PHD

# The impact of financialisation on income inequality in the context of neoliberalism. Country cases study: USA, South Korea, Argentina, Sweden

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**The impact of financialisation on income inequality in the context of neoliberalism. Country cases study: USA, South Korea, Argentina, Sweden**

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## Contents

## List of figures

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**Abstract**

The main purpose of this study is to develop an understanding of the impact of neoliberal financialisation on income inequality. The distributional patterns and their relations to financialisation in four countries (USA, South Korea, Argentina, and Sweden) between circa 1980 and 2010 are analysed and compared. This research involves addressing the question as to whether financialisation facilitates uneven capital accumulation and generates conditions that increase income inequality.

Critical realism's approach to ontology is employed to situate the empirical trajectories of economic disparity in the context of finance capitalism. Drawing on comparative political economy, the analytical framework of a financialisation-induced income inequality hypothesis was developed. This framework is based on the assumption that finance within the neoliberal mode of production facilitates upward income distribution. The investigation included developing three explanatory causal-processual analytical constructs derived from different heterodox schools of thought. It is contended, that in order to comprehend the nature of social reality in the financialisation-income inequality nexus, the non-orthodox methods of an open system, as advocated by critical realists, are required.

The results of this study indicate that there are causal relations between upward income distribution and financialisation of national economies that developed after neoliberal restructuring. In particular, new institutions of neoliberal financialisation regressively affect the functional distribution of income. Specifically, with financial liberalisation, profits and rents in financial sector increase, whilst labour's share decreases, thereby exacerbating the level of private/public debt. In USA, South Korea, and Argentina the hypothesis was confirmed, while in Sweden neoliberal restructuring was not achieved and the national model was not transformed to affect income distribution regressively.

This research has led to the identification of components of upward distribution in finance capitalism and causal links in the financialisation-induced income inequality nexus. An institutionalised generative mechanism of regressive income redistribution is an effect of finance capitalism, which transforms national distributional trajectories.

## Abbreviations

| | |
|---|---|
| ABSs | Asset-Backed Securities |
| ACC | American Chamber of Commerce |
| ACCF | American Council for Capital Formation |
| AEI | American Enterprise Institute |
| ARM | Adjustable Rate Mortgage |
| BRT | Business Roundtable |
| CCEJ | Citizen's Coalition for Economic Justice |
| CHA | Comparative Historical Analysis |
| CPE | Comparative Political Economy |
| DEEs | Developing and Emerging Economies |
| ECU | European Currency Unit |
| EPB | Economic Planning Board |
| ERA | Economic Recovery Act |
| ESRC | Economic and Social Research Council |
| EU | European Union |
| FDI | Foreign Direct Investments |
| FIRE | Finance, Insurance and Real Estate |
| FLD | Financial Liberalisation and Deregulation |
| GDP | Gross Domestic Product |
| GFO | Global Financial Order |
| GNP | Gross National Product |
| GSEs | Government-Sponsored Enterprises |
| IBFs | International Banking Facilities |
| ICT | Information and Communication Technologies |
| IET | Interest Equalisation Tax |
| IMF | International Monetary Fund |
| LO | Trade Union Federation (Landsorganisationen) |

| | |
|---|---|
| M&A | Mergers and Acquisitions |
| MCI | Ministry of Commerce and Industry |
| MOF | Ministry of Finance |
| MOFE | Ministry of Finance and Economy |
| NAM | National Association of Manufacturers |
| NBFIs | Non-Bank Financial Institutions |
| NFC | Non-Financial Corporations |
| NGOs | Non-Governmental Organisations |
| NIFA | New International Financial Architecture |
| OECD | Organisation for Economic Cooperation and Development |
| PACs | Political Action Committees |
| PCE | Personal Consumption Expenditure |
| PKI | Post Keynesian Institutionalism |
| PPP | Purchasing Power Parity |
| PSPD | People’s Solidarity for Participatory Democracy |
| RMM | Rehn-Meidner Model |
| ROA | Return on Assets |
| ROE | Return on Equity |
| SAF | Swedish Employers’ Association |
| SAP | The Social Democratic Labour Party |
| SCL | Stock Corporation Law |
| SNS | Center for Business and Policy Studies |
| SSA | Social Structure of Accumulation |
| TCC | Transnational Capitalist Class |
| VC | Venture Capital |
| WTO | World Trade Organisation |

# Chapter 1. Introduction: rethinking income inequality in contemporary capitalism

## 1.1. Defining the aim, research questions and the hypothesis

This thesis investigates the extent to which financialisation contributes to the increase in income inequality, irrespective of the characteristics of the financialised capitalist political economy. The thesis is ontologically grounded in critical realism. Theoretically it combines three heterodox approaches to the study of contemporary capitalist economies. Empirically it involves the in-depth study and comparison of the financialisation process and its effects in four distinctive political economies (USA, South Korea, Argentina, and Sweden), in order to identify if a similar generative mechanism of regressive income redistribution has been institutionalised in all cases.

Drawing on the philosophical underpinnings of critical realism, a financialisation-induced income inequality hypothesis was developed to provide explanations of the growing economic disparity by developing three explanatory causal-processual analytical constructs derived from different heterodox schools of thought. These analytical constructs comprise the financial sector policies examined in the context of the recent history of each country-case, rates of profit in the financial sector and labour's share in the national income, and levels of the rental income and private/public debt.

This study rejected methods of formalistic deductivism of the neoclassical economics with its usage of mathematical modelling that facilitates an ontological neglect. In order to comply with the critical realist ontological commitments, a pluralist framework was employed to synthesise retroductive reasoning within heterodox schools of thought. This methodological pluralism and the causal-processual analytical constructing technique applied to every country-case helped to achieve the synergy effect.

This thesis argues that the financialisation-income inequality nexus constitutes a generative mechanism of capital accumulation that facilitates and secures upward income distribution within a neoliberal mode of production. A central tenet of the thesis embraces the notion of neoliberalism as the ideological and political economy framework of the financialisation process used by ruling classes to achieve upward income distribution which, in turn, leads to income disparities. Based on the theoretical framework discussed latter in this thesis, the following research hypothesis was formulated:

> *Financialisation, as a process established during the neoliberal phase of late capitalism, exacerbates upward income distribution. In this regard increasing income inequality is an inherent outcome of the functioning of contemporary finance-driven globalised capitalism. The process of financialising a national political economy involves the institutionalisation of a generative mechanism which, national contingencies aside, appears to follow a similar pattern when it is established across different political economies, producing similar effects on income inequality.*

Ultimately, the main aim of this study is to investigate whether financialisation causes income inequality regardless of the country where it takes place. This research therefore makes an original contribution to the understanding of the relationship between finance capitalism and economic disparity by asking:

1. How should financialisation and income inequality be explored ontologically and methodologically in order to determine the distributional effects of finance capitalism?

2. How does the process of neoliberal financialisation impact on income inequality in country-specific contexts? Does neoliberal financialisation facilitate uneven capital accumulation and generate conditions that increase income inequality?

3. In what ways did government strategies, institutions and policies associated with financialisation contributed to regressive distribution and generated conditions that increased income inequality? What are the similarities and differences between the country-cases?

### 1.2. Contextualising the thesis: why income inequality?

There is a large volume of published studies describing rising inequality in income distribution as one of the most persistent global challenges, widespread not only in low- and middle-income countries but also in industrialised ones. Four consecutive Oxfam reports have presented increasingly alarming statistics. Thus, in 2015 the wealthiest 62 individuals owned as much wealth as 3.6 billion people compared with 388 individuals in 2010. Their wealth had increased from 2010 by 44% or $542 billion, while the wealth of the bottom 50% of the world's population dropped by 41%, or over one trillion dollars (Oxfam, 2016). By 2016 just 8 mostly white men possessed the same amount of wealth as the poorest half of the global population and the richest 1% controlled more wealth than the rest of the globe. Between 1988 and 2011 the incomes of the poorest decile rose by less than $3 a year compared with a 182 fold increase of the richest 1% (Oxfam, 2017). In twelve months of 2017 the incomes of the world's elite increased by $762 billion which was enough to eradicate extreme poverty seven times over. Between 2006 and 2015 worker income rose by an average of just 2% a year compared with a 13% increase for billionaires per year. In 2017 top 1% earners received 82% of all growth in global wealth whereas the poorest half of the world population did not benefit at all (Oxfam, 2018). In 2018 alone the world's billionaires increased their wealth by $900 billion or $2.5 billion a day whereas the wealth of the poorest 3.8 billion people fell by 11%. The concentration of wealth continued in 2018 with just 26 people (down from 43 in 2017) owning the same as the poorest half of humanity (Oxfam, 2019).

This view is supported by contributors to the *World Inequality Report 2018* which reveals that the richest 1% captured 27% of real income growth between 1980 and 2016, more than twice the amount of the bottom 50% individuals (Alvaredo et al., 2017). By and large, it is now well established from a variety of studies that not only has global interpersonal inequality grown (Nino-Zarazua et al., 2016) but also income inequality has been increasing both within- and between-countries over the last thirty to forty years (Bornschier, 2002; Wade, 2012; Milanovic, 2013).

### *1.2.1. Some definitions*

In the field of social science various ways of defining and measuring economic inequality exist. The distribution of income is the most common measure of inequality of the *functional distribution of income* reflecting classical political economy's classification (Galbraith, 2016). This classified income into three types: wages, profits, and rents.[1] Income includes such computed items as earnings, interest, dividends, royalties, rental income, realized capital gains, and governmental transfer payments (e.g., unemployment insurance). It is distinguished form *wealth* which is the value of assets and includes financial possessions such as money, stocks, and bonds. Wealth

[1] Concepts of distribution reflecting different ideas and metrics of economic inequality also include: *personal* and *household* distribution of income, *market* (cash earned by economic activity), *gross* (all sources of money income, market and non-market), and *disposable/net* (incomes left after paying taxes) income (Galbraith, 2016: Chapter 4).

also includes the value of real estate, cars, jewellery, and art, that is the capital value of present income flows. This is the main difference between income and wealth: the former is measured over a period of time (e.g., a week, a month, a year); the latter being a stock is measured at any given moment of time (ibid: 3). Throughout this text, reference to data on wealth is mentioned for analytical and empirical reasons and implies close relations between income and wealth and indefinite characteristics of the latter.[2]

In this study the focus is on income inequality within countries as a measure of overall economic inequality. The benefit of this approach is that it provides cross-country comparison since there are data on income inequality in most modern economies. Besides, income (and wealth) as it is more unequally distributed in market economies than education, consumption, or occupational status, is the common indicator of social stratification (Bornschier, 2002). Another reason for using income inequality as a metric of economic disparity is that it allows the assessment of the degree of egalitarianism in a given country by exploring its re-distributional policies.

It has become commonplace to distinguish *within-country*, *between-country*, and *global* inequality (e.g., Milanovic, 2005; Anand and Segal, 2008; Nino-Zarazua et al. 2016). This system of classification is useful because it allows the study of domestic and global inequality and the relations between them. It can be assumed that in an increasingly interconnected world the findings on global inequality reflect patterns of income inequalities between nations and within nations.

Historically, the income gap *between* core and non-core countries has widened ever since the Industrial Revolution. It is estimated that the income disparity ratio between the fifth of the population of the richest country and the fifth of the poorest are as follows: in 1820, 3:1; in 1870, 7:1; in 1913, 11:1; in 1960, 30:1; 1990, 60:1; in 1997, 74:1 (UNDP, 1999: 3). As Birdsall (1998: 76) explains, at the global level, “the average family in the United States is 60 times richer than the average family in Ethiopia”.

*Within-country* income inequality varies significantly from one country to another as measured by Gini coefficients ranging between 0.2 and 0.6 (World Bank, 2001). The most equal *intra*country income distribution in countries like Austria, Belarus, Slovakia, and those in Scandinavia have Gini coefficients ranging between

[2] As economist James Galbraith explains, “the definition of wealth is uncertain, the measure of wealth is difficult, the data are sparse and conclusions depend heavily on particular choices of research technique” (2016: 150).

0.20 and 0.25. The worst level of income inequality is reported in countries with the highest Gini coefficients ranging from 0.60 to 0.65 and observed in, for instance, Brazil, South Africa, and Paraguay. As an illustration of *within-country* income inequality in countries selected in this inquiry as study-cases, the Gini coefficient was 0.25 in Sweden (2000), 0.35 in Korea (2004), 0.41 in the USA (1997), and 0.53 in Argentina (2002). Another way of evaluating economic inequality and determining the division of national income among various social groups is the ratio of the wealthiest 10% to that of the poorest 10% (Thorbecke and Charumilind, 2002). This ratio varies from about 5.5 in Sweden to 17 in the USA, from 45 in Brazil to 87 in Sierra Leone.

### *1.2.2. Patterns and views*

Drawing on a growing body of literature and following Pieterse's (2002) notion of interconnectedness of income inequality and world dynamics, some patterns of and topics around economic disparity and how it might be viewed can be highlighted.

First, empirical evidence suggests that rising income inequality is not a characteristic of poor countries only. Income inequality has risen steadily in OECD countries too since the early 1980s with the USA, the richest country in the world, now having the highest Gini coefficient of high-income countries. "The per capita income of the poorest 20% in the United States is less than a fourth of the country's average per capita income – in Japan it is nearly half" (UNDP, 1996: 13). This trend has been observed since the 1980s in New Zealand, throughout Europe and the UK where Gini coefficient rose by 10 percentage points beginning from the late 1970s and reaching 0.33 in 1991 from around 0.23 in 1977 (Atkinson, 1999). Income inequality also rose in the regions previously known for their idiosyncratic development paths or socialist course. Thus, the "East Asian tigers" of Japan and South Korea experienced deviation from their traditionally egalitarian income distribution (Deininger and Squire, 1996; Atkinson, 1997). As Walton (1997: 4) states, "In some economies, including China and Hong Kong, there have been significant increases in inequality, especially in the past ten or fifteen years". In China and post-Soviet Russia between 1995 and 2015 the top 1% wealth share rose from 15% to 30% and from 22% to 43%, respectively (Alvaredo et al., 2017).

Second, in parallel to accelerating income inequality there has been an explosion in the number of super-rich. It is argued that the latter is a result of the unequal ownership of capital (Piketty, 2014; Alvaredo et al., 2017). Again, since the

1980s there has been constant transfer of public wealth into private hands in nearly all countries. Net private wealth rose from 200%-350% of national income in most industrialized countries in 1970 to 400%-700% today. Conversely, net public wealth (defined as public assets minus public debt) has declined constantly since the 1980s which, in turn, limits states' capabilities in redistributing income, regulating the economy, and mitigating socio-economic consequences of rising inequality. In the US and the UK, net public wealth (of the public sector) has even become negative, whereas in China and Russia it declined from 60%-70% of national wealth to 20%-30% (World Bank, 2000).

Third, it is important to understand how and why the rise of global income inequality might be interconnected with increasing income disparity between and within countries. For instance, Bergesen and Bata (2002) from the perspective of world-systems theory hypothesised that when the global gap between rich and poor countries widens so does the gap between individuals in the national income distribution; when global inequality declines, national income inequality also slows down. Their findings support the idea that the two inequalities move together, like during the 1983-1990 period when both between- and within-nations income inequality widened (ibid: 134). One possible implication of this is that current rise in income inequality needs to be seen in a broad historical perspective and as a complex phenomenon that has different dimensions and multifaceted explanatory mechanisms behind them. Thus, much of the literature since the 1990s has emphasized the changing global conditions that over the last thirty-forty years shaped the new societal model where progressive socio-economic achievements of the industrialised democracies and liberation movements of the Global South were revoked (e.g. Esping-Andersen, 1990; Crouch and Streeck, 1997; Atkinson, 1999; Standing, 2011). Both in affluent democracies and low-income countries drastic market-oriented reforms accompanied with pressures on wages, spending cuts to welfare systems and assaults on labour and trade unions have been rationalised to delegitimate social protection and redistribution. This affected functional distribution of income in favour of capital.

Fourth, and to reiterate the above, the pattern of deteriorating economic inequality virtually everywhere coincides with the ascendancy of neoliberal ideology in those countries (Brown and Lauder, 2001). During the "golden age" of capitalism (1950-1973) when Keynesian-oriented policies and state intervention were practiced, the average growth rate of 5% was accompanied by declining inequality both between- and within-nations (Pieterse, 2002; Galbraith, 2012). However, under the influence of neoliberal orthodoxy in the early 1980s, governments throughout the world deregulated financial markets, promoted free trade, and abandoned the very idea that income disparity might be a sign of flawed socio-economic policy (Cornia, 2003). Since then, four-decades of increasing economic inequality has been witnessed worldwide and "this trend towards an increase in inequality is perplexing and marks a clear departure from the move towards greater egalitarianism observed during the 1950s and 1960s" (Cornia, 1999: 2).

Yet, in his seminal article more than twenty years ago Atkinson (1997: 303) argued that income distribution should be described as an "episodic" characterisation rather than a trend. This means that there are episodes of rising and declining economic inequality movement, presumably in the short-term only. This is fair enough if income distribution is considered from the historical perspective. An important implication, however, is that this view on the widening gap between rich and poor undermines the idea of achieving economic democracy as one of the most progressive stages of societal developments. Rejecting an evolutionary approach to inequality legitimises, for instance, such policies as the Washington Consensus of free-market capitalism replicated all over the world and supported by the powerful transnational and domestic forces not interested in an egalitarian redistribution. It justifies further advancement of allegedly "inherently good" but "wrongly" implemented reforms in favour of finance capital. Meanwhile the number of "episodes" of rising income inequality, their durability and the cost of devastating effects for the majority are also rising, making upward income distribution the new "normality". If such drifts towards seeing policies of more equal distribution as something "abnormal" persist then the mere ideas of egalitarianism and economic democracy are off the agenda. One may consider if this is the ultimate achievement of any dominant ideology – not to be questioned.[3]

Fifth, traditionally, social scientists and economists have focused on poverty whereas studies on income inequality and distribution were neglected (Milanovic, 2007a; Wade, 2012). In his comprehensive examination of poverty as *non-relational*

[3] In this study, following Thompson (1991: 73), ideology is understood as "the ways in which meaning is mobilized in the service of dominant individuals and groups".

against the view of poverty as *relational*, i.e. *being less well off than others*, Barrientos (2010) concluded that, in poverty analysis, egalitarianism need not be considered as a final goal.[4] The mainstream economist Feldstein (1999: 37) argues that national policy should focus on poverty rather than on inequality and distributive matters, and considers in addition to unemployment, a lack of earnings ability and individual choice as sources of poverty. Likewise, the 1995 Nobel Prize economist Robert Lucas (2004: 13) declared, "Of the tendencies that are harmful to sound economics, the most seductive, and in my opinion the most poisonous, is to focus on questions of distribution". He then compares the fates of a new-born American child and his Indian brother ("equally valued by God"), with the former having 15 times more resources available at his disposal,

> "This seems to us a terrible wrong, justifying direct corrective action, and perhaps some actions of this kind can and should be taken. But of the vast increase in the well-being of hundreds of millions of people that has occurred in the 200-year course of the industrial revolution to date, virtually none of it can be attributed to the direct redistribution of resources from rich to poor" (ibid: 13).

With just one sentence the 200-year history of wars, colonialism, slavery, revolutions, and exploitation which at times have been all about *redistribution from poor to rich* is wiped out as not having anything in common with reality. This negligence towards issues of redistribution and egalitarian social democratic values in contrast to prioritising "poverty" reflects political inheritance from the 1980s-1990s when conservative dogmas of Reagan-Thatcherite-style neoliberalism was triumphant (Wade, 2012). In addition, it is assumed that a focus on poverty reduction is a minimalist agenda of the neoliberal orthodoxy distracting attention and priority from distributional matters of modern capitalism (Johnston, 2005). It is noted, for instance, that some middle-income countries with relatively similar GNP per capita have very different levels of income inequality: Gini coefficients of Brazil and South Africa (60.0 and 59.3) are much higher than of Poland and Malaysia (32.9 and 48.5) (Thorbecke and Charumilind, 2002: 1477). To understand this complex political economy, focusing on poverty only is not enough – multifaceted issues of distribution should be analysed

[4] It should be noted though that in his paper Barrientos (2010: 18) does not go as far as some mainstream economists claiming that income inequality is not an issue to worry about and acknowledges that "as well rounded development researchers they should worry about inequality too" [his emphasis]. This is at least encouraging and in sharp contrast to a statement of another professor of economics, "Poverty bothers me. Inequality does not. I just don't care" (Prof. Willem Buiter in Wade, 2014: 2).

together with the political dynamics that are brought to the foreground by studying inequality (Pieterse, 2002). This is why answering Barrientos' (2010) question *Should poverty researchers worry about inequality?*, I unequivocally answer yes. In attempting to resolve the puzzle of rising income inequality one may and should simultaneously confront other "black boxes" of the social and political realm that need to be investigated and resolved. This is why increasing economic inequality is both a crucial and complex topic – it is interconnected with too many important socioeconomic and political matters to be ignored; it is interrelated and embedded with them; it is part of the whole and yet it is a totality that needs to be lifted on the level it deserves. But in the first place, it is a political issue that has to be examined and regarded in the context of such dimensions as contemporary capitalism, ideology, re/distribution, justice, and economic democracy.

