn the rate of profit. The rate of interest is therefore a share of surplus value produced, which is split between profit of enterprise accruing to the productive enterprise and interest accruing to its creditor (Fine 1985, Fine and Saad-Filho 2004, pp. 142–143, Marx 1981, p. 475). The rate of interest (adjusted for risk, length of loan etc.) is, at a given time, determined by the concrete interactions in the money market – via the supply and demand for credit, the relative social power of creditors and debtors, and the expected profits that its use may realise, which in turn is dependent on the level of development of industry and the financial system, and the stage of the business cycle; the state has also come to play a critical role.

The credit system therefore functions to: a. collect and centralise idle funds; b. issue and circulate promises to pay, or socially recognised claims. This brief presentation serves to highlight one aspect of the functional role that credit plays in capitalist accumulation and how credit springs endogenously from real accumulation, is integral to it, and helps shape it. Our forthcoming discussion of financialisation will relate back to this in two

¹⁰ Marx’s own treatment of this is limited. In discussing banking capital in Capital Volume III (Marx 1981, p. 603) he quotes at length from *The Currency Theory Reviewed* which notes this creation of money but does not pursue the matter. Notably, in his later discussion of money capital and financial crisis this issue is not substantially revisited.

respects. On the one hand, this functional role is sometimes overlooked when depicting the financial sector as purely parasitic. On the other, the activities undertaken by the financial sector under financialisation have increasingly become disconnected from financing investment as understood via the circuit of capital. By understanding both the functional role of credit in capitalist accumulation and how certain activities within the financial sector have become divorced from these, the door is opened to understanding financialisation, instability, and crises.

The development of the capitalist credit system – and its role within capitalist accumulation – relies logically and historically on the *generalisation* of credit relations. In this respect the money and capital markets are central. At core, the money market is an interbank market for reserves of liquidity and the site where credit relations emerge in a society-wide manner rather than between individual borrowers and lenders. In practice it serves as a rediscount market for banks, an efficient mechanism for the regular settlement of matured commercial and bankers bills, a source of reserves, and a market for borrowing between banks (Itoh and Lapavistas 1999, p. 97). The rate at which banks lend to one another, itself regulated by the broader dynamics of accumulation already discussed, becomes of paramount importance in determining the generalised rate of interest,¹¹ and the manner in which the money market serves to structure the (sometimes hierarchal) relations between financial institutions.

The central bank – the ‘bank of banks’ – plays a coordinating role in the money market. Central banks centralise reserves, mediate the money market, and influence credit extension and the rate of interest via their own lending rates. The manner in which the central bank can “set the costs and terms at which it makes its liabilities available to the banking system” allows it to pursue monetary policy with varying political goals (dos Santos 2011a, p. 20). Its central objectives are to retain the market basis for the circulation of its liabilities – that is, maintaining the value of its tender – and the preservation of the aggregate profitability and stability of the financial system (dos Santos 2011a, pp. 20–21). Central banks, although originally private, are now generally public or publicly regulated. Important to our latter analysis, Lapavistas (2014, p. 132) notes that, “[f]inancialization rests on the tight connection between the central bank

¹¹ It is for this reason that rates like the London Interbank Offered Rate (LIBOR) are of such crucial importance to the modern economy.

and the state” and we shall see how central bank policy and state support for the central bank is integral to financialisation.

The central bank is also concerned with the rate of exchange between its liabilities and an internationally recognised currency able to act as a global means of exchange, measure of account, and store of value – what Marx terms ‘world money’ (see Marx 1977, chap. 3). This exchangeability conditions the legitimacy of that national currency.¹² The place of the US dollar as world money and the corresponding fact that other countries’ reserves must be denominated in US dollars, places the United States in a very unique and powerful position; such currency hierarchies are particularly important to financialisation in developing countries (see Section 2.5).

The capital market has its roots in the advent and pre-eminence of the joint-stock company which facilitated the huge fixed capital investment necessary for capital-intensive industries. Critical to our discussion of the content of capitalist financial relations is that this entails the issuance of financial securities. Marx, in line with our discussion above, considers stocks as ‘ownership titles’, more specifically he argues that “securities actually represent nothing but accumulated claims, legal titles, to future production” (Marx 1981, pp. 598–599). To clarify that “the capital does not exist twice over, once as the capital value of the ownership titles, the shares, and then again as the capital actually invested in the enterprises in question”, Marx refers to such securities as ‘fictitious capital’ (1981, p. 597). A number of Marxist scholars use ‘fictitious capital’ as central to their definition of financialisation, we do not and so we briefly explain why.

Marx’s insight that capital value does not exist twice over is important¹³ but this is not all that is entailed by the term. The quote above continues: “the share is nothing but an ownership title, *pro rata*, to the surplus-value which this capital is to realize” (Marx 1981, p. 597).¹⁴ The present value of the share, in addition to reflecting the value of the underling assets to which it lays claim, includes the expected future dividend flows, that

¹² This is particularly true in times of crisis when value flees into its most socially recognised forms.

¹³ One should also not fall into the trap of considering the value of a company as determined by the market value of its shares. The value of the shares depends ultimately on the market value of the company although, at any given time, the shares are valued by the amount for which the last purchaser of the companies’ stock was prepared to pay.

¹⁴ This should be nuanced by noting that the share is both a *pro rata* claim on the surplus value realised within the enterprise, and a *pro rata* claim on the underlying assets upon (possible) liquidation of the enterprise, that is, a sub-divided portion of the value of the company (Petersen 2012).

is, it is capitalised, and it is this that seems to lead Marx to refer to it as fictitious capital; for instance he notes: “The formation of fictitious capital is known as capitalization.” (1981, p. 597). However, let us assume that the profits are not paid out as dividends meaning that the value of the firm, and hence the ‘capital’-value of the shares, would increase as it includes the discounted value of the anticipated future earnings. In this circumstance, as Petersen (2011) argues: “The company itself could sell this business and either buy another one with the proceeds or invest the proceeds directly in setting up a productive enterprise *de novo*”. On this basis: “What part of the proceeds of the sale so utilised or invested are to be considered “fictitious” value or indeed fictitious capital?”

In other instances Marx seems to imply that the value is fictitious because in the gyrations of the market the value of the share may diverge considerably from the actual value of the enterprise.¹⁵ But this is not necessarily so, and ultimately the real value of the company reasserts itself even if this means the devaluation – or repudiation – of large swathes of claims (Petersen 2011). The possibility for this divergence between the monetary value of a share at any given moment in time and the underlying value of the company does not seem to support considering the value of the share as ‘fictitious’ or illusory.¹⁶ We maintain that a moniker such as this must usefully illuminate the subject matter and that ‘fictitious capital’ does not do so. Rather, also in line with Marx, we prefer to characterise shares as titles or claims upon the firm; this has the added benefit of making clear the connection between financial claims and the social surplus derived from the productive process, to which they lay claim. This allows us, in the context of property relations, to discuss the proliferation of financial claims as encompassing both credit and capital market relations.

This said, Marx’s stress on capitalisation is critical in that it remains a very salient feature of financial markets and accentuates the appearance that interest is a natural feature of capital, with the latter mysteriously able to self-expand. Capitalisation also lays the basis

¹⁵ “The independent movement of these ownership titles’ values, not only those of government bonds, but also the shares, strengthens the illusion that they constitute real capital besides the capital or claim to which they may give title.” (Marx 1981, p. 598).

¹⁶ The theorisation of fictitious capital has problematically resulted in some considering all capital gains – or just those that arise out of the divergence between the underlying value of the company and the share price – as “fictitious profits” (for example Carcanholo and Sabadini 2009). Others have argue that: “this capital is fictitious because it has no immediate connection with real production where value is created as a way of reproducing capital as value that valorizes itself” (Mollo 2010, p. 4).

for securitisation, as the onward selling of a financial asset is predicated on a future stream of income accruing to the new holder of that claim. This highlights how “the potential for securitization is inherent in the movement of capital” (Milios and Sotiropoulos n.d., p. 13).¹⁷

The financial claims established in both credit and capital markets are able to be alienated as capital and depending on their degree of social acceptability, to act as money or money-capital themselves. They can also be sold onwards as a commodity *sui generis*. Importantly, what occurs is that the claims can be alienated without the correlative obligation changing hands. The creditor can freely sell his or her claim onwards, but the debtor cannot pass on his or her obligation without the creditor’s consent. The freedom of the creditor to do so is essential to the functioning of credit and capital markets (Petersen 2012, pp. 5–6).

It is important to distinguish between the ownership of claims and direct ownership of commodities or capital. Direct ownership exists when a legal person (human or juridical) has the exclusive right to a thing, be it an item of clothing or a machine. Claims, entitlements, or ‘indirect ownership’ exist when the legal persons agree (or are compelled) to give or do something.¹⁸ The company (a juridical person) may have direct ownership of the machinery, intermediate inputs etc., but the shareholders (human or juridical themselves) possess a claim upon the company for payment of dividends (should the company choose to declare them) and a *pro rata* claim upon the assets should the company liquidate. They also enjoy various proprietary entitlements and some measure of control over the business.¹⁹

¹⁷ Minsky (2008, p. 2) notes the relationship between securitisation and early bank discounting of commercial bills of exchange.

¹⁸ Petersen, from whom this approach draws, distinguishes these differently, as “*primary* and *derived* forms of entitlement” (Petersen 2016, p. 2 emphasis in original). Financial claims are a derived form of entitlement.

¹⁹ Petersen (2012, para. 53) also notes: “One of the merits of keeping financial assets and their correlative liabilities conceptually distinct from real assets, is that it helps one to see why the massive creation of asset values in the financial sphere does not lead immediately to price inflation.” He continues: “This is because financial assets are not direct monetary claims on real assets. Although they are exchangeable for money, they cannot simply shed their correlative liability and all present themselves as net demand for real things. On the other hand, a narrowing of avenues for the reinvestment of the real surplus surely does carry the inherent danger of tipping the value-system into deflation and depression, or alternatively into stagflation.” Similarly, this helps to explain why the monetary value of those claims can crash, without anything happening to the underlying asset at all. On the other hand, if the underlying asset is destroyed, the entire value content of those entitlements is eliminated (Petersen 2013, p. 4).

The proliferation of such financial claims or ownership titles and their securitisation gives rise to a vast array of financial assets – derivative claims – building a castle of claims upon claims, all connected to, but further and further away from, the dynamics of real accumulation.²⁰ Other forms of claims, such as futures of credit default swaps also arise; these compel the contracting party to undertake a specified transaction on a given date or in given circumstances. Any of these might be securitised and beget further tradable paper assets. Financial markets are, therefore, in the main, secondary (liquid) markets, that is, they are markets for the origination, distribution, and circulation – essentially trading – of these financial claims; thus granting capital both liquidity and mobility. The worth of such financial assets and derivatives, however, is still disciplined by the capacity of the corporation (or those to whom it subcontracts) ultimately to exploit and produce surplus value. Financial gains, therefore, entail a redistribution of (surplus) value, and financial claims a means of appropriating a share of the social surplus, with (surplus) value creation remaining within production.

Marx notes both a logical and historical tendency towards the centralisation and concentration of capital. In the context of capital markets this proceeds on two planes. The joint stock company concentrates and centralises industrial capital as never before. The financial market first multiplies and scatters ownership claims only to centralise control over them in massive financial institutions.²¹ The stock market is thus a powerful social mechanism for the financing of industry, the concentration and centralisation of capital and claims, and the garnering of financial profit. It embodies the tendency within capitalism to replace individual direct ownership with claims of some kind. In doing so it potentially becomes more a matter of indifference to those holding the claims in what manner investment is to be made and surplus generated and footloose capital seeks hither and thither across the globe for the highest rate of return. At the same time, the large concentration of financial wealth that occurs in line with this

²⁰ Take, for instance, credit default swaps (CDS), essentially insurance, issued against a collateralised debt obligation (CDO) that is made up of tranches of mortgage-backed securities (MBS), whose income stream derives from homeowners paying their mortgages, which in turn derives from wages secured in the process of production. This illustrates the ‘distance’ between contemporary financial assets and real accumulation. This said, credit continues to play a functional role in greasing the wheels of the circuits of capital while many financial assets lay claim to profits arising out of production (for example, shares) and even the most exotic financial asset can be traced back, in some manner, to productive processes. In this way the financial system retains its important relationships with the ‘real’ economy.

²¹ This centralisation confers economies of scale, as Marx (1981, pp. 570–571) notes, it leads to “the centralization of capitals and hence of expropriation on the most enormous scale ... Since ownership now exists in the form of shares, its movement and transfer become simply the result of stock-exchange dealings, where little fishes are gobbled up by sharks, and sheep by the stock-exchange wolves.”

may result in a concentration of ownership in the hands of huge financial institutions. In this we see how financial markets (and the financial institutions which dominate within them) offer a means through which enterprises are disciplined (the concrete manifestation of which is historically and geographically specific) as well as the latent predisposition of financial markets towards ‘maximising shareholder value’, themes we take up in our discussion of financialisation.

In sum, we have characterised the financial system as a mechanism for the origination, transfer, trading, and concentration of financial claims of varying social status. Because money today is a liability of the central bank the entire monetary economy is a series of such claims. The proliferation of financial claims, and that ownership of society’s wealth is increasingly mediated via such claims, is central to the tendency towards financialisation.²² We have also illustrated the manner in which the financial system (although rooted in real accumulation) develops differentiated levels of autonomy, in line with the forms taken by assets, and this too is critical to the concrete processes of financialisation.

2.4 Structural transformation: evolving property relations and internationalisation

We propose that the era of financialisation is characterised by the proliferation of financial claims. This has entailed a quantitative and qualitative shift in capitalist property relations, and interrogating this assists us in theorising structural transformation.

Fine and Harris (1979, p. 109) discuss ‘periodisation’ (through which distinct phases of development are delineated) in terms of “the effects of the development of the forces and relations of production on the form of social relations within a mode [of production]”. They continue that “such a periodisation will reveal itself in the methods of appropriating and controlling surplus value. These methods will assume increasingly socialised forms as the socialisation of production proceeds.” We propose that the proliferation of financial claims as the predominant form of ownership can be

²² In this sense we take a similar view to Fine (2013a, pp. 11–12) who notes that “the prodigious expansion and proliferation of financial markets over the past three decades is indicative of a secular, if irregular, trend of expansion of fictitious capital at the net expense of the real economy”.

understood in these terms. Such a proliferation occurs on the basis of the “effects of the development of the forces and relations of production on the form of social relations” – centrally the evolution of the credit system – while also entailing a particular means for controlling the distribution of surplus value (while strongly influencing its generation in production). It is also no doubt an increasingly “socialised form” of ownership (as Marx notes) and spurred, as discussed below, by the increasing ‘socialisation’ of production.

We illustrate this via Marx and Engel’s materialist conception of history, which stresses the historical evolution of property relations, and the coevolution between changes in the mode of production and evolving property relations (see for example Marx and Engels 1970). Marx and Engels establish how the stage of development (within and between modes of production), the division of labour, and forms of property relations mutually define one another, also determining forms of class formation and social struggle. In this regard, they note:

“the whole internal structure of the nation itself depends on the stage of development reached by its production and its internal and external intercourse. How far the productive forces of a nation are developed is shown most manifestly by the degree to which the division of labour has been carried. ... The various stages of development in the division of labour are just so many different forms of property” (Marx and Engels 1970, p. 43).

They continue to distinguish between tribal property, ancient communal and state property, and private property. Three periods of private property are discussed, associated with the internationalisation of trade, the expansion of manufacturing and the advent on large-scale capitalist production. Each is associated with its own division of labour, as the productive forces shape property relations (Marx and Engels 1970). The rise of the joint-stock company and universal competition transforms property relations again, as private property becomes a “fetter” to production and share ownerships result in large-scale industry becoming “social property,” albeit for “the few” (Marx 1981, pp. 570–571). No longer do capitalists directly own a business and the necessary means of production. Rather they become managers while others become holders of claims, financial claims entitling them to a stream of future income from the surplus the business produces. In this stage, Marx and Engels (1970, p. 78) argue, “all natural

relationships [are resolved] into money relationships”. We propose that this is the sort of transformation of capitalism captured by ‘financialisation’ – a quantitative shift takes place in the dominant form of property ownership, claims to property and the social surplus are more and more mediated by financial entitlements, and this resolves into a qualitative shift in property (social) relations. Marx (1981, p. 568) refers to this as “capitalist production in its highest development”.

Marx also approaches capitalist development, and its periodisation, from another, related, vantage point: that of the world market.²³ For Marx the world market is both “a ‘precondition’ for the capitalist economy to come into existence [as the historic development of both the forces and relations of production giving rise to capitalist accumulation have global dimensions] and a ‘result’ that is reproduced through capitalist mechanisms” (Hoe-Gimm 2012, p. 385).²⁴ Further, it is through the world market – viewed not simply as a geographical space or sphere of circulation – that the totality of capitalist relations is expressed. It is unsurprising then that the stages of the capitalist world economy that Marx described overlap with the periods of private property that Marx and Engels observe (noted above). The former are constituted by the internationalisation of different circuits of capital.

Fine and Harris (1979, p. 147) explain: the circuit of commodity capital is the first form of capital to internationalise in the search for “expanded markets to ensure the realisation and completion of their circuit”. Next, the development of the credit system – which expands enormously on the back of industrial production and the advent of the joint stock company – facilitates the internationalisation of financial capital. This forms a central part of Hilferding’s, Lenin’s, Luxemburg’s and others’ conceptualisation of imperialism. This established international credit relations, including in share ownership. It did not, however, give rise to the complex financial system we see today. The third stage is one in which “productive capital itself is internationalised with multinational corporations controlling production processes which cross national boundaries” (Fine and Harris 1979, pp. 147–148). We propose that the expansion and deepening of the

²³ The author acknowledges that this line of thinking originated from discussions with Jeff Powell and can be found in Powell (2013b), although the basis for this chapter was originally drafted prior to the publication of that work.

²⁴ Marx notes (1981, p. 451) that “world-market itself forms the basis for this [capitalist] mode of production” and that the “tendency to create the *world market* is directly given in the concept of capital itself” (Marx 1973, p. 408).

world market in general, and the unprecedented internationalisation of production in particular, play critical roles in spurring the development of the modern financial system.

Internationalisation and analysis of the world market also brings to the fore the relationship between capital and the state and the extent and manner in which the state is able to organise the world market to the benefit of particular sections of capital. This was central to classic theories of imperialism. Lenin, like many of his contemporaries, was concerned with cartels and trusts which, in line with the internationalisation of commodity and financial capital, sought to divide the world into markets and spheres for lending. Today, multinational corporations compete not only for markets and financial areas but also for productive bases; capitals are distinguished partially “according to their ability to organise production across national boundaries” (Fine and Harris 1979, p. 148). In both instances, states have played important, although not uncontested, facilitating roles. This – together with the deepening of the world market – is explored in the concrete regarding financialisation below.

Specific institutional forms correspond to these developments. Internationalised production and exchange is expressed in the form of massive transnational corporations, whereas ownership, mediated via the centralisation and concentration of financial claims, is vested in them as well as in large institutional investors and transnational financial institutions. Further, financialisation has entailed the interpenetration of capitals. As discussed in the next chapter, not only do large financial institutions, and the financial markets through which they operate, exercise a (form of) discipline over productive enterprises, but productive capital, via the transnational corporation in the form of large holding companies, has come to resemble aspects of their financial sector counterparts. These institutional forms, the embodiment of certain social relations, are also bound up with changes in the forces of production. In particular, increasing global technological sophistication makes global communication, transport, and financial trading possible, while allowing for the restructuring of production and work – these are essential to the internationalisation of production discussed below. This reorganisation of capital (together with other factors), allows for the reorganisation of production, exploitation, and exchange in ways that revive, even strengthen, capitalist accumulation while laying the seeds for instability and crisis. As

with capitalism in general, this expresses itself fully in the world market. We turn now to a more concrete analysis of the interrelations between the advent of financialisation, the world market, and structural transformation.

2.5 Financialisation, structural transformation, and the deepening of the world market

We have proposed that internationalisation is inherent within capitalist development – that capital pushes to reach beyond national boundaries and is fully expressed on the international level – and that financialisation, its onset, and the structural transformation of which it is a part, cannot be fully understood outside of this; this will be an on-going theme in this thesis. Our purpose in this section is not to give a full account of either the development of the world market or every manner in which it has interacted with capitalist restructuring and the advent of financialisation. Rather, in line with our discussion above the following subsections highlight how a few central processes of internationalisation – a process strongly determined by the evolving forces of production – facilitate the onset of financialisation and the subsequent restructuring of the relations of production. This involves a change of track as we shift from the abstract/theoretical to the concrete/historical.

2.5.1 The deepening of internationalised finance and its relationship with commodity capital and the state

The common conception is that under the Bretton Woods framework ‘financial repression’ reigned. That following the 1929 crash, Great Depression, and World War II various restrictions were placed on financial capital is common cause. These included the separation of investment and commercial banking (in the US), fixed exchange rates, dollar-gold convertibility, capital controls, and interest rate and credit limits. These are commonly argued to fall away with the demise of the Bretton Woods framework in the 1970s, or following this. However, the Bretton Woods’ framework was not adopted without contestation and successful resistance to the most stringent forms of capital controls, and an important and steady process of liberalisation took place throughout the post-war period, indicative of the pressures towards greater internationalisation. On the international playing field this included: American finance capital opposing and influencing the Bretton Woods agreement whilst it was still being drafted; the US

refusing to institute controls to prevent European capital flight and inflows to the US post-WWII; successfully pushing for dollar-sterling convertibility in the 1950s and early 1960s; the unregulated Eurodollar markets; resisting the implementation of multilateral capital controls in the later part of the 1960s; the internationalisation of US banking institutions; and the recycling of petrodollars via private financial institutions in the mid-1970s (Walter 1993, Helleiner 1996, McNally 2009, 2010, Panitch and Gindin 2009). This indicates that the restrictions placed on financial capital were never fully observed and that pressures towards liberalisation and internationalisation were on-going.

The example of the Eurodollar markets is telling. The impetus for the Eurodollar markets arose because British banks were restricted in their use of sterling to finance trade between countries outside the sterling area and the imposition of exchange and capital controls constrained international dollar liquidity; world money was in short supply. Simultaneously, capital controls in the US restricted the extent to which US financial institutions could mediate these markets. To continue financing their international clientele offshore dollar markets arose, operated largely out of the City of London. These markets were actively encouraged by the UK government in the interests of its banking sector and condoned by the US wish to preserve the role of the dollar as international currency (this hints at the important role of the state discussed below) (Helleiner 1996).

This illustrates the telling relationship between the circuits of commercial and financial capital and how the internationalisation of finance was a necessary condition for the financing of international trade. Comparative data are difficult to come by but comparing the growth in Eurodollar markets in Battilossi (2009) and world trade data from the WTO (2016) shows a close correlation. As the WTO (2008, p. 21) notes: “In effect, for many years after the end of WWII it was currency and payments restrictions rather than tariffs that limited trade the most. The birth of the Eurodollar market was a major step towards increasing the availability of international liquidity and promoting cross-border transactions in western Europe.” This in turn spurred the expansion and internationalisation of financial capital. As Battilossi (2009, p. 3) notes the “emergence and explosive growth of the so-called Eurocurrency (mostly Eurodollar) banking” is at the “origin of [... the] epoch-making change[s]” we observe in international financial

growth from the 1970s. We would caution that it is one, albeit important, building block in this regard.

We discussed above that the world market also brings to the fore the role of the state, and the state, we propose, has played an important role in bringing about the prominence of financial capital and the structural transformation we observe.²⁵ In line with Lapavistas (2014), we regard shifts in monetary relations as central. In the face of international payment and exchange rate imbalances in the late 1960s (the latter as gold traded above the official rate of \$35 per ounce and various countries, including the UK, suffered foreign exchange crises), and in order to maintain the use of the dollar as world money, the US state suspended dollar-gold convertibility, first temporarily in 1971 and then permanently in 1973. This was a crucial intervention in the world market and precipitated substantial changes in international monetary relations – free-floating exchange rates, capital mobility, nonconvertible state credit money, and dollar hegemony – as well as signalling the death knell of the Bretton Woods system, all of which was central to the structural transformation which followed.

The suspension of convertibility did not fully resolve the monetary crises spurred by global imbalances, and runaway inflation induced considerable instability. Not only did this undermine the profitability of the financial sector, hit by the general conditions of lower profitability and devalued financial assets, but it also undermined various currencies, in particular the dollar, as a standard of value. Given globalised trade and production the interests of financial, commercial, and industrial capital in stabilising the dollar converged.²⁶ The need to maintain the US dollar as world money was, therefore, central to the US's response to inflation in the late 1970s and early 1980s, what Duménil and Lévy, arguably overstating the centrality of this event, refer to as finance's state-facilitated 1979 coup d'état.

²⁵ Another important dimension of this is financial liberalisation, taken up in Chapter 4 with specific reference to developing countries.

²⁶ Inflation was not broken simply by the imposition of high interest rates, although this was vital; it also required breaking the economic power of labour, both directly and indirectly. Indirectly high interest rates induced a recession and increased unemployment and a growth in the reserve army of labour. Directly, the breaking of the air traffic controllers' strike and wage moderation agreements in the Detroit auto industry plants in the US, and the brutal pulverisation of the mineworkers in the UK, were instrumental and symbolic.

This dominance of the US in monetary relations, originally expressed through the status of the US as the world's largest creditor, transformed itself in the post-Bretton Woods period as the US became the world's largest debtor. Panitch and Gindin (2009, p. 27) argue that "far from necessarily representing a diminution of American power, the outflow of capital and the balance of payments deficits were actually laying the basis for a dollar-based credit expansion and financial innovation, both domestically and internationally – what Seabrooke appropriately calls the 'diffusion of power through the dollar' (2001: 68)". In the first instance, this is determined by its ability to facilitate trade (as an international means of payment and purchase) and as a stable unit of account (the universal store of value), but more than one currency can act as such. Therefore, it is also the currencies role as the denominator of debt contracts that determines its place as world money, as Kaltenbrunner (from a post-Keynesian perspective) notes: "while economic agents cannot be forced to hold their assets in particular currencies, they can be forced to assume their liabilities in them" (this is an insight derived from Minsky). This "structural demand for U.S. dollars [...] supports its value stability, which in turn reinforces its role as international unit of account and store of value and with it its international liquidity premium and global supremacy" (Kaltenbrunner 2015, p. 436). In Marxist parlance, its international liquidity premium is nothing more than its social acceptability.

Originally this structural power was experienced by peripheral states as the inability to raise debt in their own currencies. This has, however, changed over time and this is critical to our understanding of how these states have been incorporated into global financial networks (the subject of Chapter 4). From the point of view of the state, the value of each nation's currency has become paramount as it is through this that international value asserts itself on the national unit and so the state's role in currency management – maintaining a monetary standard in line with its own interests and the interests of the sections of capital to which it is allied – became critical.

2.5.2 Internationalisation of production

We have also located the internationalisation of production as central and although this stretches back well into the nineteenth century it expands enormously and becomes truly global only after the Second World War. Prior to 1914, the consensus was (in line with our discussion of the stages in internationalisation of the circuits of capital) that,

“portfolio investment was a more important component of long-term capital movements ... than direct investment”, in the course of the twentieth century this rapidly changed (Bloomfield cited in Lipsey *et al.* 1999, p. 312). In the developing world, for instance, US foreign investment doubled (in real terms) between 1914 and 1940 but by 1970 was almost 5 times what it was in 1914 and more than double what it was in 1940 (Jenkins 2013, p. 6). Between 1960 and 1980 the world stock of FDI grew eightfold from \$60 to \$500 billion (Jones 2005). Comparisons with international trade, more commonly stressed as accompanying expanding financial relations, are also pertinent: already by 1971 foreign production of various ‘national’ capitals exceeded world exports, international production by US firms abroad was four times greater than US exports (Palloix 1977, p. 8).

This is not to argue that internationalised production reaches its zenith during this period. Indeed, the growth between 1945 and 1970 pales in comparison to what follows. The point made is that in the post-war period, internationalised production goes from being negligible to meaningful. It is also in this period that the important symbiotic relationship between international finance and internationalising production deepens, as Panitch and Gindin (2009, p. 32) note: “Just as the internationalization of finance had earlier accompanied the internationalization of production, so any attempt to control finance by the 1970s would not be able to leave industrial capital untouched.” Hymer argues that the processes of internationalisation helped to “forge an identity of interests between [otherwise] competing national units [of capital]” (Hymer 1972, quoted in Powell 2013b). The penetration of US banks into Europe in the post-war period (not just foreign offices but active branches), for instance, went hand in hand with expanded US production on the Continent (Panitch and Gindin 2009, p. 23). In this period, “‘finance’ evolved far beyond its classical role in credit provision and was placed directly at the heart of the accumulation process, essentially introducing a new sector that straddled credit and production [in that it mediated production, for instance through exchange rate markets, well beyond its role in the provision of credit].” (Panitch and Gindin 2009, p. 38). As Duménil and Lévy (2001, p. 587) note about the expansion of finance during this period:

“The circulation of dollars around the world played a central role, but the most crucial element was probably the convergence between the rise of this new

international finance and the internationalization of production (the development of multinational corporations). Multinational firms needed financial institutions allowing for the circulation of funds internationally. These needs could have been ensured by international institutions, under the control of various countries, but it was actually private finance that performed the task.”

We have proposed that approaches to financialisation which see it as a ‘flight into finance’ and/or as arising on the basis of the triumph of the financial sector alone are incomplete in that they overlook the role of internationalised production in spurring the growth of finance. This is problematic, as Fine and Harris (1979, p. 151) noted in 1979, “the current period of capitalism is marked by two tendencies: increasing state intervention in economic reproduction and increasing internationalisation of productive capital”. In this context international financial networks were necessary both to finance internationalised production as well as to allow for the realisation of profit.

With this in mind we can fully appreciate phenomena like the Eurodollar markets which required demand for dollar liquidity driven by huge multinational (or internationalising) NFCs, the institutional expression of internationalised production. Likewise, the structural imbalances in the US economy must also be understood with this in mind. The global explosion of foreign exchange markets after suspension of convertibility is not simply a financial system engaging in speculative orgy (although there is an element of this) but also a rational response to the need to hedge risks in the coordination of international trade and production.

The international expansion of productive capital – occurring in tandem with the deepening of the international circuits of commodity and money capital – thus places new demands on both monetary and financial services. This is in part because the transformations of capital within the circuit – between money, commodity, and productive capitals – become more and more complex, as does the realisation of value via exchange, and new forms of financial capital are needed to facilitate this. Consider production chains that involve products from multiple locations, paid for in multiple currencies, that need to be moved between countries in the assembly process and sold in still other locales. Such developments placed new demands on the financial system and as new financial markets, instruments, and techniques are called into play, new

opportunities for arbitrage emerge. The latter indicates that as the complexity of the financial system develops, and financial claims proliferate, financial profit-making opportunities that, on their surface are somewhat ‘distant’ from capitalist production, abound. This leads the financial system to gain a level of ‘relative independence’ from both trade and production.

Further, these “fractions [of capital] which are apparently tied to service functions, but which administer the conditions of production and realization of the commodity only by means of a process of circulation ... [become] more and more dominant and complex in relation to the process of production itself” (Palloix 1977, p. 15). Panitch and Gindin (2009) get at this, when they note that the role of finance in taking over business services (accounting, payroll, information systems, consulting and the like), stimulating new consumer services (like the Fed-Ex), and greatly easing financial transaction (ATMs, internet banking). Together with the information technology revolution and new techniques for managing risk, these all contributed to capitalism’s overall dynamism. This has meant a larger share of overall profits for finance. However, this does not by default make it parasitic, as they note, “[like] transportation, risk management adds a cost to the final product, yet it is a cost that non-financial capitalists have had to accept as part of what makes the expansion of global accumulation possible” (2009, p. 38); Grahl and Lysandrou (2006) make a similar point about the functional role of currency market trading in mediating production and exchange.

All of this affects the role of finance within the circuit of capital, on both the national and international levels. This close relation between the financial and productive capital is not in itself new, with monetary and financial operations always having been integral to the circuit of productive capital, but the transformations we observe are novel. Along these lines Lapavistas (2014, p. 217) notes:

“The core relations of financialisation are rooted in the financial operations of non-financial capital. Nonetheless, financialization represents neither the escape of productive capital into the realm of finance in search of higher profits, nor the turn of productive capital toward financial activities at the expense of productive investment [we argue in the next chapter that this ‘turn’ does occur but agree that financialisation should not be theorised *as this*]. It [financialisation] stands, rather,

for a transformation of the mix of financial and non-financial activities that are integral to the circuit of productive capital. This transformation has implications for the financing of investment, the pursuit of financial profit, the internal organization of non-financial enterprises, and the tendency to crisis.”

In this context we propose the pre-eminence of money capital – capital’s most malleable, developed, and internationalised form – is asserted. The role of the world market is crucial. Stephen Hymer noted in the 1970s that the integration of the system of world capital and world labour into a worldwide structure “completely changes the system of national economies that has characterised world capitalism for the past hundred years” (1972, quoted in Powell 2013b). The above highlights in the concrete the proposed relationship between financialisation, the internationalisation of production, and structural transformation. The quote from Hymer also reminds us, as discussed regarding shifts in property relations, that such structural transformations are multi-dimensional, as globalised production, for instance, goes hand-in-hand with a restructuring of work; it is these multi-dimensional transformations that our forthcoming analysis of financialisation attempts to capture.

2.5.3 Lessons from the world market

Our discussion of the world market has brought to the fore a number of conclusions. Movements towards finance’s emancipation from financial restraints begin long before the crises of the 1970s and the onset of financialisation in the 1980s. This partly reflects the financial sector’s own interests but is also premised upon the role it plays in facilitating international trade and production. The internationalisation of productive capital is important in understanding the particularities of finance’s pathway to prominence, as is the need to mediate international standards of value in order to provide a basis upon which the world market can function; the state plays a central role in this. Monetary transformations – in particular the end of dollar-gold convertibility leading to floating exchange rates – are an important turning point as they call forth the need for a host of new financial instruments and techniques. Within this new regime finance plays a prominent functional role, in managing production, exchange, and levels of demand but fertile ground for expanding speculative gain and value appropriation quickly emerges. With this in mind, financialisation, instead of being understood as a ‘flight into finance’ on the basis of a dysfunctional productive sector can rather be seen

as gaining degrees of differentiated autonomies on the back of its necessary, critical, roles in capitalist accumulation and global expansion across production and circulation.

2.6 Financialisation and neoliberalism

Throughout this chapter we have (in various manners) referred to financialisation as a central *part* of the structural transformation that occurs in mature capitalism. We would be remiss, therefore, not to briefly situate financialisation within a broader context of contemporary social, political, and economic restructuring. Such broad transformation has commonly been captured as the turn to neoliberalism. Neoliberalism is a relatively expansive notion, both theoretically and in the range of activities it describes; as Fine notes, “neo-liberalism involves a complex and shifting amalgam of scholarship, ideology and policy in practice” which are not always mutually consistent and are attached to diverse material conditions (Fine 2010c, p. 9). At root, Harvey (2005, pp. 2–3) suggests that:

“Neoliberalism is in the first instance a theory of political economic practices that proposes that human well-being can best be advanced by liberating individual entrepreneurial freedoms and skills within an institutional framework characterized by strong private property rights, free markets, and free trade ... it [neoliberalism] seeks to bring all human action into the domain of the market”.

Often emphasised is the deep penetration of markets into all facets of social life, or put the other way, the subsumption of social life under market imperatives.²⁷ Harris (2012) argues: “Indeed, never before in the history of capitalism has the ethic of competitive markets — neoliberalism — penetrated so deeply into the domestic operations of the state, into virtually every cell of the social order.” As financialisation, we argue in the next chapter, entails the dominance of financial markets then a close relationship between the two is suggested. As Fine (2010c, p. 9) notes: “financialisation has been at the heart of the three decades of neo-liberalism, not so much reducing the latter’s trajectory in any, let alone all, respects to its imperatives as influencing the content of

²⁷ In policy terms neoliberalism is usually argued to consist of: deregulation of product, finance, and labour markets; privatisation; renunciation of discretionary fiscal policy; conservative monetary policy; reductions in state social spending; reduction in taxes on business and the wealthy; an attack on trade unions and the casualisation of labour; intensified competition; and stricter application of market norms inside large corporations (Kotz 2009, p. 307).

that trajectory. Financialisation has set a major part of the global and systemic context within which economic and social reproduction has occurred”.

In line with Fine and our analysis above, we are cautious of collapsing neoliberalism, or global restructuring, into the rise of finance, as for instance Duménil and Lévy (2005, p. 17) appear to do when they note that “neoliberalism is the ideological expression of the reasserted power of finance”. A broader view may be more fruitful, as Harvey puts it, at root neoliberalism was a project to “re-establish the conditions for capital accumulation and to restore the power of economic elites” (Harvey 2005, p. 19).²⁸ Various sections of capital have, therefore, promoted and benefited from neoliberalism. This accords with our conceptualisation of financialisation as both functional to the restoration of profitability and accumulation generally and as a multi-dimensional restructuring in which financial, commercial, and productive capital are all enmeshed. Further, we suggest that, because neoliberalism is at root the reassertion of the power of markets, the preponderance of financial markets, as the most advanced capitalist marketplace, is unsurprising.

2.7 Conclusion

This chapter has spanned a range of subjects at varying levels of abstraction. We have attempted to unpick long-term trends within capitalist development – both inside and outside the financial sector – and marry those with concrete historical developments in order to provide insight into financialisation as part of a structural transformation within mature capitalism. We have grounded that within a Marxist approach to the workings and development of the financial system. We have suggested two paradigms, drawing from Marxist political economy, through which financialisation as part of a structural transformation can be viewed: shifting property relations and the world market. Finally, we have argued that we can approach the concrete restructurings of economic and social life that follow within the broader context of neoliberalism – as within a framework of the reassertion of the influence of the ‘market’, and financial markets in particular.

²⁸ The coherence of neoliberalism as a political project should not be overstated (especially in its nascent stage) as Harris contends, “The neoliberals are the product of the emerging economic system, not its source. They, like everyone else, are not in control of the system.” (quoted in Petersen 2012, p. 1).

Marx and Engels point out that structural transformations in capitalism involve reconfigurations and developments on multiple levels. The stage of development, the division and exploitation of labour, forms of property relations, class formation, state relations, and social struggle mutually define and mutually condition one another. Together, these will shape and restructure modes of economic and social reproduction. We do not profess to have captured all of those facets in our discussion. Rather, we have offered some foundations upon which we can approach the concrete restructurings that financialisation entails, the topic to which we now turn.

3 THE INTENSIVE AND EXTENSIVE EXPANSION OF FINANCE – A LITERATURE REVIEW

3.1 Introduction

We turn in this chapter to consider the concrete dynamics that characterise the manner in which financialisation has developed and evolved. This allows us to explore what is meant by financialisation, in the process reviewing a broad swathe of the literature, and to provide a characterisation of financialisation against which the South African case study can be evaluated in Chapters 7 through 10. This chapter concentrates on the general contours of financialisation with predominant focus on developed countries while the next chapter deals specifically with the developing world. If the previous chapter proposed long-term tendencies within capitalist development that help to explain financialisation as a structural transformation, this chapter unpacks what that transformation looks like.

One way in which Marxist political economy approaches unpacking concrete economic developments is through an analysis of the social relations that underpin them. In this respect, and as highlighted in our discussion of the circuit of capital and the evolving credit system, the changing operations of, and relationship between, capitals is central. We take this as the centre of gravity around which we explore the dynamics entailed by financialisation, with particular (but not exclusive) focus on the changing practices of financial and productive capital, and the relationship between them. In addition, we explore changes within the state and households, and the relationship between these and capital under financialisation. States play a double role: in both actively facilitating financialisation and as subject to its imperatives.

We understand these developments to occur on the basis of what Fine (2013a, p. 12) refers to as the ‘intensive’ and ‘extensive’ expansion of finance; he notes that “the expansion of finance has been both intensive (within existing or traditional spheres of operation) as well as extensive, that is by incorporating activities either where they were previously absent or where they were subject to normal conditions of profitability and competition”. He goes on to note that: “Within the literature, this expanding and increasing reach has been marked by reference to the increasing presence of financialisation in both economic and social reproduction.” Our analysis builds on the

previous chapter in that the developments described therein underpin the manner in which the social and economic relations analysed here have evolved.

We begin this chapter, in Section 3.2, by reviewing five approaches to understanding the altered operations of, and shifting relations between, capitals within the literature. Following this, sections 3.4 and 3.5 analyse the ways in which states and households have been bound up in financialisation, respectively. In each section we evaluate the different approaches taken and point to strengths and weaknesses. These approaches are not necessarily mutually exclusive nor do we claim this to be an exhaustive review of the literature. Some approaches, we argue, better capture the dynamics observed and, while we stress critical common local and global features, we do not advance a universal depiction of financialisation. Financialisation is rather understood as variegated with elements of the restructuring of economic activity and associated relationships context-specific. Further, the relationships analysed are not static and existing theory may not account for all on-going changes. Nevertheless, the analysis here provides us with a fertile basis against which to later assess financialisation in South Africa.

3.2 Restructuring of financial and productive capital and the relationships between them

3.2.1 Banks and non-financial corporations

Lapavitsas (2009a, 2011, 2014) approaches financialisation via the ‘molecular dynamics’ between economic actors. In particular he argues that “financialisation amounts to a systemic transformation of advanced capitalist economies pivoting on changes in the underlying conduct of non-financial enterprises, banks, and households” (2014, p. 15) and that this has entailed changes in the relationship between these. This approach is framed by the circuit of capital discussed in the previous chapter, with Lapavitsas (2014, p. 217) arguing that “financial operations intrinsic to the circuit of productive capital” serve as a point of departure. In the concrete, this means for Lapavitsas starting with how non-financial corporations (NFCs) finance their activities – the balance between ‘internal’ and ‘external’ financing, and the composition of the latter.

Lapavitsas shows that NFCs in the capitalist core – specifically the US, the UK, Japan, and Germany – have come to rely increasingly on retained earnings to finance

investment (on a net basis) and hence acquired some degree of independence from banks and traditional providers of ‘external’ finance. This is true in traditionally ‘market-based’ countries – the US and the UK – and traditionally ‘bank-based’ economies – Japan and Germany – the most striking example being Japan where corporations previously relied heavily on bank finance (Lapavitsas 2009a, p. 108, 2014, pp. 222–224) (for an earlier study of these countries see Corbett and Jenkinson 1997). This followed the mushrooming of retained earnings held by NFCs in the late 1960s and 1970s.²⁹

This runs counter to the type of financial dominance seen in the late nineteenth and early twentieth centuries, which led to Hilferding’s (1981) notion of ‘finance capital’, in which large banks exercise supervisory influence or control over productive enterprises. It does not, however, run counter to the definition of financialisation advanced here – as discussed here and in later subsections, the logic and imperatives of financial markets have still come to dominate. In fact, less reliance on bank financing has been an important element of financialisation – both with relation to NFCs’ greater financial market participation and in shifts in the operations of banks (for example, towards greater household lending and non-interest fee income).

One facet of the above is seen through a compositional shift in external financing. With the declining reliance on bank funding and trade credit, premised in part on large pools of retained earnings, NFCs have increased their reliance on securities markets, indicating a closer integration within financial markets. Further, when longer-term capital is raised in financial markets it is often associated with ‘financial engineering’. Dos Santos (2009a, p. 8) notes that, “the increased corporate bond borrowing over this period appears to be closely related to the withdrawal of equity, which typically takes the form of ‘financial engineering’ operations like share buybacks, private-equity purchases, mergers and acquisitions” and tax avoidance. At the same time the use of short-term financing has increased significantly with even wage bills frequently financed via issuing commercial paper (Lapavitsas 2010, p. 21, 2014, pp. 230–231). There is some variation across countries highlighting how financialisation is influenced by the “historical, institutional, customary, [legal,] and other contingent factors in each country” (Lapavitsas 2014, p.

²⁹ It is difficult to say exactly what has precipitated this but it is most likely a combination of the huge revenues these corporations earned during the boom years, the internal organisation of the MNC, the types of technology that prevailed post WWII, and in particular government support to industry (largely in research and development, infrastructure and indirectly through the provision of social services) (Isaacs 2011a).

207), although common trends are discernible. In sum, Lapavitsas argues that “the financialisation of non-financial corporations means that they have become more closely integrated with the financial system, while becoming more distant from banks. Productive capital is financializing, but there is no return to finance capital.”³⁰ (This is seen in the South African case in Chapter 9).

When discussing the financial sector, Lapavitsas places particular importance on banks, arguing they stand at the heart of the credit system both as the primary credit extenders and as financial market players; for instance he highlights their centrality as market makers with regard to over-the-counter (OTC) derivatives (Lapavitsas 2014, pp. 6–8). He stresses that the diminished need for NFCs to seek long-term external financing has had appreciable consequences for financial institutions, particularly banks, forcing them to seek business elsewhere and altering their lending patterns, resulting in a cascading effect throughout the economy. In the US, UK, and Germany, banks have increasingly financed themselves by borrowing funds on the open market with deposits as a share of liabilities falling; this is not the case in Japan. Bank lending to corporations in the US, the UK, Germany, and Japan fell while loans to individuals rose markedly, particularly mortgages, except in Japan. Loans to other financial institutions also rose in Germany and the UK (the two countries for which there are appropriate data).

Dos Santos (2009b, 2009a), Lapavitsas (2009a, 2010), Dymski (2009) and others emphasise how for banks income from household consumption and mortgage loans, and other financial services such as credit cards, has become central.³¹ In the US, for example, lending to consumers and for real estate transactions has accelerated from just over 30% of bank lending in 1965 to just under 50% in 2006; the same trend is true for Germany and Japan although to different degrees (Lapavitsas 2009b, pp. 128–130). This has provided two sources of income. First, it has furnished them with direct streams of

³⁰ The latter – “no return to finance capital” – refers to the notion of ‘finance capital’ as understood by Hilferding (1981) – a close supervisory relationship for banks over productive enterprises. Given the above, this is clearly not an accurate presentation of financialisation.

³¹ Dos Santos (2011b), Basu (2011), Hein and Dodig (2014), and Garcia-Arias (2015) have recently highlighted that non-productive credit, of which household credit is a large component, is also often ultimately growth retarding. This is explained due to the ‘crowding-out’ effect of consumption lending on productive lending, the inability of households to meet repayment obligations, and the instability that household integration within financial markets, brings. As Levy-Orlik and Domínguez-Blancas (2016, pp. 541–542) note the *ex nihilo* issuance of monetary debt is not a problem when this results in productive investment as such investment spending generates its own savings and means of repayment, this is not necessarily the case with consumption credit.

income in the form of interest and fees (see dos Santos 2009a, pp. 11–15) and, second, they have taken these loans and packaged them as financial assets and sold them on (mortgage backed securities being a quintessential example). At the same time, falling interest rates have meant that revenue from interest rate spreads on long-term lending has also diminished. Banks have responded by “developing new revenue streams in fees, commissions and other non-interest gains from activities associated with ‘financial market mediation’” (dos Santos 2009a, p. 4). By way of example, dos Santos (2009a, pp. 4–5) shows that in 1980 non-interest income accounted for approximately 25%, 20%, and 15% of total bank revenues in the US, Germany, and Spain, respectively; by 2005 this had grown to 41%, 34%, and 33%, respectively (these broad trends can be observed in varying degrees and forms throughout OECD countries) (analysed with respect to South African banks in Chapter 8).

This includes offering investment-banking services to corporations, brokerage firms, and institutional investors in both managing investments and facilitating capital market issuances. In a sample of eight large international banks³² dos Santos (2009a, pp. 18–22) showed that in 2006 between 1.6% and 17.7% of revenue was generated by fund-management commissions and fees, and between 6.4% and 41.7% via trading account gains (own and on behalf of others). Further, in June 2007, four of these banks were the second, third, fourth, and fifth largest dealers in over-the-counter derivatives (JP Morgan a traditional investment-bank was first). Banks’ own extensive securitisation of loans has been spurred not only by the profitability of these undertakings but also to resolve risk, liquidity, and maturity issues. In brief, by selling the securitised asset onwards they have transferred the risk and these illiquid loans off their balance sheets allowing them to refinance themselves with improved financial ratios. In short, traditional lending to earn interest has been subsumed under investment banking targeted at earning fees via creating and trading financial assets, the ‘originate and distribute’ model of banking (dos Santos 2009a, see Lapavitsas 2009b, pp. 135–138).

This description of the changing nature in the operations of NFCs and banks, and the relationship between them, is certainly critical to an analysis of financialisation and is drawn upon in later chapters. However, it appears to have three (related) weaknesses. First, there is almost no consideration of the role of non-bank financial institutions, the

³² HSBC, Citigroup, Bank of America, RBS, Barclays, BNP Paribas, Desdner, Santanger, and SMFG.

changing nature of corporate ownership, and the role of large institutional investors.³³ Second, what changing patterns of ownership mean for the operation of NFCs is not substantively explored. Third, the role of NFCs within financial markets (as financial market players) and the consequences of this integration is underdeveloped.

3.2.2 The rise of the rentier and shareholder value maximisation

We noted in the previous chapter that one strand of the financialisation literature sees financialisation as driven by the rise of a ‘rentier class’, thus offering a very different explanation of the changing operations of productive and finance capital to that discussed above, and in particular the relationship between them. Drawing on Keynes, Marx, and Kalecki, Epstein and Jayadev (2005) argue that the rentiers reflect “an active class that is fostering and profiting from the process of financialisation” (see for example Crotty and Lee 2005, Epstein 2005, Pollin 2007, Dünhaupt 2012). Consequently, rentier income “consists of the profits earned by firms engaged primarily in financial activities plus interest income realized by all nonfinancial non-government resident units” and should also include capital gains but not dividends from nonfinancial corporations as these are part of the profits of enterprise (Epstein and Jayadev 2005, pp. 49–50, see also Epstein and Power 2003). In this view, financialisation involves: the potential subordination of productive capital to the dictates of outside rentiers (financial sector shareholders) and/or the internalisation of rentier practices within the NFCs. This precipitates an increase in financial payments and/or a reorientation towards financial practices that tend to squeeze investment in productive activity.

The ‘shareholder value maximisation’ literature stresses the first of these, related to increased financial payouts, as part of the subordination of productive capital (Aglietta 2000, Lazonick and O’Sullivan 2000, Aglietta and Breton 2001, Stockhammer 2004, 2005, 2009, Crotty 2005, Lazonick 2010, 2011). This literature argues that managers, under pressure from financial markets where investors increasingly sought capital gains, began to pay closer attention to the share prices of their companies’ stocks, inflating

³³ Lapavistas (2014, p. 231) argues that commercial banks have retained and “reaffirmed their key position in mature financial systems”, illustrating this with reference to growth of their financial assets as a share of GDP. However, their holding of financial assets as a share of financial sector and total financial assets only increases in the UK and then not by much (although he cautions that measurement issues and ‘shadow banking’ in the US complicate this picture). Banks are central in other ways, for instance as traders and market makers, but not to recognise the burgeoning of the non-bank financial sector as a central feature of financialisation appears problematic.

these through massive share buybacks (originally in part to make hostile takeovers more difficult) and via mergers and acquisitions,³⁴ and distributing a higher proportion of profits as dividends and interest payments. This was achieved by means of both carrot – elephantine stock options and bonuses tied to share prices for senior managers and the promotion of financial managers – and stick – the threat of takeover and dismissal. The consequence is that management must comply with the dictates of impatient investors in terms of a higher rate of distributed profits (van Treeck 2009) (we assess, in Chapter 9, whether South African NFCs have been subject to these pressures). Some authors have associated these developments with changing business models. Lazonick and O’Sullivan (2000), for instance, argue that a shift occurred from a business model of ‘retain and investment’ in which corporate managers exercised great control over investment decisions, to one of ‘downsize and distribute’ with shareholder value imperatives dominating.

Regarding the latter – the internalisation of rentier practices within the NFCs – in addition to the points raised above, NFCs have engaged in other forms of financial market mediation, offering a range of consumer financing services, sourcing trade credit, engaging in hedging and speculative activities in secondary markets, especially foreign exchange and commodities markets, and openly trading their own and other companies’ stock. Gains from such activity are increasingly important to the overall profitability of the corporation. In 2003 GE Capital – the financial services unit of General Electric that is engaged in a gamut of financial services from health care to real estate – registered 42% of General Electric’s profits. In the same year consumer leasing arrangements accounted for nearly all the profits of General Motors and Ford with sales revenue barely breaking even with costs (Blackburn 2006, p. 44).

A substantial body of literature has focused on the detrimental effects of these developments on gross capital formation and other measures of productive investment

³⁴ Share repurchases and mergers and acquisitions are often funded by increased corporate bond borrowing and involve a withdrawal of equity that boosts the remaining shares’ price (dos Santos 2009a, p. 8) (see the example of the platinum sector in South African in Chapter 9). This withdrawal of equity should not be seen as counterposed to the financialisation of NFCs in that it decreases the influence of financial markets or shareholders. First, the buybacks do not occur to the extent that they undermine shareholder control of the company. Second, they precisely represent the dominance of the logic and imperatives of financial markets – they rely on funds that, instead of being used productively, are spent on augmenting capital gains for shareholders.

by NFCs.³⁵ Indicatively, Stockhammer (2004) finds evidence that the ‘rentier share’ and ‘rentier payments’ (the share of dividends and interest as income and payments, respectively, over the value added of NFCs) is negatively associated with real investment in the UK, US and France but not in Germany. Tran et al. (n.d.) makes a similar finding for the US between 1960 and 2007. Stockhammer (2009) also shows that the ratio of private gross fixed capital formation as a share of operating surplus has decreased on aggregate in the EU, US and Japan between the 1970s and 2000s and that residential investment has not increased. Looking at interest and dividend payments, each in relation to the capital stock, van Treeck (2008) finds that an increase in dividend payments – indicative of pressures for short-term financial gain by shareholders – illustrates rising shareholder value maximisation pressures. In the case of the NFC sector in the US (1965-2004) this has a statistically significant negative effect on capital accumulation. Interest payments do not necessarily have this effect because debt holders are more likely, he argues, to take a longer-term view of the corporation.

Onaran et al. (2011) in a time series study of the US (1962-2007) find that increases in the “rentier profit share” (net dividends and net interest payments of domestic industry as a share of nominal GDP) dampens real gross domestic investment, while the opposite is true of the “non-rentier profit share”. Given the rapid increase in debt, contributing to more than half of the growth of the financial sector in the US, this is congruent with the claim that financialisation has seen a transfer of income from the real economy to the financial sector (Tomaskovic-Devey *et al.* 2015).

Emphasis is placed on financial payments because the rate of capital accumulation has been shown to closely match the rate of retained profits and financial payments reduce the latter (Tran *et al.* n.d., Stockhammer 2004, Orhangazi 2008a).³⁶ However, this is not the only means through which financialisation can reduce physical accumulation.

³⁵ A body of research has also emerged from within the mainstream that shows a non-linear, and possibly non-monotonic relationship, between financial development and economic growth. This means the relationship is inverted U-shaped, that is, that after financial development exceeds a certain threshold level the effects are negative. Cecchetti and Kharroubi (2012), Arcand et al. (2012), Law and Singh (2014), and Samargandi et al. (2015) calculate this turning point by measuring various finance-to-GDP ratios and show it to cluster in the region of 75-100%, a ratio most financialised economies have long since passed (it is also estimated using a financial-sector-employment-to-GDP ratio) (this literature is reviewed in more depth in Isaacs 2016b and ratios for South Africa given in Chapter 8).

³⁶ The rate of retained profit is different to the overall rate of profit which may be measured prior to financial payments. A divergence therefore may be observed between the rate of accumulation and the rate of profit.

Clevenot (2010) shows that in the case of France *net* financial payments/receipts have not risen for NFCs. Instead, it is through the ‘short-term concern for financial profitability’ that capital accumulation has suffered. Efforts to achieve financial returns can increase the cost of capital and lead to high levels of financial leverage, the risk of over-indebtedness, greater volatility, and subsequent crises. These short-term planning horizons are also a consequence of shareholder value orientation, particularly the attempt to achieve a certain return on equity or other financial indicators. This places priority on core competencies, growth through mergers and acquisitions rather than investment, and quarterly performance indicators over long-run growth (Tran *et al.* n.d., Clevenot *et al.* 2010). Clevenot (2010, p. 699) shows that ‘maintaining such high levels of financial profitability ultimately came to represent a significant (and in the end unsustainable) effort for firms’.

Orhangazi (2008a, 2008b), using firm-level data of NFCs in the US (1972-2003), finds that increased investment in financial assets³⁷ and pressures to maximise short-term value has a negative impact on real investment for large firms but a positive one on small firms (relieving financing constraints), and that financial payments (interest expenses, cash dividends, and purchasing of firms’ own stocks) have a negative impact across the board (see also Davis 2013, 2014). In line with this, Weller and Helpie (2005) demonstrate that such shareholder value maximisation has steered funds away from capital investment by NFCs. The literature cited clearly shows a general trend whereby increased financialisation is associated with, and in many studies is shown econometrically to cause, depressed real investment. This is, however, not uniform across countries and sectors, highlighting the need for context-specific analysis.

The shareholder-value literature also links such rentier dominance to increased inequality. This is highlighted by financialisation’s role in a falling labour share emphasised by Tomaskovic-Devey (2013), Stockhammer (2013), Tomaskovic-Devey and Lin (2014), Dünhaupt (2012, 2013, 2014), and Alvarez (2015), as well as by income from financial assets being almost always more unevenly distributed than income from wages (see for example Nau 2011); this final point is returned to towards the end of Chapter 10.

³⁷ Regarding increased investment in financial assets, Milberg (2008, p. 421) argues that a driving factor behind the financialisation of NFCs was the growing “gap between the rate of return on manufacturing investment and the rate of return on investments in financial assets”.

Both theoretical and empirical challenges have been raised in response to the above. Empirically, Froud et al. (2006, p. 68) argue in the US case that, “the increase in the proportion of post-tax income distributed from its long-term level of around 45 per cent is apparently modest”. Durand and Gueuder (2016, p. 5) illustrate this more broadly showing that while there is a strong increase in the payout ratio in the French and German contexts there is no clear trend in Italy and the UK, and the reverse trend in Japan and to some extent the US. In France, Clevenot (2010) shows that *net* financial payments/receipts for NFCs have not risen.³⁸ The authors acknowledge that this picture is complicated because funds are also put towards other shareholder value maximisation endeavours, in particular cash-financed mergers and share buybacks. Including this makes the US trajectory consistent with an argument of an increased rentier share (Durand and Gueuder 2016, p. 6). Despite this, Durand and Gueuder’s (2016) econometric estimates do not associate increased rentier payments with lower real investment. This relationship must therefore be established on a case-by-case basis.

The empirical link between shareholder value maximisation and NFCs’ financial market mediation is also contested. Financial mediation has also been motivated by broader concerns such as efficiency gains and risks management. Financial sector intermediation by NFCs is not necessarily speculative nor motivated on the basis of achieving financial gains. A fair portion of currency trading, for instance, is motivated by liquidity, interest rate, and currency considerations in the context of globalised production and trade (Grahl and Lysandrou 2003). Further, whilst the various takeover movements and the stock repurchase programmes increased financial trading experience within NFCs, their involvement in certain financial services (like commercial credit) long preceded this.³⁹ The conflation of financial profits with rentier-income implies such banking activity is always parasitic whereas it can and does play a functional role in capitalist accumulation.

Despite contestation many of these empirical trends do hold in diverse case studies, however, the rise of the rentier approach also suffers from a number of theoretical weaknesses. Lapavitsas (2014, p. 31) points out that in this view, “financialisation represents the ascendancy of the rentier due to neoliberal economic policies”; in such a

³⁸ Instead Clevenot (2010) argues that in the French case it is because of “short-term concern for financial profitability” that capital accumulation has suffered.

³⁹ However, it is quite possible that quantitative increases can result in qualitative changes.

framework liberalisation, Powell notes, “is itself the causal factor leading to the financialisation of the economy, driven by the rise of a *rentier* class” (2013a, p. 60, emphasis in original). This posits a pernicious relationship between the rentier class and the productive sector and sees financialisation as driven by this, with a strong emphasis on distributional outcomes. By contrast, from a Marxist perspective, these factors are perceived as symptomatic of underlying material realities relating, as discussed in the previous chapter, to the stagnation of production or epochal transformations in the relations of capitalism.

The historical emergence of financialisation also does not indicate a battle between industrial and finance capital (Kotz 2008) nor is it straightforward, under financialisation, to distinguish rentiers as a class as distinct from industrial capital. Shareholders of large corporates do not represent a cohesive social class and the executives are employees and not ‘industrial capitalists’.⁴⁰ Positing financial institutions as representing a rentier class in opposition to NFCs is also fraught precisely because the form and activities of NFCs have been heavily altered in the course of financialisation. The ability to hold and use money as capital, as financial capital, or to specialise in the origination and trading of financial claims is no longer limited to ‘financial’ institutions. Further, the impression generated is one of the emaciation of the NFC, but the source of corporate profits, that is the means through which they are able to sustain distributions of value to shareholders, is largely unexplored. This is not to deny the importance exercised by large financial institutions under financialisation, nor to undermine the importance of the empirical trends pointed to, indeed we analyse such shareholder value maximisation trends in the South African case in Chapter 9. Rather we argue that a perception of financialisation – and the relations between capitals that this entails – as the realisation of the interests of a rentier class is unsatisfactory.

3.2.3 Financialisation as the restructuring of global production

Some authors have stressed the evolution of transnational corporations and the restructuring of global production as capturing the crucial features of productive

⁴⁰ Of course, some nonfinancial corporations are wholly owned and run by individuals but then the distinction becomes one between public and private corporations not rentiers and industrialists. Indeed, this distinction between large powerful publicly-owned corporations which are lead firms in supply chains, and privately-owned suppliers is very germane but it is not the one made by the rentier paradigm.

restructuring. Such transnational reconfiguration of production is also argued to explain how corporate profits have been sustained in the face of reduced productive investment and large shareholder distributions (see Milberg 2008, Milberg and Winkler 2010). Transnational corporations (TNCs), which make up a sizable share of global production, stand at the heart of this. TNCs, Serfati (2008, p. 36) argues act as “financial centres with industrial activities” or as an “organization modality of finance capital”, rather than as traditional productive units. In one study of 43 000 TNCs a core group of just 147 TNCs had control of almost 40% of the economic value of TNCs globally, with three quarters of this core group being financial institutions (Coe et al. 2014, p. 765). Milberg (2008, p. 425) notes something similar when arguing that, “many ‘manufacturing’ firms do not manufacture at all, providing only brand design, marketing, supply chain logistics and financial management services”.

Serfati (2008) points to what this means for the TNCs (trends which overlap with the more general transformations that NFCs have undergone, outlined above and below). He argues that they centralise financial claims and have become holders of ‘intangible assets’ such as patents, copyrights, design rights, trademarks, and so on. These generate income via fees and royalties and are often housed with Special Purpose Entities making this income difficult to track (Serfati 2008, p. 43). He goes on to note that: “The last two decades, have witnessed a significant broadening of private property rights to a range of intellectual activity. In that context, TNCs have become more oriented towards the generation of revenues based upon their financial and intellectual property rights than on the production process proper.” (Serfati 2008, p. 44) Companies such as Apple immediately spring to mind.

Serfati points to how such intangible assets are capitalised, securitised and traded in financial markets. This may have deleterious effects, for instance a rising share of R&D is reoriented towards “more short-term development, including expenditure aimed at reinforcing IPR [intellectual property rights] policy rather than carrying out R&D *per se*” (Serfati 2008, p. 55 emphasis in original). He also points out how their proliferation and steep rise in ‘value’ has increased firm market values and hence augmented capital gains. In the US market, intangible assets made up 43% of the book value of the S&P 500 in 2005; in France, in 2006, they accounted for 77% of stock capitalisation (54% as ‘non identified intangible assets’, 19.5% as goodwill, 13% as ‘identified intangible assets’). He

argues that the undisclosed share of intangible assets has been the driving force in the rise of market capitalisation for the top world 5 000 companies. Given the importance of capital gains outlined, this is of considerable import.⁴¹

A related strand of literature considers the importance of TNCs in global value chains (GVC) which have expanded enormously; OECD data showed in 2003 that 54% of world manufacturing trade was in intermediate goods (Serfati 2008, p. 43). Milberg (2008, p. 421) argues that “the enormous expansion of global value chains has brought a lowering of input costs to lead firms [usually large multinational, many US based] allowing them to maintain and even increase cost markups, and thus profit rates, even during a period when domestic (U.S.) product market prices were not moving upwards at historical rates”. Maintaining profit streams in the face of financialisation has not mainly come from monopolistic or oligopolistic consumer-price mark-ups but from exercising such power within supply chains;⁴² offshoring itself has been estimated to account for 40% to 60% of cost reductions and between a quarter and third of corporate profits (Milberg 2008, pp. 427–431). This fits with Serfati’s understanding of GVCs when he notes that they entail the control of a “significant share of the process of value creation” by TNCs placing them “in a position, not only to reap the value created internally (in their subsidiaries and branches), but also to capture a share of value created outside of the corporation” either through direct voting stock, production chains, or other forms of market power (Serfati 2008, p. 45).

This has been achieved through the international vertical disintegration of production with lead firms exercising oligopsony power over an increasing number of firms clamouring to supply. Lynn (2005) notes that, “today’s top firms are increasingly designed to play country against country, supplier against supplier and worker against worker” and hence shift the burden of cost reduction onto suppliers and workers

⁴¹ From a Marxist perspective this does not mean that such intangible assets are ‘creating value’. Rather, they may be leading to a disconnect between the underlying value of the firm (regulated by its ability to generate surplus value) and its market capitalisation. Alternatively (or in addition) they represent the pretext for redistributing value created by suppliers away from those suppliers on the basis that the lead firm provides the intellectual property necessary in production.

⁴² Milberg (2008, p. 430) sums this up: “the creation of monopsonistic buyer relations in global supply chains has allowed some shifting in the source of corporate profits: from traditional oligopoly pricing power in product markets to oligopsony power in global supply chains in which lead firms have greater control over input prices and greater flexibility due to the presence of multiple, competing suppliers”.

(quoted in Milberg 2008, p. 433)⁴³ (see discussion on consequences for workers in Section 3.4 and returned to in the South African case in Chapters 9 and 10). This externalisation of production could be motivated by a reduction in transaction costs in market-based relations but is certainly also undertaken to shift the risks associated with committing resources onto suppliers and reduce the capital committed by lead firms, thereby freeing up capital for other purposes (Milberg 2008, p. 434). Palpacuer (2008) points out that this can translate, for example, into demand for production flexibility and expecting suppliers to hold inventories, and that this is motivated by the need to meet, or exceed, expected shareholder returns.⁴⁴

This, Baud and Durand (2012) show, has been particularly important in global retail, supporting a rise in return on equity by major retailers even as sales growth in domestic markets have fallen, maintaining the ability to provide high returns to shareholders. In addition to the above, and the importance of pools of cheap labour in the developing world and new markets, they stress that supply chain management techniques have reduced the amount of capital tied up in inventories and extended supplier payment periods. The latter allows them to realise the gains from sale before paying suppliers and workers thus generating large pools of cash. They argue these, and other operational changes discussed above, amount to the financialisation of firms' operations. They also argue that the objectives and investments of these firms have been financialised via increased payments to shareholders and decreased capital investment together with increased financial services, respectively.⁴⁵

All of the above, it has been argued, has reduced the necessity to reinvest profits domestically (or in capital investment at all) and provides one part of the explanation for why companies have large holdings of retained earnings and, as Milberg and Winkler (2010) show, for the rise in the US profit share. This points to a source for the funds distributed to shareholders. Interesting, Milberg (2008, p. 439) finds "higher levels of

⁴³ The field of human geography has also explored the issue of financialisation emphasising (like David Harvey) the global integration that financialisation brings and relies upon, and the spatial displacement that occurs (see Aalbers 2015, Christophers 2015a, 2015b, Fairbairn 2015, Lawrence 2015, Murphy 2015, Ouma 2015, Poovey 2015).

⁴⁴ Much of the above is excellently illustrated by Froud et al. (2014) in the case study of Apple and the Chinese smartphone manufacturer Foxconn International Holdings.

⁴⁵ Global retailers are, to an extent, the exception not the norm, focusing on economies of scale in their core operations and not economies of scope. Firms in other industries, for example in the food chain, are far more integrated, both up and downstream.

shareholder value are associated with greater import reliance in global value chains”, that is amongst those most integrated into international production networks. Milberg correctly notes that it is not possible to argue that this international vertical disintegration of production was imposed by the shareholder value movement as it precedes it. However, he incorrectly labels the simultaneous emergence of this vertical disintegration and financialisation as “largely coincidental” (2008, p. 424) – the link between globalised production and financialisation has been exhaustively stressed in the previous chapter – but he correctly apprehends the mutually reinforcing nature of these phenomena, arguing that:

“I find that the globalization of production by U.S. firms has helped to sustain higher levels of financialization of the U.S. non-financial corporate sector and financialization creates greater incentives for cost-reducing and flexibility-enhancing globalized production by U.S. lead firms.” (Milberg 2008, p. 421).

The ‘downsizing’ to which Lazonick and O’Sullivan referred – a characteristic of the ‘financialised’ firm – is therefore argued not to be simply the shedding of jobs and reorientating towards ‘core competencies’ in the capitalist core but intricately connected with globalised production. Watson (quoted in Milberg 2008, p. 434), probably overstating the case, argues that disinvestment is “the only certain way of increasing shareholder value” by “selling off or closing down all but the most profitable part of the business” the firm is “guaranteed to generate higher returns on capital employed, thus providing a rationale for increase in the stock price”. This leads Milberg (2008, p. 435, see also Milberg and Winkler 2010), to conclude that “offshoring has had a dual role, one being the support of cost mark-ups, the other being the reduction of the scope of productive activities of the firm” both of these intricately bound up with financialisation.⁴⁶

Regarding shifting economic relations between capitals, Baud and Durand (2012, p. 242) argue that this has fuelled “a global shift of economic power from workers to capital and, within capital, from industrial capital to financial and commercial capital”. Financialisation, they argue, “both sustains and propagates itself through the power

⁴⁶ To this we should add the critical role of offshore ‘tax havens’ and how these are bound up with globalised production networks (see Coe et al. 2014).

relationships framed by globalization processes”. This provides a powerful explanation for a facet of the restructuring of the operations to, and relationship between, capitals. The dominant emphasis placed on supply chains however may obscure important changes in ownership, the topic of the next two subsections.

3.2.4 The market for corporate control

In a fourth stream of literature emphasising shifting relations between capitals, Froud et al. (2000, 2002), Feng et al. (2001), Froud and Williams (2007), and Ertuk et al. (2009) have emphasised the emergence of a ‘market for corporate control’, entailing a shift to viewing NFCs as bundles of assets, with varying risk-return characteristics, to be bought, sold and traded. This began with the conglomeration mania of the 1960s but was solidified in the merger and acquisition frenzy of the 1980s and early 1990s.

This view is premised on the (undisputed) rise of massive institutional investors – such as mutual funds, pension funds and life insurance companies – which have concentrated corporate and household savings – and come to dominate securities markets (although it is not the only interpretation of this trend as shown in the next subsection). According to the IMF, in 2009 institutional investors had assets worth 173% of global GDP under management, accounting for 20% of total global equities (Bonizzi 2013b, p. 35); institutional investors and investment funds, now account for over 50% of US corporate stocks.⁴⁷ Such institutions embody the centralisation and concentration of financial claims and ownership discussed in the previous chapter. Toporowski (2002, 2009) argues that the growth of large institutional investors as dominant market players has led to asset price inflation which he locates at the centre of his analysis of financialisation. He underscores the importance of demand for shares driven by the expansion of institutional investors and how this generates inflation in asset markets. Asset prices are therefore not driven by fundamentals-based price valuations as in orthodox theories of capital markets but by the inflation or deflation of capital markets as a whole.

The ‘market for corporate control’ literature argues that shareholders have come to display some indifference to the nature of investments made by corporations, and a

⁴⁷ See dos Santos (2009a, pp. 5–7) and Grahl and Lysandrou (2006) for other relevant statistics.

‘short-termism’ has developed in the outlook of investors and management – the degree to which this is accentuated depending on the type of institutional shareholder.⁴⁸ Firms, these authors argue, have come to be viewed as part of an investment ‘portfolio’ whose financial worth must be maximised at any given time. Implicit in the ‘portfolio view’ of NFCs is the notion that risk can be diversified away via portfolio management (Grahl 2001, p. 40). This trend illustrates a new form of market discipline with the threat of exit serving as the shareholders’ primary weapon. Carroll (2010), for example characterises this as a move from ‘patient money’ to ‘agile money’.

Froud et al. (2000, p. 103) have stressed that this has involved a universalising of measurement metrics in narrow financial terms (such as via EVATM and MVA) and led to the comparison of financial results between firms irrespective of the product and sector. Palpacuer (2008) notes how this has also locked firms into meeting, or rather exceeding, certain levels of return. It has been facilitated by new risk assessment and management techniques made possible by technological advances (in particular in computing and communication) and has meant a shift away from ‘soft’ or ‘relational’ risk assessment methods to ‘hard’ statistically-oriented ones. ‘Credit scoring’ has become increasingly important for companies, individuals and states, and credit rating agencies have gained new influence and represent a powerful disciplining force (including over states) (dos Santos 2009a, see Lapavistas 2009b, pp. 138–140). Grahl (2001) argues that the external cost of capital has become the reference point, a baseline rate of return, against which all investment projects are judged, meaning that market terms and costs have become internalised. This gives an additional reason to care about one’s share price as it determines the cost to be paid for risk-bearing capital. This means that external finance, and hence market sentiment, despite its diminished quantitative import, still has a prevailing influence.

⁴⁸ Hardie (2008) points out that ‘institutional investors’ is a heterogeneous category with varying types pursuing different interests. Pension funds and insurers are longer-term investors with some concern for the operations of the corporation. By contrast, hedge funds use sophisticated financial modelling, seeking short-term pricing anomalies in the market and are less concerned with the business strategies of the companies. They are also more influential than their size or proportion of share ownership. With high levels of leverage they can augment their investment and, through instruments such as contracts for differences, they can buy shares on behalf of other investors but retain the exposure to the share price performance, the quid pro quo being votes in line with their wishes. A range of mutual funds, investment bank operations, and unit trusts fall along this continuum; private equity is discussed below. Lastly, it is worth noting that international investors generally display less interest in domestic companies’ operations and enjoy a greater ease of exit.

According to Froud and Williams (2007) the latest frontier of the market for corporate control is exemplified in the currently expanding reach of private equity. Here gains are made via a differential between the buying and selling prices of corporations, the regular operating revenue of the company, and financial engineering. The latter involves flipping the debt to equity ratio (from, for example, 30:70 to 70:30), thus loading the company with debt. This means a smaller number of claimants on returns and, if debt is relatively cheap (or returns on debt capped), a redistribution in favour of (private) equity holders. This relies on a larger pool of available credit outside of the private equity sector, present in already financialised markets. In contrast to shareholder value maximisation, this has been described as an exercise in ‘value extraction’, as Froud and Williams (2007, p. 415) note: ultimately, “the extraction of value is pure financial engineering because the operating business acquires liabilities in the form of debt equal to the sum of cash taken out”. Arguably this is an accentuated form of the same underlying dynamics. Broader than private equity has been a similar growth in ‘shadow banking’, an ill-defined term, alternately referring to unregulated (or poorly regulated) financial institutions *or* financial practices; the latter may be undertaken by mainstream financial institutions, including commercial banks as well as other financial institutions.⁴⁹ By the end of the 2000s, the shadow-banking world was estimated to be comparable in size to regular commercial banking.

The ‘market for corporate control’ analysis offers insight into how the restructuring of ownership has come to shape accumulation and the relationship between capitals, an insight significantly lacking in some other approaches, such as Lapavistas’. It is clear that large institutional investors – with large market ownership – are a defining feature of financialisation, capturing the tendency towards the concentration and centralisation of financial claims. However, as we noted in the previous chapter it only *potentially* becomes more a matter of indifference to those holding the claims, in what manner investment is to be made and surplus generated.

⁴⁹ The latter best captures the world of shadow banking as securitisation and moving off balance sheet of financial assets by commercial banks while retaining contingent liability for these should be included.

3.2.5 A return to direct control?

An alternative view, also taking the growth of large investors as a starting point, emphasises the centralisation of ownership and/or control. While the literature on the market for corporate control emphasises an arms-length relationship between investors and NFCs, this literature argues that large investors have come to exercise direct control or influence over NFCs. The first step in this argument is to highlight growing global concentration and interconnectedness of ownership, together with the weight of finance therein. Peetz and Murray (2011) do this based on shareholdings in very large companies (VLCs), including the 250 largest industrial and 50 largest financial corporations. Vitali et al. (2011) concentrate on the relational structure of global control analysing connections between 43,000 MNCs. Haberly and Wojcik (2016) also undertake a network analysis mapping the ultimate 5% control tree of the 205 public and private firms, worldwide, which had more than \$50billion in sales in 2014; this allows an assessment of their ‘economic footprint’.

The scale of corporate concentration is truly staggering. Vitali et al. (2011, p. 4) find that “only 737 top holders accumulate 80% of the control over the value of all TNCs”,⁵⁰ while Peetz and Murray (2011, p. 4) show that 30 organisation own or control 51% of the assets of the VLCs studied. Haberly and Wojcik (2016, p. 16) highlight that the 20 most influential world investors are direct and ultimate 5% block holders in 56% and 61% of sample firms, respectively, indicating that effective control exceeds the portion of asset ownership. This indicates, not only large investors with huge shares but a dense web of ownership, confirmed by Peetz and Murray (2011, p. 7) in that the top 8 VLCs hold shares in more than half of the 299 VLCs studied. Regarding country of origin, companies from the UK, France, China, Germany and Japan dominate VLC asset holdings (Peetz and Murray 2011), while the US, UK, Singapore, Qatar, Belgium, Switzerland, Canada, Japan, Germany, Abu Dhabi, France, and Brazil stand at the heart of corporate networks (Haberly and Wojcik 2016, p. 15).

Central to our analysis here is the institutional make up of these dominant market players and the role of finance. Peetz and Murray (2011, p. 4), for instance, show that

⁵⁰ Interestingly, Vitali et al. (2011, p. 4) go on to note that “This means that network control is much more unequally distributed than wealth. In particular, the top ranked actors hold a control ten times bigger than what could be expected based on their wealth.”

industrial corporations hold only 9.5% of VLC assets, with financial services dominating with 42.5% – financial corporates (16.5%), mutual and pension funds (16%), and insurance companies (10%). Of the top 20 world investors by ‘economic footprint’ all but four are from the financial sector and none is an industrial corporation (Haberly and Wojcik 2016, p. 16). One firm stands out: BlackRock Inc a financial company that owns 6% of VLC assets (Peetz and Murray 2011, p. 7) whose assets under management were a staggering \$4.7tn in 2015, larger than the GDP of Germany; its 5% holding network is vast (Haberly and Wojcik 2016, pp. 10, 18). Also of critical importance is the state. Public institutions and governments hold 16% of VLC assets, a higher share than the industrial sector; eight of the largest thirty controllers of VLCs are governments (Peetz and Murray 2011, pp. 4–5). Of the top 20 world investors, four are government entities. This is mainly achieved through sovereign wealth funds and state pension funds (Haberly and Wojcik 2016, p. 16) (South Africa’s large state pension fund is discussed in Chapter 8).

Also critical to our analysis here is the manner in which these financial corporates exercise control. Haberly and Wojcik (2016) note that financialisation (although they do not call it such) has brought to the fore a sets of tensions (‘double-movements in financial marketization’ in their wording). One of these is a drive towards liquidity and efficiency in financial markets bumping up against the need for financial companies to monitor and control their investments.⁵¹ Both the move from speculative to passive investment strategies, the latter an index-based approach, and the large size of shareholdings, have lengthened shareholding times. Large passive investment funds have returned to a “buy-and-hold orientation” and have been “more or less forced into “voice”-based corporate governance activism as the only avenue to uphold [their] fiduciary duty” to their own clients (Haberly and Wojcik 2016, p. 11). BlackRock’s global head of corporate governance said: “There was a time when investors would give companies the benefit of the doubt, but there is much less tolerance now ... we are big investors and can't simply sell the shares, even if we wanted to,” while the CEO of the second-largest passive manager Vanguard said: “We’re going to hold your stock when you hit your quarterly earnings target. And we’ll hold it when you don’t ... We’re going to hold your stock when everyone else is piling in. And when everyone else is running for the exits.” (quoted in Haberly and Wojcik 2016, p. 11). Similarly, in a 2015 letter to

⁵¹ The other two relate to the role of the state and are dealt with in Section 3.3.

Fortune-500 CEOs, BlackRock's CEO "scathingly repudiated the prevailing "short-termist" emphasis of activists on draining firms of cash. Rather, he endorsed a retain-and-reinvest governance model in which firms make "big, long-term bets that create jobs and keep an economy on top of the innovation curve"" (Haberly and Wojcik 2016, p. 20). Such an investment approach is certainly at odds with the description of the market for corporate control given above.

Peetz and Murray offer a more qualified approach to that of Haberly and Wojcik. They argue that different patterns of control can be observed, in particular certain groups like BlackRock give high priority to holding 'large' stakes (anything above 5% and usually not more than 15% of share ownership), while others do not; for instance "98 to 99 per cent of the holdings of several European share controllers (including BPCE and Societe Generale) are below 5 per cent of the VLCs' shares, with around four fifths or more being less than one per cent" (Peetz and Murray 2011, p. 9). It is also clear that shorter-term strategies still prevail in more speculative institutions such as hedge-funds and that these changes in ownership patterns may mean little for the trading of financial products other than shares, such as derivatives. Interestingly though, large direct control is more common in the US and UK, markets generally considered as bastions of fragmented and decentralised control. It is possible therefore that we are passing from a period of decentralised market control to more centralised control or that large financial investors have come to exercise influence via a range of means – both 'voice' and 'exit' strategies – in a manner that is context specific. The relationship between finance and industrial capital seems neither static nor uniform but it is clear that large finance investors dominate.

3.2.6 Changing operations of and relations between capitals

Above we have reviewed five streams of the financialisation literature focused on the changing operations of finance and productive capital and the relations between them. It has become clear that financial markets have come to play a critical role, with both an intensive and extensive penetration of finance. In sum we make three observations. First, both banks and NFCs have become more deeply enmeshed in financial markets, the former through open-market funding and market making, and both through market trading. Their operations and profit sources have evolved to include the holding and

trading of a dizzying array of financial assets and issuing of liabilities specifically to garner funds for this purpose, while payouts by NFCs have increase. Second, in certain instances, NFCs, particularly large TNCs, have been transformed from active producers to finance-like holding companies. This has altered the relations between capitals with lead firms exercising enormous market power as exemplified in global value chains; in this sense the internationalisation of production has been critical.

Third, the concentration of financial wealth in massive institutional investors has been a defining feature of financialisation. These investors are the institutional embodiment of new forms of ownership and changing property relations discussed in the previous chapter; in the process the relationship between shareholders and corporates has been altered. On the one hand, the discipline exerted by relational banking has been replaced by market-based discipline via the threat of exit in a market for corporate control. Hand-in-hand has been a drive towards shareholder value maximisation. On the other hand, longer-term shareholdings have reasserted themselves, provoking large investors to take an active and longer-term involvement. These approaches may, in certain respects, be mutually incompatible, but this does not mean that each does not have something to offer. These relationships are context and institutionally specific, as are their consequences: the restructuring of capitals and their relations must therefore be interrogated empirically in given instances against this background. It is clear though that financialisation has entailed a new importance for financial markets and financial institutions in overseeing the production, realisation, and distribution of surplus value.

3.3 Financialisation and the role of the state

We turn now to consider the critical role played by the state in facilitating both the onset and maintenance of financialisation while also sometimes becoming subject to financial market imperatives; again we witness both an intensive and extensive penetration of finance. Much has been made of the ‘withdrawal’ of the state under neoliberalism. To the contrary, as Fine (2009b) argues, the state has been vital in securing and sustaining the power of financial markets through both active intervention and decisions to disengage. Here we note three related facets here: monetary policy; the withdrawal of the state from social provisioning; and direct involvement in financial markets via government-controlled institutional investors (the importance of the US

dollar acting as world money and the role of the state in cross-border capital flows are dealt with in the next chapter).

Macroeconomic policy was transformed significantly in tandem with the onset of financialisation. While academic discourse does not always translate into policy change, and policy is not necessarily based on a coherent theoretical position, the victory of monetarism over Keynesianism in the 1970s is significant. The new classical and new Keynesian theory which followed, and the advent of the new macroeconomic consensus, stressed the inefficacy of fiscal policy, the potential use of monetary policy in short-term stabilisation, and the centrality of price stability. Alongside this, theories of potentially perfectly functioning markets gained new prominence. Theories of potentially efficient financial markets, and the efficacy of financial markets in credit allocation, underpinned moves towards liberalisation and deregulation (discussed in the next chapter). While monetary policy was officially narrowed to achieving price stability, later encapsulated in inflation targeting, monetary policy more broadly conceived facilitated the restructuring of the financial system and financial relations.

Interest rates have become the central overt tool of monetary policy, purportedly used to maintain price stability; but the manipulation of interest rates has also served other purposes. High interest rates in the early 1980s (following the massive hike in 1979) induced recessionary conditions conducive to the assault on labour critical to neoliberal restructuring. Equally important has been loose monetary policy (at the capitalist core) of recent decades. Epstein (2003) and Bellofiore and Halevi (2010) note that the prevalence of low interest rates – in the context of relatively low and stable rates of inflation – has fostered massive asset price inflation and subsequent asset bubbles. The Federal Reserve’s loose monetary policy in the wake of the dotcom bubble and early 2000s recession, directly contributed to fuelling the housing bubble leading up to the 2007/2008 financial crisis.

The provision of public liquidity, Bellofiore and Halevi (2010) argue, has been integral to sustaining the expansion of financial markets. Accordingly, the “public money” emerging from both fiscal and monetary expansion, beginning in the wake of the 1987 Wall Street crash, “sustained the fireworks of private moneys and the growth of the derivative markets”. They conclude that “[w]ithout government created liquidity, the

implementation of the large private financial operations of the last decade – from investments into junk bonds to private equity take-overs – would have been much more problematical, if at all possible” (Bellofiore and Halevi 2010, p. 8).

The ability of central banks to act in accordance with financial market interests is related to the dogma of ‘central bank independence’.⁵² In order for monetary policy to achieve its purpose it must be insulated from the predilection of politicians who may loosen the money supply for political expediency. Of course, this means diluting democratic control over monetary policy. Neither the proposition that price stability would bring financial stability, nor that there is a stable trade-off between inflation and unemployment, has held true; nevertheless, the ability of the state (via the central bank) to stabilise financial markets has been important to financialisation (this is taken up in Chapter 6 regarding South African state policy).

Germane also has been the manner in which the state has chosen to reregulate financial markets. We outlined in Chapter 2 the pursuit of financial market deregulation but the *r*eregulation of finance has also been important. First, there has been a shift towards ‘market-enabling’ regulation with overwhelming emphasis placed on self-regulation and self-reporting, and capital adequacy ratios as a buffer against instability and crises, with neither of these being successful at safeguarding the financial sector or preventing rampant abuse and criminality. Such a regulatory approach for instance is captured in the international Basel I and Basel II agreements. In addition, enforcement of such regulation has been delegated to organisations closely connected to the financial system. Second, the state has acted to directly prop up financial markets, in particular through its role as the ‘lender of last resort’, the provider of deposit insurance, and the protector of banks ‘too big to fail’. The role of the central bank has been particularly important with the monopolisation of the ability to produce ‘valueless’ fiat money as legal tender conferring tremendous power and its dominant role in the money market, including its ability to influence interest rates, allowing it to pursue a range of policy objectives.

