Financial and Capital Account Liberalization, Financial Development and Economic Development: A Review of Some Recent Contributions

Alberto Botta
Department of International Business and Economics, University of Greenwich, London, England

Abstract This article presents a review of some recent contributions on the relation between global finance and economic development in emerging economies. It first, stresses the growing consensus among economists on the financial instability that financial and capital account liberalization can possibly cause in emerging economies. It then outlines and compares two alternative strategies to tame such instability. The comparison is between the "good-institutions need-to-come-first" approach put forward by some mainstream economists, and the request for a deeper reform of the existing monetary system advocated by heterodox economists.

Keywords: financial liberalization, capital account liberalization, financial crises, global economic governance

1. INTRODUCTION

Summer 2017 marks the 10-year anniversary of the outbreak of the financial crisis. Twenty years ago, the East Asian financial crisis got the headlines of most newspapers worldwide. Meanwhile, financial and economic crises also hit many other emerging economies, Russia, Brazil, Argentina and Turkey to say a few.

The fact that financial crises could hit emerging and developing countries comes as no surprise to the mainstream economists criticizing financial repression, and supporting financial and capital account liberalization as beneficial for economic growth and macroeconomic stability. A cornerstone of the so-called "financial repression" theory is the idea that financial repression implemented by the national governments in developing countries is the main cause of macroeconomic vulnerability, banks' fragility, and ultimately the disarray of the financial system as a whole. This is also a rather standard interpretation of the debt crisis of Latin American and African countries at the beginning of the 1980s. Nonetheless, it is quite hard to agree with this view when we consider the East Asian and sub-prime crises mentioned above. On the one hand, the East Asian financial crisis hit some economies that had been generally considered as world-wide examples of good macroeconomic management, if not economic miracles. Interestingly, at the beginning of the 1990s, such economies adopted those very same financial liberalization policies advocated by international economic institutions (the IMF and the World Bank) and neoliberal economists as necessary in order to favour financial development and spur economic growth. On the other hand, the sub-prime crisis started in the USA, i.e. the financial centre of the world and the economy with the most developed, sophisticated, complete and liquid financial system worldwide.

These events have effectively reinforced the conviction that the relation between financial and capital account liberalization, financial development and economic development should be reconsidered. Such a review has conducted to a "soft" revision, but also to an even deeper critique from heterodox standpoints, of the neoliberal consensus about the desirability of financial liberalization. As to the soft revision, it maintains that financial liberalization and the opening of the capital account can ultimately accelerate economic growth and prompt a more solid macroeconomic environment. The secret to reap these gains lies in the sequence, timing and gradualness with which such reforms are implemented. In order to pay off, financial and capital account liberalization need to be carried out along with a proper supervisory regulation of financial operators avoiding them from taking too risky moral hazard behaviours. As to the latter, the abovementioned examples of financial crises constitute even clearer proofs that financial and capital account liberalization, as well as financial innovations, are intrinsically destabilizing. They are sources of boom-and-bust cycles no matter how accurate and elaborated is *micro*-prudential supervision of financial systems. The solution to these problems is to be found not in the regulation, but rather in the strict impediments to certain types of capital flows and financial practices/instruments. Such impediments should constitute part of *macro*-prudential activities that constantly tame the unstable processes endogenously created by financial dynamics.

In this article, we propose a review of such opposing perspectives on the basis of some recent contributions on the more general topic of global finance and economic development. In particular, we refer to the contributions by Akyüz (2014); Knoop (2013)), as well as to the two books edited by Ülgen (2017a); Wolfson and

Epstein (2013), respectively. The article is organized as follows. The next section describes the logic of the "financial repression" theory, and hence the rationale behind the economic proposals asking for the liberalization of financial markets and capital flows. We then move to the critiques to this neoliberal paradigm. We first, present the "soft" revision of the above point as supported by Knoop (2013). We then analyse the much more radical critique to the "financial package" of the standard neoliberal policy agenda put forward by Akyüz (2014). Emphasis here is on developing countries and the several difficulties they find in implementing counter-cyclical policies once capital accounts and financial flows have been liberalized. Such review article concludes by considering the systemic criticism of modern financialized capitalist economies contained in the book edited by Ülgen (2017b). We also discuss the quest for a radical reform of the governance of world financial flows, and of the ensuing global imbalances (Balance of Payments (BoP) imbalances hereinafter), as advocated by several contributions contained in the Handbook of the Political Economy of Financial Crises edited by Wolfson and Epstein (2013).

