

FINANCIALISATION AND THE FINANCIAL AND ECONOMIC CRISIS

THE CASE OF SOUTH AFRICA

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The Nature and Form of Financialisation in South Africa is conditioned by industrial and financial developments before 1994. This is an edited abridgement from a paper produced by the Financialisation, Economy, Society and Sustainable Development (FESSUD) project, an extensive EU-funded research programme.

Over the past three decades studies on financialisation have rightly focused on the emergence of the financial sector as the new economic vortex in advanced industrial societies. Like a veritable centre of gravity, it has sucked capital investment from other sectors and re-calibrated their orbits to the point that some resemble dying stars. Financialisation marks a turning point in advanced capitalism: from a base of production to the stratosphere of speculation. It manifests the choices that owners/investors make about their preference for what to do with the profits they earn. The effects of this shift from a production economy to a casino economy are now well documented and more popularly understood, thanks to the financial crisis of 2007 – 8. What is less known are the welter of effects financialisation has had on a number of other spheres of social and economic life in emerging economies.

Financialisation is generally traced back to the 1980s when a wave of conservatism swept across some advanced industrial countries, in particular the United States and the United Kingdom. However, the ideological father of this conservatism, which became known as neoliberalism, penned his ideas in 1960 (see the article by George Monbiot in this edition). Its effect has been wide and deep across the globe, and particularly devastating for the socio-economic development of the poor



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in countries of both the north and south. But what are the specific effects of financialisation in an emerging industrial country like South Africa? How exactly can we assess its impact? This is an aspect of the casino economy that has only recently been given serious attention. Newman's study analyses some key financialisation indicators for South Africa across the areas of: financialisation and distribution; financialisation and consumption; financialisation and investment in the capital stock; and financialisation and the current account to aid comparison across country case studies.

While a global process, the form that financialisation has taken in South Africa and its implications on distribution and unemployment is conditioned upon the specific nature of industrialisation and economic development that extends further back in time than the era of financialisation often identified as beginning around 1980. It is the particular industrial and economic structure that was built during this period that laid the foundations for the rapid financialisation and deindustrialisation of the economy from the early 1990s.

As we will see below, financialisation of the South African economy has led to the reproduction of apartheid patterns of investment and thus the persistence of its skewed industrial structure with serious implications for employment and inequality. The period from the mid-1980s until the early 1990s saw persistently large financial surpluses as a share of GDP in the domestic economy. This led to an increase in acquisition of financial assets by non-financial corporations throughout the 1980s that fuelled the rapid expansion of, and developments in, the financial sector made possible by a series of financial sector reforms.



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From 1994 onwards the economy went from being a net lender to a net borrower from the rest of the world. These (largely short-term) inflows fuelled financialisation of the domestic economy and the further expansion of the financial sector.

The form that financialisation has taken in South Africa is conditioned upon the historical development of finance and industry during the period of apartheid and shaped by the macroeconomic policies of the post-liberation era. In this way, the long-run development trajectory of South Africa does not conform to one of the four dominant types: (a) debt-driven consumption boom; (b) domestic demand-led; (c) weakly export-led; or (d) export-led mercantilist). Rather, South Africa's growth trajectory is characterised by a combination of these processes that differ in relative importance at different times. Growth in the 1960s and 70s was largely driven by domestic investment and consumption. The crisis of the 1980s saw considerable divestment and an overall reduction in investment. The 1990s saw an increase in the importance of exports as a key driver of growth and the period since 2000 has seen consumption led growth driven by debt and an increasing significance in gross capital formation attached to large infrastructural investment programmes.

FINANCIALISATION AND DISTRIBUTION

Paradoxically, the period of majority rule has seen worsening inequality in the income and wealth distributions. At the top of the income distribution this is driven in part by the increased income derived from financial assets and asset inflation and the highly unequal distribution of financial assets across income groups. Unemployment is a major factor for income inequality and this has its roots in the structure of

the economy and de-industrialisation associated with financialisation. Wage inequality is the main driver of inequality in South Africa. Again, its association with financialisation comes from corporate restructuring associated with financialisation, namely downsizing and outsourcing of non-key functions and increasingly precarious employment standards and high levels of informality that place downward pressures on wages for low-skilled jobs.

There have been significant changes in the composition of racial inequality in that income inequality within racial groups has become increasingly more significant than inequality between racial groups. (Leibbrandt et al. 2010) It might be argued that neoliberalism and financialised accumulation have replaced the system of apartheid as the drivers of inequality in South Africa.

Income inequality, as measured by the inverted Pareto-Lorenz coefficient is higher today than for any time during National Party rule. The most dramatic increase in income has been experienced by the top 10% of the population who saw an increase of 4.2 percentage points in their share of total income between 1993 and 2008. The income share of the bottom 10% increased by 1.36 percentage points. The income share of the second to ninth deciles each saw a reduction in income share. Changes in the distribution of income and patterns of income growth mirror the distribution of financial assets held by households across the income distribution.