⁵² The theoretical basis of this is similar to that of inflation targeting: that equilibrium in output is possible and convergence between actual and expected rates of inflation are necessary to achieve this; that inflation is regulated by the money supply (the quantity theory of money holds); that there exists a natural rate of unemployment with stable inflation and attempts to lower unemployment below this will be inflationary; and that macroeconomic policy is fundamentally a choice between inflation and the difference between current and desired output.

Taken together the above highlights that another of the ‘double-movements in financial marketization’, raised by Haberly Wojcik (2016), has been folded into macroeconomic policy: allowing the imposition of ‘market discipline’ (for instance via deregulation) has necessitated the need for stabilisation measures. The result, they note, has been “an expansion of “big government” finance under the auspices of small-government ideology, in an escalating cycle of crises and crisis-interventions” (Haberly and Wojcik 2016, p. 12).

The withdrawal of the state from its responsibilities regarding social provisioning (housing, healthcare, pensions, education and the like), another feature of ‘small government ideology’, has required households to access such services via financial markets (private health insurance, mortgage markets, etc.), proving the basis for financial expansion (‘market-making’) and the deeper penetration of finance into social reproduction (discussed in the next subsection). This has occurred in tandem with the privatisation and financialisation of the entities providing these services (see for example Bayliss et al. 2013). This is emblematically captured in the transformation of public pension funds. In many instances those which operated on a pay-as-you-go basis – that is, current contributors funding payouts to retirees – were transformed into fully-funded schemes – that is, with their own capital base. In other instances, their operations were privatised. These, together with sovereign wealth funds, account for the large government share of stock ownership mentioned above; in fact four of the top 20 world investors are government funds (Haberly and Wojcik 2016, p. 16)

Not only do these funds exercise market control in much the same way as their private sector counterparts but they have also been actively used in promoting capital market development and corporate governance reforms. As Haberly and Wojcik (2016, p. 22) note of Japan: “the Abe administration has sought to retool the \$1.1 trillion dollar Government Pension Investment Fund (GPIF) into a battering ram to promote a more open regime of fiduciary-oriented asset management and corporate governance, as part of its “third arrow” structural reforms”. The role of the state in ‘market-making’ is returned to in the next chapter regarding developing countries specifically.

A third tension expressed by Haberly and Wojcik is between the freedom of financial markets and the pursuit of sovereign state objectives. On the one hand, states have

facilitated market growth as shown above. On the other hand, sovereign objectives maybe constrained by financial markets. The Eurozone crisis starkly highlighted how sovereign financing is subject to the whims and judgements of financial markets. Similarly, private rating agencies, for instance, hold great sway over domestic policy, particularly in the developing world. It appears, therefore, that financialisation has interacted with the state in three ways: state policy has supported financialisation, states have become important financial market players with financial markets giving them an avenue to exercise different forms of influence, and states have themselves, at times, been subject to financial market imperatives.

3.4 The financialisation of everyday life

Households and individuals have become entangled within financialisation in crucial ways, both for their own lives and for the development of financialisation as a pattern of accumulation. This includes their immediate involvement in financial markets as well as the manner in which financialisation has entailed a restructuring of work and social relations, including the relationship between labour and capital. The most obvious manifestation of this is increased debt and the increased holding of financial assets, but the reasons for this, and the restructuring of the relations that this both reflects and spurs, also need to be carefully unpacked.

Lapavistas (2014, pp. 238–244) shows increases in household financial assets and liabilities in the US, the UK, Germany, and Japan. Santos and Teles (2016) show, with some variations, congruous increases across Europe in absolute terms and as a share of disposable income, GDP, and other ratios (the developing world is discussed in the next chapter). In the US, arguably the most extreme manifestation of a broader trend (and the country for which there is much longer time-series data), household financial liabilities have grown from under 20% of GDP in 1945 to over 100% of GDP in 2006; household financial assets reached over 350% of GDP in 2006/7 up from under 250% in 1945 (Lapavistas 2014, pp. 238–244). Pertinent also is the composition of these. The largest component of household indebtedness is mortgages, although these have not increased uniformly, for instance not in Germany, and various other forms of consumer credit have proliferated. The rising holding of insurance and pension fund claims is most remarkable on the asset side, although houses remain the largest asset, with the importance of equity and deposit holdings varying: for instance, equity ownerships is

high in US while deposits dominant in Japan. In general, there has been an increase in more sophisticated forms of savings, such as bills, bonds, and mutual funds over regular bank deposits (Karacimen 2013, p. 10).

Such phenomena can only be adequately unpacked by interrogating the institutional environments and historical socioeconomic contexts (and hence social relations) underpinning these developments.⁵³ The former have included consumption norms – as Cynamon and Fazzari (2010, quoted in Karacimen 2013, p. 9) note: “changing social norms made it seem normal to consume more (as opposed to desirable to spend more, which is always the case) as well as normal to borrow in order to finance that consumption (which was certainly not always the case)” – and the increased orientation of financial institutions towards individuals as a source of profit (dos Santos 2009a). The second of these also interacted with innovations in financial markets, such as securitisation of housing loans, and new IT, especially important for consumer reach and risk management, and has been sustained by aggressive marketing by banks (for example special rewards programmes to encourage consumer credit). Low interest rates from the late 1980s also made credit cheaper (Debelle 2004).

The latter (shifting socioeconomic contexts) allow us to account for the interaction between structural transformation (neoliberal restructuring most broadly) and changes in household indebtedness. Of particular importance has been the commodification and marketisation of public services – healthcare, pensions, and education – mentioned above. As noted, housing and pensions are generally the largest household assets and access to services has become mediated via financial markets (such as health insurance), although not uniformly so, with, for example, some European countries maintain strong welfare-state provision. The changing landscape of work and pay has also been critical (Montgomerie 2009). Stagnant and declining wages following the neoliberal assault on labour have been cited as a vital contributing factor with consumer credit sustaining effective demand (Crouch 2009 has referred to this as a form of ‘privatised Keynesianism’). While this appears to be the case in the US, Santos and Teles (2016) show that this is not necessarily true across the board, with household debt increasing most dramatically in some European countries in which slowing wage growth is less

⁵³ Such developments are difficult to understand when situated within mainstream approaches to credit (based on the permanent income hypothesis, life cycle hypotheses, market imperfections, and derivatives of these) (Karacimen 2013, pp. 5–8).

apparent. They also argue that the large role that mortgages play indicates that reasons for borrowing are partially country-specific (see below). Inequality has also been cited as a cause of increased indebtedness with a number of studies stressing that, while income inequality increased in the US and Europe, consumption inequality did not increase as much, indicating that borrowing filled the gap (Fitoussi and Saraceno 2010, Tridico 2012). Santos and Teles again show that there is no uniform relationship, arguing that “high levels of consumer debt are again associated with different levels of inequality, and vice versa across Europe” (2016, p. 52).

The increase in mortgage debt has multiple dimensions worth noting. First, it is not divorced from consumer spending in that mortgage equity withdrawal and housing refinancing have allowed for houses to serve as collateral for consumption expenditure. Baily et al. (2009) show that in the US between 2003 and 2008, 20% of funds so derived were used to finance consumption and a further 17% to pay down credit-card and other debt. Second, as has been well documented, extending homeownership to low-income groups (particularly in the UK and US) was “intentionally designed to integrate previously marginalised sectors of the population into the market economy in ways that both provided new markets to exploit while simultaneously legitimising this exploitation” (Roberts, 2012 p. 25 quoted in Karacimen 2013, p. 17). Third, mortgage markets have played an important role in deepening financialisation as sites of financial engineering and profit sources. Fourth, it highlights how household financialisation can produce highly unequal terms of integration and hence outcomes, with those able to access credit (on favourable terms) profiting. A rise in property prices, for instance, can increase the wealth of those who have already managed to access the ‘property ladder’ while keeping it further out of reach for others who must now rent from property owners (Karacimen 2013, Aalbers 2015) (a specific housing case study, in the South African context, is undertaken in Chapter 10). Income from wealth ownership is increasingly more unequal than wage income, highlighting how financial market integration has distinctly favourable outcomes for a new ‘financial elite’ (Beaverstock et al. 2013).

The consequences of such financial-market integration have been profound. On the simplest level this ‘financialisation of everyday life’ has exposed individuals to financial risks (Martin 2002, Langley 2014). More deeply it has contributed to a shift in how

individuals understand themselves and others, as individuals are recast as savers and investors (with competing but reinforcing impulses “both to save and to spend (on credit)” (Fine 2013a, p. 29)); Finlayson refers to this as “forging a new ‘technology of the self’, a way in which persons relate to themselves and plan and evaluate their actions” (2009, quoted in Fine 2013a, p. 27). Allon (2014, p. 367) notes: “With the growing calls for individuals to secure their own independence and autonomy not via the state but through financial markets, practices of investment, calculation, and speculation become associated less with financial distortion than with normalization and domestication and their embrace by ordinary individuals taken as a sign of personal initiative, self-management, and enterprise rather than moral or budgetary imprudence.” Baggs et al. (2014) show how intentional policy has turned ordinary people into financial subjects as both consumers and producers of financial claims; housing in particular has been critical to this, as highlighted by Appleyard et al. (2016).⁵⁴ Finlayson (2009, quoted in Fine 2013a, p. 26) makes a similar point in the UK context when noting that:

“Under New Labour the encouragement not only of home ownership but of houses bought as sources of profit and guarantees of future financial security has been part of a wider attempt to create an asset-owning society composed of responsible yet risk-taking, financially independent yet economically ambitious individuals. This has not been confined to housing but has involved a range of policies in areas such as health and education and also specific policy mechanisms intended to encourage savings, investment and financial planning.”

The above is the consequence of overt state policy choices and has reconfigured state-labour relations. Such developments have involved the “transfer of risk and responsibility from the collective to the individual” (clearly in line with the retrenchment of the welfare state) (Finlayson 2009, quoted in Fine 2013a, p. 26) that has meant a reinvention of the role of the state. Housing markets are again illustrative, as Watson (2009, quoted in Fine 2013a, p. 32) observes: the UK government, in the wake of the global financial crisis, “offered temporary guarantees on housing market loans of up to £400,000, using public money to ensure that mortgage lenders continued to receive their payments while simultaneously allowing cash-strapped households to defer their

⁵⁴ Allon (2014) argues that this has been particularly profound for women and that households have been transformed into sites of economic calculations.

repayments without fear of having their homes repossessed”. As this covered 90% of British households the government was able to ignore “issues of housing affordability and the constrained access into private homeownership for first-time buyers”. Instead, “it concentrated on trying to protect wealth already accumulated on the housing market”.

There has also been a restructuring in the relations between labour and capital. Regarding the relationship established through debt there has been some debate within the Marxist literature over how to position this. Lapavistas (2014, pp. 143–146), who has placed great importance on the role of households within financialisation, draws from Marx and refers to “exploitation occurring in financial transactions” (Lapavistas’ words) and “secondary exploitation” (Marx’s words, albeit used very selectively) which arises from a “direct transfer of value from the income of workers to the lenders” (Lapavistas’ phrasing). This encounters a number of difficulties which Fine (2009a, 2010a) highlights. First, ‘exploitation’, in Marxist parlance is generally associated with the generation of surplus value which takes place only via production.⁵⁵ Second, different forms of credit establish different relationships, and it is not clear that lumping them together under ‘financial expropriation’ is useful.⁵⁶

Third, Lapavistas and dos Santos argue that the worker confronts the bank on profoundly unequal terms and that this asymmetry of power, mediated by specialist technology, access to information and class position, allows for systemic financial expropriation. This they distinguish from presumed more equal financial relations between capitals (Fine 2010c). However, as Fine (2009a, p. 17) argues this is only contingently so,⁵⁷ some individuals access finance on reasonable terms, and in certain

⁵⁵ Lapavistas notes this but argues that because financial expropriation “takes place systemically and through economic processes” it has an “exploitative aspect” (2009b, p. 131). This calls into question how the value of labour power is theorised (beyond our scope here) but Lapavistas’ framing seems to rely on an understanding of exploitation as the exchange of commodities at prices not equal to their value (2009b, p. 131) which is different to notions of exploitation which pertain particularly to the labour process.

⁵⁶ Mortgages are interesting in that, whilst the repayments and interest are furnished from wages, the credit itself (especially refinancing) and hence the requisite repayments are made possible via real estate (asset) inflation. This means that the interest serves as a manner of transferring the capital gains to creditors via the wage earner. This is a very different dynamic from other forms of consumer lending (for example via credit cards) (Fine 2009a).

⁵⁷ Dymski’s characterisation of subprime loans as involving “financial exploitation” (2009, p. 151) brings to the fore a similar issue. The strength of explaining the subprime crisis via the racial exclusionary practices in US in general, and in the housing market in particular, makes the thesis (of ‘financial expropriation’) advanced contingent on these features. Fine (2009a) contends that neither systemic racism nor the housing market exemplify credit extension *per se*.

circumstances, non-financial corporations might be forced into extremely unfavourable financial relations. Further, the asymmetry between bank and worker is part of the broader (and fluctuating) asymmetrical relationships between labour and capital; drawing attention to this is useful but not if the implication is that there is a categorical difference in the asymmetry between worker and banker, and worker and employer, or if this implies a form of ‘exploitation’. Similarly, it seems strange to argue that households saving via pension funds is a “further dimension of financial expropriation” (as Lapavistas 2014, p. 242 does) because the financial institution garners profit from this; in the first instance this can be a mutually beneficial financial arrangement.

While uniformly theorising household financial engagement as entailing financial ‘expropriation’/‘exploitation’ is inappropriate, it is clear that, in the main, for ordinary workers, the rise of indebtedness has increased the power of capital (and wealthier individuals); as Karacimen (2013, p. 22) notes, workers “have become more dependent on capital with the rise of indebtedness, while debt has restrained the chance to implement social, economic, and political power”. She continues that although the “wage form as means of access to consumption [already] ties workers to hard work, rising debt levels and interest, that wage earners must pay on loans, increase the pressure on them”. While this is not a new strategy – with the logic of ‘homeowners don't go on strike’ driving homeownership expansion in the US from the 1930s – it has been greatly accentuated. One consequence, Barba and Pivetti (2009) argue, is that rising debt contributed, in the US, to low wages and labour costs; it is also likely to have forced workers to accept longer hours and harder working conditions (Karacimen 2013).

This has been bound up with the “differentiated (re)position of the workforce” (2010c), as financialisation, and neoliberalism more broadly, have gone hand-in-hand with a restructuring of work and the (global) division of labour. Casualisation, labour-market flexibility, offshoring, work-time compression, and similar trends are driven in part by financial market imperatives such as shareholder value maximisation. Jung (2015) and Lin (2013) demonstrate this with particular relation to offshoring by US corporations and how this has located workforce downsizing as a key site of cost reduction; and Palpacuer (2008) highlights how this occurs due to the nature of global value chains described above. This highlights distributional shifts: over how wages are allocated, and over the distribution of value added between capital and labour and between different

locales (particularly between the developed and developing worlds); analysis of these distributional shifts form the final section of Chapter 10. On the flipside, Arestis et al. (2013) show how financialisation has also generated a ‘wage premium’ for individuals working in managerial roles and financial corporations, with white men benefiting disproportionately.

Finally, financialisation has also impacted households through the costs of social reproduction (see Fine 2010c). The case of food and agricultural production is a good example. Clapp (2014) and Isakson (2014) have highlighted the restructuring of agricultural firms as well as global agri-food commodity chains along the lines discussed above – shareholder value maximisation, greater involvement in financial assets, etc. – and the trading of food and land (see also Fairbairn 2014) as financialised commodities. Together with the growing integration between food commodity and stock prices (Lehecka 2014), these have served to raise food prices.

Financialisation has thus had appreciable consequences for the daily lives of ordinary people drawing them into financial networks in ways in which they may not even before have been aware.⁵⁸ The reasons for this – the marketisation of social services, increased indebtedness, etc. – have been integral to the development of financialisation in creating new markets, financial subjects, and pools of liquidity. This has been bound up with broader restructuring, particularly in the nature of production and work, and shaped the trajectory of such. The consequence has been a commodification of daily life in ways which are historically unique, with the penetration of finance bringing the volatile capriciousness of financial markets into sitting rooms around the world, with highly dislocating consequences.

3.5 Conclusion

In this chapter we have explored how the intensive and extensive expansion of finance in the course of financialisation has entailed a restructuring of the operations of, and relationships between, financial and non-financial capital. NFCs have become both less reliant on external financing and more deeply entwined in financial markets. Banks have

⁵⁸ As Langley (2008 p. 3 quoted in Fine 2013a, p. 17) notes, “the majority of mortgagors, credit card holders, and other borrowers seem unaware that claims on their future repayments, and the risks on their non-payment, are presently packaged and traded in the capital markets”.

turned towards financial market intermediation and consumer lending, while investment banking and market trading have burgeoned with institutional investors emerging as dominant market players. At the same time, with the expansion of international production and global value chains, TNCs have been recast in highly financialised forms with substantial market power to shift risk onto their suppliers while squeezing their profit margins.

As financial wealth becomes highly concentrated so does ownership, giving rise to shifts in the relationships between financial and industrial capital. This expresses itself in varying forms, in some instance market discipline is imposed through distance, in a market for corporate control where NFCs are bought and sold and shareholder maximisation pressures imposed. In other instances, giant financial investors have increased their direct oversight of NFCs. In both cases the power of finance is appreciable, and in many instances these trends have had deleterious effects for real capital accumulation. The state has played an important facilitating role with a concomitant realignment in the relationships between the state and capital and labour. Financialisation has profoundly altered social reproduction and the financialisation of households has transformed daily lives while also shaping the trajectory of financialisation. These developments, which appear in contextually-specific forms in each locale, give substance to how we conceive financialisation. We turn now to consider the nature of financialisation in developing country contexts specifically.

4 FINANCIALISATION IN DEVELOPING COUNTRIES, TRANSITIONING ECONOMIES AND EMERGING MARKETS

4.1 Introduction

This chapter continues our review of the financialisation literature with a specific focus on developing countries, transitional economies, and emerging market economies (DTECs). If financialisation originated at the capitalist ‘core’, this is our analysis of how it was transmitted to, and played out in, the ‘periphery’.⁵⁹ Financialisation in DTECs occurs on the basis of both the imposition of global market imperatives and as functional to the interest of domestic actors, although it brings with it new forms of vulnerabilities and instability. The imposition of global imperatives involves both the internationalisation of trade and production and the expansion of global financial markets, the latter allowing domestic corporations to internationalise and become ‘global market players’.

Here we tackle financialisation on these two interlocking planes: global financial integration (Section 4.2) and the transformations that occur within domestic economies (Section 4.3). The two are related but also distinct; while financial integration of DTECs plays a critical part in shaping financialisation in those countries, the nature of financialisation in DTECs is characterised by a broader range of variables, with various domestic dimensions of financialisation sharing strong similarities with financialisation described in the previous chapter. With this in mind, we explore the financial integration of DTECs and the financialisation of economic relationships within DTECs in distinct sections with limited overlap. These both offer signposts for our later discussion of South Africa which brings the two facets together.

It is important to note that within this group of countries there are important variations, both on a country-by-country basis and regionally. The differentiation arises from both differences between national economies and the terms upon which they are globally integrated (Doucette and Seo 2011, Ashman and Fine 2013, Kaltenbrunner and Karacimen 2016). As Kaltenbrunner and Karacimen (2016, p. 288) maintain, this means we must pay attention to the “specific historical and institutional trajectories of national

⁵⁹ We do not use these terms with the theoretical framing implied by dependency theory.

processes of capital accumulation, the structural real sector configurations and the specific forms finance takes itself'. As argued by Fine (2013b), this means that the restructuring which occurs within domestic economies as a result of financialisation, and the consequences for capital accumulation, will vary and need to be analysed on a case-by-case basis; this is the nature of our empirical analysis of the South African case. Nevertheless, it is possible to identify commonalities in both the onset of financialisation and how it manifests.

4.2 Financial integration

The integration of DTEC into global financial networks has been a critical part of their financialisation (so too their integration into global productive networks discussed in Section 4.3.3). In this section we explore the roots of that integration in Section 4.2.1, and the contours of global integration in Section 4.2.2, with reference to the evolving nature of capital flows. In Section 4.2.3 we turn to contemporary features and the vulnerabilities these bring, while Section 4.2.4 offers a framework through which to understand these vulnerabilities. Section 4.2.5 explores the relationship between global integration and state policy, highlighting the manner in which policy facilitates financialised global integration and is shaped by it.

4.2.1 The evolution towards financialisation in DTECs

A number of authors trace the beginnings of financialisation in DTECs to the resolution of the Latin American debt crisis, the institution of the Brady plan, and the integration of these countries into international financial markets in the 1980s (Pauly 2003, Paineira 2009, Vasudevan 2009b, Kaltenbrunner and Karacimen 2016). Kaltenbrunner and Karacimen (2016) argue that the Brady Plan, a programme for Latin American debt reduction in the late 1980s, had three important implications for financialisation in DTECs. First, it played a critical role in the creation of sovereign debt markets; second, dependence on international capital markets for financing needs was increased; third, it strengthened the role of international financial institutions in Latin American economies.

This interacted closely with the general integration of DTEC economies into financial markets through financial liberalisation. Liberalisation was preceded by a push for

domestic financial deregulation and the peeling away of ‘financial repression’. McKinnon (1973) and Shaw (1973) provided the original theoretical basis: in essence that deregulation, in particular free-floating interest rates, would expand the monetary base and allow the efficient reallocation of resources thus enhancing growth. Following this, arguments against financial ‘repression’ came to be applied to any restriction on the mobility of domestic or international financial capital, propelling calls for capital account and exchange control liberalisation. Accordingly, savings should flow from capital-abundant (developed) countries (with high capital-to-labour ratios) to capital-scarce (developing) countries (with low ratios) because of differentials in expected capital returns.⁶⁰ Such deregulation and liberalisation had at its heart the easing of restrictions on (local and international) corporates, with regard to both domestic and cross-border financial activity, the loosening of control over financial markets (particularly foreign exchange markets), and the ‘withdrawal of the state’ from active regulation and own intermediation (Ghosh 2005, pp. 2–3).⁶¹

Financial deregulation and liberalisation thus formed an essential part of the neoliberal reform agenda canonised under the ‘Washington Consensus’, designed to subjugate all facets of social and economic life to the market, and financial markets in particular (see Bayliss et al. 2011).⁶² Even within the mainstream there is little evidence – theoretically and empirically – that these propositions hold and purported benefits occur (see for example Kose *et al.* 2009 on the lack of evidence of the growth-enhancing nature of financial liberalisation). A post-hoc argument in favour of necessary pre-conditions for, and the sequencing of, successful implementation of financial liberalisation was therefore made; an admission of market failures, which, together with a retooling of the same prescripts, is typical of the ‘post-Washington Consensus’.

⁶⁰ Thus funding financial investment and consumption at lower cost, smoothing shocks, and facilitating higher specialisation and productivity while reducing risk through asset diversification and correcting balance of payment problems. Such flows would also allow international finance to discipline domestic economic policy (see Cooper 1999, pp. 20–21, Prasad et al. 2006, p. 2, 2007, p. 119, Paineira 2009, p. 6, Bonizzi 2013c, p. 29).

⁶¹ For a lengthier theoretical discussion see Bonizzi (2013c).

⁶² We can discern that many of the Washington Consensus prescripts (for instance liberalisation, floating exchange rates, and moderating inflation) directly strengthen financialisation globally and facilitate its penetration into domestic markets in developing countries. For a discussion of the World Bank’s role in pushing financial reforms that led towards financialisation see dos Santos (2008); for a broader discussion of World Bank driven reforms see Bayliss et al. (2011).

These theoretical and ideologically prescripts naturally intersected with pressures from international (particularly) American finance capital itself, which sought investment opportunities in the wake of the 1970s crises in the developed world, and resulting collapse in demand for credit, and large petrodollar financial surpluses. Despite the imposition of this agenda from ‘without’ it is also critical, as Kaltenbrunner and Karacimen (2016, p. 291) argue, to note that liberalisation, in many instances, “strongly reflected changing needs and demands of domestic capital to integrate into the world economy”. As Katz (2001) shows, transformations in patterns of production which increased demand for foreign capital were underway in Latin America in the 1970s, well before liberalisation. At the same time, the hangover from the debt crisis required foreign exchange to meet repayments which strengthened export-orientated models of capital accumulation. Global integration and the need to compete internationally also created new demands from domestic capital on the financial system in order to acquire working capital in different currencies and to hedge against exchange and interest rate risk. This fits with our previous emphasis on the role of internationalising production and exchange and the relationship between that and transformations in finance.

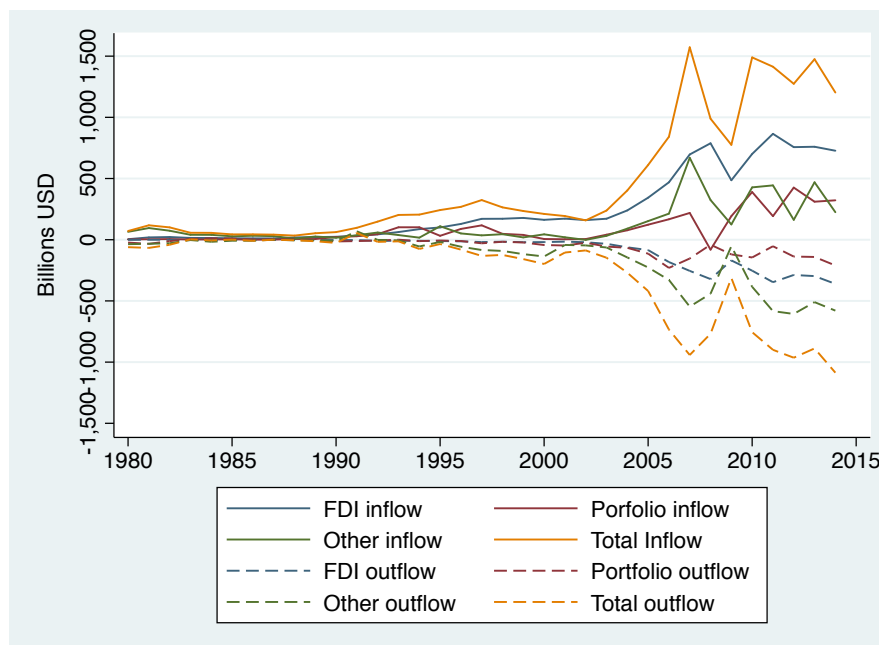
4.2.2 The changing nature of capital flows

The above meant that the early 1990s saw a marked increase in capital flows and rising volatility and instability, as is visible in Figure 4.1 and Figure 4.2 that show the nature of emerging and developing country cross-border capital flows from 1980 onwards. Gross cross-border capital flows, shown in Figure 4.1, begin to rise in the 1990s and precipitously increase from 2002 onwards (see also Obstfeld 2010).⁶³ Between 1980 and 2010 global assets increased from just over \$1tn to almost \$44tn (Bonizzi 2013d). A rise in capital flows is visible from the 1990s culminating in the East Asian financial crisis of 1997/8, but a much larger leap took place from 2002 onwards. Between 2002 and 2011, external assets and liabilities of DTECs approximately trebled reflecting the surge in private capital flows to emerging capitalist economies, from an average of \$487bn in 2003-5 to more than \$1,500bn in 2007 (Bonizzi 2013d, Kaltenbrunner and Karacimen 2016). Therefore, despite marked liberalisation and significant international integration

⁶³ We show gross rather than net flows in Figure 4.1 because the former gives a more accurate picture of the scale of flows. However, in Figure 4.2, reflecting the overall direction and composition of flows, it makes more sense to show net flows.

in the 1980s and 1990s it was during the late 1990s and 2000s that financialisation deepened in DTECs and took on the distinctive features that we see today.

Figure 4.1 Gross private capital flows for emerging and developing countries (1980-2014)



Source: IMF (2016c) Balance of Payment statistics, own calculations

Note: For ease of presentation inflows have been shown as positive and outflows as negative

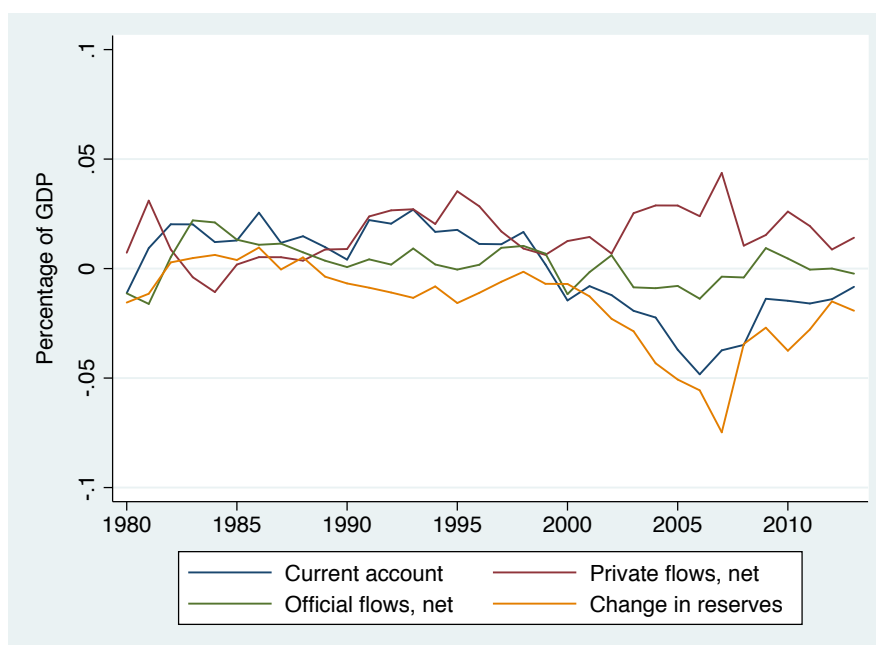
The composition of these flows is important. Both FDI inflows and outflows have been the most stable, with international integration being not only an opportunity for domestic financial and non-financial agents to access foreign funds but also a chance to internationalise. UNCTAD notes that outward FDI from emerging market economies (EMEs) increased from around \$70 billion in 1980 to almost \$400bn in 1996 (Kaltenbrunner and Karacimen 2016); the increased availability of foreign financing was crucial to this. Portfolio and banking flows display stronger cyclical tendencies. Interestingly, the two display opposite tendencies during the recent financial crises (the global financial crisis and Eurozone crisis), whereas banking inflows drop sharply, portfolio inflows rise; our later discussion sheds light on this. Interesting also, is that while FDI makes up the largest share of inflows this is not true of outflows, which are dominated by banking flows, although FDI flows between developing countries have grown in line with the internationalisation of DTEC corporates (UNCTAD 2015a).

Aggregate FDI statistics, as an indication of real foreign investment, should be treated with caution. The distinction between FDI and portfolio flows is more blurred than

might be assumed as portfolio investment that involves purchasing more than 10% of a particular company's stock is classified as FDI. In addition, substantial FDI has flowed into the financial sector, or facilitated M&As rather than greenfield investment. Within greenfield investment, real estate, in 2014, attracted the largest share, with 16 of the top 20 recipients being developing countries (UNCTAD 2015a, p. 35). Further, FDI outflows (or net FDI flows) do not capture all outflows that result from FDI (for example, repatriated profits and dividends) and such FDI-related outward flows exceeded all FDI inflows to developing countries in 2014 (UNCTAD 2015a).

In Figure 4.2 we show the net cross-border capital flows for emerging and developing countries. We see that private capital flows have persistently been positive, while official flows turned negative for much of the 2000s given weak aid flows and the repayment of official debts incurred in the late 1990s. Whereas official flows played a large role in early decades of liberalisation, as these economies have financialised private capital flows have dominated. These private flows have shifted from longer-term towards short-term debt and portfolio flows, such as domestic currency bonds, equities, and derivatives.

Figure 4.2 Net capital flows for emerging and developing countries (1980-2013)



Source: IMF (2013) World Economic Outlook statistics, own calculations
Notes: The 2013 dataset is used because more recent datasets do not contain official flows.

The most remarkable aspect of net capital flows is the overall role reversal between rich and poor countries vis-à-vis the direction of the net flow of capital (witnessed in Figure 4.2 via the current account); poor countries have become net exporters of capital and rich countries net importers of capital, the so-called ‘capital flows paradox’ (Prasad et al. 2006). A further peculiarity emerges in that when capital does flow to poorer countries it is not to those that are growing fastest, that is, presumably those with the best investment opportunities, this has been dubbed the ‘allocation puzzle’ (Gourinchas and Jeanne 2007). Contrary to the theoretical predictions, it is surplus countries that have grown fastest. This pattern of net flows has been driven by reserve accumulation; between 1990 and 2015 emerging market and development countries’ reserves (excluding gold) grew (in nominal terms) fifty-fold while their GDP grew (also in nominal terms) just under seven-fold (IMF 2016a, 2016b, own calculations).⁶⁴

On the surface, and according to the mainstream, reserve accumulation has occurred as a means through which to smooth balance of payment flows, allow for intervention in currency markets to stabilise the exchange rate through the purchase or sale of domestic currency, and to mitigate against sudden reversals in capital flows by assisting the monetary authorities in the provision of domestic liquidity. This is not necessarily incorrect, but insufficiently and inadequately theorised. For one, the scale of reserve holdings is far in excess of all measures used to estimate the necessary reserve to achieve the above objectives (Painceira 2009, p. 17). More critical is the absence from the mainstream literature of any concept of the economic relations that underpin this phenomenon (we return to this below).

Cross border flows have played an important role in deepening DTEC domestic financial markets and a range of secondary markets have arisen (see Section 4.3.1). Average daily turnover in EMEs’ derivative markets grew from under \$300bn in 1998 to \$1.2tn in 2010 (and hovered around that until 2013). This is 4% of GDP, small in comparison with advanced countries whose daily turnover is \$10.3tn, or 24% of GDP, but this displays significant growth that has outstripped growth in advanced economies (Mihaljek and Packer 2010, p. 44, Ehlers and Packer 2013, p. 56). Relevant to our discussion here is that EME currency markets have been driven by offshore trading, with advanced economies share of EME global FX OTC market turnover ten times

⁶⁴ The accumulation of reserves by emerging markets has recently slowed (IFF 2015).

higher than that of EMEs themselves. In 2013, just under 70% of all EME transactions were traded offshore, up from just under 50% in 2007, and for some key currencies – the Polish zloty, Turkish lira, Mexican peso, Brazilian real, and South African rand – this was 80% or above (Ehlers and Packer 2013, pp. 60–62). Such trading is not a capital flow in the traditional sense but it does highlight a critical feature of global financial integration (returned to below).

In sum, we witness hugely increased flows with a short-term bias, large-scale reserve accumulation, and an increase in DTEC tradable financial assets and the offshore trading thereof. We take a deeper look now at defining features of current financial integration and the new vulnerabilities this brings.

4.2.3 Capital flows and new forms of external vulnerability

Since financial liberalisation, capital flows have exposed DTECs to a range of dangers: rapid credit expansion; currency and maturities mismatches; sudden capital outflows; sharp exchange rate appreciation and depreciation with trade, balance of payments, inflationary, and sovereign and corporate solvency consequences; and longer-term draining of resources. Many of these have been accentuated in recent years. But the nature of vulnerabilities has also changed in line with shifting forms of integration. The new external vulnerabilities, the literature highlights, do not result from ‘misaligned’ fundamentals or high levels of short-term external debt – the ‘original sin’ of developing countries – that orthodox accounts of capital flows suggest. In fact, they have occurred against the backdrop of an expansion in domestically-denominated financial assets and ‘sound fundamentals’. It has become increasingly clear, as Kaltenbrunner and Paineira (2009, p. 4) argue, that rather than responding to ‘sound’ investment opportunities it is “capital flows themselves which create the conditions [and vulnerabilities] in domestic financial systems which in turn shape the dynamics of their own behaviour”. Kaltenbrunner and Paineira (2009, 2014) have been at the forefront of the literature, making extensive use of the (illuminating) Brazilian example (see also Kaltenbrunner 2010, 2014, Correa and Vidal 2012).

First, Kaltenbrunner and Paineira (2014, p. 3) place price dynamics – exchange rates, assets prices etc. – as central (see also UNCTAD 2015a). These are regulated by capital flows, and themselves affect capital flows. For instance, “favourable exchange rate

movements can attract short-term capital inflows, which in turn further appreciated the exchange rate and enticed further capital inflows (and vice versa in the case of depreciation)” (Kaltenbrunner 2014, pp. 2–3). Second, capital flows are increasingly dependent on conditions in international financial markets and largely unrelated to the domestic economic fundamentals of recipient countries. Of particular importance is loose monetary policy and low interest rates at the capitalist core both following the bursting of the dotcom bubble and with the advent of quantitative easing (QE) in the post-global financial crisis period. Vasudevan (2010) points to how fluxes in private capital flows allow the US to shift the burden of deflationary adjustment as a result of monetary expansion from the core to the periphery. A further consequence of QE (both low interest rates at the core and expanded liquidity) has been a ‘hunt for yields’ by international investors as capital moves around the globe in search of returns.

This hunt for yields has been a key reason for the surge and patterns in DTEC capital flows. Goldman Sachs notes that international institutional investors have increased their asset allocation of developing and emerging countries from below 2% in 2000 to 6% in 2010 (cited in Kaltenbrunner and Paineira 2014, p. 8). Palma (2015) notes that up to \$7tn of QE has flooded into emerging markets between 2008 and 2015 (see also Volz 2012, Bhattarai et al. 2015). In Brazil, foreign investors’ share of domestic government debt increased from 2.4% in 2007 to 10.6% by the end of 2011 (Kaltenbrunner and Paineira 2014, p. 9), participation in domestic stock and derivative markets grew enormously (Turner 2008, Kaltenbrunner and Paineira 2009). The proximate cause for the reversals of capital flows during the global financial crisis was likewise shaped by conditions at the core – a greater demand for US dollars and a fall in consumer demand and hence trade.

Third, the role of interest rates and exchange rates has changed and become central to returns earned by foreign investors. Interest rate differentials have long played a role in cross-broader investment strategies but the expansion of carry trade – whereby investors (foreign and domestic) borrow at low interest rates in developed world financial markets, particularly in Japan and Switzerland where low and stable interest rates persist, and invest in higher-yielding DTEC assets – has been enormous with emerging market carry trade estimated at \$2tn alone (Dohmen 2014). Powell (2013a) highlights this in the Mexican case.

The increased centrality of exchange rates is pivotal to the literature on new external vulnerabilities. Exchange rate markets themselves offer a lucrative sphere for investment; Kaltenbrunner (2010, p. 316) notes, for instance, that: “While the foreign exchange operations of domestic and foreign banks are driven – at least partly – by the hedging needs of their commercial and financial clients, the positions of international hedge funds are focused exclusively on betting on future exchange rate changes.” But the importance of exchange rates goes beyond this. With the growth of local domestic-currency-denominated asset markets in DTECs the currency mismatch risk has been shifted onto international financial investors; for instance, almost 100% of the Brazilian government debt is denominated in local currency. This is a significant change from early decades, and similar across many middle-income countries (Kaltenbrunner and Paineira 2014, p. 9). It therefore makes exchange rates central to the achievement of gains from cross-border financial investment, as well as highlighting a shift from an ‘old’ vulnerability – currency mismatches due to foreign-currency denominated debt – to a ‘new’ vulnerability, based on the trading of domestic-currency denominated assets.

In the Brazilian case, rising prices in domestic stock and bond markets partially relied on an appreciating real. At the same time trading of exchange rate derivatives was a central activity of both domestic and international investors; with investors in stock and derivative markets tending to be more leveraged than debt issuers (Kaltenbrunner and Paineira 2009, Kaltenbrunner 2014, p. 2). The centrality of exchange rates stretches into even more speculative investment strategies, for instance it is now common to hedge against currency risk when undertaking carry trade operations. This, shift in asset class towards derivative markets, Kaltenbrunner (2010, p. 297) argues, marks a shift from seeing DTECs assets as investment assets to seeing them as trading instruments.

Fourth, the heavy trading of DTEC assets by foreign investors in bond, equity, and derivative markets indicates the growing importance of capital gains to investment strategies. Importantly, the ability to realise such capital gains are themselves bound up in capital flow dynamics including in exchange rate fluctuations. Bonizzi (2015) – adapting Toporowski’s (2002) ‘capital market inflation’ approach (discussed in Chapter 3) in which excess liquidity (due to the rise of institutional investors) pushes up asset prices – shows that foreign investors seeking capital gains create “the conditions of

excess liquidity in the capital market that are necessary to inflate it”.⁶⁵ A critical difference is that the “liquidity which sustains price inflation in these markets is more ephemeral than in advanced countries, a sudden change of mind by some large foreign investors can quickly bring about asset price deflation” (Bonizzi 2015, p. 124). As with the authors discussed above, he concludes that “the dynamics of emerging capital markets are [therefore] dependent more on global financial conditions than domestic fundamentals” (Bonizzi 2015, p. 116).

What emerges is a picture in which interest rates, exchange rates, asset inflation, and capital flows all interact (UNCTAD 2015a, p. 37). For instance, high real interest rates and the potential for capital gains may attract capital inflows leading to appreciation in the currency, itself supporting the gains derived, and asset inflation. On the other hand, when crisis hits and flows reverse, this generates mutually reinforcing losses exacerbating the downturn and capital outflows (Kaltenbrunner and Paineira 2009, Kaltenbrunner 2014, p. 2), indicating how the nature of this integration creates new vulnerabilities.

Finally, capital flight, and more broadly illicit flows, from DTECs appears to have risen in recent years. Such net outflows amounted to \$540billion in 2015, the first year since 1988 that net flows were negative (Wheatley 2015). This occurs due to residents investing abroad (legally or illegally), reversals in capital inflows, and interest and dividend payments to foreign owners of domestic financial assets. Tax avoidance and evasion has also become a global scourge (see Farny et al. 2015 for a discussion of these terms). The Tax Justice Network (2011) estimated for 2011 that global tax evasion was in excess of \$3.1tn per year or 5.1% of global GDP with between \$21tn and \$32tn of private wealth sitting, in 2012, in tax-free havens (Henry 2012). Perversely, in view of “the challenges in intervening and sterilising the persistent inflows, some EM [emerging market] policymakers have adopted measures to encourage institutional capital outflows as a complementary policy tool to ease appreciation associated with capital inflows” (BIS 2009, p. 101). The loss of scarce capital and foreign exchange can hamper investment, erode the tax base, and retard development. This will especially be the case

⁶⁵ In the UK, total foreign portfolio holdings of institutional investors more than doubled between 2001 and 2011 with the emerging market share growing from 6.5% to 12% (Bonizzi 2013d, p. 42).

when capital flight is compensated for by foreign borrowing or capital inflows that may set in motion the dynamics described above.

4.2.4 Making sense of capital flows and new external vulnerabilities

The new external vulnerabilities described are endogenous to the current pattern of capital flows which has at its heart the “hierarchical and structured nature of the international monetary system” (Kaltenbrunner and Paineira 2014, p. 20, see also Lapavistas 2014, p. 246). This refers back to our discussion in Chapter 2 of the US dollar as world money, and relates to the terms upon which DTECs are integrated into the world market. Their subordinate position is not new, but the manner in which this is imposed and manifests has changed over time, with monetary relations taking on a critical role (see Kaltenbrunner and Paineira 2009, Lapavistas 2009c, 2014, Paineira 2009, 2010, 2012, Kaltenbrunner 2010, 2014, Powell 2013a).

We noted in Chapter 2 that in the post-Bretton Woods period the US dollar stands at the heart of monetary relations not only because of its role as a means of exchange and store of value but because it is the unit in which international debt is predominately denominated, forcing other countries to generate foreign exchange to meet payment obligations. This was originally expressed through DTECs’ inability to borrow in their own currencies, but as we note above, this is no longer universally the case (especially in middle-income countries). However, the US dollar still dominates international debt contracts, with the Bank of International Settlements (BIS) stating, in mid-2012, that approximately 60% of foreign currency liabilities of internationally operating banks were issued in US dollars (Kaltenbrunner 2015, p. 439). This structural demand for dollars supports its value stability thus reinforcing its position, allowing the US to refinance its debt obligations through injections of international liquidity.

At the same time, the role of DTEC currencies “as denominators of international debt contracts and thus international media of contractual settlement continues to be minimal” (Kaltenbrunner 2015, p. 439). DTEC currencies (excluding the outward flow of foreign reserves) therefore “remain largely investment currencies, that is, net receivers of foreign capital that has been funded on international financial markets (BIS, 2012)” (Kaltenbrunner 2015, pp. 439–440). This makes DTEC currencies vulnerable to currency appreciation (upon inflows) and depreciations (as foreign investors repatriate

investments to meet outstanding debt obligations) (Becker et al. 2010, UNCTAD 2015a). In turn, this undermines their ability “to act as international stores of value and media of contractual settlement” (Kaltenbrunner 2015, p. 440), which (in a circular fashion) makes them appropriate targets for speculation. This itself is not necessarily new but with the enormous expansion of capital flows, the importance of currency dynamics therein, and the shift towards domestically-denominated DTEC assets traded for speculative and/or capital gains, this both strongly informs and helps to explain the pattern of flows.

From the point of view of the investor these dynamics informs the significant foreign exchange hedging, as well as the necessity to exit at the appropriate moment; at the same time speculative currency markets and the sheer volume of flows exacerbates the vulnerability. From the point of view of the DTEC, it necessitates massive foreign reserve accumulation which act “as a form of insurance for international capital entering developing and emerging countries” (Painceira 2010, p. 285). In this manner, Lapavitsas (2014, p. 251) argues that the extraordinary accumulation of dollar-denominated foreign reserves by developing countries (Figure 4.2 above) – the most obvious manifestation of the dollar as world money – has, in practice, been “foisted upon developing countries by the logic of international markets”. That the resulting reverse flow of capital has “not originated in actions taken by capitalist enterprises and other private agents but in actions by public agents in both developed and developing worlds” marks a crucial difference between financialisation and earlier periods of financial integration (Lapavitsas 2014, p. 246, see in particular Painceira 2009, 2012).

Despite the purported ‘insurance’ function of foreign reserves, the enormous stock of such foreign investment means that even the extremely high stocks of foreign reserves may be insufficient to counter depreciation pressures. These dynamics also generate pressures to offer high returns on their assets and maintain foreign exchange liquidity (see below). DTECs position within the global hierarchy means that they bear the brunt of deflationary/inflationary adjustments caused by global liquidity expansion and its contraction (Vasudevan 2009b, 2010) with key prices within their economies disconnected from economic fundamentals, and the imperatives of global financial markets dominating.

It is the nature of capital flows themselves that have structured and reinforced these relationships. As Kaltenbrunner (2015, p. 443) notes: it is DTECs' "exposure to short-term capital flows and their asymmetric and hierarchic integration in the international monetary and financial system itself – rather than adverse fundamentals, as in neoclassical economics, or a country's lack of monetary credibility, as for GMKs – that underpins and perpetuates their monetary subordination"; and such subordination perpetuates the pattern of flows.

4.2.5 The role of the state: financial liberalisation, central banks and monetary policy.

We noted in Chapter 3 that states have been central to the advent and development of financialisation as well as being subject to it. We explore this here with particular reference to the manner in which state policy has facilitated and been influenced by financial integration, and in doing so shaped the nature of financialisation in DTECs (aspects of domestically-focused policy and their role in financialisation are touched upon in Section 4.3.2). Most patently, governments legislated the deregulation and liberalisation of financial markets, and have continued to make wide-ranging reforms.⁶⁶ Of significant importance has been domestic monetary policy (particularly inflation targeting) with central banks playing a leading role (as pointed to in previous chapters). Also important is the manner in which financialisation has closed down policy space. The role of central banks and the closure of policy space are explored in turn.

The maintenance of financial market stability, liquidity, and price stability are essential functions of central banks. In the context of globalised financial markets these functions include international dimensions making central banks, as Paineira (2012, p. 5) argues, "a pivot between international and domestic spheres"; with tensions potentially arising between these spheres (manifesting acutely during a time of crisis). Using the Brazilian and Korean examples, he argues that under financialisation emerging market central

⁶⁶ Correa and Vidal (2012, p. 546) note: "Among the most significant institutional reforms are: changes in national constitutions to enshrine balanced budgets, successive tax reforms, the increase in sub national government debt; the accumulation of reserves and the creation of stability funds; reaching exchange rates flexible enough to elevate financial profitability; maintaining restrictive monetary policies, strengthening minority shareholder rights (even if they are large investors), legal reforms to ease the recuperation of collateral, improvements in financial accounting registries, in financial transparency and in accounting norms; increasing domestic credit and continuing with pension system reforms." Dos Santos (2013, p. 324) also notes the relaxation of directed credit requirements favouring production loans and lifting of restrictions on lending practices to households.

banks come to favour “the international over the domestic” with distinctly different responses to the recent global financial crisis compared with that of the East Asian crisis of 1997/8 (Painceira 2012, p. 275). This is a valuable insight although we put it somewhat differently. The central bank continues to prioritise the interests and stability of financial markets broadly. However, under financialisation this increasingly means privileging the interests of international financial market actors in their interactions with the domestic economy, reflecting the economic and social relations established (via global integration) under financialisation.

Ensuring liquidity under such circumstance has had two dimensions. First, the creation of deeper and more liquid domestic financial markets has been central. Second, liquidity provision has also entailed the ability of foreign investors to convert domestic liabilities into world money and make a quick exit, as noted in our discussion of new external vulnerabilities (without this, the ‘benefit’ to foreign finance of financial liberalisation is diminished). Correa and Vidal (2012), for instance, note a shift across Latin America towards financial policies that prioritise market liquidity and the outward transfer of earnings (to which currency convertibility is essential). Liquidity has often been ensured through the rising stock and falling average maturity of liabilities issued by the central bank, particularly repos or a variant thereof. This leads to tension between the goal of maintaining the (foreign) value of the currency and the needs of international investors, as rapid exit surely means depreciation. It may also undermine domestic economic stability and development. We should note, however, that such liquidity can also be of benefit to domestic financial capital whose trading activity also requires easy access to foreign currency (Painceira seems to gloss over this in arguing the central bank chooses between the international and domestic spheres, privileging the former).

By ensuring convertibility, the central bank reinforces the nature of capital flows and thus the country’s external vulnerabilities. As Kaltenbrunner (2010, p. 318) notes in the Brazilian case, the “willingness of the Brazilian central bank to provide foreign currency to the market, meant that the country’s assets were among the first to be sold [by foreign investors during the crisis] and in the greatest volume”. The Brazilian central bank went so far as to lower its reserve requirements during the crisis in order to ensure liquidity, while the Korean central bank cut interest rates by almost half (Painceira 2012). This stands in marked contrast to the response to the 1997/8 financial crisis

(which occurred at a time when financial integration was qualitatively different) in which central banks contracted domestic liquidity in an attempt to stabilise the exchange rate and achieve domestic stability.

The accumulation of foreign reserves (noted above) is critical to ensuring liquidity and convertibility but far from costless for DTECs. First, these reserves represent funds that the government could be spending to support national development. Second, the overall domestic economy is a net loser as borrowing on international markets (by private agents or the state) incurs higher rates of interest than the yield on international reserves. Rodrik (2006) estimated that this amounted to an annual loss to developing countries of close to 1% of GDP, while Baker and Waltentin estimate the cost for East Asia as between 1% and 2% of GDP (cited in Crotty and Lee 2005, p. 423) with the increased interest burden associated with reserves pushing the Bank of Korea into deficit in the mid-2000s for the first time in a decade (Crotty and Lee 2005, p. 431). There is also the added potential of creating currency and maturity mismatches (Turner 2008, Paineira 2009, Lapavistas 2014).

Third, that foreign exchange reserves offer adequate insurance against the risks of flow reversals is far from clear: governments may be reluctant to use them during crises and given the nature of financial integration discussed above it seems unlikely they would be able to substantially contain currency depreciation (Kaltenbrunner 2010, p. 298). Fourth, as Jeanne (2007) points out, there are likely to be more profitable investments available to countries should they wish to invest surplus funds than low-interest T-Bills in which the majority of foreign exchange reserves are held. UNCTAD (2015a, p. 32) points out that the rate of return earned by foreign investors is usually greater than that obtained by both private residents and central banks of developing countries with a tendency to worsen current accounts. Reserve accumulation, necessitated on the basis of international financial integration, is, therefore, costly to the state. The gains from such integration, however, accrue to sections of both domestic and international capital, highlighting, on aggregate, not only as a net transfer of value between states but also between public and private spheres.

Related, has been the need for central banks to ‘sterilise’ capital flows, thus mopping up excess liquidity in order to counteract inflationary pressures. This is usually undertaken

by different forms of domestic borrowing, including selling domestic assets or issuing their own securities (BIS 2009), but can also occur via secondary and derivative (particularly currency) markets.⁶⁷ The result is an expansion in domestic bond markets and build-up of domestic debt, both at the reserve bank and in the private sector (as the private sector borrows to acquire these new assets). UNCTAD (2015a, p. 31) notes that under these circumstances “reserve accumulation primarily reflects an excess of inflows over the amounts that would normally be consistent with domestic spending and investment”. Akyüz (2014, p. 11) calculates that by 2013 40% of reserves held by DTECs were ‘borrowed’, in the sense that they derived from capital inflows rather than current account surpluses.

Painceira (2009) and Gabor (2010) argue that this is the leading cause of the colossal expansion of domestic public debt in developing countries and integral to their financialisation. The consequences of this are important. It has facilitated the expansion of bank balance sheets as the basis for issuing their own securities, and those balance sheets have changed with non-monetary liabilities, repo operations, and holding of liquid assets, growing in prominence. These are generally short-term liabilities thus encouraging the rise in short-term asset holding, which has affected credit allocation with banks engaging in risky and speculative activities. This is shown in the Brazilian and Korean cases by Painceira (2012) and in the case of Eastern European countries by Gabor (2010). In addition, it has, in certain instances, generated an unsustainable government debt burden, for instance in Turkey (Ertürk 2003).

Under financialisation, therefore, despite the domestic costs, what central banks have defended is the *international financialised integration of both their own and foreign capital*. Marois (2011, p. 18 emphasis in original) refers to this as the “internationalization of the state’s financial apparatus” and argues that:

“On the one hand, internationalization involves government elites and state managers accepting responsibility for *managing* their own domestic capitalist order in such a way that they also contribute to protecting the international capitalist order (Panitch and Gindin 2003, 17). On the other hand, internationalization

⁶⁷ Certain ‘non-market’ interventions, such as increasing bank reserve requirements, have gradually entered into greater usage.

involves these same actors *insulating* the state's financial apparatus from domestic politics according to international norms. The *sine qua non* of policy credibility and internationalization today, for example, involves central bank independence and inflation targeting (Mishkin 2009)."

Broad financialised policy objectives are thus folded into (and concealed by) the stated policies of central bank independence and inflation targeting (discussed in Chapter 3). The primary tool for repressing inflation, for instance, has been interest rates, with raising them purportedly limiting the money supply and thus containing inflation. However, interest rates are also used to manage capital flows and often reinforce the pernicious patterns noted above with contractionary consequences for the domestic economy (UNCTAD 2015a, p. 36). Obscured by the rhetoric of price stability, inflation targeting, in the context of fixed-interest securities "assures financial markets that any inflationary risk to the real returns on their asset holdings will be minimized" (Kaltenbrunner 2010, p. 305), an important prerequisite for remaining an attractive destination of capital flows. In the Brazilian case, despite being focused exclusively on an inflation-targeting regime, the central bank consistently intervened in the foreign exchange market to prevent a too rapid appreciation of the real. However, as Kaltenbrunner and Paineira (2009, p. 6) explain, it was precisely this intervention "which provided the liquidity to the market and stood as a support to the build up of Brazil's external vulnerability". The result is that "any attempt by the central bank to control these movements have become severely limited in the face of Brazil's increased financial integration".

Therefore, the rhetorical narrowing of monetary policy to price stability obscures the underlying objective of defending the international financialised integration of both national and foreign capital despite potential detriment to the domestic real economy and increased financial vulnerability (we return to this in the South African case in Chapter 6). This has gone hand-in-hand with the preclusion of other policy alternatives, such as capital controls. Even the post-crisis limited acceptability which capital controls have gained (Ostry et al. 2010) highlights how financialisation constrains policy. In this context capital controls are advanced to ameliorate symptoms of the crisis (and financialisation), such as financial contagion, rather than allow for a curtailment of financialisation; in fact ameliorating the symptoms serves to entrench the underlying

logic of financialisation. The limited permitted policy instruments available seem inadequate to protect domestic economies.

While monetary authorities are increasingly expected to act in accordance with the interests of international financial actors, UNCTAD (2015a, pp. 28, 38) argues that “fiscal policy is similarly limited by a compulsion to maintain a finance-friendly public policy stance, which discourages policy intervention on both the expenditure and revenue sides”. This entails lower taxation – due to reduced economic activity, market-friendly taxation, and capital flight, and lower spending. This may produce longer-term effects, such as deindustrialisation. Hardie (2011) argues that government’s borrowing capacity is also reduced due to financialisation as investors ability to exit government bond markets (or short) undermines debt sustainability, increasing debt intolerance, and raising borrowing costs and the likelihood and severity of debt crises. Direct costs can also occur, for instance in Mexico, through a series of bank bailouts, the state had, by 2006, accrued debt to the, then majority foreign owned, banking system of \$100bn (nearly 20% of GDP). In Turkey the total rescue following the 2000 crisis amounted to \$47.2bn, just over 30% of 2002 GDP (Marois 2011). Such socialisation of debt amounts to a transfer from domestic residents to domestic and international capital (the same can be said of global financial integration more broadly) indicating the role of finance, and financial integration, in shaping DTEC state policy.

In sum, we have explored in this section the process and nature of DTEC global financial integration as well as the manner in which this has generated vulnerabilities for those countries. Current vulnerabilities, we have argued, are bound up with the uneven integration of DTECs into international monetary hierarchies. State policy has both facilitated this and been influenced by it in costly ways, while ensuring the terms of global financial integration are protected. Such financial integration in the case of South Africa is the topic of Chapter 7. We now move on from global financial integration to explore other facets of financialisation in DTECs and the way financialisation has reshaped economic relations in those locales.

4.3 The restructuring of social and economic relations at the ‘periphery’

In keeping with our approach in Chapter 3 we turn now to consider, within DTEC domestic economies, the transformation in the operations of capital(s) and households

and the restructuring in the relationships between them. This helps to provide signposts for our South African analysis providing us with examples of what financialisation may look like based on the experience of other DTECs. We see that financial integration shapes the path of domestic financialisation, but that financialisation is broader than this. The transformations in domestic economies we see vary according to the political economy of individual countries and regions, and the nature of their global integration. Despite this heterogeneity, the coercive hand of already-internationalised finance is ever-present and global integration exerts common pressures on domestic economies with significant congruity in the nature of financialisation. In general, the observable phenomena that clearly coalesce in the late 1990s and the 2000s are remarkably similar to those revealed in the case of core capitalist countries, although what precipitates these transformations and how they evolve differ. Because of this, and in a desire to not rehash the analysis offered in the previous chapter, we sketch these while providing examples; unfortunately, this makes the presentation slightly fragmented. Our discussion explores these dynamics by assessing the drivers and nature of transformations in financial and non-financial capitals (Sections 4.3.1 and 4.3.3, respectively), the relationship between them (Section 4.3.4), the role of the state in developing financial markets (Section 4.3.2), the consequences for capital accumulation (Section 4.3.5), and the consequences of financialisation in DTECS for households and workers (Section 4.3.6).

4.3.1 Finance in the periphery

Domestic financial sectors in DTECs have been radically altered. In line with liberalisation and deregulation foreign bank entry has often played an important role. This, dos Santos (2008) and Stein (2010) point out, is a policy actively pushed by the World Bank, other international institutions, and international capital, while it was “generally embraced by domestic policy makers following the many banking and monetary crises taking place between 1994 and 2001” (dos Santos 2013, p. 322). In Latin American this came along with the privatisation of leading financial institutions (Correa and Vidal 2012) and mergers of the remaining locally-owned banks, further consolidating the sector, while pressure mounted to reduce the activities of public and development banks. In many instances, this set the scene for the expansion of, and changes in, the domestic financial sector.

Mexico is a paradigmatic example. Levy-Orlik and Dominguez-Blancas (2016) note that in the late 1990s the four largest Mexican private universal banks came under foreign control, followed by an explosion in total bank assets from 50% of GDP in 1997 to 163% in 2007. This has helped increase levels of market concentration and the setting of oligopolistic prices. In post-crisis Korea, foreign share ownership of the eight large commercial banks skyrocketed from 12% in 1998 to 64% in 2004, with foreign firms holding more than a 50% stake in seven of the top eight banks. In many instances the first buyers of Korean banks were private equity firms, who bought the banks at rock-bottom prices while the government absorbed the bad debt, and then sold them at many multiples of the purchase price (Crotty and Lee 2005, p. 425). The Turkish crisis of 2001 also smoothed the way for “government-authored regulatory changes, forced mergers, [and] bank takeovers” (Marois 2011, p. 179) which led to 40% foreign ownership by 2007 (Ergüneş 2009, p. 21). Ćetković (2011) shows that foreign banking entry – particularly by other E.U. banks – has also been pronounced in the Balkan countries of Bosnia and Herzegovina, Croatia, and Serbia (on Brazil, Mexico, and the Philippines see Lapavitsas and dos Santos 2008, for more on South Korea see Cho 2010, for more on Turkey see Karacimen 2014).

Foreign bank entry was motivated by both profit seeking on the part of the foreign banks, and domestic imperatives within DTECs. One aspect of the latter, in line with our previous theoretical and empirical account of financialisation, was, as in the Latin American case, “an increase in demand from local businesses and investors for financial services in foreign currency” (Correa and Vidal 2012, p. 545). This included facilitating trade, capital flight, and debt issuance. Levy-Orlik and Dominguez-Blancas (2016, p. 532) specifically link the internationalisation of Mexican financial markets to the entrance of foreign investment associated with NAFTA and the globalisation of production.

Foreign bank entry brought with it critical shifts. Dos Santos (2013, p. 322) notes that “internationally diversified banking firms relied on mass retail lending to households as a foundation for entry into geographically distant markets in which local banks possessed natural advantages in ‘soft’ information, relational lending”. This highlights a shift in banking technologies, organisation structure, strategic orientation, and practices towards arms-length lending techniques involving ‘hard’ quantitative information, and a

reorientation of credit away from production and towards individuals. Particularly in East Asia, there was a movement away from “state guided, bank-based” financial system towards “globally-open capital-market based” ones (Crotty and Lee 2005, p. 417, see Rethel 2010 in the Malaysian case, see also Lapavitsas 2014, p. 245, Karwowski and Stockhammer 2016).

This has entailed an astronomical rise in consumer lending (mortgages, credit card lending, consumer loans, and ‘payday loans’, the influence of this on households is discussed below). In Estonia, for example, dos Santos (2008, p. 1) points out that by 2004 98% of bank assets were controlled by foreign institutions, and loans to individuals rose from 10% to 46% of all lending between 1995 and 2008. In the Balkans this has meant a rapid expansion of lending and concomitant foreign borrowing (Becker et al. 2010, Ćetković 2011). In Turkey, household debt, as a percent of disposable income, grew seven-fold between 2003 and 2012 (Karacimen 2014, p. 163). Similarly, in Malaysia, household debt to GDP increased approximately five-fold between 2000 and 2006 (Rethel 2010, p. 497, see also Wong et al. 2005). Dos Santos (2013, p. 324) notes that in Brazil and Malaysia the state has actively encouraged household lending including setting targets for mortgage loans for commercial banks to meet, often to low-income borrowers.

This can also be seen from the side of the foreign banks. As dos Santos (2013, p. 322) points out: “In 2007, HSBC and Citi respectively attributed 52% and 76% of all profits in their Mexican operations to their consumer lending segments. Raiffeisen International, which expanded aggressively in Central and Eastern Europe attributed more than 34% of all of its profits to household lending activities.” Such activities are clearly very profitable. In Brazil, for 2006 and 2007, risk-adjusted profitability for banks’ corporate services was estimated to be 16%, whereas it was 39% for retail banking, the latter skewed heavily towards loans to individuals (dos Santos 2013, p. 323).

Foreign-bank entry has also meant a greater orientation towards facilitating financial transactions, fee-generating services, and own trading, as well as prioritising the banking needs of a wealthy elite (Crotty and Lee 2005, dos Santos 2013). The management of capital flows has become a critical source of profits for these banks (Correa and Vidal 2012). They have also played a key role in deepening domestic financial markets; in

Mexico, in line with foreign bank takeover(s), Levy-Orlik and Dominguez-Blancas (2016, pp. 533–534) note the growth in derivative markets from 5% of GDP in 1997 to 126% of GDP in December 2007.⁶⁸ This intertwines with the emergence of new external vulnerabilities as it is often into these markets that foreign investors channel funds. In addition to foreign banks, there has been a large increase in the presence of institutional investors in emerging markets. Combined debt and equity holdings by UK non-bank financial institutions, for instance, has grown from around £50bn in 2001 to almost £300bn in 2010 (Bonizzi 2015); Powell (2013a) highlights international shareholdings in the Mexico case.

Such activity, however, is not solely driven by foreign penetration, and domestic institutional investors have also grown in size and influence with market expansion resulting. In Chile, for instance, it was the privatisation of domestic pension funds that played a significant role in the sharp increases in financial market asset prices (Becker et al. 2010). In East Asia, according to Lee (2012, p. 12), the ownership of a sample of listed companies showed institutional investor shares rising from 9% of ownership in 1997 to 28% in 2006. Mutual funds and sovereign wealth funds played a leading role with the former having a strong presence of Anglo-Saxon fund managers. The Malaysia case is interesting. Rethel (2010) shows how the state-led PNB (*Permodalan Nasional Berhad* – National Equity Corporation) was established as a redistributive tool to increase ethnic Malay – *bumiputeras* – corporate ownership. By the 1990s the BNP was the largest institutional investors after the state-run pension fund. The gradual opening of these funds to non-*bumiputeras* (in 1996) and asset diversification show a pro-market shift with an agenda to draw more and more people into the market.

The large-scale privatisations of both financial and industrial corporates have been of great benefit to large investors. In Slovakia, domestic financial groups thrived on these in the mid-2000s (Becker et al. 2010). Similarly, widespread privatisation of social security, for instance in Slovakia and Mexico, has injected huge capital into financial markets (see Becker et al. 2010, and Marois 2011 respectively). The expansion or creation of new markets has also been critical. Housing and real estate stand out as

⁶⁸ Dos Santos (2008) notes how the securitisation of consumption lending was supported by the World Bank's IFC across DTEC countries.

emblematic, although other consumer lending, such as via credit cards, has been important; in South Korea the latter led to a bubble which burst in 2003 (Cho 2010).

One relatively specific feature of financialisation in developing countries has been attempts to ‘bank the unbanked’ thus drawing poor people into financial markets (see Section 4.3.6). Microfinance has been particularly important and has grown enormously (Bateman 2010, 2012a, 2012b, Bateman and Chang 2012). Mader (2014), in the case of India, argues that microfinance does not reduce poverty but successfully established creditor-debtor relations amongst the poor, creating markets, and financialising civil society actors who are often at the forefront of microfinance. NGOs and credit unions have been replaced by fully-fledged financial institutions. Carroll and Jarvis (2014, p. 540) note that “variants of microfinance are vastly more entwined within international capitalist relations than was the case with earlier microfinance programs”. Microfinance investment funds, Aitken (2010) shows, have become popular with large investors investing in institutions providing microcredit, or more commonly, purchasing securitised microloan-backed assets, creating a bubble-like phenomenon (Wichterich 2012, see Hudson 2008 illustrating similar trends regarding remittances). Meanwhile, microfinance loans have moved from lending for productive activities towards consumption credit and other financial services, and from group to individual lending (in South Africa see Chapters 8 and 10). Together these highlight critical transformations in DTEC financial sectors which, although having differing proximate causes and country specific characteristics, mirror the transformations in developed countries as discussed in the previous chapter.

4.3.2 State-led ‘market making’

In DTECs the state has played a crucial role as a financial ‘market maker’. Most directly, government bond markets have underpinned much of the expansion of domestic markets. In Turkey, like in other emerging economies, such as Brazil and Argentina, Ertürk (2003) stresses the role of government debt in deepening domestic capital markets (see Araujo et al. 2012 on the Brazilian case). Domestic public debt in developing countries has grown from 8.8% of that of developed countries in 1995 to 34.5% in 2005. Over the same period, the debt to GDP ratios of Brazil, Mexico, Korea, and China have risen from 21%, 6%, 9% and 0%, to 53%, 20%, 66%, and 28%,

respectively (Painceira 2009, p. 9, see also Rethel and Sinclair 2014, p. 572). Sterilisation of capital inflows and the accumulation of foreign reserves have played a leading role.

States have also played leading roles in facilitating the expansion of corporate bond markets, with the emerging capitalist economy's share of global debt market capitalisation increasing from just above 5% in 2000 to more than 15% in 2010 (Kaltenbrunner and Karacimen 2016, p. 294). Rethel and Sinclair (2014), for instance, show this across Asia where they argue that bond markets were encouraged in order to deal with the currency and maturity mismatches that played an important role in the 1997/8 financial crisis, and to increase the retention of domestic savings. The three key mechanisms they point to are the establishment (or promotion) of domestic or regional credit rating agencies, the promotion of securitisation, and the creation of Bond Pricing Agencies (BPAs), thus establishing creditworthiness, liquidity, and pricing mechanisms.

The expansion of domestic bond markets also gives impetus to secondary markets in which these bonds can be traded, as well as to derivative markets. States have been instrumental here too. In the case of Malaysia, the Cagamas Berhad (the National Mortgage Corporation) was established in 1986 to broaden homeownership. It has subsequently widened its product range and become the leader in securitisation, as Rethel (2010, p. 499) explains: "Set up foremost as an instrument of social policy, namely to increase the affordability of housing, it has evolved into the single largest issuer of asset-backed securities in Malaysia." Cagamas' largest shareholder – with 20% – is the Malaysian central bank (Rethel and Sinclair 2014, p. 575).

An important aspect of such 'market making', as noted in Chapter 3, has been the withdrawal of the state from social provisioning, privatisation, and changes to pension funds; the first two going hand in hand in many countries. Regarding social provisioning housing stands out as an emblematic example with stress on private property markets creating huge opportunity for speculative investment and increasing household debt (see Van Waeyenberge 2014, dos Santos 2013) (see Chapter 10 for the South African case). Another avenue for the retrenchment of public social services that Carroll and Jarvis (2014) note, has been through public-private partnerships, offering capital the best of both worlds: new markets and often both risk and profit guarantees. International (and domestic) financial capital has benefitted greatly. Becker et al. (2010), for instance, note

that financial actors drove the wave of privatisation in the pre-crisis years in Southeastern Europe and that these were the main drivers of FDI flows.

Critical, and important also in the South African case (see Chapter 8), is the overhaul of pension funds. Usually this involved privatising state pension funds and/or transforming them from pay-as-you-go funds – where the state or incoming pension payments cover pension payouts – to ‘funded’ or capitalised pension schemes in which funds are pooled and invested in financial markets. Becker et al. (2010, p. 233) note how Chile, in the 1980s, was an early experiment in this with money from these private pension funds streaming into local asset markets in the 1990s (see Correa et al. 2012 for a discussion of social security reform in Latin America). In many instances, such changes took place in the 1990s with domestic institutional investors growing in tandem, in both size and prominence. Bianchi and Braga (2005), for instance, point out how such pension reform was an active agenda of the Lula administration in Brazil. The World Bank’s 1994 *Averting the Old Age Crisis* report played a prominent role in popularising such shifts (Hendricks 2008, p. 4). This had important consequences for households (discussed below) but also significantly expanded domestic markets, for instance, Crotty and Lee (2005) point out how in Korea in 2004, national pension funds were mobilised to prop up the stock market. The role of the state in facilitating the transformation in DTEC financial sectors has therefore gone beyond policy changes such as liberalisation and deregulation as they actively sought to create or deepen financial markets.

4.3.3 Non-financial corporations in the periphery

We turn now to consider financialisation of the ‘real’ economy in DTECs. We again note similar trends to those observed in Chapter 3 regarding developed countries. Foreign bank entry and the growth of institutional investors, both already discussed above, as well as the internationalisation of domestic corporations, are key drivers of financialisation of NFCs in DTECs. A key consequence is the restructuring of the productive sector, entailing changes in financing strategies, shareholder value prioritisation, and a fall in productive investment (in the South African case this is discussed in Chapter 9).

Like in developed countries NFCs in DTECs have moved away from a reliance on bank financing, related to the changes in banking discussed above. Unlike large developed-country or multinational firms, Palma (2015) notes, they have not necessarily been able to rely on retained earnings meaning increased market financing. Rethel (2010) shows in Malaysia that this shift is clear from the early 1990s but accelerates after the 1997/8 financial crisis particularly regarding domestically raised funds which occurred in tandem with significant growth in the size of the Malaysian financial system. Likewise, Powell (2013a, chap. 7) shows a significant decline in bank financing in the last decade across Mexican firms of all sizes.

At the same time, Çelik et al. (2015) show that corporate bond issuance for emerging markets has grown fifteen-fold between 2000 and 2013. Much of this growth has occurred after the 2007/8 global financial crisis with DTEC bond financing from international markets rising enormously (often being leveraged into many multiples of its value). The IMF notes that that corporate debt of emerging market NFCs has increased from \$4tn in 2004 to \$18tn in 2014, with the average corporate debt-to-GDP ratio increasing by 26 percentage points (cited in Palma 2015, p. 10, Ergüneş 2009 highlights this in the 2000s in the Turkish case, see also Karwowski and Stockhammer 2016). The occurrence and consequences of this vary. In Asia, Palma (2015) argues, increased corporate borrowing has gone towards real investment and a build-up of excess capacity, while in Latin America and South Africa it was been channelled into domestic financial markets. In both instances, there is real concern that a run on such debt could occur as well as the ever-present risks of currency and maturity mismatches. While we stressed new external vulnerabilities above this indicates the persistence of older forms, in this instance spurred by QE, a hunt for yields, the rise of institutional investors, and foreign bank entry.

A greater engagement of DTEC NFCs within financial markets is also witnessed regarding their assets; they have become active investors in financial markets, particularly in Latin America, Turkey, and South Africa. These funds often originate from capital inflows, indicating the importance of global integration. Palma (2015, p. 7) argues, that these “mostly finance capital flight, a variety of deficits, M&A and all sorts of financial deeds”, as well as commodity extraction industries, although without beneficiation. Demir (2009a) shows the expansion of financial assets, especially short-

term, by NFCs in Argentina, Mexico and Turkey; Powell (2013a), in the Mexican case, associates these with carry-trade operations.

Importantly, DTEC NFCs have also been transformed due to internationalised production and their role within global value chains. The share of global value-added taking place in non-OECD developing countries, for instance, has risen from an average of 16% between 1970-1974 to 20% between 2010-2013 (UNIDO 2015, p. 32). At the same time, the WTO shows “stark asymmetries”, with DTECs’ share as suppliers within these chains, far greater than for advanced developed countries; the consequences of this are discussed below (Baldwin 2013, p. 20). Inward FDI, discussed above, has been a means through which the financialised operational and governance modes employed by foreign corporations have been transmitted to DTEC NFCs. The outward internationalisation of domestic capital has also been important. According to UNCTAD the share of developing countries’ FDI outflows increased from 5% in 1990 to 30% in 2012 (Kaltenbrunner and Karacimen 2016, p. 295).

This has been advantageous to some, particularly large, DTEC domestic corporations (as is shown in the South African case in Chapter 9). As Hiratuka and Sarti (2011, cited in Kaltenbrunner and Karacimen 2016) show with regard to Brazil, such FDI outflows were driven by firm strategies to become ‘global players’. This often took the form of M&As rather than establishing new international productive capacity, mimicking the financialised behaviour of large developed countries multinationals. Domestically, this involved a restructuring of production with large NFCs shifting away from employment-intensive production, such as textiles, towards highly profitably resource sectors or resource-based manufacturing (Ergüneş 2009, Kaltenbrunner and Karacimen 2016). This is by no means uniform across DTECs, often depending on the economic openness of the economy and the size, type, and sector of NFCs (Correa et al. 2012, Levy-Orlik 2012, Powell 2013a).

4.3.4 A market for corporate control?

Like in developed countries the transformations in financial markets, and financial and non-financial capital, have exerted new imperatives. There is some evidence that shareholder value maximisation pressures have come to be exerted over DTEC NFCs, although the number of studies interrogating this is very limited. Crotty and Lee (2005,

p. 422) note such shareholder value maximisation pressures in South Korea, where dividend payouts to foreigners, for example, rose from \$0.4bn in 1998 to \$3.1bn in 2003, together with increased share buybacks and cash holdings. As in the developed world, structures of executive pay have contributed towards managers seeking rising short-term stock prices. High real interest rates have also contributed towards increased interest payments. In Turkey, Ertürk (2003, p. 198) notes that the cost of domestic financing rose as high real interest rates increased due to inflation targeting and monetary policy choices discussed above; the net interest burden for the largest 500 NFCs rose from 6% of nominal sales in 1996 to 8% in 2001.

In the Malaysian case, Rethel (2010, p. 530) argues that “BNP’s investment decisions were [originally] based on ethnical strategic considerations, [but] nowadays increasingly performance-orientated investment and management strategies are pursued”. Such has occurred following an active shareholder value maximisation agenda, both locally and internationally. As noted by Ertürk (2003, p. 188): “major US and UK institutional investors ... led, in 1995, an initiative ... to promote international practices of corporate governance that would prioritise shareholder value [in the developing world]”. Hardie (2008) argues that international investors generally display less interest in domestic companies’ operations and enjoy greater ease of exit.

The increased listing of companies on stock exchanges has been an important facilitating factor. In East Asia, Lee (2012, p. 7) points out that the number of companies listed on the Tokyo stock exchange grew from 1 865 in 1997 to 2 416 in 2006, in South Korea it more than doubled from 776 to 1 689 over the period. This, of course, intersects with the patterns of capital flows and vulnerabilities discussed above as portfolio flows enter these markets. It has also occurred in tandem with changing evaluation metrics (as in the developed world), with Rethel (2010, p. 495) stressing the increased importance of credit scoring. The associated short-termism has consequently pervaded DTEC markets; in South Korea, for instance, in 1999 the average holding of corporate stock was less than 4 months (Demir 2009a).

While the above highlights some evidence that large investors have been critical in fostering a market for corporate control in DTECs (with the consequences discussed in

Chapter 3) this is by no means uniform. In the case of South Korea, Doucette and Seo (2011, p. 12) argue:

“Instead of seeing a universalized shareholder value regime of corporate governance, financialization in South Korea has led to an uneven economy with some sectors more prey to shareholder power from foreign financial funds engaging in asset stripping and strategic sell-offs, while others have merely used stock ownership as a means to strengthen the control of family-led firms, or Chaebol.”

While we did not discuss family-led firms in Chapter 3, this is congruous with our analysis there that highlights how avenues through which domestic corporations are disciplined vary – with the ‘portfolio view’ in a market for corporate control being only one of those. There is little literature on the subject in DTECs but this presumably relates to patterns of corporate ownership, which are heterogeneous. In Aguilera et al.’s (2012) study the share of ownership held by industrial firms in Brazil fell from 46% in 2004 to 34% in 2008 with institutional investors increasing from 10% to 15% and banks from 25% to 32% (the percentage growth being most pronounced for institutional investors). However, in Chile the shares remained constant with 72% ownership held by industrial firms. In South Korea government ownership plummeted between 2000 and 2009 from 13% to 1.5% with a drop in the already small share of ownership held by industrial firms (20% to 17%). By contrast individual ownership rose from 38% to 50% and the institutional investor share was constant at 16%. Control is still commonly exercised by powerful families even where they are not majority owners (Aguilera et al. 2012).

Besides for the general increase in foreign ownership there are few studies into how these firms are embedded into global ownership networks (as discussed in Chapter 3) although it is highly likely that large financial sector institutions have made up the lion’s share of foreign ownership. Despite heterogeneity, the common trends which emerge in the 1990s can be summed up as: a. a fall in state ownership (privatisation) – although public pension funds in South Africa and Malaysia are amongst the world’s largest (discussed in Chapter 8); b. increases in foreign ownership; c. increases in financial

sector ownerships; d. high levels of concentration.⁶⁹ Further research is therefore required, in a country-specific context, to understand how ownership restructuring, associated with financialisation, has altered the relationships between financial and industrial capital.

4.3.5 Consequences for accumulation

In line with the trends described, domestic patterns of production and accumulation have shifted. Neither the liberalisation of financial flows nor the deregulation of domestic financial sectors have brought the promised gains. We noted in the previous chapter that recent research indicates threshold effects after which ‘too much finance’ hurts economic growth; this holds for middle-income countries also (Samargandi et al. 2015). Similarly, capital account liberalisation has not been shown to be growth-enhancing (see for example Rodrik 1998, Prasad et al. 2007, and Kose et al. 2009, see also Obstfeld 2009). This is particularly the case with developing countries, for which Demir notes that the net effect of financial liberalisation is: “higher real interest rates, persistent credit rationing, lack of long-term credit [...] and increasing risk and uncertainty in key macro prices”. Further there is “increasing evidence suggesting that during this period, “financial markets lowered growth, eroded profitability, and shortened the planning horizons of the large NFCs” (Crotty 2005: 7; see also Demir 2007)” (Demir 2007a, pp. 353–354). This is not simply the case because finance has expanded – we noted in Chapter 2 the centrality of credit and the financial system in sustaining and expanding capitalist accumulation. Rather it is the extent and nature of this growth and the manner in which non-financial capital has become integrated into financial markets.

Global integration has had varying consequences for both the domestic and financial sectors. It required large internationalised NFCs to engage in currency and financial markets to hedge risk, thus developing financial expertise and opening up space to take advantage of high returns in financial markets and speculative activity. The subordinate position of local firms within global value chains has allowed leading MNCs to play firms, countries, and suppliers against each other and hence shift the burden of cost

⁶⁹ In Aguilera et al.’s (2012) study high levels of concentration were present in Brazil, Chile, South Korea, the Czech Republic, and Hungary but less so in Poland in the late 2000s (2004 – 2008).

reduction onto suppliers. This has meant that workers bear the brunt (Serfati 2008). Froud et al. (2014), for instance, show how the labour share of value added is extraordinarily low in low-wage manufacturing locales like China. Such a position in GVCs has also closed avenues for development. Whereas supplying inputs or basic commodities such as textiles previously offered developing countries a foot on the ladder towards developing higher value-added industries, this is no longer necessarily the case.

A key consequence of global integration and financialisation in DTECs has therefore been the restructuring of the DTEC real sectors with a noticeable, although not uniform, negative impact on real investment. Demir (2007a, 2009b, 2009a), focusing on Argentina, Mexico, and Turkey, shows that increased uncertainty, raised real interest rates, and increasing exchange rate and capital-flow volatility, together with a lack of availability of long-term credit, increased competition in goods markets, and the presence of high returns in financial markets, have precipitated altered investment decisions by NFCs. In Turkey financial investment has helped cushion NFCs from the impact of these negative financial shocks but at the same time the rise in liquid short-term assets has reduced spending on long-term fixed investment projects and shifted firms away from manufacturing (Demir 2009b). In Argentina and Mexico, increases in short-term capital flows raised the financial assets to fixed assets ratio (not in the case of Turkey) as did FDI in all three countries, the latter calling into question the assumed positive impact on real investment of FDI flows (Demir 2007a). Palma (2015, p. 11) shows, that the link between FDI flows and investment in real capacity is very weak in Latin America. Demir (2007a) also found that in all three cases, increases in short-term capital inflows increased financial profits more than operational ones. Finally, in Argentina and Mexico a negative relationship is found between financial profits and private investment, whereas in Turkey the relationship is positive but financial profits have an almost fifteen times smaller economic effect on fixed investment than operational profits (Demir 2007a). In the cases of Mexico and Turkey, Demir (2007b, 2009c) shows that increasing financial investments have had a deleterious effect on real sector investment whilst contributing to maintaining high profits.

Similar findings of the negative effect of total financial payments and the share of profits from financial components on real NFC fixed investment are present in Korea

(Shin 2012), as is their negative effect on R&D investment (Seo et al. 2012); this is also shown in the Malaysian case by Tan (2013). In Malaysia, market financing has also strongly favoured large established firms, with good credit history and often close links to government over small and medium enterprises (Rethel 2010). Similarly in Mexico, small- and medium-sized firms have had reduced access to credit (Powell 2013a). Garcia-Arias (2015) also argues that financialisation has diminished international financing for development.

A number of studies have cited a ‘crowding out’ – whereby financial investment reduces real investment – as a leading driver of these outcomes. Demir (2009a) notes that long-term fixed investment is shaped by the rate of return in financial markets (in comparison to returns in the overall economy) as well as by economic uncertainty. In Mexico, according to Correa et al. (2012, p. 268), the “active financial operations by the largest domestic firms” mean that “sales, operations, and investment strategies were administered under the parameters of profitability obtained in financial markets”. This has led many NFCs to invest in financial markets rather than productive capacity resulting in a fall in investment; Araujo et al. (2012) note this in the Brazilian case.

Another manifestation of this specific to DTECs is the role of domestic government bond markets (discussed above). In Turkey, Ertürk (2003, p. 119) shows that in the 1990s the share of government bonds in the total assets of banks increased from 10% to 23% while the share of loans to the private sector fell from 36% to 24%. Crotty and Lee (2005) noted the same in South Korea with funds also channelled towards other asset markets.⁷⁰ This was associated, in South Korea, with increased foreign ownership and FDI channelled towards M&A rather than new capital investment – changing ownership trumped real investment. The threat of foreign takeover also drove the holding of more cash, distribution of higher dividends, and increased share buybacks by South Korean NFCs (Crotty and Lee 2005); this, Kalinowski and Cho (2009, p. 89) note, “impeded productive investment”.

Araujo et al. (2012) also point to another underlying reason for diminished investment, again specific to DTECs: that a ‘Dutch disease’ effect has occurred due to a real

⁷⁰ The evidence from Mexico is contradictory, see Levy-Orlik and Dominguez-Blancas (2016, p. 535) in contrast to Crotty and Lee (2005, p. 428) and Correa et al. (2012).

appreciation of the currency (occurring in relation to capital inflows). Combined, these have contributed to deindustrialisation and a decline in industrial production in Brazil (Araujo et al. 2012). Across DTECs, where present, this ‘Dutch disease’ has funnelled funds towards mineral extraction or into non-tradable sectors, most obviously real estate, and into domestic asset markets more generally.

Many studies have pointed to the role of foreign banks – which have preferred lending to governments and households – in reducing lending to NFCs. Stein (2010, p. 264) notes: “The initial econometrics illustrates that in four countries (Peru, Columbia, Argentina and Chile) foreign ownership [of banks] is overwhelmingly associated with slower growth and a lower share of lending to small businesses.” In South Korea, between 1998 and 2003, foreign banks slashed corporate loans as a percent of total loans by a stunning 33 percentage points with domestic banks following suit with a 25 percentage point cut (Crotty and Lee 2005). This is related to foreign banks turn towards consumption lending. As noted in Chapters 8 and 10, and stressed by dos Santos (2013) regarding middle-income countries, consumption credit can reduce productive investment while increasing leverage, demand-pull inflation, and credit and monetary instability.

Foreign banks have also been critical in creating exposure to external vulnerabilities through currency mismatches; this is particularly the case in transition countries in Eastern Europe (see Gabor 2010), as well as to “channeling the effects of the global financial crisis into emerging markets” (Bonizzi 2013a, p. 91). In Mexico, for example, Correa et al. (2012) show the latter occurred through extensive repatriation of profits that further weakened domestic credit. The repatriation of profits, outward FDI, and capital flight have also contributed towards lower real domestic investment. Crotty and Lee show this to be the case in South Korea, for example, foreign ICT companies “repatriated 98% of profit in 2002 with almost no domestic or R&D spending” (2005, p. 422) while wealthy elites have sent money abroad. In Latin America a full \$1tn has left the region as repatriated profits by multinationals (Palma 2015, p. 12). It is clear therefore that the changes in the structure of the financial and productive sectors, as well as international financial integration, have had deleterious effects for capital accumulation (many, although by no means all of these trends are witnessed in the

South African case in Chapter 9); finally, we show negative consequences arise also in the case of households.