2. THE SHAKY THEORETICAL FOUNDATIONS OF THE "FINANCIAL REPRESSION" THEORY AND OF NEOLIBERAL-TYPE FINANCIAL LIBERALIZATION POLICIES

The simplest way to understand the economic rationale of the neoliberal critique to "financial repression", and the ensuing support to financial liberalization, is the well-known graph showing the supply and demand for loanable funds (see Figure 1).

Let us assume that r_d is the interest rate paid on deposits by banks, whilst "r" is the interest rate effectively levied on loans to firms. "m" stands for the additional information and monitoring costs (on top of the interest rate r_d) banks have to support in connection to their intermediation activity. "m" also takes into account the degree of monopoly power characterizing the banking sector. The supply of funds is upward sloped with respect to the interest rate r. The demand of funds is downward sloped in the (r–I) space.

Now assume that the national government heavily restricts the operativeness of the financial system by imposing a ceiling r^C to the interest rate levied on intermediated funds. As a consequence, banks collect funds in an amount equal to S, and finance investment projects in an amount equal to I. A considerable amount of additional investment ($\bar{I}$–I) possibly undertaken at the forcedly low interest rate r^C is not financed due to lack of savings. In the end, the "short side of the market" binds financeable projects. On top of such a "quantitative" outcome of governmentally imposed financial repression, also undesirable "qualitative" effects must be taken into account. Indeed, a few amount of poorly remunerative investment projects are financed, whilst many more remunerative entrepreneurial initiatives (I*–I) are

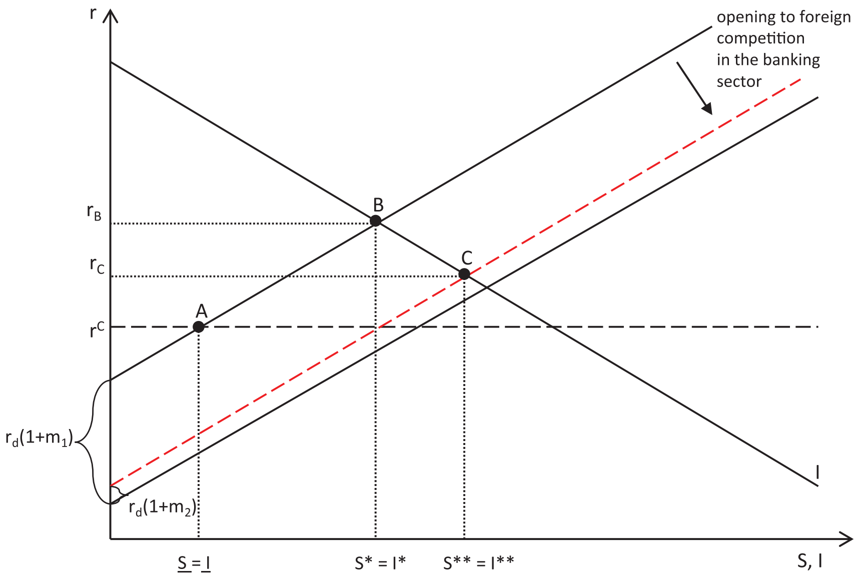

Figure 1: The Market for Loanable Funds in the Mainstream Theory.

eventually cut-off. This investment would otherwise have been financed under free market mechanisms (see point B in Figure 1). Such a distorted and inefficient allocation of loanable funds would be even exacerbated in presence of "direct credit policies" diverting funds away from private sector investment towards inefficient and poorly remunerative (due to the lack of a strong incentive for profitability) state-owned firms.

Now assume that the domestic financial sector is liberalized and any repressive policy removed. Free market mechanisms naturally bring the economy from point A to point B, with a clear increase in household savings (from S to S*), intermediated funds, and financed investment (from I to I*). In the case of developing countries, the opening of the domestic financial sector to foreign competition and foreign financial flows can also contribute to significantly improve the efficiency of the financial sector (through the adoption of international best practices) and discard any dominant position (by increasing competitive pressures). A reduction in the mark-up rate from m_1 to m_2 ensues. Accordingly, the supply schedule moves downwards, prompting a further increase in intermediated funds (S**) and financed investment (I**).

The story narrated by the supporters of financial liberalization is simple and catchy, but affected by two relevant flaws. First, following Akyüz (2014), standard mainstream theory often neglects that households, i.e. saving institutions par excellence in economic models, usually hold credits and debts at the same time. Consequently, households' reaction to financial liberalization and increases in interest rates may well go counter to what expected. Savings could actually fall rather than increase after financial liberalization, so that financial liberalization could not bring any positive effect on the volume of intermediated loans. Second, and perhaps more relevantly, mainstream theory usually takes financial operators as performing a pure function of intermediation between final savers and final investors. This way, it leaves banks' credit out of the picture. It does not appropriately consider the capacity of the banking system to *create* purchasing power ex nihilo rather than simply transferring it from creditors to debtors. The existing empirical evidence tells us that financial and capital account liberalization significantly influences economic dynamics through credit availability, i.e. by affecting the willingness of the banking sector, and financial markets more in general, to create credit for both domestic and foreign actors. When the role of credit creation and of its pro-cyclical evolution are appropriately taken into account in describing macroeconomic dynamics emerging out of financial liberalization, also the dangers set by financial liberalization itself to macroeconomic stability appear clearly.