A more detailed account of effects of income inequality, how it is measured and different theories explaining its roots, is provided in the following sections.

### 1.3. Why inequality matters

It is generally admitted that income inequality and wealth disparity present a growing social, political and economic problem (Wilkinson and Pickett, 2009; Stiglitz, 2013; Atkinson, 2015). It is even argued that income equality is more important for economic development than low government corruption and foreign debt, free trade and foreign investments (Berg and Ostry, 2011). The more equally income is distributed within a country, the longer the duration of spells of economic growth.

Savoia et al. (2010) draw attention to the effect of economic inequality on institutions and argue that the level of inequality is an important political economy factor in the relationship between political systems and economic growth. Their findings are consistent with comparative historical analysis according to which inequality is detrimental to the development of viable liberal institutions. This happens because exploitative institutions emerge and due to the rent-seeking behavior of political and business elites interested in skewed income and wealth distribution and oligarchic, rather than democratic, politics. Similarly, Glaeser et al. (2003) demonstrate that high inequality is detrimental to property rights and regulatory institutions because the wealth influence of local oligarchs or foreign capital prevail in any court.

Wade (2007) rejects the mainstream economists' argument regarding the desirable incentive effects of inequality on competitiveness, by pointing out that it is only moderate, Scandinavian-type levels of income inequality that should be tolerated. In the case of Brazil-type levels of income inequality, these effects are overpowered by undersupply of "collective goods" resulting in high social costs. Growing disparities reinforce the advantages of the rich and further disadvantage the poor leading to economic inequality in the next generation, thus creating a "vicious circle". Economic inequality might be entrenched through: 1) the attainment process when income disadvantages lead to detriments in education, health and other fields; 2) growing segregation in living areas and social relations; 3) politics when political influence is increasingly concentrated amongst the elite class (Neckerman and Torche, 2007: 345-346).

The deteriorative effect of inequality on societal institutions is demonstrated by comparing Scandinavia and Japan with India. In the first two places the coordinating capacity in resolving collective action problems is higher than in India where mistrust and skewed social institutions are embedded in economic inequality. Cross-sectional studies of the implications of inequality for social relations imply associations between increased inequality and economic segregation. In other words, the affluent and the poor prefer to live and work in different neighborhoods, becoming more segregated in urban areas (Massey and Fischer, 2003; Mayer, 2001). Another negative outcome of inequality is that it decreases social capital (Alesina and La Ferrara, 2002) and levels of trust and social cohesion are lower in countries with high income inequality (Costa and Kahn, 2003).

Another important implication from the institutional inequality-based analysis is that large economic gaps lead to distributive conflict (Figueroa, 1996) and political violence (Thorbecke and Charumilind, 2002; Duta and Mishra, 2005). According to Muller (1995) a high level of inequality is incompatible with stable democracy. As Boix (2003) argues, in countries with high inequality the elite are more resistant to democratisation, which may lead to redistribution of political and economic power. A negative impact of inequality on democracy is also found in a study of over 100 countries from 1960 to 1995 which showed that democracy occurs in line with the rise of income in the middle-class (Barro, 1999).

In the study on finance capitalism, Peet (2011) argues that inequality creates instability, recession and depression when too much of national income is grabbed by too few people, too much income is taken from the real economy and is accumulated between too few people (ibid: 390). Moreover, this kind of extreme income concentration helps the capitalist class to buy and control the government and the whole state apparatus even in countries which are believed to be democracies.

By the same token, Pogge (2007) discusses the negative outcomes of inequality on global institutional rules of governance. Rising inequality enables the affluent countries, global corporations and even individuals to shape the global rules of resource allocation in their favour via their more powerful bargaining power. Such rules help them to get the lion’s share of global economic growth, making them more powerful and further tilting international rules to their benefit, fueling rising global inequality.

Milanovic (2007b: 43-44) provided a definition of “global polity” to respond to the view that it is better to concentrate on eradication of impoverishment than on how much is consumed by others. The basic assumption is that the worse off are not concerned with the income of others. However, in an ever more globalised world, where an awareness of what and how much others are getting is growing, global inequality is important. As interactions (cultural, political, etc.) between citizens of different countries are becoming more common, the rich world cannot (and should not) fence itself off from the poor.

In their book *The Spirit Level*, Wilkinson and Pickett (2009) show various social problems exist even in rich countries, where economic growth does not help to prevent the outcomes of unequal income distribution. From life expectancy to mental health, educational performance to violence, happiness to social relations – inequality negatively affects many aspects of human life. The authors argue that this is a consequence of a long-standing belief in prioritizing economic growth over equality. In more unequal societies, rates of teenage pregnancy, violence and juvenile crimes, obesity and imprisonment are higher. Inequality is a root of shorter and unhappier lives. Income inequality facilitates isolation and anxiety and functions to drive excessive consumption, depleting global resources. Unequal societies are described as “dysfunctional” and, in spite of their affluence, as social failures. Strong evidence is presented to show that it is the size of the income gap between the richest and the poorest 20% of the population that matters rather than the size of GDP per capita and that “both the broken society and the broken economy resulted from the growth of inequality” (ibid: 5).

The relationship between inequality and social, physical and psychological well-being is questioned by some researchers but generally it is believed that social effects of income inequality are neutral or negative but certainly not positive (Jencks, 2002). Numerous studies have attempted to explain the effect of economic inequality on health. For example, Lynch et al. (2004) found that social capital is undermined by inequality because of the poorer social welfare and institutional provisions for the poor. The so-called status hypothesis claims that a subjective awareness of someone's economic deprivation negatively affects health through stress on the body or via detrimental health behaviors such as alcohol abuse and smoking (Marmot, 2004). The relationship between inequality and infant mortality was investigated by Mayer and Sarin (2005) who suggested that inequality is associated with economic segregation and higher health-care expenditure, which raises infant mortality in the first case and reduces it in the second. A number of studies found a relationship between inequality and measures of happiness. For instance, Hout (2003) shows that low-income individuals are less happy, less satisfied with their finances and feel less satisfaction with family life. Alesina et al. (2004) in their research on the contextual effect of inequality on happiness in Europe and USA argue that there is a negative association. Another study shows that there is a stronger effect of inequality on state of mind in developing countries than in more developed countries (Graham and Felton, 2005).

Kane (2004) demonstrates a relational effect of income on college enrollment in the USA. Between 1980 and 1992 when the socioeconomic gap widened, college enrollment stayed stable among the lowest income quartile but increased in other groups. Several studies have revealed that in areas with high income inequality and poor social provision, crime rates are higher (Fowles and Merva, 1996; Kelly, 2000; Savolainen, 2000). As Messner and Rosenfield (1997) showed, the effects of income inequality on crime rates might be restrained by increasing public welfare provisions.

To summarise, the literature review shows that there is a causal link between increasing income inequality and many socioeconomic and political problems. Empirical research supports the existence of a relationship between unequal societies and skewed patterns of social fabric. Though in some cases this link may be indirect it would be erroneous to underestimate its adverse effect on a variety of institutional dimensions.

### 1.4. Measurement debates and the level of inequality

The range of issues raised by income inequality poses a methodological challenge, as many different data sources and measurement tools are used which may influence conclusions. As Piketty puts it, “The way one tries to measure inequality is never neutral” (2014: 270). Various methods have been developed and introduced to measure inequality including between- and within-country elements. The first assesses disparities in per capita gross domestic product (GDP) among nations, weighting each country by its population size. The second element deals with income distribution within each nation (Neckerman and Torche, 2007).

Milanovic (2011) reminds us that the difficulty of inequality measurement became apparent from the start with the tension between two approaches: the axiomatic-based and the welfarist. The first, which is purely technical, suggests “a task of devising a reasonable rod by which the inequality of entire distribution could be summarized in one number” (ibid: 24). The second – a welfare-based idea – attempts to characterise social issues. However, this approach was abandoned because of the difficulty in applying the utility function and of the philosophical weaknesses of utilitarianism (ibid: 25). Other major studies on income inequality also report different methods and sources such as household surveys, income tax and earnings data, data on wealth, Gini coefficient and Theil’s T statistics (Atkinson, 2015; Milanovic, 2011; Galbraith and Berner, 2001).

One of the most popular measures of inequality is the Gini coefficient named after Corrado Gini, an Italian economist who developed this method in 1914. The coefficient ranges from 0 (no inequality because everybody has the same income) to 1 (one individual receives all income) and is sometimes presented in percentages. For example, the Gini coefficient ranges from about 0.25-0.3 (25%-30%) for the most egalitarian countries of Scandinavia and Central Europe, to 0.6 (60%) for countries with high levels of inequality like South Africa and Brazil (Milanovic, 2011).

It is agreed that significant income and welfare inequality exist both between- and within-countries (Milanovic, 2006; Held and Kaya, 2007; World Bank, 2007). The main contention is whether inequality has increased or declined in the past fifty years (Arestis et al., 2011). For example, Sala-i-Martin (2002) and Dollar (2007) provide evidence that poverty and income disparities have decreased whereas Wade (2007) and Milanovic (2007b) suggest that the income gap between rich and poor is actually on the rise.

The roots of this disagreement also stem from methods of measuring inequality. As Milanovic (2005) found, different concepts provide varying outcomes in the context of global inequality. One method, which includes calculations of GDP per capita, shows that world inequality increased during the period from 1950 to 2000 with a large rise in the late 1970s. However, if a population-weighted measure is used then data suggests that the wealth disparity declined especially after China and India entered an economic growth track from the 1970s. To add to the complexity of the issue, if income inequality is measured among individuals *intra*-nation inequality seems to have increased almost everywhere whereas *inter*-country has decreased.

Many recent studies have shown the importance of "absolute" notions of inequality in the analysis of income distributions as compared to "relative" notions (Ravallion, 2003; Atkinson and Brandolini, 2010; Bosmans et al., 2014).[5] Nino-Zarazua et al. (2016) analysed the data on global inequality levels during the 1975-2010 period and concluded that relative global interpersonal inequality declined steadily over the past thirty-five years driven mostly by a decline in relative inequality between countries and remarkable economic growth in China and India. By contrast, if calculated in absolute measures income inequality rose dramatically during the same period.

One of the most informative overviews on global income inequality is provided by the World Bank's database and calculations of Arestis *et al.* (2011) which shows changes during the 1971-2009 period. For the last forty years, countries in East Asia, the Pacific and South Asia have experienced considerable improvements in economic rankings which may contribute to improvements in the well-being of their inhabitants. The position of Europe and Central Asian and the Middle East and North African groups also improved, though not to the same extent. The Latin American and Caribbean group faced mixed success, whereas the Sub-Saharan African grouped dipped even further into poverty and inequality. Overall, the global inequality gap has widened between different regions and countries. Inequality remains sustained and considerable around the world and the wealth-gap within countries is widening. As evidence reveals, the population classified as the lowest income decile was able to receive between 0.5% (France) and 2.4% (Japan) of the total national income in 1960. In 2000 the range of national income for this group was between 0.8% (Brazil) and 4%

[5] In the relative approach inequality is deemed to be unchanged when everyone's income increases in the same proportion. Labelled as "rightest", the main critique of this approach is that it does not take into account absolute differences in income: if incomes of both the richest person and the poorest are doubled, the former can now buy two palaces while the latter only two shirts. An "absolute" view on inequality, "leftist", does not attach importance to relative income: if everyone is given $1 million, inequality is not changed though everyone is now rich (Nino-Zarazua et al., 2016).

(France). By contrast, these figures for the top 10% ranged between 23.4% (Canada) and 48.3% (Brazil) in 1960 and between 22% (France) and 48.5% (Brazil) in 2000. It is therefore difficult to disagree with the conclusion that little progress has been made to address income disparity. The results of this study also indicate that the majority of the total national income goes to the richest individuals in both developing and developed countries. For example, the richest 10% of Brazilian families received almost half of the total national income both in 1960 and 2000 (48.3% and 48.5%, respectively). Similarly, in US the wealthiest 10% received 26.6% in 1970 and 29.5% in 2000. This indicates the general tendency towards rising within-country income inequality.

While some scholars report an increase in global inequality between 1980 and 2000, others argue for a decrease during the same period. For instance, Sutcliffe (2007) analysed inequality patterns around the world and proposes a “10/10” ratio – the ratio of the ten poorest and the ten richest countries’ average national income. The 10/10 ratio dropped between 1950 and 1980 and then increased from the 1980s. Although it is acknowledged that the gap between the world’s rich and poor has increased since the 1980s and that the global Gini coefficient reached a level of 0.63 (the level of Namibia and Lesotho), when measuring inter-country and intra-country inequalities together, a decline in global inequality over the last two decades was evident.

From the perspective of increasing participation of developing countries in the world economy, Dollar (2007) showed that growth rates were higher in these countries relative to developed ones, especially in the 1990s. This growth generated poverty reduction not only in populous China and India but also in countries such as Bangladesh and Vietnam. Furthermore, he claims a modest decline in global inequality since 1980, while recognising an increase in within-country inequality.

Wade (2004; 2007) questions the argument that world inequality fell over the past two to three decades for the first time in more than a century and a half. Six different propositions to answer the question, “What is the trend of world income distribution?” are offered by Wade (2004: 575-579): 1) If incomes are measured at market exchange rates and expressed in US dollars, global income has become more unequally distributed; 2) World purchasing power parity (PPP)-income polarisation measured as richest to poorest decile has increased; 3) Using per capita GDPs, equal country weights (each country = one unit), and a coefficient like the Gini, between-country world PPP-income inequality has increased since 1980; 4) With countries weighted by population, between-country world PPP-income inequality has been consistent or decreased since 1980; 5) Taking into account both between- and within-country distribution, world PPP-income inequality has been on the rise over the past two to three decades; 6) Wage inequality among countries was stable or declining from the early 1960s to 1980-1982, then increased to the present.

Overall, conclusions regarding trends of within- and between-country inequality remain controversial. Some suggest that global inequality is increasing (Bourguignon and Morrisson, 2002; Dowrick and Akmal, 2005) whereas others report a decline (Bhalla, 2002; Firebaugh, 2003; Goesling, 2001). There is no solid consensus in the literature on these questions, largely because scholars disagree about how to measure inequality and how to draw causal inferences from the variables used (Brune and Garrett, 2005).

### 1.5. Causes of inequality

A considerable amount of literature has been published on factors that contribute to economic inequality. Previous research has suggested that in the 1970s developing countries could not sustain rapid economic growth, reflecting their incapacity to compete in the realities of scarce capital and high interest rates (Easterly, 2001). Various studies have assessed the detrimental effect of the globalisation of developing countries and within-country income distribution (Alderson and Nielson, 1999; Arrighi et al., 2003; Wade, 2004). Rodrik (1999) argues that weak state institutions and underdeveloped welfare systems make them more vulnerable to economic competition imposed externally. An opposite view suggests that the much needed industrialisation in poor countries and the growing similarity of national institutions accelerated by globalisation led to the decline in disparities between nations (Lucas, 2002; Firebaugh, 2003). Researchers attempted to evaluate the impact of factors such as declining power of egalitarianism-creating institutions and growing number of educated people (Pontusson et al., 2002). Movements towards more pro-market oriented economies in the former socialist bloc are also considered as factors that may increase inequality (Lindert and Williamson, 2001).

A recent study by Atkinson (2015: 82) provides a systematic review of factors contributing to rising inequality which include: 1) globalisation; 2) technological change (information and communications technology); 3) growth of finance services; 4) changing pay norms; 5) reduced role of trade unions; 6) scaling back of the redistributive tax-and-transfer policy.

According to *globalisation-based* interpretations of increasing inequality, advanced economies are challenged by competition from poorer countries where wages are lower. Industries that rely on unskilled workers have to practice outsourcing to lower-wage countries and jobs are consequently lost. The *technological change* hypothesis is based on a view that technological progress is skill-biased in that it increases the productivity of skilled workers more than unskilled ones. *Information and communication technologies* have replaced low-skilled workers and created a demand for higher-educated workers leading to widening earnings differentials. The *financial services* sector as the biggest single contributor to inequality is considered with examples such as Argentina and Brazil by Galbraith *et al.* (2007). Empirical evidence demonstrates, for instance, that in the years preceding the 2008 financial crisis there was a huge increase in the economic and power weight of the banks. It is worth noting that the reverse is also true: as the finance sector retreated, the public sector expanded, leading to a dramatic reduction in poverty and inequality in these countries.

The main idea about *changing pay norms* is that the wage market operates within a social context and that supply and demand do not fully determine pay size (Atkinson, 2015). Examples include developments in the capital markets and deliberate government policies. In the first case those developments may lessen the pay distribution when businesses come to discount future profits more heavily and do not care much about a reputation of adhering to pay norms. In the latter case, the state influences pay levels through public-sector employment.

It is generally agreed that disparities in pay distribution coincided with *fading power of trade unions* and the declining role of collective bargaining. As the OECD (2011) report *Divided We Stand* shows, declines in union density across most OECD countries coincided with minimum wages decline. The scaling back of *the redistributive tax-and-transfer policy hypothesis* implies that the growing power of the capital undermines entitlement rules. In line with this hypothesis, three main intervening institutions are distinguished – the state, nonfinancial companies, and financial services – with the last one playing a significant role in the balance of power and lobbying for policies designed to redistribute income in an upwards direction.

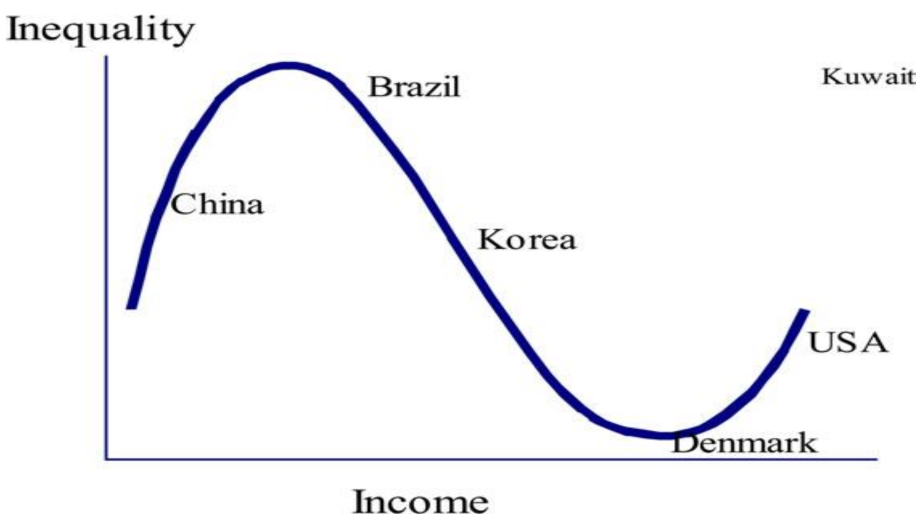
Some researchers have also examined the relationship between political regimes and economic inequality. Recent findings by Galbraith (2012) challenged the conventional wisdom that democracy automatically promotes equality. For example, the egalitarian ideology of communist and Islamic regimes did provide lower inequality than economic and geographical position would otherwise have predicted. For social democracy to produce egalitarian outcomes such democratic mechanisms as powerful trade unions, political competition among democratic parties and responsive legislature requires sufficient time to allow these institutions to develop and mature.