Moreover, the effect of financialisation on inequality has largely occurred via its effect on employment and has its roots in the industrial structure which is heavily skewed towards capital intensive industries connected to extractive industries. The wage share of GDP fluctuated around 55% from the 1940s until late 1970s. From the early 1980s a downward trend in the wage share of >>

GDP can be discerned. This downward trend mirrors the upward trend in the profit share of GDP over the same period.

Non-financial corporations in South Africa have been acquiring high levels of financial assets in lieu of productive investment since the 1980s, prior to the period of financialisation, as a result of political and economic uncertainty. Since 1994, fixed investment has recovered somewhat but with no commensurate reduction in financial investment. Non-financial corporations in South Africa use banks and capital markets to increase their financial and speculative positions. Evidence presented suggests that the shareholder preference channel is relatively weak. There is an evident preference by firms for financial investments generating short-term returns.

FINANCIALISATION AND CONSUMPTION

The relationship between financialisation and consumption varies across income groups. In aggregate, consumption as a share of GDP has been relatively stable, fluctuating between 60 and 65%. At the same time, household disposable income, as a share, has been declining dramatically. There has been increasing levels of indebtedness at all levels of income distribution. At the upper deciles of the income distribution this is related to mortgage and consumption loans. The poor have also increased their reliance on credit for consumption but this has been driven by high levels of unemployment, precarious employment relations and unstable incomes.

Consumption as a share of GDP fell throughout the apartheid period until 1980 when the trend turned positive until the early 1990s when consumption as a percentage of GDP stabilises at around 64 per cent. Between 2000 and 2007, domestic

consumption was the strongest driver of growth year on year. Debt driven consumption in South Africa is concentrated in the relatively wealthy sections of society and has facilitated the increased acquisition of financial assets by some households without an associated fall in consumption.

The savings and investment behaviour of households has changed profoundly since the 1970s. Data shows



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a long-run declining trend in the aggregate propensity of households to save out of disposable income since 1960. Since 2006, the ratio of net savings to disposable income for households has been below zero, representing dissaving, which has occurred as a result of growing indebtedness (increased incurrence of financial liabilities) and not a fall in the acquisition of financial assets by households.

Households receive around 50% of total credit extended to the private sector each year. The bulk of credit received by households has been in mortgages. Mortgage lending has been increasing as a share of GDP since the early 1990s.

Consumption credit allowed households in aggregate to expand their acquisition of financial assets

without forgoing current consumption. The period from 1995 to 2007 saw a fall in the share of wages to household disposable income that resulted in the growing significance of property income. The post financial crisis period has seen wages increase in importance as a source of household income..

Amongst the components of assets and debts, financial asset are the most unequally distributed. The top decile in the wealth distribution own 85% of all assets and the top 5% hold 75% (Finn, Leibbrandt & Levinsohn 2012).

Financialisation has led to changes in the savings and investment behaviour of the 25% of households at the top of the income and wealth distribution. For these households, future income and consumption have become highly integrated with capital markets as they increasingly depend upon dividend and interest payments and stock prices. This, together with the lack of access to financial assets and credit for the majority has profound implications on income and wealth inequality. (Ashman, Mohamed & Newman 2013). The project of 'financial inclusion' has also seen increasing indebtedness in the lower deciles of the income distribution.

FINANCIALISATION AND INVESTMENT IN THE CAPITAL STOCK

Because of its lack of integration with economic activities more broadly, expansion of the MEC-core (Minerals –Energy Complex) has occurred in relative isolation from, and at the expense of, non- MEC sectors, in particular labour intensive manufacturing of consumer goods. A major corollary of this has been an industrial structure 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.

MEC sectors continued to dominate in domestic value-addition until the 2000s when finance and business services took over as the largest contributor to domestic GVA. The late 1980s and the 1990s saw the rapid divestment and decline of non-MEC manufacturing sectors. Economic growth since 1994 has been driven by financial and business service sectors.

Investment in the capital stock stagnated in the 1980s as the debt crisis, the crisis of apartheid and economic sanctions culminated into a situation where domestic capital was reluctant to invest. But despite the transition to democracy in 1994, investment in the capital stock did not pick up until 2002. This increase in investment has been highly uneven in terms of its distribution across industrial sectors, and has largely been driven by state sanctioned infrastructure mega projects that include provisions for the 2010 Soccer World Cup, energy and port expansion. In 2013, the country planned to spend close to R1trillion on infrastructure (KPMG 2013). If one was to net out the infrastructure spends from fixed capital stock, we would show a picture of stagnant investment. In the section that follows, the evolution of the investment behaviour of non-financial corporations will be discussed.