4.3.6 Households and workers in the periphery

The inclusion of households into financial markets in DTECs has been both remarkable and important. Dos Santos (2013, p. 317) shows, that as a share of total bank loans, household loans in Brazil and Turkey grew from approximately 7% in 1994 to almost 45% in the late 2000s. In Poland household loans go from around 15% in 1997 to over 50% in 2011, and in Mexico from just over 15% in 2000 to almost 45% prior to the global financial crisis. As a share of disposable income, household debt in Turkey rose from 7.5% to 29.5% between 2003 and 2007 and interest payments from 2.1% to 4.6% (Ergüneş 2009, p. 24). In South Korea, as a percent of GDP, household debt grew rapidly from 41% in 1998 to 74% in 2002 (Crotty and Lee 2005, p. 419); by this measure household debt is particularly high in East Asia and South Africa (Karwowski and Stockhammer 2016, p. 28).⁷¹ In most DTECs the majority of this lending is made up of housing loans. However, there has also been a growth in credit card and other consumption loans, including predatory ‘payday loans’ and microcredit (in South Africa see Chapter 10).

Such lending has contributed towards rising asset prices, particularly real estate booms (as Becker et al. 2010 point out in the case of Slovakia) as well as the securitisation of these loans and expansion of secondary markets. This has also resulted in various credit crises. In South Korea for instance, an outbreak of defaults devastated the credit card industry in 2003 (Crotty and Lee 2005). Household integration within financial markets is also bound up in broader patterns of social reproduction. Dos Santos (2013, p. 317) argues that, as in the developed world, in middle-income countries this shift towards household lending has become “the central means through which households gain market-based access to services in housing, health-care, and education”. In a number of instances, as noted above, governments actively created or promoted these markets. Similarly, the expansion of institutional investors, and the channelling of household

⁷¹ On Eastern Europe and the Balkans see Becker et al. (2010), Gabor (2010), and Četković (2011); on South Korea see Cho (2010); Paineira (2012) on Brazil; and on Turkey see Karacimen (2013, 2014, 2016).

savings into these, has been actively advanced (for example see Bianchi and Braga 2005 on the Brazilian case).

Financialisation has also had important consequences for inequality and workers' livelihoods in DTECs, which can be viewed on three levels. First, there are direct distributional consequences. Regarding the functional distribution of income, labour shares have fallen across the globe with income from profits generally more unequally distributed than income from wages. Regarding the personal distribution of income, booming CEO pay and repressed real wages for the majority have increased inequality. Such stagnant wages have depressed demand and contributed towards rising debt. This lending, like in the US, has been important to sustaining aggregate demand but, as Crotty and Lee (2005) point out, the debt burden eventually constrains future spending and can lead to economic contraction.

Second, the marketisation of social services can reduce access to basic services for the majority, as well as carrying considerable costs, both individual and social. For example, Sumaria (2010) shows that in developing countries approximately one third of pension contributions are kept by fund managers through fees and commissions. This occurred in tandem with a shift away from defined benefit schemes towards defined contributions but variable benefits based on investment performance, thus exposing households to financial market fluctuations. Rethel (2010, p. 498) notes that "never has access to finance been so decisive for both social mobility and entrepreneurial success". Third, financialisation has occurred in tandem with the restructuring of work and production. In South Korea, for instance, 'irregular' jobs – including temporary contracts and part-time jobs – reached 56% of total employment, the highest in the OECD (Crotty and Lee 2005, p. 420). Financialisation also impacts employment, Demir (2010), for instance, shows that raised exchange rate volatility lowers employment growth in Turkish manufacturing firms. Pressures towards shareholder value maximisation have not only casualised work but also compressed wages (see Lee and Cheng 2011 in Hong Kong, and Correa et al. 2012 for Mexico). These three dimensions – (unequal) market inclusion, the financialisation of social services, and changes in the nature of work – structure our discussions of households in South Africa in Chapter 10.

4.4 Conclusion

This chapter has reviewed the manner in which financialisation has taken hold in developing, transitioning, and emerging economies. This process has roots in the liberalisation and deregulation beginning in the 1980s, gains momentum in the 1990s, and appears sharply in the 2000s. It manifests differently across country and region with the domestic political economy and nature and scope of financial integration being particularly salient (similarly, different stakeholders within each domestic economy are impacted differently). The internationalisation of DTEC financial and non-financial capitals as well as growth of domestic financial markets, have been critical. Central also has been the growing influence of international financial markets, in particular via capital flows and foreign bank entry, and the increasing presence of multi-national corporations.

While the financialisation of the capitalist core was driven by the interests of its own capitalist enterprises – both financial and non-financial – the coercive hand of international finance, external to DTEC countries, has been far more apparent in the financialisation of the ‘periphery’. Domestic capitals have benefited but financialisation has been highly effective at facilitating the appropriation of surplus from the periphery to the core via financial markets. DTEC states, particularly through their central banks, have actively fostered the financialisation of their economies, while policy itself has been shaped by the imperatives of financialisation with deleterious consequence for development. Together this has meant that financial market imperatives have come to play a determining role in the economic, social, and political life of DTECs, bringing new vulnerabilities, and shifting patterns of capital accumulation. This chapter forms a critical basis for our forthcoming analysis of financialisation in the South Africa case, to which we now turn.

5 THE MINERALS-ENERGY COMPLEX AND THE EVOLUTION OF SOUTH AFRICAN FINANCE

5.1 Introduction

Financialisation, we have argued in the previous chapter, is variegated and the specific political economy of each locale – and the manner in which this interacts with global integration – plays a critical role in its presence and extent, and in structuring its nature. In the South African case, we approach the specific political economy on the basis of the ‘Minerals-Energy Complex’ (MEC) (Fine and Rustomjee 1996), and this chapter interrogates that, laying the foundation for our forthcoming analysis (in particular in Chapter 9). Section 5.2 defines the contours of the MEC unpacking what it means as a system of accumulation, how it explains South Africa’s economic development, and briefly touches on its relationship to racial exploitation and apartheid. This is followed, in Section 5.3, by a more detailed analysis of the evolution of the South African financial system and related policy in the context of the MEC. Section 5.4 then brings together the preceding, exploring how the integration of mining, industrial, and finance capital is critical to both understanding the MEC and laying the foundation for post-apartheid financialisation.

5.2 Defining the contours of the MEC

5.2.1 The MEC as a system of accumulation

At the heart of South Africa’s economic development has been the country’s mineral wealth. Since the discovery of diamonds (1867) and gold (1886) and later coal, platinum, magnesium, chrome, vanadium, and other ferrous and non-ferrous metals, the interests of mining houses have dominated the economic landscape and determined the path of economic (and social and political) development. This led Fine and Rustomjee (1996) to posit the existence of a Minerals-Energy Complex (MEC). In sectoral terms the MEC has at its heart sectors relating directly to minerals and energy and other closely intertwined manufacturing sectors with strong upstream, downstream, and horizontal relationships (these range from explosives to steel processing).⁷² The MEC, however, is

⁷² The various dimensions to which the ‘MEC’ refers can give rise to confusion. Here ‘core MEC sectors’ or just ‘MEC sectors’ refers to those sectors that comprise minerals, energy, and other sectors deeply

more than a set of sectors, it refers to an evolving system of accumulation specific to South Africa. This means the MEC captures dynamics beyond the productive processes of core MEC sectors and reaches into adjoining supply chains, labour markets, public infrastructure, and financial services, as well as conditioning the relationship between private capital and the state and the formation and implementation of macroeconomic and industrial policy; thus powerfully shaping the economy at large (Fine and Rustomjee 1996, Fine 2009d).⁷³

Two further underlying dimensions help us understand the MEC thesis. First, it sought to slay the two holy cows of economic historiography of South Africa “that (flawed) industrialisation took place through protection of consumer goods, and that industrial policy was essentially a matter of tariff protection” (Fine 2009d, p. 38). Instead, industrialisation (and industrial policy) revolved around the imperatives of the core MEC sectors. Second, it was premised on a methodological approach that took a series of ‘linkage-agencies’ as axiomatic. The MEC, therefore, cannot be reduced to any set of institutional forms that may embody its dynamics at a given time; rather it is “the historically shifting form of linkagencies taken by the accumulation of capital in and around South Africa” (Fine and Rustomjee 1998, p. 691). This means that it fundamentally refers to a set of relations – between capitals and capital and the state (labour should be added) – that can be embodied in different institutional formations.

5.2.2 English and Afrikaner capital, economic development and the MEC conglomerates

The institutional expression of the MEC was, by the end of apartheid, six massive conglomerates, most comprising of intricately intertwined mining, industrial, and financial arms, and themselves connected through various cross-holdings and shared interests. The ownership structure of the six major conglomerates in 1988 is given in

entwined (as above) (see Fine and Rustomjee 1996, chap. 4), *MEC manufacturing sectors* refers to the sectors within the MEC sectors usually classified as manufacturing, ‘MEC related activities / production’ can refer to activities in other sectors taking place due to a connection with the MEC sectors, and ‘the MEC’ refers to the system of accumulation itself.

⁷³ The MEC is developed in Fine and Rustomjee (1996) and contextualised in Fine (2009d). It is also discussed in Roberts (2000a), Mohamed and Finnoff (2004), and Takala (2000a). For a critique see: Bell and Farrell (1997) and Bell (1998), and a response: Fine and Rustomjee (1998). For an excellent exposition on how the MEC thesis fits in South African historiography see Freund (2009). For recent discussion of the MEC and financialisation see Ashman, Fine et al. (2013) and Ashman, Mohamed et al. (2013).

Table 5.2, highlighting their highly diversified interests and the links between sections of capital. Table 5.1 summarises the six ‘capital axes’ that emerge and gives their market capitalisation demonstrating a huge degree of market concentration within these conglomerates, collectively owning 83% of market capitalisation in 1988. What concerns us here is unravelling how this came to be and the dynamics between these sections of capital, as it is upon this basis that we enter the period that is the prime consideration of this thesis. The path is chiefly shaped by the shifting contestations and alliances between English and Afrikaner capital and the state, and between mining and financial capital.

Table 5.1 Six ‘axes’ of the MEC (summarised) (1988)

‘Axis’	JSE market share (%)	Component parts
AAC	49.5	Southern Life, First National Bank, First Corporate Bank (no building society), AMIC, Amgold/Amcoal/De Beers/JCI
Sanlam	10.8	Sanlam, Trust/Santam Bank, Senbank (no building society), Gencor, Malbak
SA Mutual	9.8	SA Mutual, Nedbank, UAL/Finance Bank, Per Building Society, Barlow Rand, Rand Mines.
Rembrandt/Volkscas	7.6	Lifegro/Federated Life, Volkscas/Boland, Rand Merchant Bank, United Building Society, Remgro, GFSA
Liberty/Standard	2.6	Liberty Life, Standard Bank, Standard Merchant Bank (no building society; no direct mining/industrial arm)
Anglovaal	2.2	Relative independence of financing with some Sanlam and SA Mutual influence in mining and industrial holding companies.

Source: Fine and Rustonjee (1996, pp. 103, 108)

Table 5.2 Conglomerate structure (1988)

	Non-Financial		Financial**		Control
	Mining	Industrial*	Bank or building society	Long-term insurance group	
Anglo American Corporation (AAC)	Amgold Amcoal De Beers JCI	AMIC AECI Premier Group	First National Bank First Western First Industrial First Corporate Bank	Southern Life	Oppenheimer family
Sanlam	Glencor	Malbak Murray and Roberts Fedvolks Fedfoods Semtrachem	Trust Bank Santambank Senbank	Sanlam	Mutual organisation until 2000s
Stanbic/ Liberty Life			Standard Bank Standard Merchant Bank Stannic	Liberty Life	Gordon family
Rembrandt/ Remgro/ Volkskas	Remgro GFSA		Volkskas Boland Bank Volkskas Merchant Bank Rand Merchant Bank Allied United Building Society (UBS)	Lifegro Federated Life	Rupert family
SA Mutual/ Old Mutual	Rand Mines	Barlow Rand CG Smith Safren Plate Glass CGS Foods Tiger Oats ICS	Nedbank Nedfin UAL Mutual Bank Perm Building Society	SA Mutual	Mutual organisation until 2000s
Anglovaal	Anglovaal	South Atlantic			Mennell and Hersov families
* Only companies with a turnover greater than R1bn are listed					
** Only companies with worth greater than R1bn and where the shareholding is greater than 10% are listed (First Corporate is the exception at R0.8bn)					

Source: Fine and Rustonjee (1996, pp. 106–108) and Chabane et al. (2006, p. 553)

For much of the twentieth century the longest standing, and most powerful, conglomerate was Ernest Oppenheimer's gold mining Anglo-American Corporation (AAC) founded in 1917, which in 1924 became the largest shareholder in Cecil Rhodes' De Beers. De Beers had previously amalgamated diamond production in the Kimberly area and formal cross-holdings were established between the two in 1929 (Chabane et al. 2006, pp. 500–551). These represented the dominance of English capital in the first part of the twentieth century.⁷⁴ English capital continued to dominate economic development in the interwar period, which witnessed an expansion of mining and investment in manufacturing and capital equipment stimulated by the mining sector and an emerging white working class. Some attempt was made to empower Afrikaner capital⁷⁵ but the over-reliance of the economy on the surplus produced from mining proscribed this, as Fine and Rustonjee note: “the inter-war development of South African capital is best seen as one in which the strength of mining capital dictated the boundaries within which national capital could be economically, and hence, politically, supported” (1996, p. 122).

The interwar period also witnesses the emergence of a fissure between political power – first under the Pact and then Fusion governing coalitions – and English economic power. In such circumstances coherent industrial policy was difficult and the context gave rise to conflicts and compromises between different sections of capital – in mining, industry, and agriculture – and white labour on a sector-by-sector basis (Fine and Rustonjee 1996, chap. 6). One element of industrial policy that did bear fruit, and another defining feature of this and subsequent periods, was the creation of large state-owned enterprises (SOEs) centred around the core MEC sectors – Eskom (electricity) in 1923 and Iscor (steel) in 1928 – and the establishment of the Industrial Development Corporation (IDC) in 1940 that would fund successive capital-intensive MEC sector projects.

⁷⁴ ‘English capital’ refers to white capitalists of English extraction, with financial links to England, or English investment abroad. It is largely established in opposition to ‘Afrikaner capital’ referring to white domestic capital from the Afrikaans-speaking community. ‘Afrikaner labour’ is similarly situated in opposition to ‘English’ and ‘Black’ labour. ‘Black’ refers to all non-white South Africans, and ‘black African’ is sometimes used to refer to blacks excluding Coloureds and Indians.

⁷⁵ It is estimated that in 1938 Afrikaner capital owned the following meagre proportion of companies in different sectors: 1% in mining, 3% in manufacturing and construction, 8% in trade and commerce, and 5% in the financial sector (New History 2013).

Fine and Rustonjee (1996, chap. 6) argue that both the industrial development that did take place and the limited nature of an industrial policy able to diversify outside of MEC sectors in a meaningful way, points to the strength of capital in the core MEC sectors. This should not be read to mean they got it all their own way. Regarding labour policy for example, mining capital was opposed to the job colour bar – reserving particular jobs for whites at higher wages – and, in line with this, supported the South Africa Party’s brutal suppression of the 1922 Rand rebellion of white mine workers who sought to protect their jobs against black workers. It was only after this backfired with the 1924 election of the Pact Government that mining capital acquiesced to the job bar although it remained contested throughout apartheid (Lipton 1986, pp. 112–116, Natrass 1988, pp. 74–75).

It was in this context that in 1939 Afrikaner nationalists held the *Eerste Ekonomiese Volkskongres* (First Economic Congress of the People) to develop a *reddingsdaad* (a rescue act) to uplift the Afrikaner poor whites, and accelerate Afrikaner nationalism (Innes 2007). In the opening address L. J. du Plessis defined the goal as mobilising “the volk [the people] to conquer the capitalist system and to transform it so that it fits our ethnic nature” and to create *volkskapitalisme* (capitalism of the people) (New History 2013). Driving forces behind the initiative were the Afrikaner Broederbond and senior executives at the Cape Town-based insurance company Sanlam (see Section 5.3). Out of the *volkskongres* came three institutions: a finance house, a chamber of commerce, and an organisation to implement the *reddingsdaad*. These led to the consolidation of Afrikaner capital’s structure but it was only by gaining political power in 1948 that they were able to fully pursue their agenda.

The empowering of Afrikaner capital was achieved in the main via four groups, three large centralised institutions – Sanlam, Volkskas, and Rembrandt – and the decentralised network of small-scale industrial and commercial enterprises often closely tied to agricultural co-operatives (Fine and Rustonjee 1996, pp. 149–150). Rembrandt emerged as the only large, centralised Afrikaner corporation, originally centred around tobacco, cigarettes, and later alcohol, and closely associated with Afrikaner Cape Town financial capital. Afrikaner finance was centralised within Sanlam – a Cape Town based life insurance company with sizable investment arms – and Volkskas – a Transvaal and Orange Free State based commercial bank that centralised Afrikaner savings and held

the accounts of government, municipalities and state owned enterprises from the 1950s onwards. The buttressing of Afrikaner financial capital was the epicentre of Afrikaner capital's growth in the 1950s and set the scene for its entrance into the MEC proper in the 1960s. Afrikaner labour was uplifted via job reservation, civil service employment, and government welfare policies leading to a substantial increase in standards of living.

The 1950s, 1960s, and 1970s saw the expansion of mining, the extension of the boundaries of the MEC hand-in-hand with the creation of new SOEs (directly within core MEC sectors such as Sasol in petrochemicals or providing necessary support services such as in transportation),⁷⁶ and the funding of non-mining MEC sectors via the state-controlled IDC. These projects also supported the growth of Afrikaner capital that by the 1960s and 1970s had penetrated into the MEC proper leading to the easing of contestation between Afrikaner and English capital. The latter is witnessed, for example, in AAC's assistance to Sanlam's Federale Mynbou (see below), in 1964, in acquiring Genmin, a mining group, and the 1970s coal industry's consolidation and modernisation around AAC's Amcoal, Genmin's TNC, and Rand Mines' Randcoal under government guidance (Fine and Rustonjee 1996, chap. 7). The erosion of this antipathy allowed the state, in the 1970s, to adopt coordinated industrial policy for the first time.

Fine and Rustonjee's thesis is that the antipathy between Afrikaner and English capital had prevented coherent industrial policy. Presumably this is premised on the argument that English mining capital was unwilling to cede its pre-eminence to Afrikaner capital in the process of industrialisation. The resolution of this required the internalising of Afrikaner capital within the existing structures of the MEC thus largely resolving the discord. The nature of industrial development that took place – and the government policies that support it – was therefore biased in favour of capital at the heart of the MEC.

Bell and Farrell (1997, Bell 1998) contest that the MEC thesis downplays the diversification which did occur within manufacturing. It is the case that some non-MEC

⁷⁶ Sasol in coal, oil and gas (1950, largely privatised in 1979), Foskor in phosphates (1951), SATS in transport (a 1981 consolidation of individual transport SOEs), Soekor in oil exploration (1965), Armscor in arms (1968), and Alusaf in aluminium production (1967) (see Ritchken 2014 for a history of a number of these SOEs). Other large SOEs included the Post Office, Land Bank, South African Airways, Telkom (telecommunications), and the Industrial Development Corporation (IDC).

sectors do assume a larger proportion of manufacturing output, for example motor vehicles, and vibrant MVA growth rates, for example food, beverage and tobacco (see Bell and Farrell 1997, p. 603, Table 3). However, this does not undermine the thesis that capital accumulation centred around the core MEC sectors, produced a distinctive pattern of accumulation, and that this stymied coordinated industrial policy in so far as that policy might weaken those sections of capital. Further, a broad base of truly dynamic manufacturing sectors failed to emerge.

The potential for coherent industrial policy following the internalisation of Afrikaner capital within the MEC, was stymied by the mounting crisis of apartheid. Instead, the state shifted its priorities to monetary policy (see Section 5.3.3), especially after the debt moratorium of 1985 and in line with international policy trends, and funnelled its resources into armaments and coal-based synthetic fuel production. As a result of sanctions foreign disinvestment took place at the same time that domestic capital became trapped. The 1980s also saw gains in the gold price meaning substantial surplus funds washing around the South African economy. Given political instability and the limitations of the domestic market, this did not lead to substantial investment in new industries but rather precipitated a spate of acquisitions by MEC conglomerates of industrial and manufacturing enterprises, further concentrating ownership (Fine and Rustomjee 1996, chap. 7, Jones 1992a).

Sanctions also curtailed the ‘natural’ internationalisation of the economy. By virtue of the centrality of mining to South African capital, and the importance of South Africa’s minerals to the world, the MEC conglomerates were always integrated within international trade networks. Rembrandt was the earliest to hold significant international productive assets – by 1961 it had operations in more than a dozen countries – but as the conglomerates grew in the post-war period so they looked abroad for expansion and acquisition. Such ambitions were frustrated by sanctions, exchange and capital controls, and the debt crisis.

In sum, a key dimension of the MEC thesis is that not only has an economic structure centred around minerals and mineral-related manufacturing sectors stunted diversified industrialisation in non-MEC sectors, but that this is underpinned by a particular set of class relations. The disjuncture between English and Afrikaner capital – and between

political and economic power – is sharpest in the interwar period while the post-war period saw its gradual diminution. This was not achieved by dismembering the pre-eminence of the core MEC sectors but by incorporating Afrikaner capital within the MEC. Given some overlap the 1950s saw the strengthening of Afrikaner capital, the 1960s and 1970s a growing compromise between Afrikaner and English capital, and the 1970s and 1980s the interpenetration of the two. This was achieved via the expansion of the MEC both in growing its existing sectors and increasing its scope. The establishment of SOEs within MEC sectors and state funding was crucial. The institutional expression of this was the small number of massive conglomerates highlighted in the tables above. It was only after Afrikaner capital and the Afrikaner government had acquired stakes in the prevailing structure of the economy that coherent and coordinated industrial policy and diversification became possible. By the 1980s such conditions existed but were foreclosed by the mounting crisis of apartheid.

5.2.3 Race, labour and the MEC

The story above says little about another defining feature of South Africa's political economy: racially discriminatory policies associated with colonial rule and apartheid. Apartheid has its origins in the legislative agenda and social mores of the four colonies/republics that combined to form the Union of South Africa in 1910. Most important were measures to enforce social segregation, restrictions on movement, and the colour bar preventing appointments of blacks to skilled or senior jobs. This resulted in a large black urbanised working class, a large black migratory workforce with family homesteads in the Bantustans (many urbanised blacks also maintained familial ties in the Bantustans), a large impoverished rural populace engaged to a substantial degree in subsistence farming, a small black middle class and intelligentsia, and a large pool of poor black migrants from neighbouring countries. The respective weight of these groups changed over time with the latter making up for domestic labour shortages and only waning in the 1970s with black South African population growth (see Nattrass 1988, chap. 3).

Fine (2009d, p. 39) acknowledges a gap in the MEC approach, noting the need to redress “the balance in existing MEC work in its undue pre-occupation with what capital (and the state) did as opposed to the actions of labour, trade unions and other organisations of resistance and change”. Addressing this coherently necessitates

bringing together the existing MEC scholarship and a long-standing debate over the relationship between capitalist development in South Africa and policies of racial subordination, and the various struggles against this (doing so in any depth is beyond the scope of this thesis).

The defining schism in the debate is whether or not these systems (particularly apartheid) were functional or dysfunctional for capitalist development. A liberal view holds that apartheid policies inhibited modernisation and economic development based on free product and labour markets and international integration (to differing degrees see for example Lipton 1986, Nattrass 1988). A similar position is possible from an orthodox Marxist perspective, albeit without endorsing the social desirability of a capitalist economy, in so far as racist policies act as fetters on progressive economic development (for example Simons and Simons 1969 cited in Freund, 2009). Contrary to this, most Marxist scholars (the ‘Marxist revisionists’) have contested that apartheid (and colonialism) was functional to capitalist accumulation in particular via generating cheap labour and subsequently high profits (see for example Legassick 1974, 1976, Wolpe 1974, 1990, Legassick and Wolpe 1976). There are, of course, also the apologists for the apartheid regime who – in endorsing the system explicitly, tacitly, or by omission – see capitalist economic development thriving under the system of racist controls (see for example Norval 1962, Houghton 1964 cited in Freund, 2009).

This is a thorny issue as it requires a conceptualisation of the relationship between the state and capital and the extent to which the state pursues interests other than those of capital. The position taken here is that the evidence suggests that the racial segregation and domination imposed by British imperial and then Afrikaner nationalist rule did (for most of its existence) provide a functional environment within which capital accumulation could flourish. It was also compatible with the development of the MEC in terms of the provision of cheap labour that could be easily relocated as mineral deposits were discovered, while stunting any potential competitive challenge that may have emerged from black capital. Further, it is precisely when it was no longer functional to the interests of big capital that it entered into dialogue with the ANC seeking a resolution to the anti-apartheid conflict. However, this does not mean that apartheid was a necessary imposition for successful capitalist development post World War II or that it did not incur economic costs as well as benefits. Further, at times state

ideologues have exercised a relative autonomy in imposing race-based policies even when these were not in the interests of any section of capital, although the protection of Afrikaner labour goes some way towards explaining this. While the MEC thesis offers a compelling understanding of the trajectory of economic development in South Africa there is a need to incorporate a deeper analysis of the role of racial oppression regarding both its social and economic dimensions. This is a task beyond the remit of this thesis and we now return to the MEC and the role of finance therein.

5.3 The development of finance

It is already clear from Section 5.2 that finance is central to the MEC. Table 5.3 and Table 5.4 give the market capitalisation and corporate ownership of key financial institution in the dying days of apartheid (essentially viewing the economic structure shown in Table 5.2 from the vantage point of the financial sector). Three critical things stand out. First, there is a high degree of concentration of assets in a few hands, particularly regarding commercial banks. Second, in addition to a strong influence from mining, long-term insurers – Sanlam, SA Mutual, and Liberty Life – play a large role in market ownership, both of financial institutions and of industrial enterprises (the latter not shown here). Unfortunately, there is little data compiled to date on the role of private pension funds under apartheid. Third, the large degree of cross-holdings encapsulated by the six ‘capital axes’ (Table 5.1) is once again visible.

This structure is the product of the evolution of the South African financial system within the MEC and both the politics and policies that shaped it. Given the focus of this thesis we review this history in some depth. Doing so provides insight into: the structure of the financial system, for example, the high levels of concentration; the central actors, for example, the large commercial banks and institutional investors; and the development of financial markets, as well as providing insight into the development of monetary policy. These dimensions are foundational to our empirical analysis in subsequent chapters.

Table 5.3 Banks, building societies and the state financial sector (1988)

	Assets (Billions of rand)	Major shareholders
Commercial banks		
First National Bank	24.9	Anglo American Corporation
Standard Bank	19.9	Liberty Life/SA Mutual/Rembrandt
Trust Bank	12.8	Sanlam
Volkscas	10.3	Rembrandt/UBS Holdings
Nedbank	8.9	SA Mutual
Other	5.9	
	82.7	
General banks		
Santambank	5.7	Sanlam
Stannic	5.2	Liberty Life/SA Mutual/Rembrandt
First Western	4.4	Anglo American Corporation
Boland Bank	2.2	Rembrandt/Volkscas/Lifegro/Sanlam
Allied Bank	2.1	Minority shareholders/Rembrandt
First Industrial	1.9	Anglo American Corporation
Nedfin	1.7	SA Mutual
French Bank	0.8	n.a.
Volkscas Industrial	0.7	Rembrandt directors
Syfrets Bank	0.5	SA Mutual
United Bank	0.5	Minority shareholders
Other	2.4	
	25.7	
Building societies		
UBS	10	Minority shareholders/Volkscas
Perm	6.8	SA Mutual
Allied	6	Minority shareholders/Rembrandt
NBS	3.1	Minority shareholders
Saambou	2	Minority shareholders/Volkscas/Sanlam
Other	8.1	
	27.9	
State sector		
Official funds	31.3	
PIC	27.8	
Land bank	9.2	

Source: Fine and Rustonjee (1996, pp. 106–107)

Table 5.4 Merchant banks and institutional investors (1988)

	Assets (Billions of rand)	Major shareholders
Merchant banks		
Senbank	1.5	Sanlam
Standard Merchant Bank	1.1	Liberty Life/SA Mutual/Rembrandt
UAL Merchant Bank	1.1	SA Mutual
Volkskas Merchant Bank	1.1	Rembrandt/directors
Rand Merchant Bank	0.9	Rembrandt/Allied Bank
First Corporate	0.8	Anglo American Corporation
Investec	0.8	Directors/staff
Finansbank	0.7	SA Mutual
Corbank	0.5	Directors/Sanlam
	8.5	
Long-term insurers		
SA Mutual	33.2	Unlisted
Sanlam	18.4	Unlisted
Liberty Life	14.8	Standard Bank/Donald Gordon
Southern Life	9	Anglo American Corporation
Lifegro	3.9	Rembrandt/Volkskas
Federated Life	2.7	Volkskas
Other	4.4	
	82	
Pension/provident funds	38.9	

Source: Fine and Rustomjee (1996, pp. 106–107)

5.3.1 Financial sector origins

Private banking began in what is now South Africa in 1823 with British banks playing a leading role. By 1910, following a series of banking crises, mergers, and the formation of the Union of South Africa that year, two British banks – Standard Bank and the National Bank of South Africa – dominated the domestic market. With the acquisition of National Bank by Barclays Bank the domination of British banks in South Africa was secured (Verhoef 2009), and the sector remained dominated by British/English capital until the mid-1980s (Barclays became First National Bank as shown in the table above), with a British approach to banking predominating and changes often mirroring those taking place in Britain (Jones 1992a).⁷⁷ These banks predominately serviced the needs of

⁷⁷ For example, South Africa never enacted the US Glass-Steagall distinction between commercial and investment banking. Similarly, the reregulation of building societies, in the 1980s, and their mergers with commercial banks, mirrors changes that took place in Britain (see Isaacs 2016c).

large, particularly mining, capital and the more affluent (English speaking) populace. Together with the Netherlands Bank for South Africa, which was established in 1888 but remained peripheral until after World War II (Verhoef 1992a), these formed the 'imperial' banks.

Afrikaner nationalists, as noted above, established Volkskas Bank in 1934 as a people's saving bank on a cooperative basis (along the lines of the German cooperatives) to provide savings and loans to the relatively poor and largely rural Afrikaner populace. It grew successfully opening 53 branches between 1935 and 1947, experiencing phenomenal growth in assets, deposits, and loans. In 1939 it became a fully-fledged commercial bank and began to offer current account facilities, injecting new competition into the commercial banking sector (Verhoef 1992a). The founding of Volkskas was preceded by the establishment, in 1918, of two other Afrikaner nationalist financial institutions, Santam and Sanlam, providers of general insurance and life insurance, respectively. While also exposing an agenda of uplifting the Afrikaner everyman and contributing towards national development, their nationalism was more tempered with closer links with English capital. Santam and Sanlam entered an already vibrant insurance market with more than 20 insurance companies in the Cape alone (Verhoef 2008). The oldest of these was SA Mutual which begun as *The Mutual Life Assurance Society of the Cape of Good Hope* in 1845, serving as a section of English capital.

The Johannesburg Stock Exchange was formed in 1887 during the first South African gold rush. Until the late 1950s it predominately served as a market for trading shares in large South African mining corporates – with notable additions of non-mining companies, such as SA Breweries (1897), Portland Cement Company Ltd (PPC) (1910), Sappi (1937), Barloworld (1941), and Tiger Brands (1944) (JSE 2016). Until the late 1950s cash flow generated through mining was placed in London and European markets with the South African financial market underdeveloped and unsophisticated (Jones 1992b, p. 277). Financial markets were also unregulated until 1947 (JSE 2016). In commercial banking the Currency and Banking Act of 1920 introduced reserve requirements for all commercial banks and established the South African Reserve Bank (SARB) to regulate the banking sector and administer the South African exchange rate and foreign exchange reserves (Singleton and Verhoef 2010, p. 542). Despite this, the

financial sector was loosely regulated until the 1940s, an approach that changed dramatically thereafter.

5.3.2 Expansion and direct controls

The immediate post-war period was a time of rapid expansion and diversification of the financial sector in South Africa, in part on the back of the prevailing economic boom and the government's promotion of Afrikaner capital through finance (Verhoef 1992b, p. 123). The value of the sector shot up from 2.3% of GDP to 12.6% between 1950 and 1975 (although a large jump was due to changes in estimation techniques) (Jones 1992a, p. 5). Much of the dynamism within the sector came from non-commercial bank financial institutions – building societies, other deposit-receiving institutions, the Post Office Savings Bank, merchant banks, etc. – with commercial-bank innovation often driven by the smaller players although Barclays and Standard Bank retained their prominence.

This reflects a clear distinction drawn between, and differing treatment of, commercial banks and other financial institutions under the Bank Act of 1942. As commercial banks were regarded as the primary source of monetary expansion, their activities were stringently regulated (Verhoef 1992b, pp. 134–135, 2009), allowing other deposit-receiving institutions to compete vigorously with commercial banks.⁷⁸ Commercial banks' share of financial sector total liabilities fell from 56% in 1938 to 40% in 1965 (Verhoef 1992a, p. 86), while building societies and life insurance consistently grew at a faster pace throughout the period (Jones 1992a, p. 9). Wesbank, for instance, the leading hire-purchase bank, expanded from 1950 into a financial conglomerate with subsidiary activity in mortgage markets, credit cards, merchant banking, and estate management, as well as deposit markets, hire-purchase, and leasing (Jones and Scott 1992, pp. 213–220). Trust Bank was originally established, in 1955, to provide specialised short- and medium-term (particularly international) credit facilities for industry and trade, highlighting how the internationalisation of South African corporates played a role in expanding domestic banking. It later pioneered personal loans and provided investment-banking services, while developing divisions in property development, credit cards,

⁷⁸ These included hire purchase companies, people's banks, loan banks, and private savings banks, as well as building societies.

travel business, insurance and assurance, mortgages and debentures, and merchant banking, in an attempt to be a ‘one-stop’ bank. This was an emerging trend in US banking and a break with the traditional British banking approach dominant in South Africa (Verhoef 1992b, pp. 133–137).

Commercial banks tried to compete via diversification, either by acquiring quasi-bank financial institutions or by starting their own. Nedbank (the Netherlands Bank of South Africa (NBSA) until 1971) started NEFIC to provide medium- and long-term finance to industry as well as other investment services, took over leasing and hire-purchase institutions Credcor Bank and LPI, created their own insurance company, Nedicon, and acquired a large stake in Secured Investment, a company engaged in participation bonds. In addition, it grew its foreign exchange business, acceptance financing, and trust and investment business, to name but a few initiatives (Verhoef 1992a). Volkskas undertook similar expansion and early on (in 1959 and 1966) acquired two building societies. The major British banks also diversified – for instance, Standard Bank’s Stanic and Barclays Leasing were both large players in the hire-purchase market (Verhoef 1992b, p. 127) – but were slower about it. As Jones and Scott (1992, p. 224) note: “Barclays was a very traditional bank, with an extensive branch network tapping deposits widely throughout South Africa; but it was weak in what had been considered fringe banking activities, instalment finance and so on.”

The local South African banks also internationalised – as an expansion strategy, to gain access to international capital markets, and, as Singleton and Verhoef (2010, p. 539) note, because they “followed” their clients abroad. The latter again highlights the internationalisation of South African productive capital and its role in spurring financial development. NBSA, for instance, opened offices in London (1951) and New York (1958), and later in Zurich (1976), Frankfurt (1974), and Hong Kong (1980). In addition to expanding its foreign trade, exchange, and travel businesses, it also used these offices, by 1973, to raise euro-currency and long-term loans for massive South Africa corporates such as Iscor (steel), Eskom (electricity), and South African Railways and Harbours (Verhoef 1992a, pp. 100–101). International banking also worked in reverse and, in addition to the dominant British banks, a multitude of foreign banks had South African offices or branches.

During this period very important transformations took place in financial markets. The formation of the first merchant bank (UAL) and discount house (DHSA) (both led by AAC) in 1955 and 1957, respectively, marked a turning point (see Jones 1992c, and Kell 1992, respectively). This sought, through the creation of a local money market, to retain domestic capital (which as noted above was placed in European markets) and transform the stock market from a trading space for mining shares into a fully-fledged capital market. It was industrialisation, including international expansion, and industry's need for financing, which drove the financial-market expansion in the post-war period (Jones 1992c, pp. 155–156, Kell 1992, p. 194). This was successful and by 1963 the money market handled a larger volume of funds as a share of national income than the London market (Kell 1992, p. 196). The government bond market (gilts market) played a leading role, but new corporate issuances, portfolio management, and new investment instruments became increasingly important. Consequently, a secondary market, including for municipal and public corporation stock, arose.

By 1974 there were thirteen merchant banks with each of the big commercial banks controlling one and the insurance corporates having considerable stakes (Verhoef 1992b, p. 128). The number of companies listed increased from 629 in 1962 to 737 in 1970 (when it peaked), equity portfolio management became more important, and dividend payments rose at a compound rate of 7.2% between 1964 and 1973 and 19.6% between 1972 and 1982 (Jones 1992b, pp. 278–279, Kell 1992, p. 200). At the same time the large insurance firms came to play a more prominent role in the market – in their market capitalisation, influence, and connection with commercial banks. SA Mutual, for instance, was said to be the “guiding force” behind the merger between Nedbank and UAL in 1973, while Sanlam had taken over Trustbank earlier in the year and Standard Bank's ties with Liberty Life were developing (Jones 1992c, p. 185). This was in tandem with the long-term insurers' penetration into the economy as a whole. As Verhoef (2008, p. 708) notes in the case of Sanlam: by 1960 “Sanlam had extended its operations, directly and indirectly, into almost all sectors of the South African economy”.

Much of the above was shaped by the monetary policy pursued by the state. As noted already the distinction drawn in 1942 between commercial banks and other financial institutions allowed the latter to flourish and the former to acquire subsidiaries in order

to compete, thus spurring both diversification of the sector's activities and concentration; high levels of concentration have remained a hallmark of the South African banking sector (see Chapter 8). The Bank Act of 1965 fundamentally changed the financial landscape, with a crucial element being the dissolution of the 1942 distinction between commercial and other banks. This allowed commercial banks to compete on a more even footing and set the scene for the gradual demise of building societies, the expansion of commercial banks into new arenas, and the further acquisition by commercial banks of a host of other financial institutions.

The diversification of banking, as well as the new regulation, led commercial banks to reorganise their activities into holding companies, with Nedbank leading the way in 1969 (Verhoef 1992a, 1992b, p. 128). As shown in the tables above, the insurance giants, AAC, and Rembrandt, took up large stakes in these new financial conglomerates (for examples see Verhoef 1992a, p. 97, 1992b, pp. 128–130). The Reserve Bank continued to tacitly support collusion via the Register of Cooperation among Commercial Banks (ROCO) – which fixed interest rates and the parameters within which competition took place (Jones 1992a, p. 14, Verhoef 1992b, p. 123) – thus granting these giant financial conglomerates immense market power.

Strict direct monetary controls were the order of the day. Monetary policy attempted demand control via directly controlling the money supply, predominately through quantitative ceilings on bank credit managed by a liquid asset system (Addleson 1992, pp. 36–37, Skinner and Osborn 1992, pp. 66–68). This encouraged disintermediation; for instance, banks encouraged non-bank private borrowers to issue debt instruments and themselves engaged in money-broking activities and off-balance-sheet finance, spurring further controls (Addleson 1992, pp. 67–71). Strict exchange controls were also enforced in 1961, while in the 1970s a number of exchange rate policies were experimented with after a managed, but floating, rand was introduced; these included fixed gold parity and various pegs to the US dollar and pound sterling. The general global instability brought about through the dissolution of the Bretton Woods framework was exacerbated by the gyrations in the gold price, South Africa's reliance on gold, and on-going balance of payment problems (Addleson 1992, p. 38, Jones 1992b, pp. 285–289). Paranoia also arose over the considerable foreign ownership of the banking sector: at the end of 1970 foreign-controlled commercial banks held 73% of

bank deposits. The Banks Act of 1972 limited foreign shareholding in banks and holding companies to 50%, and where they exceeded the holding was to be appropriately reduced over time (Gidlow 2008, p. 34). This led to the listing of Barclays and Standard Bank on the JSE (Verhoef 2009, p. 171).

In general, despite recognising the importance of the money market and setting liquid asset requirements, “market management was not really considered part of monetary policy”, and the attitude of Treasury and SARB towards financial markets was ambiguous (Kell 1992, p. 198). Exchange controls, however, played an important role in that money was ‘trapped’ within the local economy and much of this flooded into the stock market (Jones 1992b, p. 273); for instance, a large surplus accrued following the 1979/1980 gold price surge (Addleson 1992, p. 40). Jones (1992b, p. 283) notes that this likely encouraged mergers and takeovers and increased concentration via very large holding companies.

5.3.3 Halting steps towards deregulation and the debt crisis

Monetary policy began to change in the 1980s, illustrated in the three reports (1979, 1982, and 1985) by the De Kock Commission.⁷⁹ The Reports, respectively, proposed an end to exchange controls, the deregulation of the financial sector (with some stress on building societies), and a new framework for monetary policy, each representing a decidedly ‘market-based approach’. The shift of monetary policy away from direct controls and towards open-market intervention was critical. On paper, monetary policy would aim to meet ‘flexible’ money supply targets via manipulating market interest rates. This required the Central Bank to create a shortage in the money market and then lend to banks at its own stipulated rate in order for them to meet their cash reserve requirements. In practice, a switch was made towards utilising such policy instruments, but targets were seldom met and largely disregarded by politicians. Despite this, the Deposit-Taking Institutions Act of 1990 cemented the capital-assets approach to

⁷⁹ As discussed in the next chapter a distinction should be drawn between ‘policy on paper’ underpinned by a particular scholarship, and policy in practice – the two may, and did, diverge significantly. Monetary policy under De Kock, who was Reserve Bank Governor between 1981 and 1989, has been described as ‘eclectic’ or ‘pragmatic’ monetarism. Its monetarist elements included: “an emphasis on monetary targeting; the view that, as far as possible, the level of interest rates and external value of the currency should be determined by market forces; and that policies which involve excessive intervention, or the exercising of too much discretion, on the part of the authorities are undesirable”. The non stereotypically-monetarist approaches were the emphasis on interest rates and the flexibility of the ‘monetary rule’ (or target) (Addleson 1992, p. 46).

reserve holding and made this uniform across deposit-taking institutions (Addleson 1992, p. 49, Skinner and Osborn 1992, pp. 72–73).

Exchange rate policy was to be a ‘managed float’ with the longer-term goal of a unitary rand (leading up to this South Africa had a dual currency, the commercial rand and the financial rand, the latter used for international transactions and acquired at a premium). A managed float was introduced in 1979 and a unitary rand implemented in February 1983 but the latter was short-lived. In addition, the Reserve Bank aimed to broaden the spot market and develop a proper forward market, while also widening the offshore market for rands. This was partially successful. De Kock also wished to liberalise exchange controls but not abolish all controls over residents as concern over the balance of payments was expressed (Addleson 1992, pp. 50–52), although events took things in a different direction.

As proposed by the de Kock Commission, the domestic financial sector was significantly deregulated: credit ceilings were abolished, wider margins between private-sector overdraft and Reserve Bank rates arose, control over rates on agricultural credit and mortgages were loosened, and liquid asset requirements reduced (Kell 1992, p. 207). In addition, important tax changes freed dividends from ‘double taxation’, abolished marketable securities tax, and created a ten-year tax-free window for gains from the sale of investments (Solomon 1992, p. 28), all indicating a financial-market friendly turn.

The monetary policy programme outlined was overtaken by political and economic events. In the early 1980s the general economic outlook deteriorated and government spending increased (with the public sector wage bill, social services, and military expenditure playing a large role). Tight monetary policies were not pursued (unlike elsewhere in the world) and inflation rose as real interest rates and the value of the rand fell. Then a series of crises hit in 1984/85 with the President’s ‘Rubicon speech’ proving the breaking point.⁸⁰ South Africa’s creditors declared a debt moratorium, disinvestment accelerated (spurred by foreign sanctions), the rand tumbled, the balance of payments weakened, and stringent exchange controls were implemented.

⁸⁰ In this August 1985 speech President PW Botha took an unexpectedly strident stance reaffirming the government’s commitment to apartheid. This led to widespread international condemnation and significantly increased the international isolation of the apartheid regime.

The combination of these events, previous policies, and policy changes that did occur, had far-reaching consequences for the financial sector. First, while deregulation brought increased competition, concentration increased. Trapped capital, prior to the partial lifting of exchange controls in the early 1980s, deregulation of financial services, loose regulation of financial markets, and the already high levels of concentration and conglomeration within the economy spurred this. Disinvestment meant that a small number of large South African corporates bought out the stakes of international investors in companies across the board. In the financial sector, this was intensified by an additional compulsion towards foreign disinvestment due to the 1972 restriction on foreign ownership. During 1986 and 1987 three foreign controlled banks – Barclays, Standard Bank, and Citibank – disinvested entirely (Gidlow 2008, p. 36).

Concentration in the financial sector was also heightened as the distinctions between banking institutions gave way. In particular, the privileges that building societies enjoyed were eroded and their subsequent conversion into commercial banks and frequent demutualisation (a global phenomenon, see Isaacs 2016c) meant they gradually merged with existing banking groups. Regulations in the 1990s on maximum shareholding in banks sought partially to address this but still allowed for up to 49% ownership by single institutions (Verhoef 2009, p. 176).

Second, overall, the market boomed. Equity market capitalisation increased sixfold, in real terms, between 1962 and 1987, whereas GDP increased just under two-and-half-fold, also in real terms (Jones 1992, p. 285, SARB 2017). Dividends on gold mining shares grew threefold while those on industrials increased almost fivefold. The complexity and array of market instruments also increased, both due to burgeoning secondary markets and policy; the maintenance of liquid asset requirements, for instance, encouraged banks to undertake further off-balance-sheet and money-broking activities (Skinner and Osborn 1992, p. 76). Notably, the 1980s saw government bond markets boom with the market operations of the state playing an active role. More regular issuance of state liabilities of varying maturities was central (reflecting the market-making role of the state mentioned in Chapter 4), and public pension funds and life insurance companies were compelled to take up much of these (Jones 1992b, Kell 1992, p. 207).

Third, insurance companies and pension funds experienced enormous growth, Sanlam's JSE market share increased from 10% in 1983 to 22% four years later, SA Mutual's grew from 0.6% to 8%, although AAC still dominated with growth from 52.5% to 60%. With the greater market instability of the 1970s, equity portfolio management had gained new importance and from about 1976 the long-term institutions had entered the secondary markets thereby greatly enlarging the significance of these markets (Kell 1992, pp. 200, 203). The sophistication of the sector also improved with merchant banks, institutional investors, and commercial banks all investing in computerisation.

Fourth, patterns of financing were changing. New investment in the economy declined and, despite the funds sloshing around for acquisitions, savings in the economy fell as government deficits grew. Bank lending also shifted, as bank finance – although still very necessary for trade – was not financing major investment. By the 1980s household credit, consumption expenditure, and housing prices began to grow, in tandem with fiscal austerity (Solomon 1992). The property bust of the late 1980s therefore hurt a number of commercial banks which had significantly increased their exposure. It became clear that, despite being only partially implemented, the reforms, and the scholarship upon which they were premised, together with loose government spending, disinvestment and exchange controls necessitated by apartheid policy, framed the evolution of the financial sector during this period.

This history has brought to light three sets of issues. First, it has highlighted a number of dimensions of the South African financial system that will feature throughout later chapters, for instance its oligopolistic nature. Second, it points to the beginnings of financialisation in South Africa. In a departure from existing scholarship of financialisation in South Africa – which refers to the 1980s as laying the foundation for financialisation but not as a period of financialisation itself (with reference specifically to financial asset accumulation) (for example, Ashman, Mohamed, et al. 2013, Newman 2014) – we note that a number of the trends highlighted here fit with early aspects of financialisation observed elsewhere in the world. This includes: the dissolution of boundaries between different types of financial institutions; the rising prominence of institutional investors; a (partially stymied) shift in regulation towards a market-based/monetarist approach; the deepening of financial markets including secondary markets, off-balance-sheet activity, and shareholder distributions; and shifts in patterns

of bank lending towards households. The financialisation of the South African economy is, therefore, beginning, but constrained (predominately) by international isolation.

Third, the manner in which the MEC has shaped the financial sector is clear with a distinct orientation towards facilitating the expansion of existing sectors, acquisitions by the conglomerates, and transfers of ownership within and between the conglomerates (Fine and Rustomjee 1996, p. 103). Together with a skewing towards short-term lending and money market activity, thus encouraging speculative investment, this has not calibrated the financial sector towards financing the establishment of new industries (Fine and Rustomjee 1996, pp. 176–177). Bringing these three sets of issues together, we can observe that the increasing scale and diversity of financial interests and markets, therefore, became a pivot of the MEC around which both the MEC and the post-apartheid South African economy evolved.

5.4 Conclusion: the interpretation of mining, industry and finance

The interpenetration of financial, mining, and industrial capital is a defining feature of the MEC (as made clear in Table 5.2) and critical to both the development of the financial sector, as discussed above, and the nature of the restructuring that we witness in the post-apartheid period (see Chapter 9). This interpretation dates back to at least the post-war years. In the 1950s Sanlam's investment arms acquired significant interests in manufacturing, mining, and commerce, and in 1953 Fedvolks and Bonuskor merged their mining interests to form Federale Mynbou, the forerunner to Gencor which was to become one of the largest mining houses by the 1980s (Fine and Rustomjee 1996, pp. 152–153). Volkskas diversified outside of financing with its joint venture in sugar production in 1964, and in 1971 acquired General Mining and Transvaal Corporation Ltd. By 1981 Volksas' investments in the shares of other companies amounted to 80% of group equity well above that of other commercial banks (Verhoef 1992b). SA Mutual (now Old Mutual), the longest standing Cape-based mutual insurance company, also acquired interests in mining (alongside its considerable interests in other industries) when Thomas Barlow & Sons Ltd., controlled by SA Mutual, acquired Rand Mines in 1971 (later to become Barlow Rand) (International Directory of Company Histories 1988).

With AAC and Rembrandt the acquisitions worked the other way round, from mining to finance and industry. In addition to its merchant bank, Union Acceptances, AAC controlled three banks, First National, First Western, and First Industrial, one life insurer, Southern Life, and First Corporate merchant bank; Union Acceptances was merged with Nedbank (SA Mutual controlled) in 1973 (Jones 1992c, Fine and Rustomjee 1996). Similarly, Rembrandt acquired Volkskas and United Building Society (UBS) and a range of smaller banks, and the insurance companies Lifegro and Federate Life. Rembrandt remained primarily concerned with its industrial, retail, and financial ventures but acquired a 25% stake in the mining house Genmin (later Gencor) and control of Impala platinum mines (Fine and Rustomjee 1996). Liberty/Standard was entirely financial and Anglovaal without a financial arm.

The conglomerate structure captured in Table 5.2 also belies the complexity of the cross holdings that existed through which minority shareholders – usually the founding families – were able to exercise control over the companies. Cross-holdings existed within conglomerate groups, for example UBS holdings had shares in Volkskas, and Volkskas in UBS, and between groups, for example both Rembrandt and SA Mutual had shares in Standard (whose largest shareholder was Liberty Life) and AAC did business with Standard (see Chabane et al. 2006). Such incestuous relationships consolidated the power of the conglomerates and aligned their interests (although this is not to say that conflicts between them did not emerge). With local capital trapped by sanctions in the 1980s and the ensuing spate of mergers and acquisition, such ‘pyramiding’ increased underpinning the decline in the number of companies on the JSE which fell from 737 in 1970 to 517 in 1987 (Jones 1992b, p. 279), despite some notable new listings, as in the platinum sector.

Finance was therefore integrated within the MEC in three ways: first, financial institutions (particularly SA Mutual and Sanlam) owned mining and industrial concerns; second, mining and industrial capital (AAC and Rembrandt) owned financial institutions; and third, finance provided the lubricant for the cross-holdings between the conglomerates and their acquisition and control of new subsidiaries. The MEC should better be considered the MEFC – the Mining-Energy-Finance Complex.

This chapter has therefore provided a basis upon which to understand the South African political economy – the MEC as a locale-specific system of accumulation. This approach sheds light on the economic structure – both in its sectoral composition and institutional expression – inherited by the post-apartheid government. It gives context to a number of critical aspects of the economy – such as capital-intensity and monopolistic industry – that feature in our later analysis (see Chapters 8 and 9). In exploring the development of the financial sector it highlights a key basis upon which financialisation is able to emerge as well as early moves in this direction. Beyond this, it explains South African development based on a series of class relationships within the economy, in particular between different sections of capital and between capital and the state. We return to the analysis of such relationships in the democratic era in Chapter 9. Before tackling empirical developments within the economy (Chapters 7-10) we explore the evolution of post-apartheid macroeconomic policy picking up from where we left off above.

6 THE EVOLUTION OF MONETARY POLICY IN THE POST-APARTHEID ERA

6.1 Introduction

There is a temptation, both in general and given the historical approach to financialisation adopted in this thesis, to sharply distinguish between the apartheid and democratic eras, with power shifting in 1994 following three years of formal negotiations. In certain respects, in particular regarding international integration (Chapter 7), this is true. In other respects, for instance regarding the nature of accumulation and market structure (noted particularly in Chapters 8 and 9), there are strong continuities between the apartheid and post-apartheid regimes, not least of all because the underlying social relationships captured by the MEC continue to exercise a powerful influence over the economy.

The evolution of macroeconomic policy, the subject of this chapter, is a sphere in which both continuity and change is evident; the discussion of the financial sector and monetary policy under apartheid in the previous chapter serves as a basis upon which we proceed. As discussed in Chapters 3 and 4, macroeconomic policy – and monetary policy in particular – has played a crucial role in facilitating and shaping financialisation, particularly in the developing world. By discussing these policies this chapter provides critical context for our subsequent empirical analysis. Section 6.2 discusses the broad macroeconomic policy framework while Section 6.3 turns to monetary policy in particular, Section 6.4 concludes.

When discussing policy, we adopt three postures. First, we conceive of monetary policy broadly – including, for example, financial-sector regulation – and do not reduce it to policies that pursue price stability, as is sometimes the case within mainstream economic analysis. In fact, we argue that the rhetorical narrowing of monetary policy helps to obscure important interventions made by the state. Second, and related, this allows us to appreciate that when the state takes a market-friendly turn this is not a withdrawal of the state, but an active form of state intervention, as noted regarding the Washington and post-Washington consensus in Chapter 4 (see Fine et al. 2003). Third, at times an implicit or explicit distinction is drawn between policy ‘on paper’ and policy ‘in practice’, which are more or less underpinned by certain scholarship, and more or less connected

with a rhetoric/ideology that frames, justifies, and explains them (this is drawn from Fine 2001, 2008, as used in Isaacs 2014).

6.2 Macroeconomic policy framework⁸¹

Monetary policy, the main focus of this chapter, must be viewed within a broader context of a market-based approach that was adopted by the new regime. Beginning during the negotiations, ANC economic bureaucrats were wooed by local and international capital through institutions such as the World Bank and a special committee established through which Nelson Mandela engaged regularly with the titans of South African capital. Through the power-sharing agreement between the incoming African National Congress (ANC) and outgoing Nationalist Party (NP), the NP retained control of the finance ministry and the Reserve Bank. Capital and the NP also tacitly colluded through think tanks and policy proposals that arose from outside government. The ANC was internally divided over economic policy and relatively unprepared, but as the negotiations proceeded, talk of nationalisation (the historic rhetorical position of the liberation movement) dwindled and market-friendly rhetoric increased.

The basic approach to post-apartheid macroeconomic policy is captured in the 1996 Growth, Employment, and Redistribution (GEAR) programme. Unlike many other policy programmes the central tenets of GEAR – fiscal restraint, inflation reduction, and liberalisation – were implemented, notwithstanding that the growth and employment targets were never reached. This paradigm has overwhelmingly guided subsequent macroeconomic policy and provided the cover under which a range of policies, instrumental in facilitating the restructuring of the economy including financialisation, could be pursued, while closing the door on other more progressive alternatives.

GEAR argued that “[s]ustained growth on a higher plane requires a transformation towards a competitive outward-oriented economy” (RSA 1996a, p. 1). Export orientation would occur through increased private sector investment, particularly via attracting foreign direct investment (FDI), and financial liberalisation was essential in facilitating this. ‘Macroeconomic stability’ – conventionally understood as “stable prices,

⁸¹ A thorough review of post-apartheid macroeconomic policy is given in Isaacs (2014).

stable interest rates, predictable economic costs such as tax policies and regulatory regimes and predictability about future tax and interest rates” (Naidoo 2006, p. 116) – was the lynchpin of this strategy (see Faulkner and Leowald 2008, p. 12). In order to achieve this, it was argued that government debt (that had grown in the dying days of apartheid and was accepted on unfavourable terms by the new government) must be sharply reduced, inflation suppressed, trade and capital flows liberalised, the tax burden curbed, the real exchange rate maintained at competitive levels, and greater labour market flexibility engendered.

GEAR was underpinned by a number of critical assumptions (almost all of which were shown to be inaccurate):

- That low levels of savings were a restraint on investment and that government ‘dissavings’ – via budget deficits – would ‘crowd out’ private investment.
- That high interest rates may be necessary in the short term to contain inflation but that deficit reduction would curb inflationary pressures and allow for a fall in interest rates that would spur investment.
- That the current account would deteriorate but that this was compatible with lower interest rates and a stable exchange rate because higher FDI would cover the current account deficit.
- That the current account deficit would also be curtailed via trade liberalisation, removal of exchange controls, and diversified exports.
- That demand would be driven through exports and not domestic stimulus.
- That liberalisation of capital flows would be necessary to achieve the above.
- That through a ‘social accord’ labour should compromise on wages and capital invest more.
- That the above would ‘secure business confidence’, and spur investment. (On the above, including why such policies were inappropriate, see Adelzadeh 1996, Gibson et al. 1996, Michie and Padayachee 1998, Weeks 1999, Naidoo 2006, Naidoo et al. 2008, Terreblanche 2009).

Ideologically and scholastically GEAR sits within a supply-side/new-classical paradigm with a ‘non-interventionist’ role for the state and the assumption that markets cannot be led or that this is neither necessary nor desirable (Terreblanche 2009, p. 5). GEAR clearly places growth first – with scant attention to composition of that growth – on the

basis that this would stimulate employment, with redistribution following. Support for this approach was premised on the arguments that: the South African economy was in crisis and in dire need of ‘stabilisation’; no other viable alternatives were available; this stratagem was in line with a social and redistributive agenda (articulated in the 1994 election manifesto and economic blueprint, the Reconstruction and Development Programme (RDP)); and that GEAR offered a feasible means through which to achieve those ends (see for example Gelb 2006, Naidoo et al. 2008, Aron et al. 2009).

The rhetoric of crisis was particularly powerful and given further impetus by the fall of the rand in 1996. However, despite significant structural economic challenges facing the new government, government debt was only 47% of GDP in 1994/5 and by 1996 inflation had already fallen significantly⁸² (debt sustainability, inflation, low domestic savings, and exchange rate turmoil underpinned the crisis rhetoric); even the World Bank foresaw a viable scenario of increasing the deficit and allowing it to peak at 12% in 1997 (Adelzadeh 1996). Meanwhile, the rhetoric of ‘securing business confidence’ was premised on the understanding that business is an ‘objective’ force, needing neither to be led nor cajoled, but simply provided with a free and stable market that will prompt investment and development.⁸³ The role of government as a ‘market facilitator’, creating a ‘conducive environment’ has been pervasive with important implications including for financialisation (discussed in the case of housing in Chapter 10).

In the end, the government chose to pursue short-term stabilisation and this came at the expense of a long-term reorientation of the economy.⁸⁴ GEAR did ‘stabilise’ various macroeconomic indicators (for example, debt levels) (Naidoo et al. 2008, p. 14), although some ‘successes’ credited to it, for example bringing down inflation, were attributable to a confluence of factors. But stabilising an economy means stabilising

⁸² Inflation was checked in large part due to the falling price of imported tradable goods and lower food prices. Even without an appreciating currency the price of tradable goods was declining due to trade liberalisation and cheap goods from Asia (Roberts 1997). More generally, Hanival and Maia (2009, p. 19) show the significant role of oil and food prices on inflation between 1990 and 2008, and Aron and Muellbauer (2007a) emphasise the importance of trade reform and growing openness in lowering inflation.

⁸³ Treasury officials phrase this in terms of the new democratic government lacking “credibility in the area of economic management” (Naidoo et al. 2008, p. 5). Fine (1995a, p. 20) argues that “to appeal to the need for business confidence is to apologise to business for the ANC having come to power”.

⁸⁴ It is worth noting that fiscal expenditure has, overall, been ‘pro-poor’ in the democratic era with real per capita expenditure on social services (health, education, social production and housing) rising, particularly from the early 2000s (Sachs 2016). However, as argued here, this does not mean the macroeconomic framework has had positive developmental outcomes – rather its market-bias and associated reduction in tax rates have undermined the potential benefits of social expenditure.

certain variables around a particular growth path, or system of accumulation; in this case what was stabilised was the economic relations that underpinned the evolving MEC (see Chapter 9).

The GEAR approach, we noted, has underpinned subsequent macroeconomic policy, with some notable diversions. 2001 marked a shift towards microeconomic reform and addressing ‘microeconomic blockages’ – developing skills, infrastructure (including transport), better regulating monopoly and labour markets, improving efficiency, reducing crime, developing technology, improving basic social services, and reducing barriers to entry and increasing competition. Government intervention in these regards (particularly via industrial policy) was given legitimacy and public sector investment was now thought to ‘crowd in’ private sector investment, and there was some movement away from an obsessive reliance on FDI (RSA 2003, Knight 2004, Streak 2004, Naidoo 2006, Presidency 2006, DTI 2007, 2010, 2013, Naidoo et al. 2008). Nevertheless, precisely because the only reforms on the table were pitched at the microeconomic level, the macroeconomic framework outlined above remained largely undisturbed.

In the late 2000s it appeared that more progressive and interventionist policy was on the horizon, with discussions of a ‘development state’ and the need for a New Growth Path (Economic Development Department 2010). The outcomes of this were contradictory. On the one hand, more space opened up for industrial policy and market intervention. This was supported by the creation of the Economic Development Department under ex-unionist Ebrahim Patel, and by the National Treasury, under Finance Minister Pravin Gordhan, taking a more accommodating stance toward such interventions than under former-Minister Trevor Manuel. On the other hand, a ‘conservative consensus’ (see Isaacs 2014) over the macroeconomic policy framework was reinforced, captured in the Harvard Panel Review (established by Treasury) (Frankel et al. 2006, Frankel and Sturzenegger 2008), government budgets, international policy prescripts (for example see OECD 2010, 2013, Lysenko and Barnard 2011), and the adoption of the National Development Plan (NDP) in 2011 (National Planning Commission 2011). Around these coalesced a fiscal policy that was to include: the maintenance of fiscal discipline, countercyclical fiscal policy, a shift from current to capital expenditure, and a structural budget balance (Frankel and Sturzenegger 2008, Naidoo et al. 2008, OECD 2010, 2013, Strauss 2013).

The NDP is even less interventionist than previous policies, dismissing the role of state-led investment and industrial policy, narrowly conceptualising growth, and even ignoring competition policy. The NDP includes a revival of a militant adherence to an export-led growth path that was apparent in GEAR, with trade liberalisation remaining firmly entrenched. In these respects the NDP is highly congruent with GEAR, emphasising liberalisation, deregulation, and the cold winds of international competition (see COSATU 2013, pp. 22–30 for a critique). The ‘conservative consensus’ macroeconomic policy framework – both in policy on paper and in practice – is, therefore, clearly in the GEAR mold, which had set the parameters for post-apartheid macroeconomic orthodoxy, including in monetary policy to which we turn shortly. It is clear also, throughout that discussion, that the faltering steps towards reform in the late-apartheid period very much laid the groundwork for the policies pursued in the democratic era.

6.3 Monetary policy

As noted above we conceive of monetary policy broadly. The narrowing of monetary policy to price stability – as is often the case in orthodox economic accounts – obscures a range of critical interventions that the state makes in terms of the financial and monetary economy. In fact, we argue below that this can mask the manner in which monetary policy serves particular interests, and in this case, creates a conducive environment for financialisation. In this vein, policy instruments (particularly relatively high real interest rates) justified on one basis (inflation reduction) can have other significant consequences (supporting short-term capital inflows, asset price appreciation, etc.). In line with this and our discussion of the nexus between state policy and financialisation in Chapters 3 and 4, this section interrogates: the liberalisation and reregulation of the financial sector (Section 6.3.1), the state’s focus on price stability and central bank independence (Section 6.3.2), and the state’s role as a market maker (Section 6.3.3).

6.3.1 Liberalisation and the reregulation of the financial sector

External liberalisation – both financial and trade – were critical in the early years of the democratic era. This is unsurprising given the extreme isolation and capital controls in

the final years of apartheid, previous frameworks advancing the need for liberalisation, the global push towards liberalisation, and the general neoliberal macroeconomic framework pursued by the post-apartheid government. With arguably undue praise, Aron et al. (2009, p. 5) note:

“The ANC recognised that successful economic policy was subject to constraints laid down by the international system. An export oriented economy based on private sector investment would have to be acceptable to the international trading and financial system. Since coming into power, the ANC has moved consistently in the direction of responsible monetary and fiscal policies. Liberalisation began with enthusiasm: the pace of trade liberalisation was quite marked initially, privatisation initiatives were begun, and financial sector liberalisation was extensive, particularly the lifting of controls on foreign investment. However this trend did not continue unchecked or extend to all sectors.”

In March 1995 virtually all exchange controls and restrictions on foreign capital were removed together with the unification of the exchange rate via the abolishment of the financial rand. This permitted foreign companies to access domestic credit and markets, and allowed for the return of foreign banks (beginning in 1995 – see Chapter 8). In line with this, the JSE expanded rapidly (see Chapter 8) and the Exchange expanded membership (of traders) to non-residents and corporates as part of its ‘Big Bang’ liberalisation (which took place in 1995 although various regulatory hurdles persisted) (Falkena 2001). In addition, foreign insurance firms could set up local subsidiaries, and sovereign credit ratings were established towards the end of 1994 paving the way for South Africa’s formal re-entry into international bond markets.

The liberalisation of controls on domestic investors was more gradual and by 1998 approximately three-quarters of these had been removed. This allowed for international investment and capital flight (see Chapter 7), including the listing of companies offshore (see Chapter 9), while institutional investors were the main conduit for international portfolio diversification (Aron et al. 2009, p. 10). Capital market liberalisation occurred in tandem with trade liberalisation, moves towards privatisation (see Chapter 9), and financial-sector reregulation (see below) (Hawkins 2004, Gelb 2006, Aron et al. 2009, Singleton and Verhoef 2010). It is worth noting that liberalisation has been an on-going

feature of financial-sector policy. In the midst of the 2007-2009 financial crisis, controls on capital outflows were loosened in order to encourage outflows in an attempt to balance the current account deficit and stem currency appreciation. South Africa was one of only three leading emerging markets, out of a sample of sixteen, to respond in this way (National Treasury 2011, p. 27, Baumann and Gallagher 2013).⁸⁵

International integration has been accompanied by domestic reregulation as well as regulatory change in order to conform to international standards, such as those laid out in the IMF's Financial Sector Assessment Programme, Basel II, Basel III, and other similar international agreements.⁸⁶ Regulation has been put in place to manage new market segments often encouraging growth in the financial sector. For instance, microlending to the poor was rigorously pushed under the rhetoric of 'banking the unbanked', with a wide range of actors investing in microfinance institutions (MFIs) (Bateman 2014, 2015, James 2014); this is discussed further in Chapters 8 and 10. A financial market example is the private equity sector, where ceilings were raised on the investments that pension funds could make in private equity and tax legislation amended to exempt foreign investors in private equity fund structures from South African capital gains tax (SAVCA 2015). This example followed on the heels of market deregulation in the 1990s, as a report endorsed by the SARB Governor stated: the "structure of regulation [in the 1990s] moved strongly in the direction of deregulation, with significantly more reliance on market forces" (Falkena 2001, p. 159). Reregulation continued into the 2000s, for example, with the promotion of securitisation. At the same time significant effort has been made towards improving consumer protection, expanding access, ensuring stringent corporate governance, and anti-money-laundering initiatives.

Notable, is that the updating of regulatory frameworks has reflected a recurring focus by regulators on prudential regulation and financial stability (National Treasury 2010a) rather than sectoral restructuring of the domestic economy. For instance, the financial sector continues to be highly concentrated – as discussed in Chapters 5 and 8 – despite

⁸⁵ Others sought to reduce foreign borrowing, speculative trading, and financial vulnerability, via imposing tax, reserve or minimum stay requirements, or limiting financial market participation in a variety of ways.

⁸⁶ Most recently, as is the case internationally, there is movement towards a 'twin peaks' regulatory framework – separating prudential and market conduct regulators – with little focus on the manner in which aspects of the systemic functioning of the sector may affect economic development.

the Competition Commission's Banking Enquiry, launched in 2006 (Competition Commission 2008) aimed at addressing aspects of this. Tellingly, changes undertaken in wake of the Enquiry were incorporated within the sector's non-statutory *Code of Banking Practice* rather than directly regulated by the state. The National Treasury (one of the bodies tasked with acting upon the recommendations) clearly indicated that market innovation and market-driven competition were preferred to direct fee regulation, despite the sector previously (wilfully?) failing to engender precisely such competition (National Treasury 2010b, Hawthorne et al. 2014).

Amongst these various regulatory developments, liberalisation (in sync with domestic reregulation) stands out as a core element of monetary policy, both in the scope of the change that was implemented and its consequences for the sector and economy.⁸⁷ The continued emphasis on liberalisation was critical to the restructuring that was already underway and accelerated with the implementation of GEAR policies. Lifting of restrictions on capital flows and offshore listings facilitated the restructuring of the conglomerates, and the internationalisation of their operations, the integration of South African corporates into global financial markets, and the subsequent processes of financialisation that took place.

6.3.2 Price stability and central bank independence

Price stability has been the central stated objective of monetary policy (narrowly conceived) in the post-apartheid period. Initially this was conceived to be achieved by maintaining a monetary target through interest rate manipulation (as was proposed by the de Kock Commission). A range of other indicators including the exchange rate, balance of payments, output gap, asset prices, wage settlements, credit growth, and the fiscal stance, complemented this target (Stals 1997). However, the monetary target guidelines, upon which the SARB's existing policy hinged (Stals 1996), were ill-suited to the context of liberalised domestic financial markets and rapid capital flows, it being almost impossible to control the money supply tightly and directly in such a circumstance.

⁸⁷ Although weak linkages with particular international derivative markets and domestic risk management requirements sheltered the South African financial system from direct financial contagion in the 2007/2008 global financial crisis. However, the crisis impacted the economy through capital flows and international financial trading (Chapter 7) and trade (Chapter 9).

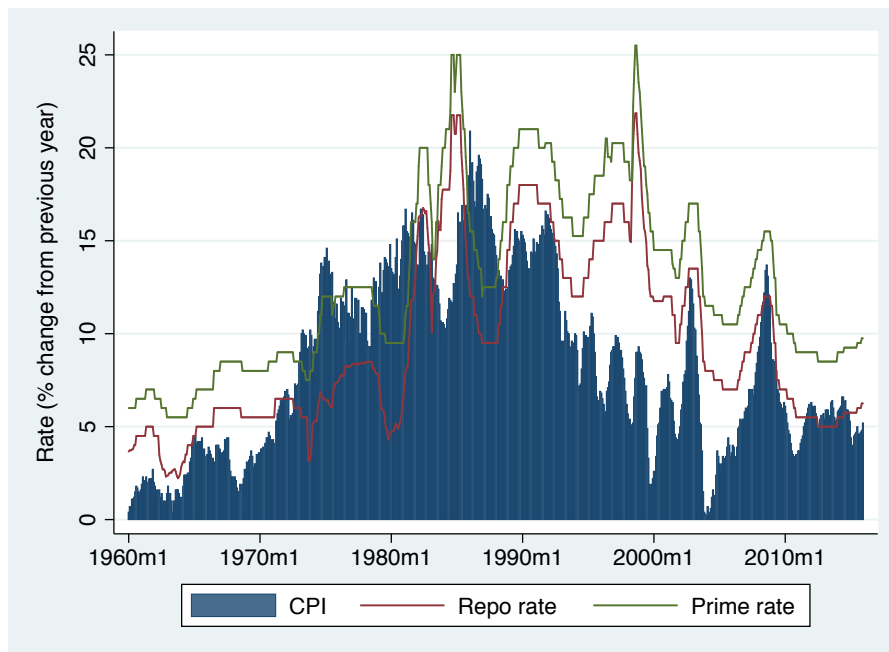
The de Kock (1985, p. 253) Commission had advanced that the SARB “should primarily be charged with ... protecting the internal and external value of the currency”, and exchange rate management still formed an active part of monetary policy. This was incorporated into the Bank’s mission statement of 1990 and the 1993 Interim Constitution. Between 1996 and 1998 the currency plummeted in successive crises and the interventions aimed at exchange rate stabilisation proved both futile and extremely costly.⁸⁸ These failed interventions cemented the decision to move away from the dual objectives of stabilising both the internal and external value of the rand in favour of a focus on domestic price stability. Moves towards this were already evident in the self-conscious rewording of the 1996 Final Constitution, which defined the SARB mandate as simply to “protect the value of the currency” (RSA 1996b, para. 224.1) (this has implication for international trading discussed in Chapter 7).

In line with GEAR prescriptions, interest rates steadily increased between 1994 and 1998 in order to curb inflation. This was despite the fact that by 1994 inflation had already fallen from its recent peak of almost 17% in October 1991 to 7% in April 1994, the month of the first democratic election, and remained moderate, as illustrated in Figure 6.1. Despite this, inflation was the key concern expressed by monetary authorities. In 1998 the Reserve Bank announced its intention of aligning domestic inflation with the inflation rate of South Africa’s major trading partners – essentially its first inflation target. On 23 February 2000 South Africa officially adopted an inflation targeting monetary policy regime. Again approvingly, Aron et al. (2009, p. 7) explained this shift in the following terms:

“GEAR interpreted the long-term monetary policy objective as keeping the real effective exchange rate at a competitive level, inflation low and real interest rates positive, but monetary policy continued to lack a transparent and credible target by which to hold the central bank accountable. The consequence was further uncertainty regarding the goals of monetary policy, until the new and transparent system of inflation targeting was introduced in 2000 (see Chapter 3).”

⁸⁸ The SARB’s net cumulative intervention between mid-February and the end of April 1996 alone was US\$5.3bn, and its net open forward position (NOFP) expanded from negative US\$12bn to US\$23bn between April and August 1998 (Aron and Muellbauer 2007b, pp. 726–727).

Figure 6.1 Inflation and lending rates (1960-2015)



Source: SARB (2016a)

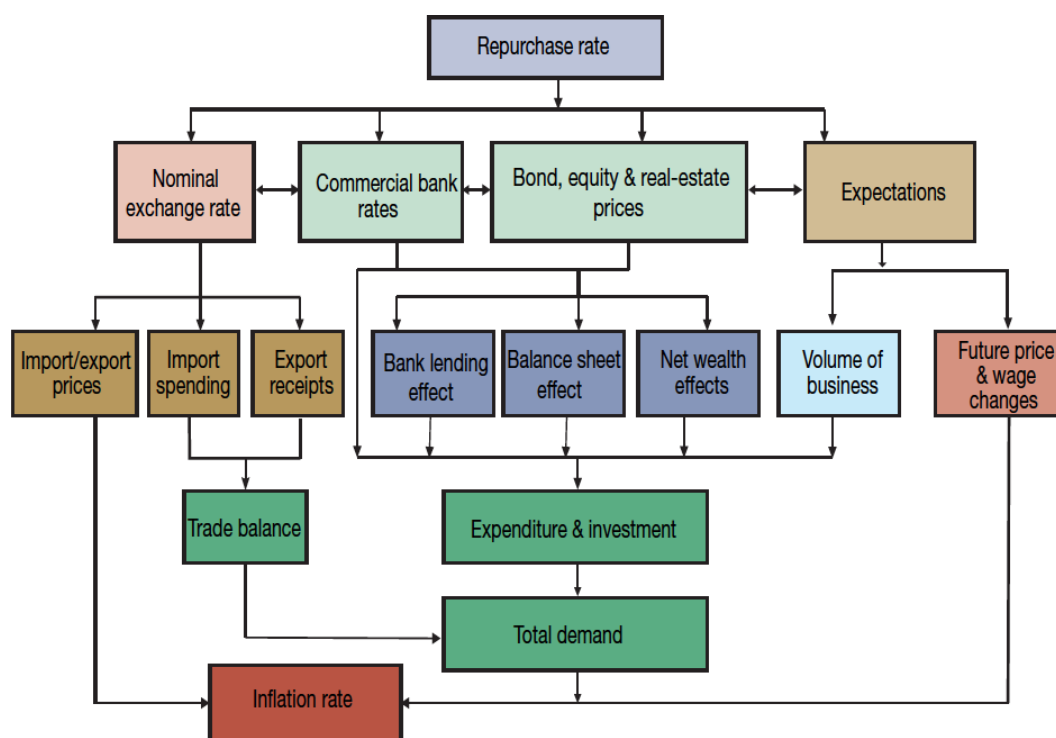
Inflation targeting in South Africa was specified as a commitment to a 3 to 6% target range; this was set by Treasury in consultation with the SARB, with the latter having ‘operational independence’ in achieving this end. The target was originally set to be achieved as an average over a calendar year, and then revised, in 2003, to be achieved on a continuous basis. Over time the SARB has taken a somewhat more flexible approach and does not attempt to bring inflation within the target range over the shortest possible time horizon (2007b, p. 711, Kahn 2008, p. 114). Further, the ‘explanation clause’ allows the SARB to communicate expected deviations in the case of adverse supply-side shocks. The SARB uses the repo lending rate as the prime policy instrument, with interest rates raised to depress inflation. In fact, government officials acknowledge that the SARB has used interest rates “almost exclusively” in its fight to control inflation (Hanival and Maia 2009, pp. 18, 21). More recently, the SARB has received some criticism for being overzealous, maintaining too narrow a focus on inflation, and raising and maintaining interest rates too high. In 2010, in a letter from the Minister of Finance to the SARB, the SARB was instructed to take into account other factors that impact upon sustainable growth. The consensus emerged that the right policy mix is required: a tighter fiscal stance in order to allow for somewhat looser monetary policy (Frankel et al. 2006, Frankel and Sturzenegger 2008).

The purported ability of interest rates to control the money supply is the basic rationale behind their use as the primary tool of inflation targeting. The South African Reserve Bank argues that exogenous shocks – international oil price hikes, currency depreciation, ‘excessive’ domestic wage increases, an increase in food prices, etc. – could ‘trigger’ inflation but that only a continued increase in the money supply ‘sustains’ inflation. Hence, “[p]reventing excessive money supply growth is therefore a crucial element in combating inflation” (SARB 2012a).

The mechanisms through which this operates (in the view of the SARB) is summarised in Figure 6.2 (SARB 2015a). An increase in the repo rate is purported to have four effects. First, it spurs an appreciation in the nominal exchange rate (due to increased demand for rands) directly altering prices via import prices, and indirectly impacting total demand via changes in import spending and export receipts (the trade balance). Second and third, it raises the cost of commercial bank loans, and puts downward pressure on bond, equity, and real estate prices. These reduce bank lending, weaken companies’ balance sheets, and have negative net wealth effects. Together with lowered expectations of the volume of business this reduces expenditure and investment and thus total demand, thereby containing inflation. Finally, expectations are altered, with higher interest rates seen to lead to lower inflationary expectations, thus checking inflationary wage increases (SARB 2004, pp. 23–25).

The last mechanism is seen to be particularly important in containing second round effects of supply-side shocks. These shocks – such as hikes in oil prices – might logically only lead to a one-time rise in the price level. However, the concern is that “higher prices raise expectations of more inflation to come by businesses and trade unions with price and wage setting powers,” causing them to “raise prices and wages in expectation of more inflation and by so doing, cause more inflation” (Kantor and Kavli 2011, pp. 1–2). The SARB is clearly concerned about these inflationary expectations – as they have repeatedly stated publicly – and institutes tight monetary policy to contain them almost irrespective of the nature of the original shock.

Figure 6.2 South African Reserve Bank Monetary Policy Transmission Mechanism



Source: SARB (2015a)

This schema has significant weaknesses both empirically and theoretically. Most patently, rather than acting as a brake on the growth in the money supply, high interest rates have fuelled an increase in the money supply, in part via short-term capital inflows destined almost entirely for the monetary sector that banks lend onwards at high domestic interest rates (these issues are discussed in Chapters 7 and 8). This has fuelled asset bubbles, speculative investment, consumption spending (the opposite effect to that hypothesised above), a rapid growth in imports, and a dramatic worsening of the current account.

Evidence that reductions in inflation occur via the other channels described by the SARB is also weak. Kantor and Kavli (2011) have shown that realised inflation has only had a modest impact on inflationary expectations, but even more clearly the reverse has not held – realised inflation has not been affected by inflationary expectations. This is because inflationary expectations in South Africa are, on the whole, backward looking (as is wage setting). Using the interest rate to target these expectations, particularly in the case of second round effects, is unproductive (it essentially attempts to influence inflation rates that already occurred 2-3 years ago), extremely costly, and can lead to pro-cyclical monetary policy (see Frankel et al. 2006). Kantor (2011) has also provided

evidence to show that inflation in South Africa actually follows (rather than leads) the exchange rate, and is in fact dominated by it; with the exchange rate being “dominated by degrees of global risk aversion” (Strauss 2013) and the nature of capital flows and rand trading discussed in Chapter 7. This exchange rate pass-through effect has been shown to have strengthened since trade and capital account liberalisation (Aron et al. 2012). Further, as higher interest rates may depress domestic demand and growth this may lead to a weaker rand and hence greater inflation (Kantor and Holdsworth 2009).

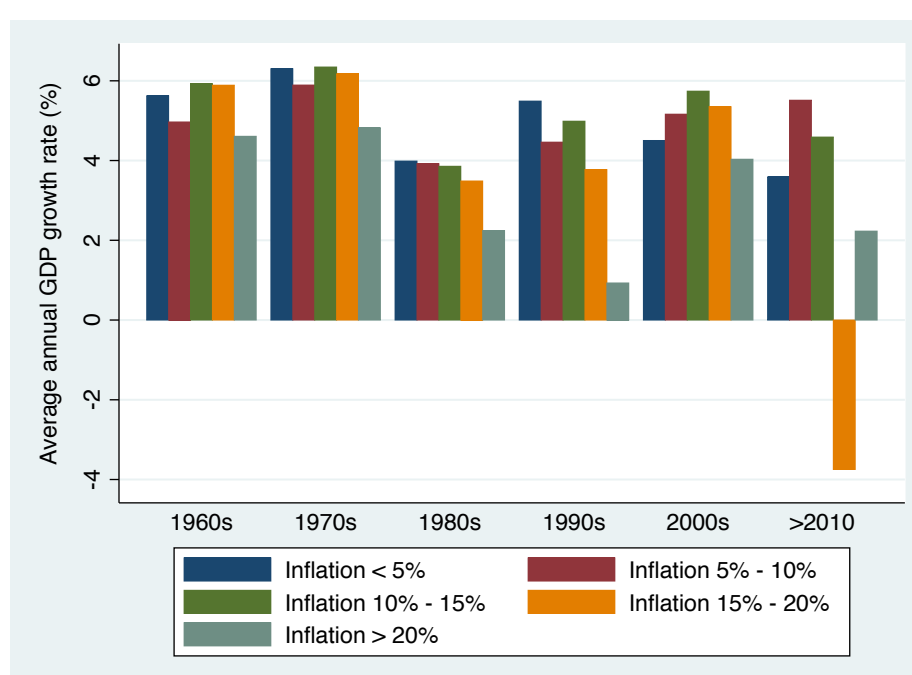
There is some evidence that high interest rates have been successful in containing inflation by constraining domestic investment and output (as mentioned above, the heavily lauded fall of inflation in the 1990s cannot be ascribed to this). However, it does not follow that excessive investment, or an increase in the money supply, is causing inflation, nor that this is the most effective and least costly policy intervention.⁸⁹ The costs are in fact high, and there is little evidence, as proponents of inflation targeting have argued, that under inflation-targeting regimes the losses to output or employment from contractionary monetary policy are lower (Epstein 2003). There is also considerable debate over the extent of harm caused by moderate levels of inflation. Epstein (2003, p. 13) highlights how, for 37 upper-middle income countries, inflation up to 20% had “no clear impact on most real economic variables such as economic growth, investment, inflows of foreign direct investment and similar variables”. IMF research on emerging markets has shown that there are growth benefits to reducing inflation from hyperinflation levels to around 8%.

However, South Africa does not have a history of hyperinflation and by the mid-1990s (1994-1996) inflation was averaging just over 8%. As Barnardt noted: “trying to crush [inflation] below 8 per cent yielded very little reward in relation to the pain such an exercise could involve” (quoted in Padayachee et al. 2000, p. 1361). Comparative data also indicate that countries with moderate inflation (between 8% and 12%) have shown stronger growth than those with low inflation (under 4%). This is highlighted in Figure

⁸⁹ Tackling monopoly pricing, price regulation, industrial policy aimed at increasing productive capacity, targeted policies aimed at slowing down particular inflationary sectors or protecting others, targeted interest rates, financial market reform, and maintaining a competitive exchange rate, all have a role to play in containing inflation. Demand-pull inflation only results from increased demand if present supply conditions are left unaltered. Essentially, the logic of the Reserve Bank needs to be reversed: the expansion of the economy needs to be given priority and if aspects of this are inflationary then the channels through which this is occurring need to be tackled directly.

6.3 which shows average growth rates for middle-income countries at different levels of inflation over different decades; as can be seen higher inflation is not necessarily associated with lower growth. The case for a 3% to 6% target range is, therefore, at best, thin, and as Barnardt argued, on the eve of the institution of inflation targeting, “[i]t takes only a quick glance at our situation to see that accelerating growth and job creation are much more important in the next five years than getting inflation down to 4 per cent or 5 per cent”.⁹⁰

Figure 6.3 Average growth rates for middle-income countries with different inflation levels (1960-2015)

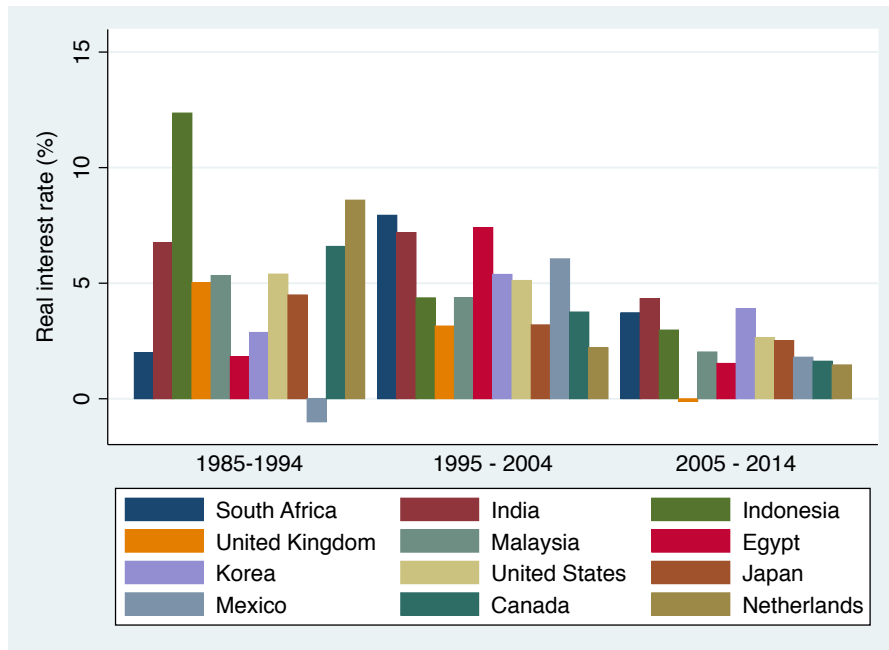


Source: World Bank (2016b), own calculations

The choice of instrument also matters: if inflation is curbed by expanding the economy and increasing domestic supply then the trade-off between low inflation and high growth may not arise. Under certain conditions, wage increases, expansionary government spending, and low interest rates can promote domestic investment and increase productivity, thus expanding supply with a deflationary impact. However, the choice of interest rates as the key policy lever has precluded such a possibility. Given this choice, a clear consequence of post-apartheid monetary policy has been high real interest rates. Figure 6.4 highlights this, comparing South Africa’s interest rates to those of a range of other countries, illustrating that they are comparatively high.