According to the classical work of Kuznets (1955), economic inequality is the result of stages of development. There was a relatively equal distribution of wealth in countries with low levels of economic development. But as a country develops, more capital is acquired which leads to the owners of this capital having more income which, in turn, increases income inequality. Gradually, by using various redistribution mechanisms (i.e., social welfare programs) a developed country moves back to lower levels of inequality. Kuznets plotted the relationship between level of income and inequality and predicted that the level of inequality in middle-income economies would bulge out to form what is known as the Kuznets curve. The curve shows that income inequality will decrease eventually as a country reaches the latter stages of development. However, new studies and data show that there was an upward turn in inequality after the 1970s in countries like the US and UK (Atkinson, 2015; Piketty, 2014). This implies that another cycle is occurring and Kuznets' theory is not necessarily outdated.

As Galbraith (2011; 2012) admits, Kuznets' message is not that the same curve is applicable to all countries but that the basic nature of inequality comes from *structural changes* that are an inevitable part of economic development. Galbraith (2009) developed Kuznets' curve (Figure 1.1) to show the pro-cyclical relationship between inequality and economic growth that takes place in high-income countries such as USA, Japan and the UK. It demonstrates that in these countries a positive relationship between growth and rising inequality is again apparent. This happens because new sectors of the economy such as finance services and technology attracts high income and leads to increasing inequality.

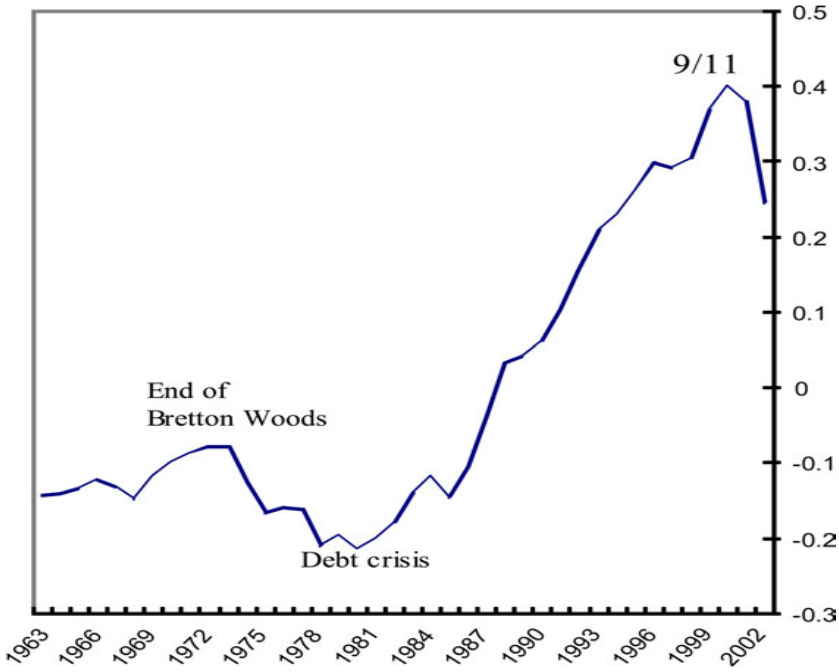
Galbraith (2011) also maintains that global terms-of-trade between different sectors might play a vital role in determining levels of inequality. In fact changes in these terms might be even more important than internal structural change. Galbraith and Kum (2003), for instance, demonstrate the global effects of financial and commodity markets in a common time pattern on changes in inequality within countries from the 1970s. Inequality is measured as the dependent variable whereas country, year and per capita income are presented as the independent variables. Global shifts are then described in chronological order beginning from 1963 with three important periods highlighted. The first covers the period from 1971 to 1980 and is characterised with the end of the Bretton Woods financial framework and the rise of inflation abetted by commercial bank lending, and was associated with a decline in inequality (Figure 1.2).

**Figure 1.1. Stylised augmented Kuznets curve, with selected countries**




Source: Galbraith (2009: 201)

**Figure 1.2. Global time effect in two-way fixed-effects panel regression on inequality in manufacturing pay**




Source: Galbraith (2011: 15)

The second phase was characterised by a large increase in inequality, beginning in the early 1980s with the rise of the neoliberal counter-revolution and the turbulent global debt crisis, the collapse of the Soviet Union and a wave of deregulation and financial liberalisation in some countries (up to the 1990s). It is acknowledged, however, that China and India were the exceptions because they did not borrow from commercial banks, which prevented a rise of inequality in these countries during this period. The third phase began in 2001 and is characterised by declining inequality. For the purpose of this study it is important to accentuate that the abandonment of Washington Consensus policies coincided with this decline. Therefore it is reasonable to suggest that it is particular choice of policies and economic ideology in general which plays an important role in inequality increasing or declining.

Overall, Galbraith's (2011) argument relies too heavily on the globalisation phenomenon, underestimating the case of the two economic powers, China and India. These countries implemented idiosyncratic national policies and prevented some of the negative consequences of globalisation. Another limitation with Galbraith's (2011) explanation is that it does not explain *why* neoliberal policies (particularly deregulation and liberalisation) were chosen in some countries and not in others. Galbraith (2011: 22) admits that with the convergence of many governments in the 20$^{th}$ century towards a capitalist economy often in neoliberal policy clothes, there is an opportunity to investigate the relationship between the dynamics of inequality and political regimes. Moreover, in the same paper it is acknowledged that even in democratic regimes which allegedly should have more egalitarian societies it might be the constraints of the neoliberal policy order that narrow the choice for higher inequality (ibid: 24). It is believed that this neoliberal and free-market agenda has been responsible for the growing economic disparity worldwide from the 1970s onwards (Cornia, 2003; Cammack, 2002). As such, there is a need for more research on the impact of policies such as privatisation, trade and finance liberalisation, de-unionisation and other pro-market strategies to define their cumulative impact on income distribution.

### 1.6. Bringing income inequality studies back into political economy

In 1985, Robert Dahl published *A Preface to Economic Democracy*, a book in which he essentially showed that political inequality is rooted in economic deprivation. Modern capitalism makes wealth abundant and the very same mechanisms make it concentrated, promoting unequal distribution and destroying liberal democracy. Yet, as Dahl tried to demonstrate, it is possible to achieve both economic equality and political liberty. One of the solutions includes cooperative ownership by workers (e.g. Mondragon cooperatives in Spain). To discard corporate capitalism's income and wealth inequality which promotes a 100:1 ratio between the highest and the lowest wages he goes as far as discarding the question of what political form the ownership should take, capitalist or socialist. Commenting on ownership, Dahl (1985: 150-151) argues,

> "But is this question fundamentally important? Surely the key question is not how a proposal is to be labelled but whether and how much it would help a people to realize their fundamental values… Viewed from one perspective, then, a self-governing system would look something like capitalism; viewed from another, it would look more like decentralized socialism".

For Dahl the ideal level of income distribution is around 3:1 and this can be achieved within self-governing enterprises. The latter, in turn, promote economic democracy on a broad societal level and political order thus achieving political equality.

In general, supporting Dahl's ideas, I reject the idea of classifying the capitalism vs. socialism debate as an insignificant question of "labelling" and as irrelevant for the topic of income inequality. Reducing issues which are directly related to the functional distribution of income to mere “technical” subjects or concerns with “labelling” not worth mentioning delegitimises the concepts of cooperative ownership, self-governing enterprises, progressive taxation, and economic democracy. It facilitates attempts to present ideas and policies of egalitarian redistribution as allegedly irrelevant for the scientific agenda debates. It also resembles misleading debates on whether to focus on inequality or poverty mentioned above. Rather than trying to simplify the subject, economic inequality needs to be problematised as an important political economy component.

A number of studies on the relations between economic inequality and ideology and political reforms convincingly show that inequality is in the first place a political phenomenon, other explanations being secondary and proximate causes (Wisman and Smith, 2011). Thus, Acemoglu and Robinson (2000) provide examples from the nineteenth-century European history of power dynamics between elite and workers and how political changes (e.g. franchise extension) would have distributional consequences to prevent unrest. In Britain, improvements in workers’ welfare and increases of their income followed “the Luddite Riots from 1811-1816, the Spa Fields Riots of 1816, the Peterloo Massacre in 1819, and the Swing Riots of 1830” (ibid: 1183). In Germany, the 1848 revolution eventually led to modern democracy with progressive redistributional effects. In Sweden, demonstrations and strikes resulted in a series of franchise extensions in 1866 and 1909. Accordingly, “inequality peaked approximately at the time of the major political reforms, and fell sharply after the extension of the franchise” (ibid: 1193). In France the elite in fear of workers’ insurrection agreed in 1898 to create compulsory workers’ compensation insurance (Wisman, 2017: 353).

Thus, historically, the changes in distributional patterns and inequality were not caused by economic factors such as market and technological developments but politically generated. As Wisman (ibid: 354) argues, “nineteenth-century European history clearly reveals that the inflection point of the Kuznets Curve – where economic growth switched from increasing to decreasing inequality – was fully political, following upon the reaction of the ruling elites to the threat of violence and revolution”. Similarly, Wade (2014: 11), describing conditions for curbing inequality in modern times asserts that,

> "The policies and institutions of the post-war decades which helped to drive inequality down – including high upper-bracket tax rates, laws protecting trade union bargaining power, financial sector constraints, capital controls, fixed exchange rates, and Left political parties which were left-wing (in contrast to today) – could not have happened without *elites being deeply fearful* of mass unrest, based on fresh memories of the Depression and war, strong trade unions, and the nuclear-armed Soviet Union providing an apparently plausible alternative to capitalism" [his emphasis].

Throughout the history of human civilization religion served to legitimate inequality, and so do secular ideologies today justify ever *increasing* income inequality (Wisman and Smith, 2011).[6] It is argued that with the rise of modern capitalism the legitimation of income disparity has been provided in economic terms. Thus, during periods of mercantilism (circa 1500-1750) and classical political economy when the Enlightenment principles of equality and the French Revolution ideas of *liberté, égalité, et fraternité* were gradually entrenching from individual unconsciousness to social consciousness, inequality-legitimating doctrines were actively employed to justify elites' privileges. Interestingly, some of these theories which originated during the Classical School – such as the utility of poverty thesis, the wages-fund and the Malthusian population doctrines – are still utilised to legitimate rising income inequality. More recently, "the invisible hand" doctrine combined with new metaphors like "the trickle-down effect" have become especially popular in the neoliberal narratives of conceptualising an economy guided by forces of supply and demand and, thus, "naturally" achieving a state of equilibrium if markets are left alone.[7] But the principle goal of these "economic" explanations in the context of distribution of income has been to serve as ideological tools legitimising increasing income inequality and removing the political factor from the subject matter, thus presenting economic disparity as a "natural" and "unavoidable" characteristic of an "efficient" economy.

[6] It is worth citing Marx's (1978[1846]: 172) characterisation of ruling ideas as a tool legitimising the status-quo, "The ideas of the ruling class are in every epoch the ruling ideas: i.e., the class which is the ruling material force of society is at the same time its ruling intellectual force. The class which has the means of material production at its disposal, has control at the same time over the means of mental production, so that thereby, generally speaking, the ideas of those who lack the means of mental production are subject to it".

[7] According to the trickle-down thesis, economic growth is the result of investments carried out mostly by the rich. More equal distribution is harmful for economic dynamism because less is saved and invested and all will be worse off because it is presumed that growing economy is beneficial to everyone ("a rising tide lifts all boats"). Consequently, high taxes as allegedly affecting economic dynamism will do more harm than good for the poor. The invisible hand thesis was used first by Adam Smith to describe selfish interests pursued by individuals who in the process benefit the whole society. This created moral, social, and "scientific" justification for the *laissez-faire* policies of unregulated markets which if left alone would allocate resources more effectively than the state.

As Wisman (2017: 357) notes, “Economics, wearing the mantle of science, gradually evolved to serve as the dominant ideological instrument for legitimating inequality, a role it continues to perform today”. He explains that in the 1870s what would be latter called “economics” was separated from *political economy*, “from its earlier “classical” orientation that understood economic phenomena in terms of social classes and political power, often drawing substantially on history and institutional structure to clarify the complex relationships economics examined” (ibid: 359). Modern mainstream economics, often referred to as *neoclassical* economics, is based on principles and orientations defined during this “neoclassical revolution”. In the 1941 landmark volume *Production and Distribution Theories* that traced the development of economic thought, Nobel Laureate George Stigler pointed out that between 1870 and 1895 “economic theory was transformed from an art, in many respects literary, to a science of growing rigor” (Stigler, 2017[1941]: 1). The most important implication of this transformation for the explanations of distributional matters is that this new “economic science” focused primarily on the market nexus emphasizing the calculus nature of its theories in an attempt to look more scientific. Wisman (2017: 359) highlights that in the contemporary neoclassical economics theories of, for instance, marginal productivity and general equilibrium, allegedly free from ideological components, employment of increasingly sophisticated formalistic modes of arguments has created ethical justifications and “scientific” explanations of economic disparity. The latter, thus, is a just result of a competitive market economy free from inefficient government interventions. In this theoretical framework, historical, cultural, and social factors, power relations and how they create and define, for instance, property rights and class relations, are completely ignored. This implies that market capitalism as such is rational and ethically unprejudiced.

In that respect, Milanovic (2007a: 111) claims that there are attempts, facilitated by some economists, to eliminate and expunge an issue of distribution from politics. Again, rejecting both political and academic considerations of income inequality and contrasting the latter with poverty, there seem to be attempts to divert attention from distributional matters.[8] For example, Anne Krueger (2002: 3), former deputy managing

[8] Milanovic (2007a: 117) put it straightforwardly, “The concern with poverty is a price that the rich are willing to pay so that no one questions their incomes. In other words, the concern with poverty works like an anesthetic to the bad conscience of the many. For many of the rich, helping the poor is “social money laundering”, an activity engaged in by those who either have acquired wealth under dubious circumstances or have inherited it, or might have made more money than seems socially acceptable”.

director of the IMF, argues that, “Poor people are desperate to improve their material conditions in absolute terms rather than to march up the income distribution. Hence it seems far better to focus on impoverishment than on inequality”.

The inequality-justifying theories of neoclassical economics are further supported by such doctrines as libertarianism and fluid vertical social mobility rooted in Western Enlightenment traditions and conflated with economics and socio-philosophical components (Wisman and Smith, 2011).[9] They are centered on the sacred right of self-ownership and belief in personal responsibility and equality of opportunity. For libertarians, for example, income inequality is justifiable as soon as, in the process of distribution, nobody’s rights are violated; theoretically, then, it is acceptable if an individual would receive all of society’s revenues in a lawful manner.[10] The libertarian philosopher, Robert Nozick (1974) in his *Anarchy, State, and Utopia*, challenges the notion of redistributive justice and maintains that any government intervention is an infringement of one’s rights.[11] Any attempts at redistribution are construed as confiscation and violation of the right to self-ownership.

However, these highly inegalitarian theories fail to acknowledge that even “natural rights” are social creations of particular historical and institutional circumstances and as such can be redefined to meet changing socio-political circumstances and legitimacy criteria (Wisman and Smith, 2011: 995). Similarly to mainstream economics, these approaches to income inequality totally ignore the reality and the issue of power, the social and political impact under which personal preferences are shaped and whether “freedom of choice” actually exist in particular circumstances. Again, disregarded historical and cultural factors which have an enormous force in shaping and defining the real patterns of opportunities and upward mobility for generations.[12] All in all, it might be suggested that extreme libertarian

[9] Thus, Milton Friedman and his followers in the Chicago School, ardent advocates of free market capitalism and intellectual defenders of economic inequality, viewed libertarian approaches as complementary to their theoretical propositions.

[10] Libertarian economist Ludwig von Mises (1990[1955]) even argued that, “Inequality of wealth and incomes is the cause of the masses’ well-being, not the cause of anybody’s distress. Where there is a “lower degree of inequality”, there is necessarily a lower standard of living of the masses”.

[11] Nozick even compares taxation with forced labour. Another influential libertarian, Ayn Rand (1905-1982), an author of the two best-selling novels, *The Fountainhead* and *Atlas Shrugged*, is an architect of a philosophical system *objectivism* which glorifies egoism and *laissez-faire* capitalism and rejects any forms of collectivism.

[12] In 1833, the British government took one of the largest loans in history, equivalent to £300 billion today, to compensate slave owners as required by the Slavery Abolition Act for “the loss of property”. It is estimated that just 6% of claimants, as the largest owners of slaves, received more than 50% of total revenues. The freed slaves, mostly black plantation workers, in contrast, were not granted any compensation (Manjapra, 2018). It is not too

views, having their roots in the 17th and 18th centuries' intellectual contention to challenge "divine" legitimation as opposed to natural realms, have served to legitimate and justify contemporary Anglo-Saxon-style capitalism with skyrocketed remuneration for CEOs and compensation packages for bankers. As Isaiah Berlin (1990: 63) reminds us, "total liberty for the wolves is death to the lambs".

It is suggested that over the past forty decades many economic theories illustrating excessive income inequality as the outcome of unleashed capitalism, have been left outside of mainstream economics (Wisman and Smith, 2011; Wade, 2012). But back in the 1930s, John Maynard Keynes (2016[1936]) challenged the orthodox view of *laissez-faire* policies and argued that government intervention and greater spending would restore total demand and full employment. Moreover, downward income redistribution is vital for total consumption which prevents an economy from falling into recession and crisis. Commenting on economic theories more generally, Keynes (2016[1936]: 373) argued that, "The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes". The Keynesian consensus of "embedded" liberalism and demand management helped to lessen gap between the rich and poor and proved that equality-based policies do not harm economic efficiency and reside in the political realm.

Contrary to inequality-legitimating theories and neoclassical economics biased towards issues of equality,[13] the very name political economy reflects an understanding that political and economic dimensions, particularly in the matters of functional distribution of income, are closely related and should not be separated (Goodwin and Ackerman, 2000). As early as in 1817, David Ricardo (2004: 1) in his influential *On the Principles of Political Economy and Taxation*, wrote, "To determine the laws which regulate this distribution [of rent, profit, and wages], is the principal problem in Political Economy". Atkinson (1997: 298) argues that although distributional factors are important in understanding what determines shares of wages and profits in the national income, "the other links in the chain need to receive attention". Similarly, Ackerman (2000) in an overview essay to *The Political Economy of Inequality*

speculative to suggest that the black descendants of those freed slaves are still in less advantageous positions in regards to social mobility and prospects in life if compared with the mostly white successors who inherited large wealth from those who had been compensated. For instance, black citizens in the UK are more than twice likely than their white compatriots to work in low-paid and insecure jobs (ibid).

[13] Feldstein (1998: 358), for instance, even writes of "spiteful egalitarianism".

highlights the strong connection between the economics of inequality and the politics of inequality. It is suggested that income distribution is mistakenly studied through a supply-demand nexus only in combination with technological change whereas historical or institutional factors are ignored. As Wisman (2017: 347) points out, “This mistake of focusing on proximate causes while ignoring underlying political forces is itself political. It masks the true cause of inequality and presents it as if it is natural or due to the forces of progress”.

Atkinson’s (1997) advice “to bring income distribution studies in from the cold” is timely more than ever. In the aftermath of the 2008 financial crisis researchers have shown an increased interest in economic inequality.[14] Increasingly, their focus is not restricted to economic analysis only. To re-incorporate studies on the functional distribution of income into the main body of economic analysis “we need to go beyond purely economic explanations and to look for an explanation in the theory of public choice, or ‘political economy’” (Atkinson, 1997: 315). There has been renewed interest in the revival of the political economy of income inequality and understanding of its multidimensional approach in contrast to the unidimensional perspective of mainstream economics (Martins, 2012). The latter is of paramount importance since neoclassical (mainstream) economics presumes closed systems in its theoretical assumptions (Lawson, 2003).[15] Thus, in his *The Idea of Justice*, Sen (2009) criticises contemporary economics for employing fictitious agents in its analysis and constructing ideal situations and economic models that have no connection to reality.

There is an urgent need to address developments in contemporary capitalism that cause income inequality to rise. Ultimately, the research on income inequality is research about the political economy of modern capitalism and helps to reveal where it leads humanity. Is our route guided by ideas of economic democracy without which other liberties are inadequate and a mockery of history? Or are we condemned to repeat the same mistakes again and again? There are too many complex and interrelated factors in the relations between neoliberal financialisation and increasing income disparity to be ignored. Apart from ideological explanations, there must be some deep conceptual and methodological reasons for misunderstanding and denial of inequality and issues of re-distribution which have theoretical and political

[14] Major volumes referenced in this thesis include, for instance, Hacker and Pierson (2010), Piketty (2014), Atkinson (2015), Milanovic (2016), Galbraith (2016), Bartels (2016), Temin (2018), and Boushey, et al. (2017).
[15] The notion of closed and open systems is discussed in detail in Chapter 3.

implications. What are needed are multidimensional and multifaceted approaches to the economic disparity studies which would encompass and explain those complex developments.