2.1. Financial Liberalization and Macroeconomic Instability: Are Gradualism And Good Institutions The Right Remedy?

After almost 40 years of financial and capital account liberalization in both developed and developing countries, there seems to be a solid empirical evidence that financial crises have become much more frequent in the aftermath of such reforms. Knoop (2013) cites a previous paper by Kaminsky and Reinhart, and notes that "in 26 banking crisis episodes, 18 of them occurred within five years of significant financial liberalization (Knoop, 2013, p. 94)". Knopp also stresses that "in countries where financial liberalization has recently taken place and where there existed high pre-crisis levels of credit growth and low levels of bank capitals, banking crises were significantly more likely to occur (Knoop, 2013, p. 84)". The reason for such financial liberalization-led instability lies "in the role that financial liberalization plays in freeing banks to engage in riskier behaviour. This can encourage moral hazard lending and a rapid expansion in credit and leverage. Much of this credit gets funnelled into asset markets, creating debt-fuelled price booms (Knoop, 2013, p. 85)". Bank crises and asset markets boom-and-bust seem to be tightly connected, since "stock and housing bubbles consistently precede banking crises in both developed and emerging economies (Knoop, 2013, p. 94")."

Financial instability is even exacerbated when domestic financial liberalization is carried out together with capital account liberalization. Indeed, freeing capital flows allows (rampant) foreign capitals to take part in asset booms following domestic financial liberalization, thus making booms and the ensuing collapses even more pronounced. Also, domestic banks can get easier access to cheap international loans to then finance strong expansions in domestic credit. Such a connection between foreign debt and domestic credit exposes the domestic financial sector to dangerous exchange rate mismatching, as well as to the volatility of external financing. The whole domestic economy eventually gets much more vulnerable to external shocks. It is not by chance that "booms in external debt levels consistently precede banking crises as part of the overall boom in credit (Knoop, 2013, p. 94)".

The tight connection between domestic and external financial liberalization and financial crises casts serious doubts on the alleged ability of financial liberalization to favour financial development and thus economic development. This holds in particular if one takes into account the high real-side costs, i.e. overall economic contraction, lower or stagnant investment, dramatic job losses and high unemployment levels, usually associated to financial shocks.

These facts notwithstanding, several mainstream economists still maintain that financial liberalization is potentially beneficial. According to them, it is not financial liberalization in itself to set risks for macroeconomic stability, but the way such reforms are implemented. This is the logic embraced by Todd Knoop. In his words, "*indiscriminant and rushed* [italics is mine] financial liberalization has repeatedly led to asset bubbles and banking crises throughout the world over the last 30 years (Knoop, 2013, p. 110)". This has happened because "financial liberalization can only increase growth when the *microeconomic* [italics is mine] fundamentals for solid growth are already in place (Knoop, 2013, p. 111)". In turn, such microeconomic fundamentals mainly consist in good institutions and high-quality governance in the form of well-developed prudential regulation; rules of the game encouraging competition; well-developed legislation ensuring property rights, favouring quick resolutions of legal conflicts and avoiding corruption; macro-policy rules favouring macroeconomic stability (i.e. central bank commitment to low inflation and fiscal rules impeding governments to run unsustainable fiscal deficits). In Knoop's own words, "without institutions such as prudential regulations in place, there is no reason to think that liberalization will increase growth […]. Capital account liberalization is beneficial for growth only when good institutions and quality governance are first in place [and] the impact of liberalization depends crucially upon how it is sequenced (Knoop, 2013, pp. 112, 113)".

Knoop proposes financial liberalization to be included in a wider set of reforms staged in the following way:

(1) The liberalization of the domestic good market comes first, including the opening of the home economy to international trade
(2) The second step to adopt is macroeconomic stability. This implies low inflation and consequently the avoidance of large fiscal deficits that could be eventually

monetized under pressures by national governments on the domestic central bank. From an institutional point of view, the corollaries of macroeconomic stability are the adoption of an inflation targeting monetary policy rule; of an independent central bank; of a fiscal policy rule binding domestic governments to balanced fiscal budget (at least in the medium run)

(3) The next step is micro-prudential regulation, particularly in the form of capital adequacy ratios imposed to banks, and restrictions to moral hazard lending. When prudential regulation is in place, domestic authorities can then proceed to liberalize domestic financial systems (i.e. deregulate bonds and stock markets and privatize state-own banks)

(4) The final step is capital account liberalization, which should be staged in such a way that long-term foreign direct investment is liberalized first and short-term portfolio investment as the last.