⁹⁰ What is peculiar is that there was little pressure at the time coming from foreign investors, or global credit rating agencies, to reduce inflation to such low levels (Padayachee et al. 2000, p. 1361).

Figure 6.4 Comparative real interest rates (1985-2014)



Source: World Bank (2015b), own calculations

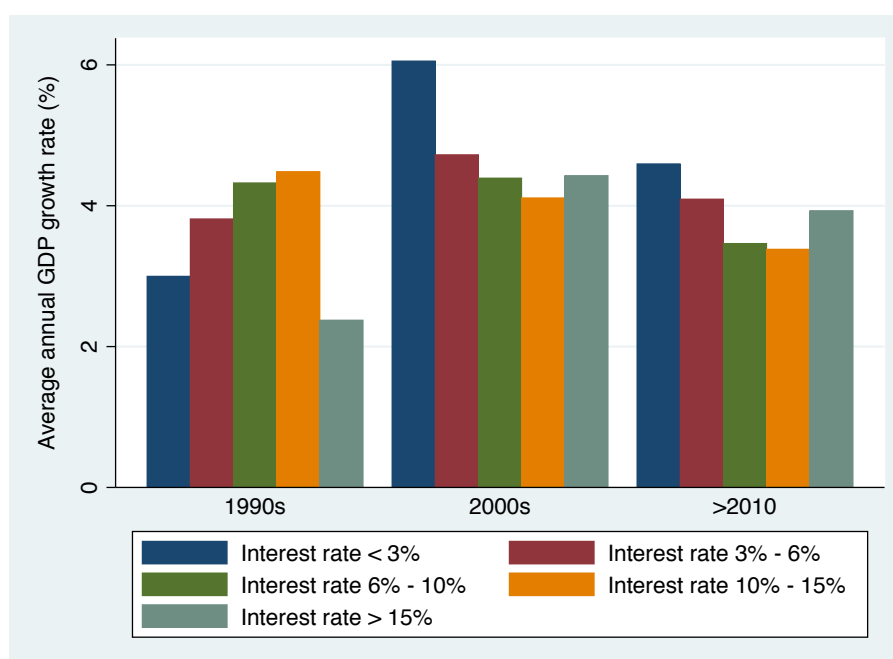
Neo-classical economic theory would argue the impact of such interest rates to be theoretically neutral: in the long run full employment prevails and monetary policy can only affect nominal variables, such as the price level or inflation, and not real variables such as employment or investment.⁹¹ However, in practice, few policy-makers or monetary policy analysts argue that this holds. Instead, considerable concern has been raised over the growth-retarding impact of high interest rates and we can see in Figure 6.5 that, during the period of inflation targeting, middle-income countries with lower real interest rates have grown faster. Even proponents of inflation targeting in South Africa have conceded that excessively high real interest rates in the 1990s hurt domestic growth (Aron and Muellbauer 2007b, p. 725). In 1998 Chris Stals, then Governor of the Reserve Bank, accepted that:

“Nobody will deny it that South Africa has extremely high interest rates at this stage [...] Nobody will deny it that the high level of interest rates is bad for the South African economy, particularly at the current stage of the business cycle and a rather depressed domestic economic situation [...] the high interest rates

⁹¹ This is premised on the veracity of the classical dichotomy for the long run, which implies that real outcomes cannot be affected for long.

will most probably reduce consumption financed with borrowed funds, and also investment in fixed capital, equipment and inventories. The future production capacity of the economy is therefore constrained by the present adverse financial conditions. In terms of domestic needs, South Africa now requires a stimulation of the economy, and would prefer lower interest rates to encourage economic development.” (Stals 1998)

Figure 6.5 Average growth rates for middle-income countries with different real interest rate levels (1990-2015)



Source: World Bank (2016b), own calculations

In general, high interest rates can both impede and distort lending and investment, which has negative ripple effects on employment and national income. Epstein (2003, p. 12) argues that the costs to GDP are high, and Samson (cited in Samson and Bayat 1999) estimates that between 1989 and 1996 disinflation cost South Africa 40% of a year’s national income. However, proponents maintain that this was not the case in the 2000s under the inflation-targeting regime, which they argue is consistent with high growth rates (Aron and Muellbauer 2007b, Kahn 2008). Contrary to this, South Africa has seen mediocre growth and the ‘boom’ of the early and mid-2000s was driven by unsustainable consumption spending (see Chapter 8 and 10). In recent years there have been increasing calls from the business and financial sectors to maintain lower interest rates in order to stimulate growth (Biz-Community 2012). This highlights how the premises of GEAR – that high interest rates would only be necessary in the short term

and that FDI, encouraged by falling interest rates, together with trade and financial liberalisation would contain the current account – have proven to be incorrect.

Inflation targeting, as discussed in Chapters 3 and 4, has been associated with changes in the law that enhance central bank ‘independence’ and this is seen to boost ‘accountability’, ‘credibility’, and ‘transparency’. The South African Reserve Bank Act of 1989 clearly grants the SARB independence in its operations. The Bank continues to have private shareholders (relatively rare internationally) and almost always posts a yearly profit; the Bank is also financially independent with full control of its own resources. The Act also places limits on the Bank’s ability to monetise state debt – that is, limits on state debt that it can purchase – curtailing its ability to play an expansionary role in this regard. This independence was codified in the democratic era in both the interim and final Constitution of the Republic of South Africa. In 2000, the same year as the official institution of inflation targeting, Reserve Bank Governor Tito Mboweni rigorously defended SARB independence on the grounds it was found to have a negative correlation with inflation and budget deficits, and no relationship with growth (Mboweni 2000).

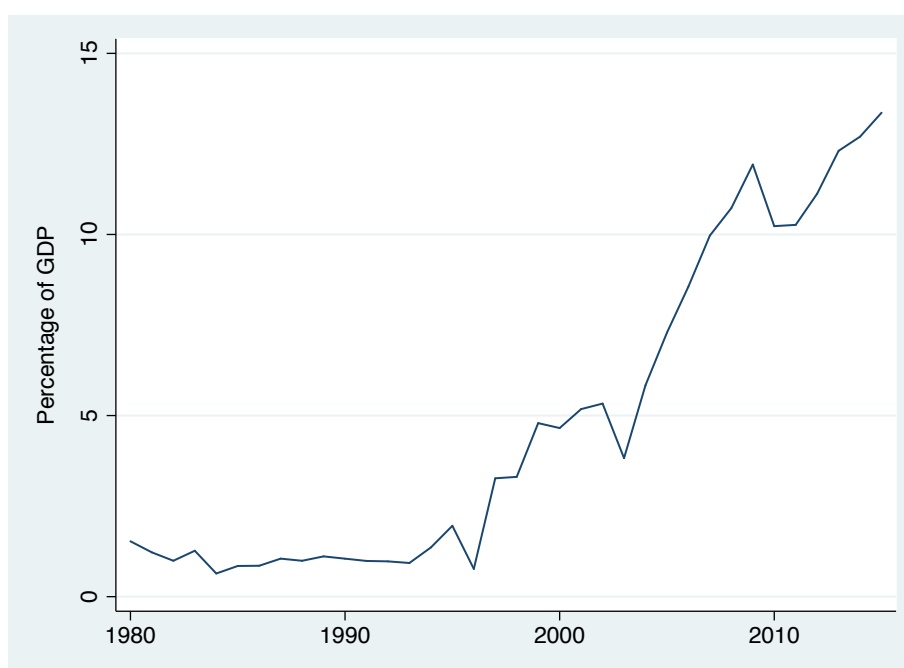
The Central Bank does not enjoy ‘full’ independence in the sense that policy is coordinated with the National Treasury and the Treasury can issue explanatory memoranda instructing the SARB to pursue certain policy objectives, as was the case with inflation targeting (2000) and its later partial relaxation (2010). The SARB, however, retains operational independence over how this is to be achieved, allowing it to pursue price stability through the channels discussed above, irrespective of the broader developmental consequences. The Bank is also mandated to improve ‘transparency’, which it has done through regular reports to the public, shareholders, and Treasury; this has greatly expanded access to SARB information. The specific consequences of this independence, beyond the usual insulation of the Central Bank from direct democratic control and the fact that the Central Bank feels the need to cater to financial market pressures, are unclear. Certainly greater independence has gone hand-in-hand with inflation targeting and conservative monetary policy more generally, and this has facilitated the Bank’s ability to undertake such policy under a guise of neutrality. The binding nature of inflation targeting combined with independence, therefore, acts as a deterrent to policies with alledged inflationary consequences, such as

progressive labour legislation (Aron and Muellbauer 2007b, p. 736), indicating the very political nature of insulating monetary policy from ‘political interference’.

6.3.3 The exchange rate, reserve accumulation and market making

Despite the heavy emphasis on domestic price stability, concern over the exchange rate has not disappeared from monetary policy. The currency crises in 1996 and 1998 led the SARB away from direct intervention aimed at stabilising the exchange rate and so it has pursued other measures to manage exchange rate dynamics. The central intervention, in line with international trends, has been foreign-exchange reserve accumulation (SARB 2004), the build-up of which is highlighted in Figure 6.6. This has come along with costly sterilisation and liquidity provision, topics taken up in the next chapter. Other interventions proposed to tackle the rand’s volatility and appreciation (the latter in the early and late 2000s) included: countercyclical fiscal policy to balance structural deficit and offset private capital inflows; active market intervention using reserves; liberalising capital outflows; raising the savings rate; and, as a last resort, instituting market-based disincentives to discourage destabilising short-term capital inflows (OECD 2010, pp. 15–16, 48–49, 2013, p. 23, Lysenko and Barnard 2011, p. 14). All of these, barring an increased savings rate and capital-flow disincentives, have been enacted over the last decade and their consequences are explored in later chapters. The NDP makes it clear that measures employed to combat currency volatility should not be unduly interventionist and this is certainly congruent with current policy.

Figure 6.6 International reserves (1980-2015)



Source: IMF (2016a, 2016b) via Quantec, own calculations

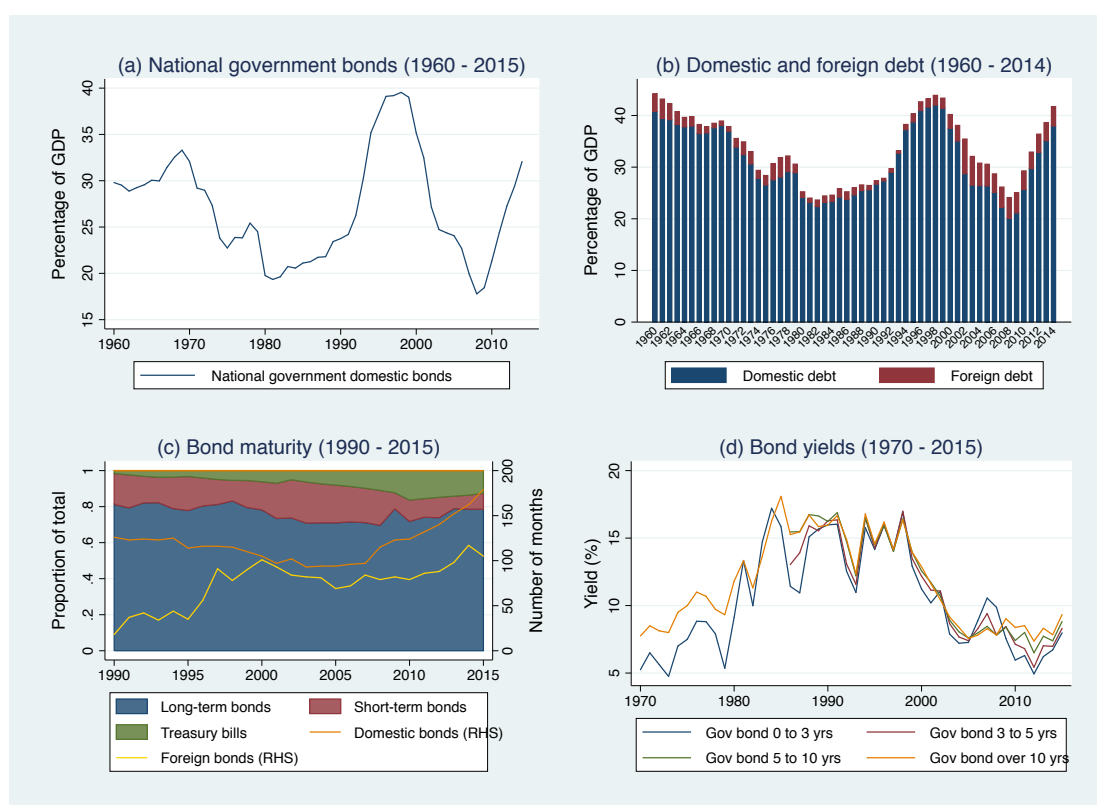
Note: SARB (2015a) data on international reserves in USD show slightly higher amounts (particularly for 1980-1995) although the trend is the same

We also discussed in Chapter 4 the role of the state as a market maker. In South Africa, we noted in Chapter 5, that the state played this role very early on, with expanding local bond markets in the 1960s essential to the development of the capital market more generally. These, we noted, gained greater depth and liquidity in the late 1970s and 1980s. The current state of the South African national government debt markets (for both bonds and Treasury Bills) is shown in Figure 6.7. In Figure 6.7a we see that the domestic bond market in 1970 was as large (as a percentage of GDP) as it was in 2014 (32%), with a significant spike in the late 1990s. Total debt is overwhelmingly domestic, as can be seen in Figure 6.7b, with a recent increase in foreign debt in the 2000s; the private non-bank sector, most prominently large institutional investors, consistently holds the largest share of domestic debt. Figure 6.7c shows that the state has also managed to increase the maturity of its debt. While this highlights how government bond maturities have lengthened, other instruments such as very short-term repos and debentures, have grown enormously, thus ensuring market liquidity, this is taken up in the next chapter.

Aron et al. (2010) note how government foreign borrowing provides a benchmark against which other South African borrowers access international capital. They stress

that, “this benchmarking function may be viewed as one of the primary goals of external borrowing as the developed domestic bond market has long provided a key source of public sector financing” (Aron et al. 2010, p. 3). The bond yields are, however, high, as can be seen in Figure 6.7d. Given this benchmarking function, the cost of capital for South African borrowers on international capital markets is often also high. One reason for these high bond yields is likely to be high domestic interest rates tied to inflation targeting.

Figure 6.7 Breakdown of South African government debt



Source: SARB (2016a) via Quantec, own calculations

Figure 6.7 illustrates that the national government may not be playing a new market-maker role via its bond markets. Rather, it is through other markets that this role is being played. This includes new or much larger bond markets for local government and parastatal debt, as shown in Table 6.1 (pension funds and long-term insurers hold the overwhelming majority of this debt). The state has also encouraged (not least of all through liberalisation) the growth of currency and derivative markets; markets explored in greater depth in forthcoming chapters. Finally, the state has also played an important role in promoting mortgage markets and securitisation as will be discussed in Chapter 10.

Table 6.1 Local government and public enterprise domestic marketable bonds (1995-2015)

Bond issuer	R millions			Percentage of GDP		
	1995	2005	2015	1995	2005	2015
Local government	7,480	4,665	17,943	3	2	6
Non-financial public enterprises and corporations	58,014	65,800	230,094	20	23	81
Financial public enterprises and corporations	2,964	5,466	34,659	1	2	12

Source: SARB (2016a), own calculations

Notes: years refer to end of period on 31 March of that year

6.4 Conclusion

Building on our discussion on the evolution of monetary policy under apartheid in the previous chapter, this chapter has reviewed a number of crucial ways in which the post-apartheid government has intervened in the financial and monetary economy – demonstrating both continuities with the past and important innovation. Three seemingly independent interventions have been explored here: radical financial liberalisation and financial market reregulation; price stability as the stated objective of monetary policy and the use of interest rates to achieve this; and the role of the state in stabilising the exchange rate, accumulating reserves, and market making. The three, while presented in separate subsections, are very much interconnected.

The state's relationship to this interconnection is contradictory. On the one hand, government policy has at times appeared to conceive of each of them independently of one another. For example, while liberalisation and price stability both feature within GEAR the interrelation between liberalisation, a particular pattern of capital flows, and what this means for the ability to achieve price stability, is poorly captured in the SARB framework. This is implicitly premised on false dichotomies drawn in orthodox economic theory between the macro and the financial. On the other hand, the means through which price stability has been pursued serves other (often unstated) objectives. For instance, high real interest rates have provided the basis for high yields in capital markets tilted towards short-term speculative flows. This has been achieved, for example, via carry-trade operations and asset-price inflation, while sharply influencing the movements, levels, and volatility of the rand and necessitating reserve accumulation and sterilisation to ensure market liquidity in different ways. At the same time such

inflows have compensated for significant capital flight, both legal and illegal; all of this is taken up in Chapter 7. Another false dichotomy, between the financial and the real economies, obscures how their interactions influence the dynamics of investment within the economy – between financial and real investment, corporates of different nature and size, and between corporates and the state, often entrenching patterns of lending that favour large established corporates; these issues are pursued in Chapters 8 through 10. The state's relationship to the interconnectedness of these three aspects of monetary policy is contradictory because it appears to pursue them in partial isolation from each other despite the manner in which they are clearly connected.

Nonetheless, there is a coherence across these contradictions, because the combination of policies serves particular interests within the economy that revolve around the restructuring of the MEC (Chapter 9) and facilitates a comprehensible outcome – financialisation (even if this is not necessarily a planned and coordinated intent of the state). Indeed, the narrowing of monetary policy to price stability – that is, the separation of these dimensions from one another – serves to obscure the relationships entailed between them and hence how the outcome is reliant on their mutual coexistence. The prioritisation of inflation targeting and the use of relatively high real interest rates towards that end, despite the demonstrable deleterious consequences – while partly premised on the uncritical adoption of international 'best practice' – can only be fully understood in this context. The rhetorical narrowing of monetary policy to domestic price stability has allowed for the manner in which its practical exercising has facilitated, and been shaped by, financialisation to go unremarked. As with the (rhetorical) pursuit of macroeconomic 'stabilisation' more generally, such policy choices accept the existing growth path and economic configuration and obscure the on-going financialisation of the economy.

The policy framework laid out in this chapter, as will become clear in later chapters, has been critical to the broader restructuring that has occurred, at the heart of which stands financialisation, as well as the maintenance of the MEC. For instance, Chapter 9 highlights that central to the restructuring of big capital in South Africa (represented by the former conglomerates) was the ability to diversify abroad and take capital out of the domestic economy as part of global integration of South African productive and financial capital. Similarly, Chapter 7 explores the terms upon which South Africa has

been incorporated into global financial markets, demonstrating not only that policy has shaped this integration but also how policy itself is bound by the nature of this integration; it is to this we now turn.

7 INTERNATIONAL FINANCIAL INTEGRATION

7.1 Introduction

A persistent theme in the previous chapter was the liberalisation of the South African economy. In Chapter 4 we showed how this has been crucial to financialisation in DTECs. In this chapter, based on our discussion in Chapter 4, we interrogate South Africa's international financial integration. We focus, in particular, on the nature of capital flows and new external vulnerabilities, the former having strong consequences for the latter. We begin, in Section 7.2, by examining the extent of liberalisation and the composition of capital flows in the post-apartheid period. We then turn, in Section 7.3, to assess whether South Africa has become exposed to similar external vulnerabilities as those observed in the financialisation literature. In particular, we focus on the trading of the rand and currency dynamics, carry trade, and the relationship between capital inflows and domestic asset markets. These have had various consequences for the economy and elicited important responses from the state, some of which are explored in Section 7.4. Finally, we highlight, in Section 7.5, the scope and nature of capital flight from South Africa and what this means for the economy. Together, these allow us to assess the nature of South Africa's global integration and some preliminary consequences of this. This chapter reveals the importance of international financial integration for financialisation in South Africa, a theme present throughout the rest of the thesis.

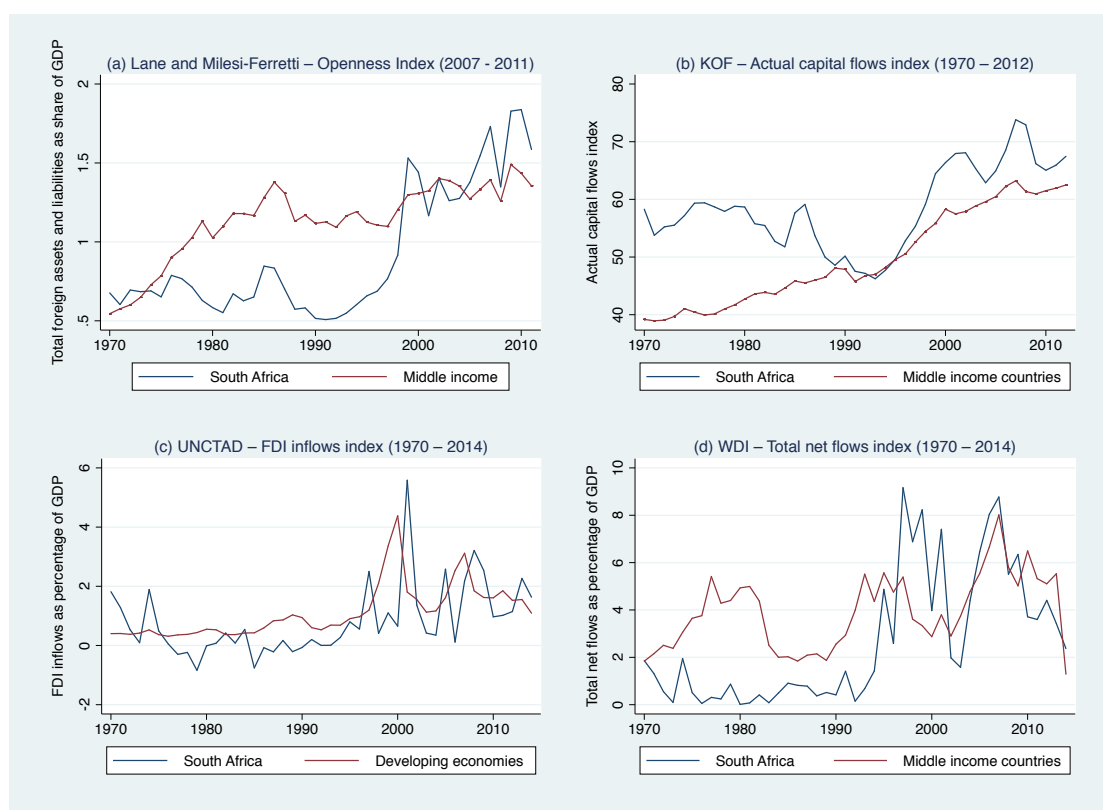
7.2 Financial liberalisation and the pattern of capital flows

7.2.1 Liberalisation

There is no consensus on the best way to measure financial openness with three approaches dominating: *de jure* measures – which reflect legal restrictions (or lack thereof) on capital mobility – and *de facto* measures – which reflect the actual extent of capital mobility – or some hybrid of these two. Here we use six prominent datasets to assess the level of openness of the South African economy (see Quinn et al. 2011, Clark 2012). Interestingly, and despite the process of liberalisation described in the previous chapter, according to *de jure* measures, most of which use the IMF's *Annual Report on Exchange Arrangements and Exchange Restrictions* (AREAER), the South African economy is

shown in Figure 7.1 to be relatively closed. In Quinn and Toyoda (2008) (Figure 7.1a and Figure 7.1b) South Africa is less open than all regional averages for almost all years (although because this dataset ends in 2004 its value is somewhat limited). Similarly in Chinn and Ito's (2006) and Fernández et al.'s (2015) indices (Figure 7.1c and Figure 7.1d, respectively), South Africa is more closed than middle-income averages. By contrast, Yu (2014), using a weighted system, shows that South Africa is the ninth most open economy of the G20 countries, indication that not all *de jure* analyses yield identical results.

Figure 7.1 *De jure* measures of financial openness

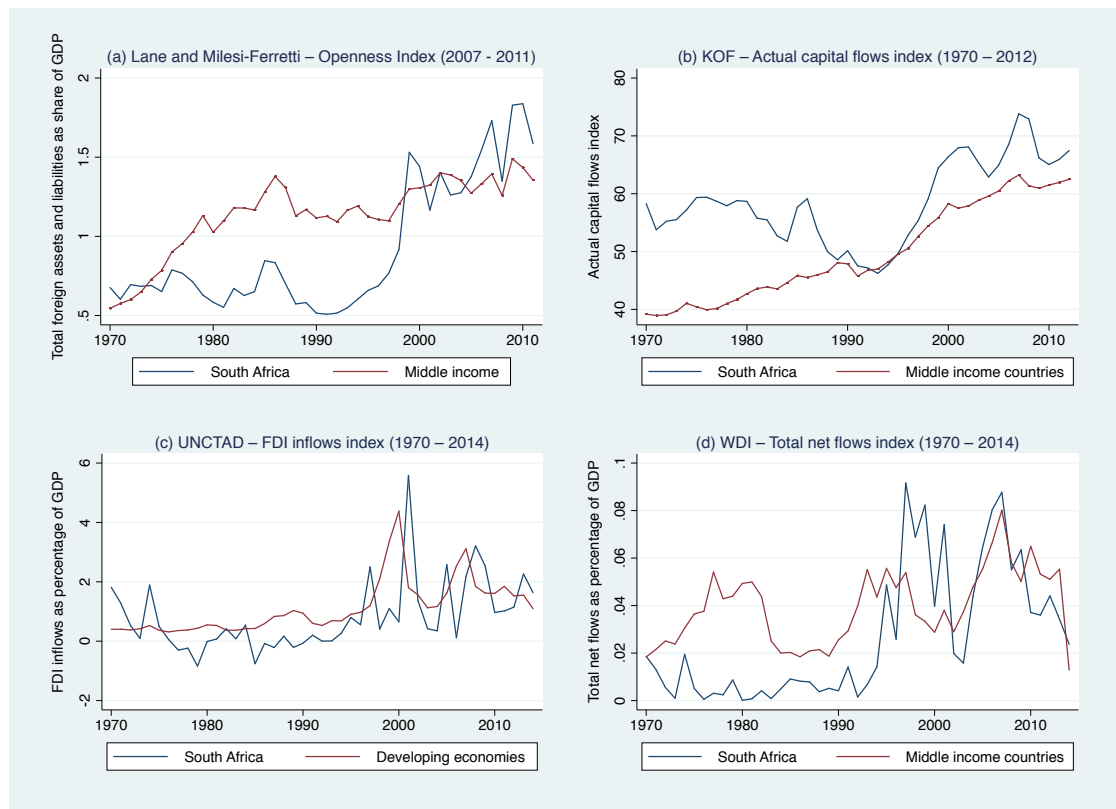


Source: (a) and (b) Quinn and Toyoda (2008); (c) Chinn and Ito (2006) updated to 2013; (d) Fernández et al. (2015)

When it comes to *de facto* measures, shown in Figure 7.2, South Africa appears relatively open. In Lane and Milesi-Ferretti (2007) (Figure 7.2a), which uses Kose et al.'s (2009) preferred measure of *de facto* openness and arguably the most comprehensive of the *de facto* measures, cross border capital flows shoot up in the late 1990s, and from the mid-2000s, South Africa shows itself to be more financially liberalised than the middle-income country average. The timing of this jump is congruent with capital account liberalisation, which accelerates from 1995 onwards, and increased financialisation in the

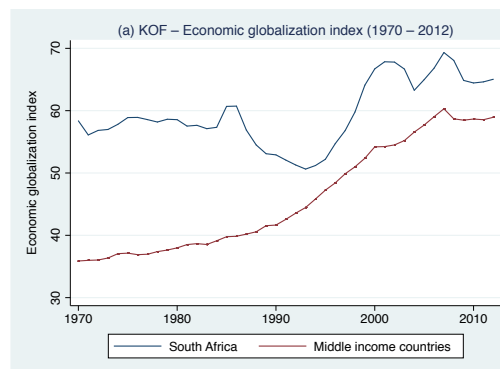
2000s. The KOF actual capital flows index (Dreher 2006) also shows South Africa as consistently more liberalised than the middle-income country average (Figure 7.2b). UNCTAD's (2015b) measure of FDI inflows as a percentage of GDP is also used to measure liberalisation (Figure 7.2c). Here, South Africa is close to, but just below, the middle-income country average for most years. This, however, says more about the composition of capital flows than the extent of liberalisation. Using the World Development Indicators we can see that when you take account of net FDI inflows, net portfolio, and debt flows, as a percentage of GDP, South Africa, for most years since the mid 1990s, exceeds the middle-income country average (Figure 7.2d). Finally, in the KOF hybrid index (Dreher 2006) shown in Figure 7.3, a composite of *de jure* and *de facto* measures, South Africa is consistently more liberalised than the middle-income country average. These *de facto* and hybrid measures make it clear that the legislative process described in Chapter 5 as well as potential unregulated flows show up as greater capital openness. Financial liberalisation is therefore reflected in Figure 7.4 which shows a dramatic increase in the stock of foreign assets and liabilities as a percentage of GDP rising from a low of 17% and 29% in 1990/1 to 117% and 121% in 2013, respectively. This occurs in tandem with *de facto* liberalisation shown above and policy changes discussed in the previous chapter.

Figure 7.2 De facto measures of financial openness



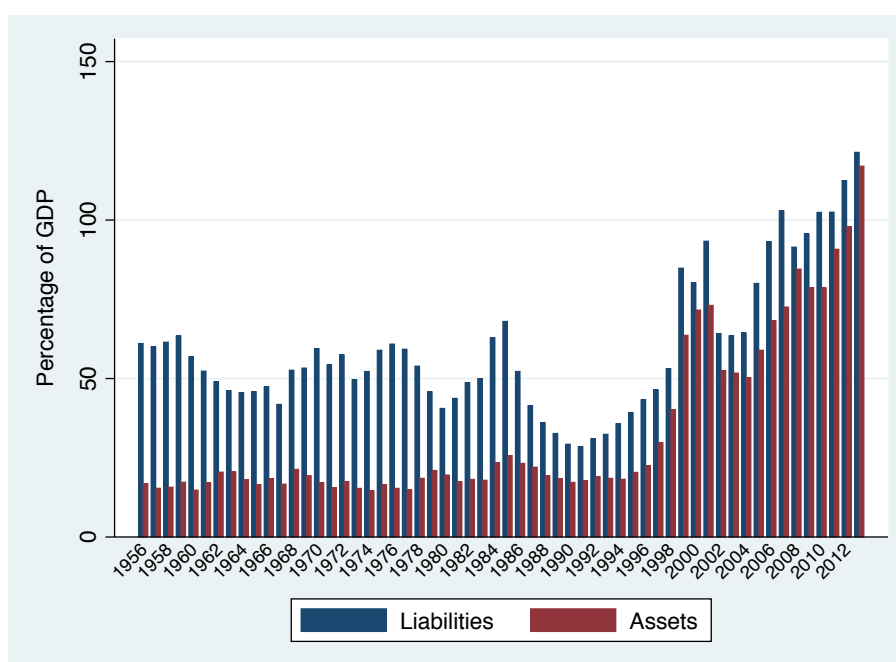
Source: (a) Lane and Milesi-Ferretti (2007) updated to 2011; (b) Dreher (2006) updated to 2012; (c) UNCTAD (2015b); (d) World Bank (2015a).

Figure 7.3 Hybrid measures of financial openness



Source: (a) Dreher (2006) updated to 2012

Figure 7.4 Stock of foreign assets and liabilities (1956-2013)



Source: SARB (2015a) via Quantec, own calculations

7.2.2 Composition of capital flows

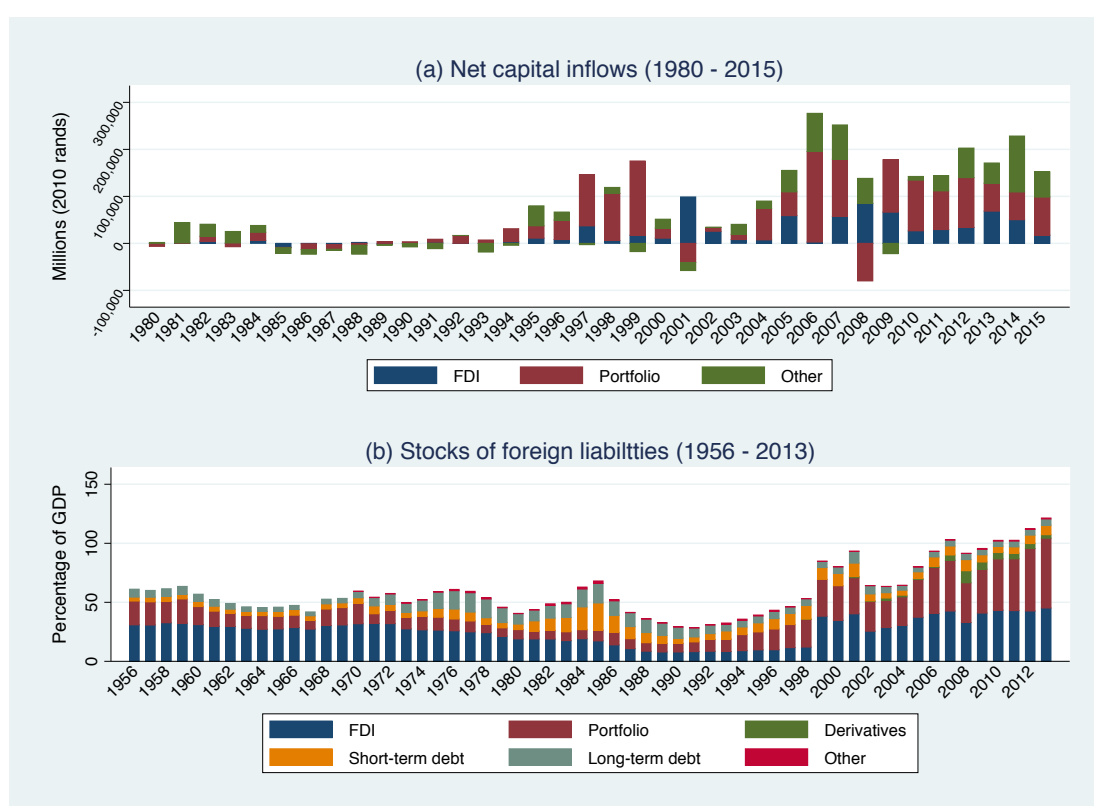
The composition of capital flows plays an important role in determining their eventual impact on the domestic economy. On an aggregate level, portfolio flows (investments in debt and equity securities) have been the most significant, with FDI and ‘other’ investments (the latter including loans, trade credit, currency and deposits, and others) playing a secondary role.⁹² The nature of inflows (investment in South Africa from abroad) and outflows (South African residents investing abroad) is somewhat different. This reflects South African political economy as well as variation in the process of liberalisation. As noted in Chapter 6, whereas the lifting of exchange controls and global integration abolished almost all obstacles for foreign investment into South Africa, the lifting of restrictions on outward investment was more gradual.

Figure 7.5 shows net capital inflows split by type and the net stock of foreign liabilities also by type (the latter are assets held in South Africa by foreigners). These confirm the predominance of portfolio inflows as well as a clear increase in flows post liberalisation. Although FDI increased after 1994 these inflows have remained comparatively low,

⁹² It is worth recalling that any portfolio equity flow constituting more than a 10% acquisition of a company’s stocks is considered FDI and not portfolio, thus potentially undervaluing a true reflection of the latter.

indicating the failure of FDI-orientated macroeconomic policy (beginning with GEAR, see Chapter 6). Several large spikes in FDI inflows are associated with economic restructuring and foreign bank entry (discussed further in Chapters 8 and 9). In recent years FDI inflows to South Africa have been driven by the service sector, with finance and real estate playing a leading role (other service sectors like retail, telecommunications, and transport are also important); the stock of inward manufacturing FDI has steadily declined as a share of overall FDI (UNCTAD 2015c).⁹³ FDI inflows are considerably below the level received by other middle-income countries which averaged 2.9% of GDP between 2007 and 2016, compared with South African average inflows of 1.7% over that same period (SARB 2015a, World Bank 2016a). While FDI inflows have been lacklustre, Figure 7.5b shows that there is still considerable foreign ownership of the South African economy. In 2008 the stock of FDI as a percentage of GDP was 28% whereas UNCTAD estimates the average stock of FDI in developing countries to be 25% in the same year (with considerable variation across countries) (Aron et al. 2010).

Figure 7.5 Capital inflows and stocks of foreign liabilities

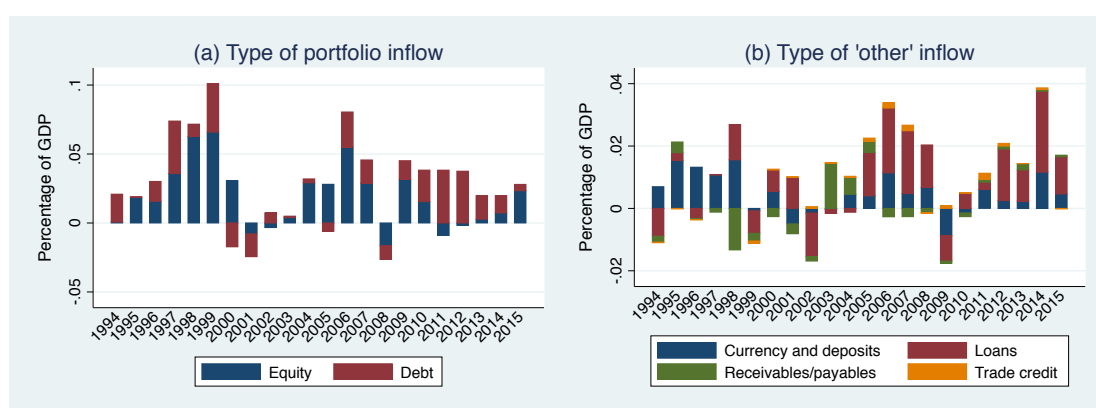


Source: SARB (2015a) via Quantec

⁹³ We discuss some of these developments and the accompanying restructuring of South African corporates in Chapters 8 and 9.

Figure 7.6a and Figure 7.6b disaggregate portfolio and ‘other’ inflows, respectively. Regarding portfolio flows, distinct periods stand out. In the wake of liberalisation, 1997-1999 is a period of portfolio rebalancing by both residents and non-residents. The facilitation of ‘asset swaps’ plays a critical role here. This enabled South African institutional investors (up to a given limit) to swap blocks of domestic assets with non-residents for foreign assets (Aron et al. 2010).⁹⁴ This was intended to support foreign diversification but also highlights the importance of institutional investors (taken up in the next chapter) and the process of internationalisation discussed in Chapter 9. The 2001-2003 slump in inflows relates to both domestic and international factors, the former included political events, such as uncertainty in the mining sector, as well as economic factors. Again, the restructuring of relationships between now UK-based Anglo American and SA-based De Beers had a major impact in 2001. The fall (2001-2003), rebound (2004-2006) and crash (2007-2008) of equity flows highlights the importance of international factors. During the fall (2001-2003), net portfolio equity to the developing countries reached its lowest level in US dollar terms since the early 1990s. Loose monetary policy at the core and the global financial crisis help explain the rebound and crash, respectively. Aron et al. (2010) show that US growth, the expansion of US stock markets, and international risk aversion played important roles in driving inflows into South Africa, as does the relative price of South African stocks.

Figure 7.6 Types of inflows (1994-2015)



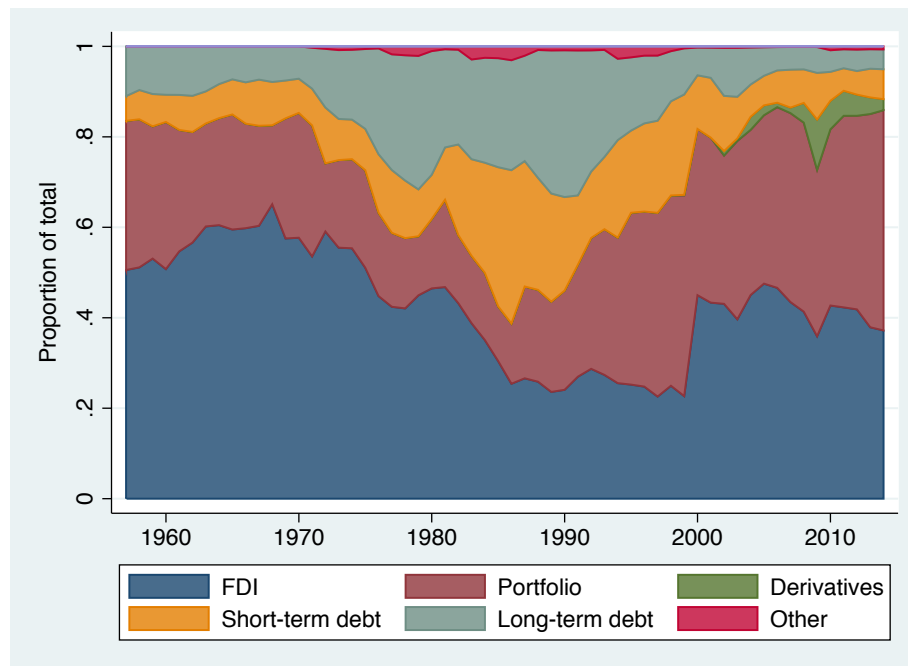
Source: (a) and (b) IMF (2016c), own calculations

⁹⁴ The limit in 1995 was 5% but this was increased to 10% in 1996 and 15% in 1998, and to 20% for collective investment schemes in 2000. In addition, there was a ‘cash flow allowance’ based on the value of the net inflow from the previous year subject to the overall foreign asset limit. The swaps also included a ‘lock-in’ period for foreign investors to protect the balance of payments. The asset swap mechanism was withdrawn in 2001 having achieved its diversification objective. These asset swaps played an important part in the exchange rate crises of this period (Kantor 2013).

Regarding bonds it is crucial to note that the currency denomination has shifted, whereas foreign currency denominated foreign debt (of the government and private sectors) was 83% of foreign debt in 1990 it fell steadily reaching a low of 43% in 2012 then rising to 56% in 2015 (SARB 2016a, own calculations). Further, only 10% of government debt is in foreign currency (National Treasury 2016, p. 85); we return to the significance of this in Section 7.3. Subsequent to the global financial crisis, debt has also taken on a leading role, with government debt dominating (IMF 2016c, own calculations).

The general ebb and flow of ‘other’ inflows (Figure 7.6b) is similar to portfolio flows with loans and deposits playing a prominent role. These ‘other’ inflows are overwhelmingly short-term – currency and deposits, receivables/payables, and trade credit are short-term by nature, while the majority of loans are also short-term, particularly loans made to banks. SARB data in Figure 7.7, showing the proportion of the stocks of foreign liabilities, confirms a marked shift around 1990 with the share attributable to long-term debt and FDI falling and the stock of portfolio assets rising. More disaggregated SARB flow-of-funds data (not shown) also confirms a shift towards short-term inflows (SARB 2015d, own calculations).

Figure 7.7 Stocks of foreign liabilities (1956-2013)



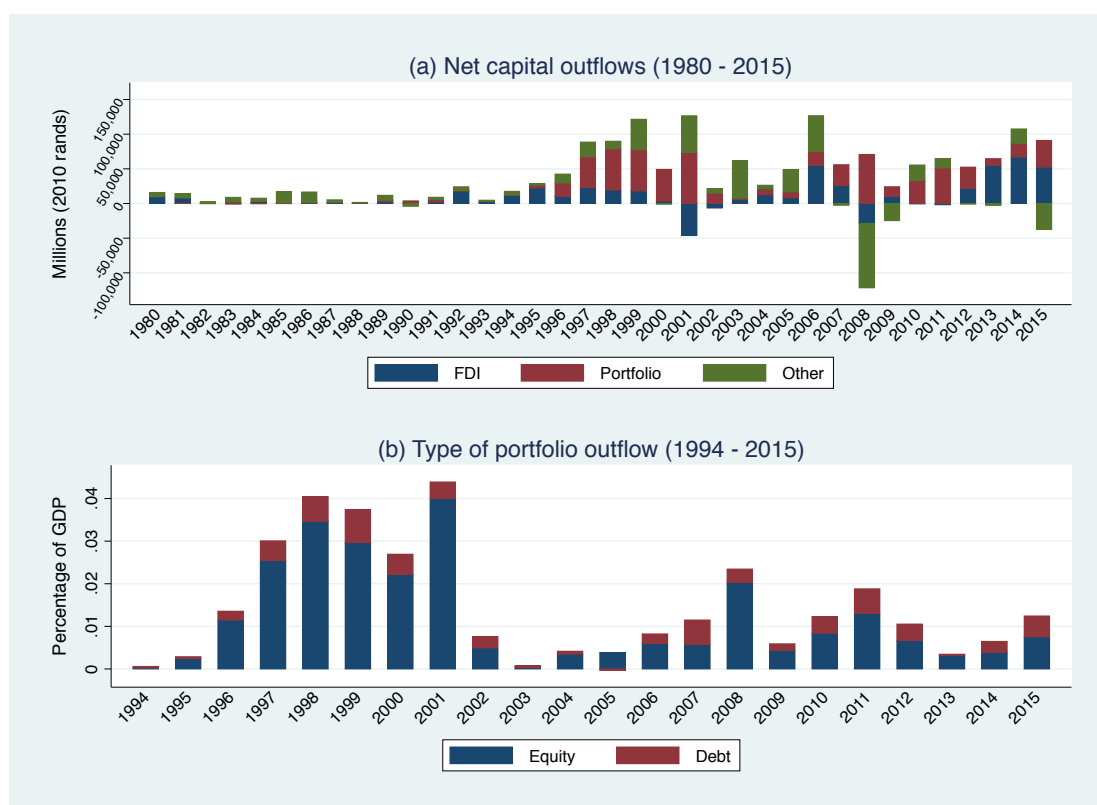
Source: SARB (2015a) via Quantec, own calculations

As discussed in Chapter 4 regarding DTECs generally, capital inflows to South Africa are strongly influenced by conditions at the capitalist core. Portfolio and other flows, for instance, drop sharply from a net inflow of R6bn in the third quarter of 2008 to a net outflow of R64bn in the fourth quarter of the same year in line with the onset of the global financial crisis. Conversely, there is a sharp recovery in the wake of QE contributing to a net inflow of portfolio and other flows of R42bn in the third quarter of 2009. A spurt of QE occurs in the first half of 2011 and inflows spike in tandem to R50bn. These inflows peak at R100bn in the third quarter of 2014 following a year and half of balance sheet expansion by the Federal Reserve (SARB 2015a, Federal Reserve 2016).

Capital outflows from South African residents are displayed in Figure 7.8 (flows) and Figure 7.9 (the stock of foreign assets held). Similar to capital inflows we see a large rise after 1996 although outflows are less than inflows. Portfolio flows make up a sizable share of these flows, particularly from 1997 to 2001 when the ‘asset swaps’ discussed above played a leading role. FDI is negative in 2001 again relating to the corporate restructuring discussed in Chapter 9. Net outflows are weaker after this initial surge but pick up immediately before and during the global financial crisis and have steadily increased since then. Figure 7.8b shows that, unlike for foreign investors, South

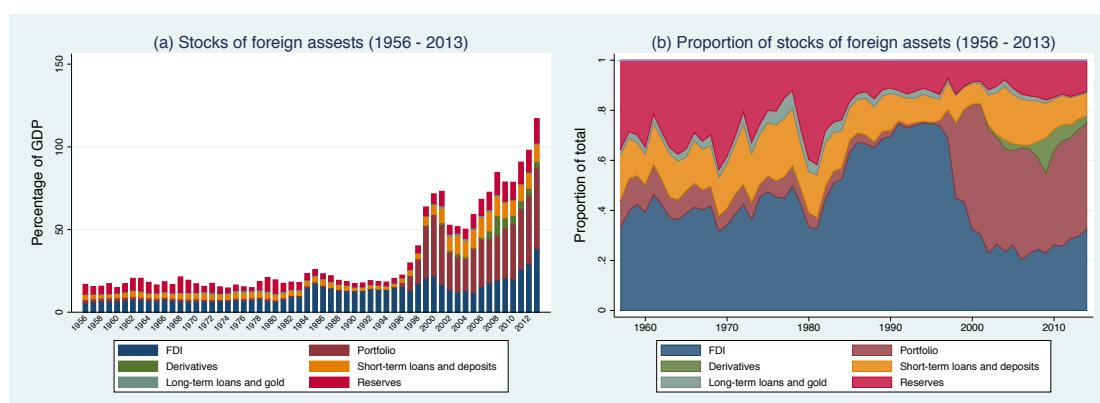
Africans are investing in equity not debt. This makes sense given the importance of emerging markets' debt markets to international investors, and the portfolio diversification needs of local South African investors. Debt is held predominantly by non-bank financial institutions but banks play a role, particularly in the last decade, whereas equity assets are held by (ill-defined) 'other sectors' which includes NFCs and non-bank financial institutions (IMF 2016c, own calculations). In certain years 'other' outflows are significant, predominately due to deposits made abroad, and predominately by banks (IMF 2016c, own calculations). Investment outflows (dividends and interests payments) have also been significant, given large foreign ownership; from 2005 FDI accounted for the largest share of such outflows (Strauss 2016). In recent years, outward FDI has been important as South African businesses expanded more heavily into Africa and this is reflected in the growing stock of FDI from the mid-2000s shown in Figure 7.9a. Despite this, Figure 7.9b highlights that portfolio assets have grown extraordinarily as a share of foreign assets since 1995 from 2% to 42% in 2013.

Figure 7.8 Capital outflows



Source: (a) SARB (2015a) via Quantec, own calculations (b) IMF (2016c), Balance of Payments, own calculations

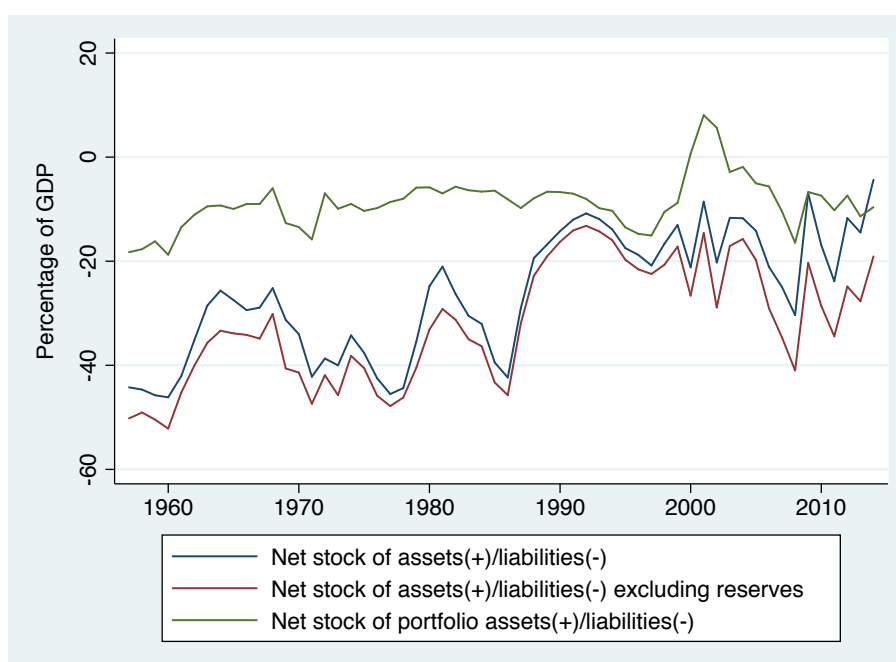
Figure 7.9 Stocks of foreign assets and liabilities (1956-2013)



Source: SARB (2015a) via Quantec, own calculations

Given that inflows outstrip outflows and stocks of liabilities are greater than stocks of assets, it is no surprise that South Africa remains a net recipient of funds from the rest of the world, at odds with the emerging market trend and despite a significant increase in the holding of foreign reserves (see Section 7.4.2). We see in Figure 7.10 that the net stock of foreign assets/liabilities is consistently negative and that from 1990 onward it is far more closely related to the net stock of portfolio assets/liabilities than in prior years indicating the determining role of these flows in recent decades. We discussed in the previous chapter how South Africa has had to maintain high interest rates in order to sustain these capital inflows. The pro-cyclical nature of capital flows means that increases to interest rates are likely during hard times in order to continue to attract capital with the potential to further exacerbate the downturn by constraining domestic investment.

Figure 7.10 Net foreign position and net portfolio stock (1956-2013)



Source: SARB (2015a) via Quantec, own calculations

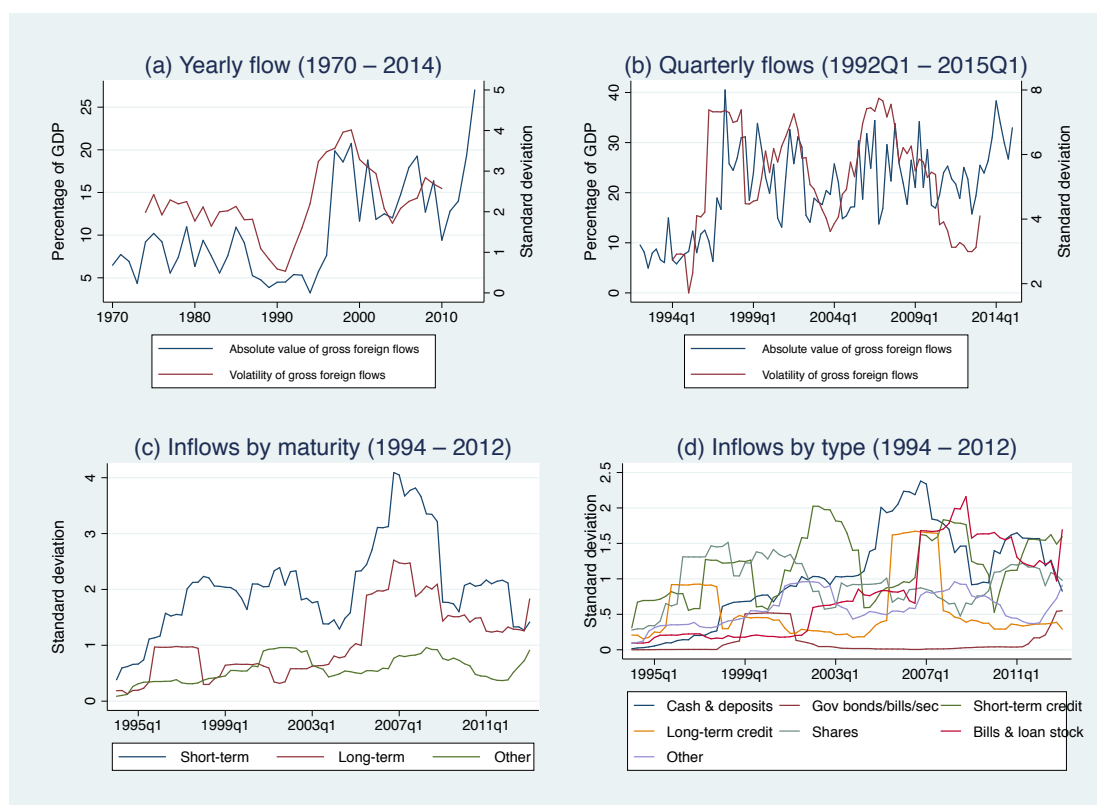
Given the rise in short-term flows shown above it is no surprise that we observe in South Africa significant increases in the volatility of capital flows since 1996. This is significant as we noted in Chapter 4 that volatility in capital flows has harmful consequences on growth and output. Figure 7.11 shows volatility of various flows using yearly and quarterly flow-of-funds data, measuring the standard deviation from a rolling mean (as laid out in Broto et al. 2008, p. 13).⁹⁵ We see in Figure 7.11a that volatility picks up in the early 1990s and in Figure 7.11b that it is again particularly pronounced around the global financial crisis, again highlighting the relationship between capital flows and the capitalist core. The main driver of this volatility has been short-term flows, as shown in Figure 7.11c, with the volatility of different types of flows shown in Figure 7.11d. Interestingly, Aron et al. (2010) argue that it is debt not equity flows that drive portfolio volatility and show that between 1999 and 2006 bonds were, on average, held for only 1.2 months by foreigners whereas equity was held for 13.6 months; however, the latter is down from around 15 years in the 1980s (Bowman 2016, p. 28).⁹⁶ This is reflected in Figure 7.11d where ‘bills and loan stock,’ essentially debt, become

⁹⁵ The standard deviation is not necessarily the most refined measure of volatility (see Broto et al. 2008), but one widely used, including in publications from the World Bank (Claessens and Ghosh 2013) and IMF (Ghosh et al. 2014). For yearly flows (1970-2014), the rolling mean is taken over a five-year period and, for quarterly flows (1992Q1-2015Q1), the rolling mean is taken over nine quarterly periods. These calculations use the absolute value of foreign sector ‘sources’ (inflows).

⁹⁶ Unfortunately the data necessary to calculate the turnover of foreign shareholdings (see Table 2 in Aron et al. 2010, p. 30) are not publically available.

more volatile, by the mid-2000s, than ‘shares,’ essentially equity. The rapidity of bond turnover is crucial to our later discussion of carry trade that forms part of our analysis of new external vulnerabilities that South Africa faces.

Figure 7.11 Capital flows and their volatility



Source: SARB (2015d), own calculations

In sum, South Africa has witnessed increasing global financial integration with increased capital flows and rising stocks of external assets and liabilities. There has been a shift in the composition of these flows and stocks as they have become increasingly short-term, in particular through portfolio flows. A general turning point appears to be in the mid 1990s, with steep increases in the late 1990s and early 2000s, slightly earlier but broadly in line with global trends as discussed in Chapter 4. One of the consequences has been increased volatility.

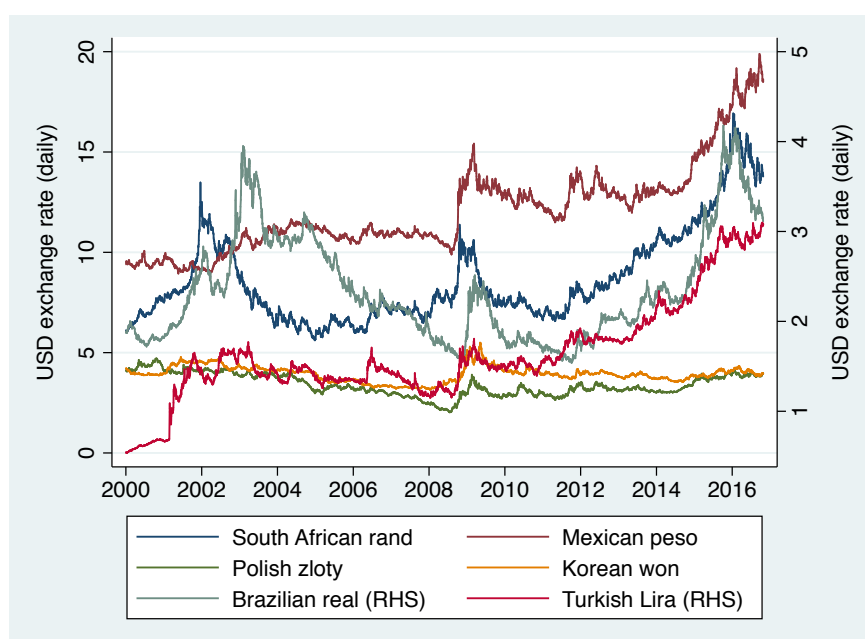
7.3 New external vulnerabilities: financial flows, currency markets, carry trade and asset appreciation

In Chapter 4 we reviewed the literature on new external vulnerabilities faced by DTECs. These vulnerabilities predominately emerged after the East Asian financial crisis and

accelerated from 2002 onwards, thus closely associated with the intensification of financialisation. They involve new patterns of financial flows and highlight the relatively subordinate position that DTEC countries find themselves in in the global monetary hierarchy, indicating a crucial currency dimension. In brief, we showed that currency movements have become an important element in gains made by international (and local) investors. This is true of the direct trading of currency market assets but also because currency movements have been important to capital gains derived from the trading of DTEC assets more generally, this in turn relates to the shifting composition of both those assets (discussed in part above) and the actors involved. In addition to currency price differentials interest rate differentials are also increasingly the source of speculative gains via carry trade, with currency movements also influencing these gains. This subsection – using the examples of currency-market trading, carry trade, and asset price appreciation (and the currency dimension thereof) – shows that these phenomena occur in South Africa. In the next section we explore the consequences of these new vulnerabilities and certain responses to them.

Figure 7.12 shows the dollar exchange rates for six DTECs, illustrating a high degree of volatility and the close co-movements between these currencies. This gives us preliminary reason to believe that it is not economic fundamentals driving these movements and that South Africa may suffer from similar vulnerabilities to those outlined for other countries in Chapter 4. Importantly, data from the Bank for International Settlements (BIS) in Table 7.1 illustrates that the South African rand (ZAR) is one of the most highly traded global currencies (ranked as the 20th most traded in 2016). Importantly, rand trading as a share of global currency trading has increased five-fold from 0.2% in 1995 to 1% in 2016; by contrast South Africa's share of global GDP was less than half this in 2015 (0.43%) (World Bank 2016a, own calculations).

Figure 7.12 USD exchange rate for select DTEC currencies (2000-2016)



Source: Bloomberg (2016)

Note: For ease of display the Korean won has been multiplied by 0.0035 and appears on the left hand y-axis

Table 7.1 Currency distribution of OTC foreign exchange derivatives for select currencies (2016)

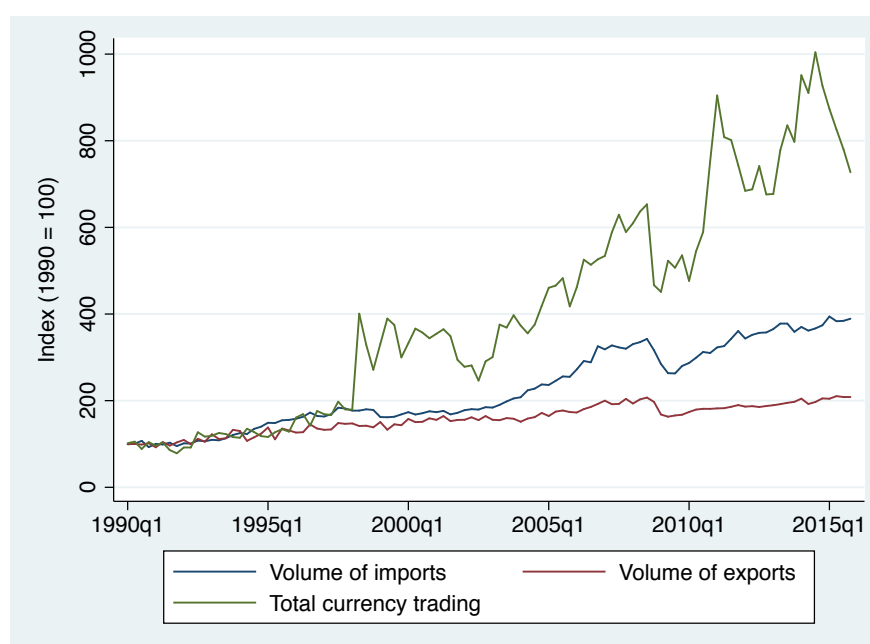
	2016	
	Share	Rank
United States dollar	87.6	1
European euro	31.3	2
Japanese yen	21.6	3
British pound	12.8	4
Australian dollar	6.9	5
Canadian dollar	5.1	6
Chinese renminbi	4	8
Mexican peso	2.2	10
New Zealand dollar	2.1	11
Korean won	1.6	15
Turkish lira	1.4	16
Indian rupee	1.1	17
Russian rouble	1.1	18
Brazilian real	1	19
South African rand	1	20
Polish zloty	0.7	22
Thai baht	0.4	24
Malaysian ringgit	0.4	25
Chilean peso	0.2	30

Source: BIS (2016a)

Notes: (1) This is shown on a 'net-net' basis; (2) Because two currencies are involved in each transaction the total (for all currencies) will add up to 200%

Figure 7.13 and Figure 7.14 reinforce this by showing the enormous increase in rand trading, including trading in the spot market and forwards and swaps (this is confirmed in BIS data, which also shows a nine-fold increase, between 1998 and 2016, in OTC interest rate derivatives in South Africa, BIS 2016a). The value of (local-bank reported onshore) average daily turnover in rand foreign exchange markets rose from \$2.7bn in 1994 to \$15.6bn in 2016 (peaking at \$20bn in 2014). Importantly, the composition of trading has also changed. In 1995, 43% of trading was in the spot market (where direct funding of domestic asset purchases or capital outflows would be reflected) whereas in 2015 it was 16%; a precipitous decline occurs in 1998 in line with deregulation. Some of this change would be due to hedging as required by greater international trade and production. However, it also is indicative of an increase in speculative rand trading, with Figure 7.13 showing how growth in currency trading has vastly outstripped growth in imports and exports; in 2016 global trading of rands was approximately 72 times greater than combined imports and exports of the previous year (both in USD) (BIS 2016b, IMF 2017c).

Figure 7.13 Growth in foreign trade and currency market turnover (1990-2015)



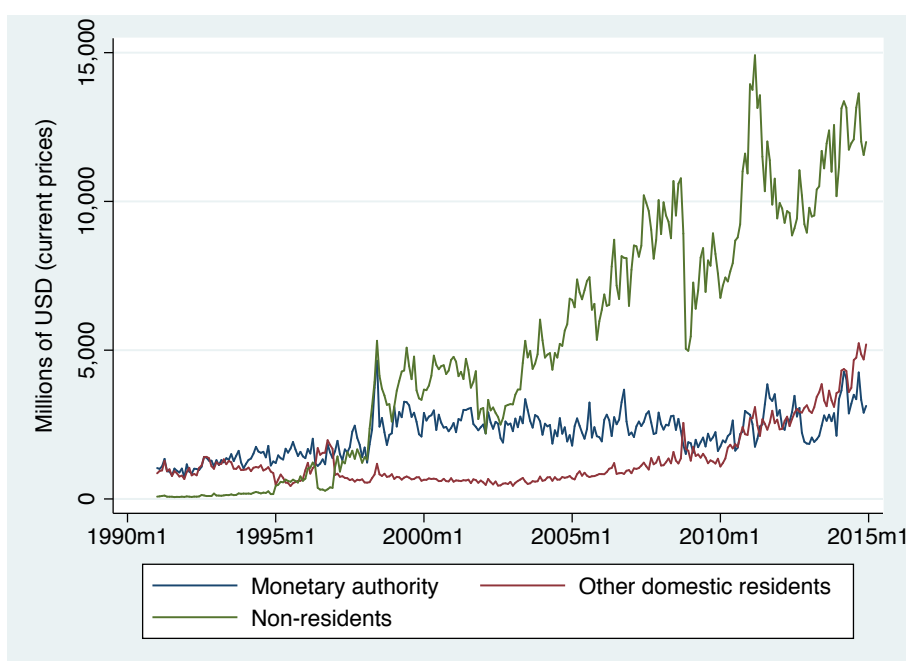
Source: SARB (2015a) via Quantec

The composition of rand traders changes in three important respects. First, Figure 7.14 shows the extraordinary increase in foreign participation in (onshore) currency trading,⁹⁷

⁹⁷ SARB data only record rand currency trading where one party is resident in South Africa.

growing post-liberalisation and truly accelerating from 2002/3 onwards in line with the increased financialisation of DTECs and their currencies more generally (Chapter 4). Second, as Ehlers and Packer (2013, p. 55) note in a BIS review “offshore trading of EME currencies has surged, far outpacing the growth in total FX turnover in EME currencies”. The offshoring of trading is one important gauge of how international a currency is. For the rand, this share rose steadily in the 2000s to reach 80% in 2013 (Ehlers and Packer 2013, pp. 61–62).

Figure 7.14 Transactions against the rand in currency markets by resident type (1990–2015)



Source: SARB (2015a) via Quantec

Third, the share of trading by ‘other financial institutions’ – including non-reporting banks, institutional investors, hedge funds, and proprietary trading firms, as well as official sector financial institutions – has grown from 26% in 1995 to 42% in 2016, peaking at 51% in 2013 (BIS 2016b), in line with general emerging market trends. This highlights that a sizable share of trading is undertaken directly by large institutional investors and hedge funds (the exact share of trading by these entities is difficult to report as banks also trade on behalf of such institutions). Therefore, similar to other DTEC countries (the Brazilian example was discussed in Chapter 4), the rand has become a portfolio asset for these investors and that trading is highly speculative. Recall that the majority of debt is in local currency thus shifting currency risk onto foreign investors. Further, the official sector has played a more active role as monetary

authorities have needed to use currency markets to stabilise exchange rates or lean against appreciation pressures (Ehlers and Packer 2013) in part as a response to the dynamics above. In South Africa, some growth in this sector is shown in Figure 7.14, with a spike in 1998 when the SARB intervened to try stave off currency depreciation.

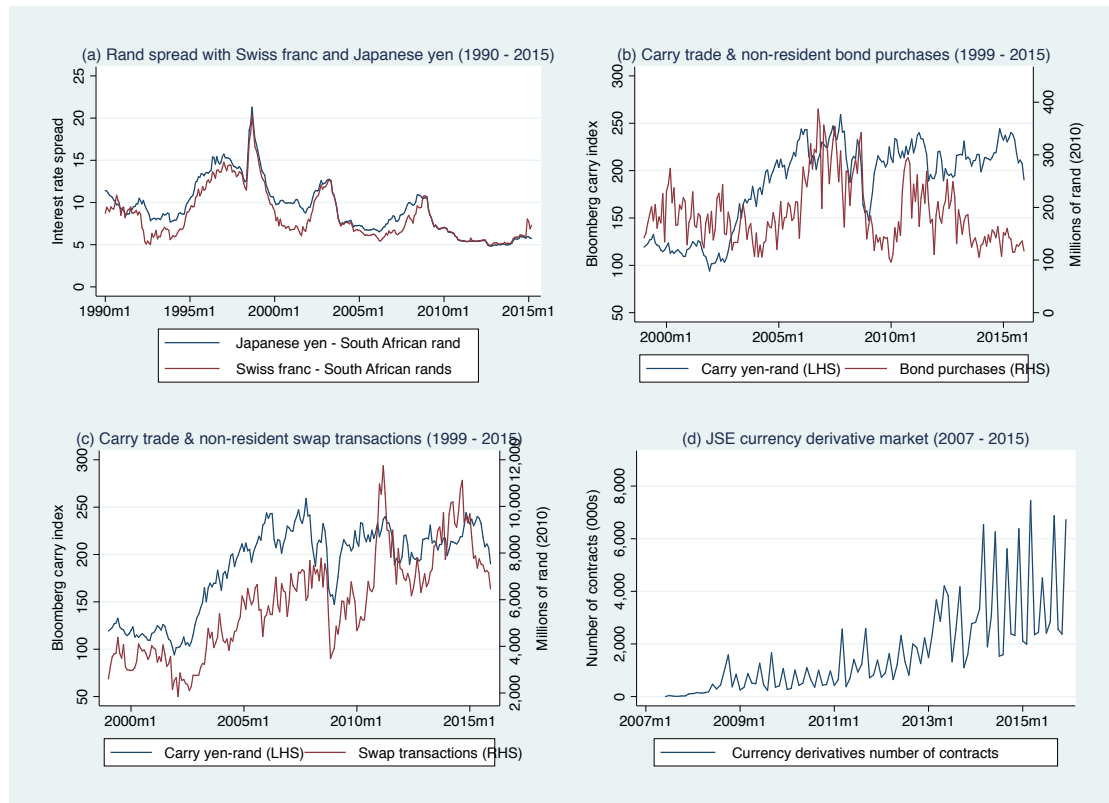
A significant factor behind both the increase in capital flows and currency market turnover is carry trade operations. Carry trade is most classically borrowing in a low-interest ‘funding currency’, buying the high-interest ‘target currency’ in the spot market, using the proceeds to purchase fixed-income high-yield securities denominated in the target currency (often government bonds), and finally converting the payoff back into the funding currency. However, carry trade can also be implemented via derivative markets, for example by selling the currency forward when it is at a significant forward premium. Currency options can also be used to hedge the exchange rate risk to which carry trade exposes the arbitrageur (Galati et al. 2007). As with asset prices the currency dimension has come to play a central role in returns to carry trade operations.

Carry trade is notoriously difficult to track (see Galati et al. 2007). A standard measure of carry trade appeal is the carry-to-risk ratio (the ratio of the interest rate differential to expected exchange rate volatility). Periods of high correlation between this and foreign exchange turnover indicate likely carry trade implementation. Galati et al. (2007) report, for South Africa, a low-frequency correlation between the two of 0.36, the third highest after the Norwegian krone and Australian dollar. In Figure 7.15 we use a number of measures to illustrate carry trade operations in South Africa (see also Hassan 2015). Figure 7.15a shows the interest rate spreads between the Japanese yen and Swiss franc and the rand (together with the yen, the franc is a common funding currency), clearly indicating the opportunity for carry trade operations.⁹⁸ This is shaped by the relatively high interest rates in South Africa, as discussed above and in Chapter 6; Galati et al. (2007) note that currency trading is highest for countries with high policy interest rates.

⁹⁸ The Japanese yen is widely recognised as a common carry trade funding currency, in large part due to the stable and very low interest rates in Japan (Galati et al. 2007, Hassan and Smith 2011). Therefore, following Hassan and Smith (2011) and Hassan (2015), we use the yen-rand index. Interestingly, according to the IMF (2011), the majority of fixed-income flows to South Africa – assets commonly bought as part of carry trade operations – flowed through Jersey, Cayman, British Virgin Islands, Bermuda, Bahamas, and Liechtenstein, jurisdictions which according to the BIS (Galati et al. 2007) received the largest net yen flows between 2002 and 2007. These jurisdictions are home to hedge funds (and, until recently, off balance-sheet structured investment vehicles) that are heavily involved in carry trade operations.

The drawing down between 1998 and 2004 of the huge net open forward position (NOFP) incurred during the 1996-1998 exchange rate crises, also reinforced perceptions of the rand as a ‘one-way bet’ (Aron et al. 2010).

Figure 7.15 Carry trade



Source: (a) FRED (2016); (b) and (c) Bloomberg (2016) and SARB (2016e) via Quantec; (d) JSE (2016) via Quantec

Note: The interest rate used for the Japanese yen and Swiss franc is the overnight interbank rate (at which funds can be borrowed), the rate used for the rand is interest rate on government securities (into which funds are often invested)

In Figure 7.15b and Figure 7.15c, following Hassan (2015), we contrast the Bloomberg yen-rand carry index (short yen, long rand, three month trade horizon) against monthly bond purchases and the (dominant) swaps components of rand currency turnover.⁹⁹ We do this because carry trade most commonly involves the purchases of bonds and/or the use of currency swaps. The two are closely correlated with the carry index indicating yen-funded rand-targeting carry trade might be an important factor driving South African bond purchases and rand swap turnover; indicative of carry trade operations via

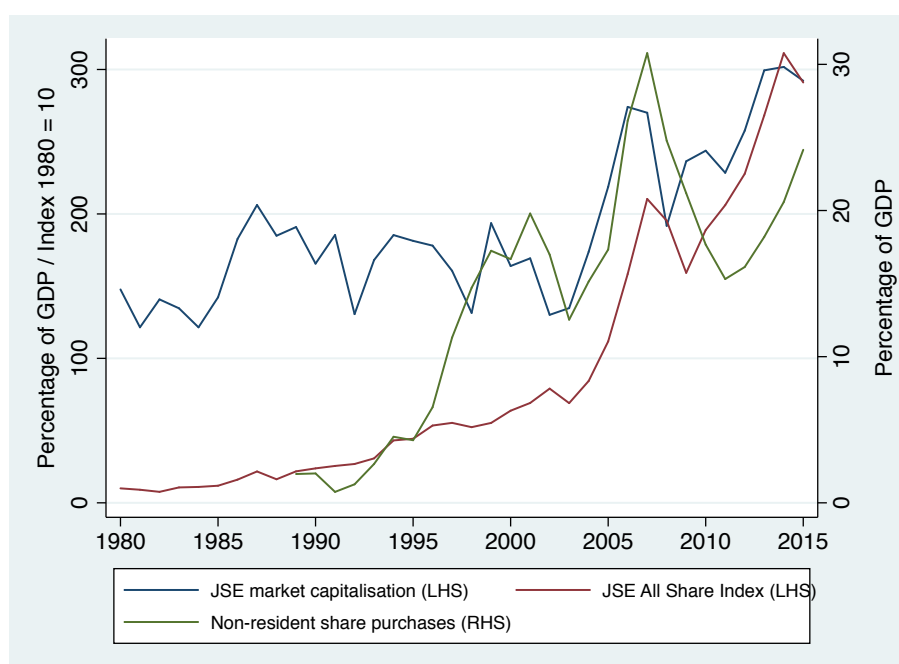
⁹⁹ Indicating the weight of non-resident participation in these markets: the non-resident share of bond market capitalisation doubled from 11% in 2001 to 22% in 2016 with non-resident bond market turnover per year almost double that of residents in the mid-2000s (SARB 2017, own calculations); non-resident participation in currency markets has surged, as shown in Figure 7.14.

both spot and derivative transactions (recall the extremely rapid turnover of foreign-traded South African government bonds noted by Aron et al. (2010) as well as the high level of bond volatility shown in Figure 7.11). Finally, Figure 7.15d highlights the growth of currency trading via the JSE currency derivative market. It was only established in 2007 making it more difficult to assess the long-term relationship between currency trading on this exchange and the exchange rate. Nevertheless, the large increase is congruent with the trends already discussed.

Hassan and Smith (2011) show that rand carry trade is also highly profitable, and between 2002 and 2008 more so than the Australian and New Zealand currencies, those often regarded as the main carry trade targets (Brunnermeier et al. 2008). Rand carry trade is also more profitable than the same frequency trading on the JSE All Share Index (which fund managers find difficult to consistently outperform, see Bartens and Hassan 2010) with similar variance of returns and lower crash risk than buy-and-hold investment in the JSE, and is hence highly attractive.

A further issue tackled in Chapter 4 was the importance of DTECs as opportunities for foreign investors to generate capital gains from investing in DTEC domestic financial assets (local-currency and dollar denominated), as well as the role of such investments in spurring asset price appreciation in DTEC markets. Once again we observe these trends in the South Africa case. Figure 7.16, for instance, shows the large rise in non-residents share purchase as a percentage of GDP (with the Johannesburg Stock Exchange (JSE) market capitalisation (as a percentage of GDP) and the JSE All Share price index (where 1980 = 0.1) rising in tandem). Share trading (the absolute value of sales and purchases of shares) by non-residents on the JSE rose from R13.6 trillion in 1989 to R194 trillion in 2015. However, as a percentage of total value of stock exchange transactions the change is less dramatic. In 1991 this stood at 41.5% and rose from this base to hover between 55% and 65% from 1994 to 2001 after which it fell, sitting just below 40% in 2015 (JSE 2016 via Quantec, own calculations). This highlights the domestic basis of JSE market capitalisation as well as the size of South African domestic investors, which, as we will see in the next chapter, grew enormously in the post-apartheid period thus eventually eclipsing (as a share of total trading) the increase in foreign participation.

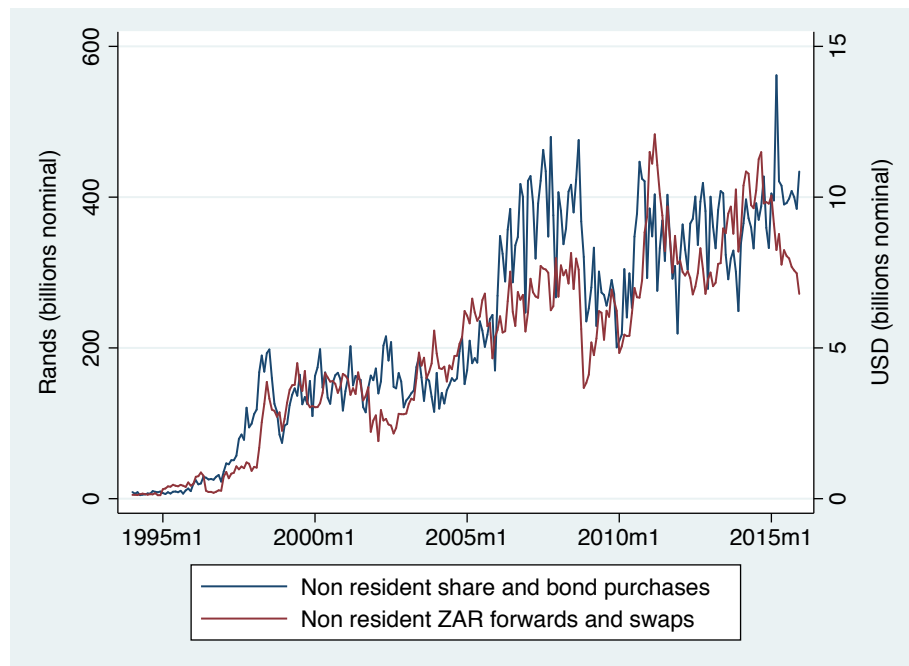
Figure 7.16 JSE market capitalisation, price index and share purchase by non-residents (1980-2015)



Source: JSE (2016) and SARB (2015a) via Quantec, own calculations

The profitability of such investment – in terms of capital gains – is clear in the rise of the JSE all share index, also visible in Figure 7.16. Currency appreciation, for instance the 47% rand appreciation against the dollar between the end of 2001 and start of 2006, accentuates such gains. Even when currency depreciation has occurred (excluding periods of crisis) the JSE was still profitable for foreign-currency investors; for instance, between the start of 2005 and the end of 2007, the currency depreciated 21% but the JSE All Share Index appreciated by 130%. Calculating the gains or losses due to currency fluctuations is beyond the scope here but Figure 7.17 shows the concomitant rise, and extremely close co-movements between, non-resident share and bond purchases and non-resident rand forward and swaps, likely pointing in part to hedging against currency risk in share and bond investment. This is confirmed by Ehlers and Packer (2013) who note that in South Africa there is a strong correlation between mutual fund flows (a proxy for the investment activity of international investors) and foreign exchange market turnover. This gives further indication of the role of currency markets in foreign investor trading in South Africa.

Figure 7.17 Non-resident share and bond purchases and rand currency trading (1994-2015)



Source: SARB (2016a) via Quantec, own calculations

7.4 Consequences and responses

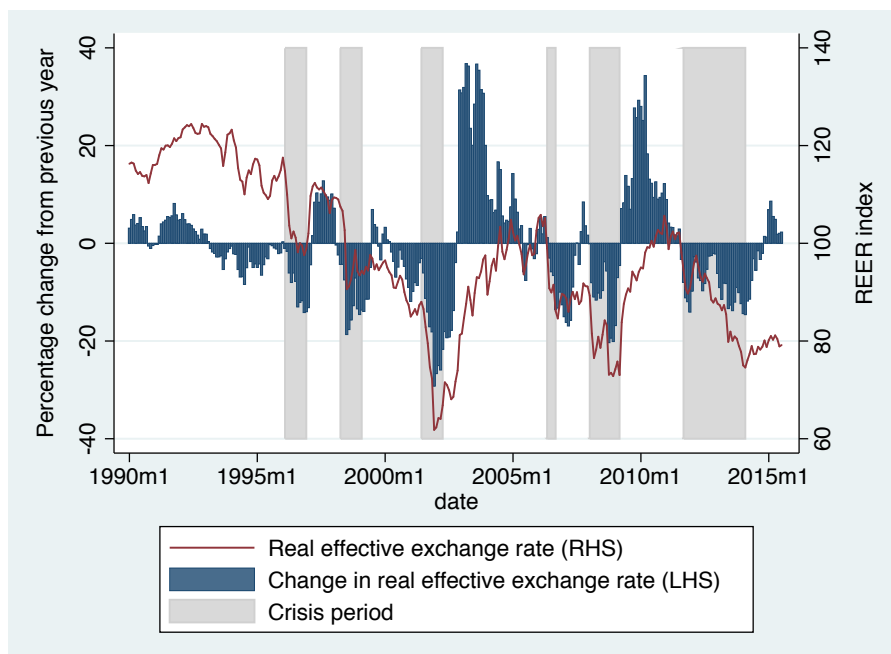
The vulnerabilities highlighted above, as well as the (changing) patterns of capital flows, have had a number of consequences for the economy to which the government has attempted to respond, with those responses incurring their own costs. Here we highlight how the dynamics above led to currency volatility and asset appreciation, with the pattern of flows and investment reinforced by comparatively high real interest, and how government has responded, particularly to currency dynamics, via the accumulation of foreign reserves and maintenance of currency-market liquidity.

7.4.1 Consequences: currency volatility, interest rates and asset appreciation

Figure 7.18 shows the high levels of volatility and numerous ‘crisis periods’ – involving sharp and rapid depreciations of the rand (highlighted in grey) – that have beset the rand in the period since liberalisation. In our own analysis of the volatility of twelve currencies between 1994 and 2015, the rand ranked as one of the top three most volatile

in all but six of the twenty-two years, and first in five years (Bloomberg 2016, own calculations).¹⁰⁰

Figure 7.18 Real effective exchange rate, ZAR-USD (1990-2015)

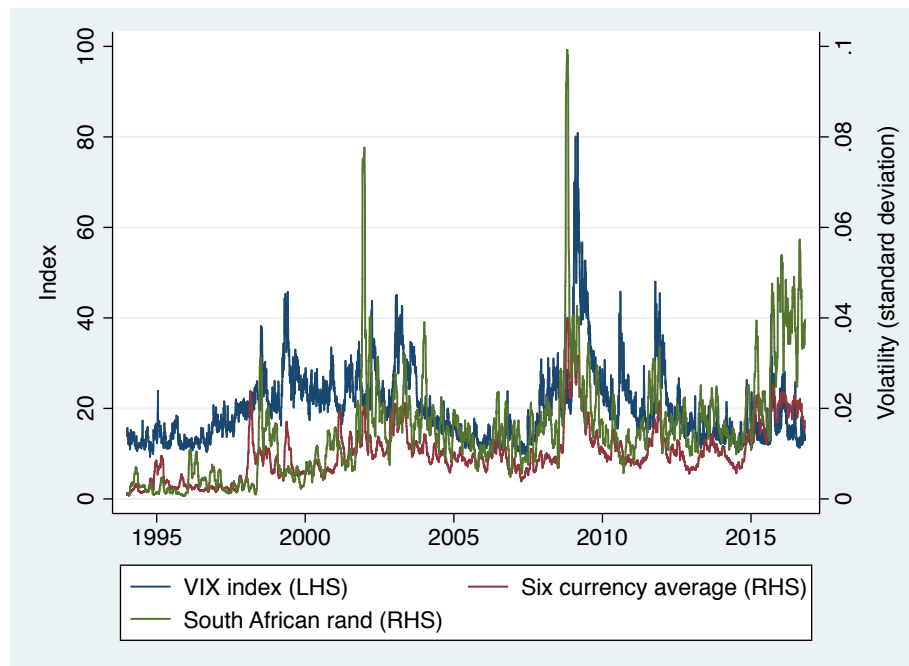


Source: IMF (2015a), own calculations

The evident volatility is strongly shaped by developments in the capitalist core speaking to the role of global integration and capital flows. This is seen in Figure 7.19 which illustrates the close correlations between the VIX (a common index of risk aversion based on S&P 500 volatility), rand volatility, and the average volatility of the currencies shown in Figure 7.12. The synchronicity between the depreciation of these currencies and the global financial crisis is further evidence of this correlation. Volatility in the South African rand (and generally) has clearly increased with financial liberalisation, free floating exchange rates, increased portfolio flows, and currency trading (Ng'ambi 2015, Mpofu 2016). The growth in currency markets and the offshore and/or speculative nature of the trading therein (shown above) – whether for its own sake or to ensure gains from other forms of investment – have been very important in the South African case.