### 1.7. An overview of the thesis

In the new global economy, distributional matters and their methodological complexities have become a central issue for understanding the risks the world faces. This introductory chapter aimed to provide accounts on why increasing income inequality is an issue of the political economy of contemporary capitalism. The chapter has also defined the aim of the study, its hypothesis and research questions. This section has provided a brief review of the academic literature relating to income inequality and described the key terms used in the paper. The rest of the thesis is organised as follows.

In the chapter that follows, I present the historical and theoretical background of the study and its political economy context, neoliberalism. Various concepts on financialisation and finance capitalism will be described along with identifying a knowledge gap in the field of study. Chapters 3 and 4 are concerned with the methodology and approaches used for this study. Chapter 3 begins by laying out the philosophical dimensions of the research and explains why critical realism is essential in the study of the financialisation and income inequality nexus. Chapter 4 discusses the analytical framework of the research, methods employed, and research design with a focus on the necessity to synthesise heterodox approaches. In particular, I describe the methods of retroduction and explanatory causal-processual analytical constructs developed for the study. Chapters 5 to 8 provide the main findings on the country case studies of the USA, South Korea, Argentina, and Sweden, respectively. A final discussion is offered in Chapter 9 where I conceptualise the financialisation-induced income inequality hypothesis and develop its components. Chapter 10 concludes with a description of the limitations of the study, generalisability, contribution and an agenda for further research.

# Chapter 2. Neoliberal financialisation: a conceptual framework

## 2.1. Introduction

As argued in the previous chapter, rising income inequality should be one of the central issues of the political economy of modern capitalism. In this chapter I highlight the importance of examining the relationship between neoliberalism and financialisation, thus establishing a conceptual and theoretical framework for the link between income inequality and finance. Developing this theoretical position helped to generate a hypothesis of the study, its research questions and design, and a conceptualisation of findings (Trafford and Leshem, 2008).

First, from a historical perspective it will be explained how neoliberalism from the intellectual project of the Mont Pelerin "thought collective" has become a hegemonic political project both in advanced and developing capitalist countries. Employing a "class-based" approach influenced by Marx, it will be argued that a decreased share of capital in national income instigated the ruling classes to introduce neoliberal policies that later would develop into financialisation as a new mode of capital accumulation which most decisively resolved distributional issues in their favour. Importantly in this regard, the new global financial architecture will have to be explained, as will factors behind its origin, in order to understand the interests of national and transnational capitalist classes who support this system. This, in turn, will help to understand how neoliberal financialisation is legitimised to re-emerge as what I will call, the "new old phase" of the modern capitalism.

Second, theoretical accounts will be presented to discuss the phenomenon of financialisation and its relation to the concept of finance capital. The review of the academic literature on financialisation will help to highlight its relation to neoliberalism and its description as a mode of capital accumulation. That will lead to identifying the knowledge gap in the current debate on the financialisation and income inequality nexus.

## 2.2. The political economy context: dimensions of neoliberalism

### *2.2.1. Neoliberalism as a "new old phase" of capitalism and transnational hegemonic "thought collective"*

The subsection below describes the rise of the politico-economic context where, as the thesis title claims, the financialisation and income inequality nexus occurs, namely, neoliberalism. In particular, I will focus on the origin of neoliberal ideology, its main doctrinal tenets and its strategy to become hegemonic.

There has been a wave of neoliberal policies implemented worldwide beginning in the 1970s (Saad-Filho and Johnston, 2005; Birch and Mykhnenko, 2010). Policies like deregulation, privatisation, and the withdrawing of the state from social protection and welfare delivery became a common trend across different countries, from former Soviet republics to high-income social democratic welfare states. It has been argued that implementing such reforms would not have been possible without the "capturing" of key positions in national governments, media, academia and corporations by proponents of neoliberal ideology (Miller, 2010), backed by international institutions such as the International Monetary Fund (IMF), the World Trade Organisation (WTO), and the World Bank (Peet, 2003).

Such ideas, policies and reforms were in stark contrast to the politico-economic paradigm that emerged after World War II, when a different set of social and economic institutions and policies were established, both globally and in various states to ensure, among other objectives, that the consequences of socio-economic conflicts would not threaten peace and, in the case of capitalist states, capitalism itself. In the international arena, institutions such as the United Nations, the International Labour Organisation (ILO), IMF, and the World Bank were organised to ensure peace, economic co-operation and development in an international order where sovereign national states were – at least in principle – committed to socio-economic justice and the protection of human rights (Supiot, 2012). Indicatively, prominent US social scientists like Robert Dahl and Charles Lindblom (1953) in their book *Politics, Economics, and Welfare* argued that it was important to build the right combination of state, market, and democratic institutions to secure peace and well-being, since both unregulated capitalism and communism had failed.[16] Thus, in the domestic arena of many advanced capitalist countries, politics began to be centred on the creation of institutions and policies to guarantee a compromise between capital and labour. Most developed countries gradually became social democracies where the state would intervene to promote economic growth, full employment, and social protection. Years

[16] It is worth to note how much their political economy analysis of socio-political alternatives in the 1950s appears to be relevant to contemporary debates. In particular, they maintained that, "…classic liberalism and classic socialism suffered from rather similar limitations, but these deficiencies never reached to the core that is identical in both, and the core is still the grand strategy of rational democratic social reform" (Dahl and Lindblom, 1953: 511).

later, concepts like "embedded liberalism" (Blyth, 2002) or the "Keynesian compromise" (Isaacs, 2011) were used to describe this post-World War II consensus as a unique policy combination where market and corporate activities became controlled, and restrained, by substantive economic regulations and a web of social and labour protection policies. During the 1950s and 1960s high rates of economic growth and industrialisation had been achieved in high- and low-income nations with simultaneous redistributive policies, strong trade unions, and controls over the free mobility of capital and welfare state-building in the advanced capitalist countries supported by expanded public expenditures.

One of the key outcomes of the "embedded liberalism" in the post-World War II era was evidenced in the trend towards more equal income distribution, where the economic power of the upper class became gradually restrained by the growing power of labour. For instance, probably for the first time in economic history in the United States, the share of the national income of the top 1% fell from the 16% of the pre-World War II rate, to less than 8% in the post-war era and stayed at the same level for almost three decades (Harvey, 2005). However, by the beginning of the 1970s a combination of slowing economic growth, the breakdown of the Bretton Woods system of fixed exchange rates, "stagflation" and high unemployment put severe strains on state budgets. "Embedded liberalism" appeared to have reached its limits and other alternatives to overcome the emerging crisis were called on. For its proponents, the moment of neoliberalism had arrived.

Philip Mirowski, a historian of economic thought, explains that neoliberalism is "a general philosophy of market society, and not some narrow set of doctrines restricted to economics" (2014: 8). As a political movement, it aimed at reviving pro-market conservatism after World War II. It was reinforced by neoclassical economics in promoting an account of the economy devoid of any political element, similar to natural sciences (Mirowski 2005: 89). As Mirowski and Plehwe (2009) argue, the rise of neoliberalism was the result, in the first instance, of the creation of a "thought collective" that can be traced back to the creation of the Mont Pelerin Society in 1947.

The birth date of neoliberalism as an intellectual tradition might be marked as the last days of August 1938 when a group of twenty five thinkers from Europe and USA met in Paris at the colloquium to discuss the American columnist Walter Lippmann's book *The Good Society* published in 1937 (Biebricher, 2018). The book outlined the political and intellectual drift towards collectivism and totalitarianism defending political, economic and personal freedom against all forms of collectivism, socialist planning and market regulation. Liberalism had been stagnating since the late 19th century as "in the name of progress, men who call themselves communists, socialists, fascists, nationalists, progressives, and even liberals, are unanimous in holding that government with its instruments of coercion must, by commanding the people how they shall live, direct the course of civilization and fix the shape of things to come" (Lippmann, 2005 [1937]: 3). Future neoliberal Knight (1938: 866) praised the book for providing a detailed "Agenda for Liberalism" as "a concrete program for making liberalism real and permanent by maintaining the framework of the free-market economy". The World War II postponed the neoliberal project for regular meetings and network building until April 1947 when sixty participants met in Switzerland to form what will become the Mont Pelerin Society.

Neoliberalism as an intellectual-political project was conceived in the context of, what early neoliberals believed, was "the decline of liberal age", a crisis of liberalism (Biebricher, 2018: 14). During the first half of the twentieth-century mainstream ideologies of collectivism, central planning, Keynesianism, and protectionism provided political framework for the rise of the Keynesian welfare state, New Deal progressivism and state corporatism. In times when liberal ideas associated with *laissez-faire* capitalism were in decline the prevailing collectivist ideas had to be fought to save capitalism from what intellectuals like F.A. Hayek believed to be an existential threat. Liberalism had to be modernised, its values and ideas had to be reinterpreted, reinvented and reoriented to create a renewed intellectual tradition able to rival mainstream ideas. Intellectuals like Hayek, Milton Friedman and Lionel Robins successfully constructed in their works a false dichotomy between collectivism and liberalism to establish *neo*liberalism as liberal thought and an anti-thesis to socialist and interventionist views. Anti-collectivist ideas of the classical economic liberalism were claimed to save capitalism and prevent totalitarianism and economic catastrophe, the latter two allegedly being the inevitable outcomes of all forms of collectivism and interventionism (Turner, 2007).

As a result of long-term concerted efforts of intellectual and political work combined with well-funded and well-organised infrastructure the doctrine was fine-tuned, reconstructed and elaborated over the time attracting new generations of scholars and supporters. Although transnational in its scope, this "thought collective" encouraged a degree of local innovation and taking advantage of instances of domestic political momentum to achieve implementation of its doctrines. Mirowski evidenced how, in the neoliberal “thought collective”, “sanctioned members [were] encouraged to innovate and embellish in small ways, but that an excess of doctrinal heresy [got] one expelled from participation” (Mirowski, 2014: 13). As it will be argued later, when the thesis will explore the process of neoliberalisation in the countries used as case studies, this transnational and consolidated “thought collective” helped to achieve an epistemic shift in the study and practice of economics in those countries. Although Mirowski has been accused of anti-capitalist propaganda (Bagus, 2015) and even falling over conspiratorial theories (Cahill, 2014), he nevertheless makes a compelling case as to how and why neoliberals disguised their true ideas and allegiances from the public, by adopting a kind of “doublespeak”, especially since neoliberal philosophy itself was a conflation of various and rival theoretical traditions (Mirowski, 2014). He argued,

> “the ubiquitous political necessity of saying one thing and doing another was especially salient when it came to neoliberal doctrine. The neoliberals believed that the market always knew better than any human being; but humans would never voluntarily capitulate to that truth. People would resist utter abjection to the demands of the market; they would never completely dissolve into undifferentiated “human capital”; they would flinch at the idea that the political franchise needed to be restricted rather than broadened; they would be revolted that the condition of being “free to choose” only meant forgetting any political rights and giving up all pretence of being able to take charge of their own course through life. Neoliberal ideals would always be a hard sell; how much easier to avoid all that with simplistic stories that fogged the mind of the masses: government is always bad; everything you need to know is already in Adam Smith; you can be anything you want to be; there is no such thing as class or the dead hand of history” (Mirowski, 2014: 30-31).

In the same vein, Fink (2016: 163) maintains that it was an intentional strategy to disconnect public declarations and actual discreet actions which also led neoliberals to stop calling themselves “neoliberals”. This strategic decision of alleged non-existence of concerted planning helped to make believe that the success of neoliberal ideas “were merely unstoppable natural “market forces” working themselves out” (ibid: 160).

Meanwhile, an organising campaign was launched to advocate pro-market and corporate interests and to curtail the potential of human agency acting in the opposite direction. As mentioned above, first initiated as the Mont Pelerin Society (MPS) in 1947 in Switzerland by Friedrich Hayek, the author of *The Road to Serfdom*, the organisation included mostly scholars and rich individuals with like-minded political and philosophical ideals diverging from classical liberalism. Bagus (2015) highlights that there is common confusion of relating most neoclassical economists and libertarians to the neoliberal camp. Yet, there are important differences even among the three theoretical schools which founded the MPS:  the Austrian school (Ludwig von Mises and Friedrich Hayek), ordoliberalism (Walter Eucken and Wilhelm Ropke), and Chicago school (George Stigler, Frank Knight, and Milton Friedman).[17] Basically, the three theoretical traditions created an alliance in opposition to socialist and egalitarian perspectives of the welfare state. Some of the founding members of the MPS (Hayek, Knight, and Friedman) also participated in the Free Market Study (1946-1949), the project organised by Aaron Director, professor at the University of Chicago Law School, and funded by the right-wing Volker Fund. The main goal of the research group was "the formulation of liberal economic policy" (Director in Van Horn and Mirowski, 2010: 200) which is almost identical to Friedman's neoliberal doctrine of the Chicago school: "economic freedom is an end in itself" (Friedman, 1962: 8). Later, the president of the University of Chicago, Robert Hutchins, hired Leo Strauss[18] and created the Committee on Social Thought, a centre of neoconservative intellectuals. In this regard, the Chicago school became central in the effort to reconcile the political aspects of neoliberal ideas with theoretical presumptions of the neoclassical economics. Steadily, by the 1980s, and with MPS at the center of the neoliberal "thought collective", academic departments in various universities (such as the Ivy League schools where many members of the politico-economic elites are educated) became dominated by neoliberals. Another layer of the neoliberal infrastructure has been and continues to be various foundations which play an important role in promoting neoliberal doctrines in different countries. Equally important in creating a well-organised and coherent movement that is responsible for the perpetuation and

[17] For instance, the Austrian school does not consider itself as neoclassical mainstream let alone neoliberal. Also, there are crucial distinctions in methodological approaches of the Chicago school which employs a positivist view with mathematical modelling and equilibrium theories (see Chapter 3) and Misesian tradition of viewing reality as a dynamic process of human interaction.

[18] Leo Straus was a political philosopher who influenced the neoconservative movement in the USA and is believed to introduce doublespeak into neoliberalism with his doctrine of esotericism in the theory of politics where the "secret" truth is known only by the elite (Mirowski, 2014; Fink, 2016).

expansion of the “thought collective” are think-tanks that had played a critical role in the epistemic shift in the intellectual and political landscape of different countries.[19]

Neoliberalisation emerged as a set of prepared receipts only after long and chaotic experiments converged to the new orthodoxy in the 1980s and culminated in the so called “Washington Consensus” (Williamson, 1990). Gradually the neoliberal thought collective developed into a set of ideas capable of being opportunistically employed and embedded in various political situations of different countries. Borrowing from Van Horn and Mirowski (2010: 197) and Mirowski (2014: 22) I outline below key neoliberal tenets that can serve as a conceptual context of the financialisation-income inequality nexus.

1. The market is the most efficient information processor and market society is therefore the natural state of humankind. All problems, even if they are caused by the market, can be fixed in the first place by the market. As Harvey (2005) explains, the market is presented as natural to all humans and necessary for the best functioning of all social and economic institutions. Virtues such as “individual freedom” and “human dignity” are connected to and equated with the freedom of the market that guarantees them. Here neoclassical economics, with its formal mathematical modelling, represents the capacities of the market as information processor.

2. Though neoliberals are usually described as *laissez faire* advocates, in fact their goal is not to destroy the state but to take control of it in order to embed and further market-friendly institutions and culture. Even Harvey (2005), while maintaining that one of the main neoliberal ideas is the withdrawal of the state, which should be left with minimum obligations, agrees that the result is just *a neoliberal state* whose ultimate goal is to guarantee market institutions and business interests. In the words of Van Horn and Mirowski (2009: 161), “Neoliberalism is first and foremost a theory of how to reengineer the state in order to guarantee the success of the market and its most important participants, modern corporations. Neoliberals accept the precept that

[19] Neoliberalised academic institutions in addition to the University of Chicago include the London School of Economics, L’Institut Universitaire des Hautes Etudes Internationales at Geneva, St. Andrews in Scotland, Freiburg, the Virginia School, and George Mason University. The special-purpose foundations are organised as charitable and philanthropic entities and include the Volker Fund, the Intercollegiate Society of Individualists, the Foundation for Economic Education, the Lilly Endowment, the Earhart, the Relm, the John M. Olin, the Bradley, the Coors, and the Koch foundations. Among think-tanks are the Heritage Foundation, Institute for Economic Affairs, American Enterprise Institute, Swiss Institute of International Studies, the Hoover Institution at Stanford, and one of the most important, with 495 affiliated think-tanks in 96 countries, the Atlas Economic Research Foundation (Mirowski, 2014: 16-18).

they must organise politically to take over a strong government, and not simply predict it will 'wither away'". Therefore, state coercion can be applied if necessary to form markets where they did not exist previously.[20]

3. International initiatives and forms of inter-state governance can be called upon to discipline the nation-state to follow the neoliberal course. The neoliberal takeover of the IMF, the WTO, the World Bank (often through the recruitment of educated bureaucrats from Ivy League schools) and other previously classical liberal transnational institutions facilitates this task, especially in the case of "latecomers" and developing countries. These international institutions advocate "free trade", floating exchange rates, and the interests of transnational corporations. Often, as will be demonstrated in the country-cases, neoliberals employ crisis-driven rhetoric (USA, Sweden) and even create crises (South Korea, Argentina) to push for radical restructuring (Fink, 2016).

4. *Private/market/consumerism* should eclipse *public/politics/citizenship*. "Freedom" is "negatively" defined as "freedom of choice" for consumers in the market place and "freedom" of corporations to pursue profit. From this perspective, these freedoms are considered to be more important than social justice. Capital should always be allowed to flow across national borders.

5. Income and wealth inequality should be cherished as they stimulate competition, innovation and productivity.

Neoliberalism in this thesis is understood as the political economy regime which embodies a reaction and response to the crisis of capital accumulation that excludes any forms of collectivist organisation and egalitarian income distribution. Neoliberal ideology and its set of strategies, in this regard, provide conditions that sustain and maintain a capitalist mode of social organisation. Neoliberal political economy project establishes a political and socio-economic framework for capitalism to overcome its internal and inherited deficiencies and at the same time to continue capital accumulation by employing certain strategies, particularly by shifting from Keynesian

[20] As Antonio Gramsci (1891-1937), an Italian Marxist philosopher, explained, "it must be made clear that *laissez-faire* too is a form of state "regulation", introduced and maintained by legislative and coercive means. It is *a deliberate policy*, conscious of its own ends, and not the spontaneous automatic expression of economic facts. Consequently, *laissez-faire* liberalism is a political programme, designed to change – in so far as it is victorious – a State's leading personnel, and to change the economic programme of the State itself – in other words *the distribution of the national income*" [emphasis added] (Gramsci, 2005 [1971]: 160). Also, Klein (2007) demonstrated how neoliberal policies were implemented in Chile by Pinochet dictatorship and in Iraq after the 2003 invasion.

welfarism towards a set of policies favouring markets and unfettered finance (Larner, 2000). Neoliberalism is described as an antithesis to the Fordist-Keynesian rationale of the politico-economic institutions that used to govern the industrialised capitalist countries during the 1950-1980 period (Campbell and Pederson, 2001: 5). When, by the early 1970s, the international economy was in crisis, the neoliberal "thought collective" and its organisational structure were mobilised effectively to launch an assault upon major international and domestic institutions (Fink, 2016). In a sense, neoliberal counter-revolution can be considered as a "new old phase" of finance capitalism, a return to a liberal financial framework of the "Gilded Age" which began in the 1870s, a period when cross-border movements of financial capital were unregulated. That was an era of the "gold standard" with high real interest rates (which is the nominal rate minus the rate of inflation), that is, high returns to rentiers.[21] That period in history was also characterised by widespread poverty, rising inequality, and the high concentration of wealth. Although neoliberal policies developed through a long process of different historical, political, and institutional traditions in different national locations, their ideology began to be embedded in the political agenda from the 1970s onwards. For authors like Harvey (2005), one of the main explanatory reasons was that the crisis of capital accumulation in the 1970s was perceived as a severe political threat by the economic elites, businesses and ruling classes of advanced capitalist countries. The next subsection further explores this assertion.