Interestingly, Knoop interprets some of the most recent financial crises hitting emerging economics as due to the lack of one or more of these preconditions. In the case of the 1994 "Tequila crisis" in Mexico, most of the problems lied in a process of privatization of domestic banks actuated too rapidly without introducing adequate anti-corruption, pro-competition, and micro-prudential regulations. At the beginning of the 90s, Mexican "privatization took place rapidly and without sufficient transparency to prevent corruption […]. Significant barriers to entry were not removed…so that state-owned banking monopolies were replaced with privately owned banking monopolies […]. Most importantly, little prudential regulation was put in place to moderate banks' behaviour once they were deregulated. Bank capital requirements were lower than international standards and connected lending and corruption were rampant (Knoop, 2013, pp. 95, 96)".

Knoop provides the same explanation for the East Asian crisis. Despite quite good macroeconomic fundamentals, such as low inflation and low budget deficits, the banking systems of those economies were exposed to significant currency mismatch, and, even more importantly, they were weakly and badly supervised: "Despite dangerous levels of currency mismatch, a banking crisis in East Asia was not inevitable if the banking system in the region had been making profitable loans and held fundamentally valuable assets. Unfortunately, this was not the case, as loan quality was extremely weak because of the extensive problem of moral hazard […]. Moral hazard was largely unchecked by prudential regulation after the financial deregulation of the 1980s […]. One final source of moral hazard in East Asia was the belief among banks that any large losses they incurred would eventually be assumed by the government in a bailout (Knoop, 2013, pp. 150, 151)".

Last, in the case of the 2001 Argentinian crisis, Argentinian institutions did well both in terms of restoration of inflation control (after a period of hyper-inflation) through the adoption of a currency board exchange regime, as well as of supervision and regulation of the banking system. Here, the missing requirements (for successful liberalization) were efficient and competitive good and labour markets, and, more importantly, a disciplined fiscal policy:

> There were three significant problems with this 'Argentinian miracle' of the 1990s. The first is that within this strong system of prudential regulation there were few restrictions on dollar-denominated debt […]. The second problem was Argentina's lack of fiscal discipline […]. The third problem was the general microeconomic inefficiency of Argentinian labour and product markets (Knoop, 2013, p. 134).

In Knoop's view, the persistence of inefficient and inflexible labour and good markets was inconsistent with the adoption of a currency board. Indeed, a hard peg exchange rate regime would have required extremely flexible prices and wages accommodating any external shock through internal nominal adjustments. On top of this, excessive government borrowing made the exchange rate peg and the central bank commitment against inflation poorly credible:

> A currency board could never work in Argentina given their dysfunctional institutions and their inability to play by the rules. Outright dollarization would have been a better option if Argentina was truly committed to stabilizing inflation and promoting economic integration with the rest of the world, as it would have taken monetary policy entirely out of the hands of Argentinian government (Knoop, 2013, p. 136).

3. THE INTRINSIC INSTABILITY OF FINANCIAL DYNAMICS AND CAPITAL FLOWS: THE QUEST FOR DEFINANCIALIZATION

There is a series of contradictions in Knoop's arguments, as well as in the more general view that good institutions and quality governance are necessary and sufficient (pre-) requirements for successful financial liberalization. First, some of the prudential regulations Knoop is advocating effectively amount to restrictions to capital flows and to the free behaviour of deregulated financial institutions. This is the case of limits to the accumulation of foreign currency denominated debt. In the end, and perhaps paradoxically, it seems mainstream economists ask for wide financial liberalization on the one hand, but they also demand for regulatory measures that would impede *full* financial liberalization on the other. Second, lack of fiscal discipline by domestic governments does not seem to be a primary source of financial disruption. Knoop himself notes that "banking crises cause sovereign debt crises, but not vice versa (Knoop, 2013, p. 94)". Indeed, empirical evidence shows that financial crises took place even when public budgets were well managed and under control. Rather, it was the private sector to be the leading source of financial instability. Third, Wolfson (2013) reports a long list of bank and asset market collapses, possibly causing systemic crashes, taking place *even* in the worldwide most developed US financial system since the end of the 1970s. Interestingly, Wolfson (2013) notes how these crises are significantly different from the typical Minskian financial disturbances characterizing the golden age of capitalism, which were less frequent, less severe and generally associated to the peak of the real business cycle. Also, it is worth noting that the new financial instruments and institutions, which contributed to spread the last sub-prime crisis and make it a systemic shock, were initially conceived as safe products/institutions, functional to improving the operativeness of the financial system. This is the case of securitization and collateralized debt obligations (CDOs) transforming high risky mortgages in investment grade assets. This is also the case of credit default swaps (CDS) providing private insurance against defaults events, or repurchase agreements (REPOs), i.e. secure collateralized lending. Finally, the same can be said about money market mutual funds' shares, which were considered as more remunerative substitutes for bank deposits.