¹⁰⁰ South Africa, Brazil, Mexico, Argentina, India, Russia, Poland, Chile, South Korea, Turkey, Australia, and Canada. Volatility is measured as the standard deviation from the mean of that year using an index of the daily exchange rate. The index is established by taking 03 January 2000 as the base.

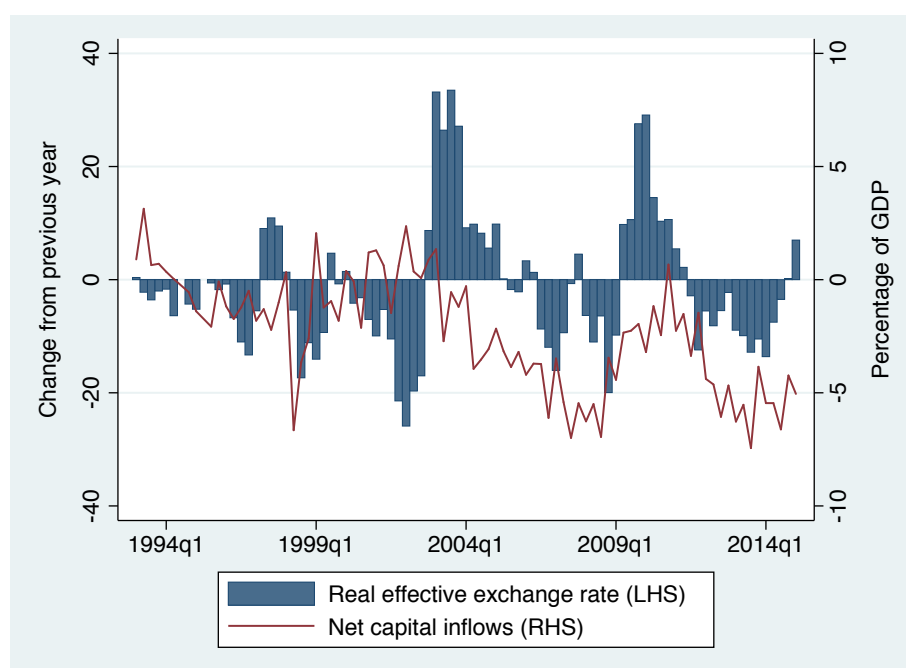
Figure 7.19 Currency volatility and VIX index (1994-2016)



Source: Bloomberg (2016), own calculations

Capital flows have therefore come to play a leading role in shaping currency movements with inflows causing appreciation and outflows depreciation; portfolio flows play a particularly leading role in the South African case (Gossel and Biekpe 2012, Syden 2012, Kantor 2013, Iyke and Odhiambo 2015). A clear correlation between net capital flows and changes in the real effective exchange rate (REER) is shown in Figure 7.20. There is also a clear correlation between changes in such flows and periods of crisis as shown above in Figure 7.18. The currency also appreciates after 2003 in tandem with a rising JSE market capitalisation and All Share Index (shown above); this is not coincidental with a large volume of flows going towards stock purchases (Kantor 2013).

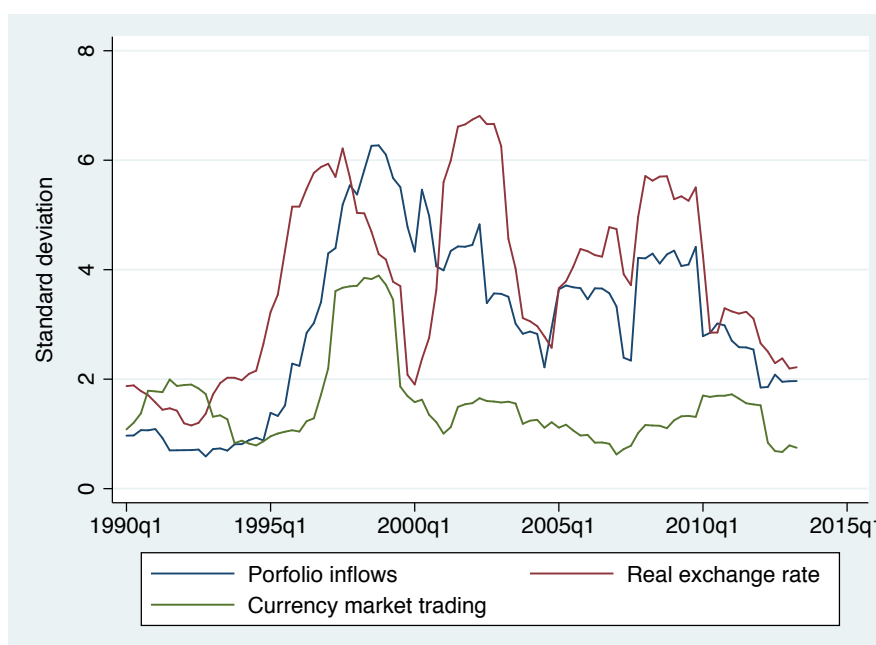
Figure 7.20 Change in real effective exchange rate and net capital inflows (1993-2015)



Source: IMF (2015a) via Quantec and SARB (2015d), own calculations
 Note: presentation of net inflows is inverted

This correlation is further strengthened by a strong correlation between the volatility in portfolio inflows and volatility in the REER, and a weaker but present relationship between the REER volatility and volatility in currency market trading as shown in Figure 7.21. We notice also a clear correlation between the volatility of these variables in Figure 7.21 and currency crises in Figure 7.18. It is important to note that the impact of such exchange rate volatility on the domestic real economy has been shown to be both varied and deleterious. Statistics South Africa (2016), for instance, notes that currency volatility has a negative impact on manufacturing output, Mpofu (2013) shows it therefore has a contractionary impact on manufacturing employment growth. Similarly, Ncube and Ndou (2013) highlight that exchange rate shocks hurt exports.

Figure 7.21 Volatility of the real exchange rate compared with volatility of capital inflows and currency trading (1990-2015)



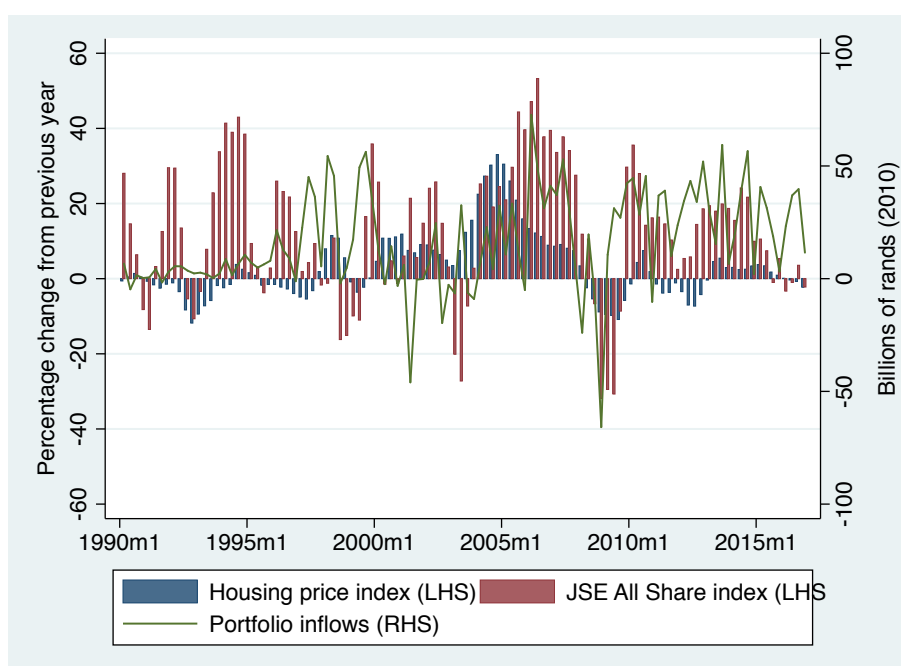
Source: SARB (2015a), IMF (2015a) and JSE (2016) via Quantec

Note: Both portfolio flows and currency market trading are calculated as a percentage of GDP. The latter series includes swaps, forward, and spot transactions. The measure of volatility is the standard deviation over a rolling mean (four quarters in the past and four in the future).

Capital flows have had other consequences too. Importantly, the maintenance of short-term flows has relied on comparatively high real interest rates. We discussed in the previous chapter the attendant negative consequences of this for the real economy, but we should add here that these comparatively high real interest rates also reinforce the current pattern of flows – and contribute towards appreciation in the rand (Frankel 2007, Raputsoane and Todani 2008) – as well as provide the impetus for various speculative activity, most notably carry trade.

Capital flows have also contributed to asset price inflation and onward lending. Figure 7.22 shows the strong correlation between capital inflows and South African asset prices. The JSE price index and net capital inflows move in tandem although this is not always strongly the case nor does it hold across all periods; it is particularly present from the early 2000s onwards. The figure also shows the correlation between net capital inflows and changes in the ABSA Housing Price Index (an index tracking housing prices). The relationship present confirms that capital inflows are often onward lent into housing markets and that this contributes substantially to housing price appreciation (discussed briefly in Chapter 10).

Figure 7.22 Change in housing and JSE price index and foreign inflows (1985-2016)



Source: Absa(2016), IMF (2017), OECD (2017) and SARB (2017) via Quantec, own calculations

Capital flows, however pertinent, are only one dimension of the manner in which a country's global financial integration and financialisation makes it vulnerable; carry trade, and the relationship between carry trade and capital flows is another. Carry trade affects fixed-income portfolio flows, spurring capital inflows, market inflation, increased onward lending, the need to sterilise, and the risk of flow reversals. Critically, carry trade has serious consequences for the exchange rate, as Hassan and Smith (2011, p. 5) note: "being an attractive carry trade target leads to an exchange rate process for the rand characterised by gradual appreciations (with small random disturbances around the path) when the rand turns into an alluring target, punctuated by infrequent but potentially large and rapid depreciations when for example global risk appetite changes or the yield differential turns unattractive, causing carry trade reversals".¹⁰¹

A self-fulfilling cycle can occur where currency appreciation (in the short to medium term) makes carry trade even more attractive. Although lower inflation may serve as a counter-speculative measure, inflation targeting can exacerbate speculative activity by sterilising capital inflows or maintaining high real interest rates (and hence large interest rate differentials) in order to curtail inflation. Further, depreciation (following reversals)

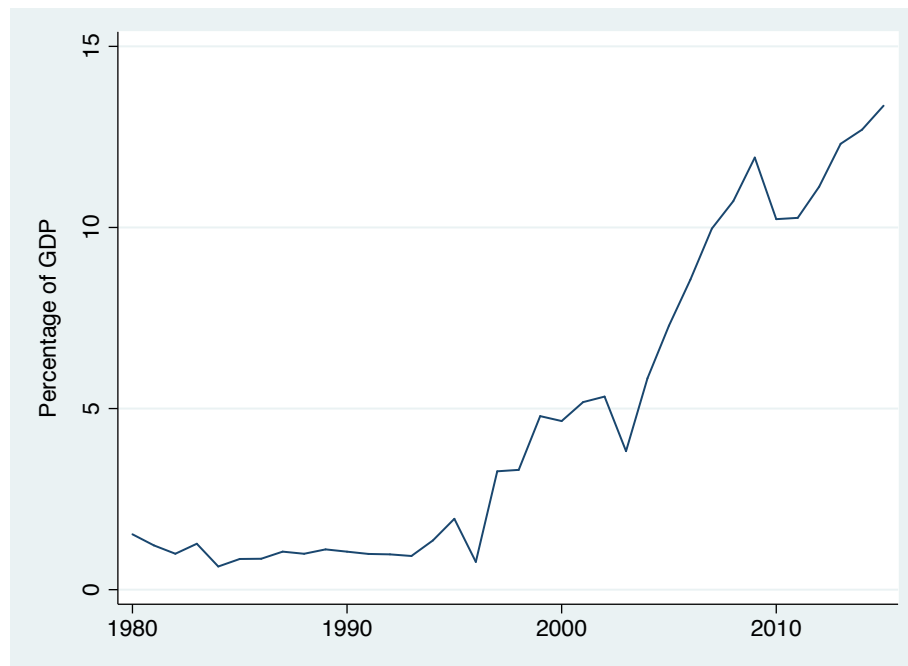
¹⁰¹ Movements in the exchange rate are, of course, precipitated by other factors also, but strong appreciations, e.g. between 2001 and 2006, and post the global financial crisis, are associated with high levels of bond market turnover, mostly likely reflecting carry-trade activity.

can also exert inflationary pressures, particularly in South Africa where inflation is ‘imported’, and hence also motivate interest rate increases. Carry trade itself is usually only reversed by external shocks or when speculators hit funding constraints (such as during a crisis or periods of market turmoil). The reversal can be rapid, the losses large, and the depreciation of the target currency precipitous. In addition, while curbing currency volatility may be valuable for the real economy it can, perversely, encourage carry trade as some level of short-term volatility adds risks and discourages carry trade (Hassan 2015). Tackling carry trade within the currency policy framework of heavily liberalised markets and inflation targeting is therefore difficult. This is thus a clear instance of international integration and financialisation having exposed South Africa to new external vulnerabilities, causing both financial instability and potential harm to the real economy.

7.4.2 A response: reserves, sterilisation and liquidity provision

One manner in which the state has responded to the vulnerabilities noted above is through reserve accumulation, which in South Africa has followed similar trends to elsewhere in the developing world. Although as a percent of GDP reserves tend to be comparatively lower for South Africa (Hassan and Smith 2011, p. 22), they nevertheless remain in ‘excess’ of requirements for trade and precautionary purchases (discussed briefly in Chapter 4, see Paineira 2009). Figure 7.23 shows the build-up in reserves, which has accelerated dramatically from 1.6% of GDP in 1996 to 15% in 2014 (growing rapidly in the 2000s). Further, the growing financing gap on the SARB balance sheet indicates that domestic borrowing is being undertaken in order to finance the build-up in reserves, a proposition confirmed by Brink and Kock (2010) in a Reserve Bank working paper.

Figure 7.23 Reserves as a percentage of GDP (1980-2015)



Source: IMF (2016a, 2016b) via Quantec, own calculations

Our discussion in Chapter 4 noted the costs of reserves, one of which derived from the interest rate differentials between local borrowing and reserve accumulation. The SARB, unfortunately, does not give the currency denomination or market instruments that comprise its reserve portfolio. The majority of emerging market foreign reserves are, however, denominated in US dollars and, although some diversification has occurred, a substantial share remain in US Federal Reserve Treasury Bills (Wooldridge 2006, IMF 2014, Ito et al. 2015). Figure 7.24 therefore shows the Treasury Bill rate for the United States (in which reserves would be held) and the South African repo rate (the rate at which some sterilisation borrowing occurs in SA).¹⁰² The two diverge markedly, beginning in the late 1980s, with the spread averaging 7.6% in the post-apartheid period indicating the costly difference between the rate at which the SARB must borrow and the return it receives on reserve assets.¹⁰³

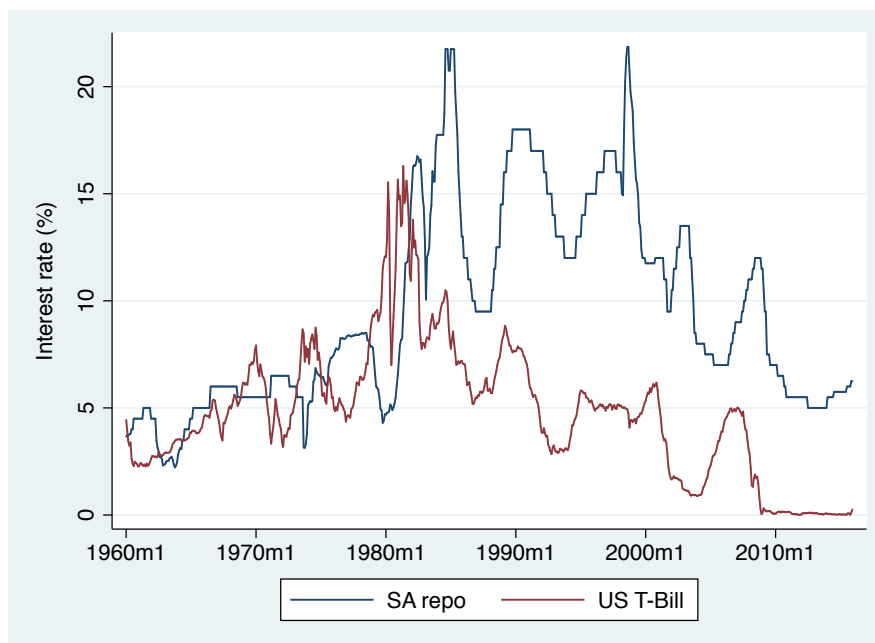
Although reserve accumulation was intended, in part, to replace the costly exchange rate interventions of the late 1990s (in particular the amassing of a huge net forward open position between 1996 and 1998), it has clearly brought its own considerable costs. To

¹⁰² Not all local borrowing by the SARB will be at the repo rate but it gives a very good indication.

¹⁰³ Brink and Kock (2010) point to another cost incurred from the SARB liquidity management strategies. Essentially, its short-term money market operations earn about 30 basis points below what it pays on its longer-term debentures and reverse repos. They estimate that between June 2007 and June 2009 this interest rate differential cost it just more than R5bn.

the extent to which reserve accumulation is done to counter balance predominately short-term and speculative inflows: “the returns to speculators from targeting the rand through the carry trade [or returns on other speculative investment] are proportional to, and correlated with, the costs to the Reserve Bank from accumulating reserves of low-interest currencies” (Hassan and Smith 2011, p. 21).

Figure 7.24 Interest rate differentials: South African repo rate and the United States Treasury Bill rate (1960-2016)



Source: IMF (2015a) and SARB (2016e) via Quantec

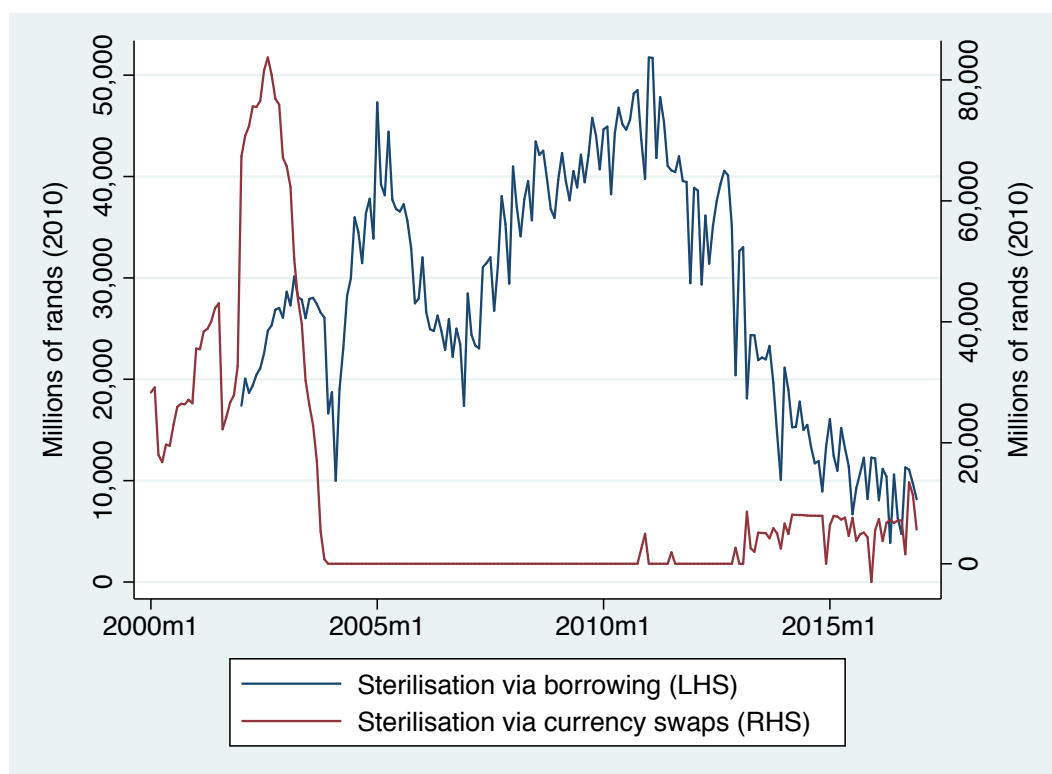
Large sterilisation operations by the SARB, to drain excess liquidity resulting from capital inflows and reserve accumulation, are also visible on its balance sheet. This is shown for repos and debentures in Figure 7.25, the two growing from an average of R8.6bn per month in 1999 to an average of R35bn per month in 2011 (in 2010 rands). The SARB has also used currency swaps to sterilise inflows and these are also shown in Figure 7.25.¹⁰⁴ The fall in SARB sterilisation via borrowing, from 2010, is accounted for by a decline in demand for SARB liabilities together with the National Treasury agreeing to assist in sterilisation due to its high costs.¹⁰⁵ Sterilisation operations are also costly to the SARB as the interest paid on these debentures and reverse repos exceeds that earned

¹⁰⁴ The use of swap transactions to drain liquidity from the market means the SARB will always reflect an overbought forward position.

¹⁰⁵ This assistance is reflected as National Treasury ‘sterilisation deposits’ with the SARB which amounted to R67bn in March 2016, equal (in real terms) to the peak in SARB sterilisation borrowing in 2010/11; this avoids sterilisation costs incurred due to interest rate differentials but is at the expense of these funds being used for other expenditure (Marcus, 2012; Mminele, 2013; National Treasury, 2016b: 24).

from the underlying asset (Mminele, 2013; SARB, 2014);¹⁰⁶ Brink and Kock (2010) calculate this differential at 30 basis points and estimate that between June 2007 and June 2009 this cost the SARB just more than R5bn.

Figure 7.25 Sterilisation by SARB (1995-2015)



Source: SARB (2016e) via Quantec, own calculations

Note: The SARB data distinguished between foreign currency swaps undertaken by the SARB in general and those associated with sterilisation, the former averages considerably higher. The low levels of currency swaps associated with sterilisation in the figure does not match statements made by the SARB regarding its use of currency swaps for this purpose.

Reserve bank liabilities are also increasingly short-term, thus ensuring greater market liquidity. The shift is shown in Table 7.2 and is particularly accentuated regarding debentures, with the new 7- and 14-day debentures, introduced in 2012, accounting for 62% and 15% of total debentures by 2016, respectively. This indicates one manner in which the SARB has promoted greater market liquidity, reinforcing both the patterns of flows and rand asset trading, and associated vulnerabilities.

¹⁰⁶ Given exchange rate depreciation it can be argued that the increased rand value of the dollar reserves counterweighs these costs; however, such would only be realised at particular exchange rates and if reserves were actually sold.

Table 7.2 Maturity structure of SARB reverse repos and debentures, amounts allocated (percentage of total) (2008-2016)

Reverse repos				
	7 day	14 day	28 day	56 day
2008	0	0	99	1
2012	0	7	14	76
2014	9	21	38	33
2016	12	5	59	24

Debentures				
	7 day	14 day	28 day	56 day
2008	0	0	52	48
2012	24	18	47	11
2016	62	15	21	2

Source: SARB (2017)

Note: These data were provided directly by SARB

Such interventions can also promote other aspects of financialisation. Sterilisations, for instance, leads to an expansion of domestic bond markets and a build-up of domestic debt, both at the SARB and in the private sector (as the private sector borrows to acquire these new assets). Given the short-term nature of these SARB instruments, the liquidity of bank balance sheets is enhanced which serves as the basis for the bank issuing its own securities and short-term liabilities thus affecting credit allocation, leading to shorter-term lending (often to households) and speculative investment (Gabor, 2010; Paineira, 2012). The ability of domestic banks to hold short-term public securities also enables them to capture more foreign resources. Such trends are visible in South Africa, as seen in Chapters 8 and 10. We also noted in Chapter 4 that part of liquidity management was ensuring ease of exit. This is visible in the South Africa case; for instance, in the wake of the global financial crisis foreign exchange controls were relaxed with the express purposes of allowing foreign capital to exit the market (Baumann and Gallagher 2013).

In sum, the transformations in capital flows and the type of international investment witnessed in the wake of international integration has brought currency volatility and asset price appreciation, while ensuring the maintenance of high real interest rates. In response to the noted pattern of flows and investment, large foreign exchange reserves have been accumulated, purportedly as insurance against flow reversals, but these, together with other measures to ensure liquidity in the currency market, actually

reinforce the nature of foreign financial investment and trading as well as accruing significant fiscal costs.

7.5 Capital flight

A final feature of financial integration we explore here is capital flight, the scale and deleterious effects of which a number of scholars have stressed in the South African case, with prominence given to its consequence of undermining funds for real fixed investment and eroding the tax base (Mohamed and Finnoff 2004, Ashman et al. 2011b). Capital flight, as we noted in Chapter 4, is a global phenomenon. Ndikumana et al. (2014) quantify capital flight from 39 African countries (including South Africa) as reaching a cumulative \$1.3tn (in 2010 dollars) between 1970 and 2010, with just over a fifth of this occurring between 2005 and 2010 alone. Besides for what is formally defined as ‘capital flight’ (a term whose parameters are contested – see below) there are other ways in which capital leaves the country both legally and illegally. ‘Illicit financial flows’ – generally defined as “[m]oney illegally earned, transferred, or used that crosses borders” (World Bank 2016c) – have received much attention of late. Both capital flight and illicit flows are often a means to escape taxation or avoid domestic political and economic risks, or as an act of embezzlement or theft. More prosaically there is also the repatriation of earnings for investment or portfolio purposes. Here, we briefly explore a few dimensions of such ‘capital exit’, broadly conceived, in an attempt to highlight a loss of funds to investment or taxation rather than illegality *per se*.

South African corporates, since the fall of apartheid, have moved considerable funds offshore. A critical (legal) means through which this has occurred is the (primary or secondary) listing of corporations on overseas stock exchanges including by some of South Africa’s largest (this is taken up again in Chapter 9). This, we noted above, has been a key element in the increased holdings of foreign assets by South African residents. However, much of those international holdings cannot be explained by productive investment abroad. The IMF’s (2015b) Coordinate Portfolio Investment Survey (CPIS) data tells an interesting story. In December 2014 a staggering 37% of all reported South African assets held abroad sat in low-tax jurisdictions, up from 24% in

December 2001.¹⁰⁷ Of the top ten countries in which South African assets abroad are held, in December 2014, seven of them, as shown in Table 7.3, were low-tax jurisdictions accounting for 35% of total foreign assets in these ten locales. This is not necessarily illegal but highlights the extent to which corporates hold offshore assets in an attempt to reduce their domestic tax burden.

Table 7.3 Top 10 countries in which South African assets are held abroad (December 2014)

	Country	Amount (millions)	Percentage of total
	Value of Total Investments	\$154,865	
1	United Kingdom	\$62,920	41%
2	United States	\$25,638	17%
3	Luxembourg	\$22,740	15%
4	Ireland	\$15,727	10%
5	Bermuda	\$9,851	6%
6	Guernsey	\$3,592	2%
7	Jersey	\$1,728	1%
8	Canada	\$1,394	1%
9	Malta	\$1,325	1%
10	India	\$964	1%
	Low-Tax Jurisdictions	\$54,963	35%

Source: IMF (2015b)

These locales, and others, are also used as common sites of trade misinvoicing or as sites of shell companies through which to reroute local revenue. The United Nations (UN 2016, p. 27) report on illicit flows calculates that approximately 4% of South African GDP is lost each year to illicit flows – enough to significantly raise South Africa’s gross fixed capital investment – reaching a cumulative total between 1970 and 2008 of \$81.8bn. One element of this is trade misinvoicing through which imports or exports are incorrectly valued. This can be detected through comparing South African exports to a country or region with that country or region’s imports from South Africa (and vice versa). This forms a crucial part of many studies of formal ‘capital flight’, and is generally added to the World Bank’s ‘residual method’ which calculates unrecorded

¹⁰⁷ There is no universally accepted list of ‘tax havens’ prompting us to use the broader and more widely accepted definition of low-tax jurisdictions. Amongst these, South African businesses, households, and government institutions hold assets in: Bahamas, Kingdom of Bahrain, Bermuda, Cayman Islands, China, P.R., Hong Kong, Guernsey, Ireland, Isle of Man, Jersey, Luxembourg, Maldives, Malta, Monaco, Switzerland, and British Virgin Islands.

Balance of Payment transactions to get a common measure of ‘capital flight’ (Ndikumana et al. 2014).¹⁰⁸

A number of studies have used this method to calculate capital flight from South Africa. Ndikumana et al. (2014) (using the most sophisticated version of this method) calculate cumulative capital flight from 1970 to 2010 (in 2010 USD) to be \$49bn; in 2010 they show it be 13.5% of GDP. Mohamed and Finnoff (2004) show capital flight to have averaged at 6.6% of GDP between 1980 and 2000, while Ashman et al. (2011b) show a range of between -2% and 20% of GDP between 1986 and 2009 (peaking in 2007).¹⁰⁹ A range of other studies focus on the late-apartheid period and calculate varying but significant levels of capital flight.¹¹⁰

Capital flight is interesting in that, in addition to being an international trend, it closely reflects the domestic political economy. Mohamed and Finnoff (2004) argue that between 1980 and 1985 capital flight was encouraged through early moves towards liberalisation and induced by economic uncertainty and rising political upheaval whereas between 1986 and 1993 its fall was strongly influenced by the debt crisis, the imposition of stringent controls, and the need to run a trade surplus. Between 1994 and 2000 political uncertainty regarding the post-apartheid government as well as poor economic conditions prior to the end of apartheid is thought to have motivated capital flight. Fine and Rustomjee (1996) and Ashman, Fine et al. (2011b) point to the economic structure of South Africa as playing an important part. Given the role of the MEC in shaping South Africa’s accumulation path it is unsurprising the majority of trade misinvoicing is shown to occur in the ores and metals sectors.

¹⁰⁸ Another approach is the ‘hot money’ approach which adds to the residual method forms of short-term cross-border speculative capital flows (see Schneider 2003, Ndikumana et al. 2014).

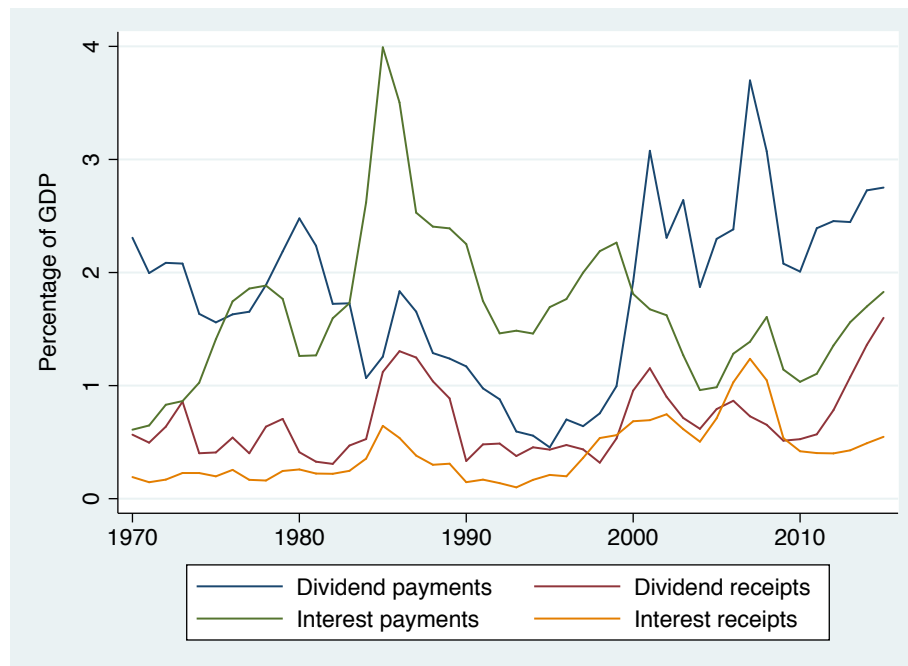
¹⁰⁹ The calculations in these papers were not verified by the author and are viewed with caution. For instance, the current account data given in Mohamed and Finnoff (2004) does not match that accessed through either World Bank (2016a) or IMF (2016c) databases. Similarly, for Ashman, Fine et al. (2011b) the figures for net foreign investment as a percentage of GDP differed from those calculated by the author, and the figures for change in reserves as a share of GDP appear to be the negative value of the IMF Balance of Payment ‘Reserves and related items’ (IMF 2016c).

¹¹⁰ Kahn (1991): \$15bn (1985 prices) between 1970 and 1985; Smit and Mocke (1991): \$6bn between 1980 and 1988; Fine and Rustomjee (1996): \$55bn between 1997 and 1998 and 7% of GDP between 1970 and 1988; Wood and Moll (1994): between \$2 and \$5bn between 1970 and 1985; and Fedderke and Liu (2002): \$628mn between 1980 and 1989 and \$462mn between 1985 and 1995 (summary in Mohamed and Finnoff 2004, p. 23).

Ashman, Fine et al. (2011b) also place global and domestic financialisation, and the global integration of the South African economy, at the heart of their analysis of capital flight. They note, in line with our discussion in Chapter 6, the role of conservative government policy in shaping financialisation and that such policy has played an important role in capital flight. They point, for example, to the 2010 'Exchange Control Voluntary Disclosure Programme' (VDP) – essentially an amnesty for illegal capital flight – as an example of permissive government policy (in the context of general commitment to liberalisation). Interestingly, a second VDP is planned for institution in October 2016.

Also in line with corporate globalisation and financial integration has been the legal repatriation of dividend and interest payouts (the increase of which is generally associated with the shareholder value maximisation movement). This, of course, relates to the sizable share of foreign ownership of large corporates as discussed above. Net international interest and dividend payments are shown, as a percentage of GDP, in Figure 7.26. Cross-border interest payments decreased steadily from the mid-1980s due to the repayment of large foreign apartheid-era debt. However, we see a clear jump in foreign dividend payments in line with liberalisation and (importantly) the foreign listing of South African corporates. We also see that both dividend and interest payments exceed receipts indicating net outward flows. Notably, such dividend outflows are a significant contributor towards South Africa's current account deficit, with dividend outflows on direct investment averaging around 40% of the current account deficit between 2004 and 2012. This is common in emerging markets but compounded in South Africa by the persistent negative trade balance (Samuel 2013). Together the trends described above highlight large-scale capital exit that has surely played a role in poor levels of domestic investment.

Figure 7.26 Dividend and interest payments and receipts with rest of world (1970-2015)



Source: SARB (2015a) via Quantec, own calculations

7.6 Conclusion

Our analysis in this chapter has revealed that South Africa's global integration has followed a similar pattern to those observed in other financialising DTECs, albeit with a context-specific trajectory. Since liberalisation capital flows have increased dramatically with the majority of these short-term and highly volatile. This pattern of flows has exposed South Africa to new external vulnerabilities. The South African rand has become a portfolio asset for large investors and hence a heavily traded currency and vehicle for considerable speculative carry trade operations, while capital flows have been closely connected with asset price inflation and foreign investors seeking capital gains. The currency has displayed significant volatility in line with other DTEC currencies and, shaped by monetary conditions at the capitalist core, this has meant that the rand's value is increasingly disconnected from real economic fundamentals. In line with other DTECs, South Africa has engaged in costly sterilisation of capital inflows and large reserve accumulation. Finally, capital flight has been a perennial problem.

The above has occurred on the basis of policy changes discussed in the previous chapter and in tandem with the process of financialisation observed in DTECs generally, as laid out in Chapter 4. In line with our theorisation of financialisation, international capital markets have clearly come to exercise significant influence over the South African

economy. Also in line with our previous analysis, external financial integration, while exposing the domestic economy to numerous vulnerabilities, has evolved in a manner that has privileged international financial capital as well as dominant sections of domestic capital, while being shaped by local political economy factors. The manner in which liberalisation interacts with domestic financialisation will be more fully highlighted in the following chapters.

8 TRANSFORMATIONS IN THE FINANCIAL SECTOR

8.1 Introduction

In Chapters 3 and 4 we reviewed the intensive and extensive expansion of finance and the manner in which the financial sector, NFCs, and households, and the relationships between them, have been altered in the course of financialisation and how certain of these transformations are foundational to our understanding of financialisation. This chapter probes transformations in the South African financial sector with two objectives. The first is to assess whether the sector has financialised, or changed and how so, in the post-apartheid period. The second is to describe changes within the financial sector that will be important for our discussions regarding the relationship between finance and NFCs and households (in Chapters 9 and 10 respectively). The latter element is more descriptive and the implications of certain phenomena described are tackled in later chapters and not here.

Regarding the former, we use our previous characterisation of financialisation in order to assess the extent of financialisation in South Africa. At the broadest level we analyse the aggregate growth of finance within the economy (Section 8.2). As banks stand at the heart of the sector, a large portion of this chapter is focused in their direction, with an assessment of whether the banking sector has transformed and whether the operations of banks have altered (Section 8.3). We argued in Chapter 3 that banks should not be analysed to the exclusion of financial markets and financial-market institutions. Building on the historical analysis offered in Chapter 5 and the literature in Chapters 3 and 4 we explore the evolution of financial market instruments and intermediaries in the post-apartheid period (Section 8.4). Our final section (8.5) focuses specifically on institutional investors and private equity, critical to how financial markets come to exert influence over the productive sector. In each section we lay out what we may expect to see given financialisation elsewhere and against these expectations, we can assess the extent of the financialisation of the financial sector in South Africa.

While our focus is on change, it is worth noting again that continuities with the past are also telling. As previously noted, the financial sector experienced both (faltering) reregulation and growth in the 1980s, in part fuelled by large surpluses and trapped capital. We noted in Chapter 5 that this saw: the dissolution of boundaries between

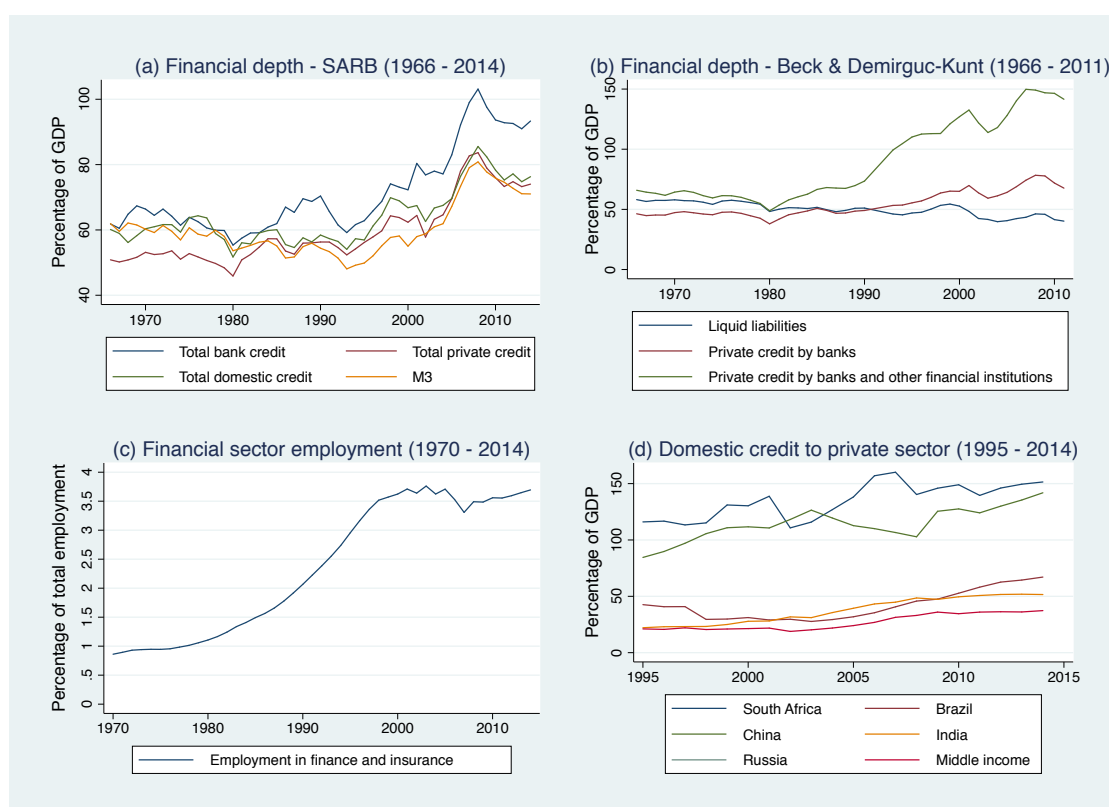
different types of financial institutions; the rising prominence of institutional investors; a (partially stymied) shift in regulation towards a market-based/monetarist approach; the deepening of financial markets including secondary markets, off balance sheet activity, and shareholder distributions; and shifts in patterns of bank lending towards households. It is against this – already financialising – canvas that we interrogate changes in the post-apartheid period.

8.2 Financial depth

There can be little doubt that domestic finance has expanded significantly in South Africa. We observe in Figure 8.1a that from around 1995/1996 onwards – coinciding with financial liberalisation – credit as a share of GDP by a variety of measures, increases significantly peaking between 80-104% of GDP in 2008. This is precisely the ‘threshold’ range established in the ‘too much finance’ literature, previously discussed, after which financial deepening has a harmful effect on growth (Arcand et al. 2012, Cecchetti and Kharroubi 2012, Law and Singh 2014, Samargandi et al. 2015). Demirguc-Kunt et al.’s (2013) prominent Financial Development and Structure Dataset (Figure 8.1b) shows private credit by banks and other financial institutions peaking in 2008 at just shy of 150% of GDP; this dataset shows liquid liabilities and private credit of banks at lower than the SARB (2015b) data. Figure 8.1c shows that employment in the finance and insurance sector has similarly grown enormously, from under 1% of economy-wide employment in 1970 to over 3.5% in 2014. South Africa, therefore, sits just shy of the international average turning point, 3.9%, found by Cecchetti and Kharroubi (2012), after which negative growth effects are associated with financial employment.¹¹¹

¹¹¹ The mainstream econometric studies for South Africa of the relationship between finance and growth – showing contradictory results – are reviewed in Isaacs (2016b).

Figure 8.1 Financial development



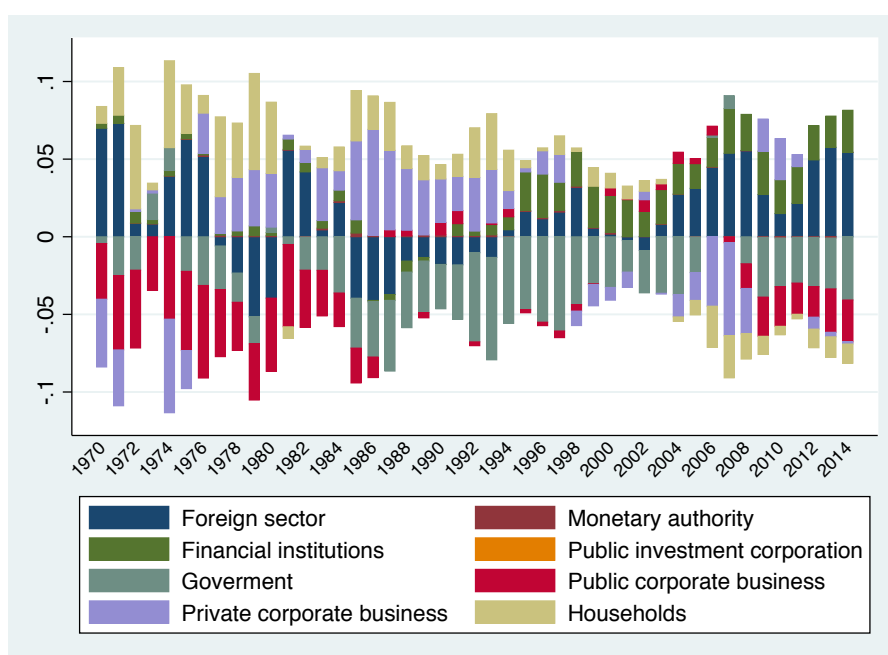
Source: (a) and (c) SARB (2015b), own calculations; (b) Beck et al. (2016); (d) World Bank (2016d)

We highlighted in the introductory chapter that finance has also grown as a share of gross value added (GVA), whereas the broad measure of the financial sector averaged at 12% of GVA between 1960 and 1993 it almost doubled to an average of 21% between 2005 and 2015. By way of comparison, amongst BRICS countries, South Africa and Brazil had the highest share of GDP in the tertiary sector (68% and 71%, respectively), compared with Russia, India, and China at 60%, 53%, and 48%, respectively. Figure 8.1d compares domestic credit to the private sector in South Africa with other BRICS countries as well as the middle-income country average, showing South Africa as the highest in the set and more than triple the middle-income country average. As Rashid (2011, p. 7) notes, the “size of the financial sector puts South Africa in the league of large financial centers”.

Figure 8.2 breaks down credit extension in South Africa by sector using flow-of-funds data. We see that households, which were the largest net savers in the 1970s, became net debtors by the 2000s. The government’s net acquisition of debt in the late 1980s and 1990s reverses in the early 2000s and then grows following the 2007/8 financial crisis as does the debt of public corporations. We see that debt expansion from 2002 onwards is

supported predominately by the foreign sector and that this is particularly true of the consumption-led boom of 2002/3 to 2006/7. Net debt and credit expansion is, unsurprisingly, strongest during 2007. Finally, between 2009 and 2011 the private corporate sector is a net supplier of credit with net credit/debt supply/acquisition close to zero in subsequent years, speaking to the over-capitalisation of NFCs and their reserves of cash savings (see Chapter 9).

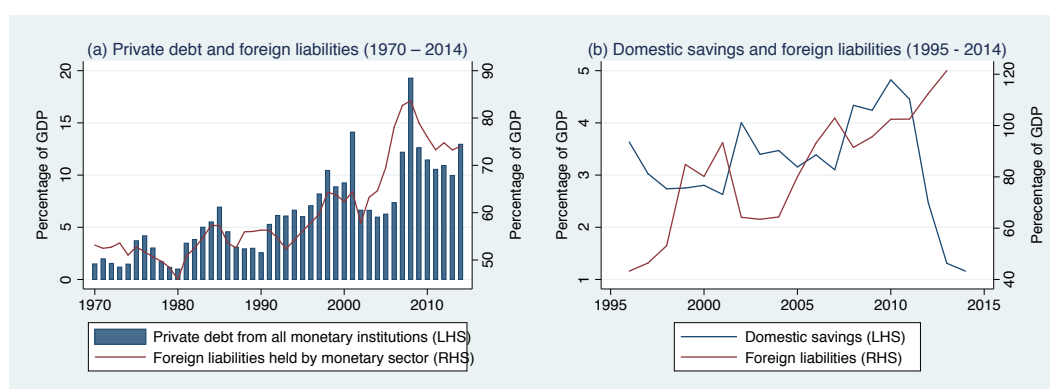
Figure 8.2 Borrowing and lending by sector as a proportion of total borrowing (-) / lending (+) (1970-2014)



Source: SARB (2015a), own calculations

Building on our analysis in the previous chapter it is worth unpacking the relationship between domestic debt and savings as is done in Figure 8.3. In Figure 8.3(a) we see, in the monetary sector, a very strong correlation between foreign inflows and domestic credit expansion. In Figure 8.3(b) it is clear that domestic savings have declined as foreign inflows have risen. These indicate how the foreign sector has fuelled credit expansion in tandem with decreased savings in the domestic economy. The growth of the financial sector is consistent with our previous exposition of financialisation while the increasing reliance on foreign funding is illustrative of the terms upon which international integration has occurred as discussed in the previous chapter. We turn now to consider the banking sector.

Figure 8.3 Foreign and domestic sectors: debt, savings and credit



Source: SARB (2015a) via Quantec, own calculations

8.3 Banking sector

The banking sector, we argued in Chapters 3 and 4, is central to the process of financialisation, in particular with regard to patterns of lending and its role in financial markets. Our analysis here begins with a descriptive review of potential shifts in the structure of the banking sector, with particular attention to concentration (Section 8.3.1) – which has been a hallmark of the South African banking sector as discussed in Chapter 5 – and the role of foreign bank entry (Section 8.3.2) – which our analysis in Chapter 4 suggests may be important for financialisation. The most detailed analysis of banking operations focuses on their balance sheets and income structure. Regarding the asset side of banks' balance sheets (Section 8.3.3) financialisation elsewhere suggests we should interrogate whether a. lending patterns have changed; b. lending to households has increased in prominence; c. lending to NFCs has decreased in prominence; and d. if financial-market investment and trading have increased in prominence. Regarding bank liabilities (also Section 8.3.3) we may expect to find that: a. deposits have decreased as a source of funding; and b. short-term money market borrowing has increased in scale. Regarding bank income (Section 8.3.4) we interrogate whether fee income, particularly from households, as well as income from financial market trading, have increased in weight.

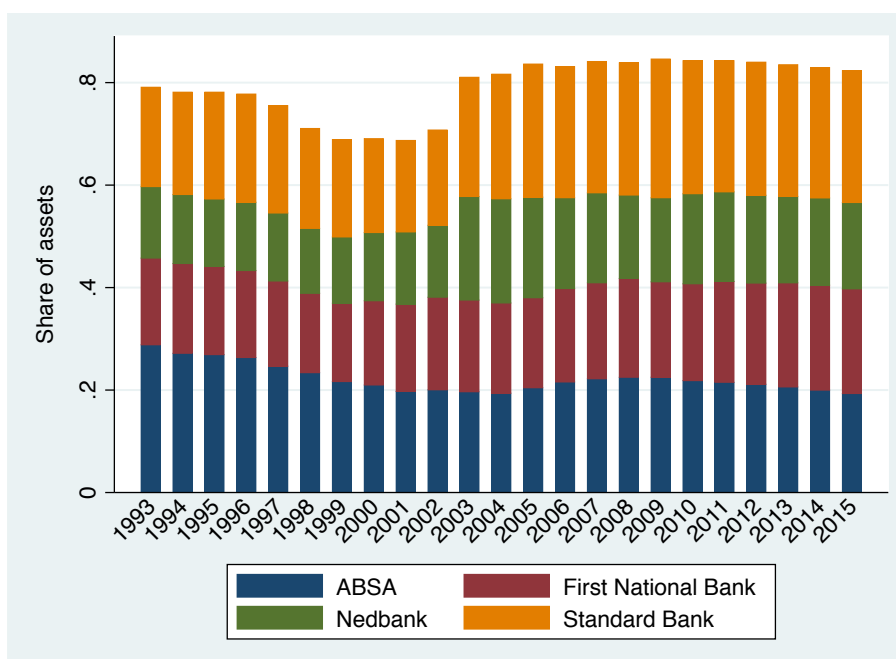
8.3.1 Banking concentration

The high degree of concentration and middling levels of competition that so characterised South African banking, as discussed in Chapter 5, have continued to be a hallmark of the sector. Figure 8.4 shows the share of banking assets held by the 'big

four' banks from 1993 to 2015. This dipped from 79% in 1993 to a low of 69% in 2001 as new entrants, such as African Bank, entered the market. However, after a further consolidation process (between the end of 2001 and 2003 the number of registered domestic banks fell from 39 to 23 with the Nedcor-BOE merger of particular importance), the share of assets held by the big-four banks rose above 80% and has remained so since then (Gidlow 2008, p. 33). In a cross-country analysis of the ten most rapidly growing emerging-market banking sectors, South Africa ranked highest in bank asset concentration by a large margin (Ernest & Young 2013).

Dramatic concentration is confirmed by estimates using the Herfindahl-Hirschman Index (HHI) (a common measure of concentration) which shows South Africa declining from 0.17 in 1994 to 1.4 in the late 1990s and early 2000s and then back up to 0.19 by 2007 onwards following the consolidation mentioned above; anything above 0.18 is considered high (Verhoef 2009, SARB 2011, see also Simatele 2015). Such concentration is associated with higher margins and higher bank charges (see below). It is also argued that efficiency gains can arise as economies of scale allow for innovation and cost spreading (Hawkins 2004); however, efficiency (as conventionally measured) appears to have fallen in the post-apartheid period (Verhoef 2009, Mohamed 2014).

Figure 8.4 Share of total banking assets held by 'big four' (1993-2015)



Source: SARB (2016b) via Quantec, own calculations

Despite high levels of concentration important developments took place outside the four big banks, in particular the growth of microlenders, lending towards the lower-income end of the market traditionally neglected by the big banks. This includes a range of specialised microfinance institutions (MFI) geared towards small business and household lending but also new banks such as Africa Bank and Capitec targeting this market. James (2014) describes a three-tiered financial sector – the large formal banks, formal microlenders, and informal lenders – each plugging gaps left by the other two; while our analysis in this chapter focuses on the first we return to microlending below (and informal lenders in Chapter 10).

8.3.2 Foreign banks

In Chapter 4 we discussed the importance of foreign bank entry in the process of financialisation in DTECs. Contrary to the trends observed there, the South African banking sector has remained predominately domestically controlled; currently there are only six foreign-owned South African banks, five of which have very small market shares. The other is ABSA – one of the big four commercial banks – in which the UK's Barclays, in 2005, acquired a 54% stake. Including ABSA the foreign-ownership stake stands at roughly 20% of total banking assets and liabilities but excluding Barclays' ABSA ownership it is a measly 0.5% (SARB 2016b, own calculations). The other significant foreign investment was in 2007 when the Industrial and Commercial Bank of China (ICBC) purchased a 20% stake in Standard Bank; this has been followed by other partnerships between the two, for example ICBC's purchase of 60% of the London-based trading house Standard Bank PLC (The Economist 2014). Barclays announced in February 2016 that it would sell its now 62% stake in Barclays Africa, the company which owns the South African subsidiary (ABSA), and other interests on the continent. It cited regulatory capital requirements as the proximate cause for withdrawal, but slow growth, rand devaluation, and political uncertainty in South Africa, as well as Barclays' own strategic priorities, are likely contributing factors. Unless the stake is taken up by another foreign bank, this will leave South Africa with very low levels of foreign ownership in the banking sector.

The relatively low presence of foreign ownership is likely due to the large and sophisticated nature of South African private banks as well as the high degree of concentration, and conglomerate ownership patterns (see Chapter 5), already established

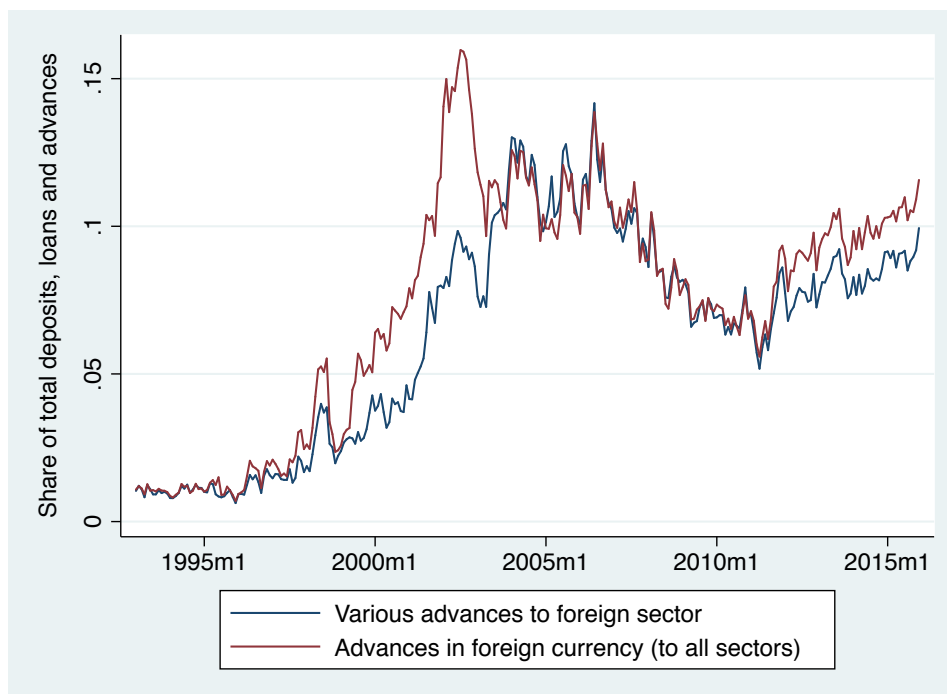
prior to liberalisation. It also reflects the power of South African finance capital that was able to manage liberalisation in ways favourable to its own interests. In the South African context, foreign-bank ownership would have entailed taking up hefty stakes in large existing banks without much room for further market consolidation, or the opening of new banks in a highly concentrated oligopolistic market.

Instead, foreign banks have opened local branches, with the number of branches rising in the wake of liberalisation from 5 in 1995 to 15 in 2005 (with still only 15 branches in 2016), representative offices grew from 31 in 1992 to 61 in 2000, falling to 46 in 2005 and 39 in 2016 (Singleton and Verhoef 2010, p. 554, SARB 2016b). These have focused on high-yielding business within the corporate sector rather than retail deposits. Sophisticated capital markets and large interest rate differentials between home countries and South Africa have made this attractive (Gidlow 2008, Verhoef 2009, Singleton and Verhoef 2010) and regulation requiring South African branches (or foreign-owned local banks) to be separately capitalised from the parent company, has made entering retail banking unenticing. This has brought new banking practices to South Africa, as did Barclays' takeover of ABSA, which was followed by a restructuring of personnel, a rationalisation of branches, and the imposition of new assessment and risk metrics.

Despite low levels of foreign ownership, South African banks have nevertheless internationalised dramatically with outward expansion into Africa and elsewhere. Tellingly, low-tax jurisdictions were some of the first countries in which South African banks opened branches between 1995 and 1997 (Singleton and Verhoef 2010, p. 553). This speaks to the large capital exit discussed in the previous chapter as well as the internationalisation of South African corporates discussed in the next chapter. Following this (1998 onwards) branches were opened across Latin America, Europe, and Asia, with African expansion becoming prominent between 2000 and 2005. Internationalisation can also be proxied by the share of lending by South African banks to the foreign sector which is shown in Figure 8.5; while this has significantly grown in prominence it is clear that the primary source of banking activity remains domestic. The internationalisation of South African banks has brought them into a global market place. Presumably this has, in line with financialisation, shaped the alteration of banking

practices we explore below. This noted, more research on the relationship between bank internationalisation, bank concentration, and shifting banking practices is required.

Figure 8.5 Foreign currency advances (1993-2015)



Source: SARB (2016b) via Quantec, own calculations

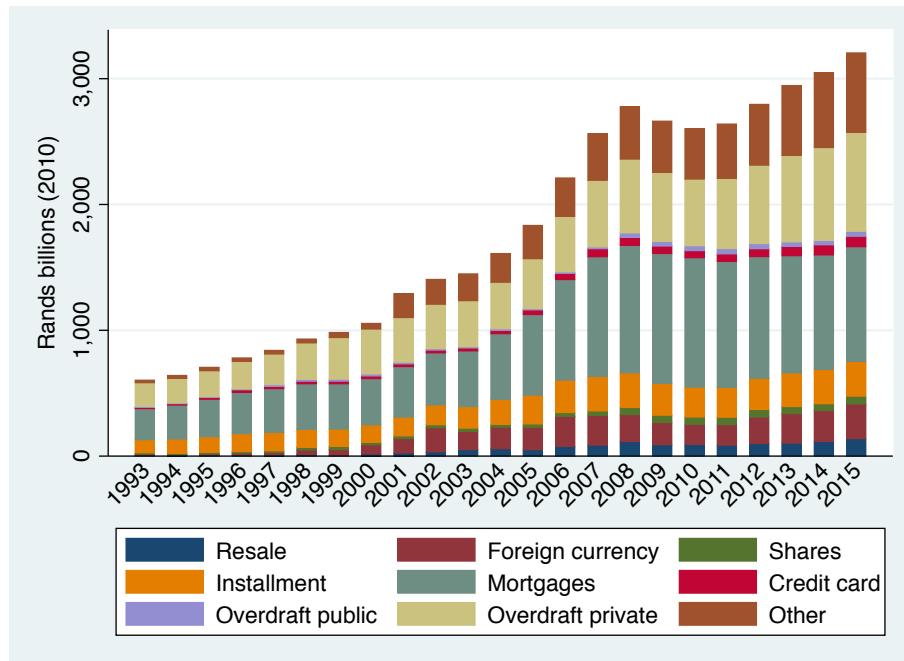
8.3.3 Bank balance sheets

Bank balance sheets have changed notably. Unfortunately, disaggregated data in this regard only reliably began in 1993.¹¹² Figure 8.6 breaks down ‘deposits, loans, and advances’ by banks. We see that such credit extension grew fivefold in real terms between 1993 and 2015 and that mortgages and private overdrafts make up the lion’s share.¹¹³ Credit cards play a minor role but, as discussed below, have grown from insignificance. Notable is that money-market instruments became increasingly important; for instance, as shown in Table 8.1, negotiated certificates of deposits (NCDs) as a share of South African banks’ deposits, loans and advances almost double between 2001 and 2011 only to fall again by 2015. The trends in Figure 8.7, which breaks down lending by the recipient sector, shows that lending to households and for residential mortgages has driven credit expansion.

¹¹² For a discussion of the data sources and various issues arising please see the Appendix.

¹¹³ These figures, and those below, show corresponding growth when considered as a percentage of GDP rather than in real terms.

Figure 8.6 Types of assets held by commercial banks (1993-2015)



Source: SARB (2016b) via Quantec, own calculations

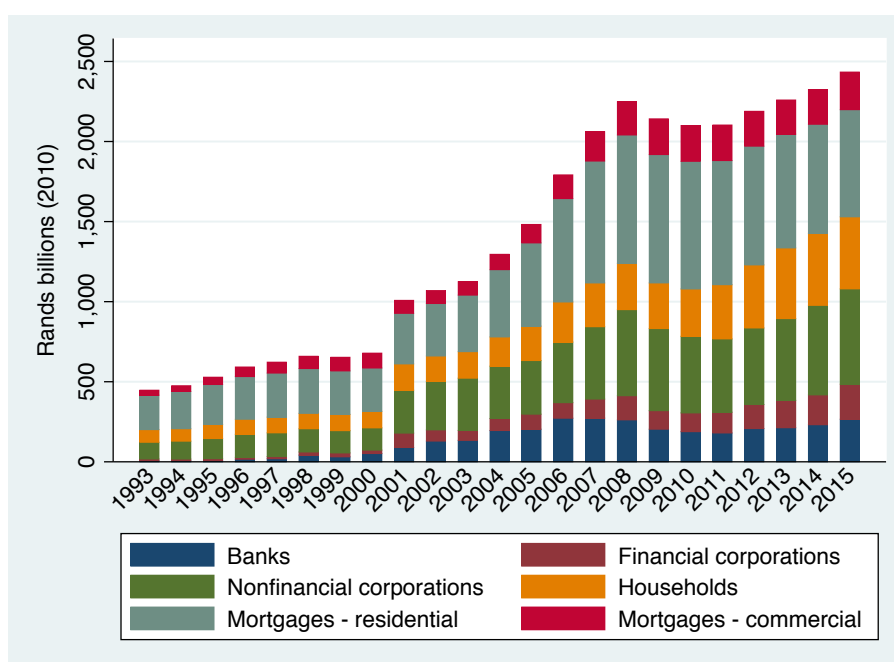
Note: Shares refer to redeemable preference shares held by banks (this is distinct from their shares held as investment assets)

Table 8.1 Example of money-market assets held by South African banks (2001-2015)

	2001	2005	2010	2011	2015
NCDs as percentage of total deposits, loans and advances by South African banks	31	31	42	59	32

Source: SARB (2016b) via Quantec, BA900 banking data series, own calculation

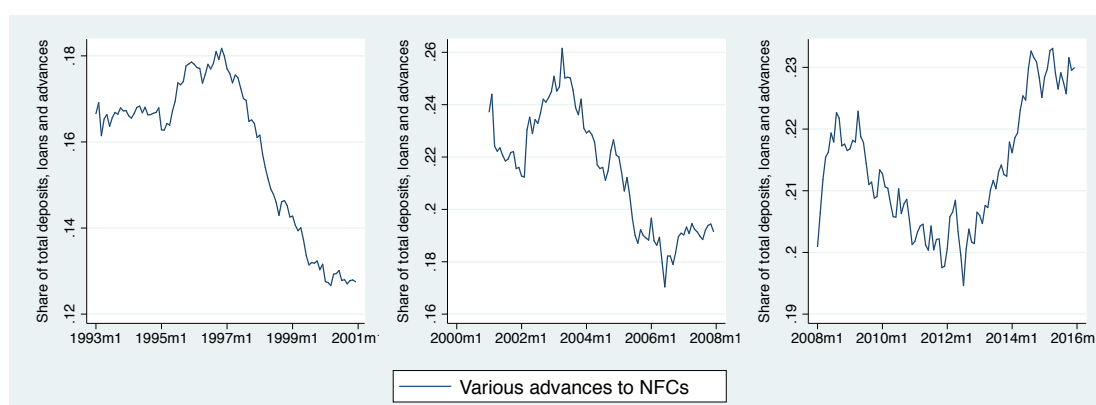
Figure 8.7 Bank assets according to sector (1993-2015)



Source: SARB (2016b) via Quantec, own calculations

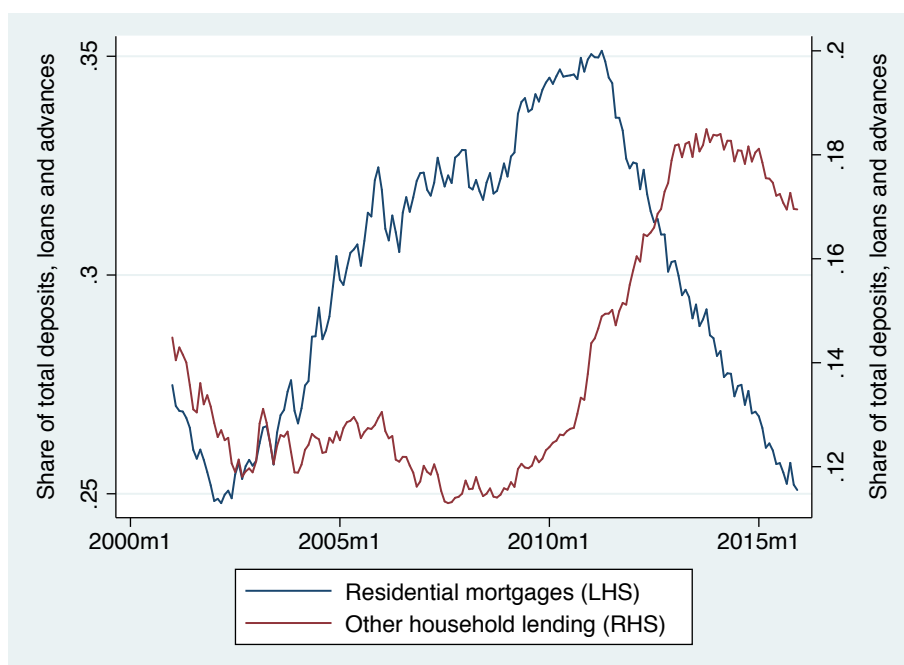
Regarding lending to NFCs, the data unfortunately have a number of breaks: for certain credit types NFCs are only distinguished from other sectors from 2001 or 2008 onwards. In Figure 8.8 we therefore cut the data series into three internally consistent pieces (1993-2000, 2001-2007 and 2008-2015). We observe a decline in bank assets held as deposits, loans and advances to NFCs as a share of overall deposits, loans and advances in all three periods, indicating a reduction in bank lending to NFCs. However, this trend has two periods of reversal: in early 2008 and from 2012 onwards (with a short-lived revival in 2002 also). In Figure 8.9 we see an increase in residential mortgages, as a share of bank assets between 2000 and 2011, as well as a steep increase in other loans to households from 2008 onwards. The increase (from 2012) in deposits, loans and advances to NFCs as a share of total deposits, loans and advances is closely related to the fall in mortgages as a share of these deposits, loans and advances. This reversal, also reflected in banking income (Section 8.3.4), is attributable to increased mortgage defaults in the late 2000s, regulatory changes due to the National Credit Act, and a pulling back of the banking sector from certain mortgage classes (see Chapter 10). The increased share attributable to NFCs from 2012 may also relate to financing large infrastructure projects although these got underway a few years earlier; the spike in the share attributable to NFCs in 2007/8 is related to the financial crisis and a fall in lending to the financial sector.

Figure 8.8 Bank assets attributable to non-financial corporate sector (1993-2015)



Source: SARB (2016b) via Quantec, own calculations

Figure 8.9 Bank assets for residential mortgages and to households (2000-2015)

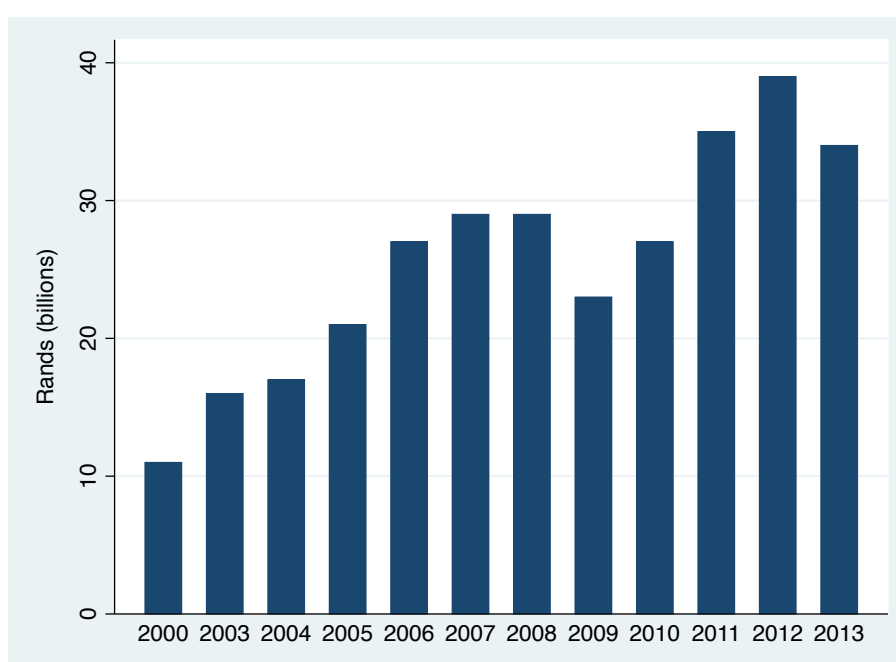


Source: SARB (2016b) via Quantec, own calculations

The rise in household lending shown in Figure 8.9 should be complemented by a specific focus on microlending, which has also been shown to crowd out other productive lending (Bateman 2014, 2015). This is not necessarily clearly visible on the aggregate balance sheet of the banking sector which is dominated by the big four banks, although they have engaged in some microlending as well as providing wholesale finance to MFIs. Data are hard to come by but the increase of MFI microlending is shown in Figure 8.10, rising steeply from around R10bn in 2000 to almost R40bn in 2012. Amongst formal banks, African Bank and Capitec Bank specifically targeted this market and saw extraordinary growth; African Bank's assets increased ninefold between

2000 and 2015 with Capitec's growing by the same between 2009 and 2015 alone. The importance of such lending to these banks is shown by the fact that 'other loans and advances' to households make up between 60-90% of their total assets, whereas this is 2-5% for the banking sector as a whole (for a case-study analysis of these two banks see Bateman 2014, 2015).¹¹⁴ This is because the big banks have far more diversified portfolios with less concentration on lower-end lending; we return to the dynamics and consequences of such lending in Chapter 10.

Figure 8.10 Microloan gross debtor book estimates (2000-2013)



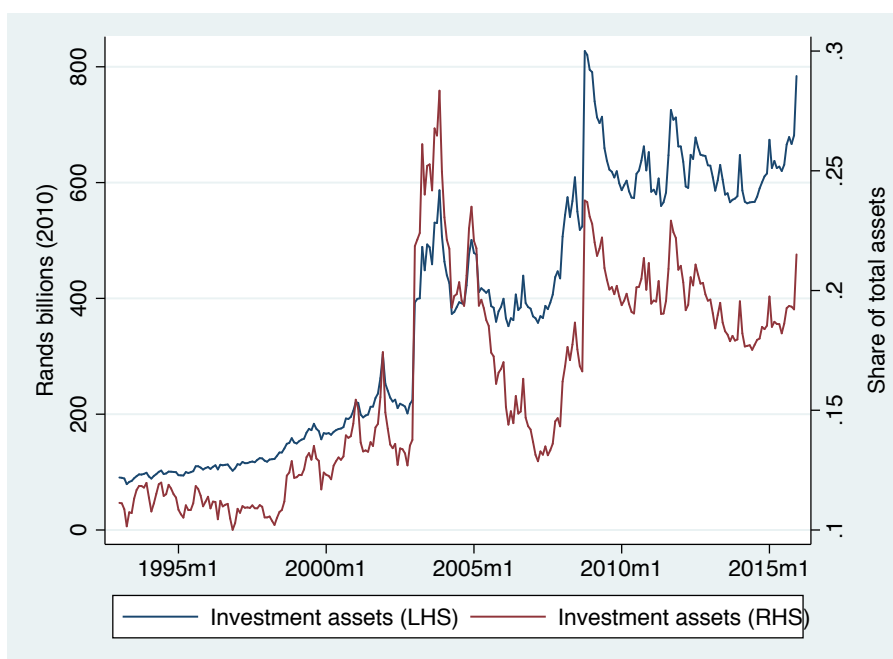
Source: NCR (2006, 2007, 2014), Gardener (2008), Calvin and Coetzee (2009), and Ahmed et al. (2013)

A crucial illustration of these diversified portfolios is the heavy engagement in financial markets that has developed amongst the big banks since the end of apartheid. Figure 8.11 shows this with a large increase in investment assets (securities, equity, derivatives, etc.) in real terms and as a share of overall bank assets, with a predictable slump around the time of the global financial crisis. This is decomposed in Figure 8.12 which shows investment assets by type (Figure 8.12a) and sector (Figure 8.12b). Here we see a large increase in derivatives, as a type of asset held, together with a large increase in other banks as a sector holding investment assets. This correspondence is unsurprising as banks are most commonly counterparties to derivative contracts (as shown in

¹¹⁴ These banks are also highly leveraged with the ratio of deposits to asset generally lower than the banking sector as a whole.

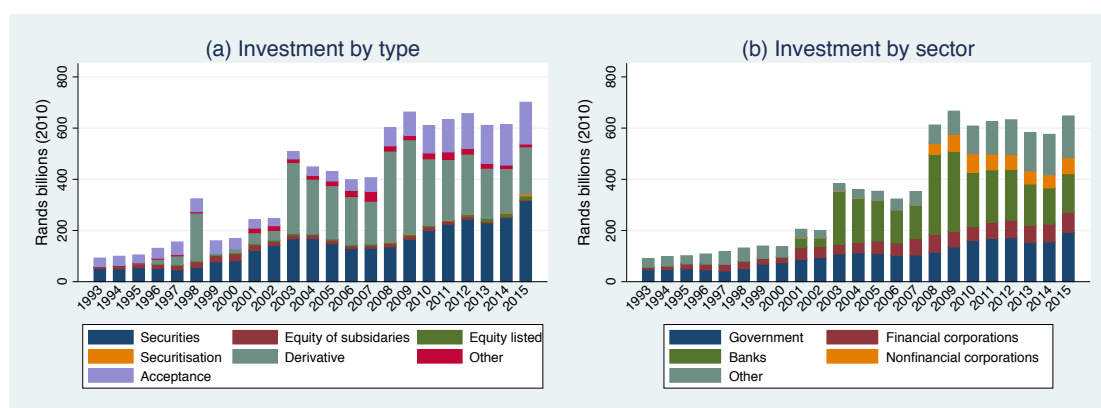
Lapavitsas 2014 and discussed in Chapter 3). The rise in securities and in government holdings also relate to one another as government securities make up the lion's share of such securities (although bank holdings of NFC securities increase significantly as a share of assets and in real terms in 2013 and 2015 despite remaining small).

Figure 8.11 Investment assets of banks (1993-2015)



Source: SARB (2015c) via Quantec, own calculations

Figure 8.12 Bank investment assets by type and sector (1993-2015)



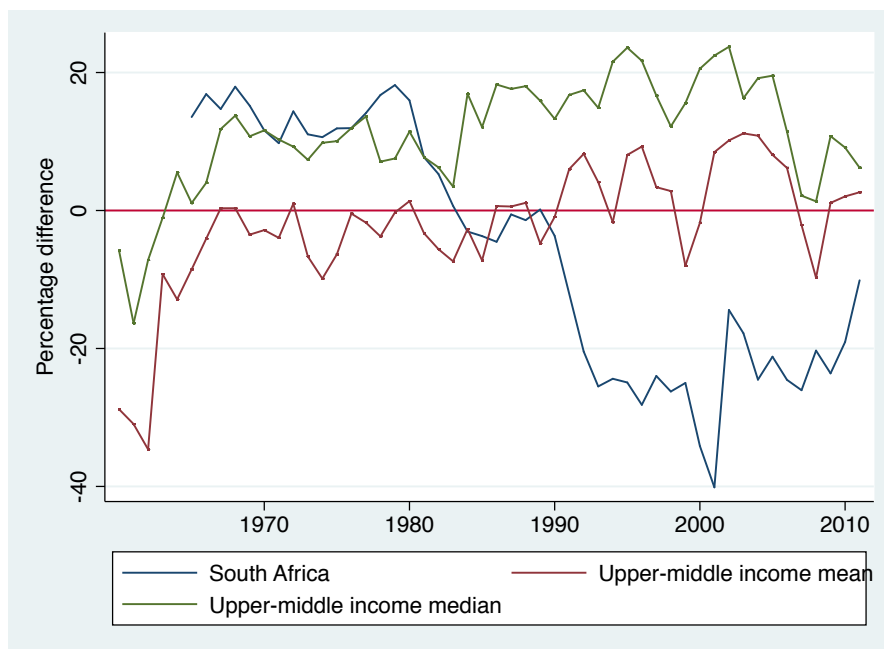
Source: SARB (2015c) via Quantec, own calculations

In sum, on the asset side of the bank balance we have seen four important trends. First, an increase in household and mortgage lending, in absolute terms and as a share of overall assets, although the former dips post 2010, as well as the growth in microlending. Second, a fall in lending to NFCs, albeit with a recent recovery. Third, an

increase in money-market participation as witnessed via the share of NCDs in total deposits, loans and advances. Fourth, a strong growth in financial market investment activity. All of these are congruent with increasing financialisation of South African banks. We do not see large holdings of NFC stock, also congruent with our analysis that financialisation does not involve direct control of NFCs by banks.

The liability side of the banks' balances is also important. This is visible in Figure 8.13 which shows that there is a large negative relationship between bank deposits and bank credit indicating that South African banks are financing a considerable part of their lending with borrowed funds. This difference is significantly greater than in other middle-income countries as shown in Figure 8.13. The banking sector is also the largest holder of foreign liabilities exposing South African banks to some risk; however, the overwhelming majority of banking liabilities are still domestic.¹¹⁵ We see in Figure 8.14 a steady increase in banking liabilities and that they are overwhelmingly composed of deposits, which runs counter to trends in the developed world where declining deposit to liability ratios for banks has been associated with financialisation (Lapavitsas 2014).

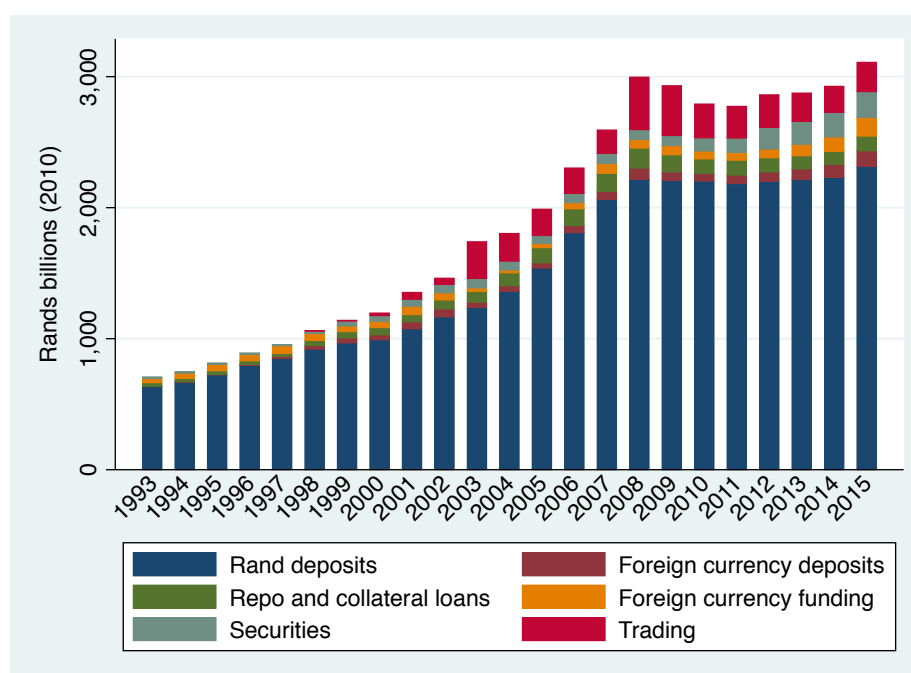
Figure 8.13 Percentage difference between bank deposits and bank credit (1970 - 2011)



Source: Demirguc-Kunt et al. (2013), own calculations

¹¹⁵ Unfortunately, it is impossible to adequately analyse foreign liabilities of banks because foreign holdings of domestically denominated liabilities are only distinguished in the time series from 2008 onwards.

Figure 8.14 Composition of bank liabilities (1993-2015)



Source: SARB (2016b) via Quantec, own calculations

This said, we can still discern an increase in financial market related activity on the liability side of bank balance sheets. First, Figure 8.14 shows trading instruments, such as derivatives, have taken on new prominence from 2003, in both real terms and as a share of total liabilities (although this series only begins in 1998). Second, when we decompose the type of deposits and instruments we see that money market instruments – interbank funding, negotiable certificates of deposit (NCDs), repos, and other funding liabilities – become more important throughout the 2000s in comparison to regular deposits (demand, notice and fixed, and savings). This is shown in Table 8.2 where we see a rise in NCDs as a share of total deposits from 14% in 2001 to 19% in 2010 although this falls to 13% by 2015.¹¹⁶ The subsequent fall in NCDs is probably due to the rise in household savings from 17% of all bank liabilities in 2010 to 21% in 2015, as visible in Table 8.3, because in real terms NCDs continue to increase steeply. Third, Table 8.3, which decomposes deposits by type of depositors, shows that the most dramatic change is an increase in liabilities of the non-bank financial sector – unit trusts dominating this segment (discussed below). At the same time deposits of other South African banks as a share of total deposits, fall significantly (related to their own money-market activity) while household deposits fluctuate moderately and deposits of NFC, as a percentage of total deposits, remain fairly constant. The above indicates increased

¹¹⁶ Unfortunately, disaggregated data are unavailable before 2001 and in some series not before 2008.

integration into financial markets by South African banks, as well as increased short-term borrowing, both consistent with financialisation. Bank balance sheets therefore reveal the increased – although not uniform – financialisation of the South African banking sector particularly in the 2000s in line with trends in other DTECs.

Table 8.2 Examples of money-market borrowing (2001-2015)

	2001	2005	2010	2015
Repo and collateralised borrowing as percentage of total borrowing	4	6	4	4
NCDs as percentage of total deposits	14	15	19	13

Source: SARB (2016b) via Quantec, own calculations

Table 8.3 Percentage of deposits held by type of depositor (2001-2015)

	2001	2005	2010	2015
South African banks	12	7	7	4
Government and public bodies and enterprises	9	13	10	8
Financial corporate sector (excluding banks)	19	27	35	33
Nonfinancial corporations	26	27	25	27
Households	23	19	17	21
NGOs	3	3	3	2
Foreign sector	3	1	1	2
Other	5	3	2	2

Source: SARB (2016b) via Quantec,, own calculations

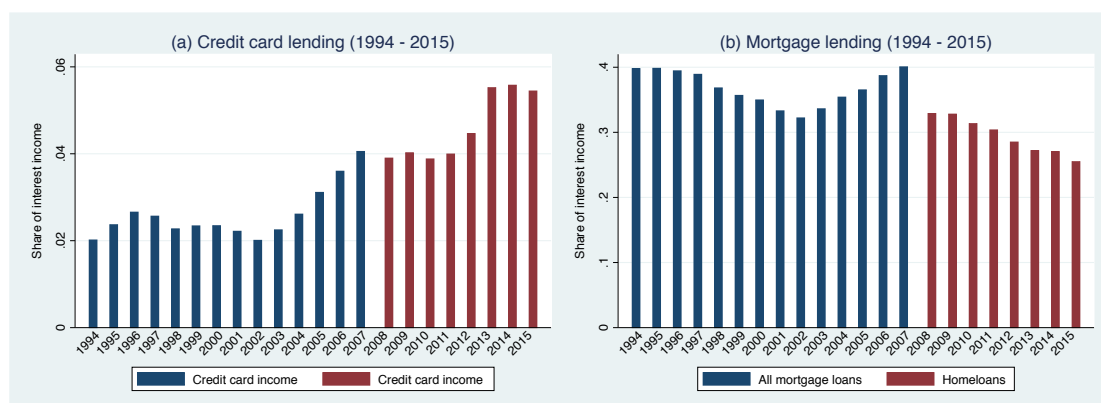
8.3.4 Banking returns

Banking income, we noted in the introduction, is also revealing of the orientation of the sector. It is worth noting that the banking sector has remained highly profitable – Return on Equity (ROE), for example, is higher for major South African banks than for their counterparts in the US, Canada, and Australia (PwC 2015). What most concerns us here, however, is changes in the composition of certain categories of bank income as reflected in Figure 8.15, Figure 8.16, and Figure 8.17 below. Unfortunately, the time series data are not consistent. Between 1994 and 2007 bank income statements were submitted to the SARB on DI200 forms, and the blue series in the figures below reflect data from these forms; before 2001 not all line items are reported. From 2008 onwards income was reported on BA120 forms, reflected in the red series in the figures below,

which consist of differently labelled and disaggregated line items. The items matched below are a good fit but the continuity between the two datasets should be treated with some caution.

Figure 8.15a shows that income from credit cards, as a share of interest income, has become increasingly important, approximately doubling (from 2% to 4%) between 2000 and 2007 and then reaching 5.4% in 2015 (Figure 8.15a) (reflecting the almost doubling of credit card debt as a share of bank credit). Interestingly, mortgage income, while rising from 32% in 2002 to 40% in 2007 was not higher in 2007, as share of interest income, than in 1994, and income from homeloans, as a share of interest income, has fallen between 2008 and 2015 (Figure 8.15b). In gross terms, not shown here, interest from mortgages grows in tandem with interest rates until 2005 when mortgage interest income growth accelerates despite falling interest rates, indicating that this is driven by the volume of mortgages extended not their price.