### *2.2.2. The crisis of capital accumulation and the restoration of class power*

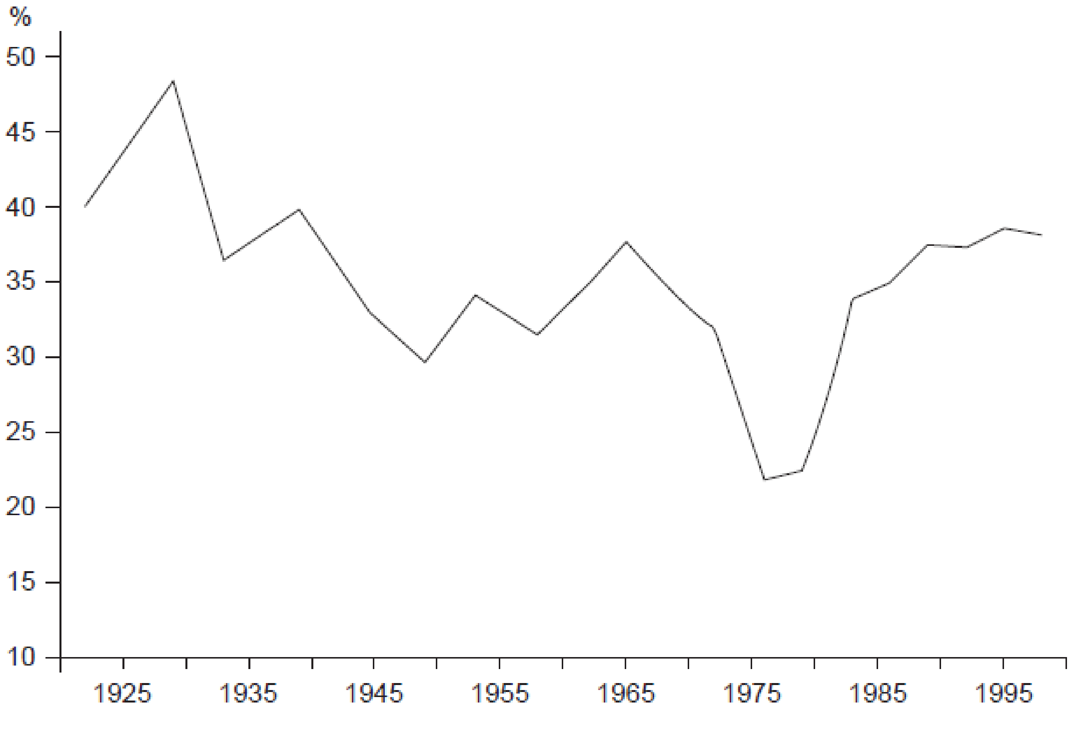
Drawing from the work of Dumenil and Levy (2001; 2004a; 2004b; 2004c; 2005; 2011) and Harvey (2005; 2007) who analysed income accumulation from a historical-materialist perspective, it can be argued that the transformations that took place in the early 1970s and 1980s in the core capitalist countries were primarily initiated by those classes whose interests had been negatively affected in the post-war period of "regulated" capitalism.

To begin with, the 1973 recession accelerated the crisis of capital accumulation; a crisis whose signs already began to be manifested in the late 1960s. In his studies

[21] Between 1870 and the interwar period average real interest rates in the advanced capitalist countries were around 4% compared with average 2% from 1950 to 1970, the "Golden Age". Between 1981 and 1993, with deregulation of the international financial markets, the average interest rates in major industrial countries reached 5.1% (Eatwell and Tylor, 2000: 32).

of trends in wealth inequalities Wolf (1996; 1997) demonstrated that the wealth of the top 1% of US households' reached almost 35% of the total national wealth (securities, property, stocks) in the period between early 1950s and mid-1960s before experiencing a deep plunge that lowered their share to 22% (Figure 2.1). However, by 1986, the richest 1% share of income again reached the 35% threshold and even surpassed it. In the same vein, Piketty and Saez (2003: 11, 14), in a paper on top shares of income and wages in the United States, demonstrated that the share of the top 10% income-earners was about 40%-45% during the interwar period. It declined to 30% during World War II and then remained stable at about 32% until the 1970s when it increased again. By the mid-1990s this number crossed the 40% level and almost reached the pre-war level.

**Figure 2.1. Portion of total wealth held by the richest 1% of US households**




Source: Wolf (1996) in Dumenil and Levy (2005: 11)

Furthermore, it is a well-established fact that from the late 1970s and early 1980s onwards the income and wealth of the richest of the rich in the US have increased continuously (Wolff, 1996, 1997; Piketty and Saez, 2003). For instance, from the early 1980s to 2013 the share of wealth owned by the 400 richest Americans increased from 1% to over 3% (Saez and Zucman, 2016). The top 0.01% earned 50 times more than the average income-earner in 1970 but by 1998 they got almost 250 times the average income (Piketty and Saez, 2003: 11, 14). Likewise, the ratio of the salaries of CEOs to the median compensation of workers increased from 30 to 1 in 1970 to 500 to 1 by the beginning of the new millennium (Harvey 2005: 16). For Dumenil and Levy (2005; 2011) these dramatic shifts in inequality are clear indications that the richer strata in most advanced capitalist societies managed to recapture political control and extend their financial power via a shift from Keynesian socio-economic policies towards a political agenda favouring pro-market policies in the early 1980s.

Still, beyond the advanced capitalist economies of the global North, these neoliberal reforms that included deregulation of financial markets, privatisation and a *laissez-faire* approach in the policy agenda were also implemented in middle-income countries, often under authoritarian rule. Key examples from the 1970s are Chile, the first adopter of neoliberal reforms, following the coup d'état of General Pinochet in 1973, and Argentina following the coup d'état of Lieutenant General Jorge Rafael Videla in 1976; though in the latter neoliberal reforms were fully implemented ten years later under President Menem’s government (1989-1998) (Undurraga, 2015). Other historical examples of increased income inequality following the adoption of neoliberal policies include countries as diverse as Brazil and China, South Korea and Russia, Kazakhstan and UK. Such examples demonstrate that neoliberal reforms and economic policies do not need – and in many cases did not have – domestic democratic legitimacy. The exercise of power to redistribute income for the benefit of the ruling classes occurred not only in cases of western democratic regimes but authoritarian regimes as well.

Against this background, authors who employ the class struggle theory describe the process of neoliberalisation as, effectively, a political project to re-organise favourable conditions for capital accumulation that re-confirm the power of economic elites (Harvey, 2005: 19), a project that provided a set of ideas and a set of means to restore the class power of these elites (Dumenil and Levy, 2004), the vast majority of which are from the global North. This process is also defined “as a project of sociospatial transformation” which offers a new regime of socioeconomic governance (Peck et al., 2009: 95). The neoliberal project, therefore, is a concept which originated to offer, first and foremost, an alternative social organisation for the ruling classes in a particular historical moment when their wealth and income accumulation was under threat of enduring decline. Successful implementation of the neoliberal concept guaranteed restoration of class power to the richest layers (Dumenil and Levy, 2004a, 2004b) in a variety of national settings, but it would be severely limited to perceive it only in domestic terms. For, the power resources that were mobilised to facilitate upward income distribution required action both on the national and global levels. The establishment of a new international financial order was central in this effort. Such an interpretation then helps us to understand the genealogy of financialisation and its rationale: the neoliberal political agenda unites the top class's interests globally, a set of neoclassical economics concepts and politically conservative values and beliefs to employ finance as an instrument for upward income distribution.

### *2.2.3. The emergence of the new global financial order*

To consider the international dimension of neoliberal restructuring, we need to explore how finance globalised and broke from the Bretton Woods financial order. Indeed, a number of key global events that took place as early as the 1960s and 1970s have to be accounted for to examine the financial liberalisation trend of the 1980s. Helleiner (1994), writing from the perspective of international political economy (IPE), provides detailed accounts on how the global financial system emerged to end the restrictive order of the post-World War II Bretton Woods financial architecture and its commitment to capital control and fixed exchange rates.

The Bretton Woods exchange rate system was at the heart of the international financial regime and was a cornerstone for sustaining domestic forms of regulation and non-liberal financial order with a strong endorsement of capital controls (Eatwell and Tylor, 2000; Soederberg, 2004). Thus, both on the international and domestic levels there were institutions that allowed states to practise expansionary monetary policies to maintain redistributive welfare regimes, engage in international trade and at the same time prevent speculation and arbitrage.

The first attempts to eliminate capital controls in the arena of international capital transactions were implemented by the elimination of exchange controls in 1958 (Campbell, 2005). In the late 1950s, to ease obstacles of capital control for international market operators, the so-called Euromarket was created in London. It expanded rapidly in the 1960s as bankers, especially those from the US, who were supported by the US Treasury and the Federal Reserve, began to reap the benefits of unregulated capital transactions. Meanwhile, the US balance of payments continued to worsen year after year as the world supply of dollars increased which, in turn, created inconsistency between the par and market values of the currency, thus opening up arbitrage possibilities (Blyth, 2002). At the same time, capital mobility increased the pressure on the dollar. In an attempt to prevent foreign borrowing in dollars and a devaluation of the dollar itself (Helleiner, 1994) an interest equalisation tax (IET) was introduced by US authorities in 1963. US financial capital began to flow massively to the Euromarket, threatening the position of New York as the centre of global capital transactions. Pressure on the US dollar continued to increase with the rise of unregulated amounts of capital, gold continued to drain from the country (as some foreign states perceived that the US was abusing its seigniorage privilege of the issuer of the world key currency) and eventually in 1971 the US suspended convertibility of the dollar (Eatwell and Taylor, 2000; Peet, 2003). The Bretton Woods exchange rate system and its non-liberal financial order was ended.

From this point on, American policy on how to reconstruct the international exchange system and capital movements was reflected in its push towards the neoliberal approach of removal of all capital controls and establishing a system of floating exchange rates (Helleiner, 1994; Campbell, 2005). Proposals of the European and Japanese governments to re-establish internationally backed fixed exchange rates and strengthened capital controls were rejected by the US authorities. When in February 1973 a currency crisis broke out, the US announced that it would abolish all capital controls by December 1974 but in fact did so in January 1974.

The emerging international financial order provided new opportunities to finance the growing US external and budget deficits, thus preserving US policy autonomy in the face of its declining economic competitiveness (Helleiner, 1994). In fact, within this new global order, consecutive US governments dramatically enhanced what Strange (1988) calls “structural power” where the “dollar weapon” has been used to transfer the burden of adjustment of correcting the country’s current account deficits to foreign countries. As the result, by 1973 the US current account deficit was mostly reduced. Consequently, the US, to the benefit of its financial markets and finance capital, vetoed proposals to recycle billions of OPEC petrodollars in 1973 (as the result of the oil crisis) through IMF channels. Instead, in the name of liberal and market-based financial systems, all of these windfalls were "recycled" through private American banks as loans to developing countries (Helleiner, 1994).[22]

Thus, the endorsement of a liberalised and deregulated international financial order by the US government, as a hegemonic capitalist country, was instigated by its changing global position when it had to deal with its growing current account and budget deficits in the 1960s resulting from the Vietnam War escalation and President Johnson's Great Society program (ibid). International financial markets became for the dominant US actors the new sources for adjusting to the decline of economic power and maintaining a hegemonic position in the new financial order (ibid). This dominant position in the new open international financial order has become the key reason for the US government to promote and sustain financial liberalisation and deregulation both domestically and internationally. This finding has important implications for understanding why and how the global financial architecture, backed by the US geopolitical power, has been able to restructure different national models. The shift from the capital-restrictive Bretton Woods regime towards a regime facilitating the unregulated and free movement of capital also reflected the interests of finance capital represented by what can be described as the "Wall Street–Federal Reserve complex". The latter will play an important role in re-empowering a transnational finance-driven capitalist class and promoting its interests globally. At the same time, advocates of the neoliberal politico-economic paradigm who began staffing influential administrative and political positions in their countries, propagated such a liberal financial order on the grounds that it would allocate capital more efficiently from both internal and external financial markets. It is important to note that neoliberals rejected concerns over speculative capital flows disrupting the Bretton Woods exchange rate system and thus undermining the state's ability to maintain welfarism and progressive redistributive policies, favouring instead floating exchange rates in accordance with orthodox fiscal and monetary ideals. In fact, international financial markets have been considered by neoliberals as a disciplining force against state intervention in areas such as welfare expansion, progressive income taxation or labour and environmental

[22] The initiative to recycle petrodollars through commercial banks' channels came from Citibank CEO Walter Wriston who is also infamous for his remark in defence of this policy. He is allegedly said, "why not, governments never go bust" (Blyth, 2002: 188). Eventually, low-income countries borrowed heavily which led to the Debt Crisis of the 1980s (Peet, 2003; Steger and Roy, 2010).

protection in an increasingly competitive global market economy (Gowan, 1999; Soederberg, 2004).

## 2.3. Neoliberal financialisation: the essence of finance capitalism

### *2.3.1. Historical and theoretical overview of finance capital*

A seminal study on the political economy of capitalism which might be considered as the first historical study of the early twentieth-century neoliberal financialisation is Rudolf Hilferding's (1981[1910]) *Finance Capital*.[23] The Austro-German Marxist theoretician was the first to introduce the term "finance capitalism" and warned of the dangers associated with concentration of capital and the transformation of competitive capitalism into monopolistic finance capitalism, thus anticipating the process of contemporary financialisation. Hilferding (ibid: 225-226) explained,

> "I call bank capital, that is, capital in money form which is actually transformed in this way into industrial capital, finance capital… An ever-increasing proportion of the capital used in industry is finance capital, capital at the disposition of the banks which is used by the industrialists... With cartelization and trustification finance capital attains its greatest power while merchant capital experiences its deepest degradation. *A cycle in the development of capitalism is completed*". [emphasis added]

Hilferding highlighted the increased power of finance as a result of capital's growing concentration and centralisation. To obtain investments, monopolistic corporations amalgamate with banks which provide finance, and thus unite industrial and banking capital with the latter in a dominant position. Hilferding (ibid: 112) also identified a new form of profit, "promoter's profit", which accrues as the result of share issuance. As stock markets develop, future profits equal the rate of interest, whereas the rate of profit is generated by the capital actually invested. Prices paid for shares are higher than the capital actually invested because the rate of interest is lower than the rate of profit. Hence, those who issue shares, benefit tremendously, as do finance managers who master share flotations.

Systemic explanations of finance capital were picked up by Nikolai Bukharin (2011[1914]) in the *Economic Theory of the Leisure Class,* who developed the notion

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[23] Prominent Marxist and social democratic theoreticians Karl Kautsky (1854-1938), "the Pope of Marxism", and Otto Bauer (1881-1938) praised Hilferding's volume and described it as a completion of Marx's Capital (King, 2010). Reaffirming the sustained influence of *Finance Capital*, recent appraisals are provided in Lapavitsas (2004; 2011), King (2010), Vouldis et al. (2011), and Sotiropoulos (2015).

of parasitical rentier of the capitalist class encouraged by increased circulation of “financial paper”. Hilferding’s analysis of transformation of the capitalist economy and the theory of imperialism were further deepened by Bukharin’s (1972[1915]) *Imperialism and World Economy* and Vladimir Lenin’s (1968[1916]) *Imperialism, the Highest Stage of Capitalism*. Thus, the idea of “financialised capitalism” was discovered in the pre-1914 era and later deepened by Bukharin’s rentier stratum of inter-war capitalism where finance dominated (Erturk et al., 2008). In the same vein, the assessment of capitalism and how it leads to imperialism were taken up by Rosa Luxemburg (1951 [1913]) in her the *Accumulation of Capital*. Answering how capitalism will accumulate capital in the absence of profitable markets, she followed Marx’s critique of classical economic doctrines and asserted that a process of continual capital accumulation is sustained through imperialism, exploitation of colonies (non-capitalist countries) and their transformation into capitalist ones (Aznar, 2004).

Social scientists different from the Marxian political economy tradition also focused on developments in the realm of finance as early as in the pre- and inter-wars period of the 1920s and 1930s and its influence on capitalist social relations (Erturk et al., 2008). As early as in 1904, one of the founders of institutional economics offering a non-Marxist critique of capitalism Thorstein Veblen (1958[1904]: 75) maintained that,

> “The goods markets…is no longer the dominant factor in business and industrial traffic as it once was. The capital market has taken first place…The capital market is the modern economic feature which makes and identifies the higher “credit economy” as such”.

In early twentieth-century capitalism, access to credit ultimately increases the discrepancy between business and industrial capital values and leads to management’s ability to manipulate the value of business capital and over-capitalisation, and to the liquidation crisis.

In the context of the unstable and crisis-prone stock market capitalism of the 1920s and 1930s the liberal agenda of reformed capitalism rested on the viewpoint that rentier claims should be limited. This is opposed to the mainstream neoliberal views of the 1990s which claimed that the pro-shareholder policies would facilitate a better allocation of capital (Erturk et al., 2008). Almost thirty years after Hilferding, in his influential *General Theory*, Keynes considered “the rentier aspect of capitalism as a transitional phase which will disappear when it has done its work” (2016[1936]: 377).

To solve the problem of “the functionless investor” he proposed “the euthanasia of the rentier, and, consequently, the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity-value of capital” (ibid: 376). In addition, Josef Schumpeter (1961[1912]) in his *Theory of Economic Development*, warned of the dangers of unsound credit expansion during the boom period with erroneous expectations which cause depression (Vouldis, et al., 2011).

It was Michal Kalecki (1899-1970), a Polish-born economist, who synthesised Marxist class analysis and literature on oligopoly theory which has significantly influenced both neo-Marxian and post-Keynesian theoretical schools (Toporowski, 2013). His theory of the business cycle, which is closely related to Keynesian theory, analyses investment processes and challenges the general equilibrium of the neoclassical orthodoxy. The debt issues of an indebted capitalist economy can be resolved by business investments. The problem, however, is that capitalist economy does not provide mechanisms that allocate enough business investments to service the debts as well as to generate full employment (Kalecki, 1937; 2017[1969]).

Schumpeter’s prominent student Hyman Minsky, who followed Keynesian tradition, came to the same conclusions. He stressed the importance of financial market regulation and opposed the over-accumulation of private debt. His financial instability hypothesis is based on the assumption that accumulation of debt which is caused by hedge, speculative, and Ponzi finance is a key mechanism that eventually leads to a crisis (Minsky, 1992). Another significant aspect of Minsky’s scholarship relevant to the current discussion is what he called “money manager capitalism” (Minsky, 1996). In the aftermath of the Federal Reserve’s interest rates increase (from 11.2% in 1979 to 20% in 1981), which paved the way for monetarism, pro-market financial liberalisation and deregulation policies spurred finance innovations such as securitisation of mortgages and derivatives and transformed attitudes of corporations and households about the debt level. Economic development began to rely on consumption fueled by increased private debt and not by government spending and real income growth (Wray, 2009). As Minsky (1996: 358-359) put it,

> “Capitalism in the United States is now in a new stage, “money manager capitalism”, in which the proximate owners of a vast proportion of financial instruments are mutual and pension funds. The total return on the portfolio is the only criteria used for judging the performance of the managers of these funds, which translates into an emphasis upon the bottom line in the management of business organizations. It makes the long view a luxury that

> only companies that are essentially owned by a single individual and that are not deeply dependent upon external financing can afford".

Minsky's analysis helps to connect contemporary financialisation with Hilferding and Veblen's analytical framework and to understand finance's role in unequal income distribution.[24] It might be the case, then, that the neoliberal counter-revolution of the 1980s (that bears some characteristics of the 1920s Belle Époque) should be considered as the intrinsic prerequisite that spurred the *re-emergence of the power of finance* in the 1990s (Isaacs, 2011) or what Wray (2009: 812) calls "the glorious restoration of finance capitalism". Hence, it can be argued from the vantage point of an attempted historical periodisation that financialisation represents an *old* new stage of the capitalist economy where unrestricted finance facilitates income maldistribution as it did back in the pre- and inter-wars period of the 1920s and 1930s.

This section has provided a brief summary of the literature relating to finance capital and its rise from a historical perspective. The notion of finance capital constitutes a precursor of financialisation which is an intrinsic feature of modern capitalism, a notion considered by mainstream economic "orthodoxy" as a heterodox concept (Lawrence, 2015). However, for the analytical purposes of this thesis it is a key concept in building the conceptual bridge with the work of those political economy scholars who currently explicitly use the term "financialisation"; a body of work which, if nothing else, highlights the growing socio-political concern about finance's impact and power in the contemporary world.