Traditionally, under a 'productionist' model, firms reinvested significant portions of the surplus obtained from production to increase the capital stock and thus the productive base of the firm. The 'productionist' model saw firms as the core site of capital accumulation. By contrast, the process of financialisation, or a 'financialised' business model, sees an increase in firms' financial operations and motives. The financialised firm has a very different relationship with the financial sector, itself transformed from simple intermediary between households' savings and firms' investment into



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regulator of firm and household behaviour. (Froud et al. 2002) One dimension of this is the tying together of firm performance with performance of its stocks and shares on capital markets associated with the shareholder value movement.

Financial assets as a percentage of fixed capital stock has been increasing since the 1980s. Rather than signalling the onset of financialisation, the increase between 1980 and the early 1990s should be interpreted as the consequence of economic sanctions, tight capital controls and keeping capital within the country together with the reluctance to invest in physical investments for fear of seizure in the case of the political transition. This period also saw an increase in the share of income from financial investment.

We now look at the evolution of the retention ratio for non-financial corporations listed on the JSE. Higher retention ratios are suggestive of investment by firms which fits with rapid increases in the capital stock since the mid-2000s. We should be cautious at drawing such a conclusion, however, without a closer look at the way in which firms finance investment and the types of investment that they finance. As we have already seen, the increase in capital expenditures

by firms was not accompanied by a commensurate decrease in the acquisition of financial assets. Income from financial investments increased from around R750,000 million to around R1.1trillion between 2006 and 2007, and continues to increase thereafter.

FINANCIALISATION AND THE CURRENT ACCOUNT

South Africa has been running a persistently large current account deficit since the late 1990s which has been financed by massive capital inflows attracted by high domestic interest rates. Capital account liberalisation in South Africa has resulted in capital flight and the expansion of short-term portfolio inflows that have financed short-term credit expansion by the banking sector.

The global financial crisis had the initial effect of a contraction in export value, but more importantly a sharp contraction in portfolio inflows and hence a squeeze on credit that had the immediate impact of contraction in manufacturing and wholesale and retail trade sectors. While further relaxing of capital controls saw rapid recovery in financial flows, manufacturing has not recovered. This has had the effect of shifting the distribution of employment for low and medium skilled workers towards lower paid service sectors. South Africa did not suffer the contagion effects owing to its relatively low exposure to toxic US assets and low levels of securitisation.

South Africa ran a current account surplus from 1985 until 1993. During this period there was a sustained outflow of capital seeking a safe haven from the political and economic instability and uncertainty that pervaded South Africa.

In addition to official outflows of capital, capital flight has been a constant feature in South Africa's >>

capital flows. Mohamed and Finnoff (2005) estimated that capital flight as percentage of GDP increased from an average of 5.4 per cent a year between 1980 and 1993 to 9.2 per cent between 1994 and 2000. Ashman et al. (2011) calculated that there was a further increase in capital flight as percentage of GDP to 12 per cent on average between 2001 and 2007. Net exports peaked in 2001, following a contraction in imports in 1999 and little growth in 2000. Since then, net exports has been in decline, becoming negative from 2004. Imports have continued to be greater than exports since 2004.

High interest rates in South Africa have attracted substantial short-term inflows as part of an increasing trend in carry-trade from advanced economies where interest rates have been low.

In addition to financing of the current account deficit, the rapid and extensive liberalisation of exchange controls have in essence regularised much of the illegal outflow of capital from the South African Economy which was estimated to be as much as 20% of GDP in 2007 (Ashman et al. 2011).

Unlike the financialised economies of the global north, the financial sector hardly took a hit. The South African economy has relatively little exposure to US toxic assets. There has been little securitisation of banking sector assets - in 2007, only 3% of mortgages were securitised.

By contrast, manufacturing took a much harder hit and has failed to recover. As already discussed above, financialisation contributed to the long-run decline in manufacturing in South Africa. Manufacturing output in the first quarter of 2009 declined by 12.8 per cent (compared with a 6.8 per cent decline in GDP overall). Other sectors that saw similar contractions included retail and wholesale trade. 484,000 workers lost their jobs in the third quarter of 2009, 150,000 of these were from manufacturing. Employment in manufacturing has not recovered since.



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To summarise, the relatively low levels of securitisation and limited exposure to toxic US assets meant that contagion effects from international financial markets were few. The main transmission mechanisms have been

through a contraction of export value from falling commodity prices and a contraction in portfolio inflows that led to a credit squeeze that had a disproportionately negative effect on manufacturing industries that have on the whole failed to recover. The financial sector benefited from further capital account liberalisation that financed a rapid recovery in credit extension that has led to a recovery in consumption and therefore wholesale and retail sectors. Overall aggregate performance was supported by on-going large infrastructure spend. In a sense, economic policies have dampened the crisis at the macro level but has further cemented the process of financialisation and its implications for domestic investment and inequality. [NA](#)

The complete study on Financialisation in South Africa by Susan Newman can be obtained from FESSUD: www.fessud.eu