Figure 8.15 Income from household lending (1994-2015)



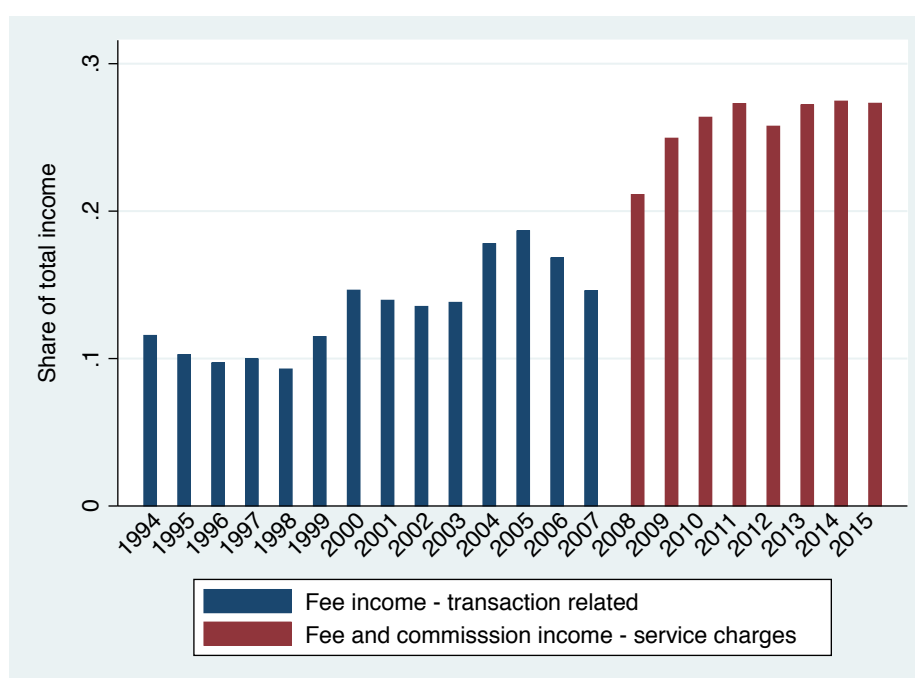
Source: SARB (2016c, 2016d), own calculations

Note: in (b) 'all mortgage loans' (1994-2007) presumably refers to commercial and residential loans whereas from 2008 the new series 'homeloans' (distinct from 'commercial mortgages') is used.

In line with trends elsewhere in the world we see that fee income becomes increasingly important to South African banks. For the five years 1995-1999 these average at 10%, compared with 27% between 2011-2015. This, is indicative of the shift away from traditional sources of interest income from commercial loans towards service and market-trading fees. Figure 8.16 shows the former while the latter is highlighted in Figure 8.17b. In Figure 8.17b 'knowledge-based fees' refers to income derived from facilitating buyouts, listings, mergers and acquisitions, and similar financial market expertise. This grows in the late 1990s in line with the period of deconglomeration and

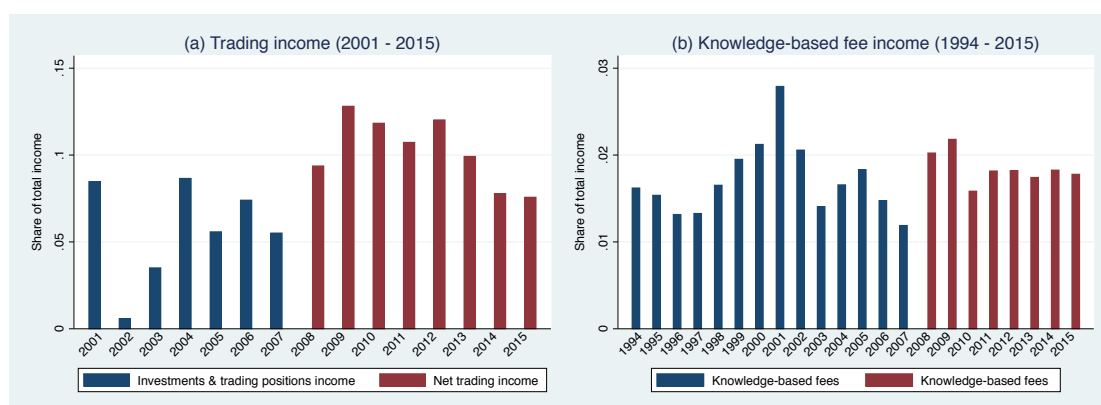
corporate restructuring. The subsequent drop and later fairly static nature of this fee category relates to a larger share of such activity facilitated outside of the commercial-banking sector, in particular through large foreign investment banks. Finally, income from investments and financial market trading is shown in Figure 8.17a and is highest between 2008 and 2013. These trends, while not always corresponding directly to bank balance sheets, also reflect the increased financialisation of South African banks.

Figure 8.16 Fee income (1994-2015)



Source: SARB (2016c, 2016d), own calculations

Figure 8.17 Income from financial markets



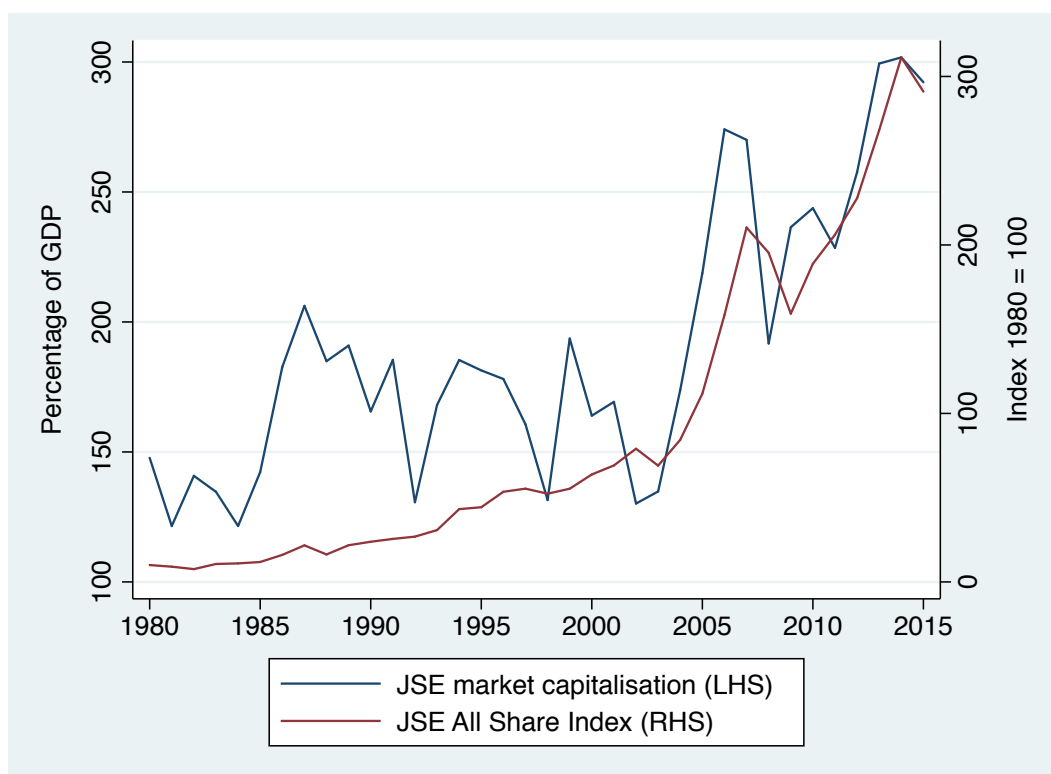
Source: SARB (2016c, 2016d), own calculations

8.4 Financial markets

In our discussions of financialisation in DTECs we stressed not only the changing operations of banks, clearly illustrated above, but the growth of financial markets. This, like altered patterns of bank lending, has important consequences for the productive sector, and the manner in which financial markets and large financial institutions exercise influence over NFCs and the latter's inculcation into financial markets. In this and the next section we explore those changes in financial markets while we only tackle how these relate to the productive sector in the next chapter.

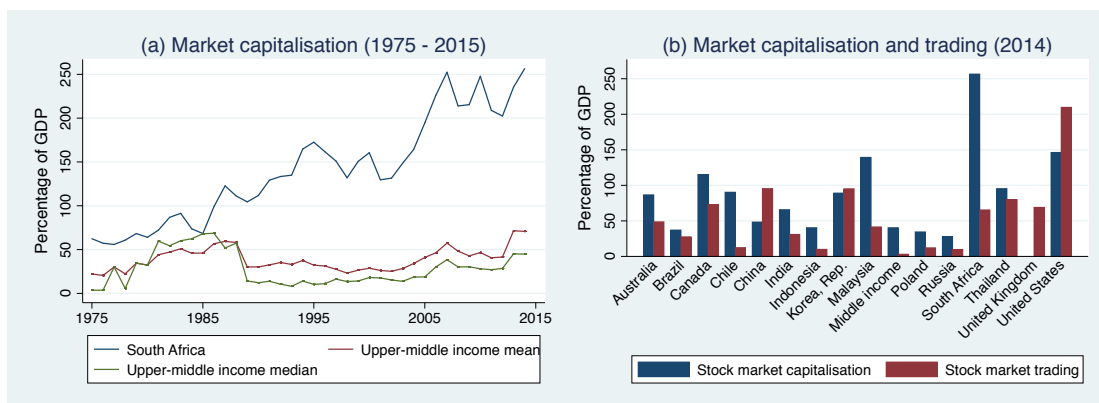
Financial markets, already deep and relatively liquid by the end of apartheid, have experienced significant expansion with market capitalisation to GDP increasing from 1994 and leaping in the last decade to just over 300% of GDP in 2014, double what it was in 1980 (according to SARB data), some of the most dynamic growth anywhere in the world. This has occurred in tandem with a similar rise in the JSE All Share Index, both visible in Figure 8.18, with the JSE All Share Index persistently outperforming the MSCI Emerging Market Index (MSCI 2016). We see in Figure 8.19a that growth in market capitalisation in South Africa outperforms other middle-income countries by a large degree. Similarly, we see in Figure 8.19b, that in 2014 market capitalisation as a percentage of GDP was higher in South Africa than in a range of emerging markets and higher even than in the US, although trading on the JSE, while still higher than most emerging market peers, was not dramatically so. In addition, JSE SAFEX derivative markets have grown extraordinarily, as can be seen in Table 8.4. The total contracts traded on the SAFEX Commodities Derivative market more than doubled between 2002 and 2015 from 154 000 to 363 000. In June 2007 a Currency Derivatives market was launched – with the number of deals in currency trading growing 140% between 2012 and 2015 – and the Equities Derivative Market has likewise seen extraordinary growth.

Figure 8.18 JSE market capitalisation and JSE All Share Index (1980-2015)



Source: SARB (2016a) via Quantec, own calculations

Figure 8.19 Market capitalisation comparisons



Source: (a) Beck et al. (2016); (b) World Bank (2016d)

Table 8.4 JSE derivative markets (2002-2015)

	2002		2009		2012	
	Value (R Bn)	Trades / deals	Value (R Bn)	Trades / deals	Value (R Bn)	Trades / deals
Commodities	209	153 669	216	238 271	511	324 983
Equities - options	78	12 960	82	17 510	39	23 369
Equities - futures	861	133 057	3 075	1 329 048	4 186	2 055 739
Currency - options			1	735 285	32	4 628 483
Currency - future			61	7 177 562	126	14 293 564
	2015		2009 - 2015 (% increase)		2012 - 2015 (% increase)	
	Value (R Bn)	Trades / deals	Value (R Bn)	Trades / deals	Value (R Bn)	Trades / deals
Commodities	749	362 901	247	52		
Equities - options	28	19 921	-66	14		
Equities - futures	6,619	3 526 147	115	165		
Currency - options	158	11 251 621			399	143
Currency - future	446	33 917 069			255	137

Source: JSE (2016), own calculations

In addition to expansion in financial markets and financial-market instruments, there has also been an increase in financial-market intermediaries, in particular in the ‘shadow banking’ sector, whose growth we noted in Chapter 3 has been a feature of financialisation. The term is ill-defined, alternately referring to unregulated (or poorly regulated) financial institutions or financial practices, the latter which may be undertaken by mainstream financial institutions, including commercial banks, as well as other financial institutions (such as hedge funds, securitisation vehicles and the like). In line with this, the international Financial Stability Board offers two measures of the shadow-banking sector. A broader measure refers to ‘other financial intermediaries’ (OFIs) – those not designated as central banks, banks (broadly defined), insurance companies, pension funds, or public financial institutions – and a narrow measure according to economic functions, “through which non-bank credit intermediation may pose bank-like systemic risks to the financial system” (FSB 2015a, p. 3).

The size of assets within the South African shadow banking system, according to the broad measures, is given in Table 8.5 (the table also illustrates the large growth of institutional investment within the economy, discussed in the next section). While assets of banks and pension funds approximately trebled between 2002 and 2014, those of OFIs (the broad measure of shadow banking) grew over sevenfold, from \$28bn to

\$200bn. Shadow-banking assets as a share of overall assets held by financial institutions is relatively high in South Africa as seen in Figure 8.20. By the broad measure South Africa ranks eleventh out of twenty-six countries studied by the FSB due to the prominence of shadow banking in their economies, and the fourth highest emerging market (Figure 8.20a). The share of shadow banking in South Africa is comparatively low using the narrow measure (Figure 8.20b), hovering around \$100bn between 2010-2014, half that of the broad measure.

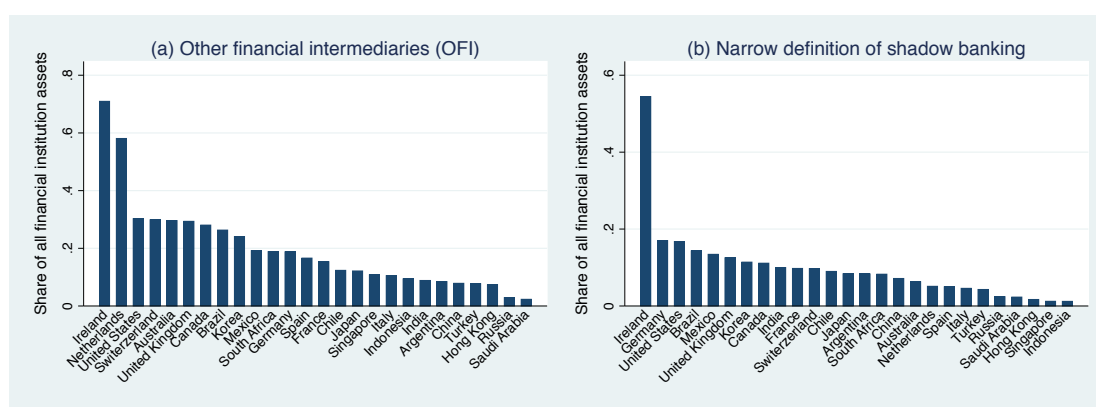
Table 8.5 Financial institutions and broad measure of shadow banking assets (USD billions) (2002-2014)

	Financial Insts.	Central Banks	Banks	Insurance Companies	Pension Funds	Public Financial Insts.	Other Financial Intermediaries (OFIs)
2002	340	16	126	91	71	7	28
2006	809	29	295	198	160	13	114
2010	1,235	48	464	247	257	22	197
2014	1,063	54	356	211	224	18	200

Source: FSB (2015b)

Note: Banks refer to the broader category of deposit-taking institutions. Data for insurance companies and pension funds show total assets minus fixed property.

Figure 8.20 Measures of shadow banking for various countries (2014)



Source: FSB (2015b), own calculations

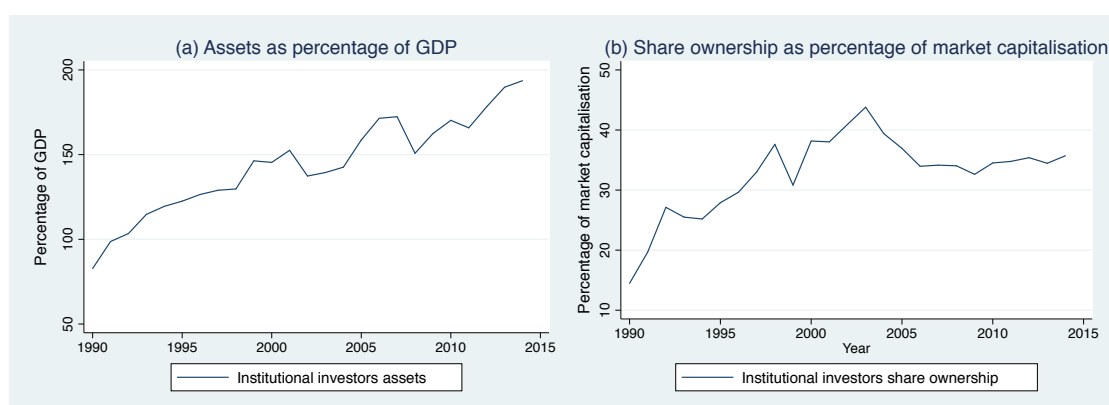
Important also is that the exposure of South African banks to OFIs is extremely high with ‘banks funding risk’ (the percent of bank assets held by OFIs) at almost 20% in 2014, second only to Brazil and four times that of the US (FSB 2015a, p. 29). Similarly, South Africa ranks third regarding ‘OFI credit risk’ to banks. Market instability in either sector is, therefore, likely to have a strong impact throughout the financial system. The

growth in financial markets, accompanied by a proliferation of financial assets and trading institutions, is a further illustration of the growing prominence of finance within the economy, and a central element of financialisation.

8.5 Institutional investors and private equity

In Chapters 3 and 4 we highlighted the growth of institutional investors and ways in which they have come to exercise influence in the economy at large. As we noted in Chapter 5, such institutions, particularly insurers, have long played a substantial role in the South African economy. This began accelerating in the 1980s as households channelled huge funds into pensions (see Chapter 10), with their size and influence growing significantly since 1990; ‘other financial institutions,’ including unit trusts and investments vehicles, have seen very strong growth in the recent years. This growth is highlighted in Figure 8.21. Figure 8.21a shows institutional investors’ assets as a percentage of GDP, increasing from 83% in 1990 to 194% in 2014. Figure 8.21b shows institutional investors’ share of market capitalisation increases from 14% to 36% over the same period. The composition of these assets and shareholdings has also changed considerably as visible in Figure 8.22, although the sudden inclusion of the Public Investment Corporation (PIC) in 1984 distorts the series. Nevertheless, the weight of long-term insurers has decreased significantly as pension and provident funds, unit trusts, and the PIC have grown in size and share. This is indicative of a greater ‘portfolio view’ of shareholdings: whereas long-term insurers generally held long-term stakes in companies, unit trusts, and pension and provident funds are much more heavily engaged in market trading.

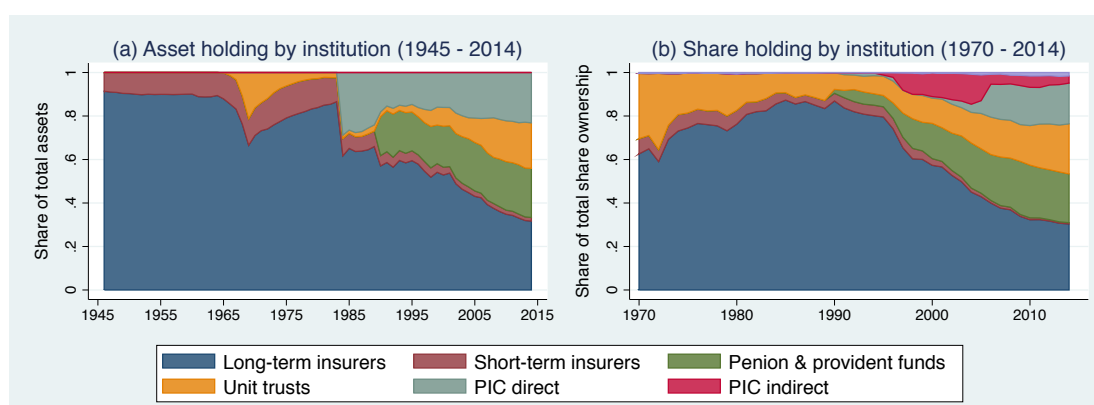
Figure 8.21 Institutional investors' assets and share ownership (1990-2014)



Source: SARB (2015a), own calculations

Note: Institutional investors shown here include: long- and short-term insurers, unit trusts, pension and provident funds (public and private), and the Public Investment Corporation (PIC).

Figure 8.22 Type of institutional investor



Source: SARB (2015a), own calculations

There have also been notable internal transformations within these subsectors, particularly regarding pension funds and the PIC. In line with World Bank prescriptions and developments in other DTECs (see Chapter 4), South Africa, in the dying days of apartheid, moved away from a pay-as-you-go (PAYG) public pension system to a fully-funded (FF) scheme (well-documented in Hendricks 2008). This was motivated not only by changing international attitudes but underpinned by the desire of apartheid-era public servants to guarantee their own pensions in light of political change. Critically, the new fund was capitalised through the issuance of government bonds, the state was therefore essentially “borrowing money from itself in order to secure the pension funds and retrenchment packages of apartheid-era civil servants” (Hendricks 2008, p. 6). This borrowing, Hendricks continues, represents “the single most important variable in the dramatic increase in national debt over such a short period of time, just prior to the possibility of a redistributive democratic government”. Government debt, as we noted

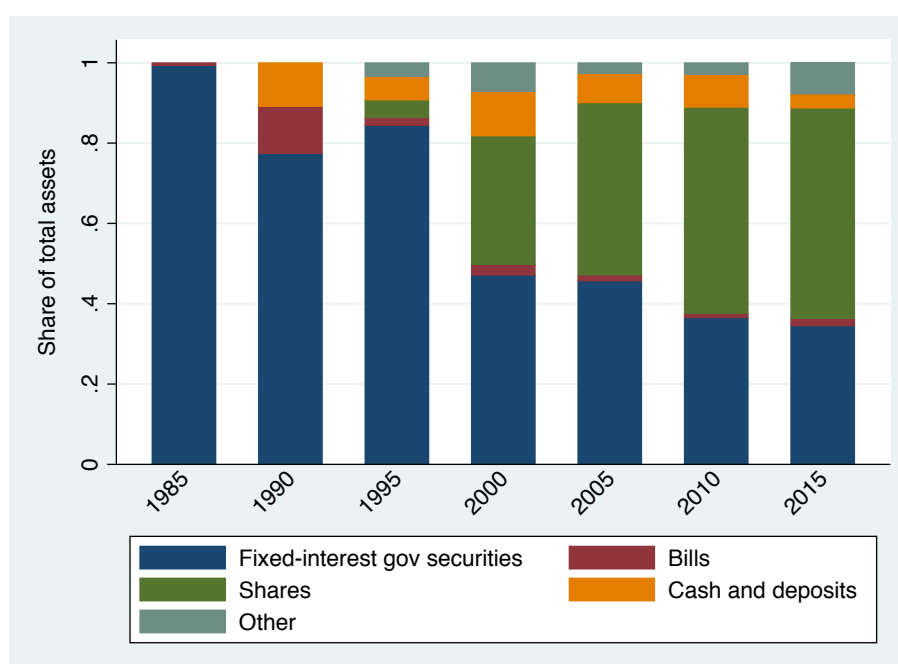
in Chapter 6, underpinned austere government spending by the new regime and provided the most important rhetorical cover for (and actual impetus towards) the neoliberal GEAR macroeconomic policy agenda. The consequences of this move from PAYG to FF public pensions is, therefore, far-reaching including the justification of a policy framework conducive to financialisation.

The decision also had a huge impact on financial markets, and corporate restructuring and Black Economic Empowerment (the latter two discussed in the next chapter). The Government Employees Pension Fund (GEPF) was established in 1996 to rationalise the multiple, and highly differentiated, apartheid-era pension schemes (Hendricks 2008). In 2015, with assets worth \$103bn under management, the GEPF was the 20th largest pension fund in the world and the 8th largest sovereign pension fund globally. Malaysia is the only developing country with a larger fund (Willis Towers Watson 2016).

The PIC manages the assets of the GEPF, the latter accounting for approximately 90% of PIC assets under management. Since 1994 the PIC (and GEPF) has undergone a process of commercialisation. This accelerated in 2004 with the Public Investment Corporation Act (No. 23 of 2004) (RSA 2004). The Act established the PIC as an “institution outside the public service” and although government is the sole shareholder, the Act places distance between government and direct control of these pension funds. It further makes a number of provisions that appeared to pave the way for future privatisation (Hendricks 2008, p. 12) although this has not occurred to date. The PIC has free reign in its investments and has traditionally focused on profit maximisation not developmental ends; as the GEPF itself notes: “the GEPF has grown and now operates [...] very much like any large private sector business” (quoted in Hendricks 2008, p. 10). It has, however, played an important role in promoting the interests of a small black elite and in maintaining investment biased towards MEC sectors (discussed in the next chapter). The commercialisation of the GEPF is reminiscent of similar commercialisation of the PNB (*Permodalan Nasional Berhad* – National Equity Corporation) in Malaysia, which Rethel (2010, p. 502) notes has helped “to reproduce and sustain a capital market-based financial system” and also create “new vulnerabilities by increasing individual exposure to the capital market”.

In line with the above, the composition of PIC assets has changed dramatically over the past thirty years as is clear in Figure 8.23. In particular, its equity stake has increased enormously and with this its weight in the stock market. According to the PIC 2015/16 annual report its “portfolio represents over 12.5% of the Johannesburg Stock Exchange (JSE) equities market capitalisation and we [the PIC] hold more than 42% and 50% of Government bonds and SOE bonds respectively”. This means that the PIC, and through it the GEPPF, is the largest JSE market shareholder by far. Aspects of these holdings, and their consequences, are dealt with further in the next chapter.

Figure 8.23 PIC assets by type (1985-2015)

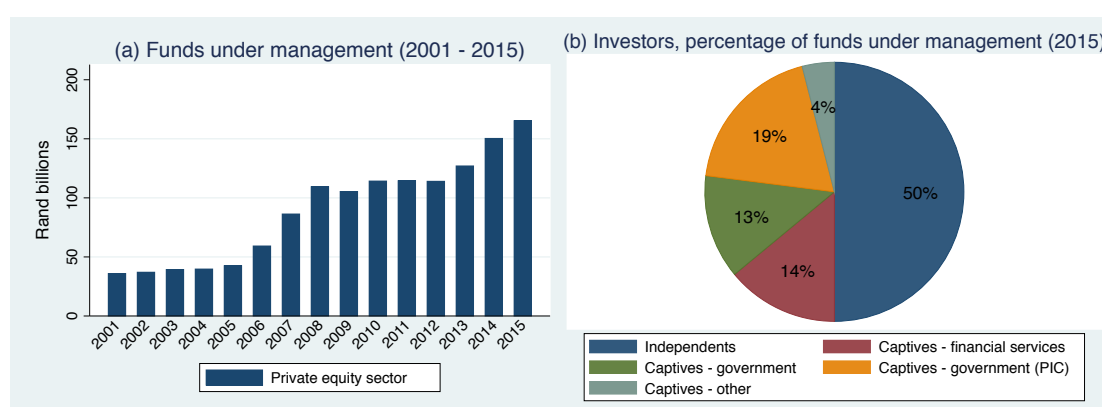


Source: SARB (2015a), own calculations

In addition to the traditional insurers, unit trusts and pension funds, private equity has come to play an increasingly important role with South Africa now regarded as one of the most dynamic emerging-market private-equity investment destinations (Groh et al. 2016). While comparatively small in gross terms, as a share of GDP the South African private-equity market was, in 2015, the fifth largest in the world (SAVCA and KPMG 2016, p. 17). Private equity, as noted in Chapters 5 and 6, has an established history in South Africa. However, it grew in line with the deconglomeration and corporate restructuring which occurred in the second half of the 1990s (discussed in the next chapter) and accelerated in the 2000s. This is clear in Figure 8.24a which shows that total private equity funds under management grew from R36bn in 2001 to R165bn in

2015. An important change has been the growth in third-party funding (from the early 1990s) and the concomitant externalising of private equity outside of banking, initially as banking-group owned subsidiaries and then as independent entities (SAVCA 2015). This can be seen in Figure 8.24b, which highlights that 50% of private-equity funds under management are managed by ‘independents’, accounting for 75% of private-sector managers (the alternative designations – ‘captives’ – refers to funds run by institutions who use their own capital rather than third-party funds).

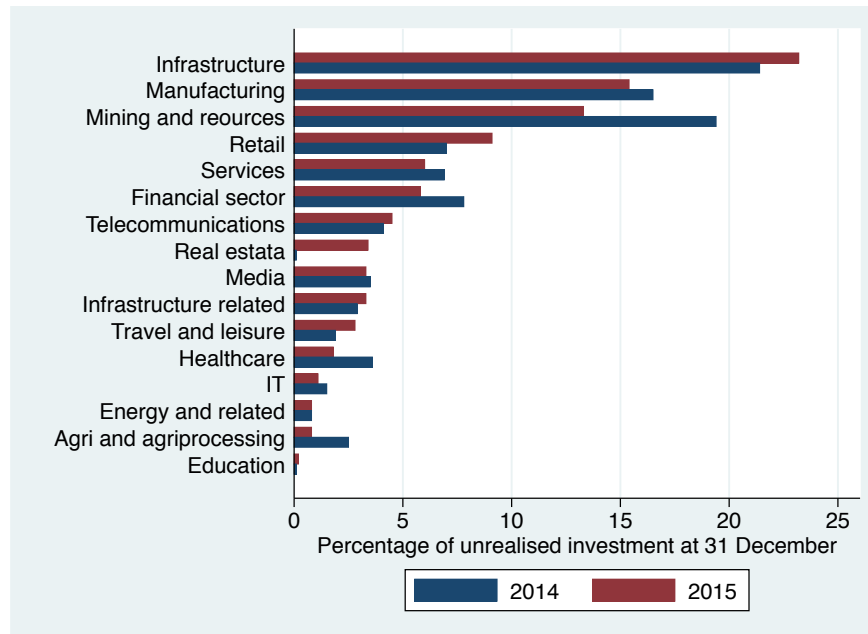
Figure 8.24 Private equity funds under management and type of investor



Source: SAVCA and KPMG (2016, pp. 10–11)

Another important change was the amendment, in 2011, to Regulation 28 in the Pension Funds Act of 1956 (RSA 1956) allowing pension funds to increase their share of private equity holding from 2.5% of their fund’s total assets to 10%. The PIC has also been an important player increasing its private equity allocations significantly. Pension and endowment funds and government entities now represent the two largest sources of private equity funds (SAVCA and KPMG 2016, p. 20), with these relying on large pools of available credit outside of the private equity sector, present in already financialised markets. The majority of these funds are locally raised but international investors, particularly from the UK, US, and rest of Europe play an important role (SAVCA and KPMG 2016, p. 21). The allocations of outstanding private equity commitments between economic sectors is shown in Figure 8.25. The heavy weight towards infrastructure is telling and relates to the large investments made by private equity in semi-privatised social services such as roads and rail, another frontier of financialisation. In general, the growth of private equity, like that of institutional investors, highlights the dominant role of large financial institutions, a topic taken up in the next chapter.

Figure 8.25 Private equity unrealised investment by sector (2014 & 2015)



Source: SAVCA and KPMG (2016, p. 28)

8.6 Conclusion

In Chapter 2 we argued that a crucial manner in which the concentration and centralisation of capital has been expressed under financialisation is by the concentration and centralisation of financial claims in the hands of large financial corporates. This chapter offers a first take on this in the South African case, showing how banks' and financial intermediaries' presence in financial markets has increased while institutional investors have grown in prominence and size. In both Chapters 3 and 4 we highlighted the concrete dynamics of such trends elsewhere in the world and this chapter has shown many of these are present in post-apartheid South Africa. These include a turn towards household lending and financial-market intermediation by commercial banks, visible through asset holdings, outstanding liabilities, and fee income. This has occurred in tandem with their increased internationalisation and the liberalisation of the financial sector. Financial markets, instruments, and institutions have burgeoned with an increased role for OFIs, institutional investors, and private equity. These entities have come to assume a much larger share of ownership in the economy.

This financialisation has been made possible on the basis of a particular policy programme, discussed in Chapter 6, and facilitated by the internationalisation of South African finance and the penetration of international finance capital into South Africa, as outlined in Chapter 7. What remains to be highlighted, in Chapters 9 and 10, respectively, is how this interacts with the restructuring of the productive economy, and the consequences that it has had for households; topics to which we now turn.

9 A FINANCIALISED MEC: THE RESTRUCTURING AND FINANCIALISATION OF THE PRODUCTIVE SECTOR

9.1 Introduction

This chapter turns to an analysis of the productive sectors of the South African economy. It does so, however, by relating the changes observed, and those analysed in early chapters, to the reshaping of South Africa's historic path of accumulation – the MEC, discussed in Chapter 5 – highlighting both important shifts and underlying continuities. In this way it more directly relates the changes observed to structural transformation in post-apartheid South Africa. The most significant development in the structure of the productive economy has been changes in ownership of the diversified conglomerates and operating models of state-owned enterprises (SOEs), the dominant corporates of the apartheid economy and the original manifestation of the MEC. This has occurred due to deconglomeration (Section 9.2.1), internationalisation (Section 9.2.2), forms of privatisation (Section 9.2.3), and Black Economic Empowerment (BEE) (Section 9.2.4). Financialisation – as motivator, facilitator, and outcome – has been central to these processes as have policy changes discussed in Chapter 6, liberalisation elucidated in Chapter 7, and the metamorphosis in the financial system tackled in Chapter 8.

These processes have together altered the behaviour of South African corporates with the intensive and extensive penetration of finance into their core operations. This reflects on their balance sheets (Section 9.3.1), which display significant financialisation, is present in the prioritisation of shareholder value maximisation (Section, 9.3.2), and has contributed to subsequent lacklustre real investment (Section 9.3.3). While important new sectors have emerged, we show that key structural elements of the economy remain intact including dominance by core MEC sectors and various MEC linkages within the economy (Section 9.4.1) together with on-going high levels of concentration and monopolisation (Section 9.4.2). Together these processes, we argue in the concluding section of the chapter (Section 9.5), produce a financialised form of the MEC as the post-apartheid path of accumulation.

9.2 Shifting patterns of ownerships: deconglomeration, internationalisation, privatisation and Black Economic Empowerment

9.2.1 Deconglomeration

The most marked change to the South African economic landscape has been the unbundling and rebundling of the major conglomerates, a process that has gone hand in hand with the liberalisation of the economy and their own internationalisation. Table 9.1 shows how the proportion of JSE market capitalisation in the hands of the conglomerates fell dramatically from 84% at the end of apartheid to 20.5% in 2012. The unbundling meant a sharper focus on ‘core competencies’ and a movement away from unrelated diversification. The subsequent ‘rebundling’ – facilitated via a slew of merges and acquisitions – has entailed the consolidation of core mining-related business domestically and expansion internationally as well as vertical integration along value chains (see Chabane et al. 2006).

Anglo American Corporation (AAC) is a leading example; it controlled 60% of market capitalisation in 1987 and from 1996 gradually spun off or sold its stakes in almost everything save its core mining concerns in which it has expanded both locally and internationally.¹¹⁷ This has also entailed an untangling of the complex cross-holdings that existed and a shift away from family control and in favour of professional management (although the powerful controlling families earned enormous rewards in global markets in exchange for giving up control and influence) (Chabane et al. 2006, Ashman, Mohamed, et al. 2013).¹¹⁸ This has not, however, dislodged the former conglomerates from their position at the heart of the economy. By 2017, of the JSE Top 40, just over half of companies listed still had roots in the major conglomerates or apartheid-era public enterprises. Deconglomeration, therefore, while involving transfers in ownership did not entail large South African capital letting go of concentrated control.

¹¹⁷ These include: copper, diamonds, iron ore, manganese, metallurgical coal, thermal coal, nickel, and platinum.

¹¹⁸ Rembrandt (now Remgro) remains the most notable exception and has retained both its diversified nature and family control.

Table 9.1 JSE ownership by major corporations for select years (1985-2012)

	1985	1994	1996	1998	2004	2012
Anglo America Corporation	53.6	43.3	27.5	17.4	18.7	8.9
Sanlam**	12.2	10.5	11	9.9	2.7	
S A Mutual**	10.6	9.7	10.2	8.8	4.5	3.3
Rembrandt/Remgro	3.8	13	10.6	9	7.9	7.2
Liberty Life/Standard Bank	2	7.2	11.1	9.5	4.7	1.1
Apartheid top five conglomerates	82.2	83.7	70.4	54.6	38.5	20.5
Foreign**	5.9	2.2	4.1	3.9	18.5	30
Institutional / unallocated**	1.7	0.9	0.8	4.2	10.3	19.4
Directors*	8.1	7	10	14.4	5.8	9.2
Black groups*			6.3	9.6	6.3	3.9
RMB/Firststrand		0.5	1.7	4.8	4.9	3.9
Sasol		1.7	2.1	2.2	4.2	
Investec/Fedsure		0.4	1.1	3.3	0.8	0.7
Naspers			0.4	1.2		
Anglovaal***	2.1	3.6	3	0.8		
Bidvest Group				1	1.2	0.9
SA Breweries (foreign)/ SABMiller					5.1	9.2
* Black-controlled & director-controlled companies are defined by an empowerment stake or director holding exceeding 26% with no other dominant shareholder						
** With the exodus, unbundling and disinvestment of Anglo, SAB, Sanlam and Old Mutual, the control of a number of companies have moved to institutional, foreign and other control, such as BHP Billiton, Impala Platinum, Sappi, AECI, Chemserve, De Beers, C G Smith, Illovo Sugar, Nampak, Murray & Roberts, and Tiger Brands						
*** No longer offering						
Note: Once control has been allocated the full market capitalisation of that company is used in the calculation for comparative purposes						

Source: McGregor (2004) and Who Owns Whom (2013)

Financialisation and international finance capital was an important force behind these changes, as Carmody (2002, p. 266) notes: “international financial capital want[ed] the conglomerates to become more tightly focused ‘investment vehicles’ – to focus on their core operations, diversify geographically, and to abolish the pyramid structure of crossholdings between companies”. In 1997 AAC’s Chairman Julian Ogilvie Thompson argued that unbundling and independent management were necessary “to create a structure that meets the needs and wishes of today’s investors” (quoted in Wackernagel 1997). In competing with other TNCs for financial capital, share prices, dividend payouts, and other shareholder value metrics all took on new importance. In many

instances, these conglomerates became diversified holding companies in much the same way as discussed in Chapter 3, often with large shareholdings in the hands of institutional investors. Also in line with international trends, the financial arms of these corporates took on new prominence. In 2012 the net assets of Anglo American Capital PLC – a wholly owned financial subsidiary of AAC – amounted to over 25% of those of AAC itself (Ashman, Mohamed, et al. 2013, p. 34). Critical to the transformation of these conglomerates into true TNCs has been the liberalisation and internationalisation of the South African economy.

9.2.2 Internationalisation

The state and the country's major conglomerates drove liberalisation and internationalisation in the democratic era. Although international operations were present under apartheid, these were heavily curtailed by international isolation and capital controls, imposed in the 1980s at the same time that the conglomerates found that their geographical confinement was depressing profits. Illegal capital flight and the setting up of offshore companies were the initial response but these were limited; in 1990 when US corporations derived 30% of their profits from abroad, international operations only accounted for 7% of South African companies' profits. Within this context it is not surprising that "large-scale Anglophone and Afrikaner capital pressed for a negotiated settlement with the ANC, so that they could globalise their activities" (Carmody 2002, p. 262).

GEAR and the surrounding regulations promoted a development path premised on exports and FDI inflows, thus justifying trade liberalisation and financial deregulation. FDI inflows would purportedly compensate for scarce domestic capital while trade liberalisation and an export orientation would drive economic growth.¹¹⁹ The most dramatic consequence was the offshoring of some of South Africa's largest corporations in tandem with their deconglomeration. This included the (primary or secondary) listing of corporations on overseas stock exchanges including by Billiton, SAB, ACC, Old

¹¹⁹ In addition to the financial reforms discussed in previous chapters, sweeping trade reform was initiated (also building off reforms introduced by the previous government) including: the lowering (by approximately one third between 1995 and 1999) and rationalisation of tariffs, and removing trade-related measures which contravened WTO rules, such as local content requirements and export incentives. These measures went beyond those required by the GATT agreement in line with the macroeconomic liberalisation strategy (Roberts 2001, p. 799).

Mutual, and Dimension Data (Chabane et al. 2006, p. 559). The purported reason was to improve global competitiveness, raise funds more cheaply, and facilitate increased investment in South Africa.

In reality, between 1994 and 1999 South African corporates invested \$1.6bn more abroad than came into the country, thus deepening dependence on portfolio flows (discussed in Chapter 7). At the same time these corporates significantly expanded their overseas operations diversifying out of the sluggish South African economy. Such offshoring has continued, for example by retail giant Steinhoff in 2015 (UNCTAD 2016b, pp. 68, 208) (see below). The offshore listing by major South African corporates went well beyond the globalisation strategies of many transnational firms worldwide and unlocking ‘shareholder value’ was a clear driving factor. As Carmody (2002, p. 263) explains:

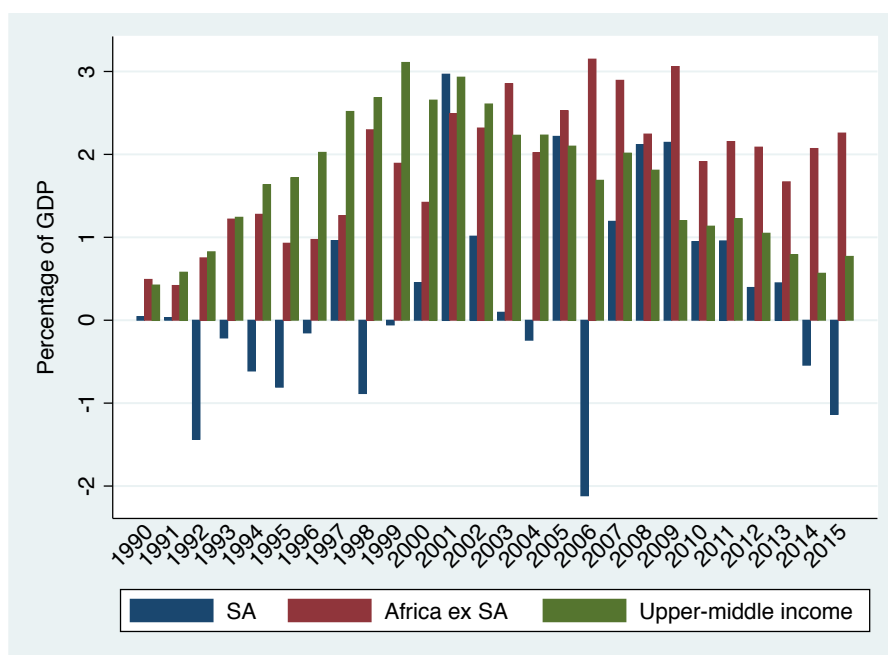
“While the stock market capitalisation of many companies in advanced capitalist countries, such as the US, are above their net asset values on the basis of projected future profits, Anglo’s market capitalisation was 22 per cent below its net asset value in 1995. By moving to London, these companies’ assets became denominated in more secure hard currency, which increased asset values and consequently share prices. Additionally, those conglomerates that became part of the Financial Times Stock Exchange (FTSE) 100 index, received an additional boost to their share prices as tracker funds, which mirror movements in such indices, are required to invest in such companies. While Anglo’s stock price had been erratic, based on price movements in commodity markets, by early 2001 the value of its shares was 37 per cent above its asset value.”

The consequences for the South African economy were mixed. Figure 9.1 shows net FDI inflows for South Africa, Africa excluding South Africa, and all upper-middle incomes countries.¹²⁰ We see that net FDI for South Africa is negative in the 1990s and strongly so in years with large offshoring, e.g. 1998. The strongest period of net FDI inflows to South Africa was between 2007 and 2011 but these have subsequently dwindled and turned negative in recent years. Net FDI flows into South Africa are

¹²⁰ See Roberts (2000b, pp. 90–91) for a discussion of complexities in measuring FDI and discrepancies between various datasets.

weaker than the comparator groups in almost all years. Importantly, a dominant share of FDI has been cross-border mergers and acquisitions (M&A) – both the number of deals and their value, rising from near obscurity in 1990, peaking in the late 1990s and remaining high ever since, as seen in Figure 9.1 – with portfolio flows in which greater than 10% of shares are acquired, also considered FDI.

Figure 9.1 Net FDI inflows: South Africa and other country groups (1990-2015)



Source: UNCTAD (2016a), own calculations

M&As are closely associated with unlocking shareholder value as well as rationalisation (or downsizing) without necessarily bringing new investment and possibly resulting in job shedding. M&As were often the preferred manner of restructuring and offshoring (Goldstein 2001) with new companies (under the same control) formed on foreign exchanges to buy local corporates, for instance Dimension Data in 2000, and the reverse takeover of South African retail giant Steinhoff by holding company Steinhoff International Holdings N.V. for \$20bn, the fourth largest global cross-border M&A deal in 2015 (UNCTAD 2016b, pp. 68, 208).

The evolution of the sectoral composition of M&As speaks to the shifting sectoral composition of the domestic economy (see Section 9.4). Outward M&As (South African companies acquiring stakes abroad), by and of the ‘consumer’ sector (often retail), have been particularly prominent with notable expansion in the communications sector and local ‘basic materials’ companies (mining) also. Acquisition of financial

corporates has been modest in value terms but the number of such deals has increased significantly while South African financial corporates have become the second largest acquirers in value terms of M&A stakes abroad. There has also been a steady rise in the share of deals undertaken as private equity purchases (Bloomberg 2016, own calculations).

For inward M&A activity (the purchase of SA corporates by corporates from abroad) the basic materials sector still dominates in the number of deals and value terms reflecting the on-going attractiveness of South African mining; financials, between 2005 and 2016, were second in the number of announced deals. The acquisition of South African Massmart by retail giant Wal-Mart is the most important M&A in the consumer sector but it is notable that outward investment by this sector is much larger than acquisition by international firms. International private equity firms have played an increasingly prominent role in inward M&As although not as much as with outward M&As and with other financial institutions being important players in the acquisition of South African corporates (Bloomberg 2016, own calculations).

The flipside of this is that the level of greenfield investment in South Africa has been lacklustre. South Africa, on average, received 8% of African inward greenfield investment between 2003 and 2015 while its GDP accounted for, on average, 19% of the continent's GDP over the same period; similarly South Africa received an average of 1.1% of inward greenfield investment destined for developing economies compared with a GDP share of 1.7% (UNCTAD 2016b). Nor have exports substantially increased (as a share of GDP) as envisaged under GEAR. This is highlighted in Table 9.2: exports were 28% of GDP in the 1980s and 30% between 2010 and 2015 (although the composition of exports has changed with gold declining as a share).

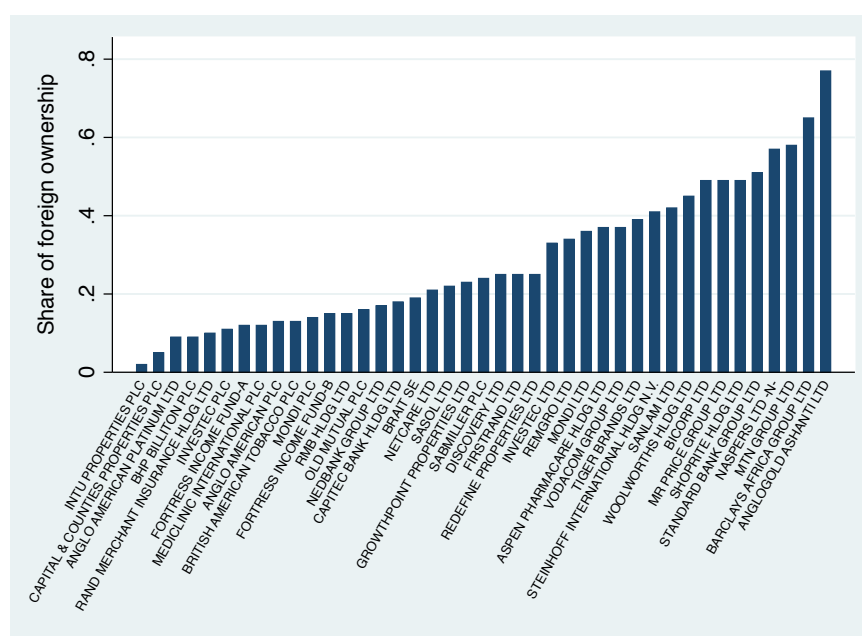
Table 9.2 South African exports as a percentage of GDP (%) (1980 - 2015)

	1980 - 1989	1990 - 1994	1995 - 1999	2000 - 2009	2010 - 2015
Exports as a percentage of GDP	28	22	24	29	30

Source: Balance of Payments (BPM5 and BPM6) via UNCTAD (2016a)

In line with the offshoring of major corporates, inward M&A activity, strong portfolio inflows, and limited FDI inflows, foreign ownership of the JSE has increased significantly. In 2002, 30% of the free-floating shares of the JSE All Share Index were foreign owned; in 2015 this was 46% (42% if you exclude dual listings), just below the record 48% in 2014 (Lamprecht 2015). The share of foreign ownership for resources was 60% (fairly constant since 2005 and reflecting offshoring), for financials 25% (reflecting heavy concentration), and for industrials 50%; the latter having seen enormous growth from 10% in 2002. Of the JSE Top 40 companies, almost half are a third or more owned by non-residents, as shown in Figure 9.2; this may be underestimated if the foreign composition of local shareholders is not accounted for. The consequences of this are difficult to pin down but as discussed in Chapter 4 the ownership of DTEC domestic shares by large foreign investors is an important avenue through which the demands of the shareholder value movement and credit ratings agencies are brought to bear (see Section 9.3). In addition, as discussed in Chapters 4 and 7, this exposes South African listed corporations to the volatility associated with shifting global portfolio capital flows (Ashman, Mohamed, et al. 2013, p. 30).

Figure 9.2 Foreign ownership of JSE Top 40 firms (2015)



Source: TimBukOne (2016)

Regional shifts have also occurred. The share of inward M&A investment originating from Europe and North America, for instance, fell from three-quarters between 1995 and 2004 to a quarter between 2010 and 2016 with the Asia Pacific region picking up

much of the slack for most years since 2005. Most striking and persistent, however, is outward M&As into Africa. While Europe has remained the largest regional target of South African corporates' M&A activity between 1995 and 2016 (35% to 40% of M&A value), the African share has risen from 4% in the mid 1990s to 23% between 2010 and 2016, with the North American share falling (Bloomberg 2016, own calculations).

This reflects a process of regionalisation which began in the early 1990s. Between 1991 and 1995 investment in Sub-Saharan Africa grew fivefold to account for 25% of total outward FDI; between 1994 to 1998, 42% of outward investment was in Africa (Carmody 2002, p. 262). Not only did South African corporates have geographic proximity and highly developed economic sectors, but many African countries were also undergoing (or had recently undergone) structural adjustment programmes, making foreign penetration easier, while forced privatisation allowed for the acquisition of state entities on the cheap (including mining operations) and currency devaluations reduced the cost of labour (Carmody 2002, p. 263, Daniel et al. 2003). Large infrastructural projects (in part rehabilitating infrastructure destroyed in wars with apartheid South Africa) also offered investment opportunities for South African construction and related firms. It is hard to overstate the footprint that South African firms have on the continent in infrastructure, utilities, telecommunications, retail, mining, banking, and other industries. For South African corporates, such African investment has been highly profitable and provided a springboard for future globalisation. For the recipient countries this was a mixed blessing with some perceiving it as a form of neo-colonialism (Daniel et al. 2003).

In many instances, South African corporates have worked together across major sectors (Daniel et al. 2003, p. 380). Most striking, and related to our theoretical discussion of expanding circuits of capital, is that financial and industrial outward expansion has gone hand in hand. South African financial institutions – both in South Africa and their branches in different African countries – have played crucial roles in financing and facilitating African expansion by South African corporates. The Industrial Development Corporation (IDC), a public financing agency which supported the founding and expansion of parastatals and capital-intensive industries under apartheid, has also played a leading role in regional expansion. The IDC self-consciously leverages investment in Africa to “benefit the South African economy” in part through lending to “companies

promoting services and products from South Africa” (IDC 2015). This includes the parastatals, such as Eskom (electricity) and Spoornet (rail), which have massive regional projects. As under apartheid, such investment has shaped the path of accumulation (see Section 9.4) reinforcing the MEC both locally and expanding it regionally.

Given South Africa’s international isolation and rapidly advancing globalisation and global integration, some degree of liberalisation was both necessary and inevitable, but an alternative (or complementary) development path existed to overcome the limitations of the domestic market facing major South African firms than the rapid and extensive internationalisation undertaken: redistribution and the deepening of domestic markets (Carmody 2002). For this to be effective it would have required substantial asset redistribution as well as tackling the apartheid-era legacy of an underdevelopment of skills in the workforce. The relative higher cost of labour (compared with Asia and parts of Latin America) would also have meant diversifying beyond traditional MEC manufacturing sectors and active industrial policy to move up the value chains.

Not only were alternative routes available but these may have borne better results. Roberts (2000b, p. 118) highlights a “lack of any clear relationship from trade liberalisation to improved trade performance to growth”. He highlights the importance of an expanding domestic market for developing export capabilities and increasing production; the need to leverage (or alter) existing linkages within the economy; and the fact that mineral-related (often capital-intensive) manufacturing subsectors which thrived under apartheid did so with extensive state support. Following the fall of apartheid, the export-orientated policy framework was ‘supported’ through a supply-side industrial policy, reflecting the belief that such measures would improve productivity and international competitiveness (Roberts 2001). The side-lining of alternative policy blueprints has created what Carmody (2002, pp. 261–262) calls ‘negative autonomy’; he argues:

“Negative autonomy is where the state appears autonomous from domestic social forces, but that autonomy is the obverse of dependence on global forces, and therefore reflective of their priorities. Thus, the state liberalises the economy to maintain the ‘confidence’ of international investors and uses the global market to discipline productive capital and labour, rather than being able to discipline them

on its own to achieve developmental goals. In this way, the state uses its power to constrain its power. As the state globalises, the success of the government's development strategy increasingly depends on private sector actions and investment.”

The conglomerates preferred such market-centric globalisation with large (now internationalised) South African capital losing interest in domestic developmentalism and redistribution beyond narrow BEE lines. This also opened the doors to the financialisation of the South African economy. As Carmody (2002, p. 266) notes, already apparent in 2002 was that “as globalisation from the ‘outside in’ and ‘inside out’ intertwine with one another, South African conglomerates and state elites are being absorbed into a broader transnational capitalist class project where global financial capital, given its greater fungibility and mobility, and hence structural power, sets the agenda”.

9.2.3 Privatisation

Privatisation is another (potential) avenue for the significant restructuring of ownership, control, and production within the economy. In South Africa, privatisation has been a heavily contested and contradictory process. In the next chapter we discuss privatisation, and the private sector's role more generally, in social provisioning. Here we are concerned with privatisation of productive economic assets, many of which stand at the heart of the South African economy. As noted in Chapter 5, it is vital to appreciate that under apartheid (and before) parastatals were central to structuring and facilitating the mineral-centric South African growth path – by 1985 57% of capital stock was in state hands (Fine and Rustonjee 1996, p. 109). In the 1980s a series of reports and policy proposals mooted the idea of privatisation. The government's attitude was generally lukewarm to the idea until 1988 when sweeping privatisation measures were announced (Fine 1995b, pp. 7–8). Following this, further stakes in Sasol were sold, in 1989 Iscor was fully privatised, and in 1991 National Sorghum followed, after which the privatisation programme largely stalled.

There is some debate over how best to understand these decisions. On the one hand, Hentz (2000) argues that there was not a compelling economic case for privatisation – external debt was falling, inflation was easing, and the budget deficit was not yet a crisis

– and transferring ownership into the hands of the conglomerates (the most likely domestic purchasers) would not increase competition in the economy. In this light privatisation is seen as a means to place state assets beyond the control of those about to assume state power usefully highlighting the political nature of privatisation as a form of state intervention. In doing so this would perpetuate economic power of large-scale capital by placing state assets in the market in which white capital enjoyed enormous advantages (Fine and Rustomjee 1996, Hentz 2000).

On the other hand, it is not clear that by 1988 the NP had accepted the inevitability of a future ANC-led democratic regime. Further, privatisation was incredibly limited with the crown jewels – electricity, the railways and ports, and telecommunication – still left in state hands. For sure, anti-apartheid forces vigorously opposed privatisation but Fine (1995b) argues that it was the reluctance of international and domestic capital to purchase stakes in SOEs that ran the programme aground (see also Jerome and Rangata 2003), indicating that it was the ability to raise funds that drove the privatisation agenda in the first place. The apartheid government was also driven by an attempt to achieve a ‘systemic economic transformation’ through which the “transfer of appropriate functions, activities or property from the public to the private sector” whereby “services, production and consumption can be regulated more efficiently by the market and price mechanisms” (Republic of South Africa, 1987, p. 8 quoted in Narsiah 2002, p. 33). And, as discussed in Chapter 4, in the age of financialisation, financial markets become particularly important.

The apartheid privatisation programme failed and the ANC government inherited over 300 SOEs comprising 50% of fixed capital assets (Jerome and Rangata 2003, p. 6). However, this systemic agenda reasserted itself in the 1990s as part of the broader neoliberal policy agenda discussed in Chapter 6 – whereas the ANC and Cosatu historically opposed privatisation and the RDP was ambivalent, GEAR firmly advanced the ‘restructuring’ of state assets (on policy shifts and the position of various parties see Mostert 2002).¹²¹ White capital saw this as a means to wrest control of parastatals from the hands of the new ANC government, while sections of the ANC viewed privatisation as a means through which to transfer assets into black hands (Pitcher 2012).

¹²¹ The fulfilment of this agenda has been more present in government service provision in comparison with restructuring productive enterprises.

A privatisation programme got underway in 1996 but was largely limited to (often partial) divestiture from ‘non-core business’ including broadcasting stations, air travel, resorts, and forestry company, SAFCOL. The most significant divestitures were a 30% stake sold in telecommunications giant Telkom and a 20% stake in South African Airways (SAA). Despite renewed efforts in the early 2000s, key SOEs, including Eskom (electricity), Transet (transport), Denel (defence), and Telkom (telecommunications), remain in state hands; by 2003 the government had sold only 9% of state assets, and SOEs still comprised 44% of fixed capital assets (Pitcher 2012, p. 245). This followed a conscious shift in approach, as Barbara Hogan, the former minister for public enterprises said in 2009, “since 2004, government policy has shifted decisively from preparing SOEs for privatisation to ensuring that they are sustainable businesses that provide economic benefit to the country” (Hogan 2009, p. 2 quoted in Pitcher 2012, p. 245).

Limited privatisation speaks to a confluence of interests. Trade unions, determined to retain public-sector jobs, ardently opposed privatisation and were bolstered by widespread well-organised anti-privatisation protests from consumers, NGOs, and social movements (Pitcher 2012, p. 246). At the same time SOEs offered black professionals and managers an avenue for advancement that was often closed to them within the private sector, although attempts to leverage privatisation for BEE also failed and, by 2004, 40% of the value of SOE stakes sold (predominately in Telkom) was to foreign investors (the failure of BEE schemes is discussed below, on Telkom see Rumney 2004, pp. 407–408) (Pitcher 2012, p. 245).

Three (contradictory) agendas replaced privatisation. The first was a (rhetorical?) commitment by the state to leverage SOEs for a developmental agenda, contributing to jobs, growth, addressing market failures, providing infrastructure, offering procurement, absorbing labour, and serving as a partner to the private sector on large capital outlays (various government announcements in Pitcher 2012, p. 246). In addition, the government stressed the importance of SOEs in providing public services and in supporting BEE firms and small businesses (Pitcher 2012, pp. 246, 249). In support of this, SOE investment was increased significantly, while most SOEs met employment equity targets.

This developmental agenda (real or rhetorical) ran up against a second trend – the corporatisation (becoming a public company with the state as the sole shareholder) and commercialisation (rendering services for a profit and following market-based governance principles) of SOEs underpinned by financialisation and neoliberal policy reforms (in much the same way as these underpin privatisation); this is a trend that has roots in the late-apartheid period.¹²² These processes centred on the promotion of efficiency, corporate governance, and market principles. It resulted in an emphasis on full cost recovery (including from the poor and often resulting in price increases) as well as a ‘rationalisation’ of these entities that meant job shedding and casualisation (Rumney 2004, Pitcher 2012). Many of these now also have fully-private subsidiaries undertaking various for-profit projects. Eskom Enterprises’ Africa footprint, for instance, is massive, and as noted above such projects tend to facilitate the regionalisation of other sections of South African monopoly capital.

The commercialisation of SOEs had diverse and wide-ranging consequences; for example, concern for their balance sheets has meant SOEs, which own vast amounts of (well-located) public land, have refused to release this for public housing (Isaacs 2016a). The policy and regulatory environment shifted to accommodate such commercialisation, including attempts to create competitive markets in these sectors with oversight delegated to ‘independent’, ‘neutral’ authorities. On the one hand, this was a welcome development within monopolistic industries. For instance, the division of Eskom between transmission, distribution, and generation during its corporatisation allowed for independent (often renewable-energy) power producers to sell into the grid (a programme that has somewhat stalled due to Eskom’s intransigence). On the other, a dogmatic adherence to market-principles undermined the potential of SOEs to play an equity-enhancing or developmental role. Cosatu, for instance, argued that the proposed regional electricity distributors would end cross-subsidisation for households while bulk (often capital-intensive) users would still be able to buy electricity directly at a lower price (see Mostert 2002 on the potential contradictory consequences in other sectors).

¹²² For example, South African Transport Services (SATS) was renamed Transnet and incorporated in 1990 (Hentz 2000, p. 204) while Telkom corporatised and commercialised in 1991 and “oriented towards making profits, responsible for paying taxes and dividends, securing its own financing and taking care of its own pension plan” (Horwitz, 2001, p.192, quoted in Teer-Tomaselli 2004, p. 19).

Eskom is also a good example of the consequences. In 2001 Cabinet “took a firm decision and made a definitive announcement that Eskom would never again build a power station in South Africa and that all new power stations would be built by private sector companies” (Ritchken 2014, p. 31). In 2003 much fuss was made over Eskom’s declaration of dividends (the state being its only shareholder) as evidence that privatisation was not the only manner in which SOEs could be profitable (Rumney 2004, p. 408). Despite the reversal of this policy in 2004 the damage was done with insufficient capacity resulting in rolling blackouts between 2007 and 2015 that severely undermined the economy. Market imperatives have thus been accommodated via other means than full privatisation; other avenues for this have been public-private partnerships and the outsourcing of service provision to private companies.

A third agenda has been the outright looting of the SOEs by a corrupt faction within the ANC often associated with current state president Jacob Zuma. This has received extensive media coverage and is vividly captured regarding Eskom’s dealing with the notorious Gupta family over coal provision in the Public Protector’s *State of Capture* report (Public Protector South Africa 2016). At the heart of this agenda is a R1tn proposed nuclear deal that would see the President and his coterie massively enriched. Similar scandals have rocked Transnet, South African Airways, and other SOEs. It is notable that in a number of instances this corruption is taking place via traditional MEC sectors (mining, arms, and energy stand out).¹²³ In some sense there are parallels with the 1980s – coordinated industrial policy became possible after Afrikaner capital had been internalised within the MEC but was stymied by the crisis of apartheid, now black capital has been internalised within the MEC (see below) but leveraging this has been precluded by corruption.

Corruption conflicts with and undermines both drives toward leveraging SOEs for developmental purposes and ‘sound’ market-orientated corporate governance. However, it also rides upon the coattails of these two shifts – ‘transformation’ is used to justify awarding contracts to black associates and the undermining of state capacity necessitates such outsourcing. Corporatisation has changed the format of state ownership without wholesale privatisation, occurring in tandem with a reorientation of

¹²³ Corruption occurs in other sectors but these tend to have less state involvement and therefore illegality within the private sector often takes place through collusion (construction, bread, and banking being notable examples).

these entities towards the market, with financial market imperatives enormously influential in their internal transformation.

9.2.4 Black Economic Empowerment

A final form of ownership restructuring sought to redress apartheid's racial inequalities and historic dispossession of the black majority. This took the form of Black Economic Empowerment (BEE). The ANC was originally opposed to ownership redistribution to a black capitalist class (the core principle of BEE), initially advanced by black business groups, as a means of restitution. However, during the negotiated settlement and early years of democracy they embraced this as part of a broader policy paradigm – “[t]he belief was that fostering a black capitalist class would facilitate a ‘trickle-down’ effect, improve the socio-economic position of all black South Africans, and thereby strengthen South Africa’s economy” (Ponte et al. 2007, p. 940). The initial focus, in practice, was therefore on securing ‘black’¹²⁴ ownership of shares in major corporations.

In the first phase (roughly the second half of the 1990s to the beginning of the 2000s) black empowerment was measured along narrow equity-ownership lines, with financial market mechanisms playing a central role; Chabane et al. (2006, p. 263) explain:

“During the first phase, transfers of ownership were facilitated by the introduction of special purpose vehicles (SPVs), whereby financial institutions provided funding to black entrepreneurs, who in turn offered as collateral preference equity capital in the companies acquired. Such deals rely on the share values outweighing the finance cost. If this condition is not met within a specified period, typically the shares are transferred to the financial institution. More than half of black ownership on the JSE in the second half of the 1990s was created via SPVs.”

This phase saw limited redistribution (see Table 9.1) in part due to the government's limited willingness to take a strongly interventionist approach; only about 200 individuals directly benefited (Carmody 2002, p. 265). The nature of the transactions

¹²⁴ Some legislation equates ‘black’ with ‘historically disadvantaged South Africans’ which includes women and disabled persons of all races. More recent legislation specifically relates ‘black’ to race, with ‘black people’ most often including black Africans, Coloureds, and Indians; sometimes foreign black nationals are excluded (Ponte et al. 2007, p. 933).

made viability reliant on strong share performance while heavy gearing exposed new black shareholders to interest rate risks. The process suited, even facilitated, the conglomerate agenda of unbundling and internationalisation as many BEE deals involved non-core conglomerate assets. The economic turmoil of the late 1990s meant a number of these deals went sour. In some instances the (ex)-conglomerates bought back assets that they had unbundled and sold to BEE groups for a fraction of what those groups had paid for them (Carmody 2002, p. 265).¹²⁵ The result was, as shown in Table 9.1, a slide in ownership of JSE market capitalisation by 'black controlled groups' from a high of almost 10% in 1998 to a mere 3.5% in 2002 (McGregor 2004).

The second phase, dubbed Broad-Based Black Economic Empowerment (B-BBEE), took a broader view of empowerment through which ownership was only one of seven main criteria upon which the empowerment credentials of businesses in South Africa would be assessed.¹²⁶ This period sought to leverage government procurement, demarcating eligibility based on a scorecard of B-BBEE compliance. Other normative measures have included the establishment of sector-specific charters; the targets contained therein, however, were often non-binding although the Codes of Good Practice which followed had legal standing. BEE deals during the second phase have been concluded through a private equity model and via mergers and acquisitions (Chabane et al. 2006, Ashman et al. 2011a). The portion of M&As identified as connected with BEE grew from 10-15% of the total number between 1998 and 2002 to 24-32% between 2003-2005 (Ponte et al. 2007, p. 947). In narrow terms, however, black market ownership sat at only 3.9% in 2012 after a new high of 7% in 2009, financial crisis once again taking a larger toll on this group (Who Owns Whom 2013). Despite the 'broad-based' policy agenda, a small number of well-connected black business moguls have continued to benefit disproportionately.

Some broader redistribution of ownership has also occurred. Royal Bafokeng Holdings (RBH), for instance, invests on behalf of the Royal Bafokeng Nation Development Trust which benefits the Royal Bafokeng Nation a previously-dispossessed population in the North West province. Their investments have traditionally been in mining,

¹²⁵ Perversely, Afrikaner businessmen with pre-existing capital and thus less exposed to interest rate risks saw their JSE market share rise from 24% to 36% between 1996 and 1999 as large-scale English capital divested (Carmody 2002, p. 265).

¹²⁶ The others being: management representation, employment equity, skills development, preferential procurement, enterprise development, and corporate social investment.

particularly platinum group metals (PGMs) abundant in the area. However, since 2010, RBH has increasingly invested in the financial sector that now makes up 62% of its portfolio, with mining at approximately 15%, infrastructure (mainly telecommunications) at 13%, property 6%, and mining services 3%. Their assets under management are a staggering R25bn and the RBH functions almost identically to a regular private-sector investment fund (RBH 2015).

Evocatively, the incorporation of black capital into the heart of the South African economy has parallels with the previous inclusion of Afrikaner capital, although accomplished far more swiftly. The competitive threat that black capital may have posed was quickly neutered and political power rapidly aligned with existing economic power. The latter is apparent in that many of the newly empowered were drawn from the senior ranks of the ANC – not to mention the ANC itself most likely being a beneficiary – as well as the centrality of the MEC. For instance, in 2008, of the 16 black business people in the top-50 South African ‘rich list’ the largest share (seven) acquired their wealth through mining and of the 207 ‘empowerment transaction’ in 2007/8 worth R143bn, 49 were in the mining sector, totalling R58bn, the largest share by far. MEC-manufacturing subsectors and construction made up another 35 with finance, real estate, and business services a further 38. The other large shares are in communications, retail, and computer related services, reflecting the structure of the economy discussed in Sections 9.2.2 and 9.4 (McGregor 2008, pp. 45–50). Unlike with the National Party’s *volkskapitalisme* (‘people’s capitalism’ or ‘capitalism for the Afrikaner people’), other levers of the state – its banking and spending in particular – were not originally leveraged under BEE, although more recently eligibility for public procurement contracts have entailed local-content requirements amongst other measures. However, without industrial policy to activate new industries, much of this is fulfilled by highly mechanised or low-wage sectors.

Black empowerment via the redistribution of ownership – whether to individual capitalists or investments funds like the RBH – has occurred through highly financialised mechanisms while deepening financialisation within the economy and not meaningfully disturbing existing economic power relations. This market-orientation is further reflected in how BEE has been ‘managerialised’ through which the principle/political objective is eclipsed by technical evaluation and the ‘outsourcing’ of

its management from government to the private (auditing) sector (note the parallels with the commercialisation of SOEs). This has shifted “responsibility for promoting change and for bearing the consequences of failure away from elected government and towards a generic ‘system’” (Ponte et al. 2007, p. 935). BEE has thus fitted neatly with neoliberal policy reform while suiting dominant white capital with the conglomerates able to “sell assets no longer deemed ‘core’ to black business groups, claiming credit for being engaged in empowerment transactions, while at the same time organizing finance for these groups at full commercial rates” (Ponte et al. 2007, p. 946). At the same time the advancement of a financialised market-orientated approach to racial redress and its purported ability to achieve this has precluded (or obscured) more radical policy options. It has also contributed to the growing sophistication and dominance of financialised markets while making the wealth of the politically-influential black elite dependent on financial market trends.

9.3 The shifting operations of NFCs and the consequences for accumulation

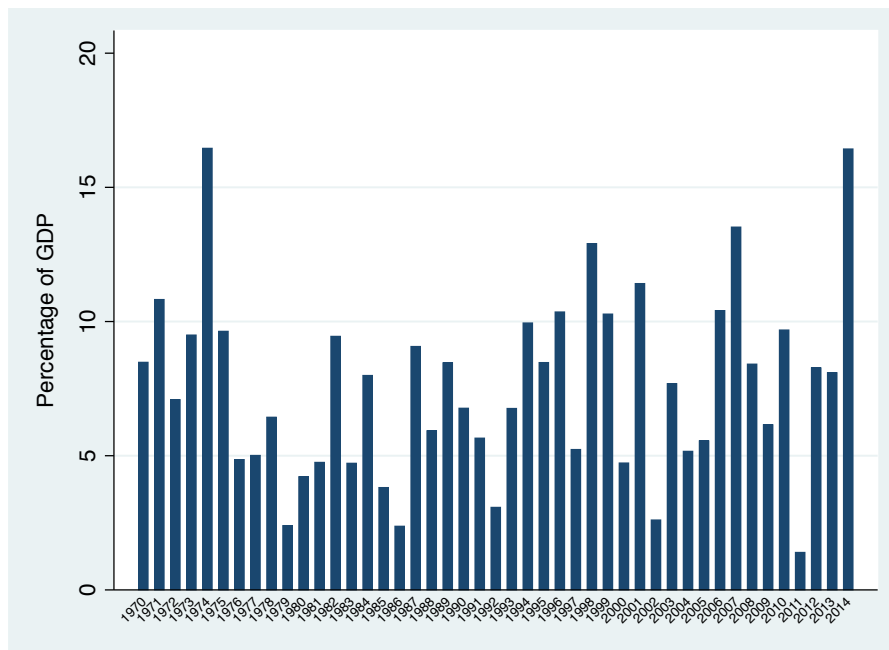
Section 9.2 has offered a thorough analysis of the restructuring of ownership that South African corporates have undergone. In this section we deepen our analysis of the manner in which these restructured NFCs have become integrated into financial markets – seeking to assess the intensive and extensive penetration of finance into the productive sector – and whether this and the restructurings described have financialised their operations and priorities. We do so via an analysis of NFC balance sheets (Section 9.3.1), pressures towards shareholder value maximisation (Section 9.3.2), and the consequences for real investment (Section 9.3.3) (some of the distributional consequences of these trends are discussed in the next chapter).

9.3.1 Financial entanglement: NFCs balance sheets

Given the experiences of other countries we may expect the balance sheets of South African NFCs to show increasing engagement with debt and capital markets, a decreased reliance on bank funding, and an increase in the accumulation of financial assets and greater financial income. Figure 9.3 begins by showing the net acquisition of financial liabilities by NFCs as a percentage of GDP. We see an increase in liabilities from the late 1970s onwards, with financial liability acquisitions averaging 9.5% of GDP

between 1994 and 1999 (as shown in Table 9.3), higher than in any other period. We also see a shift in the structure of funding from the 1980s into the democratic period. Table 9.4 shows that, whereas internal funding made up 66% of funding for NFCs in the 1980s, external funding takes up a larger share in the post-apartheid period. However, neither the size of borrowing (as a percentage of GDP) nor the share of funding that is external is significantly different in the post-apartheid period than was the case in the 1970s.¹²⁷

Figure 9.3 Net acquisition of financial liabilities by corporate private sector (1970-2014)



Source: SARB (2015d, 2015b), own calculations

Table 9.3 Net acquisition of financial liabilities by corporate private sector as percentage of GDP, average for four periods (1970-2014)

	1970 - 1979	1980 - 1993	1994 - 1999	2000 - 2014
Average for period	8.1	5.9	9.5	8.0

Source: SARB (2015d), own calculations

Table 9.4 Internal vs. external funding of private corporate sector as share of total funding, average for four periods (1970-2014)

	1970 - 1979	1980 - 1993	1994 - 1999	2000 - 2014
Internal funding	0.52	0.66	0.53	0.56
External funding	0.48	0.34	0.47	0.44

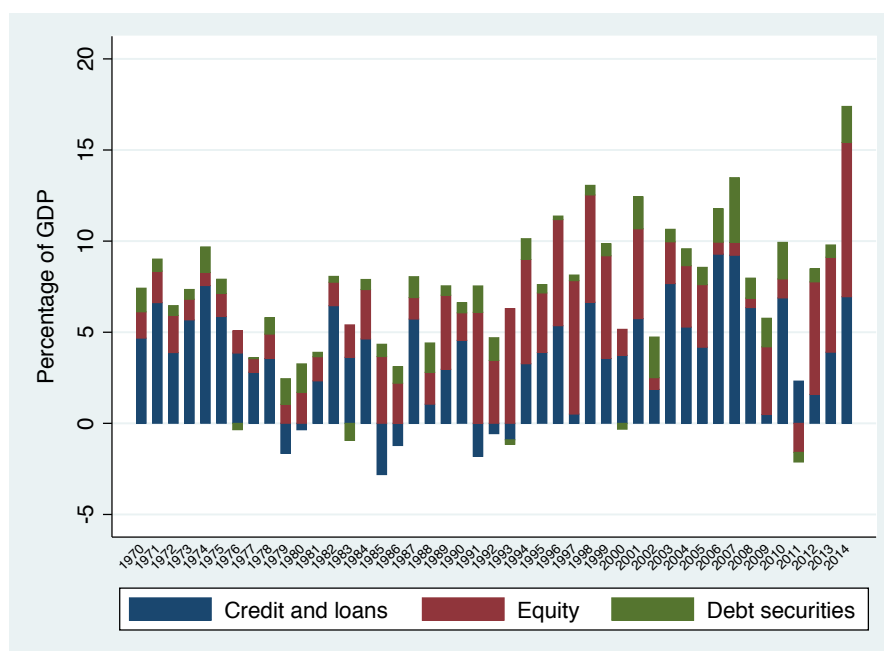
Source: SARB (2015d), own calculations

¹²⁷ Corporate level data indicate that borrowing as a share of fixed assets rises steadily from 1988 onwards indicating increased indebtedness relative to capital investment (INet BFA 2015, own calculations).

This said, the type of external funding does change in a meaningful manner. Figure 9.4 shows the breakdown of external funding between credit and loans, equity, and debt securities. We see that credit and loans account for a very large share of funding in the 1970s and much of the 1980s. By contrast, from the 1990s, equity becomes a more important source of external funds with debt securities playing a larger role from 2001 onwards. This indicates increased access to financial markets for NFCs and the increased share of foreign borrowing visible in corporate-level data (not shown) indicates greater access to international capital markets (INet BFA 2015, own calculations). The reduction in equity as a funding source in the late 2000s may relate to a difficulty in raising equity around the time of the financial crisis, although this drop occurs first in 2006. More interestingly, this corresponds with a period of share buybacks in the domestic market and share purchases in the foreign market (see Section 9.3.2 below).

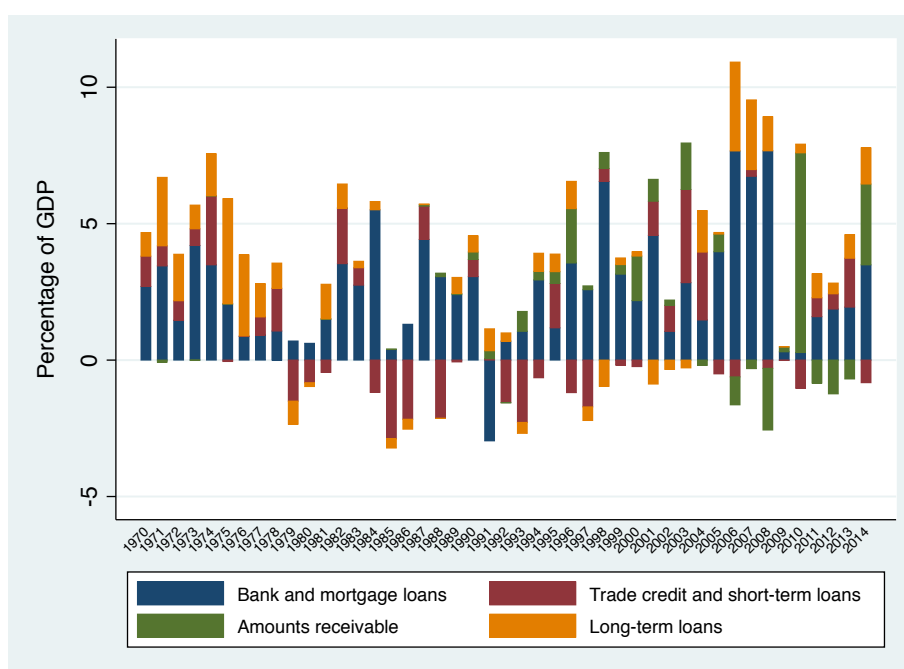
Despite increased market engagement, credit and loans continue to play an important role as is clear in Figure 9.4 (potentially reflecting a persistence of the close relationship between banks and NFCs established within the MEC conglomerates). Figure 9.5 breaks down this category showing the on-going importance of bank loans while also highlighting a shift away from long-term loans (that made up a substantial and stable share in the 1970s); with short-term borrowing more important in the post-apartheid period than before (although erratic). In sum, unlike in many other financialising economies, internal and bank funding remain dominant while acquisition of financial liabilities is not meaningfully higher than in the 1970s. However, a deeper engagement with financial markets (domestic and foreign) is visible as well as a shortening of the term structure of borrowing potentially establishing maturity mismatches with long-term capital investment. A mixed picture of financialisation regarding NFC liabilities is therefore present.

Figure 9.4 Types of external funding of private corporate sector (1970-2014)



Source: SARB (2015d, 2015b), own calculations

Figure 9.5 Types of credit drawn by private corporate sector (1970-2014)

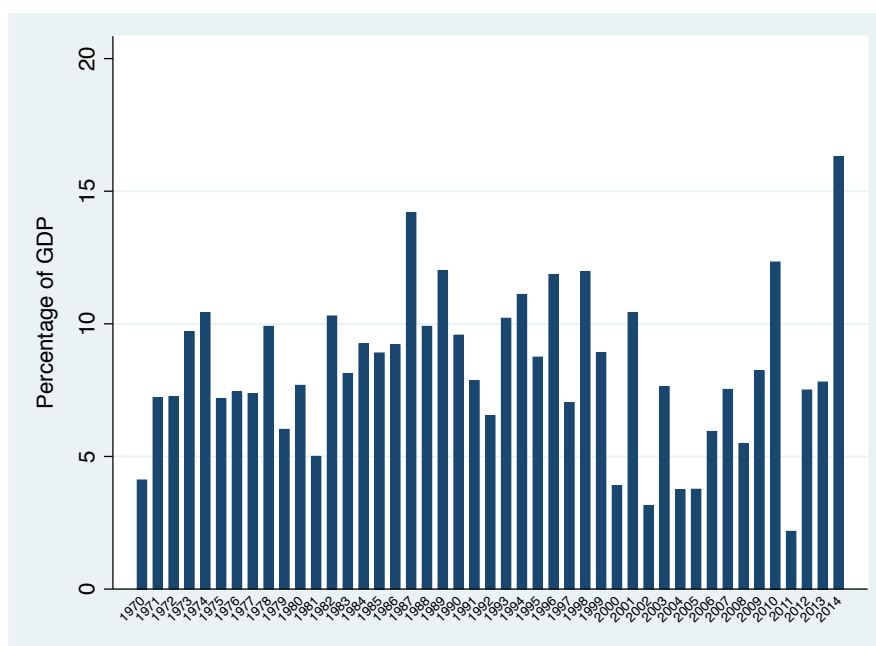


Source: SARB (2015d, 2015b), own calculations

On the asset side of the balance sheet, we once again observe mixed trends. Figure 9.6 shows the yearly net acquisitions of financial assets by the private corporate sector since 1970 as a percentage of GDP. Table 9.5 gives the averages for four periods. We see in Table 9.5 that the net acquisition of financial assets as a percentage of GDP averaged at 8% in the 1970s, rising to 9% in the 1980s most likely a product of trapped capital

under sanctions (the highest period average is between 1985 and 1994) (Ashman, Fine, et al. 2013, Ashman, Mohamed, et al. 2013, Newman 2014). It reached just under 10% in the years of restructuring and asset swaps (1994-1999) after which it falls to the lowest period average of 7% (although we may be seeing an upward trend most recently).

Figure 9.6 Net acquisition of financial assets by corporate private sector (1970-2014)



Source: SARB (2015d, 2015b), own calculations

Table 9.5 Net acquisition of financial assets by corporate private sector as percentage of GDP, average for four periods (1970-2014)

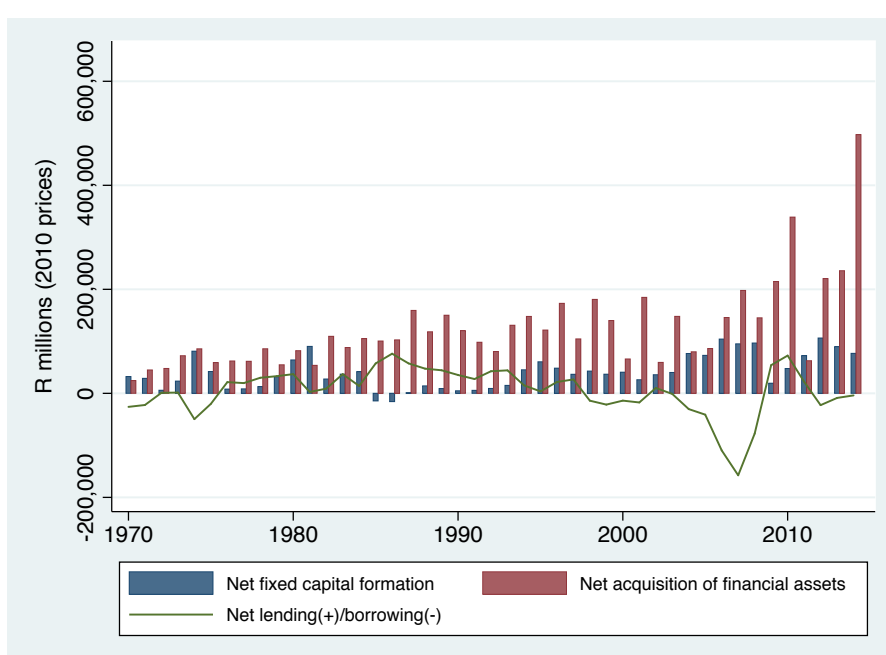
	1970-1979	1980-1993	1994-1999	2000-2014
Average for period	7.7	9.2	9.4	7.1

Source: SARB (2015d, 2015b), own calculations

This finding differs markedly from most previous studies of financialisation in South Africa (see Ashman, Fine, et al. 2013, Ashman, Mohamed, et al. 2013, Mohamed 2014, Newman 2014, although it is congruous with Rodrigues Teles Sampaio 2014). Using a variant of Figure 9.7 (see for example Ashman, Fine, et al. 2013, p. 24) these studies attribute the increase in financial asset acquisition in the 1980s to trapped capital under sanctions, rather than financialisation, while noting that it laid “the conditions for the form and pace of financialisation in the South African economy from the early 1990s” (Newman 2014, p. 10); thereafter increased asset acquisition is viewed as a sign of financialisation. This rise is present in absolute terms (Figure 9.7) but not as a

percentage of GDP (Figure 9.6). In line with our analysis throughout this thesis we view the latter as the more appropriate measure (as in Figure 9.6 and Table 9.5). Similarly, the ratio of financial asset acquisition to fixed net capital formation is higher in the 1970s (a ratio of 3.9) than in the post-apartheid period (a ratio of 3.4), as shown in Table 9.6. Other firm-level data yield mixed results regarding (financial) investment income as a share of total income or non-fixed assets as a share of total assets (INet BFA 2015), indicating the need for further sectoral-level analysis.

Figure 9.7 Net fixed capital formation, net acquisition of financial assets and net borrowing/lending by private corporate sector (1970-2014)



Source: SARB (2015d, 2015b), own calculations

Table 9.6 Ratio of net acquisition of financial assets to net capital formation by corporate private sector, average for four periods (1970-2014)

	1970-1979	1980-1993	1994-1999	2000-2014
Average for period	3.9	6.2	3.3	3.4

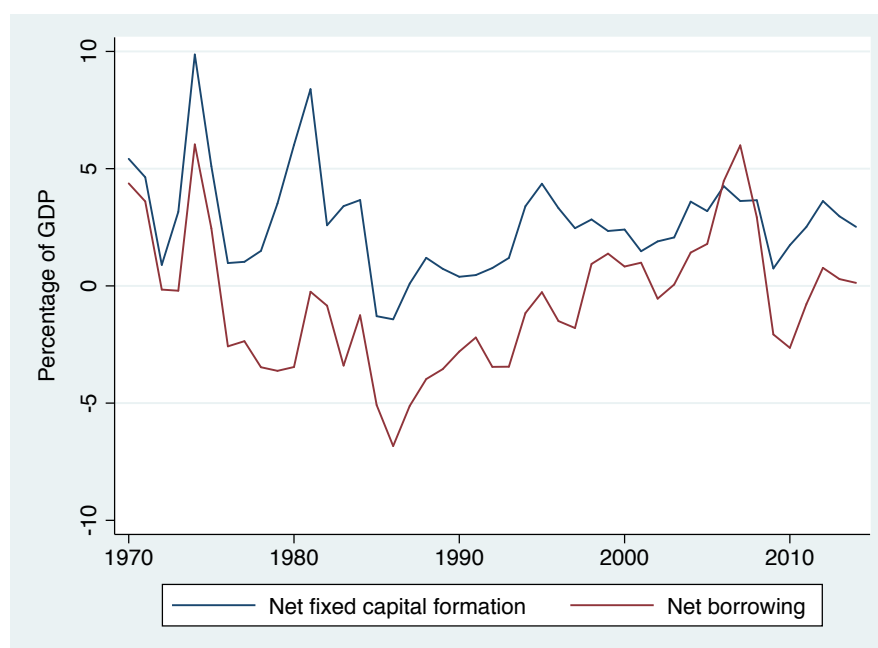
Source: SARB (2015d), own calculations

Note: the anomalous ratio of 147 in 1987 has been excluded. Other high ratios of 17 for 1989 and 1991 and 25 for 1990 skew the 1980-1993 period average upwards, excluding these drops the period average to 2.3.