### *2.3.2. Financialisation as a neoliberal regime of income accumulation*

It is necessary to clarify exactly what is meant by financialisation and its relation to neoliberalism. The first mention of the term appeared in the early 1990s, although some research on the shift in capitalism toward finance begun in the late 1960s with exploration by Baran, Sweezy, and Magdoff (Sawyer, 2014). As Foster (2007) admits, the use of the term "financialisation" belongs to the works of Kevin Phillips in his *Boiling Point* (1993) and *Arrogant Capital* (1994). In the latter, he writes of financialisation as

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[24] It should be noted that Minsky insisted that, "The aim of policy is to assure that the economic prerequisites for sustaining the civil and civilized standards of an open liberal society exist. If amplified uncertainty, extremes of income distribution, and social inequality attenuate the economic underpinnings of democracy, then the market behaviour that creates these conditions should be constrained. If it is necessary to give up a bit of market efficiency, or a bit of aggregate income, in order to contain democracy-threatening uncertainty, then so be it. In particular, there is need to supplement private incomes with socially provided incomes so that civility and civic responsibility are promoted (Minsky, 1996: 364).

“a *prolonged* split between the divergent real and financial economies” to explain the proliferation of new financial instruments and trading (Phillips, 1994: 82).

Numerous researchers provide various definitions and explanations for the rise of finance. For instance, Epstein (2005: 3) defines the term as “the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies”. This somewhat all-embracing description reflects the increasing economic and political power of a rentier class, echoing Hilferding’s and Lenin’s analysis picked up by Dumenil and Levy (2004a; 2011) who interpret financialisation as a new phase of capitalism. In line with this logic, “neoliberalism is the ideological expression of the reasserted power of finance” (Dumenil and Levy, 2005: 17). The financial dominance or financialisation led to neoliberal restructuring as a means to benefit financial capital (Dumenil and Levy, 2004a). According to the authors, “neoliberalism is the expression of the desire of a class of capitalist owners and the institutions in which their power is concentrated, which we collectively call “finance”, to restore...the class's revenues and power” (ibid: 1-2). Indeed, for some analysts, financialisation simultaneously became the culmination of the neoliberal era, a period spanning from the 1980s until nowadays (Birch and Mykhnenko, 2010: 12).

Another type of evidence of financialisation as a new epoch of capitalism in which finance has become more dominant is provided by the monopoly capitalism school first developed, as mentioned above, by Baran and Sweezy (1966) in *Monopoly Capital*. In this seminal contribution to Marxian economics, stagnation theory is elaborated, whereby modern capitalism, characterised by oligopolies, faces the problem of profitability and overcapacity as capital is accumulated. This capital over-accumulation is alleviated by different strategies such as defense spending and *various forms of debt*. But these remedies are limited due to monopoly capital’s inherited deficiencies which lead to economic stagnation.

Similarly, within a Marxist political economy approach, the concept of financialisation was expanded in an effort to relate flourishing finance to badly performing production. The fundamental theoretical and empirical analysis of the “financial explosion” of the 1970s and 1980s was laid out by *Monthly Review* editors Magdoff and Sweezy (1983) who published *Stagnation and the Financial Explosion* in 1987. According to their arguments, capitalism escaped stagnation in the 1970s as more surplus was injected into the financial sector, indirectly stimulating production and employment in this sector and generating wealth creation through capitalist class consumption. This financial superstructure creation was referred to by Sweezy as "the financialisation of the capital accumulation process" (in Foster, 2014: xxiv).[25] Unlike in the analysis of accumulation and falling profit rates within classical Marxism, in contemporary capitalism an ever-expanding surplus is generated by monopolies. The sphere of production cannot absorb excessive capital and results in stagnation. As this fundamental problem of the "absorption of the surplus" arises, capital begins to circulate and engage in speculative activities of finance. Hence, financialisation is the result of the inundation of the sphere of production by the investible surplus (Sweezy, 1994; 1997).

The theory of monopoly capital is further developed by Foster (2007; 2014) who argues that there is a shift in economic activity from production to the finance sector which is a key pillar in the financialisation of capitalism (Foster, 2007; 2014). However, the main problem of accumulation within production continues.

> "Instead, financialisation has resulted in a new hybrid phase of the monopoly stage of capitalism that might be termed "monopoly-finance capital". Rather than advancing in a fundamental way, capital is trapped in a seemingly endless cycle of stagnation and financial explosion. These new economic relations of monopoly-finance capital have their epicentre in the United States, still the dominant capitalist economy, but have increasingly penetrated the global system" (Foster, 2007: 1).

According to this logic, financialisation as a result of the stagnation tendency of monopoly capitalism led to neoliberalism. Foster (ibid: 6) argues that "the growth of neoliberalism as the hegemonic economic ideology beginning in the Thatcher and Reagan periods reflected to some extent the new imperatives of capital brought on by financial globalisation". The rise of the "monopoly-finance capital" from the 1970s to 1980s where financialisation is a permanent structural necessity also implies three crucial things. First, capitalists are highly dependent on capital accumulation to save and enlarge their capital. Second, there is the growing problem of the bursting of speculative bubbles because the financial structure of the capitalist system is not able to expand independently from its base in the underlying productive economy. Third, financialisation cannot overcome stagnation within production. Another important

[25] Foster (2014) in his *Introduction to the New Edition* also notes that some parts of a newly developing theory on financialisation had been articulated by Magdoff and Sweezy as early as in 1983 in their article *Production and Finance*. An explicit outline of the changes in the capital accumulation which latter is to be named financialisation can be also traced in theoretical analysis of Sweezy's (1994) *The Triumph of Financial Capital*.

implication of this analysis is that, in line with the description of the neoliberal state (where it plays a crucial role in implementing neoliberal agenda), in the era of financialisation, the state has to meet its new imperatives. The state now is fully incorporated in this finance capitalism by, for example, explicitly employing a “too big to fail” policy (ibid).

Previous research has established that, in the 1960s, profit rates in production were lowered because of the exacerbated competition but the crisis was evaded for a while with the help of exchange rate manipulation and cheap credit, which encouraged demand (Brenner, 2006; 2009). Harman (2009) and Callinicos (2010) continue with this analysis to show that financial expansion was able to create the illusion of prosperity but the crisis inevitably occurred in 2008 as soon as credit growth was reduced. For both researchers, financialisation is therefore a consequence of modern capitalism.

Fine (2014: 55) employs a Marxist political economy framework to define “financialisation as the intensive and extensive accumulation of fictitious capital or, in other words, the increasing scope and prevalence of interest bearing capital in the accumulation of capital”. This definition implies that finance is not simply expanding in scope and quantity to incorporate non-financial agents such as households, non-financial companies and the nation-state. It is also the subordinate role of such finance to interest bearing capital “in the form of assets that straddle the roles of money as credit and as capital” (ibid: 56). In other words, financialisation also relates to creating a modern form of economic governance which helps to incorporate credit relations into the trajectory of fictitious capital. From a Marxist perspective it is natural to consider financialisation as the next stage of capitalism. Indeed, since financialisation penetrated many aspects of economic and social reproduction, creating an infrastructure for application of interest bearing capital, this phenomenon is the most important characterisation of the contemporary capitalism – neoliberalism (ibid: 57).

Borrowing from Hilferding’s methodological approach, according to which rising finance transformed the 19th century capitalism, it might be argued that neoliberal financialisation has transformed the capitalist mode of income accumulation upward. Lapavitsas (2011: 619), one of the leading Marxist economists and scholars of financialisation defines it “as a systemic transformation of the capitalist economy”, accordingly,

> "The era of financialisation has evident analogies with Hilferding's and Lenin's time: multinational corporations dominate the world economy; finance is on the ascendant; capital export has grown substantially; a certain type of imperialism has reasserted itself".

The difference with Hilferding's analysis is that today's large corporations are more independent from banks since they have become "financialised", i.e. more involved in financial activities. Banks, in turn, have shifted towards investment banking and transacting with households. Consequently, the latter have led to the financialisation of workers' revenue, which includes increased borrowing (for mortgage, health, education) and expanding financial assets (insurance, housing, pensions). It is worth noting that financialisation of workers' revenue occurred alongside wages becoming stagnant since the late 1970s. This logic also provides the analytical tool for understanding how the development of financial profits from workers' salaries lead to "financial expropriation" (Lapavitsas, 2009a) and more broadly how "financialisation appears to have rebounded against employed labour with regard to inequality" (Lapavitsas, 2011: 621).

Marxian analysis is also employed by Harvey (2003: 147) who explains that "accumulation by dispossession" is used in capitalism to break barriers to capital valorisation.

> Some of the mechanisms of primitive accumulation that Marx emphasised have been fine-tuned to play an even stronger role now than in the past. The credit system and finance capital became, as Lenin, Hilferding, and Luxemburg all remarked at the beginning of the twentieth century, major levers of predation, fraud, and thievery. The strong wave of financialisation that set in after 1973 has been every bit as spectacular for its speculative and predatory style. Stock promotions, ponzi schemes, structured asset destruction through inflation, asset-stripping through mergers and acquisitions, and the promotion of levels of debt incumbency that reduce whole populations, even in the advanced capitalist countries, to debt peonage, to say nothing of corporate fraud and dispossession of assets (the raiding of pension funds and their decimation by stock and corporate collapses) by credit and stock manipulations – all of these are central features of what contemporary capitalism is all about…But above all we have to look at the speculative raiding carried out by hedge funds and other major institutions of finance capital as the cutting edge of accumulation by dispossession in recent times (ibid: 147).

Similarly, explaining the reasons behind the growth of debt since the 1970s and relating it to what he terms "the capital surplus absorption problem", Harvey (2010: 26, 30) identifies "the financialisation of capitalism's crisis tendencies". The era of finance capitalism or financialisation was born out of necessity since 1973 to deal with the surplus absorption problem. Surplus is always produced by capitalists in the form of profit. Competition forces them to recapitalise and reinvest at least part of that surplus in expansion, which is why new profitable markets have to be found. Increased leverage of banks – the debt-deposit ratio – was used by banks by lending to each other to create surplus fictitious capital to absorb the surplus. As a result, surplus liquidity increased and the banking sector became the most indebted industry by 2005 with the leveraging ratio at 30:1.

Another approach to financialisation based on economic sociology is the theory of the cyclical pattern of evolution of hegemonic capitalist formations developed by Arrighi (1994; 2007). World hegemons follow a certain pattern of evolution to succeed each other. As their productive power diminishes, the sphere of finance begins to grow, representing financialisation as a sign of hegemon change. In retrospect, powers that used to dominate such as Genoa, the Netherlands, Britain and now the USA lost their dominant positions in trade and production and had to enter a financialisation era. Similarly, Krippner (2005: 174), an economic sociologist, considers financialisation as "a pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production". In investigating the rise of finance from a historico-evolutionary viewpoint, she argues that financialisation is the result of a transformation of the US economy over the past several decades and the policy regime that supported these changes (Krippner, 2011).

The economic sociology school on money and finance is represented by regulationist theories describing the disintegration of Fordist modes of production and changes in the mode of corporate governance (Boyer, 2000; Lazonick and O'Sullivan, 2000; Lavoie, 2013). According to Boyer (2000), one of the founding figures in the French regulation school, the new regime of regulation is developed around financial markets, particularly the stock exchange. His research is focused on the US as an example to demonstrate that a finance-led growth model has replaced Fordism. In the same vein, Lavoie (2013) employing the "shareholder value" notion argues that the Fordist regime of accumulation that relied on high real wages is transformed through financialisation into a regime based on high consumption and debt. There is a connection between the rise of this new regime, a change in the way companies are being operated and the rise of neoliberalism as the last is linked to financialisation.

The 2008 financial crisis should be considered as an ultimate outcome of the shift towards neoliberal policies, with securitisation playing a negative role. The current neoliberal regime "is based on financial deregulation, zero or near-zero inflation, predatory profits for the finance industry at the expense of the real economy, high income inequality, low median real wages, high propensities to consume, and rising household debt ratios" and is therefore unsustainable (ibid: 232).

Post-Keynesian analysis of finance capital has focused on the adverse impact of thriving financialisation on production and is based on the notion of "the rentier" (Stockhammer, 2004, 2008; Epstein, 2005; Crotty, 2005, 2008, 2009a; Pollin, 2007). As mentioned, according to Keynes' analysis of mature capitalism, the rentier is a parasitical economic entity and makes profits out of the scarcity of capital and thus depresses investment. In this regard, Epstein (2005) shows that capital favors investment in finance rather than production, which explains the poor performance of the real economy sector affected by the extension of the financial sector. Important for this analysis is that the re-emergence of "the rentier" is to some extent due to implementation of the neoliberal economic agenda which has promoted finance at the expense of industry (Crotty, 2005). Drawing on the assumption that the Fordist accumulation regime came to an end, Stockhammer (2004) views financialisation from the "shareholder value" perspective and proposes the notion of a "finance-dominated" accumulation regime to highlight that the current pattern of accumulation is essentially shaped by financial developments (2008: 184). Likewise, the connection between financialisation and rising shareholder power and its relation to the increasing assault on labour, redistribution at the expense of wages, and capital accumulation, is analysed by Hein and van Treeck (2010) from the Kaleckian model vantage point.

The relationship between financialisation and neoliberalism is investigated by Kotz, who employs the social structure of accumulation analysis (SSA).

> "The changing role of finance in the economy in recent decades can, in our view, best be captured, not by the idea of dominance by the financial sector, but by the concept of "financialization", which suggests an expanding role for finance in economic activity… [T]he immediate cause of the financialization process of recent decades is found in neoliberal restructuring, rather than financialization explaining the rise of neoliberalism" (Kotz, 2008:1).

For Kotz, neoliberalism is "understood as the latest institutional form of capitalism" (ibid: 2). In accordance with SSA theory, after a particular social structure of accumulation ceases to function effectively in promoting profit-making, a period of crisis begins, bringing new SSA. The new SSA characterised by the neoliberal form of governance is believed to have been established in the early 1980s (ibid). The changing role of the financial sector during the neoliberal period not only means the quantitative expansion of its activities and profits. During this era of neoliberal capitalism financial institutions began to pursue their own profit-making activities through finance and terminated their role as servants of nonfinancial capital accumulation. Hence, it may be argued that it is during that period of the neoliberal era that a process of financialisation began to take place.

The link between financialisation and neoliberalism is examined by Sawyer (2014) who points that current forms of financialisation began in the late 1970s, the period which is broadly referred to as the beginning of the neoliberal era.[26] However, this period should not be considered as the start of financialisation but rather the beginning of the era where financialisation had already had previous continuing processes. These include acceleration (e.g. deregulation, the growth in volume of financial transactions) and novelty (e.g. securitisation). Hence, it is important to consider different eras of financialisation with different intensities, forms and implications, such as "neoliberal financialisation" (Vercelli, 2013-2014 in Sawyer, 2014: 7). In line with this argument, there are eight features of the current era of financialisation which have a strong association with neoliberalism: the expansion and propagation of financial markets over the last forty years; deregulation of the economy in general and the financial system in particular; financial innovation at the heart of the expansion of financial instruments, institutions and markets; domination of finance over industry; association with market mechanisms reinforced by policies that have underpinned inequality generally and rising income inequality in particular; the extension of credit to sustain consumption; the dominance and penetration of finance into the wide range of both social and economic reproduction and fabric of society; and association with particular culture.

To conclude, the two last sections have demonstrated that there is a historical connection between the notion of finance capital from the beginning of the 20th century and the financialisation phenomenon which took place in the last thirty-forty years.

[26] Sawyer's (2014) research was implemented under the FESSUD project (Financialisation, Economy, Society and Sustainable Development) which run from 2011 to 2016 and was sponsored by the European Commission. The project is co-ordinated by the University of Leeds and is lead by Prof. Malcolm Sawyer.

Neoliberal restructuring of the 1980s bears similar characteristics to the *laissez-faire* era of the pre- and inter-wars period when income inequality was on the rise. It might be inferred from this section's literature review that there are three fundamental aspects implied by various theories on financialisation. First, essentially it is about changing modes of income accumulation. Second, derived from the first conclusion, modern capitalism has been financialised. Third, there are intrinsic implications for income distribution in these transformations of contemporary capitalism, with adverse effects on income inequality. Drawing on this conceptual and theoretical framework and as outlined in Chapter 1, a theory developed in this study argues that financialisation serves as a generative mechanism of capital accumulation. In the process if this upward income accumulation the generative mechanism is created that increases income inequality.

### 2.4. Establishing a knowledge gap in the financialisation and income inequality nexus – previous empirical studies

A number of mostly heterodox studies have explored the idea of a new type of capitalism which is broadly described as "financialisation of capitalism" (Foster, 2007). Other descriptions apart from those already mentioned are Minsky's (1996) "money manager capitalism" and terms such as "coupon pool capitalism" (Froud et al., 2002), "grey capitalism" (Blackburn, 2006), "finance-led capitalism" (Guttmann, 2008), "financialised capitalism" (Lapavitsas, 2009a), "finance capitalism" (Peet, 2011), "patrimonial capitalism" (Piketty, 2014)[27], and "financial capitalism" (Tridico, 2017).[28] Most of these studies have either only focused on financialisation *per se* or suffer from the fact that, though explicitly or implicitly claiming increased income inequality in the financialisation era, discrete *causal factors* leading to the alleged upward income distribution remain either too abstract or undiscovered and unexplained. As an example, in their analysis of contemporary financialisation, cultural political economists claim, that "[t]he clearest empirical result so far is increased inequality of income and the presumption must be that inequalities of income and wealth are powerfully inscribed in the frame of coupon pool capitalism" (Erturk et al., 2008: 29).

[27] Guttmann (2008) asserts that the first usage of the term "patrimonial capitalism" was made by Michel Aglietta, an author of the highly acknowledged *A Theory of Capitalist Regulation: the US Experience*, in 1998 in his French volume *Le Capitalisme de Demain*. See also Aglietta (1998) which is relevant to the current discussion.
[28] Throughout the text of this study these terms may appear interchangeably.

Other studies have attempted to explain how finance changes social institutions and the consequences of these transformations for inequality without specifying *instrumental and causative components of the financialisation and income inequality nexus* (Piketty, 2014; Davis and Kim, 2015). The basic argument is that income inequality is exacerbated when institutions such as nonfinancial corporations and the state are financialised. Increased revenues from financial investments are not reinvested in production, but are instead reinvested in other financial assets, leading to stagnation of real salaries and indebtedness of workers (Stockhammer, 2004; van der Zwan, 2014). Carruthers and Ariovich (2010) show that this trend transformed Americans into the biggest borrowers, whereas in the past they were a nation of savers. Another explanation for increasing income inequality caused by finance is disproportional earnings, that became more apparent in the US financial sector (Tomaskovic-Devey and Lin, 2011). Thus, according to Kaplan and Ruah (2010) the top earners' league in the USA consists of investment bankers. In a study on economic elites and income inequality, Nau (2013) found that income from financial investment was one of the most prominent causes of income inequality. Lin and Tomaskovic-Devey (2013) assert that reduction of labour cost, as a major effort of shareholder-oriented companies, contributed to the widening income disparity.

Such approaches, however, have failed to address the underlying *combinatorial effects* of variables such as rates of financial profit and rent, levels of wages and debt, and institutional transformations which impact power dynamics in labour-capital relations in finance capitalism. The generalisability of much published research on this issue to a larger number of countries is also problematic since it mostly explores advanced capitalist countries without comparing them with low- and middle-income countries. The latest investigations that have been able to draw on any systematic research into the determinants of the increase in income inequality in connection with financialisation focused only on OECD countries (Kus, 2013; Tridico, 2017). However, there is a growing literature that recognises that the process of financialisation has taken place in developing and emerging economies (DEEs) also known for their unequal distribution of income (e.g. Barbosa-Filho, 2005 on Brazil; Akyuz and Boratav, 2005 on Turkey; Lapavitsas, 2009b; Bonizzi, 2013). Recent studies investigating financialisation in DEEs found, in accordance with non-mainstream economic theories, that different patterns of financialisation negatively affect development (Karwowski and Stockhammer, 2017)[29] and exacerbated the disadvantageous position of these countries in the international monetary system (Bortz and Kaltenbrunner, 2018).

To further justify this inquiry, it is relevant to consider studies that have attempted to show the connection between income inequality and the changing role of finance.