Following Arestis (2017), all the above observations are in line with the Minskian "theory of endogenous financial instability, which can explain the tendency of the financial system to generate crises as part of its 'normal' functioning (Arestis, 2017, p. 23)". Also, they are in line with Kindleberger's view that (endogenous) financial innovations are the ultimate sources of destabilizing asset bubbles, and that they can hardly be prevented by any micro-prudential regulation (see Knoop, 2013). Indeed, following Ülgen (2017b): "in liberalised and innovative financial markets, complex interconnections are created among different institutions. These connections contribute to the development of financial markets and give the impression of a greater efficiency in the use of loanable funds, but at the same time they contain the seeds of a contagion at systemic level, a contagion that is out of the reach of individuals and financial institutions. [This is why] in liberalized market economies, there is no automatic bridge between micro-prudential behaviour and macroeconomic stability (Ülgen, 2017b, pp. 62–65)".

Akyüz (2014) reframes these points in the context of emerging and developing countries whose capital accounts have been liberalized and opened to foreign capitals. He criticizes the "weak institutions" interpretations of financial crises by noting that "financial openness tends to create *systemic* problems *regardless* [italics is mine] of the order in which various markets are liberalized and distortions removed (Akyüz, 2014, p. 39)". This is why, even though prudential regulations and bank supervision are important to avoid moral hazard and financial instability, "measures such as capital requirements are not always enough to reduce financial fragility: it may also be necessary to act directly on the asset portfolio of banks and restrict lending against or investment in highly capital-uncertain assets, such as securities and property (Akyüz, 2014, p. 46)". This is a clear quest for the reintroduction of much tougher and pervasive regulations and controls of financial operators, i.e. a return to some form of financial repression.

Akyüz (2014) provides at least four reasons to support the (re) introduction of restrictions, if not the complete ban of some forms of capital inflows, in particular in the case of emerging/developing countries.

(1) Mainstream economists advocated the liberalization of developing countries' capital accounts, and in particular the opening to foreign direct investment (FDI), in order to increase available (domestic and foreign) savings and raise investment. However, the empirical evidence about the alleged positive link between surge in (liberalized) FDI and savings/investment is weak to say the least. Most of the time, total savings did not grow at all. Foreign savings simply displaced domestic ones. On top of this, since the 1990s, Latin American countries experienced considerable increases in net FDI, but gross fixed capital formation stagnated or even fell with respect to pre-crisis decades. The same can be said for African countries. Only in rapidly growing East Asian newly industrialized countries a positive relationship between FDI and investment seems to exist. In the end, fiscal and monetary policies do emerge as the most relevant determinants of investment decisions rather than capital account liberalization per se. On the one hand, capital accumulation seems to respond positively to monetary policies that keep interest rates relatively low, and maintain the real exchange rate at a stable and competitive level. Similarly, investment decisions seem to be positively affected by disciplined fiscal policies, which nevertheless maintain high levels of public investment, and do not blindly pursue austerity targets. On the other hand, restrictive monetary and fiscal policies can cause a significant slowdown in productive investment. Following Akyüz (2014), restrictive policy stances have been often adopted in many emerging economies in the aftermath of capital account liberalization in order to attract foreign investment. Such policies certainly "played an important role in creating conditions favourable to asset acquisition but not to fixed capital formation [so that the economy eventually experienced] strong surges in FDI but stagnant or declining gross fixed capital formation (Akyüz, 2014, p. 87)".

(2) Financial and capital account liberalizations, and the ensuing initial booms in capital inflows, are often the primary sources of boom-and bust cycles and pronounced macroeconomic volatility. Indeed, capital flows are strongly pro-cyclical. According to Akyüz (2014), most international capital flows are portfolio investment characterized by short-term speculative purposes. They likely overflow in recently liberalized developing countries in order to exploit capital gain

opportunities in the security market or in the real estate, or to take advantage of arbitrage opportunities linked to high interest rate differentials. This way, massive portfolio investment gives rise to credit booms and asset bubbles that come together with unsustainable macroeconomic imbalances: exchange rate appreciations, widening current account (CA) deficits, over-indebtedness on external financial markets and currency mismatch in the balance sheets of domestic banks and firms. When, sooner or later, booms end and bubbles burst, sudden stops and capital reversals of short-term portfolio investment trigger the crisis by inducing exchange rate gyrations and asset price collapses. In the case of developing countries such financial shocks eventually give rise to abrupt economic contractions.