A second contention in the existing literature is that the (purported) increased financial asset accumulation is debt funded, as NFCs become net debtors from the late 1990s (as

indicated in Figure 9.7).¹²⁸ This is possible but not certain, as shown in Figure 9.8 net capital formation exceeds net borrowing in all but two years (2006 and 2007) meaning that the increased borrowing could have gone entirely to fixed capital formation. However, if this were the case one would need to explain why capital investment was suddenly coming from borrowing rather than retained earnings. By the same token one would also need to explain why similar levels of net financial asset acquisition were now coming from borrowing rather than retained earnings. Instead, we hypothesise that this increased borrowing is being used for shareholder distributions – which show a marked change from earlier periods as discussed in Section 9.3.2 – as was clearly the case in the platinum sector in the 2000s (Bowman and Isaacs 2014, 2015, Bowman 2016), although such a relationship needs further research.

Figure 9.8 Net capital formation and net borrowing of private corporate sector (1970-2014)



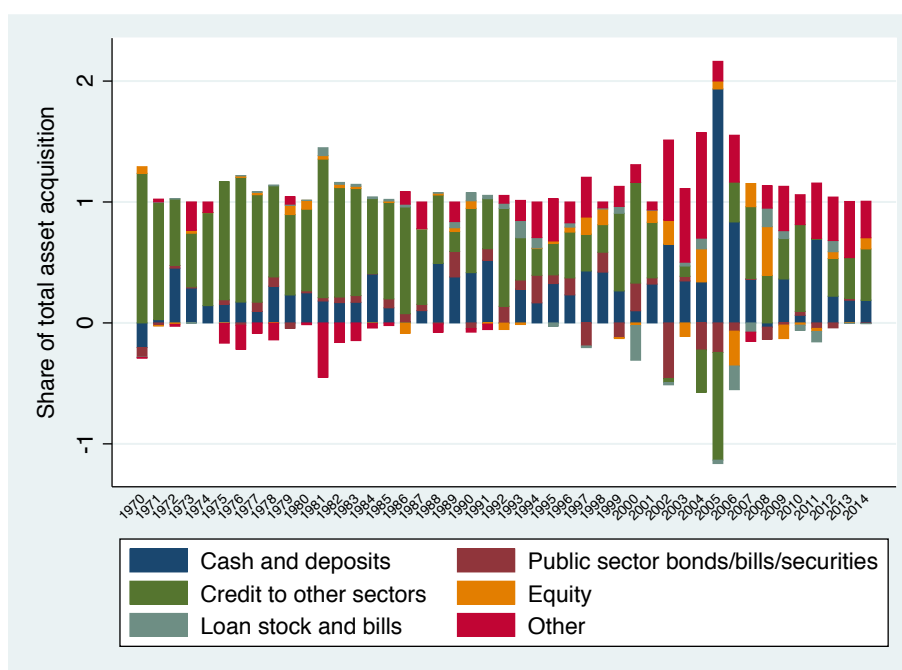
Source: SARB (2015d, 2015b), own calculations

Finally, the composition of financial assets has undergone notable changes in the post-apartheid period as visible in Figure 9.9. Lending to other sectors has fallen dramatically indicating more profitable local and international investment options. This is due to a fall in short-term lending (not shown here) while long-term lending, as a share of asset acquisition, has remained largely stable (barring large drops in 2002 and 2012). The

¹²⁸ For instance, Ashman, Fine et al. (2013, p. 25): “The period since 1994 has also seen non-financial corporations moving from their positions of net lenders to net borrowers [...] suggesting that increased acquisition of financial assets has been financed through the expansion of credit.”

holding of cash and the acquisition of stocks and shares has increased, as did fixed interest securities in the 1990s,¹²⁹ highlighting deeper engagement with financial markets and a shift towards short-term asset acquisition possibly indicating a shift towards greater speculative investments. Indeed, firm-level analysis in the mining sector has shown how mining firms use financial markets to support speculation in mining assets (Karwowski 2015), while over-capitalisation and market speculation has also been demonstrated in a wider set of large list NFCs (Karwowski 2012). The ‘other’ category of financial assets acquisition increases predominately due to a rise of ‘other assets/liabilities’ but also due to growth in ‘interest in retirement and life funds’. The former refers to transactions not (yet) categorised and hence often reflects financial-market innovation, the latter again indicates greater financial market involvement. In sum, while financial asset acquisition appears not to meaningfully increase on aggregate in the post-apartheid period its structure changes becoming more diversified and liquid with greater financial market integration, congruent with increased financialisation.

Figure 9.9 Financial asset acquisition by private corporate sector by type (1970-2014)



Source: SARB (2015d, 2015b), own calculations

The non-financial corporations that emerged in the wake of the corporate restructurings (discussed above), financial liberalisation (Chapters 6 and 7), and financial market expansion (Chapter 8) clearly exhibit different operational behaviour. The level of

¹²⁹ The movement of the components within this category is complex and not discussed here).

acquisition of financial assets and liabilities is not necessarily higher than in previous periods, although due to a reduction in lending to other sectors the sector becomes a net borrower. Importantly, the nature of financial assets and liabilities changes, most notably indicating deeper engagement with financial markets and shorter-term structures.

9.3.2 Shareholder value maximisation

This increased short-termism and integration into financial markets is exhibited by the restructured NFCs in another manner: the increased prioritisation of ‘shareholder value maximisation’. As noted in Chapters 3 and 4 this usually entails increased concern for the company’s share price and financial ratios, and increased distributions to shareholders. This is witnessed through the rise of ‘corporate governance’ principles, share buybacks, and dividend payouts, with executives incentivised by rising pay and bonuses increasingly tied to the company’s financial performance. In these respects, the restructured corporates display a high level of financialisation.

Figure 9.10 shows dividend and interest payments and receipts for the non-financial corporate sector between 1995 and 2014;¹³⁰ such payments represent the importance of shareholder distribution while such receipts highlight the importance of income from financial payments (see Isaacs 2016b for a discussion of various shareholder value maximisation metrics). Both series increase from 1995 but decline in the wake of the financial crisis, the former more dramatically. This drop in dividend payouts (as a share of gross value added) could reflect the global trend of dividends declining as the preferred method of shareholder distribution (see below).

Figure 9.11, for all non-financial JSE-listed companies, however, shows persistent growth in dividend payments with a steady rise from 1988 to 2015¹³¹ and without the dramatic post-crisis fall present in the SARB data.¹³² This series may be more instructive in that it measures dividends as a share of operating profit (rather than GVA) therefore highlighting the allocation of funds within the business. This series shows a strong drop

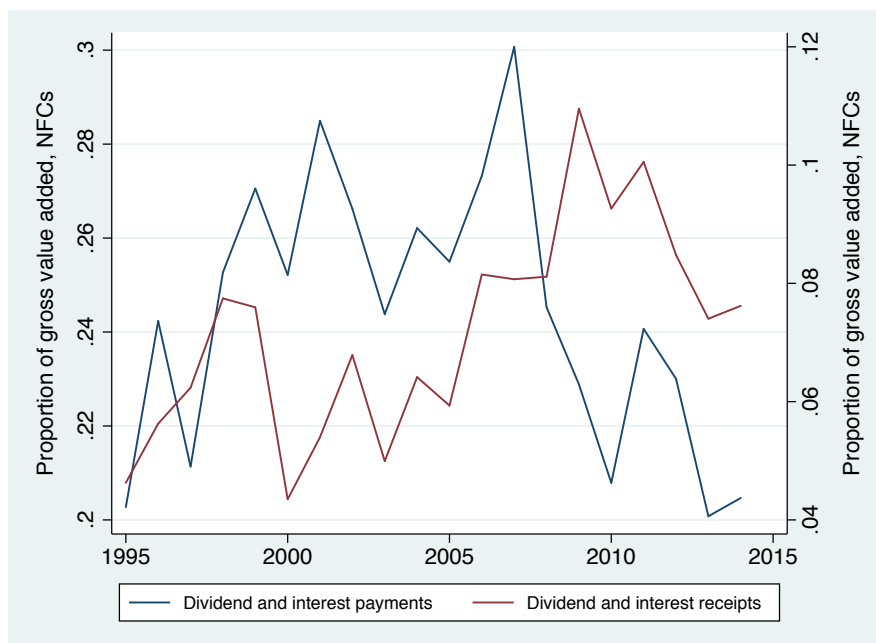
¹³⁰ Unfortunately, this is the longest time series available from the SARB.

¹³¹ In Chapter 1 we noted that aggregate corporate data from INet BFA were only provided from 1988 onwards.

¹³² This distinction is not due to the inclusion of interest payments in Figure 9.10 as these make up a small portion of the aggregate measure.

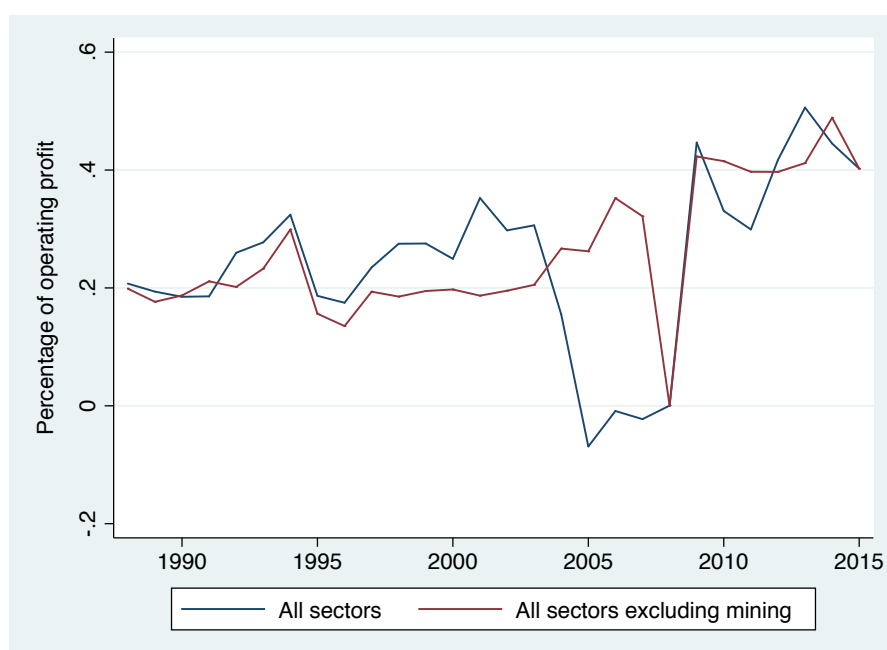
in the 2005-2008 period, however, when excluding mining the drop is only in 2008. The 2008 fall relates to the financial crisis while the mining-related fall follows the end of the commodity super-cycle (see Bowman and Isaacs 2014 in the case of the platinum sector). Data availability makes a proper comparison with the apartheid period impossible but the upward trends in the post-apartheid period are apparent.

Figure 9.10 Dividend and interest payments and receipts for non-financial corporations (1995-2014)



Source: SARB (2015a) via Quantec, own calculations

Figure 9.11 Dividends paid as share of operating profit (1988-2015)



Source: INet BFA (2015), own calculations

Globally, share buybacks have grown enormously in recent decades eclipsing dividends as the preferred means of returning value to shareholders. Grullon and Michaely (2002) show that in the US share buybacks grew at an average annual rate of just over 26% between 1980 and 2000 compared to dividends which grew at almost 7%; in 2005 funds spent on buybacks exceeded dividends and have continued to widen since then (Dittmar 2008).¹³³ Buybacks can serve to boost the share price allowing for larger capital gains, return cash to specific shareholders (rather than general dividends), or consolidate ownership, and can sometimes be favourable from a taxation perspective.

Buybacks have been permitted in South Africa since July 1999 with the Companies Amendment Act (No. 37 of 1999, RSA 1999) and have since become popular. Research into buybacks is complicated by the lack of comprehensive public data in large part due to weak reporting requirements (see Bester 2008, Madubela 2011, Wesson et al. 2015). The only systematic collection of buyback data is by researchers at the University of Stellenbosch Business School (USB) for the period 1999 to 2009 and includes all ordinary and/or N-class companies with a primary listing on the JSE for which there is at least three years of data, excluding basic materials and financial sectors (Bester 2008, Wesson and Hamman 2009, Bester et al. 2010, Wesson et al. 2015). This includes 227 companies and is a good dataset for our purposes despite ending in 2009.

Table 9.7 and Figure 9.12 show the strong growth in share buybacks since their permissibility. While dividends clearly still dominate (Figure 9.12), the compound growth rate in share buybacks over the period was 27%, compared with 19% for dividends. The total dividends paid over the period, as shown in Table 9.8, equalled R247bn with 178 (or 78%) of firms declaring dividends, this number rising from 59% of firms in 2000 to 75% if 2009. The number of firms engaging in buybacks increased over the period from 8% in 2000 to 24% in 2009, with 115 (or 51%) of firms doing so to a total value of R137bn. Dividends therefore accounted for 64% of total distributions, although their share of total distributions fell over the period (Wesson 2015, Wesson et al. 2015). Wesson et al. (2015, pp. 51–52) stress the importance of buybacks in the post-crisis years noting that share buybacks “are becoming the favoured payout method,

¹³³ Both statistics use companies listed in Compustat, the first Compustat industrials, and the second all Compustat companies excluding financials and utilities.

when compared with dividend payments”. In particular, special dividends, usually paid out in the context of excess cash, fell from 9% of total dividends in 2000 to 7% in 2009 (particularly in the latter sample years) in tandem with the increase in share buybacks indicating a possible substitution between the two (Wesson 2015, pp. 112–114).

Table 9.7 Share buybacks by sample companies (2000-2009)

Year	Number of companies	Percentage of companies (%)	Buyback value per annum (R billions)
2000	16	7.8	2.7
2001	38	18.2	3.0
2002	47	23.5	4.3
2003	56	29.6	3.7
2004	41	24.7	2.9
2005	40	25.8	12.2
2006	38	26.0	20.1
2007	29	19.3	25.8
2008	40	27.8	21.7
2009	33	23.6	40.5
TOTAL			136.9

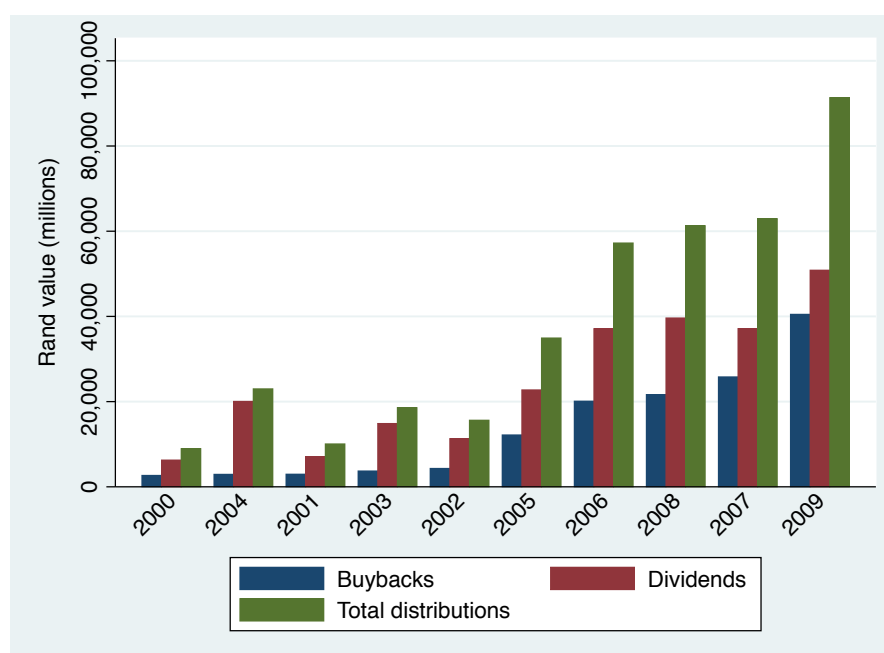
Source: Wesson (2015)

Table 9.8 Dividends paid by sample companies (2000-2009)

Year	Number of companies	Percentage of companies (%)	Dividend value per annum (R billions)
2000	121	58.7	6.3
2001	108	51.7	7.1
2002	104	52.0	11.3
2003	116	61.4	14.9
2004	124	74.7	20.1
2005	114	73.6	22.8
2006	119	81.5	37.1
2007	115	76.7	37.1
2008	115	79.9	39.6
2009	105	75.0	50.9
TOTAL			247.1

Source: Wesson (2015)

Figure 9.12 Value of share buybacks and dividends paid by sample companies (2000-2009)

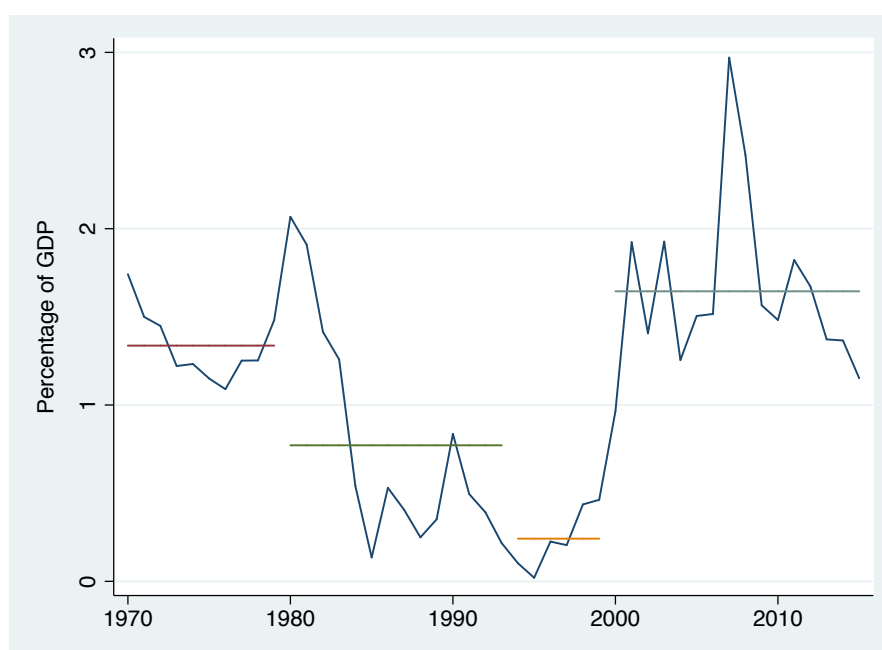


Source: Wesson (2015)

In general share buybacks in South Africa have been shown to have positive short-term and long-term effects on the companies' share price, in particular in companies with high book-to-market ratios (Wesson 2015), making them an effective means of distributing value to shareholders. At the same time, they divert funds that could be used in long-term investment (the consequences discussed in the next subsection) and, even in financial terms, can result in a net loss. ACC for instance spent \$10.5bn on repurchasing 212m shares in the late 2000s only to have those shares worth only \$3bn in 2009 (Staff Writer 2009).

Such distributions can also be a net loss for the domestic economy. Figure 9.13 shows the increased outflow of dividends due to increased international ownership within the economy – net outward payments average 1.6% of GDP from 2000 onwards compared with 1.3% in the 1970s and 0.8% between 1980 and 1993, the low outward flows in the early years after apartheid correspond with the period of restructuring after which outward dividend flows rise dramatically. In addition, the dramatic increase in foreign shareholding (Section 9.2.2) would imply that funds spent on buybacks may also entail a loss to the local economy. This illustrates the link between shareholder value maximisation and restructuring and internationalisation discussed above.

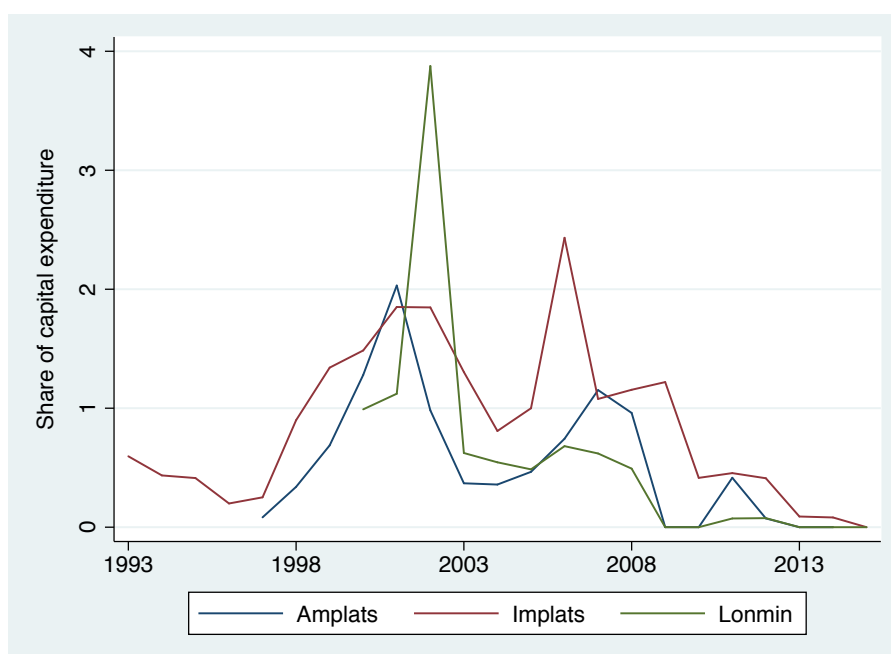
Figure 9.13 Net dividend payments to rest of world (1970-2015)



Source: SARB (2015a) via Quantec, own calculations
 Note: calculated as outward payments less inward receipts

The dynamics of corporate payouts are well-illustrated in the case of the newly-restructured mining houses (mining having been excluded from the USB dataset); Bowman and Isaacs (2014, 2015) and Bowman (2016) show this in the case of the three major platinum producers (one of the most important mining subsectors in post-apartheid South Africa). During the commodities boom, lasting roughly from 1998 to 2008, Anglo American Platinum (Amplats), Impala Platinum (Implats), and Lonmin returned enormous funds to shareholders. Figure 9.14 shows distributions to shareholders (dividends and share buybacks) as a share of capital expenditure highlighting how distributions during the boom considerably exceeded fixed expenditure. Between 2000 and 2008, distributions for all three companies combined were, on average, 106% of capital expenditure, with distributions, in some years, reaching almost four times capital expenditure in the case of Lonmin in 2002.

Figure 9.14 Distributions to shareholders (dividends and share buybacks) as a share of capital expenditure for three major platinum producers (1993-2015)



Source: Bowman and Isaacs (2014) and Bowman (2016), own calculations

This is in contrast with previous booms during which cash had been retained. Rand Platinum Mines (the forerunner to Amplats), for instance, stated in 1987 after two successive years of record profit: “the policy was deliberately continued of strengthening the Group’s financial position in order to be better able to withstand a deterioration in market conditions” (RPM, 1987 p. 4, in Bowman 2016, p. 33). Similarly, in 1994, RPM stressed a focus on “building cash reserves during the good times” (RPM, 1994, p. 5 in Bowman 2016, p. 33). By contrast Implats stressed in the early 2000s its “mission” of shareholder value delivery, and “returning the benefits of any excess cash to shareholders” (Implats 2001, p. 7, 2004, p. 7-14, in Bowman 2016, pp. 34–35). This led the companies into significant debt; Implats for instance went from a net cash position of R8.5bn in 2007/8 to a net debt position of R2.3bn in 2012, distributing R16.3bn to shareholders in the interim. Similarly, with distributions of R26bn in just two years, Amplats went from a R4.9bn net cash position at the end of 2006 to a net debt of R19bn at the end of 2009 (having raised debt of R23bn in the interim), forcing it to raise equity of R12.5bn in 2010 and highlighting how borrowing has financed shareholder distributions. As analysts at JP Morgan noted: “[b]orrowing to pay dividends in a cyclical single commodity miner has never been the smart thing to do” (JP Morgan, 2010, p. 8, quoted in Bowman 2016, p. 32).

These choices have everything to do with the restructurings previously described as well as financial market dynamics discussed in Chapter 8. Ownership has shifted, with financial-market actors playing a far more prominent role with much shorter investment horizons. This is reflected, for instance, in share turnover. The average free-float shareholding periods for Amplats (previously RPM) fell from four years to under one year between the early 1990s and mid-2000s; for Implats, the fall over the same period was from around one year to just a few months (Bowman 2016, p. 28). As one bank analyst noted in 2002 about the PGM sector: “the majority of PGM investors are far more geared to a three-month view”, while only “about 15% of the PGM investor population are fundamental long-term participants [of three to five years]. [...] The obvious issue therefore, is that of share price value” (ING, 2002, p. 30, quoted in Bowman 2016, p. 28).

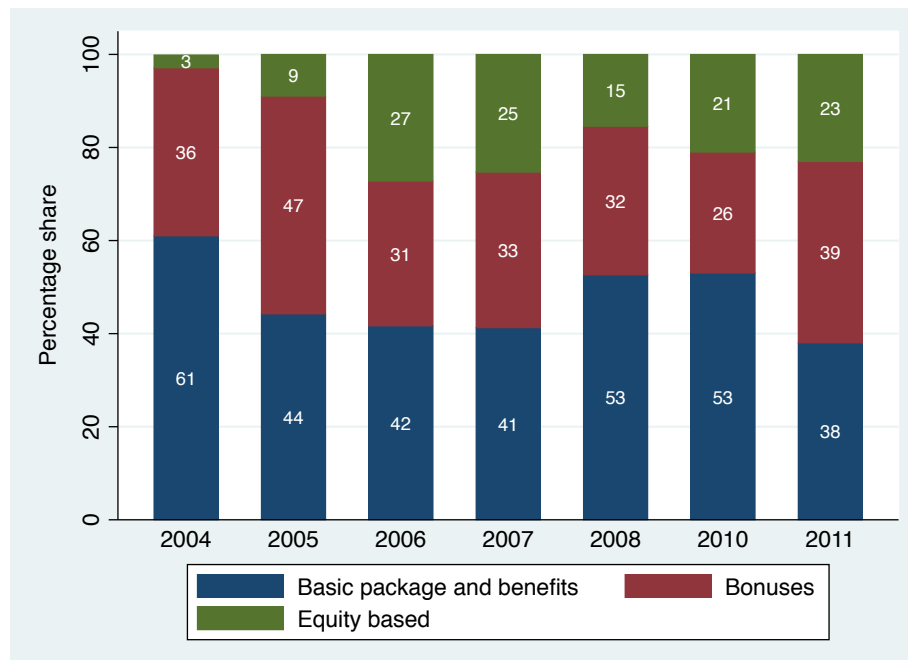
In fact, in the wake of the commodities downturn 40-50% of the Top 50 shareholders of the big three platinum producers exited their investment (calculated between 2007 and 2016). Data from 2000 to 2015 show that, while Lonmin’s distributions and share issues were roughly equal, Implats’ distributions were around eight times their capital raised and Amplats just under four, as Kay (2012, p. 28, quoted in Bowman 2016, p. 36) notes: “Equity markets today should primarily be seen as a means of getting money out of companies rather than a means of putting it in”. Such demands are generalisable across South African sectors, as PWC (2012a, p. 3) reported: “In 2011 shareholders became more vocal that the Top 40 should give more profits back, either by way of dividends or shareholder buybacks.”

Amplats reflects the restructurings in another way. With its parent company AAC increasing its shareholding from 50% to 80% between 2000 and 2008, increased dividends were about competitive struggles between AAC and other major global mining conglomerates headquartered in London, and AAC’s attempt to boost its own share price (by 2008 Amplats was generating a quarter of earnings before interest, taxation, depreciation and amortisation (EBITDA)) (Bowman 2016, pp. 33–34).

One final element of this picture is the structure of executive remuneration. This has shifted in South Africa in line with global trends towards higher variable, increasingly complex, stock-related pay (short-term and long-term incentives) tied to diverse means

of measuring financial performance. PwC South Africa (2013, p. 10) noted in its 2013 comprehensive *Executive directors: Practices and remuneration trends report*: “Incentives, including bonuses and share awards, used to average around 60% of guaranteed package, but now they are heading to nearly 200% [...] in certain sectors of the financial services industry [this] has been even more extreme, with incentive remuneration representing 5 to 10 times the value of guaranteed pay package”. Figure 9.15 shows this change for executive directors in the crucial years of the late 2000s when equity pay went from 3% of remuneration in 2004 to 23% in 2011. Comparable data are not available after 2011 but the trend continues, short-term incentives for executive directors of large-cap industrial firms, for example, grew by 75%, 0%, and 69% in 2013, 2014, and 2015, respectively (PwC 2016, p. 62). Despite hugely increased pay and pay restructuring, the South African research, in the main and in line with global trends, finds little correlation between executive pay and company performance (Bussin and Modau 2015, Ndofirepi 2015, Ngwenya 2016). Despite this, the drive by executives to maximize shareholder and spend funds remains, including when this may undermine longer-term productive investment.

Figure 9.15 Remuneration structure for JSE executive directors (2004-2011)



Source: PwC (2009, 2011, 2012b), own estimates

9.3.3 Consequences for capital formation

A well-recognised consequence of increased financial market engagement, growing short-termism in asset and liability structures and planning horizons, and shareholder maximisation distributions, is falling real investment in the economy (in both developed economies and DTECs, as shown in Chapters 3 and 4). In South Africa, fixed capital investment hit an all-time low in the second half of the 1980s and early 1990s (as visible in Figure 9.8) as confidence in the economy plummeted, investment opportunities dried up, and capital was put towards diversified acquisitions by the conglomerates. What is notable is that net capital formation (NCF) by NFCs has in the post-apartheid period failed to reach pre-crisis levels as visible in Figure 9.16. Between 1970 and 1984 NCF for the sector averaged at 4% of GDP, in the crisis years (1985-1993) it fell twentyfold to 0.2% and then rose to just under 3% in the post-apartheid period (1994-2014).

Figure 9.16 Net capital formation by corporate private sector (1970-2014)

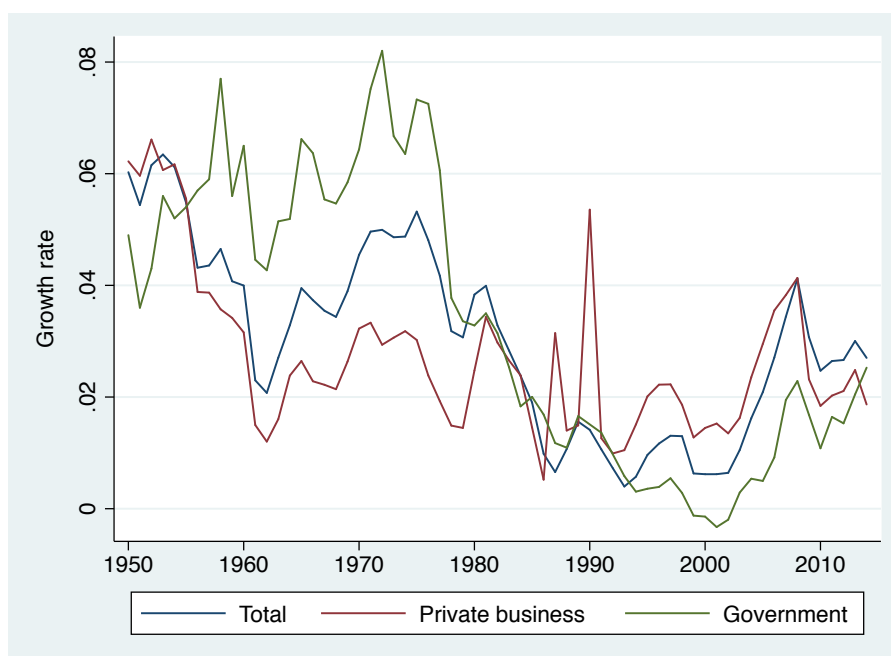


Source: SARB (2015d, 2015b), own calculations

The growth of FCS has picked up significantly – as visible in Figure 9.17 – but this remains far below the post-war highs compounded by the on-going depreciation of aging fixed capital that depresses net capital formation. The recent spike in the late 2000s comes from the private sector's role in large government spending on a small number of megaprojects, some of which – like the football World Cup stadiums – do not enhance productive capacity in the economy. The levels of gross capital formation

and net savings are shown in Figure 9.18. They move in tandem until 1994 when they diverge noticeably; this divergence indicating a change in the distribution of funds, most likely due to rising shareholder payouts (and possibly financial asset acquisition).

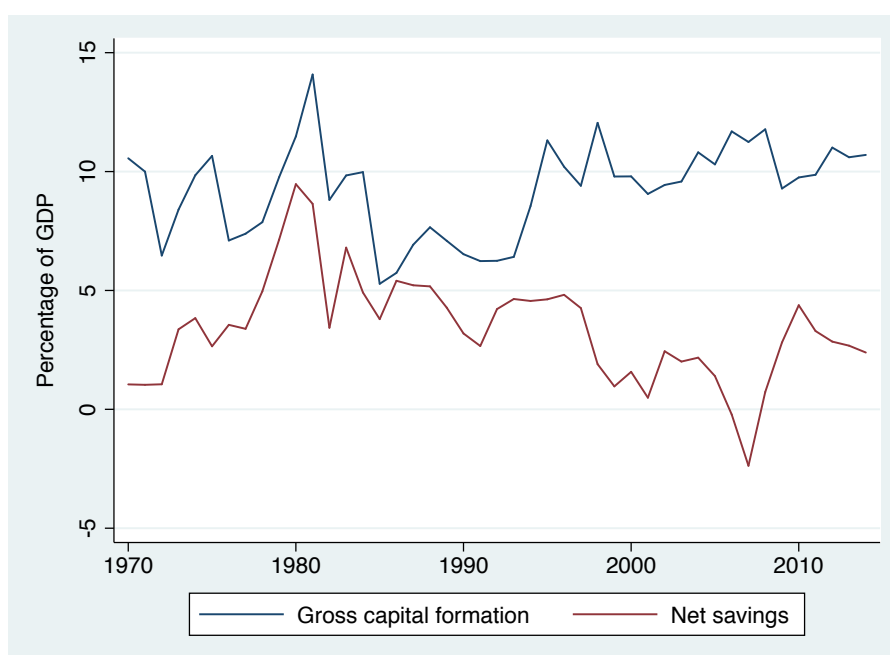
Figure 9.17 Growth rate of fixed capital stock (1950-2014)



Source: SARB (2015a) via Quantec, own calculations

Note: the “private business sector” here refers to financial and non-financial corporates but while the FCS of the financial sector has grown significantly (see Section 9.4) the driving force beyond the trends in this series are NFCs. Outliers of government fixed capital stock growth rate of < -0.02 have been removed (2 outliers).

Figure 9.18 Gross capital formation and net savings of corporate private sector (1970-2014)



Source: SARB (2015d, 2015b), own calculations

Note: 'net savings' appears in the SARB flow-of-funds data and is taken from the national income (and production) accounts. It refers to gross savings less consumption of fixed capital. Gross savings of the corporate private sector is effectively retained income (prior to use on fixed capital).

These trends notwithstanding, it would be wrong to cast the expansion of finance as necessarily and solely harmful to the 'real' economy; as noted in Chapter 2, the credit system is essential to capitalist accumulation. Rather, it is the extent and nature of that financial expansion. As the mainstream literature, cited in Chapter 3, shows 'too much finance' can be harmful for growth, and, as the financialisation literature reviewed in Chapters 3 and 4 shows, this is largely due to its deleterious impact on investment and wages. This in turn, is due to the terms upon which NFCs have been incorporated into financial markets, put differently: the nature of the intensive and extensive expansion of financial market activity. This was shown in the previous chapter to include a decline in bank lending to NFCs. It has been shown here that financial market participation has been skewed towards short-termism, speculative investment, shareholder payouts, and strategies to raise share prices and financial profits, all at the expense of fixed investment.

These trends in capital investment also speak to other aspects of financialisation covered in this thesis. The (partial) failure of the South African financial sector to channel funds towards fixed investment relates to the financing of the current account deficit via short-term financial flows (Chapter 7) destined for speculative investment in

the financial sector (Chapter 8) or other asset markets like housing (Chapter 10). It also reflects high levels of poverty and inequality with the majority of the population living on scanty incomes with low levels of consumption and almost no ability to save (Chapter 10). In sum, Section 9.3 has highlighted the increased interpenetration between the restructured NFCs and financial markets leading to speculative investment, short-termism, shareholder distributions, and low levels of real investment.

9.4 Structures of production

We have thus far explored the restructuring of ownership in the economy and the changing operations and priorities of NFCs. A critical question which arises is whether these marked shifts have altered the prevailing growth path, or system of accumulation, as captured by the MEC. This section therefore interrogates the structural composition of the post-apartheid economy highlighting the persistence of the MEC, albeit with some important sectoral alterations.

9.4.1 Sectoral composition and linkages

Figure 9.19a and Figure 9.19b show the average annual growth rate in gross value added (GVA) and change in fixed capital stock (FCS) between 1994 and 2015, respectively. A number of trends stand out. Gold mining shows negative movement in both series with coal and other mining (in particular iron ore and PGMs) adding considerable FCS. The tertiary sector is the fastest growing in terms of GVA (3.5% average GVA growth rate compared to 2.6% in the secondary sector and 0.3% in the primary sector). Financial services is the fourth fastest growing subsector in terms of GVA while adding the sixth highest amount of FCS; this ranking is even higher when considered from 2000 onwards, with finance ranking first with an average annual GVA growth of 7.5%;¹³⁴ business services clearly experiences significant growth as does communications. Equally importantly, manufacturing displays a lacklustre performance with the notable exceptions of those subsectors tied closely to mining – basic iron and steel, energy, petroleum, chemicals, non-ferrous metals – as well as motor vehicles and leather which have received considerably support under the Motor Industry Development Programme (MIDP).

¹³⁴ This makes sense given our discussion in previous chapters of how financialisation really takes off in the 2000s.

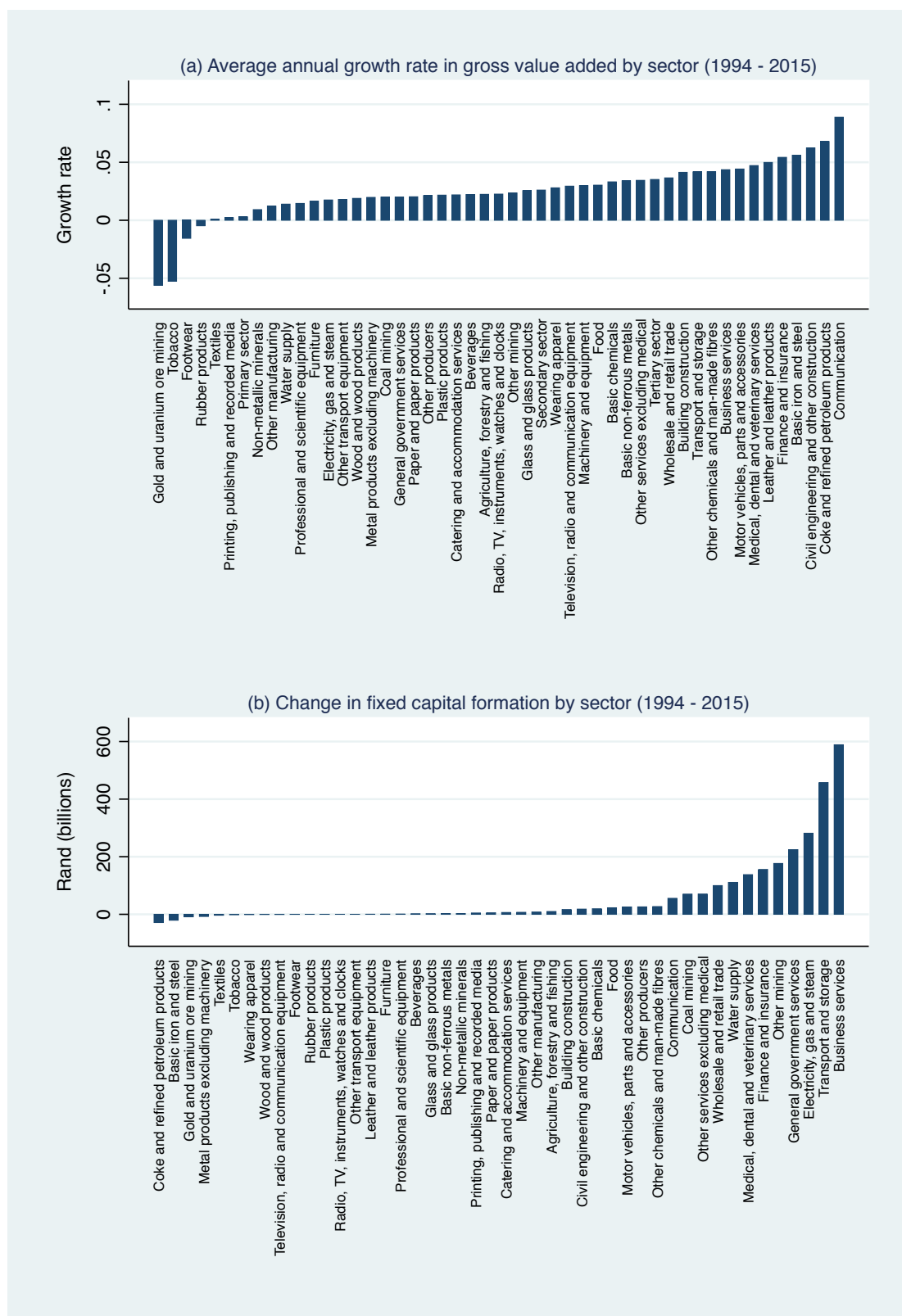
This demonstrates that, while deconglomeration may have changed the structure of ownership in the economy, sectoral biases captured by the MEC remain. On the one hand, the share of GVA associated with the MEC has been declining steadily as shown in Figure 9.20 in favour of a rapidly rising tertiary sector with finance leading the way. On the other hand, the share of total FCS within MEC sectors is higher today (at 21%) than in 1970 (15%) with non-MEC manufacturing and the tertiary sector equal in the two years (at 4% and 68%, respectively) (Ashman, Fine, et al. 2013, p. 13).¹³⁵ Recall also that structural linkages between finance and MEC sectors led us to argue that the MEC could originally be thought of as the MEFC. Further, MEC sectors remain closely linked to one another, with on-going weak linkages with the rest of the economy. As Newman (2014, p. 13) summarises:

“70% of productive inputs into the MEC sectors come from the MEC core itself and 56% of intermediate output from MEC sectors goes back into the MEC core as inputs. By contrast, only 25% of intermediate inputs into non-MEC manufacturing sectors are sourced from the MEC and only 10% of intermediate output from non-MEC sectors is fed into MEC sectors as inputs.”

This, it is argued below, represents the emergence of a financialised version of the MEC – strong growth in finance and other services while the traditional MEC primary and manufacturing sectoral concentrations remain, with retarded growth in non-MEC manufacturing subsectors (Newman et al. 2010, Ashman, Fine, et al. 2013, Ashman, Mohamed, et al. 2013, Newman 2014). The industrial structure, therefore, is still “skewed in favour of capital intensive, heavy, industries with limited labour absorption that have made up between 50 and 62 per cent of total manufacturing output since the 1970s” (Newman 2014, p. 14).

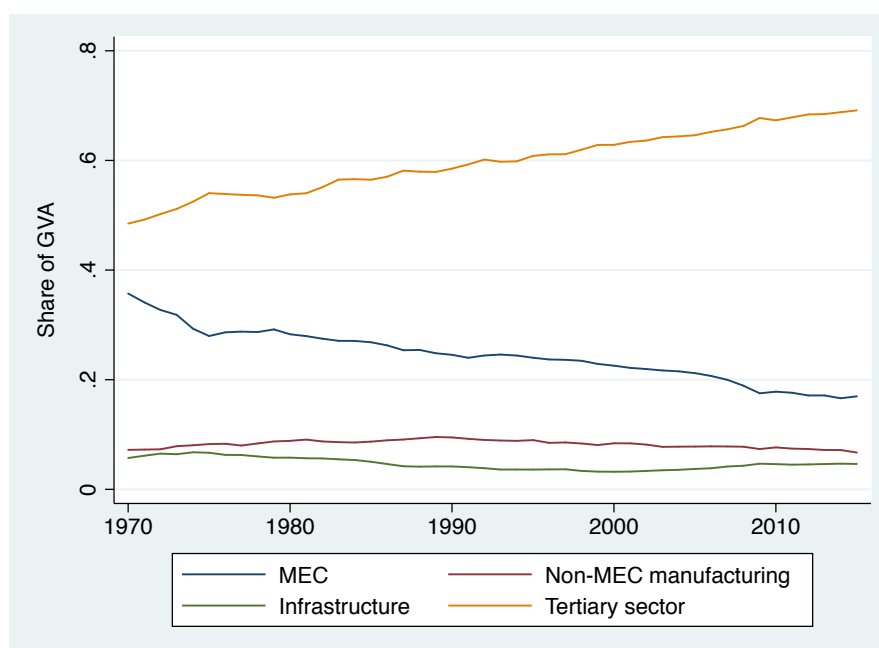
¹³⁵ Despite falls in certain mining subsectors it is worth noting that South Africa remains “rich in mineral reserves and the richest nation in the world by ‘commodity wealth’ according to Citigroup, which estimates its mineral reserve are worth \$2.5 trillion” (Ashman et al. 2011a, pp. 179–180)

Figure 9.19 Average annual growth rate of gross value added and change in fixed capital stock by subsector (1994-2015)



Source: Quantec (2016), own calculations

Figure 9.20 Share of GVA between MEC, non-MEC manufacturing and the tertiary sector (1970-2015)



Source: Quantec (2016), own calculations

Both this MEC bias and the heavy weighting towards the tertiary sector have adverse developmental consequences. Newman et al. (2010) show via an input-output analysis that it is manufacturing subsectors, especially non-MEC subsectors, that have a combination of strong backward linkages and high employment multipliers necessary for job-generating economic growth. But investment has maintained a capital-intensive bias with liberalisation combined with limited supply-side industrial policy supporting capital-intensive industries able to achieve economies of scale (Roberts 2000b, pp. 115–117). In addition, in many instances it is those MEC subsectors, in particular capital goods and engineering, “which have historically been critically important in the structural diversification of industrialising economies” that “have been very hard hit by trade liberalisation” (Carmody 2002, p. 269). AAC, for instance, “shifted the high value-added and higher technology parts of the business to Europe leaving South Africa with low value-added production and exports and more reliant on importing higher value-added manufactured products that had been produced in the country”. Already between 1994 and 1999, employment in the metal and engineering industry declined by 9.2% (Carmody 2002, p. 269). Further, the expansion in service sectors can itself have adverse consequences. These sectors are often characterised by high levels of casualisation and low pay (see Chapter 10); their growth also highlights broader societal dysfunctions with domestic work and security guards, large service subsectors, reflecting crime and

inequality. In addition, growth in retail can be dependent on unsustainable consumer debt (also discussed in Chapter 10).

The post-apartheid economy, therefore, experienced a deepening of “sectoral disarticulation, or structural dualism, as the conglomerates continue to invest in some major mineral processing projects, but divest from other sub-sectors, and the information economy is confined to the elite” (Carmody 2002, p. 271); to the latter should be added the financial economy. Such skewed investment continued to be state supported most notably in the early years after apartheid, in particular by the IDC (a leading proponent of liberalisation), which supported large capital-intensive investments. By 2014 the IDC’s Africa exposure was R7.5bn covering 60 projects in 20 countries (IDC 2014), offering both financing and sharing risk by taking direct stakes in some projects. Of their local and regional funding approved in 2015 34% is for infrastructure and services – the three largest shares being energy and water, financial intermediation, and transport – and 21% for mining. 45% of funding goes towards manufacturing with the majority in metals, machinery, equipment, iron and steel, chemicals, and other mineral-related production. The IDC has diversified somewhat with a focus on manufacturing and SMEs but maintains an MEC bias (see Section 9.2.2 above). The trends noted in this early period have deepened further.

9.4.2 Concentration and monopolisation

Despite changes in the structure of ownership inherent in corporate restructuring, high levels of concentration within economic sectors remains (Competition Commission 2009). In 1977 the Mouton Commission found that in 37 sectors three or fewer producers shared more than 75% of the sector’s market. An analysis of more than 100 sectors in 2003 found that: “the degree of concentration discovered by Mouton has increased. It is now hard to find sectors where there are not three or fewer dominant players.” (McGregor 2004, p. 67). Such concentration has persisted with most sectors still dominated by one or two firms that are often highly vertically integrated (Competition Commission 2009, p. 37, Ashman, Mohamed, et al. 2013, p. 2). Barriers to entry are compounded by institutional linkages, such as informal market-sharing agreements, which have evolved over time.

Such concentration means that “it is difficult for new firms to enter and grow except through acquisition of one of the existing dominant players, although there have been some exceptions to this, notably in rapidly growing services such as mobile telecommunications, media, information technology and healthcare” (Ponte et al. 2007, p. 947). Monopolistic power combined with liberalisation has had negative developmental consequences, with liberalisation failing to allow, as it is argued it would, for specialisation, easy of entry, and greater competition. The investment strategies of these dominant corporates are important, not only in their own right but also because they structure systems of financing, linkage and demand effects, and technological spillovers thus affecting the success of small businesses and the potential for sustainable job creation.

The monopolistic (capital-intensive) nature of upstream industries in the polymer industry for instance, resulted in rents and weakened the competitiveness of more labour-intensive downstream industries including their export-competitiveness (Roberts 2001). In many sectors, profitability depends upon high prices and not productivity increase (Ashman, Fine, et al. 2013, p. 14). Manufacturing, and economic performance has, therefore, not necessarily improved as a result of the restructurings described above, while there remain strong continuities with the historic South African growth path illustrated by sectoral biases, monopolistic industries, and capital-intensity.

9.5 Conclusion: South Africa’s path of accumulation – a financialised MEC

Three central and intertwined themes have detained us throughout this chapter. First, the reengineering of ownership structures within the economy including conglomerate unbundling and rebundling, internationalisation, SOE corporatisation and commercialisation, and BEE. Second, the enmeshing of these restructured NFCs within financial markets particularly with regard to short-term funding and investment and shareholder value maximisation pressures, with subsequent deleterious consequences for levels of real investment. And third, the on-going centrality of MEC-sectors to the economy together with the precipitous growth in finance, communications, retail and other service sectors. These three themes are closely intertwined – it is after all *restructured* NFCs which are analysed in the later sections – and also reflect one another, for instance the composition of cross-border M&As speaks to the sectoral composition

of the domestic economy. Further, these themes intertwine with previous chapters, for instance the importance of institutional investors in new ownership patterns.

Two crosscutting concerns need to be picked up on: financialisation and the MEC. Regarding the latter, it is unsurprising that the apartheid conglomerates stood at the centre of transformations in the domestic economy. It was them, and their propulsion towards restructuring, which drove liberalisation and internationalisation. Throughout, there has been a two-way relationship between the local and international – the conglomerates sought to internationalise and then international capital markets strongly influenced their restructuring. Similarly, globalisation was pushed (in large part) ‘from the inside out’ – and not from a dominant position in order to benefit from profit repatriation but rather as a means of offshoring – while also opening the door for international pressures to significantly shape the local economy. This has meant a reliance on international (financial) markets: “rather than enforcing redistribution and resource mobilisation internally, ‘industrialisation by invitation’ – drawing capital from overseas – became an attractive strategy for the South African state” (Carmody 2002, p. 260). Important, as stressed in Chapter 7 regarding international financial integration, it is not simply internationalisation that matters but the terms upon which this occurs.

In post-apartheid South Africa, liberalisation increased the structural power of large South African capital – who could threaten to invest elsewhere if the policy environment in South Africa was not conducive to their operations (Roberts 2000b, p. 17) (they did so irrespective) – while integrating large South African capital within networks of increasingly-financialised international capital. Similarly, this structural power was important to the unfolding path of BEE and the corporatisation and commercialisation of SOEs, embedding both of these in financial markets. The increased financial engagement of NFCs and their altered operations and priorities makes sense within this framework.

A narrow compositional analysis of the economy – with the large rise in service subsectors and the dismantling of the conglomerates – may lead one to consider the MEC no longer a viable means through which to understand the transformations above. This would be misjudged on a variety of levels. The traditional linkages within the economy persist – and have even expanded regionally – and these continue to stunt

non-MEC manufacturing. While growth in service sectors is observed internationally, the particular, and severe, skewing away from labour-intensive manufacturing in South Africa must be viewed in the context of the MEC. Further, the oligopolistic nature of these service sectors reflects another defining feature of the MEC. The fact that mining subsectors and certain mining-related manufacturing subsectors have fallen on difficult times only makes the endurance of the MEC more debilitating to domestic development. The role of finance within the MEC has also changed – from being internalised within the MEC to being externalised but still biased in similar ways.

Therefore, the underlying configuration of class relations captured by the notion of the MEC persists. This is not to say it has not changed, indeed it has, just as it did with the incorporation of Afrikaner capital as discussed in Chapter 5. But the heart of those changes – financialisation and internationalisation – has served to reinforce the position of large domestic capital while integrating these internationally. This has brought to the fore the contradiction between the stated equity-enhancing objectives of the ANC post-apartheid regime (and certain progressive laws and policy agendas such as labour protection) and an economic structure that is not conducive to job creation and does not prize domestic developmentalism. In fact, with the onset of financialisation these have only been accentuated. What this means for ordinary South Africans is the final subject to which we now turn.

10 FINANCIALISATION, HOUSEHOLDS AND LABOUR

10.1 Introduction

The final empirical inquiry of this thesis pertains to the manner in which households and individuals have been drawn into financial markets, building on our discussion of this in Chapters 3 and 4. Here we explore this across three dimensions. First, households have globally become deeply directly enmeshed in financial markets, the 2007/8 global financial crisis being but one instructive example. In many instances this results from the liberalisation and deregulation of the financial sector as well as shifts in the operation of banks. We interrogate, in Section 10.2, the extent, nature, and unevenness of household engagement in financial markets in South Africa and their alteration over time.

Second, we noted the manner in which social provisioning has become financialised: that the financial sector has managed to exercise influence over policy in its own interest, that equity and access have been retarded by a financialised approach, and that this relates to, and has further deepened, patterns of financialisation throughout the economy. In Section 10.3, we analyse the financialisation of social services via the case study of low-cost housing. Third, financialisation has had significant consequences for the structure of society, the nature of work, and the distribution of wealth and income. We explore these in Section 10.4, with particular cognisance of South Africa's extremely high levels of poverty and inequality and the interaction between this and the financialised structure of the economy discussed in previous chapters.

10.2 Household financial integration

An analysis of South African household integration into financial markets must be viewed against a history of 'credit apartheid' or the 'dual economy of credit' whereby the black majority's engagement with the formal financial system was limited and structured by racial oppression. In the main, access to credit was usually confined to the acquisition of furniture and appliances from retailers via hire-purchase (James 2014), one reason for this being the lack of property collateral. Financial asset accumulation was also extremely limited due in large part to low wages and jobs without retirement benefits, with low formal savings.

This picture changes markedly, with some shifts in the 1980s and widespread changes in the post-apartheid period. We explore this in four subsections. The first (Section 10.2.1) uses flow-of-funds and other time-series data to explore aggregate household financial behaviour and the role of this within the economy. The second (Section 10.2.2) unpacks the economic consequences of these aggregate trends while the third (Section 10.2.3) investigates the differential integration (or exclusion) of different social classes. Lastly, the fourth (Section 10.2.4) unpicks the structuring of the (mostly unequal) relationships between households and various providers of financial services.

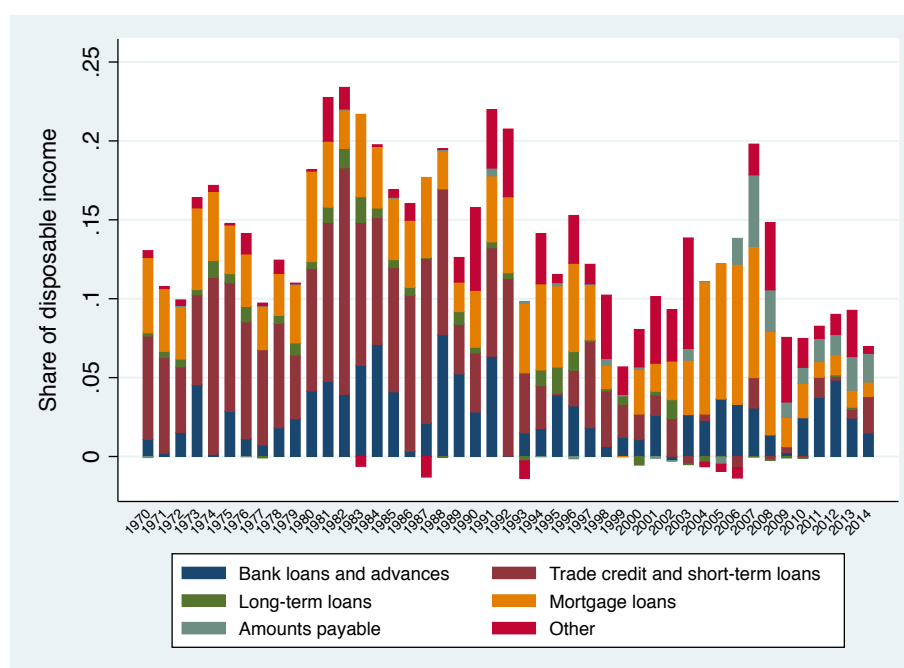
10.2.1 Households financial assets and liabilities: aggregate engagement

Figure 10.1 and Figure 10.2 show the acquisition of financial liabilities and assets as a share of disposable household income¹³⁶ for the household sector.¹³⁷ As with the private corporate sector the acquisition of financial assets and liabilities is not higher in the post-apartheid period; in fact, in this case, it is lower than all other periods and the 1980s are clearly a period of increased financial integration for households. The composition of liability acquisition also remains similar until the 2000s when loans diminish and mortgages rise as a share of total acquisitions – from 25% in the 1980s to an average of 35% between 2000 to 2014 – as do (short-term) amounts payable and ‘other’ financial liabilities (‘other’ usually reflecting recent financial-market innovations).

¹³⁶ We analyse these data as a share of disposable income because we are interested in the changes viewed from the perspective of the household. This said, analysis as a share of GDP yields almost identical trends.

¹³⁷ This includes unincorporated businesses and the non-profit sector serving households.

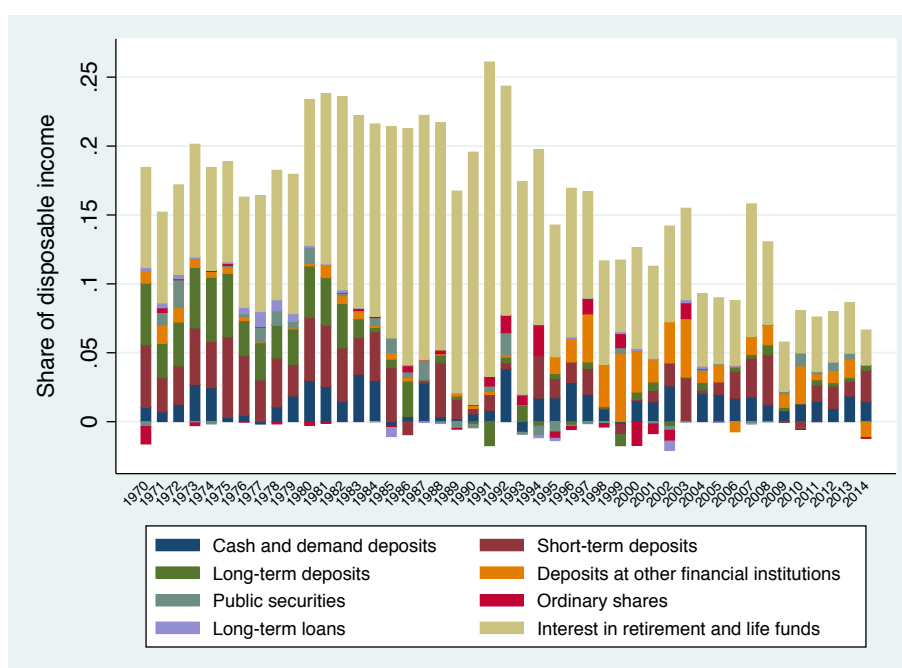
Figure 10.1 Acquisition of financial liabilities by households by type (1970-2014)



Source: SARB (2015d, 2015b), own calculations

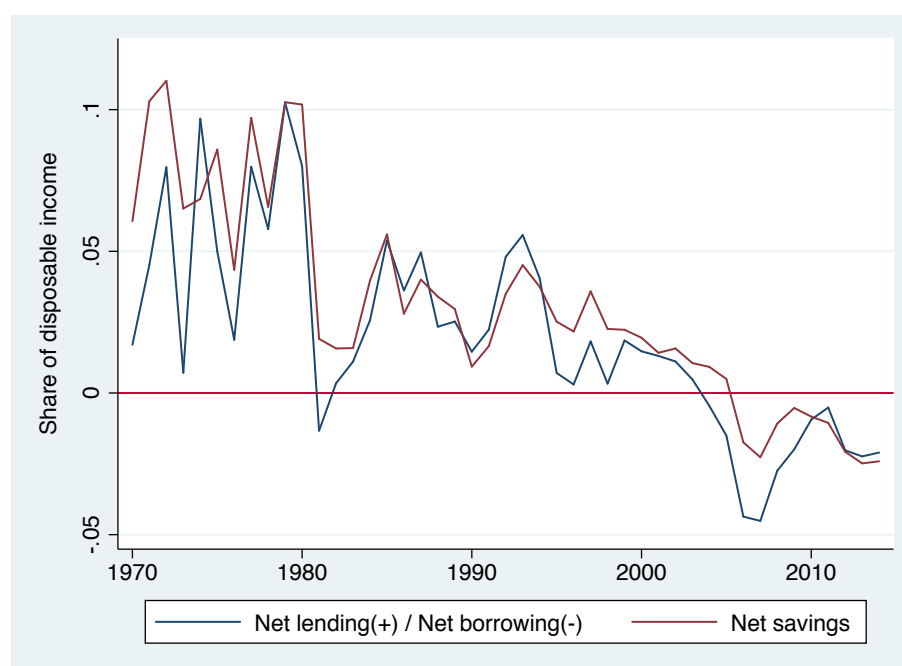
In the case of financial asset acquisition (Figure 10.2), the composition begins to change markedly in the 1980s when a decline in all forms of asset accumulation, barring interest in retirement and life funds, is witnessed; by the mid-1980s, long-term deposits have almost disappeared. This highlights the important growth of institutional investors (discussed in Chapter 8) and speaks to the growing incorporation of households into financial markets in the 1980s. This integration is furthered from the mid-1990s as ‘deposits with other financial institutions’ – mainly for investment in shares, bonds and/or money-market instruments predominately through unit trust companies – and direct acquisition of shares rise. The trend of market engagement reflected through pensions and insurance in the 1980s is therefore deepened and diversified in the post-apartheid period. Important also is that Figure 10.3 shows that household net savings and net borrowing/lending (as a share of disposable income) becomes negative in 2000s, indicating households become net debtors.

Figure 10.2 Acquisition of financial assets by households by type (1970-2014)



Source: SARB (2015d, 2015b), own calculations

Figure 10.3 Net financial position of household sector (1970-2014)

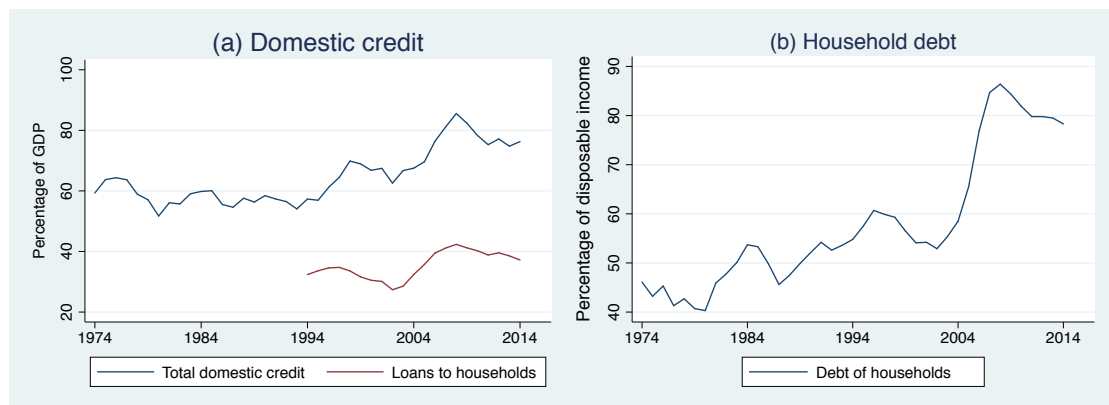


Source: SARB (2015d, 2015b), own calculations

The lower level of financial asset and liability acquisition over the last two decades obscures the gross build up of debt and assets. On the liability side Figure 10.4 and Figure 10.5 show the enormous build up of debt in the economy. Figure 10.4a shows that loans to households – which have increased from 32% of GDP in 1994 to a high of 42% in 2008 – have played an important role in driving this (discussed in Chapter 8).

Household debt as a share of disposable income has burgeoned, whereas it averaged 44% in the 1970s and 50% between 1980 and 1994, it climbed to an average of 58% in the early democratic period (1995-1999) and reached an average of 71% from 2000 onwards, peaking at a staggering 86% in 2008. According to the World Bank (2016e), 86% of South Africans were engaged in some form of borrowing in 2013/2014, the highest proportion in the world.

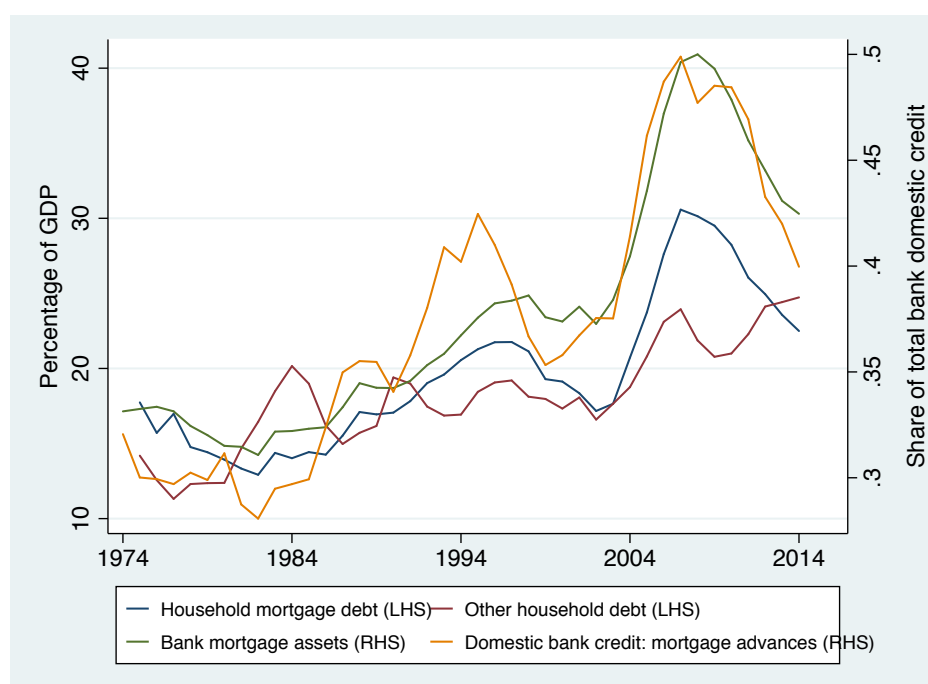
Figure 10.4 Debt of and credit to household sector (1974-2014)



Source: SARB (2015b), own calculations

The majority of debt accumulated is for mortgages, which averaged, according to SARB data (2015b), 53% of overall household liabilities between 1994 and 2014, compared with 47% in the 1980s. The crucial role of mortgages in the credit market is shown in Figure 10.5; household mortgage debt rises from 18% of GDP in 1975 to a high of 31% in 2007. Mortgage debt begins to decline from 2007/8 with restrictions imposed by the NCA, over-indebtedness, and the nature of global integration (see below) helping to explain this. Notable is that, as mortgages fall, other forms of debt rise from 17% of GDP in 1994 to 25% in 2014.

Figure 10.5 Mortgage and other debt (1975-2014)



Source: SARB (2015a) via Quantec, own calculations

Note: Not all mortgages in the latter two series are necessarily residential although the majority are

National Credit Regulator (NCR) data (NCR 2016a) in Table 10.1– breaking down gross outstanding debt by type – confirms the predominance of mortgages, albeit with slightly different percentages. Notable, is that as mortgages fall (from 64% in 2008 to 53% in 2015) unsecured lending rising (from 4% to 10%). Mortgages also count for a very small number of loans (4-5%) indicating their large size, with credit facilities (credit cards, store cards, and bank overdrafts) accounting for the majority of outstanding loans (62-64%) while the number of secured-credit loans falls over time (from 16% in 2008 to 10% in 2016) and short-term loans double in both value and number. The rise in non-mortgage lending is reflective of the trebling of microcredit between 2000 and 2013 discussed in Chapter 8. It is also important to note that NCR data exclude informal (predominately microloan) lending with comprehensive data difficult to come by.

Table 10.1 Gross debtor book by credit types (2008, 2012, 2015, yearly averages)

Rand value (millions)			
	2008	2012	2015
Mortgage	64	59	53
Secured credit	20	20	22
Credit facility	12	11	13
Unsecured	4	10	10
Short-term	0	0	0
Developmental		1	2

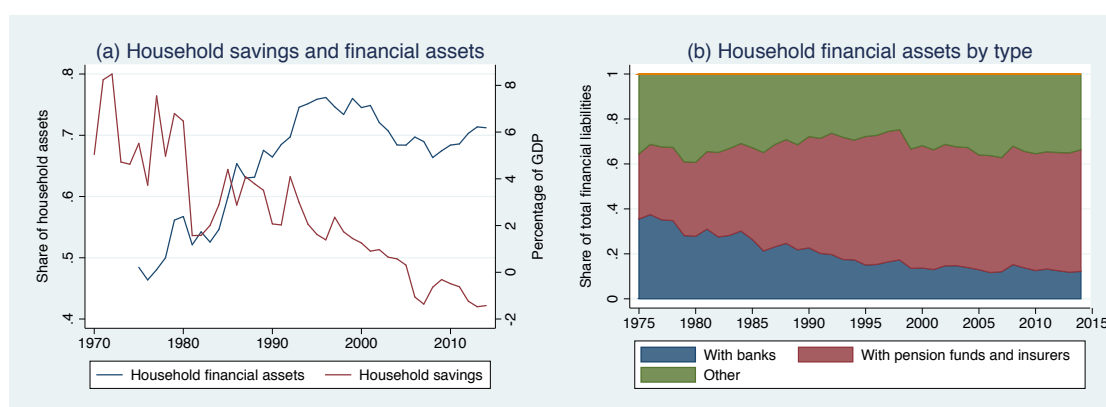
Number of loans (millions)			
	2008	2012	2016
Mortgage	5	5	4
Secured credit	16	12	10
Credit facility	64	62	63
Unsecured	14	20	16
Short-term	1	1	3
Developmental		3	3

Source: (NCR 2014, SARB 2014) (NCR 2016a)

The patterns of debt accumulation also speak to global financial integration with debt extension closely related to portfolio and banking inflows into the banking sector, which are then lent onwards to households; this is highlighted in the case of mortgages in Section 10.3 below. The fall in debt in the wake of the 2007/2008 global financial crisis is again reflective of global integration, both regarding a fall in inflows but also due to a negative impact on South African household incomes (mainly through trade-related job losses) and credit worthiness.

Turning to household financial assets we see, in Figure 10.6a, that they rise as a share of total household assets, from under half in 1975 to over 70% in 2014. Figure 10.6b shows the composition of these assets and this confirms what we noted in the flow-of-funds data above: investments in financial products become considerably more important with bank assets considerably less important. Bringing assets and liabilities together in Figure 10.6a we see that savings plummet (debt rises) in line with the rise of financial assets (as a share of total assets), indicating the potential that in some instances debt may finance financial asset acquisition. The reverse is certainly true, that rising asset prices (particularly houses) are leveraged to support greater borrowing.

Figure 10.6 Stock of household financial assets and savings (1974-2014)



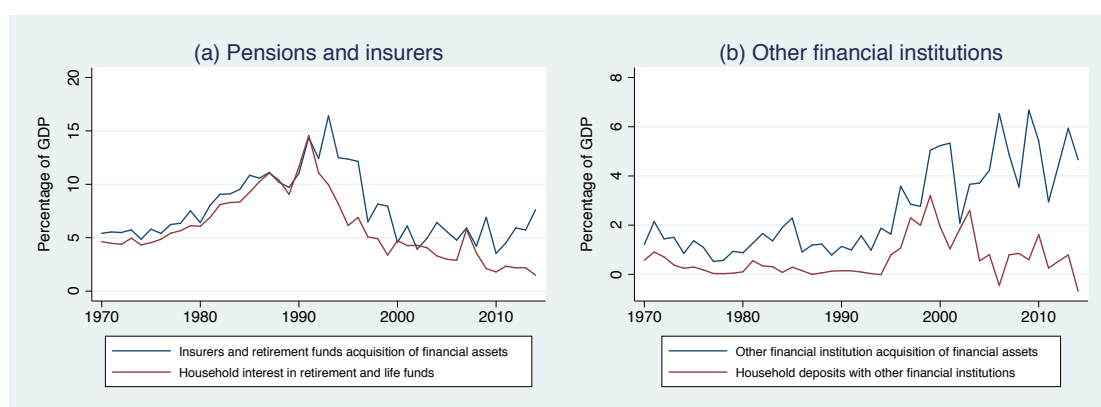
Source: SARB (2015b), own calculations

10.2.2 The aggregate consequences for the economy

This penetration of finance with respect to households has a number of important economic consequences. Pensions, and later other market investments, have fuelled the dramatic rise of institutional investors from the 1980s onwards, with these institutions gaining enormous market influence and exerting significant shareholder pressure (Chapters 8 and 9). Households have naturally played a crucial role in that growth. Figure 10.7 shows the correspondence between household investment in pensions and insurers Figure 10.7a and other financial institutions (mainly unit trusts) (Figure 10.7b) and these institutions' acquisition of financial assets. The acquisition of pension and insurance assets, as a share of GDP, rose noticeably in the 1980s and early 1990s (Figure 10.7a), indicating, as pointed out in Chapter 8, early dimensions of financialisation. The subsequent fall (in relative terms) indicates a shift in the composition of household assets, with investments with 'other financial institutions' rising in the late 1990s and early 2000s (Figure 10.7b). Acquisition of such assets slowed as household balance sheets weakened and debt rose, both before and after the global financial crisis.¹³⁸ The increased stock of financial assets held by households (albeit highly unevenly), has increasingly exposed them to financial market risks and opportunities.

¹³⁸ The divergence shown, in particular in Figure 10.7b, is due mainly to the private corporate sector's more recent investment in these institutions (as noted in Chapter 9), as well as pension and insurers (and to some extent banks and the PIC) investing in unit trusts.

Figure 10.7 Household contributions to institutional investors (1990-2014)

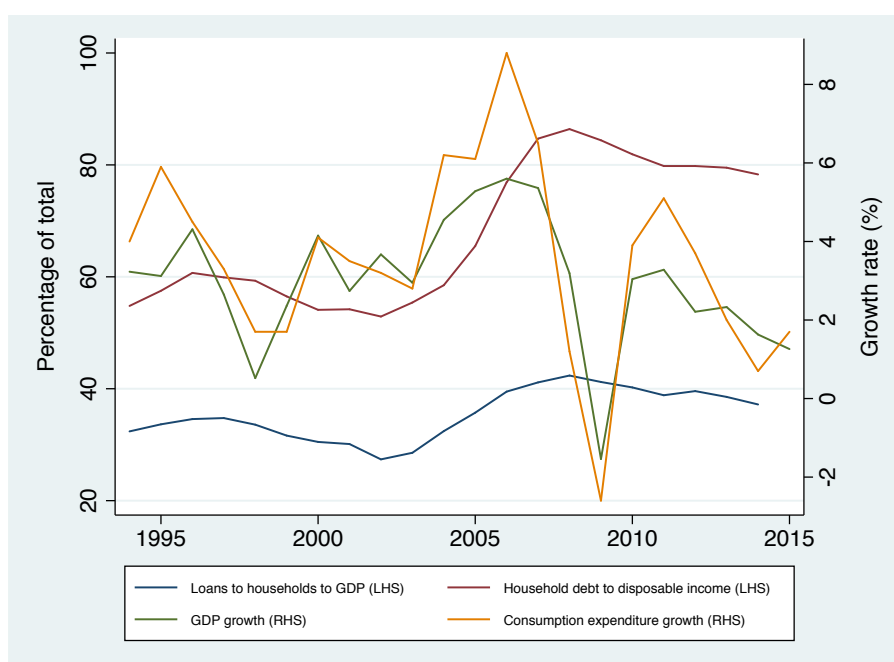


Source: SARB (2015d, 2015b), own calculations

Household debt has also played an important economic role. Figure 10.8 shows that household debt rises in tandem with consumption. This in turn is highly correlated with GDP growth highlighting the role of consumption, and the importance of debt therein, particularly in the mid-2000s boom.¹³⁹ Such consumption-led growth under present income levels, and the ability of debt to maintain this, has proved unsustainable, and, as noted in Chapter 3, consumption debt benefits the economy less than borrowing for investment. Further, the negative net savings behaviour of households has reduced the savings-pool available to fund investment (although given large uninvested surpluses held by NFCs and shareholder distributions this cannot solely explain low levels of investment). High levels of debt may also stunt growth as debt-service costs rise. This is shown in Figure 10.9, where debt-service costs move exactly opposite to consumption and GDP growth rates, rising precipitously (2004 to 2008) just before consumption spending and GDP growth rates plummet (2006-2009).

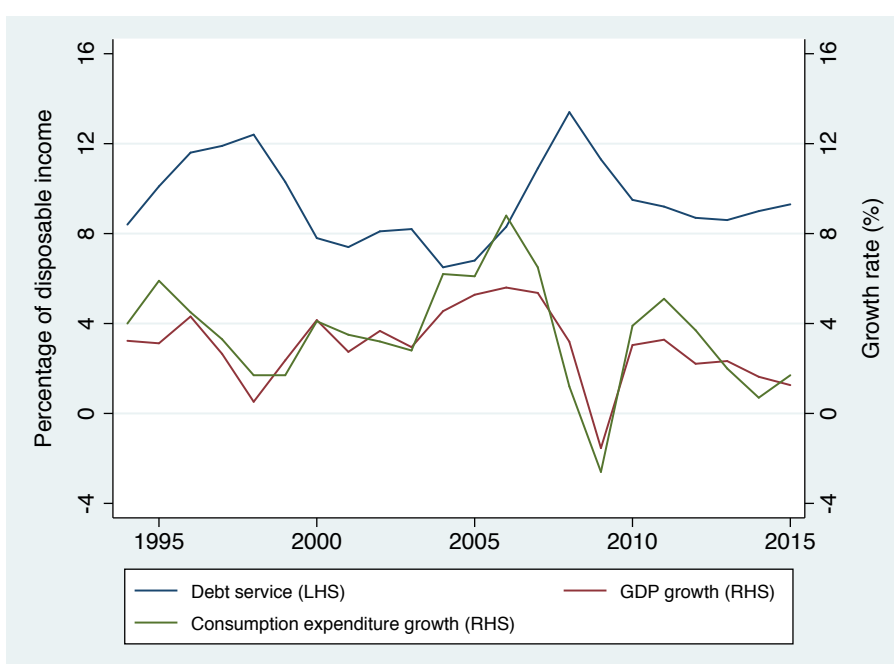
¹³⁹ In this period, consumption would also have been boosted by rising real wages (and presumably drawing down on savings) while investment expenditure also rose and would have boosted growth.

Figure 10.8 Household debt and consumption and GDP growth (1994-2015)



Source: SARB (2015b), own calculations

Figure 10.9 Debt-service, consumption and GDP growth (1994-2015)



Source: SARB (2015b) via Quantec, own calculations

The growth of microlending to households had a number of other economically destructive consequences. The premise of microcredit is that it will encourage ‘bottom-up’ enterprise development, thus creating jobs in the poorest communities, and that some microenterprises would grow into SMEs (Bateman 2015, p. 11). This has not proven to be the case in South Africa (nor in most other locales) (the following from

James 2012, 2014, Bateman 2014, 2015). First, microcredit has predominately been lent for consumption not productive investment thus ‘crowding out’ lending to potentially sustainable (particularly manufacturing) SMEs which are vital for industrialisation and growth.

Second, where microcredit has been used in enterprise development it has been so prolific that the high levels of competition resulting have driven down wages and profits in the informal sector with neutral or negative net job creation. This has also led to social tensions, for instance between local and foreign township shop owners, and to business failures with demand in working-class communities unreliable due to highly-precarious incomes (James 2014). In fact, often it is informal lending which is seen as the most viable economic opportunity. Third, the scope for microenterprises is restrained by other structural economic factors rather than a lack of microcredit. This indicates a logical fallacy that supply creates its own demand, in that the supply of credit will not necessarily result in the demand for goods, the latter restrained by structural factors such as high levels of unemployment and working poverty. Fourth, there is little evidence to suggest microenterprises will eventually lead to the growth of the far more productive SME sector. Finally, the ownership patterns of large formal MFIs has led to an extraction of wealth from poor communities distributed to wealthy (often white) managers and shareholders. All in all, Bateman (2014, p. 5) argues that the evidence “unequivocally shows the microcredit model to have been one of the most calamitous policy and program interventions in the post-apartheid era” leading to a locale-specific subprime-like crisis.

This crisis is reflected in extremely high levels of over-indebtedness, a problem that has both demand-side (demand for credit) and supply-side (often unscrupulous pushing of credit) factors which are compounded by ‘financial illiteracy’ and uneven power relations (see Section 10.2.4). As indicated in Table 10.2, of the 22 million active credit users in 2015 a staggering 43% or 10 million were in default, extremely high by international standards; this is down from 48% in 2013 and up from 37% in 2007. There are less impaired records (as a share of all accounts) indicating a larger number of accounts held by those in good standing. While South Africa has not had a spectacular credit bubble burst like in the United States, over-indebtedness is a slow-boil crisis, particularly amongst those with low or moderate incomes.

Table 10.2 Credit standing of consumers (millions, yearly averages, 2007-2015)

	2007	2010	2013	2015
Good standing	10.6	9.8	10.6	13.2
Impaired records	6.3	8.5	9.7	10.2
Credit-active consumers	16.9	18.3	20.3	23.4
Impaired records as a percentage of credit-active consumers	37%	46%	48%	43%

Source: NCR (2016b)

10.2.3 Exploring the terms of financial engagement by income group

The analysis above has taken households as an aggregate but this obscures important distinctions between social classes. Figure 10.10, using data from the FinScope consumer survey (FinMark Trust 2016), shows the extent to which different income groups¹⁴⁰ are ‘financially included’.¹⁴¹ We see that the lower income groups, unsurprisingly, make less use of banking services, more use of informal financial products, and are more likely to be ‘financially excluded’; whereas in 2006 only 38% of those in the low-income group had bank access, this was 95% and 100% for the middle- and high-income groups, respectively. The extent to which those in the low-income group have bank access almost doubled (from 38% to 72%) between 2006 and 2016. Some of this has to do with the expansion of banking – and advances due to digitisation in particular – but a large degree is due to the payment of social grants with debit cards and their inclusion in the definition of ‘bank access’.

¹⁴⁰ Finscope’s three income groups overlap with the SARS tax brackets. In 2006 low income was R0 – R2,999, middle income R3,000 – R19,499, and high income R19,500+. In 2016 the three categories were R0 – R5,999, R6,000 – R39,000, R30,000+, respectively (FinMark Trust 2016). The percentage of the adult (over 16) population falling in the three groups, in 2016, was 81%, 16%, and 3%, respectively.

¹⁴¹ ‘Financial inclusion’ in the FinScope survey refers to those with access to transactional and/or saving accounts, and/or credit, and/or insurance products (FinMark Trust 2016).

Figure 10.10 Financial access by income group (2006 and 2016)



Source: FinMark Trust (2016)

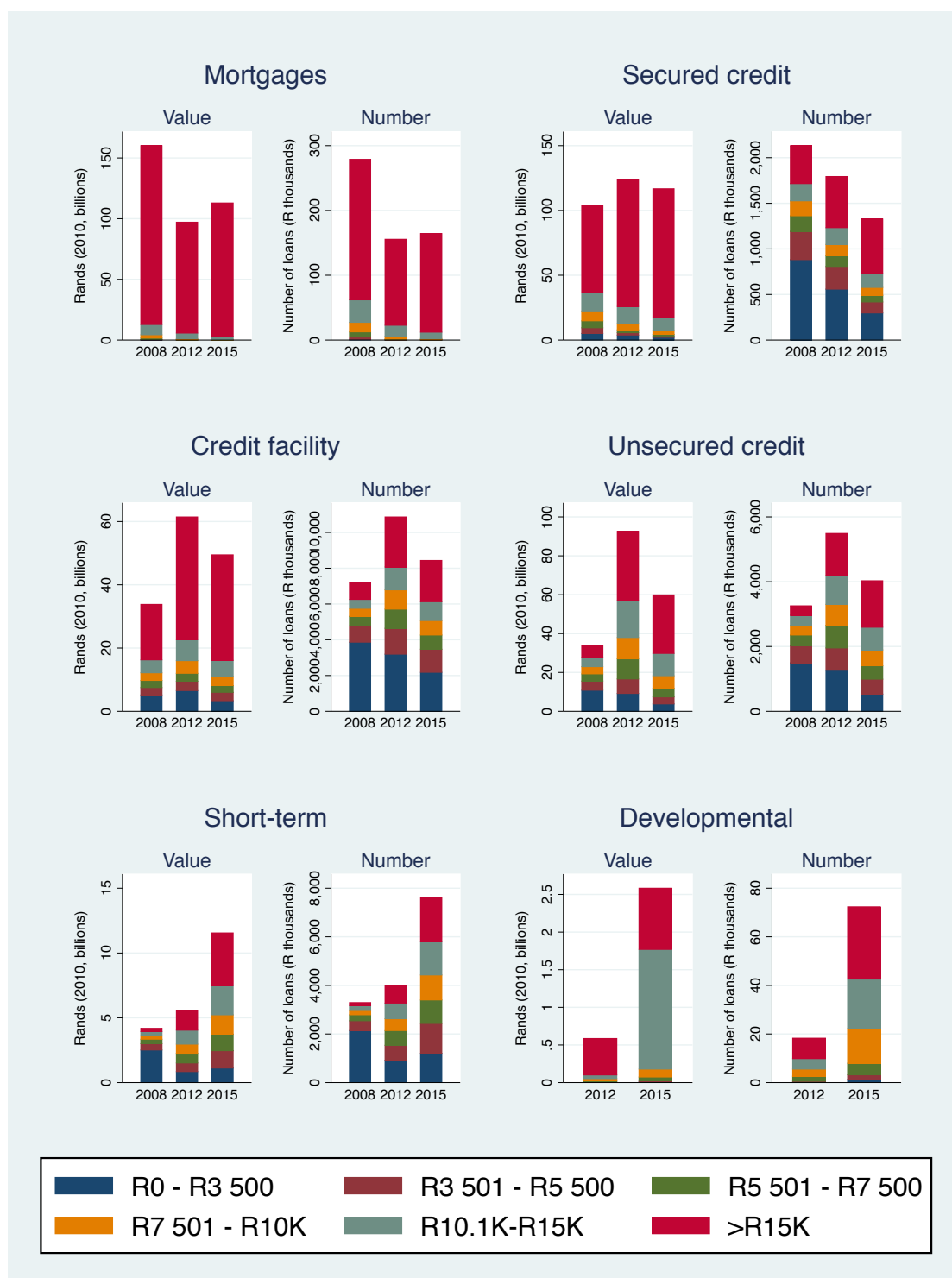
The type of credit granted by income group also varies markedly; a number of trends are revealed in Figure 10.11. First, higher-income groups access the majority of credit in the economy. This is most stark in the case of mortgages in which those earning above R15,000 account for almost all of loan value. This is less the case regarding credit facilities (credit cards, store cards, and bank overdrafts), unsecured credit, and short-term credit, indicating that lower-income earners tend to have shorter-term unsecured borrowing. Second, the weighting towards higher-income groups is less pronounced when it comes to the number, rather than the value, of loans (although only marginally so for mortgages and not in the case of ‘developmental credit’¹⁴²). This indicates that, unsurprisingly, lower-income groups receive smaller loans but more of them, reflecting Table 10.1; the lowest three income groups received 9.6 million non-mortgage loans in 2015 compared to the highest income group’s 152 000 mortgage loans.