In the first example Zalewski and Whalen (2010) employed Post Keynesian Institutionalism (PKI) and drew on the leading PKI scholar Hyman Minsky. Unlike the neoclassical school, this study combines both the real and financial sectors of the economy and enables an investigation into how gains and losses from economic development are generated from financial turbulences and are spread across different social groups. This method also stresses the significance of shifts in economic and political power and thus addresses serious distributional issues. It is important to consider the question addressed in this investigation (ibid: 769), "whether there is likely to be a neoliberal convergence, in which non-Anglo-American countries evolve toward this model, or movement toward more egalitarian regimes as a result of the recent global financial meltdown". Acknowledging the importance of cultural differences and social order in examined countries, which prevent firm conclusions regarding the relationship between inequality and financial systems, the researchers, nevertheless, demonstrated that the US's elite's interests have prevailed over the prosperity of the rest of US citizens. In contrast, in Nordic countries progressive tax and welfare systems have mitigated the consequences of financialisation for the population. Overall, the study concluded that an increase in inequality occurs in parallel with a greater reliance on financial markets. In the context of the PKI theory the research argues that a market-based financial system drives income inequality and managed-money capitalism aggravates financial instability. Yet, one of the main limitations of the study was that it covered only industrialised countries with no mention of less developed countries.

The research on the relationship between finance and income inequality investigated within neoclassical orthodoxy can be exemplified by Clarke, Xu, and Zou (2006). The paper analysed the impact of financial intermediary development on

[29] Karwowski and Stockhammer (2017: 80) particularly highlight that future research should analyse the effect of financialisation on income distribution.

income distribution in 83 high- and low-income countries using data from 1960 and 1995.[30] The findings of the study reject the inequality-widening hypothesis of financial development and, on balance, do not support the inverted U-shape hypothesis where income disparity first increases and then decreases before finally stabilising. A number of limitations need to be considered. First, the authors are somewhat biased against heterodox and Marxist theories which they accuse of supporting the hypothesis that financial development is beneficial only for the rich and well-connected elites (ibid: 580). Second, although the study includes a wide range of countries, it is limited by having 1995 as its last data year. This time span might influence the main findings, since from the theoretical perspective described above, neoliberal financialisation began circa 1980. A fifteen year span (from 1980 to 1995) might not be long enough to assess the implications of financialisation and, thus, contribute to its full understanding. Finally, the most important limitation of the study is the fact that the neoclassical theory that has monopolised the study of economics does not study inequality *per se,* which is an important part of the economic model (Milanovic, 2016). As a prominent researcher of inequality phenomenon Milanovic explains the mainstream economists' position on that matter,

> "The reasons are very clear: inequality simply stems from the assumptions of the economic model, hence it does not need further research. In a model of perfect competition, prices are determined in the market – there is no variable like power in the neo-classical models; and inequalities in income arise simply from differences in the initial endowments with which each agent comes to the market – and these endowments are taken as a given, they are exogenous to the model" (Milanovic, 18 March, 2016 in an interview for Social Europe).

This reminds us of the importance of ideological and academic impartiality, which is questionable given the fact that all three researchers were employed by the World Bank at the time of research, one of the leading international financial institutions which has long been accused for promoting orthodoxy of neoclassical economics and of "faith-based social science" (Wade, 2007: 107; Chang, 2003a).

The third study includes *Capital in the Twenty-First Century* by Piketty (2014), who uses the analytical tool of the theory of production and growth, enabling an analysis of the functional distribution of income. The inequality phenomenon,

[30] In the tradition of the World Bank the researchers used the vague term "financial development" instead of "financialisation" to test their hypotheses.

therefore, is a central issue of the research and is considered in historical context. The work highlights an intrinsic tendency in capitalism to increasing inequality. Capital ownership inequalities and income from capital decreased in the 1914-1945 period due to the world wars and the welfare state reforms of the post- World War II period. However, since the 1970s there has been increasing income concentration, leading to a slowing of economic growth and an upward trend in income and wealth inequality in industrialised countries. For example, Western workers are now paid in real terms what they were paid thirty years ago, though they are more productive than ever before.

According to Piketty, one of the main reasons for increasing income inequality is the greater proportion of income coming from capital and wealth. Also to blame is the rising share of the so-called super-stars of the management and financial sector. Thus, there are two types of inequality in Piketty's interpretation: a patrimonial one (where concentrated returns on wealth and inheritance dominate) and a managerial meritocratic one (of super-high salaries).

Another topic of focus in this in-depth and detailed analysis is the rate of return on wealth (*r*) and the rate of growth (*g*) relationship where the former is generally higher than the latter ($r > g$). The danger here is that, whilst economic growth in the long-run will be around 1.5% and the rate of return on capital would be about 4-5%, the highly probable scenario would be an ever rising capital-income ratio of capital in national income when one simply becomes a rentier without contributing economically. This is a fundamental factor behind rising income inequality and a "central contradiction of capitalism" (ibid: 571). It is argued that when two conditions are met – inheritance capital stocks are large enough and inherited wealth is concentrated – a "hyperpatrimonial" capitalism is originated in a "society of rentiers" (ibid: 264, 410). It seems that Piketty's approach is an attempt to place what is in essence a neoclassical perspective within a historical and institutional context. However, unlike in orthodox economics, there is not much mathematical formalism in the study. Piketty's account for the neoliberal assault on welfarism and neoliberalism ascendancy in politics is limited, which deprives his analysis of the important analytical logic of financialisation supremacy in the current stage of capitalism. However, his claim about the reappearance of capital accumulation in the financial sector at a rate exceeding GDP growth as the driving force for contemporary inequality is an important theoretical link for the financialisation-income inequality nexus.

In light of existing literature, my contribution is to combine and synthesise theories mentioned above into a single empirical model tested in a variety of cases that include high-, middle-, and low-income countries. The research found either concentrates on financialisation *per se*, or on inequality in a broader perspective, without identifying the underlying causal links between them. The extent to which published research on financialisation and income inequality nexus can be generalised is problematic because of the uncommon conclusions derived and insufficient theoretical frameworks employed. In addition, little is known about the mechanisms and logic of neoliberal financialisation leading to income accumulation during the stage of its introduction and its institutionalisation in different national settings. Subsequently, far too little attention has been paid to the impact of financialisation on income inequality in the context of neoliberalism across a wider range of countries. Indeed, no research has investigated this combination of issues from a comparative perspective, for instance, examining patterns in income distribution in countries as different as Argentina, Sweden, South Korea and USA in the context of neoliberal financialisation. Another important finding from the literature review (which has implications for how the research in this thesis has been conducted) is that orthodox economics, in contrast to heterodox political economics, does not consider finance, let alone dimensions of the contemporary capitalism, as a possible major cause of growing income inequality.

The analytical procedures, methods and research design based on the conceptual framework of this study – broadly described as *a paradigm of hegemonic finance and changing social and capital accumulation relations* – are described in the next two chapters.

### 2.5. Conclusion

The main aim of this chapter was to develop a conceptual framework for the study through reviewing different theoretical perspectives discussed in the current debates on financialisation and income inequality. The chapter began by describing neoliberalism and its origins, putting at the center the crisis of capital accumulation. It went on to describe the emergence of the new global financial order, explaining why and how the US, as the hegemonic capitalist world power broke away from the Bretton Woods regime and began abandoning Keynesian macroeconomic management and welfare redistributive mechanisms in favour of a new global institutional architecture that was to “dis-embed” finance capital from national regulations. That, together with the broader neoliberal agenda, contributed to the process of financialisation of national and global economies and evidently facilitated the trend towards increasing wealth accumulation for the benefit of ruling classes.

In this chapter, different concepts on finance capital, financialisation, and finance capitalism have been re-visited and considered. I argue that their interconnectedness helps to build a tentative model of causal links between financialisation and increased income inequality that includes both the processes of its institutionalisation and an assessment of its effects. As the arguments and empirical evidence from the literature review suggest, there is an intrinsic connection between neoliberalism and financialisation. Hence, heuristically speaking, financialisation might be considered as a neoliberal regime of *upward* income distribution and ruling classes' vehicle for upward income accumulation.

This review of abstract concepts and categories of modern capitalism invites us to ask deeper and more meaningful questions about the *ontological and epistemological* challenges accompanying the study of the actual causal relationship between financialisation and income inequality and the reasons behind its rise. Thus, a theory underlying research questions is manifested as *the financialisation-induced income inequality hypothesis*.

It has also been demonstrated that there is a lack of systematic empirical study on the impact of financialisation on income inequality in different high- and low-income countries over the last thirty-forty years. The evidence for this relationship in the current literature is inconclusive.

The next two chapters describe the philosophical foundations, methods, approaches, and research design used in this investigation to answer the research questions. In particular, arguments are presented to justify a methodological-pluralist perspective and the employment of heterodox schools of thought within a critical realist framework that critically investigates the financialisation-induced income inequality hypothesis.

# Chapter 3. Philosophical foundations of the methodological approach

*"My own rather different starting point has been the (widely recognised) phenomenon that modern economics mostly fails to illuminate the world in which we live and, indeed, is in a state of disarray, coupled with a conviction that we ought to do something about it, and specifically to seek to replace, or at least supplement, dominant strategies with others that are rather more capable of being explanatorily successful and useful"* (Lawson, 2008[1999]: 452).

## 3.1. Introduction

This and the next chapter set out two parts of the investigatory strategy that elaborate the approaches and methods undertaken. The conceptual framework drawn from theoretical perspectives of financialisation (presented in the previous chapter) established that the latter embodies the neoliberal phase of finance capitalism. The most important implication of this is that, from the perspective of income accumulation, the political economy of this form of capitalism creates new institutional configurations which regressively affect income inequality. Thus, the purpose of this study is to investigate the impact of neoliberal financialisation on income inequality in political economies that have experienced the process of financialisation in different ways. The second aim is, from the comparative perspective of the critical political economy, to examine whether financialisation has a regressive effect on income distribution regardless of a country where finance capitalism takes control. To answer these main questions the *analytical framework of the financialisation-induced income inequality hypothesis* is developed (chapter 4).

To fully investigate this theoretical proposition, the research was grounded in a critical realist philosophical approach. This approach, as demonstrated in this chapter, rejects neoclassical orthodoxy and mainstream economics' mathematical-deductivist approach as irrelevant to the study of social ontology. The first part of the dissertation's methodology, thus discusses the perception of reality and knowledge in critical realism. It will be argued that the insight advocated by critical realists into social ontology is an essential philosophico-methodological condition and ethical principle underpinning the study of the financialisation and income inequality nexus.

The epistemological and ontological perspectives of the study based on the critique of philosophy of positivism and neoclassical economics' deductivist methods provided grounds for the pluralist approach to the study. This methodological approach, in turn, allowed this study to draw upon different heterodox schools of thought to build a unique combination of *explanatory causal-processual constructs,* all discussed in the second part of the dissertation's methodology, the next chapter.

### 3.2. Epistemological and ontological stances: the perception of reality and knowledge in critical realism

In the quest to understand how finance capitalism causes income inequality and the ontology of these relations, I begin from the fundamental principle that the social realm exists independently of our knowledge and regardless of personal subjective experience. The researcher's role is to understand, interpret and explain it while taking into account diverse perspectives which may offer different types of interpretation (Ritchie and Lewis, 2003). This diversity enriches our understanding of what is an ontologically multifaceted reality but challenges our attempts to fully comprehend it, especially the epistemological aspects of how to identify, for instance, causes of income inequality. *Realism*, therefore, is central to the ontological position in this research and relates to the external reality which may be comprehended through socially constructed meanings and the human mind (Blaikie, 2007). However, Roy Bhaskar in his seminal *A Realist Theory of Science* warns of confusing the two, the real world, i.e. reality (ontology) and our knowledge of it (epistemology). There is a risk of committing "the epistemic fallacy" which is

> "the view that statements about being can be reduced to or analysed in terms of statements about knowledge; i.e. that ontological questions can always be transposed into epistemological terms. The idea that being can always be analysed in terms of our knowledge of being, that it is sufficient for philosophy to 'treat only of the network, and not what the network describes' [reference to L. Wittgenstein, Tractatus Logico-Philosophicus], results in the systematic dissolution of the idea of a world (…an ontological realm) independent of but investigated by science.…[T]he epistemic fallacy is manifest in a persistent tendency to read the conditions of a particular concept of knowledge into an implicit concept of the world. Thus the problem of induction is a consequence of the atomicity of the events conjoined, which is a function of the necessity for an epistemically certain base" (Bhaskar, 2008[1975]: 26-27, 28).

In his critique of the orthodoxy of positivism and its conception of science, Bhaskar (2008[1975]) offered *transcendental realism* as an alternative, *realist* position. A major problem with the former is that experience cannot be shown in this philosophical conception as an adequate system since it does not explain under which conditions knowledge can claim an independent existence of phenomena. In contrast to this position, in transcendental realism, phenomena are generated by the *structures* and *mechanisms* which are the objects of knowledge and where the latter is the product of the social activity. These *structures* are independent of our knowledge and experience and, contrary to empiricism, it is *they* – the structures – not *events,* that constitute objects of real knowledge. Contrary to idealism, these objects are both human constructs and intransitive. Therefore, "a constant conjunction of events is no more a necessary than it is a sufficient condition for the assumption of the operation of a causal law" (ibid: 15). According to this philosophical position, the world exists independently of knowledge, and they are both structured and differentiated. Science is not a by-product of nature, nor is nature a result of human activity.

The term "positivist philosophy" was coined by the French philosopher Auguste Compte (1798-1857) who had been influenced by works of the Scottish historian and economist David Hume (1711-1776) attacking metaphysics. For Hume, knowledge was the result of sensation and habit and ideas, thus, reflected impressions gained from the senses. For the logical positivist, for instance, as for positivism more generally, empirical observation is the key foundation of our knowledge of the world and even philosophical problems can be resolved through logical reconstruction and by mathematical formulas (Hughes and Sharrock, 1997: 46). In a Humean version of positivism, the account of being cannot be demonstrated by reason (Dow, 2003). As Lawson (1994a: 517) explains from the transcendental realist perspective, in positivism, there is an inadequate analysis of an account of being, restricted to experimental control. The role of theory is, thus, devalued whereas generalisation is potentially illegitimated. However, since the real world can exist regardless of our knowledge of it and the latter may be at different levels and may not be accessible, the realist's aim is to find this knowledge and, thus, explain reality; that is, the *underlying structures that produce events*. The positivist approach in its attempt to build formal models in the form "if A then B" that include constant conjunction of events, is inherently unable to uncover *causes of events* unless a controlled experiment is undertaken. Correspondingly, such a philosophical and methodological approach to knowledge, if applied to the current research, would limit its ability to explain complex political-economic issues of income distribution in contemporary capitalism.

Contrary to positivism, transcendental realism focuses on the nature of social reality, ontology, which is fundamental for how knowledge about it is constructed (Dow, 2003). From this perspective, the nature of reality is not subsumed in epistemology and exists independently of knowledge and how we gain it. As Dow (2003: 21) explains, in transcendental realism the real world exists at different levels: the *actual*, which can be experienced directly; the *empirical*, which can help to measure the actual; and the *real*, which cannot be accessed directly. The *causal mechanisms* of the social realm operate on the level of the real, which is not accessible directly and can be learned at the actual and empirical levels. To uncover the nature of the causal mechanisms, one has to know whether they operate within closed or open systems. In *a closed system* with both extrinsic and intrinsic closures, empirical regularities are generated by law-like causal mechanisms. By contrast, *an open system* is influenced by unanticipated outside forces, evolution, and interaction within the system. It is almost impossible to construct experiments in the social reality because social world is an open system. Here the causal mechanisms are represented in the form of powers or tendencies which interact with each other and may or may not be active. This philosophical perception regarding the ontology of social reality is further supported with reference to human agency, the evolution of social institutions, and creativity of human behaviour. Since positivism's explanatory models regard social reality as a "closed" system, it is impossible within positivism to generate adequate explanations of phenomena associated with emergent properties of structures in an "open" system (Syll, 2010). As Bhaskar maintains (2008[1975]): 43),

> "Only if the mechanism is active and the system in which it operates is closed can scientists in general record a unique relationship between the antecedent and consequent of a lawlike statement. The aim of an experiment is to get a single mechanism going in isolation and record its effects. Outside a closed system these will normally be affected by the operations of other mechanisms … so that no unique relationship between the variables or precise description of the mode of operation of the mechanism will be possible".

One of the implications of the transcendental realist philosophical orientation for social science and methodology is that there are outside forces from which a scientist has to abstract. This is what Lawson (1994a: 513) calls "an alternative conception of science" in the transcendental realism school of thought. According to this critical characteristic, the world, in contrast to empirical realism, which views the social realm as consisting of experience and events constituted by experience, is comprised of objects that are *structured* (that is, irreducible to the events of experience) and *intransitive* (existing and acting regardless of their identification). This constitutes the crucial advantage of the transcendental realism approach, since from its perspective, science is not restricted to the mere looking for "constant conjunctions of events" (ibid: 514). The primary task of (social) science, thus, is to identify and investigate the structures and mechanisms that underlie and cause events to happen.

Bhaskar's (2014[1979]) *transcendental realism* and perspective on reality as structured and intransitive has been further extended into *critical naturalism* and developed by Tony Lawson (1994a; 1996; 1997; 1999a; 1999b; 2003) into the perspective of *critical realism*[31] to include the specifics of the social realm. It also has critical implications about mainstream economics inadequacy.[32] In fact, critical realism is even considered as a form of transcendental realist philosophy as the former borrows various concepts and terms from the latter (Wilson, 2004). According to Uskali Maki, a contributor to the ontological presuppositions of economics, "the label 'critical realism' has been adopted by philosophers to indicate the view that there is a difference between that which is experienced and that which exists independently of being experienced. More generally, philosophers advocating such views emphasise the possibly distorting contribution of the knowing subject to the cognition" (Maki, 2008[1998]: 436). The latter implies that any theory or knowledge claims are in principle fallible, which makes realists oppose dogmatism as well as radical scepticism (ibid). My study follows Lawson's (1994a: 513) definition of *reality* which, in accordance with the critical realist position,

> "is constituted not only by events, and our experience or perception events, but also by (irreducible) structures, mechanisms, powers, tendencies that, although perhaps not directly observable, nevertheless underlie actual events and govern or produce them. Thus, not only does the autumn leaf pass to the ground, and not only do we experience it as falling, but, according to this perspective, underlying such movement and governing it are real mechanisms such as gravity. Similarly, the world is composed not only of such "surface phenomena" as skin spots, puppies turning into dogs, and relatively slow productivity growth in the United Kingdom, but also of

[31] These two terms ("transcendental realism" and "critical realism") are used sometimes interchangeably depending on the context though the term "critical realism" is used more often in relation to economics (Fleetwood, 1999; Fullbrook, 2009).

[32] For more recent and critical accounts on critical realism supplemented by Tony Lawson's replies see Fullbrook (2009) and two interviews with Lawson (2009) and Dunn (2009).

> underlying and governing structures or mechanisms such as, respectively, viruses, genetic codes, and the British system of industrial relations".

This has critical implication for the perception of knowledge and the epistemological perspective in regards to building investigatory, exploratory and explanatory procedures employed in this thesis for my research on the financialisation-income inequality nexus. In transcendental realism philosophy, *knowledge* is of "transformational conception" and as such develops into hypothesis and hunches through social practice. Such practice in scientific experiments inevitably manipulates reality, transforming our account of it (Lawson, 1994a: 514).

Since reality is viewed as intransitive and structured, the critical realist position is that epistemology is derivative of ontology with the latter being primary and determining the former. In short, knowledge is dependent on the nature of the subject matter (Sayer, 2000). In addition, human beings and social institutions as being able to intervene into social structures and transform them and thus manipulate the reality, are also of knowledge containing (Lawson, 1996).