(3) Developing countries do not have margins of manoeuvre. They can hardly contrast the destabilizing forces of free capital flows with their own macroeconomic policies. In the end, under full capital account openness, both monetary and fiscal policies face relevant dilemmas, and turn out being pro-cyclical.

Monetary policy, for instance, may try to tame the initial foreign credit-led boom by increasing interest rates. But domestic interest rates persistently higher than foreign ones attract foreign capitals even further. Alternatively, domestic central banks can try to avoid the initial appreciation of the (real) exchange rate by intervening on the foreign currency market and piling up reserves. In doing this, however, they will allow for the expansion of domestic credit, hence, fueling the boom. Finally, the attempt to sterilize the newly created base money faces the risk of increasing the interest rate on government bonds, and putting the solidity of public budget under pressure.

In the case of fiscal policy, empirical evidence shows it often turns to be expansionary when foreign capitals surge due to the attempt to take advantage of easy and cheap access to foreign lending. Nonetheless, when the crisis erupts, it turns into ultra-restrictive, thus strengthening deflationary pressures in the economy.

(4) Last, the economic crashes following financial crises are particularly severe and can last much longer than "normal" recessions associated to pure real business cycles. Indeed, exchange rate and asset price collapses cause considerable financial disarray in the balance sheets of banks and non-financial firms. Banks try to deleverage and ration credits, this way jeopardizing new entrepreneurial projects in search for external funding. Non-financial firms exploit recovery in order to primarily consolidate their financial position, so that productive investment and employment creation usually lag far behind. Post-financial upswings, if they ever take place, are usually characterized by jobless, mild recoveries characterized by depressed investment. Empirical evidence shows that over the

entire (finance-driven) business cycle job destruction is deeper than (initial) job creation, and that growth rarely returns at pre-crisis levels even in East Asian miracle economies (see Akyüz, 2014; Chandrasekhar, 2013).

4. ENDOGENOUS FINANCIAL CRISES IN THE WORLD ECONOMY: REFORM PROPOSAL FOR GLOBAL GOVERNANCE

The response of emerging economies, in particular East Asian countries, to financial instability has taken the form of macroeconomic policies aimed at avoiding the emergence of new financial turbulences.

(1) Several emerging/developing countries have adopted *managed* exchange rate regimes in place of hard pegs. On the one hand, the former provide emerging economies with more autonomy in the conduction of monetary policies. On the other hand, managed exchange rate regimes leave central banks potentially free to intervene on foreign currency markets when exchange rate dynamics are inconsistent with the economic goals of domestic authorities. Since 1997, East Asian countries have deliberately attempted to maintain a competitive and depreciated (real) exchange rate in order to avoid CA deficits.
(2) Consistently with the previous point, the central banks of East Asian countries (as well as, the central banks of many other developing countries) have accumulated enormous amounts of foreign reserves. Of course, this is functional to maintaining a depreciated exchange rate. Also, it constitutes a precautionary stand against possible speculative attacks against domestic currencies.
(3) In East Asian countries, "*hyperactivism*" on the foreign currency market has been accompanied by a relatively tight monetary policy and extremely stringent prudential regulation, which eventually cut available credit for domestic investment (see Chandrasekhar, 2013, pp. 319, 320).
(4) Fiscal policy has been generally restrictive. This is consistent with a more general policy stance aimed at compressing domestic demand and putting even more emphasis on export-led growth. This is why Chandrasekhar (2013) describe the ensuing gap between domestic savings and investment as the result of an *investment famine* rather than a savings glut.

Deflationary policies certainly contributed to the relative anaemic growth records (with respect to the 1970s and 1980s) that even successful East Asian countries registered after 1997. This fact provides an additional good reason for the reintroduction of quantitative restrictions, and sometimes complete impediments, to certain capital flows, in order to open more space for autonomous expansionary policies. Nonetheless, restrictions to capital flows represent just a single piece, although important, of a more general reform strategy of the global governance of international financial markets, and of the world economy as a whole. This is due to the fact that the financialization of developed economies is *endogenous* to the evolution of capitalism, as are recurrent surges in capital flows to developing countries and the subsequent crises. Hence, a systemic approach to the issue of global finance and economic development is needed.