Third, the more rapid fall in the number of secured loans (mortgages and secured credit) compared with their value indicates the size of loans has grown over time. Most likely, the assets against which they are secured have risen in value supporting larger loans; this speaks to the relationship between asset inflation and debt. Fourth, the number of

¹⁴² ‘Developmental credit’ includes (in the main): educational loans; small business loans; or loans for the acquisition, rehabilitation, building or expansion of low-income housing.

mortgage and secured-credit loans granted in 2015 is lower than in 2008 but this is not the case for all other categories, indicating a shift in debt composition (see Table 10.1). The fall in mortgage value fits with the downward trend noted above, as does the spike in other debt in 2012 (see Figure 10.5).

Figure 10.11 Credit granted by type, year, and income bracket (2008, 2012, 2015)

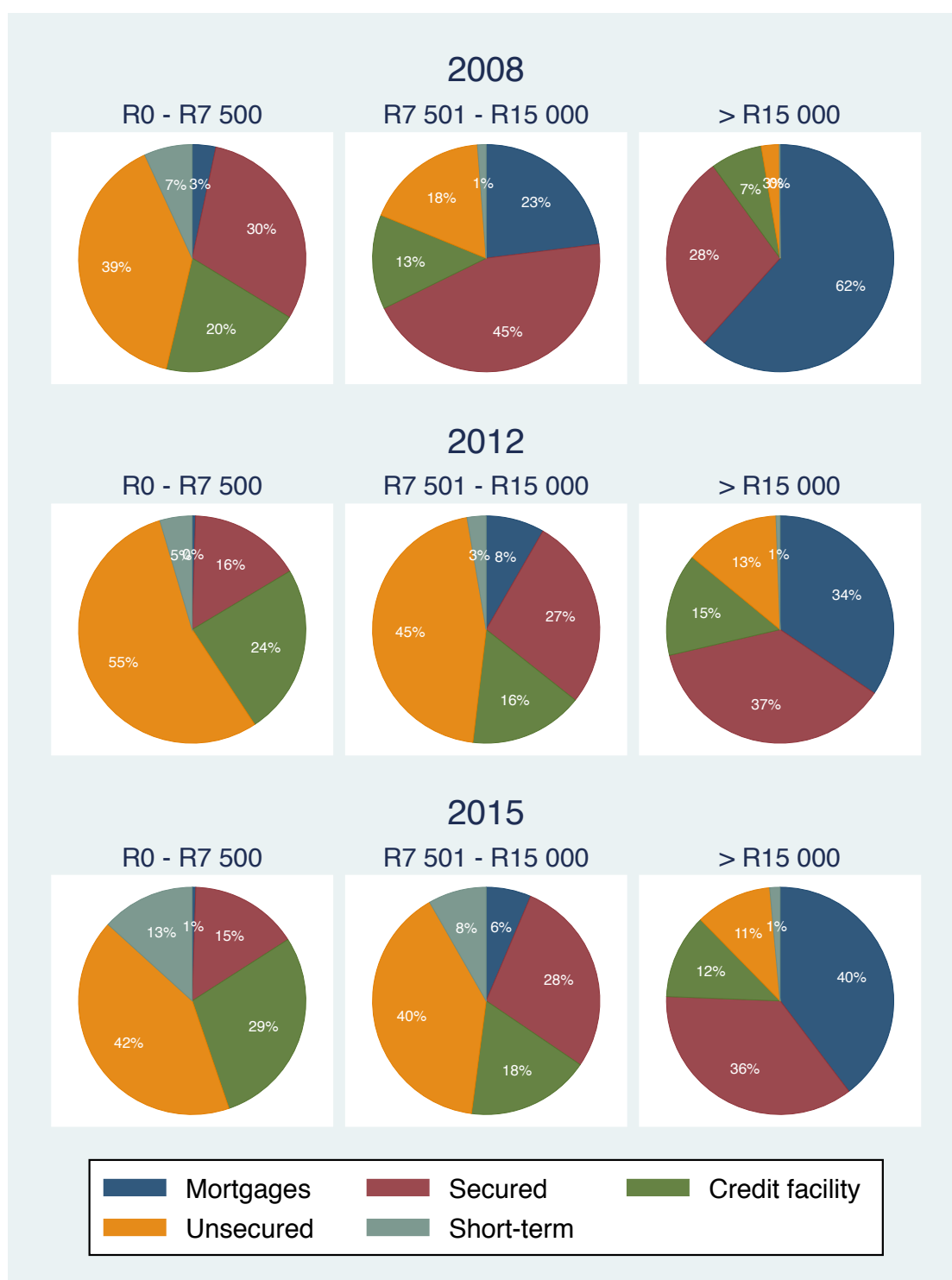


Source: NCR (2016a)

Figure 10.12 shows that the composition of debt held by different income groups also varies. Here we see that the largest slice of the lower-income group's credit is unsecured and that this has grown from 39% of their borrowing in 2008 to 55% in 2012 and then 42% in 2015. Credit facilities make up the second largest share in all three years, with short-term credit almost doubling between 2008 and 2015 (from 7% to 13%). For the middle-income group, secured credit granted has dropped dramatically from 45% in 2008 to 28% in 2015. In 2015 (as with the low-income group) unsecured lending was the highest (at 40%), secured second (at 28%), and credit facilities third (at 18%) (almost identical to 2012). Mortgages granted to this middle group is not insignificant (as it is for the low-income group) but dropped from 23% in 2008 to 6% in 2015. The high level of formal microloans is therefore clear for low- and middle-income groups, although it is important to appreciate that this data excludes informal lending. As expected, mortgages make up the largest share of credit granted to higher-income earners (except in 2012 when they are second) although, as already noted, mortgage credit has dropped dramatically from 2008 with secured credit rising in tandem. Granting of unsecured credit and credit facilities has risen but accounts for a dramatically smaller share (23% combined in 2015) than for lower- and middle-income earners, with short-term credit being negligible for higher earners.¹⁴³

¹⁴³ These trends do not change markedly when altering the low-income group to R0-R5,000 and the middle-income one to R5,001-R15,000. However, trends are distorted somewhat because the NCR income bands do not change over time in line with inflation.

Figure 10.12 Income groups' credit by type (2008, 2012, 2016)



Source: NCR (2016a)

The cost of credit differs per loan type and therefore income group; this is reflected in the NCR-imposed interest rate caps and fees. Most caps use the repo rate in their calculations, for instance mortgage loans are capped at repo plus 12% and unsecured microloans at repo plus 21%; a 2016 amendment to the NCR regulation has lowered the

caps. In addition to caps, a ‘service fee’ can be levied per loan – R50 prior to the 2016 amendment and R60 thereafter – as can ‘initiation fees’ when the loan is made; these vary by loan type. Based on the maximum interest rate caps and maximum fees, we have shown in Table 10.3 the calculated maximum potential charge per loan for loans of different types, amounts, and maturities. Table 10.3 shows that fees (potentially charged) can make small loans extremely expensive. Presuming the maximum fee and maximum interest rate is levied, a credit facility of R500 repayable over two months can amount to an effective rate of 15% per month or 178% per annum.¹⁴⁴ As the loan size rises the maximum effective rate per annum falls as fees have a smaller impact on the overall repayment sum. However, such loans are still very expensive, for example, an unsecured loan of R2,500 due over five months will cost the customer R3,100, equivalent to an effective annual rate of 59% whereas one for R25,000, over 36 months, incurs a total cost of R38,000 or an effective annual rate of 18%. It is clear therefore that the fee structure – if the maximum fees are levied and they may not be due to competitive market pressure – disadvantages lower-income earners taking out smaller loans. This excludes informal lending which are charged at up to 50% per month (James 2014). We return to this regarding housing loans in Section 10.3.

¹⁴⁴ The ‘effective rate’ shown here can be lower than the interest rate cap because the outstanding principle declines each year and this rate is shown as the interest charge (total cost less principle) over the full time period.

Table 10.3 Maximum costs of loans by type, size and maturity (2016)

Credit facility				
Loan size (R)	No of months	Repayment total (R)	Monthly rate (%)	Annual rate (%)
500	2	648	14.8	177.8
1,000	3	1,245	8.2	98.1
2,500	5	3,068	4.5	54.5
5,000	10	6,219	2.4	29.3
10,000	20	13,048	1.5	18.3

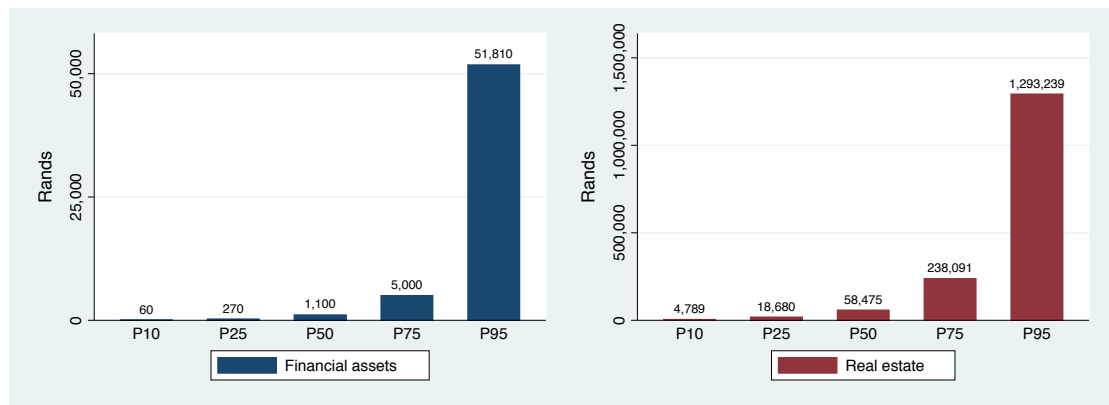
Unsecured				
Loan size (R)	No of months	Repayment total (R)	Monthly rate (%)	Annual rate (%)
500	2	653	15.3	183.1
1,000	3	1,257	8.6	102.8
2,500	5	3,113	4.9	58.8
5,000	10	6,389	2.8	33.3
10,000	20	13,738	1.9	22.4
25,000	36	38,337	1.5	17.8

Source: own calculation based on schedules in RSA (2015)

Note: assumes a repo rate of 7%

Different income groups also have very different engagement regarding financial assets with extreme levels of wealth inequality. Using data from the National Income Dynamics Survey (NIDS) (Daniels and Augustine 2016), Figure 10.13 shows that financial assets of those at the 95th percentile are R52,000, compared with a mere R60 and R270 at the 10th and 25th percentiles respectively. Striking is the very low levels of financial wealth held by even those at the median and 75th percentile, R1,100 and R5,000, respectively; real estate is also unequally distributed but slightly less so at the median and 75th percentile. This has resulted in wealth inequality being much higher (a Gini of 0.9) than income inequality (a Gini of 0.6) as seen in Table 10.4. Table 10.5 breaks this down showing a somewhat more disaggregated picture of the unequal distribution of financial wealth, with the top 10% holding 99-100% of all financial assets and the top 1% holding 96-97%. Orthofer (2016), however, argues that NIDS does a poor job at capturing wealth data particularly of pension and long-term insurance assets and financial assets and that this should be supplemented by tax data, not yet publicly accessible (Daniels and Augustine 2016 also acknowledge the under-sampling of the rich in NIDS).

Figure 10.13 Financial and real estate assets by income percentile (2014/2015)



Source: Daniels and Augustine (2016)

Table 10.4 Gini coefficients (NIDS data, 2014/2015)

Income	0.61
Property assets	0.88
Retirement assets	0.87
Financial assets	0.92
Net worth	0.90

Source: Daniels and Augustine (2016)

Table 10.5 Wealth inequality (NIDS data, 2010)

	Top 1%	Top 10%
Wealth	47	92
Total assets	50	92
Total liabilities	42	99
One-shot wealth	60	97
Pension and life assets	97	100
Non-pension financial assets	96	99
Real estate assets	32	71
Capital income	58	100

Source: Orthofer (2016)

The reason for financial market engagement by income groups is also very different. Regarding savings, low-income earners tend to save little (far less than higher earners) except via community-based saving mechanisms (such as *stokvels* in which members contribute monthly and receive pay-outs from the group according to a prearranged formula). Regarding borrowing, it is striking that low-income borrowers do so to service basic needs; in 2016 41% of FinScope's low-income group borrowed to buy food while none of the high-income group did so. However, borrowing for education transcends income group supporting James' (2012, 2014) argument that borrowing by the black

working and middle classes is not predominately for conspicuous consumption (as sometimes argued) but for life investments, including marriage, death, and higher education. Regarding financial products, except for funeral cover the level of insurance and pension plans held by lower-income individuals is dramatically lower than for middle- and high-income earners (NCR and FinMark Trust 2012, 2016).

Certain forms of financial engagement capture well the ‘financialisation of everyday life’ discussed in Chapter 3, with a particular context-specific flavour; for instance the use of debt to pay *lebola* (brides wealth, a common feature of black South African culture). Because *lebola* is already seen to establish relationships of long-term obligation between families, taking out debt to pay for *lebola* has historically been avoided. However, now it forms a common reason for young men – unable to afford *lebola* on their salaries – to become debtors (James 2012, pp. 22–23). Another example is that *stokvels*, community savings groups which have a long history in South Africa, have become financialised, for instance some *stokvels* have themselves become microlenders earning returns for their contributors (James 2012, p. 26).

High levels of borrowing, in the context of low incomes, therefore, explain the extremely high levels of over indebtedness amongst lower-income earners (Ntsalaze and Ikhide 2016). The profile of formal credit impairment confirms this, in 2014, around the height of credit default, only 6% of mortgage and 7% of vehicle loans were in arrears (as noted above predominately held by higher-income groups). By contrast, 40% of clothing accounts and 45% of loans at furniture stores (the majority held by low- and middle-income earners) were in default and the retail JD group reported in the same year that 50% of its book was 90 days or more in arrears (Melzer 2014). Similarly, Melzer (2014) estimates that in 2014 upwards of 50% of African Bank’s lower and middle income client base was defaulting (the subsequent collapse of the bank bears this out). Once again this excludes the informal sector in which both low- and middle-income households are heavily entangled (James 2012).

10.2.4 The relationship between borrowers and lenders

In addition to an uneven integration of different groups within financial markets, financial integration has also structured unequal relationships between borrowers and lenders. We noted in Chapter 3 a movement towards more ‘arms length’ relationships

between borrowers and lenders and the use of technology in assessing risk profiles and relating to clients. Regarding this, South Africa has seen contradictory trends. The big banks have exercised their market power in these manners – redlining borrowers considered too risky or unprofitable, and repossession and blacklisting in the case of default. At the same time, they continue to prioritise a more affluent client base with which banking relationships can be mutually beneficial, as is also the case between the rich and pensions, insurance, and investment providers. At the same time these big banks have made forays into microlending but mainly through funding other MFIs.

Retailers and other product-based credit providers have maintained closer relations with ‘the man on the street’. While the ‘portfolio’ of debt may have changed from hire-purchase agreements to overdrafts, store cards, and microloans many lenders are the same, particularly the large retailers. These providers have, however, used technology to exercise market power; in particular they have turned to emoluments attachments (commonly known as ‘garnishee orders’) to have funds deducted directly from borrowers accounts on payday, stripping them of agency; these have proliferated.¹⁴⁵ Relationships with, and power exercised by, microlenders have been even more ‘personal’; to ensure repayment, for instance, (formal) microlenders often confiscate the ATM cards of borrowers so they can ensure withdrawal of funds on payday (they have also started confiscating ID books needed to open alternative bank accounts).

Crucially, just as the sources and availability of credit has expanded so too has the possibility of ‘juggling’ it closed (James 2014). While it is common for debtors to take out new loans to repay old ones, a technologically sophisticated architecture for sharing debtor information has emerged making it easier for debtors to be tracked. Perversely such information, including information purchased from other technology-related sources such as cellphone providers, has made marketing financial products and/or consumer products that may rely on credit for purchase, much easier. The extremes of this have been exposed in the recent scandal regarding the debit cards used to withdraw government-provided social grants, administered by Cash Paymaster Services (CPS) a private company. Other companies in the Net1 network (which owns CPS) have been using the grant database to market their own products, including the loans necessary to pay for them (and the loans needed to repay the loans!). Payment for these have been

¹⁴⁵ The Constitutional Court, in 2016, imposed greater restrictions on the granting of these.

deducted from the recipient's social grant seconds after it arrives in their account; given the lack of branch network and opacity, it has proved incredibly difficult for grant recipients to challenge this (Torkelson 2017).

Relationships with informal lenders or '*mashonisas*' (neighbourhood money lenders) are complex. On the one hand they sometimes charge rates in excess of the NCA caps and also confiscate cards. On the other, these people are often deeply imbedded in the communities and offer loans that are more flexible and with lower interest rates than store cards. This speaks to the heterogeneous nature of this group with large lenders acting much like formal MFIs, while smaller lenders can charge as low as 15%, be "less stringent in the calculation of interest over time," and "have no formal system of collateral such as retaining customers' ATM cards" (James 2012, p. 25).

In general, the above reflects that the majority of the population engages with financial institutions and lenders on highly unequal terms, albeit in ways specific to South Africa. This illustrates that rather than an undoing of 'credit apartheid', systems of control and exclusion have evolved alongside unequal forms of inclusion. The majority are excluded from long-term credit and rely on more expensive shorter-term unsecured alternatives. They are also significantly over-indebted while new technology has streamlined the pursuit of defaulting borrowers. These uneven terms of integration mean that a small (still predominately white) South African banking elite profits handsomely out of the 'financial inclusion' of the black majority. We turn now to the case study of housing.

10.3 The financialisation of social provisioning: a case study of housing

We discussed in Chapter 4 the privatisation and financialisation of social provisioning drawing on examples from other DTECs. We also noted in Chapter 9 that this has been widespread in South Africa (mainly through PPPs). We focus here on one case study: urban housing, and low-cost housing in particular, exposing a multi-layered relationship between social provisioning, private sector involvement, and financialisation. We explore the role of the financial sector in shaping policy (Section 10.3.1), the consequences of the approach adopted for access (Section 10.3.2), and how this intersects with broader financialisation trends (Section 10.3.3) (see Isaacs (2016a) for a fuller evaluation of the housing 'system of provision').

10.3.1 The commodification and privatisation of housing policy

The commodification and privatisation of housing provision is central to its financialisation (see for example Rolnik 2013). Commodification transforms housing from an “occupation-related benefit to a private consumption item and household asset” (Wu 2015, p. 9). Access to housing is therefore dependent on access to (usually privately-provided) finance and (usually privately-provided) housing stock. Housing markets determine the availability, production, and geographical distribution of housing, as well as providing the fulcrum for housing as an investment asset subject to market appreciation and depreciation and the extraction of financial capital therefrom.

The pursuit of this approach in South Africa must be seen in light of policy contestation in the late-apartheid period and the prevailing housing crisis. In 1994, the ‘housing backlog’ was estimated at 1.5 million households, due to grow at 200 000 households per year, an estimated 2.6 million households lived in informal settlements (some formally housed); over half of the population was urbanised. This was a product of land confiscation, mass evictions, and urban segregation associated with colonial and apartheid dispossession. It resulted in cities characterised by urban sprawl with the white minority living in leafy suburbs and the black majority relegated to poorly-serviced low-density townships on the urban periphery; in the countryside whites owned the arable farmland while the majority of rural households resided in the overcrowded former ‘independent homelands’ (see Wilkinson 1998 for a history).

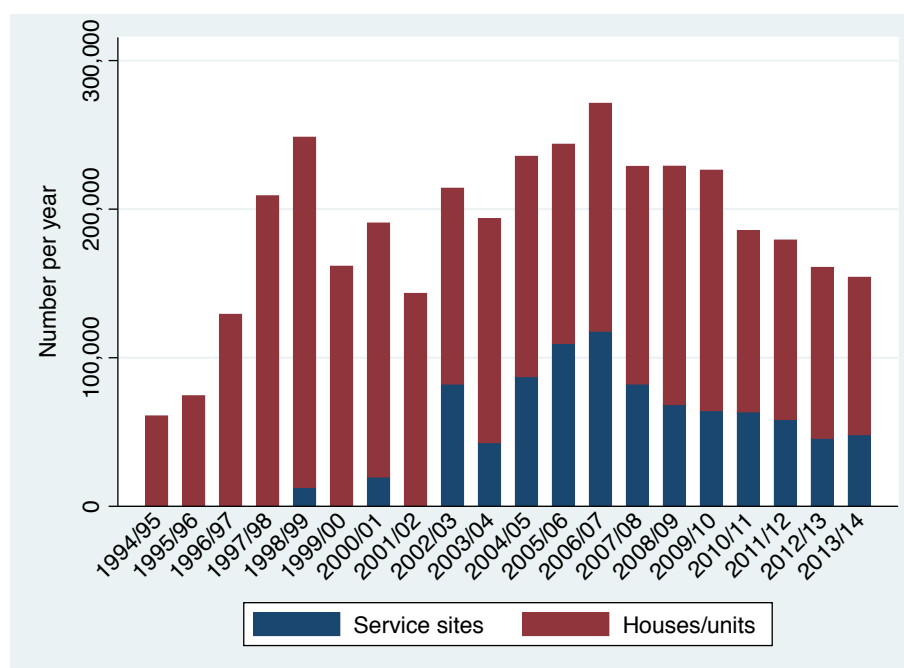
The late apartheid government’s response to mass urbanisation was the attempted creation of a ‘stable’ community of home-owning families in townships. They adopted the Urban Foundation’s (UF) – a pro-business think-tank – proposal for the mass provision of standardised serviced sites through a once-off capital subsidy upon which people could build their own homes; this was undertaken by the Independent Development Trust (IDT) and Joint Housing Board (Huchzermeyer 2001, Charlton and Kihato 2006). During the National Housing Forum (NHF), which ran between 1992 and 1994 as part of the negotiated settlement, the UF, IDT, and financial sector sought a continuation of the capital subsidies, on the premise of an individual freehold ‘site-and-service’ approach. The Mass Democratic Movement (MDM) – comprising the ANC, COSATU, and civic organisations – advanced a formal state-built rental accommodation model, along the lines of the European social democratic model, but

failed to place a concrete proposal on the table; the construction sector supported the MDM approach (Huchzermeyer 2001, Khan and Thurman 2001, Charlton and Kihato 2006, Pitthouse 2009).

In brief, the ‘compromise’ of the 1994 Housing Summit, canonised in the subsequent White Paper (Department of Housing 1994, Napier 2005), was the capital-subsidy approach supporting individual freehold ownership of free-standing serviced sites with very basic 25m² ‘starter houses’ (Gordon et al. 2011a) for those earning R3,500 and under (a threshold that has not been raised since the inception of the programme). Priority was given to breadth over depth, i.e. the ‘delivery’ of mass standardised houses without room for significant personalisation or community participation. Progressive realisation (as worded in the Constitution) was interpreted to mean the opportunity to improve the ‘starter house’ over time, in the main via private sector financing. The private sector would provide the housing, with Government’s role focusing on subsidy dispersals and establishing favourable market conditions (an ‘enabling environment’).

Estimates (in 2015) are that up to 4 million such ‘RDP houses’ have been delivered since the late 1990s, as shown in Figure 10.14; however by late 2015 the housing backlog had grown from 1.5 million to 2.1 million units, with the number of informal settlements up from 300 to 2 225 (Tomlinson 2015). Over time, policy has evolved in important ways (discussed extensively in Isaacs 2016a). However, despite these developments, in practice: the “fundamental policy and development principles introduced by the [1994] White Paper on Housing continue to guide all developments in respect of housing policy and implementation” (Tissington 2011, p. 21).

**Figure 10.14 Delivery of serviced sites and houses/units via government subsidies (1994-2014)
(estimates)**



Source: Department of Human Settlements (2014a, 2014b)

This commodified approach has individualised the relationship to housing, and fulfilled the UF's vision of using housing to "demobilize or stabilize the urban work force and to encourage consumerism" (Huchzermeyer 2003, p. 601). Importantly, in requiring the land to be bought – with government recoiling from land expropriation even from its own SOEs – it has entrenched the dominance of land markets and existing spatial patterns (Kihato and Berrisford 2006, see Napier and Ntombela 2006). This occurred in tandem with the express shift towards viewing housing as an economic and financial asset (explicit in BNG, Department of Housing 2004, pp. 9, 15), the logic being that functioning housing markets would improve upward mobility (Adebayo 2011, p. 4) (returned to below).¹⁴⁶ In 2005, then Housing Minister Lindiwe Sisulu stated (quoted in Lemanski 2011, p. 58): "We are moving towards the concept of a house as an asset. [...] they [people] can rebond a house and have access to more money [...] or they can improve the house and sell it a few years down the line and make a profit."

The financial sector has played a dominant role in shaping the above policies with access to private finance critical to housing upgrades. The sector also opposed the formation of a state retail housing bank and instead the National Housing Finance

¹⁴⁶ This has all occurred in line with international trends pushed strongly by the World Bank (see Van Waeyenberge 2014).

Corporation (NHFC) was established in 1996 mainly providing wholesale finance and mortgage insurance on a for-profit basis (Calvin and Coetzee 2009, Ahmed et al. 2013); the NHFC (through its subsidiary Gateway Homeloans) was also one of the first institutions to experiment with homeloan securitisation (Gyamfi-Yeboah and Ziobrowski 2010). As part of the early ‘market stabilisation’ agenda the sector ensured government: encouraged consumers to resume payments (after the 1980s boycotts), took over non-performing loans from the private sector, and established the Mortgage Indemnity Fund to promote lending in underserved areas. Despite this bank lending to lower-income households was paltry (see below).

The jettisoning of the proposed 2002 draft Community Reinvestment Bill, which would have compelled banks to meet certain lending targets, in favour of the voluntary Financial Services Charter (FSC), is emblematic of the sector’s policy influence supported by the National Treasury (see Tomlinson 2005, 2007, Freeman 2008). The FSC is seen to lack teeth (Moss 2008) with the financial sector consistently failing to meet targets. The more recent Finance Linked Individual Subsidy Programme (FLISP) has been instituted to give subsidies to those purchasing houses (via a mortgage) who earn too much to qualify for RDP houses – the ‘gap’ or ‘affordable’ market (now R3,501 to R15,000). Together with tax incentives to developers building houses worth less than R3,000, and R1bn in mortgage insurance from the NHFC, this has been viewed as highly favourable to capital.

10.3.2 The failure of low-cost housing markets

Despite the role of the financial sector in shaping policy it has splendidly failed to service this sector with housing loans as shown in Section 10.2.3. The market-segment is perceived to be higher risk with the smaller size and potentially larger volume of loans requiring greater administrative capacity (NCR and Devnomics 2012). The provisioning of microloans (as discussed above and in Chapter 8) has been more profitable with higher fee and interest rate caps. In addition, low-cost and township property markets have failed to take off making houses poor collateral (see below); this is compounded by the poor quality of available stock with structural defects, or lack of sewerage or water, disqualifying up to 50% from mortgages.

This has pushed consumers towards microloans and informal lending. Pensions and provident fund-backed housing loans are available from all major banks and many MFIs as a form of secured loan. It is estimated that at least 10 to 33% of all unsecured loans and credit facilities are used for housing-related purposes (Isaacs 2016a, p. 162), the latter typically at building-supply stores on a revolving basis. Recently, as seen in Section 10.2.3 specialised developmental housing loans have been made available via housing-orientated MFIs (see Isaacs 2016a, pp. 163–164 for a summary).

We showed in Table 10.3 the expense associated with unsecured loans and credit facilities; here, in Table 10.6, this is complemented by the maximum cost of mortgage and developmental housing loans. Assuming a repo rate of 7%, the current interest rate cap for mortgages is 19% – although most middle- and upper-market mortgages hover around 11% – whereas the cap for developmental housing loans is 34%. Our calculations show that the effective annual interest rate on a mid-size mortgage of R2mn is 14.5% (if the cap of 19% is levied whereas usually a rate of 11% applies) whereas developmental housing loans (R10,000-R100,000) attract an effective rate of 24-29%. Recall from Table 10.3 that small loans using unsecured credit and credit facilities – also often used for housing supplies – can attract even higher interest rates (although are also sometimes more cost effective). Lower-income households once again pay more to borrow.

Table 10.6 Maximum costs of housing loans by type, size and maturity (2016)

Developmental housing loan				
Loan size (R)	No of months	Repayment total (R)	Monthly rate (%)	Annual rate (%)
2,500	5	3,055	5.2	62.5
5,000	10	6,256	3.2	38.9
10,000	20	13,305	2.4	28.8
25,000	36	36,650	2.0	23.8
100,000	160	280,968	2.3	27.1

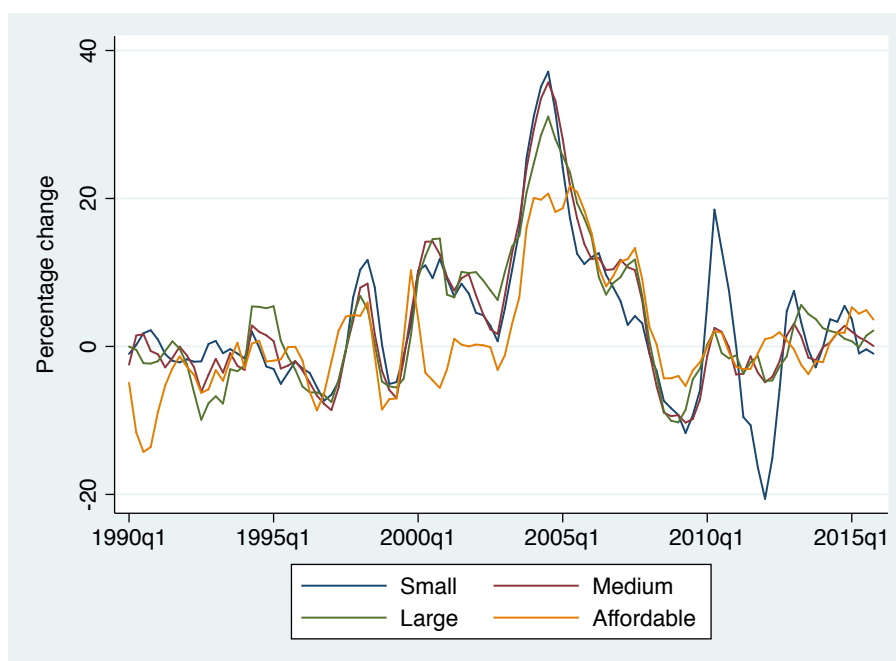
Mortgage				
Loan size (R)	No of months	Repayment total (R)	Monthly rate (%)	Annual rate (%)
100,000	160	280,968	1.1	13.6
500,000	240	1,950,132	1.2	14.5
2,000,000	240	7,784,597	1.2	14.5

Source: own calculation based on schedules in RSA (2015)

Note: assumes a repo rate of 7%

In addition, dysfunctional low-cost housing markets – suffering from weak demand, insufficient supply, and a range of transactional market failures – have crippled the ability to leverage housing as an asset. Further, many low-income households also primarily view their home as a social or symbolic asset and are reluctant to leverage it (Napier 2007, Lemanski 2011). Rates of housing-value appreciation have also been a problem. Figure 10.15 shows that during the 2000s housing boom (1999-2007), large houses appreciated by 188% in real terms, while the ‘affordable’ segment appreciated by under half of that, 91%, slower than all other segments. This has caused a double bind. On the one hand, the appreciation that has occurred has contributed to the unaffordability of ‘affordable’ housing; we found the average selling price of houses to be around three times greater than what could be afforded with an average income in the nine major metros (Isaacs 2016a, p. 174). On the other hand, for those that can afford ‘affordable housing’, their ‘financial asset’ has appreciated more slowly than other houses thereby placing the next rung on the ‘housing ladder’ further out of reach. The situation is even worse for government-subsidised houses. Gordon et al. (2011b, p. 39) found that in 2008 the cost of developing an RDP house was between R99,000 and R120,000 while the resale price was only R54,000; these house owners are therefore locked into this market segment. The individualistic commodified paradigm, therefore, has generated market reliance while the market has failed lower-income households.

Figure 10.15 Year-on-year change in real housing prices by type (1990-2015)

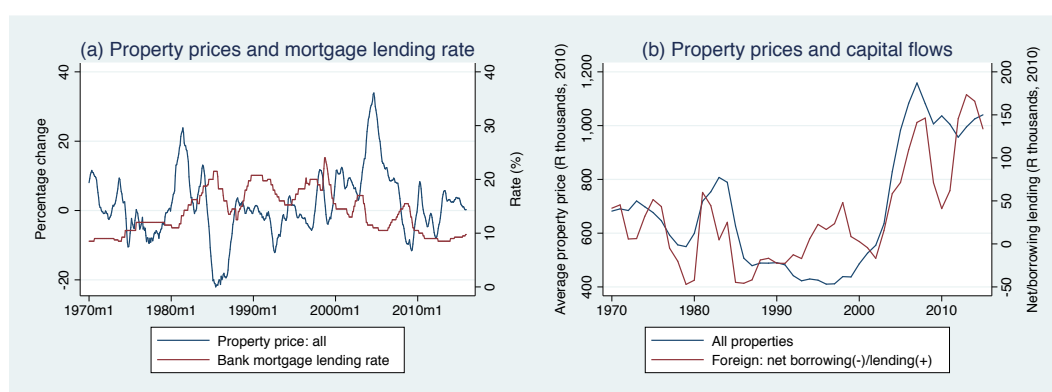


Source: Absa (2016) and IMF (2016a), via Quantec, own calculations

10.3.3 The integration of housing and finance markets

The housing appreciation noted in Figure 10.15 also highlights the integration between housing and capital markets and how financialisation has influenced housing affordability; this is particularly the case regarding external liberalisation. Figure 10.16a shows the year-on-year real change in property prices and the predominant bank mortgage lending rate, while Figure 10.16b shows real property prices and foreign sector net borrowing/lending. The movement in interest rates certainly contributes towards the 2000s boom and post-crisis fall but does not appear to be dramatic enough to explain it. Capital flows, however, are highly correlated with housing prices from the 2000s onwards, illustrating how short-term flows have been onward lent.

Figure 10.16 Property prices, mortgage lending rate and capital flows (1970-2015)

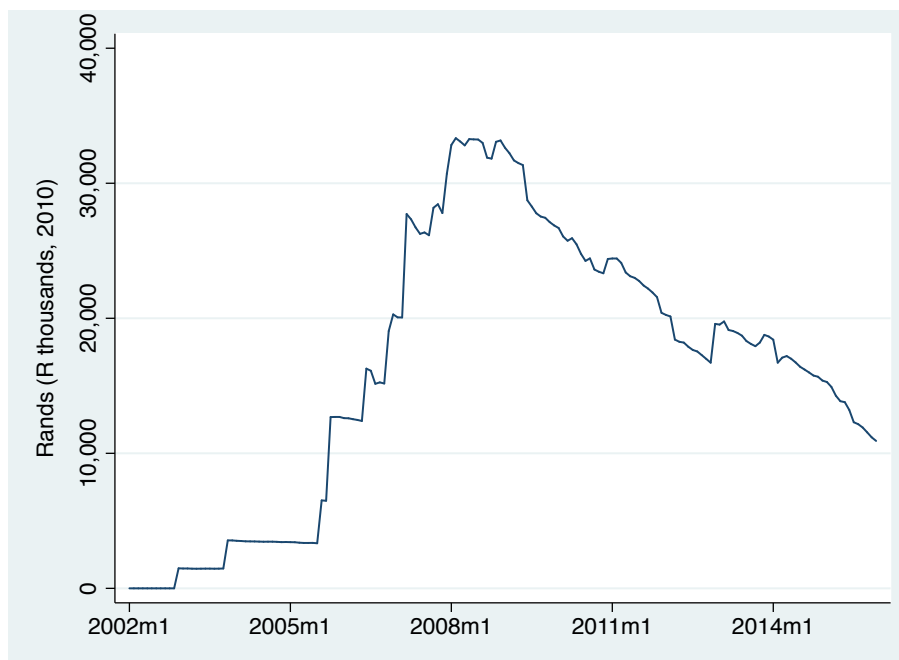


Source: Absa (2016), IMF (2016a) and SARB (2015d), via Quantec, own calculations

Housing markets also contribute towards financialisation, noted above regarding the leveraging of housing for debt consumption but also illustrated through the role of housing in encouraging secondary markets. A viable secondary market for conventional mortgages first emerged in 2001, with South African Home Loans (SAHL), a private entity jointly funded by JP Morgan and Standard Bank, the first to issue residential mortgage-backed securities. The market expanded rapidly between 2001 and 2007 and is one of the most active securitisation markets in emerging market economies, albeit tiny by comparison with large developed economies and encompassing only a small share of outstanding mortgage loans. The residential securitisation portfolios of big banks (the only detailed data publicly available) only took off (precipitously) from 2005, rising until 2008 after which there has been a steady slide as shown in Figure 10.17. The close

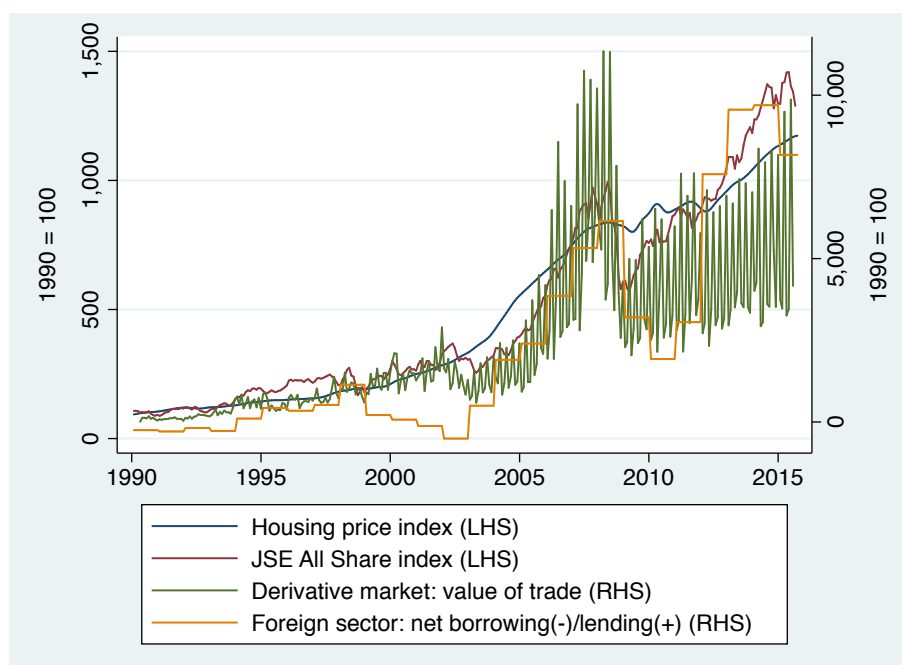
correlation between all these dimensions is well captured in Figure 10.18, which shows how the housing, JSE, and derivative markets all move in tandem with capital inflows.

Figure 10.17 Outstanding residential mortgage backed securities held by major banks (2002-2015)



Source: The Banking Association South Africa (2016), and IMF (2016a) via Quantec, own calculations

Figure 10.18 House price, JSE all share, capital flows and derivative market indices (1990-2015)



Source: Absa (2015) and SARB (2015d, 2015a) via Quantec, own calculations

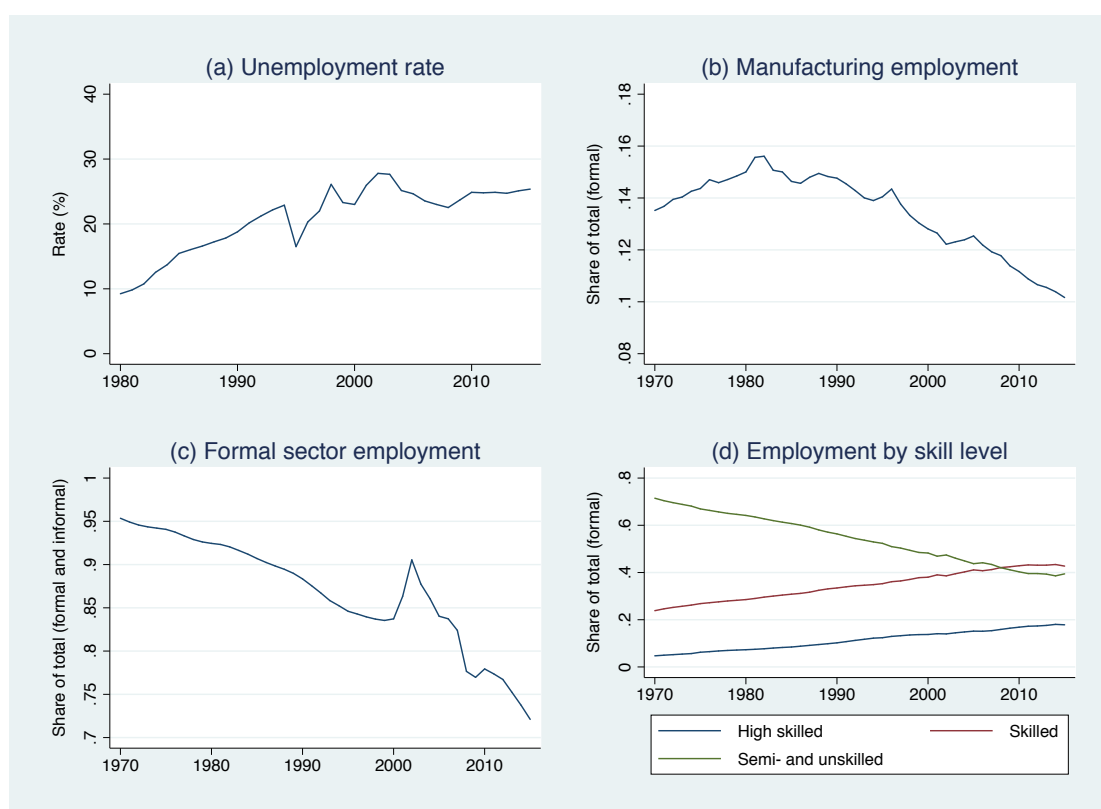
Note: foreign sector flows have been inverted so lending shows as positive and multiplied by 2.5 for display purposes

In sum, this case study highlights the manner in which the financial sector influenced an aspect of social policy to ensure a market-centric, privatised, commodified, and financialised approach to social provisioning. It further shows how this market-centric approach has failed, on its own terms, resulting in lower-cost housing becoming unaffordable and inaccessible. The broader financialisation of the economy – in particular foreign capital flows and asset appreciation – has contributed to this, while housing markets have deepened financialisation.

10.4 Restructuring of livelihoods: employment and inequality

A third manner in which financialisation impacts households, we argued in Chapter 4, is through the broader restructurings of the economy laid out in previous chapters, most directly in the consequences for employment, the nature of work, and the distribution of wealth and income. Regarding employment, key aggregate trends in the labour market are given in Figure 10.19, Figure 10.20, and Figure 10.21. We see in Figure 10.19a that unemployment (narrowly defined) has more than doubled since the 1980s peaking at almost 30% in the late 2000s (unemployment broadly defined is around 7-10 percentage points higher). Formal-sector employment (generally better paid and somewhat more secure) has declined as a share of total employment and the share of semi- and unskilled jobs has fallen as a share of total jobs in the formal sector, as shown in Figure 10.19c and Figure 10.19d, respectively.

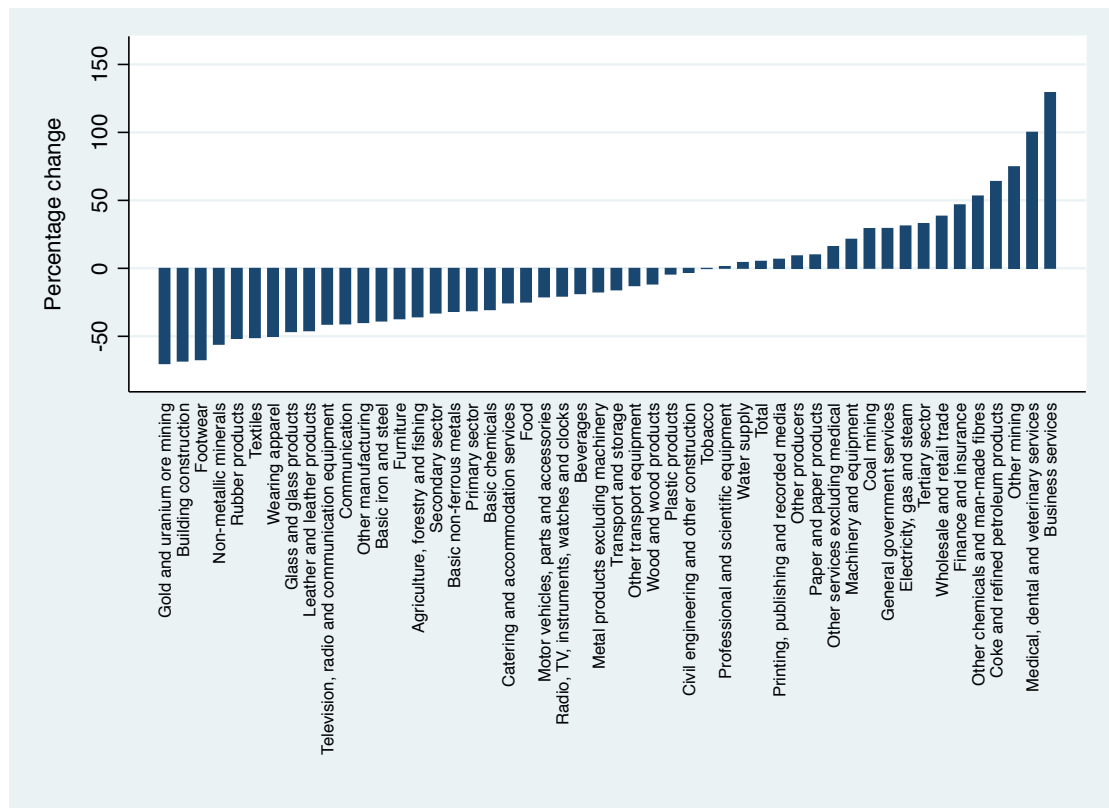
Figure 10.19 Key employment trends (1970-2015)



Source: IMF (2016b) via Quantec, and Quantec (2016), own calculations

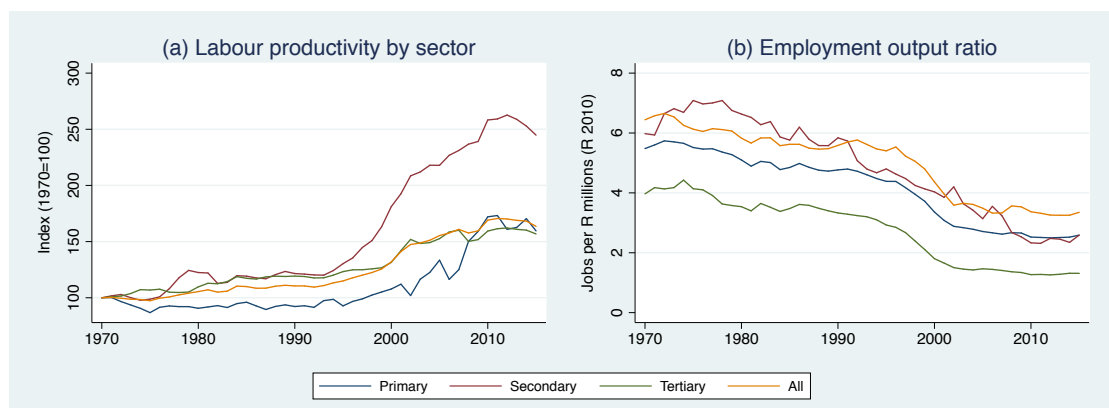
The structure of the economy, discussed in Chapter 9, has played a critical role. Figure 10.20 shows changes in employment by subsector between 1994 and 2015 as was shown in the previous chapter with respect to GVA and FCS; we see overlapping trends. Absolute formal-sector employment in the economy has hardly changed (sitting at around 11 million). While the tertiary sector has seen a 33% increase, the secondary and primary sectors experience an equivalent fall of 33% and 31%, respectively. Trade liberalisation, part of the broader liberalisation agenda, has been shown to have had overall deleterious effects on employment with some sectoral variation and sometimes positive impacts on real wages (Edwards 2004, Jenkins 2006, Fiandeiro and Rankin 2008, Edwards and Jenkins 2015). Labour-intensive manufacturing, such as clothes and textiles, household appliance and furniture manufacture, and machine production, have been particularly hard hit. Further, we see, in Figure 10.21, that labour productivity has increased and jobs per output fallen, in this case indicating, in part, increased capital intensity. All of this has been exacerbated by the global financial crisis which has hit South Africa predominantly through a fall in trade and a squeeze on state spending. Even prior to this, the patterns of inward investment – skewed towards portfolio flows and M&As – have not been job enhancing.

Figure 10.20 Percentage change in absolute formal-sector employment by subsector between 1994 and 2015



Source: Quantec (2016), own calculations

Figure 10.21 Labour productivity and the employment output ratio by major sector (1970-2015)



Source: Quantec (2016), own calculations

The above indicates the deleterious effects of a financialised MEC growth path for employment. In addition, it is critical to appreciate how global integration and economic restructuring, have impacted the nature of work, most significantly the related trends of outsourcing and informalisation. The former is reflected strongly in the growth of the tertiary sector and both are reflected in falling formal employment in manufacturing

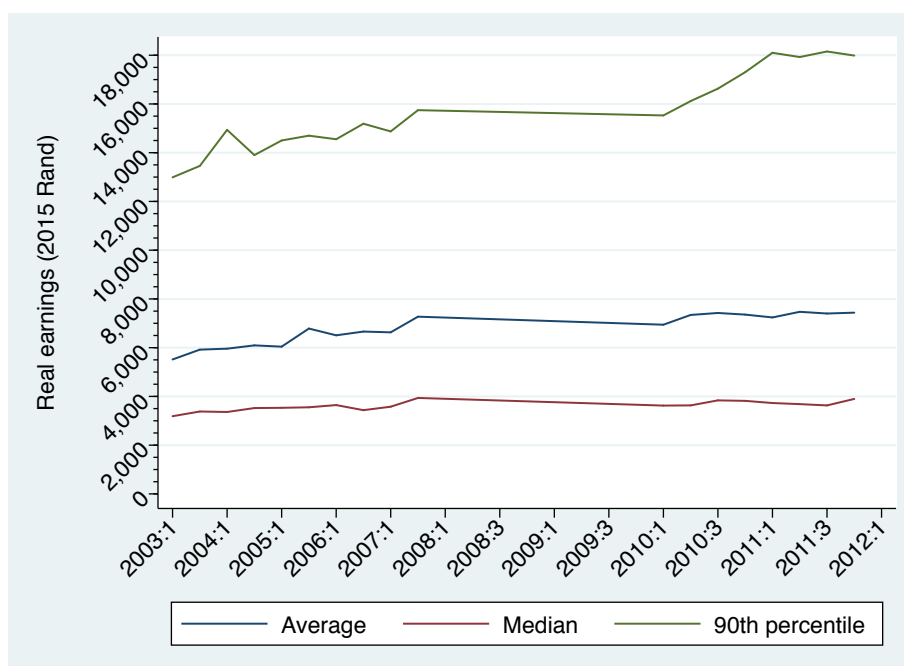
(Figure 10.19). Tregenna (2010), for instance, shows that between 2001 and 2007 we observe negative growth in the employment of cleaners in manufacturing and security guards in the public sector compared with large projected positive growth should outsourcing not have occurred. In fact, 59% of the growth in cleaners and 28% of the growth in security guards in the service sector is estimated to be due to outsourcing in other sectors. Such outsourcing has penetrated beyond 'non-core' functions (such as cleaning), in mining for instance core mining-related tasks began to be outsourced in early 2000s (Webster and Omar 2003).

Outsourced work is associated with casualisation, precarity, fewer benefits, and low wages (Mohamed and Roberts 2008, Di Paola and Pons-Vignon 2013); casualisation, for instance, grew by at least five percentage points between 2001 and 2006 (Bodibe 2006, p. 56). It is also associated with decreased union density which fell from 40% to 34% between 1997 and 2013 (Bhorat et al. 2014). International integration, and financialised business practices, as we noted in Chapter 4, also results in cost pressures being displaced down the value chain. This has occurred in South Africa, for instance in the footwear sector – a sector hard hit by rapid liberalisation – where a large degree of informalisation occurred together with a shift towards piecework (Webster and Omar 2003); more vulnerable workers, for instance women, usually disproportionately bear the brunt.

The above has resulted in low wage growth for the poorly paid – between 2003 and 2012 the median wage rose by only 22% – outstripped by higher wage growth at the top – average wages and wages at the 90th percentile rose by 35% and 38%, respectively (shown in Figure 10.22). Hourly wages in the informal sector – 28% of the earners in 2014 – are about two-and-a-half times lower than in the formal sector (Stats SA 2015, own calculations). This contributes to high levels of poverty and inequality, with income inequality in South Africa severe at a Gini coefficient of 0.66 in 2014 (Hundenborn et al. 2016). The driving force behind this, despite high levels of unemployment and hence zero-earners, is wage inequality within the labour force (offset somewhat by redistributive government grants), unsurprising given its weight in overall income (Leibbrandt et al. 2010, Hundenborn et al. 2016). The striking level of wealth inequality, shown in Section 10.2.3, is the second largest contributor to income inequality (Hundenborn et al. 2016). Table 10.7 shows that whereas the top 10% receive 56% of

employment income they receive almost 100% of investment income; the top 1% receives a staggering 88% of total investment income. This relates back also to our discussion of financialised executive remuneration trends in Chapter 9 as well as differential integration into financial markets discussed above.

Figure 10.22 Wage earnings trends for different percentiles (2003-2012)



Source: Kerr and Wittenberg (2013), PALMS dataset treated as per Finn (2015), own calculations

Table 10.7 Investment and employment income inequality (2010)

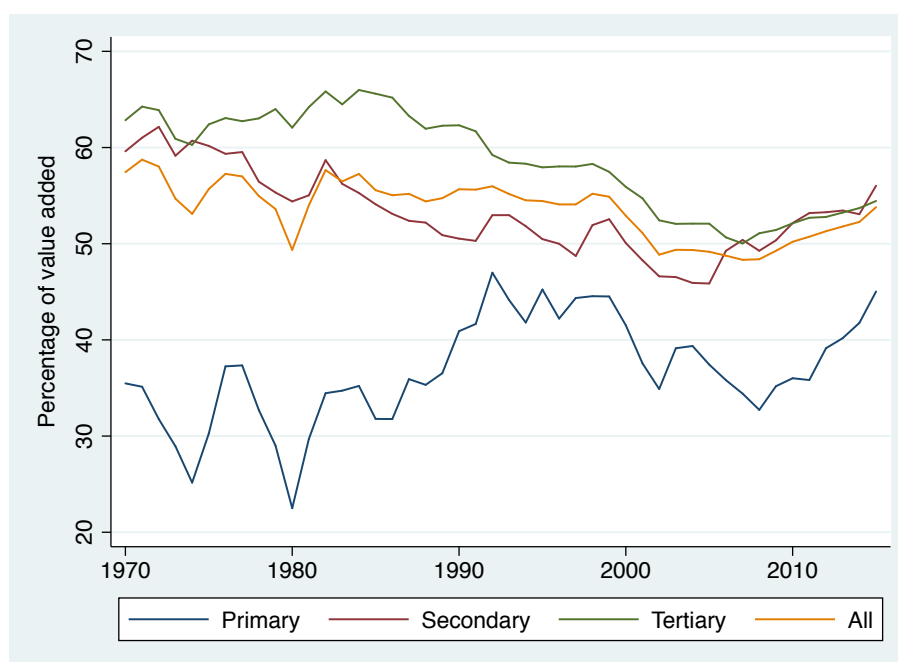
	Top 1% (% of income)	Top 10% (% of income)	Gini
Investment income			
Local interest	84	98	0.98
Total investment	88	99	0.99
Total investment and pensions	61	96	0.96
Other income			
Employment	16	56	0.70

Source: Orthofer (2016)

The shifting structure of corporate incentives and the drive to maximise shareholder value have also brought distributional shifts in the functional distribution of income – which shape and reinforce personal income inequalities. Figure 10.23 shows that remuneration as a share of value added has fallen in all sectors except for the primary sector (this reflects increased wages and a different skills profile in the mining sector).

This has meant that the wage share – having fluctuated around 55% from the 1940s until the late 1970s – has declined substantially: from 56% in 1990 to a low of 48% in 2007 and 2008, and then risen modestly to 52% in 2014 with modest profit growth from 2009 (see Strauss and Isaacs 2016 on the negative consequences of a falling wage share). This is visible for all listed NFCs in Figure 10.24 where wages comprised 55% of value added in 1994 but only 46% in 2014; note how dividends and interest payments grew in tandem. Such trends are closely associated with financial liberalisation¹⁴⁷ and financialisation; not only is there a direct fall in distributions to workers but shifts away from long-term productive investment reinforces the structural patterns above and their detrimental consequences for workers.

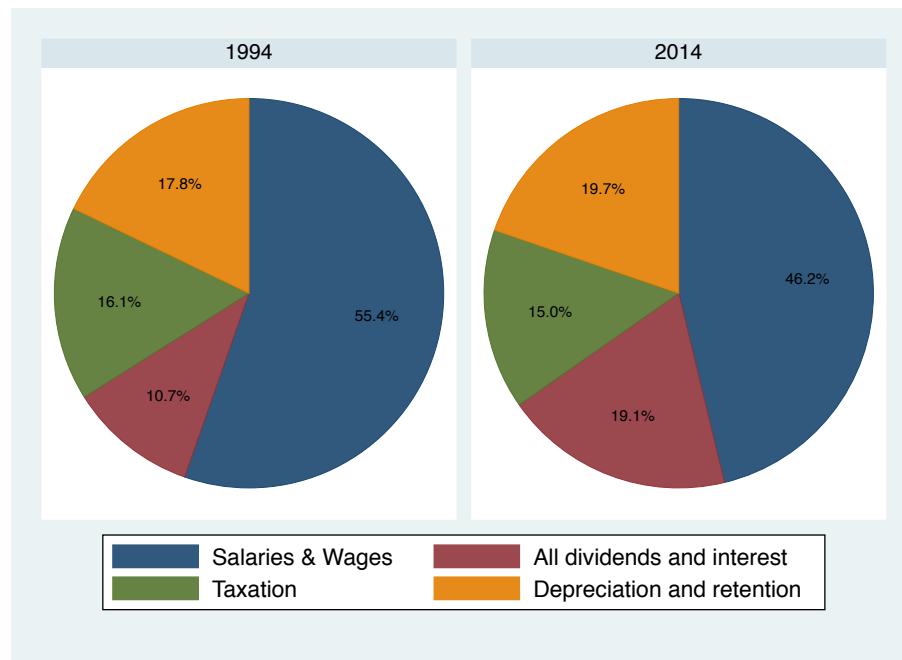
Figure 10.23 Remuneration to value added ratio (1970 - 2015)



Source: Quantec (2016)

¹⁴⁷ For a review of the mainstream literature on the relationship between inequality and financial liberalisation see Isaacs (2016b, pp. 83–85).

Figure 10.24 Allocation of value added within listed non-financial corporations from company accounts (1994 and 2014)



Source: INet BFA (2015), own calculations
 Note: "Minority interests" and "other" excluded

In sum, the trends above reflect the intersection of liberalisation, internationalisation, financialisation, and the evolving MEC. Internationalisation has resulted in both capital export and the displacement of jobs, as production shifts elsewhere or is outsourced to foreign suppliers, and as rapid trade liberalisation (without sufficient countervailing mechanisms, such as subsidies or interventions to support diversification and export growth) devastates local manufacturing sectors. This is accompanied by financialised business models through which shifts in the distribution of value added, as well as financial market investment by NFCs, has led to a fall in productive investment and stagnation in the real economy, as well as outsourcing, casualisation, and falling union density, while capital reaps the benefits from rising labour productivity. All of this is compounded by the historic structure of the economy – the MEC – characterised by capital intensity and weak linkages with employment-intensive growth-enhancing manufacturing sectors, as well as its evolving nature with strong growth in low-wage precarious service subsectors. The result has been a fall in employment (relative to the workforce) which exacerbates poverty and inequality while the latter is further deepened by the distribution of financial wealth. This pattern of accumulation is reinforced by incomes of the elite being tied to financial markets and internationalised business, as well as by the growth retarding consequences of inequality and poverty.

10.5 Conclusion

We noted at the outset that this analysis must be approached against the background of a previous system of ‘credit apartheid’. What has been revealed is that while exclusion is not the order of the day, the significant penetration of finance into the affairs of households has been highly uneven with overall deleterious social and economic consequences.

The rich have managed to accumulate significant financial assets, diversifying from the build up of pension funds in the 1980s into other financial products and stocks in the post-apartheid period. They have undertaken significant borrowing but generally on the most favourable terms and have used this to augment their wealth, in particular via mortgage-financed housing acquisition. At the same time, asset price inflation has allowed them to leverage these to undertake further consumption or investment. The poor and middle classes face a very different situation. They have entered the scene mainly as borrowers, and most often via shorter-term, more expensive products allowing “them to reproduce themselves in the context of low wages, precarious employment relations and high levels of unemployment” (Newman 2014, p. 59); vast numbers have become over-indebted. They have generally accumulated less financial assets and benefit less from financial market products such as insurance. Further, the financial elite have also been the beneficiaries of finance’s penetration into other households with highly unequal power relationships between borrowers and lenders.

The case study of housing highlights how the financial sector has managed to craft social policy in a manner aimed at creating financial markets – both for lending and trading. Despite this, ‘credit apartheid’ remains entrenched in this sector with lower-income households largely excluded from housing finance, or accessing it on less-favourable terms. At the same time housing market appreciation at the middle and upper-end – in part due to the broader facets of financialisation, such as capital flows – pushes houses further out of reach even for middle-income earners while their own assets appreciated less or not at all. At the same time, household integration has deepened financialisation, for instance through new markets for mortgage backed securities, increased debt-fuelled consumption, and the channelling of household wealth into financial assets.

Financialisation has also impacted households through the manner in which it has shaped the economy's growth path – the financialised MEC. Employment has remained static despite population growth; and its composition has shifted further away from labour-intensive, growth-enhancing manufacturing subsectors towards casualised, outsourced, and precarious jobs, predominately in the tertiary sector. On the back of this, wages for the majority have grown only modestly and poverty remains exceptionally high, while national income has shifted away from labour and towards profits, with the latter used for shareholder distributions not long-term investment thus further reinforcing lacklustre growth. All of this has led to mounting inequality, a hallmark of post-apartheid South Africa, which in turn has reinforced this growth path. The financialised MEC has, therefore, acted as a break on more equitable and inclusive growth.

11 CONCLUSION

This thesis was born out of a concern for South Africa's economic future and an interest in its past, combined with a fascination for finance and a firm conviction that Marxist political economy is a lens through which critical analysis of political, economic, and social life can be approached. Through the study of finance as part of the rise of neoliberalism in the United States (Isaacs 2011b), grounded within Marxist political economy (Isaacs 2011a), finance was understood as "something which is at once creative and predatory, supportive of and in tension with production" (Powell 2013a, p. 300). The growing financialisation literature, particularly in the wake of the global financial crisis but with important contributions predating this, clearly pointed to common characteristics across a range of institutionally diverse settings, particularly within the capitalist core. Given a small body of existing literature, including my own preliminary analysis (Isaacs 2012), the questions of whether South Africa had 'financialised,' and what this might mean for its trajectory, seemed both pertinent and worthy of exploration.

The international literature, reviewed in Chapters 3 and 4, points to financialisation's common characteristics, as well as its variegation. These include (but are not limited to): the growing weight of finance within the economy, including the proliferation of financial markets, institutions, and products; the increased importance of financial-market investors; a turn by both banks and non-financial corporations towards financial-market financing and investing; increased lending to households, the uneven integration of them within financial markets, and the prominent role of finance in social provisioning; and the importance of state policy in furthering financialisation while also being subject to it. To this the developing country literature added greater financial global integration and the uneven terms upon which this occurs. Further, the consequences, in both core and periphery, were often shown to be deleterious for real investment while enhancing inequality.

But common characteristics are insufficient for an adequate theorisation of financialisation. We have approached financialisation as entailing shifting social relations between: sections of capital; capital and the state; and capital, the state, and households. In particular, we explored in great detail the different ways in which the relationships

between financial and productive capital have been (re)made, while rejecting a straightforward takeover of the latter by the former. We do not claim to have provided a new theory of financialisation, but have rather situated our own work within certain existing approaches while rejecting others, together with some innovation. Two issues help to bring this thesis to a conclusion, both theoretically and empirically: financialisation as a key part of the structural transformation of mature capitalism and how this relates to a financialised MEC in South Africa, and the political nature of a study of financialisation in the current South African context. These are discussed in turn.

11.1 Financialisation, structural transformation and the financialised Minerals-Energy Complex

The South African case study presents a potential tension between our broad conceptualisation of financialisation, as being characterised by a novel set of relations – a key element of the structural transformation of mature capitalism – and arguing that financialisation results in a ‘financialised MEC’, thus highlighting strong continuities with the past. In resolving this, let us revisit the discussion of structural transformation followed by a summary of South Africa’s neoliberal turn and financialisation, and then return to the financialised MEC.

Regarding structural transformation, I argued, in Chapter 2, that financialisation is rooted in both contingent historical circumstances as well as long-term trends within capitalist development. The latter is characterised by quantitative and qualitative shifts in the nature of property relations, whereby ownership comes to be increasingly mediated via financial claims. This is a latent tendency within capitalist economic relations, with the historical deepening of the internationalisation of the circuits of commodity and money capital, and the unprecedented internationalisation of the circuits of productive capital, critical in nudging it along, and resulting in finance being called forth to play new roles in mediating both circulation and production.

At the same time the prevailing system of monetary relations (most critically Bretton Woods’, partial and contested, fixed exchange rates and restrictions on capital flows) were exhausted – due, in part, to the needs of global production, the restlessness of finance capital, and the imperatives of American imperialism. This brought about

floating exchange rates and the rise of currency markets, necessary to mediate global production and exchange but with opportunities for speculation rife, while laying the basis for future capital flows; it also transformed the role of the US dollar as world money with far-reaching economic and political consequences.

While financialisation first manifests at the capitalist core, the approach taken is clearly conceptualised in terms of the world market. The dynamics of the world market are argued – both theoretically and historically – to be integral to the onset of financialisation and financialisation is most fully expressed, as capitalism itself is, on the global stage.

The approach, therefore, provides a theoretical-historical context for understanding how financialisation becomes central to the structural transformation of mature capitalism and the onset of neoliberalism; the latter defined by the bringing of “all human action into the domain of the market” (Harvey 2005, pp. 2–3), and financial markets in particular. Bringing greater precision to our understanding of the historical basis of financialisation is a necessary component of deriving a precise theory of financialisation (Bayliss et al. 2016), and the thesis contribution in this regard.

Such an epochal shift – the rise of neoliberalism – does not however mean that the past has no bearing on the future. Indeed, I have argued that financialisation (and neoliberalism) expresses itself differently based on the local political economy, something highlighted in the literature reviews. Put differently, the lens of structural transformation refers to a generalised shift in capitalist development but does not entail the unravelling of the existing political economy of each economy.

We see this in the South African case. South Africa is reintegrated into a financialised global economy at a time when the financialisation of DTECs is on the rise. The timing of this has an important bearing, as does the existing political economy. Regarding the timing, Fine’s two stages of neoliberalism is useful; this is summed up by Ashman, Fine, et al. (2011a) as follows:

“Globally, the first phase of neoliberalism, from the late 1970s to the early 1990s, took the shock-therapy form of the direct state promotion of private capital in

general and of finance in particular. The second phase of neoliberalism, still in place if momentarily shaken by the crisis, has involved more extensive and overt state intervention both to sustain financialisation and to temper its worst effects, as in public-private partnerships as opposed to privatization.”

In the South African case, international isolation stunted South Africa’s potential neoliberal turn in the 1980s, although faltering steps towards quasi-monetarism and the like bear its mark. The demise of apartheid occurs, therefore, during the overlap between these two phases of neoliberalism, and the post-apartheid period can be viewed as displaying a rapid acceleration of the first, overlapping closely with the second.¹⁴⁸ For instance, Fine (2016a, p. 6) notes that, in general, “[the] first phase [... is associated with] the hollowing out of the institutional forms in which policy was previously made in ways that displace democratic participation in the formulation, implementation and monitoring of policy, only for new forms of policymaking to be rolled out in the second phase that more fully reflect and engage with financial interests and imperatives”. This is certainly true of South Africa, in the (re)configuring and exercise of economic and political power. While not discussing the hollowing out of the South African civil service in the 1990s and the gradual undermining of parliament and democratic policy participation, the institution of GEAR as ‘non-negotiable’ in 1996 speaks to both these elements while subsequent policy formulation clearly advances the interests of finance.

Without reducing neoliberalism to financialisation, I previously noted that financialisation can be situated at neoliberalism’s economic core. And it is financialisation’s processes and relations, as a central component of South Africa’s neoliberal turn and the rapid march of its second phase, to which this thesis has added substance, in a wide-ranging manner.

Summarising those – and pointing to future avenues of research – I argue that central to this transformation has been the liberalisation and internationalisation of the South African economy, greatly increasing the influence of (speculative) global financial investors. This has brought new vulnerabilities with patterns of capital flows playing a crucial role in the trajectory of financialisation and economic development; detailed

¹⁴⁸ Fine (2016a, p. 8), from which this draws, notes: “Consequently, post-apartheid, developments can be usefully seen as rapidly hurdling the first phase in combination with both the second phase of neoliberalism and the particular challenges and conditions posed by the inheritance of apartheid.”

study of each of these vulnerabilities, together with cross-country analysis, continues apace, and South African work in this regard is important.

Liberalisation has also meant the insertion of domestic productive and financial capital (at the MEC core) into global financial markets, in the process of which they have become deeply entwined with global financial capital. This, together with other elements of domestic restructuring (such as partial privatisation and BEE) has changed patterns of ownership, as well as the operations and priorities of NFCs. The latter do not include greater acquisition of financial assets and liabilities – highlighting the variegated nature of financialisation – but do involve the changing composition of these, centred on a turn towards short-term market funding and investment and burgeoning distributions to shareholders. Financial markets – both existing and new – have expanded in tandem, with institutional investors playing critical roles in ownership and distribution. This thesis has charted these trends but more remains to be done, especially a deeper analysis of the networks of ownerships – who really owns what and how, and with what consequences for economic development?

Similar transformations are witnessed at the level of banks and households. Banks have also deepened their engagement with financial markets, acquiring a greater share of short-term capital market related assets and liabilities. They have increased lending to households which have become enmeshed in financial markets on highly uneven terms, including their access to social services, while financialisation has increased inequality and hindered employment. Further research is required regarding potentially heterogeneous behaviour amongst banks, including foreign banks/branches, and any specific consequences of the (as yet limited) foreign purchase of local banks. At the same time deeper analysis is needed of the financialisation of both social provisioning and the everyday life of households. State policy has facilitated all of the above, while the South African state has become beholden to international financial markets; the contours of the latter need to be made more explicit. There are therefore many similarities between the South African case and those covered by the international literature, although the instances in which South Africa does not conform need to be delineated and explained.

Such financialisation may also be laying the basis for what Fine (2016b, p. 11) refers to as a third phase of neoliberalism – also requiring close empirical scrutiny in the South African case – with the following characteristics: “first is close integration between largescale globally-organised finance and industry; second is a renewal of state expenditure on economic and social infrastructure through active involvement of private finance; and third is a renewal of state intervention to promote such developments in tandem with one another”.

The processes summarised above cannot be viewed in isolation from one another. Indeed, the Marxist dialectic requires us to view the parts in relation to the whole. For instance, shifting patterns of bank lending, which have increasingly channelled funds towards households and financial markets, together with a partial fall in funding of non-financial corporations, have been influenced by state policy and capital flows, with consequences for financial markets, households, and real accumulation. The contradictions that emerge – another element of the Marxist dialectic – are important. Like elsewhere, financialisation has the potential to undermine both productive activity and the realisation of profit through the market, and hence the generation of the social surplus upon which capital ultimately relies.

On a broader level, approaching the ‘whole’ also requires the bringing together of economic and social reproduction (Fine 2016b). While a Marxist materialist theoretical framework situates the mode of production at the heart of social relations and social reproduction, this has always been uneven in practice. Financialisation has entailed an increased scope for the extensive and intensive penetration of the logic of capitalist markets, and financial market imperatives in particular, into social reproduction. The chapter on household financialisation has highlighted this in the South African case, with social reproduction increasingly engaged with, and incorporated into, market(-like) structures.

To return to the tension noted at the outset of this subsection. In this thesis financialisation is understood to involve the remaking of inter- and intra-relations between capitals, the state, and households, in historically specific ways based on the intensive and extensive penetration of the logic of financial markets into ever more spheres of economic, social, and political life. This has been underpinned by a

generalised transformation in property relations, integrally tied to developments in, and expressed most fully on, the world market. The empirical evidence in the South African case is congruent with this approach to financialisation and the trends noted constitute essential features of South African neoliberalism.

At the same time, the manner in which this has evolved and the ways in which it expresses itself are 'bounded' by the context-specific system of accumulation, the existing political economic of that locale. Prevailing economic circumstances – with foundations laid in the late-apartheid period – have shaped the processes of financialisation in South Africa. This is seen, for example, through rapid liberalisation in the second half of the 1990s, the existence of a highly sophisticated (albeit skewed banking system), and the presence of large multinationals seeking to internationalise. These are themselves manifestations of a particular system of accumulation and the historic trajectory of the economy, most notably expressed in the conglomerate structure and the role of finance therein. So the particular economic circumstances of the late-apartheid period and the (not unrelated) structure of the MEC have given impetus to and shaped the nature of financialisation in South Africa. In addition, financialisation has reorientated, but not destroyed, that system of accumulation; the underlying structure of the economy developed over a century, cannot be so easily swept aside. It is therefore not a contradiction to argue that a phenomenon central to a broad global structural transformation in capitalist production and reproduction appeared in South Africa as the economy re-entered the global economy, and that the local manifestation of that is context-specific based on the prevailing system of accumulation while reshaping, but not sweeping aside, that system.

When viewed from a developmental perspective the two – financialisation and the MEC – have actually compounded one another with deleterious developmental outcomes. Recall that within the historic MEC: non-MEC manufacturing subsectors were already retarded; monopolisation and capital-intensity were commonplace; and work practices were already highly exploitative and insecure, with low levels of pay. The retardation (and skewed patterns) of capital accumulation, shown in Chapter 9, therefore results from a combination of the old and the new, with this particular context accentuating the contractions of financialisation in specific ways. South Africa actually requires reorientation away from the financialised MEC in order to set it upon a viable

developmental trajectory. By situating financialisation within the framework of a financialising MEC, we have therefore not only been better able to make sense of financialisation in South Africa but have also contributed towards advancing our understanding of South African political economy, as well as illustrating the context-specific nature of financialisation for a developing country.

11.2 The political nature of a study of financialisation: the South African case

Finally, financialisation is political not only in the sense that state policy has been bound up with it, but also in that it has meaningful consequences for the political trajectory of countries (and the globe), as well as for the attendant struggles waged over economic, political, and social futures. South Africa again stands at a crossroads with the current conjuncture characterised by four dominant features. First, South Africa's growth path continues to immiserate and marginalise the majority, while inequality remains exceptionally high; a recipe for on-going social tensions already clearly visible. Second, corruption is eating away at the heart of the ANC and at the ability for Government to administer the state and deliver services necessary to maintain, never mind expand, economic and social development.

Third, the Tripartite Alliance partners – the ANC, Cosatu, and SACP – have, over the last decade, stressed the need for 'radical economic transformation' to purportedly tackle the structural manner in which the economy reproduces unemployment, inequality, and poverty. However, this is increasingly being used as a rhetorical shroud to advance the forces of corruption and/or as a rhetorical distraction while neoliberal orthodoxy is preserved.¹⁴⁹ Fourth, new forces of resistance are coalescing – around a new trade union, civil society formations, anti-corruption sections of capital, progressive elements within the ANC, and the radical-left political party the Economic Freedom Fighters (or shifting membership of, and alliances across, these groups), although many are weak and fragmented; the right wing, economically-liberal, socially-reactionary Democratic Alliance has also been strengthened. Both the third and fourth of these features reflect the unravelling of the post-apartheid political settlement and its dynamics.

¹⁴⁹ This said, there are some within the alliance with a genuine commitment to meaningful economic transformation.

In this context, while shifting and open to contestation, the battle lines have been drawn, and the struggle cast (predominately), as one between ‘state capture’ and ‘good governance’.¹⁵⁰ But even should the latter win – and this is an essential outcome – the future could involve a return to neoliberal orthodoxy. In this context too, the past has been muddled. At one pole, the neoliberals, who traditionally blame “high wage, social expenditure and trade union militancy” for the country’s malaise (Ashman et al. 2011a, p. 192), will, rightly, add corruption to this list and remain closed to systemic critiques.¹⁵¹ At the other pole, the forces of corruption advance superficial populist critiques of ‘white monopoly capital’ as the root of South Africa’s economic ills with ‘radical economic transformation’ losing all meaningful content.

With this in mind, what role for an analysis of financialisation? As always, advancing an analysis of the past is essential in proposing an alternative future. This task is particularly relevant today as the dominant (popular) narratives are shallow and/or ideologically driven, and as the content of a movement for change is being defined. In these fraught times, an analysis of financialisation, as part of explaining the post-apartheid economic trajectory, is therefore a deeply political project. Such can contribute towards an interpretation of South Africa’s economic malaise that disrupts the narratives of both neoliberal orthodoxy and rhetorical hand waving at ‘white monopoly capital’ and ‘radical economic transformation’. Further, analysis of financialisation specifically is particularly important: its global dimensions necessitate the adoption of internationalism that is critical to contemporary progressive struggle, while local progressive reregulation of finance is key to containing the influence of capital. Without tackling (at least dimensions of) financialisation, economic development that expands employment, raises incomes, reduces inequality, and improves the quality of life for the majority, is unlikely.

This thesis is scholarly in nature and but a small slice of a much-needed broader analysis. However, it hopefully makes a modest, but meaningful, contribution towards building an understanding of the forces and relations of production which underpin the

¹⁵⁰ This is not uniformly so with some progressive formations attempting to broaden the struggle from an almost-exclusive concern with ‘good governance’ to include a wider transformative agenda.

¹⁵¹ Big business is fairly homogenous in such rhetoric, although there are exceptions. The political elite, on the other hand, is more heterogeneous with even some at the heart of economic policy making offering progressive critiques and proposals (see, for instance, Jonas 2017).

current manifestation of South Africa's system of accumulation; to paraphrase: not only in order to understand it, but to change it.

12 APPENDIX – DATA SOURCES

In the introduction I briefly explained the data sources. Here I provide more detail.

12.1 SARB Data

SARB data is constructed in line with international System of National Account norms (SARB 2015e).

12.1.1 Quarterly Bulletin/Macroeconomic time series data

As noted, the South African Reserve Bank's (SARB) macroeconomic time series data associated with the Quarterly Bulletins (SARB 2014, 2015a, 2015b, 2016a) are a key source. These data present stocks (for instance, total debt in the economy), yearly instances (for example, GDP for a particular year), or flows (for instance dividends sent abroad in a given periods). Because the data were accessed over a number of years, different years are reflected in the references, with some series running up until the end of 2014, 2015, or 2016; where possible earlier datasets were updated to reflect more current data.

As noted, the data can either be accessed directly from the SARB website¹⁵² or via a prominent South African statistical database Quantec,¹⁵³ which also hosts other local and international datasets. Access to Quantec, through which most of the data was downloaded, was via the University of the Witwatersrand at which I was employed or a visiting researcher from *circa* 2014; before this the SARB website was used directly. The start of the series varies accordingly to availability and relevance; the longest SARB series begin in 1946, although 1956 is the earliest year shown in this thesis and usually data are shown from 1970 onwards. The data can be divided into eight subsections that give a sense of its content:

¹⁵² <https://www.resbank.co.za/Research/Statistics/Pages/OnlineDownloadFacility.aspx>

¹⁵³ <http://0-www.easydata.co.za.innopac.wits.ac.za/>

Table 12.1 SARB Quarterly Bulletin data categories

Money and banking (S2-28)
Capital market (S29-45)
National financial account (S46-47)
Public finance (S48-79)
International economic relations (S80-107)
National accounts (S108-135)
General economic indicators (S136-145)
Key information (S146-157)

The SARB also releases some of these data on a monthly basis.¹⁵⁴

12.1.2 Flow-of-funds

Flow-of-funds data (SARB 2015d) were also used extensively. The flow-of-funds data (available yearly from 1970 and quarterly from 1992) are not available via the SARB website and were solicited directly from the SARB in 2015, with the dataset ending in the first quarter of 2015 used throughout. This provides information on the uses and source of funding, broken down by instruments, and the economic sectors acquiring or disposing of those. It therefore provides a dynamic perspective on the evolution of balance sheets for each sector. These data “measure financial flows across sectors of the economy, tracking funds as they move from those sectors that serve as sources of capital (...) to sectors that use the capital to acquire physical and financial assets” (Teplin, 2001, p. 431, quoted in Rodrigues Teles Sampaio 2014, p. 65).

The flow-of-funds specifically focus on financial assets, defined by SNA: “An asset that entitles its owner, the creditor, to receive a payment, or series of payments, from the other unit, the debtor, in certain circumstances specified in the contract between them” (UN et al, 1993, p. 276, quoted in Rodrigues Teles Sampaio 2014, p. 65); this naturally corresponds to a financial liability for the debtor. There are 24 assets types in the flow-of-funds, four items referring to savings and fixed investment, and four items aggregating asset and liability acquisition. ‘Uses’ refers to acquisition of assets, ‘Sources’ refers to acquisition of liabilities. The full list is given in Table 12.3. There are eleven economic sectors under five main headings; these are given in Table 12.2.

¹⁵⁴ <https://www.resbank.co.za/Research/Statistics/Pages/MonthlyReleaseOfSelectedData.aspx>

12.1.3 SARB bank data

A third SARB dataset (SARB 2015c, 2016b) is based on the detailed monthly compulsory reporting of banks of their balance sheets based on a standard set of forms issued by the SARB. Data from these are available from 1993 to the present. However, beginning in 2008, the line items on the forms changed significantly. Bank historical data – mainly balance sheet data – are found in DI900 (1993–2007) and BA900 (2008 onwards) forms. An adaptation of the DI900 form to match the BA900 form line items can be found on the Quantec database under the BD900 code. Chapter 8 uses the BD900 data, therefore consistent for 1993 to 2015, although not as detailed as the newer BA900 data.

The SARB (2016c, 2016d) also collects data on bank incomes. Between 1994 and 2007 bank income statements were submitted on DI200 forms; before 2001 not all line items are reported. From 2008 onwards, income was reported on BA120 forms, which consist of differently labelled and disaggregated line items. In Chapter 8 we attempt to match appropriate line items.

12.2 Other South African data

The other key South African datasets are given in Table 12.4 including what they focus on and how they were accessed.

12.3 International data

Similarly, key international datasets, their purpose, and the source of access are given in Table 12.5.

Table 12.2 Flow-of-funds economic sectors

	Sector	Notes
	Foreign sector	
1	Foreign sector	
	Financial intermediaries	
2	Monetary authority	South African Reserve Bank
3	Other monetary institutions	Banks, mutual banks, postbank
4	Public Investment Corporation	
5	Insurers and retirement funds	
6	Other financial institutions	Unit trusts and other investment vehicles
	General government	
7	Central and provincial governments	
8	Local governments	
	Corporate business enterprises	
9	Public sector	State owned enterprises
10	Private sector	Non-financial corporations
	Households	
11	Households etc.	Includes non-profits servicing households
12	Total	

Table 12.3 Flow-of-funds all items

S/U 1	Net saving
S/U 2	Consumption of fixed capital
S/U 3	Capital transfers
S/U 4	Gross capital formation
S/U 5	Net lending (+)/net borrowing (-) (S)
S/U 6	Net financial investment (+) or (-) (U)
S/U 7	Net incurrence of financial liabilities (Total S 9 – 32)
S/U 8	Net acquisition of financial assets (Total U 9 – 32)
S/U 9	Gold and other foreign reserves
S/U 10	Cash and demand monetary deposits
S/U 11	Short/medium-term monetary deposits
S/U 12	Long-term monetary deposits
S/U 13	Deposits with other financial institutions
S/U 14	Deposits with other institutions
S/U 15	Treasury bills
S/U 16	Other bills
S/U 17	Bank loans and advances
S/U 18	Trade credit and short-term loans
S/U 19	Short-term government bonds
S/U 20	Long-term government bonds
S/U 21	Non-marketable government bonds
S/U 22	Securities of local governments
S/U 23	Securities of public enterprises
S/U 24	Other loan stock and preference shares
S/U 25	Ordinary shares
S/U 26	Foreign branch/head office balances
S/U 27	Long-term loans
S/U 28	Mortgage loans
S/U 29	Interest in retirement and life funds
S/U 30	Amounts receivable/payable
S/U 31	Other assets/liabilities
S/U 32	Balancing item

Table 12.4 Key South African datasets (excluding SARB)

Data series	Purpose	Method of access
Absa Housing Price Index	House price movements	Accessed via Quantec
INEF BFA	Company level data aggregated over the sectors	Provided via email on 10 November 2015
Johannesburg Stock Exchange (JSE)	Market trading	Provided via email on 31 November 2016
National Credit Regulator	Consumer Credit Market - the distribution of credit - and Credit Bureau Monitor - credit standing	Downloaded from website http://www.ncr.org.za/
Post- Apartheid Labour Market Series (PALMS) Version 2.1	Harmonized dataset based on Statistics SA's OHS, LFS and QLFS surveys, 1994-2012	Accessed via Datafirst - https://www.datafirst.uct.ac.za - and cleaned as per Finn (2015)
Quantec	Standardised industry data, input-output tables	Accessed via Quantec

Table 12.5 Key international datasets

Data series	Purpose	Method of access
Bank of International Settlements' Triennial Central Bank Survey	Used for derivative market trading data	Accessed via http://www.bis.org/
Bloomberg	Used for exchange rate and related data and M&As	Accessed via Bloomberg Terminal
IMF's Balance of Payments (BOP) / International Investor Position (IIP)	Summarises transactions between residents and non-residents	Accessed via data.imf.org/
IMF's Coordinate Portfolio Investment Survey (CPIS)	Distribution of offshore assets by country	Accessed via http://cpis.imf.org/
IMF's International Financial Statistics (IFS)	Shows international assets and liabilities at a particular point in time	Accessed via data.imf.org/
IMF's World Economic Outlook (WEO)	Limited standardised variables such as GDP, exports, government debt	Accessed via Quantec and/or http://www.imf.org/
OECD		
UNCTAD	International trade data	Accessed via http://unctadstat.unctad.org/
World Bank's World Development Indicators (WDI)	Key development indicators including aggregate capital flows	Accessed via http://databank.worldbank.org/data/

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