Arriola (2017) describes the financialization of developed countries as the consequence of "the depletion of the sources of growth of relative surplus value (Arriola, 2017, p. 33)". Accordingly, the most recent financial crisis must be "analysed from the long-term trends that manifest themselves in the form of a structural crisis of capitalism. [It is] the symptom of the exhaustion of the procedures set up by US capital in the late 1970s and early 1980s to continue to attract material resources from all around the world (Arriola, 2017, pp. 32, 33)". From the point of view of developing countries, recurrent surges in capital inflows take place when "peripheral" countries offer higher remuneration to global capital than advanced economies do. This often happens in connection with cheap money and abundant liquidity on international markets, and (post-crisis) economic stagnation in the "centre" of the global system. In the end, the financial turbulences of the last 40 years must stand out as endogenous components of the post-Bretton Woods era.

The financial order emerging out of the end of the Bretton Woods system is "the result of the US decision to deal with its balance of payments problems without any real adjustment of its economy (Arriola, 2017, p. 33)". D'Arista and Erturk (2013) define such a regime as the "Unilateral Dollar Standard". In this system, the US Dollar has become the international reserve currency without any remaining connection with gold. This has allowed the US trade deficit to become structural, and actually necessary to maintain global growth. Also, it has induced a restricted bunch of surplus economies, i.e. Germany, Japan and oil-exporting countries, to invest their surpluses in the US financial system. The US financial system has then recycled such capitals into developing economies, with the well-known consequences in terms of heightened instability in the latter.

Such a triangulation has partially broken down after the outbreak of the East Asian crisis. Since then, East Asian countries have adopted quite restrictive policy stances in order to achieve large CA surpluses. Together with China, they have accumulated massive foreign reserves, as many other developing countries started to do thanks to capital inflows larger than CA deficits. Mounting reserve stocks in emerging economies mirrored the allocation of BoP surpluses in the US. Differently from the past, these funds have been mainly re-lodged in the US economy, fuelling the housing bubble and a household debt-led growth regime, rather than redirected towards developing economies. Nonetheless, such a different way of "recycling" international imbalances has equally led to the very same unstable outcomes.

Alongside with the above changes in the international financial architecture, also international economic institutions have significantly modified their modus operandi. Since the breakdown of the Bretton Woods system, the IMF has increasingly addressed long-term development goals and poverty reduction. Long-run economic development has been pursued through the concession of financial support conditional to the implementation of comprehensive structural reforms in the fields of trade, industrial, labour market, monetary and fiscal policy. The IMF has been increasingly involved in the resolution of financial crises. In doing this, the IMF's loans have been used to maintain capital account convertibility and secure the reimbursement of foreign credits. Poor attention, if any, has been devoted to the financing of (temporary) CA imbalances and the support of economic activity, i.e. the IMF's original tasks.

Akyüz (2014) proposes a rather radical reform of international economic governance in order to address the existing structural CA imbalances, and to promote world-wide prosperity. His proposal is in turn consistent with the need to overcome the "*Unilateral Dollar Standard*" as emphasized by D'Arista and Erturk (2013); Ocampo (2013). A few points are worth mentioning.

(1) The IMF should return to its primary (and original) goal, i.e. short-term financing of temporary CA imbalances. The IMF's loans should act as a buffer against the volatility of private capital flows and possible trade shocks (say temporary reductions in the prices of primary commodities). They should aim at maintaining growth and employment, and avoid the correction of CA imbalances through drops in economic activity and imports.
(2) Long-term development and poverty reduction should be out of the scope of the IMF. The financing of development policies is primary responsibility of the World Bank. Accordingly, IMF loans should be totally delinked from any structural conditionality. Conditionality on IMF loans, if any, should be related to the nature of the CA imbalances they address. Conditionalities on fiscal, monetary and exchange rate policies should be imposed only in the case of CA deficits due to excessive domestic absorption and expansionary policies. When CA deficits are the consequence of temporary shocks, IMF financing should come with no conditionality. The financing of structural CA imbalances due to the development needs of backward economies should be accommodated by long-term loans conceded by development institutions, certainly not the IMF.
(3) The IMF should not be engaged in the resolution of financial crises. Rather, it should focus on their prevention by strengthening the surveillance of macroeconomic policies. In the past, the IMF performed very poorly as to foreseeing and neutralizing upcoming crises in emerging economies. Also, it wrongly interpreted them as uniquely due to unsustainable fiscal and monetary policies, so that the austerity packages subsequently advised (or imposed)

simply made post-financial crisis recessions even deeper. In the future, the IMF should adopt a symmetric stand. It should recognize the role played by volatile financial capitals and by spill-over effects emanating from macroeconomic policies in developed countries as relevant factors behind financial crises in emerging economies.

(4) Problems of debt overhang should actually be disciplined by ad-hoc international regulations as happens at national level. In this sense, Ocampo (2013) put forward the institution of an international debt court. And Akyüz (2014) stresses how the rules regulating international debt crises should foresee temporary debt standstills and automatic rollovers to alleviate the costs of debt management on the shoulder of debtor countries.

(5) Finally, D'Arista and Erturk (2013); Ocampo (2013), and Akyüz (2014) support the idea of transforming *Special Drawing Rights* (SDRs) in the new international reserve currency in place of the US Dollar. The IMF, or a new international monetary authority, should be responsible for issuing SDRs. Issuances should be based on country needs rather than on quotas to the IMF. In their view, all these measures should aim at correcting existing external imbalances, but at the same time create the condition for the adoption of expansionary stances. On the one hand, developing countries would be allowed to downplay the current overemphasis on the accumulation of foreign reserves, and abandon the "obsession" for export-led growth regimes. Even further, international resources could be increasingly deployed in developing countries to support productive investment and development efforts, rather than being diverted towards the US financial system. In the end, a much more equitable international monetary system would emerge, closely similar to that originally thought by John Maynard Keynes.

5. CONCLUSIONS

After decades of increasing financial liberalization, a quite widespread consensus is growing among economists that the opening of developing countries' capital account to foreign capitals can seriously impinge on their own financial and macroeconomic stability. Thus, two different strategies have been proposed to avoid serial financial crises in the aftermath of financial liberalization. The first proposal is centred on a "single-country" approach. It simply requires each single economy to first adopt adequate *micro*-prudential regulations, and to appropriately liberalize other parts of the economy (the good and labour markets, for instance) before embarking on financial liberalization. The adoption of good institutions and high-quality governance would be enough to ensure the latter to be fruitful. The alternative heterodox perspective relies upon a "systemic approach", according to which recurrent financial crises are endogenous consequences of the intrinsic dynamics of capitalistic economics, as well as of the normal functioning of financial markets. If so, what is needed is the implementation of constantly updated *macro*-prudential regulation, tight impediments to some form of capital flows, as well as a general reform of the existing asymmetric and biased (in favour of the interests of developed countries) international monetary system. In this sense, the Keynes' original request for the institution of an International Clearing House and the introduction of the "Bancor" at the time of the Bretton Woods agreements still constitutes the perfect guide describing how world international institutions should evolve to secure financial stability and global shared prosperity.

REFERENCES

Akyüz, Y. (2014). *Liberalization, Financial Instability and Economic Development*. London: Anthem Press.

Arestis, P. (2017). Financial liberalization, crises and policy implications. In F. Ülgen (Ed.), *financial development, economic crises and emerging market economies* (pp. 12–30). London: Routledge.

Arriola, J. (2017). Global financing: A bad medicine for developing countries. In F. Ülgen (Ed.), *Financial Development, Economic Crises and Emerging Market Economies* (pp. 31–50). London: Routledge.

Chandrasekhar, C. P.., & Ghosh, J. (2013). The Asian financial crisis, financial restructuring and the problem of contagion. In M.H.. Wolfson, & G. A.. Epstein. (Eds.), *the handbook of the political economy of financial crises* (pp. 311–325). New York: Oxford University Press.

D'Arista, J., & Erturk, K.. (2013). Global imbalances and the international monetary system. Problems and proposals. In M. H. Wolfson & G. A. Epstein. (Eds.), *The handbook of the political economy of financial crises* (pp. 230–247). New York: Oxford University Press.

Knoop, T. A. (2013). *Global finance in emerging market economies*. London: Routledge.

Ocampo, J. A. (2013). International and regional cooperation for dealing with financial crises. In M. H. Wolfson & G. A. Epstein (Eds.), *The handbook of the political economy of financial crises* (pp. 544–562). New York, NY: Oxford University Press.

Ülgen, F. (2017a). Financial development, economic crises and emerging market economies. London: Routledge.

Ülgen, F. (2017b). Financial development, instability and some confused equations. In F. Ülgen (Ed.), *Financial development, economic crises and emerging market economies* (pp. 51–76). London: Routledge.

Wolfson, M. H. (2013). An Institutional theory of financial crises. In M. H. Wolfson & G. A. Epstein (Eds.), *The handbook of the political economy of financial crises* (pp. 172–190). New York, NY: Oxford University Press.

Wolfson, M. H., & Epstein, G. A. (2013). *The handbook of the political economy of financial crises*. New York, NY: Oxford University Press.