Another important feature of critical realism is a concept of causal powers which means that social structures' internal elements are interrelated and in constant combination, producing various social processes and conditions if and when their causal powers are activated (Sayer, 2000). Subsequently, since causation is not considered as the Humean model of regular successions of events, explanation of phenomena does not need finding and searching for those events or data to prove causation. As it is argued, "[e]xplanation depends instead on *identifying causal mechanisms* and *how they work*, and *discovering if they have been activated* and *under what conditions* [emphasis added]" (ibid: 14). In this regard, abstraction, in critical realism, is an important methodological device used to capture the real. It is different from how abstraction is understood by orthodox economists who adopt an "instrumentalist" approach (Mearman, 2006a: 109). For critical realists "empirical adequacy" of theories is a fundamental value of science (ibid: 110). As Lawson (1989: 240) put it, "The main realist criterion of theory adequacy is depth of explanatory power rather than predictive accuracy – its ability to illuminate a range of empirical phenomena". Unsurprisingly, then, although (and because of it) in critical realism truth is both absolute and relative, knowledge is relative and can be reviewed. Hence, the notion of a stratified reality, where the elaboration of its deeper levels – causal structures and mechanisms – is the primary task of scientific investigation (Mearman, 2006a: 106).

However, critics question the ability of critical realism to comprehend the nature of the capitalist system as a totality (Brown, 2007; 2014). The critical realism's open system ontology of multiple separable structures is useless when synthesising from a specific demi-regularity.[33] Though a specific underlying structure can be hypnotised, the critical realist ontology of separate structures potentially obscures comprehension of the capitalist system as a whole. Thus, a system-wide perspective of the capitalist system (or its conditions such as neoliberalism and financialisation) may be potentially unrevealed because "[t]he critical realist injunction to analytically separate structures from one another and from agents is misplaced when studying the myriad analytically inseparable structures, forms and activities definitive of the system: making profit, earning wages, paying interest, paying rent, exchanging commodities, etc" (Brown, 2014: 118-119). From the system-wide perspective, social activities and social relations should not be separated as they exist within a totality of capitalism. This research contributes to the study of financialisation and its connection to rising income inequality by operationalising Brown's (et al., 2002; 2007; 2014) "systematic abstraction" (or systematic dialectics) where (using Brown's words, 2014: 119) a starting point for systematic abstraction is rising income inequality in the neoliberal era of capitalism. Rising economic disparity, as developmental tendency (Brown, 2007: 506), is uncovered in this thesis "through detailed theoretical and empirical work, potentially aided by systematic dialectics" (ibid: 516). Investigating specific case studies which includes relevant descriptions and analyses resonate with the critical realist approach (Brown, 2014: 119). By employing explanatory causal-processual analytical constructs (section 4.3) to uncover a generative mechanism of financialisation, this study restrains limitations in the critical realist approach and satisfies Brown's appeal to consider contemporary capitalism as a historically specific totality.

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[33] Demi-regularities are defined as "the result of contrasts between apparently similar objects – for example, the contrasting productivity records of the (otherwise similar) British and German economies" (Lawson, 1997 in Brown et al., 2002: 774).

Drawing from Lawson's (1994a; 1996) discussions of a non-positivist alternative in social science, I now briefly elaborate on the advantages of the critical realist perspective in the study of financial capitalism and its relation to income inequality. Critical realism provides the hermeneutic awareness of social material which is of a concept-dependent nature and recognises that social structure depends on human actions. As such, social structures are either *reproduced* or *transformed* by human agency, though the latter does so unintentionally and is not in total control of the former. As Lawson (1994a: 520) puts it, "[s]tructure and human agency, in sum, each presuppose, although neither can be reduced to, identified with, or explained completely in terms of, the other". Thus, irrespective of whether financialisation is consciously or unconsciously pursued – either, for instance, for shareholder-value reasons or as part of the post-Fordist stage of restructuring contemporary capitalism – a widening income gap might be the result of its negative consequences which can be captured empirically.[34] There are several implications of this transformational conception of the social realm for the ontological and epistemological insight of social phenomena in general and this study particularly.

First, because of the transformative potential of human agency, social structure as dependent on the latter is only *relatively enduring* and space-time bounded or geohistorically based. For the financialisation and income inequality nexus this implies that both phenomena may have causal links with each other or may not, depending on the particular case and the eccentricities and contingencies associated with a country (e.g. history, culture, traditions, values, etc.). The aim of (social) science, thus, is to uncover and explore those social structures and activities or what critical realist refer to as "generative mechanisms" (Lawson, 2003).

Second, as a consequence of the abovementioned critical realist view of the social world, the primary goal of science and especially economics and political economy is "to identify the structures governing, the conditions surrounding, facilitating as well as being transformed through, some human activities of interest" (ibid: 520). Thus, the task of this research is to provide explanations of certain activities and practices to understand motivations and conditions under which those practices occur, together with unintended outcomes and to build an adequate analytical framework that

[34] For this aspect of critical realism Lawson (1994a: 519) provides an example of the rules of grammar which exist irrespective of peoples' who speak this language awareness of these rules.

embraces matters of the social realm. By way of illustration, finance capital may be facilitated by deliberate (neo)liberalisation policies, motivated by the class interests or an intention to increase profit, conditioned by the power of labour, and brings about (un)intentional costs for income distribution impacting wage and household debt levels.

Third, and as a requirement to adopt a critical realist approach, is to understand that there is *a concept of a position* which is *the contact point* between agency and social structure and where social relations occur.[35] It follows then that a group of people having a specific social position have a collective interest which constitutes the basis for a theory of collective action and possibility of a conflict of interest. Social science, therefore, should focus, at least from the standpoint of critical realism, on understanding and explaining such issues as distribution, resources, and social positions. As Lawson (1994a: 522) explains, “the need to provide an account of the point of contact between human agency and social structure gives rise to the concept of the position-practice system, a conception that in turn gives impetus to a range of insights and perspectives with which contemporary orthodox economics cannot contend”.

Overall, according to critical realism reality is “structured” into multiple levels and a task for science is to explain reality by “’digging deeper and deeper’ into a ‘structured’ – and by extension ‘stratified’ – reality” (Brown, 2007: 503). Uncovering deeper powers and associated structures helps to reveal causal powers that generate events and actualise a phenomenon. Social structures are generated by relationships between social positions rather than human activities. However, critical realism also argues that social structures depend on human agency but social relationships continue to exist only if enough individuals engage into the existing social positions (ibid: 504). Critical realism in social science seeks to disclose social structures through *abstraction* which is understood in accordance with “its traditional meaning of focusing upon certain aspects of something to the (momentary) neglect of others. It is a process of focusing on some feature(s) of some thing(s) while others remain in the background” (Lawson, 1997: 227). Two purposes are achieved: 1) at the level of actual particular

[35] Social relations are distinguished by external and internal relations. In the former, two aspects are not constituted by their relationship (e.g. bread and butter); in the latter, two objects are what they are because of the relation to each other (e.g. landlord and tenant). As such, social material should be considered as highly relational (Lawson, 1994a: 521).

aspects of social reality are identified together with identification of partial or demi-regularities. Demi-regularities abound in social world and have practical use for social investigation: "The most obvious role for observable rough patterns or demi-reg[ularities] is that they can serve to *direct* social scientific investigation, through providing evidence that, and where, certain relatively enduring and potentially identifiable mechanisms have been in play" (ibid: 774-775); 2) uncovering the "real essence" of the social phenomenon by using hypotheses. Previously identified demi-regularities are served to hypothesise the existence of internal mechanisms and underlying social structures (Brown et al., 2002).

Taken together, these studies outline a critical role of the critical realist perspective in questioning the positivist stance with respect to the social realm and intentional social change which, subsequently, is reduced to mere amelioration of the *status quo*. This is because, essentially, in the orthodox positivist research approach, complex and interconnected social, political, and economic phenomena or objects which are under constant interaction with each other are studied by deploying the inadequate "if A then B" form, where it is believed that all events are predetermined. Critical realism, in contrast, aims for human emancipation, which is possible because social structures can be replaced if and when exposed to explanatory critique. Through systematic abstraction and using the financialisation-induced income inequality hypothesis, in this thesis financialisation as the generative mechanism of increasing economic disparity is revealed. It is my hope that the current study is potentially emancipatory and "explanatorily powerful" (Lawson, 2013: 954) in attempting to explain *the actual nature of the generative and transformative mechanisms* of financialisation and finance capital of the neoliberal era in relation to distributional issues and income inequality.

In the next subsection, by adopting a critical realist stance, I present a critique of mainstream economics' methodological approaches rooted in the positivist philosophy and neoclassical orthodoxy, to further develop the rationale for building adequate methods to explore and explain the relationship between financialisation and income inequality.

### 3.3. Inadequacy of mainstream economics orthodoxy and its methods

There is a consensus among social scientists, mostly from the heterodox camp but also some mainstream economists, that neoclassical economics[36] has been inadequate and has failed to contribute to the understanding of, for instance, income inequality or the 2008 economic crisis (e.g., Blaug, 1998; Colander, 2000; Davis, 2006; Colander, et al., 2009; Syll, 2010; Lawson, 2012a).[37] The grounds of this inadequacy are traced first and foremost to neoclassical economics' deep-rooted foundations in positivist orthodoxy (Lawson, 1994b). It is argued that, in the latter, epistemological issues have been favoured over ontological ones for too long and this philosophical tradition is "not only epistemologically and ontologically flawed; it is also co-responsible for many of the social ills and political catastrophes of the modern world" (Patomäki and Wight, 2000: 213). To justify this thesis's research approach based on "outside the 'closed system' of scientific experiment" (Brown, 2014: 115) and its view of *social reality as having a causal-processual nature* (rather than a *deductively closed system* with *stochastic and stationary economic processes)*, I will discuss mainstream economics' origin, nature, methods and its affiliation with neoclassical orthodoxy.

The most consistent critique of the neoclassical economics paradigm from the perspective of critical realism is provided by Lawson (1989; 1994b; 1995; 1997; 1999b; 2008[1999]; 2003; 2009a; 2012a; 2013). Before discussing what mainstream economics actually is and why its methods are insufficient and inappropriate for this study, it is worth citing Lawson's (1994a: 511) explanation of the link between positivist philosophy and contemporary economic orthodoxy,

> "Any theory of knowledge […] presupposes an ontology, an account of the nature of reality, and in the case of positivism […] this comprises *atomistic events and their constant conjunctions*. It is a conception that gives rise to the image of science noted above, and *which is entailed by just about all branches of contemporary economic orthodoxy*… Positivism, then, supports a conception of *human agents as passive sensors of atomistic events* and recorders of their constant conjunctions. It is this conception, of course, that encourages the behaviourist theories of contemporary economic orthodoxy.

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[36] In this study, the term "mainstream economics" is interchangeably used to refer to "neoclassical economics" given that the latter is a key component of the former; mainstream economics comprises essentially of neoclassical economics' methodological approaches as opposed to the heterodox ones and constitutes the current orthodoxy in economics (Lawson, 1994b; (2008[1999]); 2012; Arnsperger and Varoufakis (2006).

[37] Syll (2010: 23, 24) goes as far as calling neoclassical economics "a degenerative research program in dire need of replacement" and claiming that "Modern economics is sick". Arnsperger and Varoufakis (2006: 17) label neoclassical economics "a religion with equations" criticising non-pluralist and opportunistic approach of the mainstream economics academia towards the discipline's axioms and methodological debates.

> It is this that underpins the orthodox conception of agents as, in effect, mindless (albeit frequently programmed to be endlessly optimising) atomistic automata, perpetually rebounding under the influence of external market signals and the like… In fact, in positivism, whatever is experienced is an event, while experience, because in effect constitutive of the world, is in consequence held to be certain. The impression, the viewpoint, sustained, then, is that *science is monistic, the accumulation of incorrigible facts*. In consequence, clearly, the certainty of facts, the incorrigibility of knowledge in positivism, serves ultimately, if implicitly, to undermine the possibility of substantive scientific criticism. The result is *a conservative ideology* that serves always to rationalize *contemporary orthodox practice*; a perspective notoriously expressed within positivism itself precisely as *a denial of the usefulness of methodology/philosophy*" [emphasis added].

For Lawson (1994b; 1999a) one of critical realism's primary goals is to reveal the essential nature and characteristics of mainstream economics, whereas most of its critics have instead focused on its particular substantive claims such as theories of rationality or of equilibrium. He argues that, "[i]t has been the contention of critical realism, in contrast, that *it is at the level of method that its essence lies*. In fact the insight that it is not substantive theory that defines the project is clear enough once we recognise that, despite the mainstream project being widely regarded as persisting, specific substantive theories come and go, often with some rapidity" [emphasis added] (Lawson, 1999a: 4). A notable exposure of the flawed methodological approach of neoclassical orthodoxy was exemplified by Nicholas Kaldor, a prominent post-Keynesian and a forerunner of critical realism (Lawson, 1989; Jefferson and King, 2009). In his critique of the general equilibrium theory he points out that there is persistent discrepancy between reality and how it is presented in order to build an assumption in economic theory (Kaldor, 1972; 1975).[38] This is exactly where the principal and focal point of the defective mainstream economics' epistemology is laid down and where its affiliation with positivism and incompatibility and irreconcilability with critical realism is located. In the mainstream project, orthodox economic theories are constructed by employing *fictional assumptions* and are set in an artificial institutional context to create general propositions (Dow, 2003: 25). Practically, these propositions by definition cannot be tested empirically and theoretical models are yielded for the sake of models. Their value and consistency may be assessed only in

[38] Thus, Kaldor (1975: 347) indicates, "My basic objection to the theory of general equilibrium is not that it is abstract; all theory is abstract and must necessarily be so, since there can be no analysis without abstraction; but that it starts from the wrong kind of abstractions and therefore gives a misleading "paradigm"…of the world as it is: it gives a misleading impression of the nature and the manner of operation of economic forces" (Kaldor, 1975: 347).

relation to the very theory which produced them, whereas realism is left for the introspection analysis.

The issue of the reality and theory compliance was devalued in Milton Friedman's (2008[1953]) methodological essay which is described in the preface to its new edition as "the most influential work on economic methodology of [the twentieth] century" (ibid: 145). There he argued that reality was only important when predictions of a theory were evaluated in relation to actual outcomes. The assumptions as such need not reflect reality.[39] Moreover, since realism of a theory is judged by its ability to produce "sufficiently accurate predictions", the more unrealistic an assumption is, the higher the likelihood of prediction.[40] Friedman's theorising of the predictive power of the economic model as the best test for describing law-like behaviour might be behind the stochastic character of and negligent attitude in the new classical economics and monetarism led by Robert Lucas Jr. and Friedman respectively, to any disturbing forces which cause deviation of variables in a model. This disregard of disturbances from social reality is an indication that mainstream economics models are closed systems (Dow, 2003). Lawson (1989: 70), referring to Friedman's arguments on abstraction and how it is used in mainstream economics describes the exercise as "forming artificial constructs, or fictionalising".[41] This, in turn, explains claims that

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[39] "Truly important and significant hypotheses will be found to have "assumptions" that are wildly inaccurate descriptive representations of reality, and, in general, the more significant the theory, the more unrealistic the assumptions (in this sense) [reference to admitting that unrealistic assumptions do not guarantee a significant theory]. The reason is simple. A hypothesis is important if it "explains" much by little, that is, if it abstracts the common and crucial elements from the mass of complex and detailed circumstances surrounding the phenomena to be explained and permits valid predictions on the basis of them alone. To be important, therefore, a hypothesis must be descriptively false in its assumptions; it takes account of, and accounts for, none of the many other attendant circumstances, since its very success shows them to be irrelevant for the phenomena to be explained (Friedman, 2008[1953]: 153). But see Hoover (2009) who calls Friedman "a causal realist" and appeals to reconsider the latter's anti-realism.

[40] As Friedman (ibid: 153) concluded, "To put this point less paradoxically, the relevant question to ask about the "assumptions" of a theory is not whether they are descriptively "realistic", for they never are, but whether they are sufficiently good approximations for the purpose in hand. And this question can be answered only by seeing whether the theory works, which means whether it yields sufficiently accurate predictions. The two supposedly independent tests thus reduce to one test".

[41] Milton Friedman was very eloquent disputant and thanks to his regular column in *Newsweek* and series on US television (*Free to Choose*) he later became something of a star. Here is a description of his professional characteristics attributed by other economists, Galbraith or Bhagwati, "there is one and only one successful tactic to use, should you happen to get into an argument with Milton Friedman about economics. That is, you listen out for the words "Let us assume" or "Let's suppose" and immediately jump in and say "No, let's not assume that". The point being that if you give away the starting assumptions, Friedman's reasoning will almost always carry you away to the conclusion he wants to reach with no further opportunities to object, but that if you examine the assumptions carefully, there's usually one of them which provides the function of a great big rug under which all the points you might want to make have been pre-swept". (Retrieved from: http://crookedtimber.org/2004/08/19/the-correct-way-to-argue-with-milton-friedman/).

contemporary orthodox economics rejects methodological reasoning (Lawson, 1994b). As already mentioned, mainstream neoclassical economics is underpinned by the two main premises of positivism – the event regularity conception of science in the form "if A then B" and the human agent as the passive receptor of atomistic events – and its rootedness in the latter's tradition of the reduction of reality to events and of events to experience (ibid: 113-114). Since, it is argued, these positivist philosophical perspectives are untenable, the whole project of the mainstream economic orthodoxy, let alone its methods, is under serious question (ibid).

However, the axiomatic-deductive reasoning and obsession with prediction (of events in *a closed experimental system*) in orthodox economics has led to widespread usage of econometrics and mathematical modelling, on the one hand, and reluctance to engage in methodological issues, on the other (Lawson, 1994a; 1994b; 2009a).[42] The major problem with formalistic modelling is that to fit with closed atomistic worlds described in (mathematical) models, only *specific* categories have to be employed regardless of their relevance to social reality; and these categories have to be interpreted in such a way as to fit predictions the models themselves presuppose (Lawson in Dunn, 2009: 494). Commenting on the lack of ontology in mainstream economics and this absence as major contributor to its malaise, Lawson (2008[1999]: 442) suggests that "most of the projects contributing to the development of modern economics are not nearly realist enough". He labels mainstream economists and especially econometricians as anti-realist because there are elements of *anti*-realism in their arguments on the status of their theoretical models which (in their own comments) cannot be true models as there is no such thing as a true model (ibid: 444).

[42] Lawson provides examples of mainstream economists' arrogance and indulgency towards methodology by citing the jibe "those who can – do orthodox economics, while those who cannot – do methodology" (1994a: 509) and rejects an idea that only those who are doing mathematical modelling should be admitted to economics academia. His view on econometrics and deductive-mathematical modelling is noteworthy, "I think that if forty years of econometrics has revealed anything of value to us it is that you cannot very often make successful predictions of the sort that economists seek. Despite the claims of some econometricians, most results they achieve are pretty useless. Anyone can run millions of regressions with a set of data and report a result that seems to pass all tests – though the fact that millions of regressions are run means that most of the conditions of the tests are violated. But even with such results we find that as soon as new data come along the previously reported results or models typically break-down" (2009: 116). This echoes Gunnar Myrdal's evaluation of econometrics as a method. He was at first attracted by mathematical modelling and contributed to the creation of the Econometric Society in London. However, latter he criticised the movement for substituting Greek letters for missing data and defective logic, for not paying attention to the distribution of wealth and fixation on economic growth. "Correlations are not explanations and besides, they can be as spurious as the high correlation in Finland between foxes killed and divorces". (Retrieved from: https://en.wikipedia.org/wiki/Gunnar_Myrdal).

Moreover, this anti-realist orientation is persistent in modern economics orthodoxy since both economists and academia continue to carry on with the mathematical deductivist project of economic theory. This ontological neglect constitutes the primary failure of neoclassical mainstream which is “omitting to investigate the nature of social reality with a view to determining the basis of potentially more fruitful alternatives” (ibid: 444-445). Even if propositions of neoclassical theories are tested empirically, the assessment is conducted with a set of event regularities in a closed system, i.e. a set of facts or fake constructs only understood as objective and using econometric techniques.

Historically, however, it is argued that, contrary to the contemporary anti-realists who build their models in closed systems, many prominent social scientists such as Marx[43], Veblen, Keynes, Galbraith, and Lewis were open-systems theorists. For instance, Veblen’s work is consistent with an open systems approach as having interdisciplinary nature and rejecting determinism; he emphasised the importance of local conditions and accepted multiple causations in explaining the development of institutions and structures (Mearman, 2002: 577). Likewise, Keynes’ criticism of econometric analysis is cited as a precursor to critical realism’s matters; for him an examination of a phenomenon in different contexts was important (Downward and Mearman, 2002: 409). As for Galbraith, he is described as a realist whose methods included the analysis of many factors, thus meeting requirements of the ontological approach (Dunn and Mearman, 2006). In his analytical approach, he conceptualised economic process from historical and evolutionary perspectives; his theoretical system is interpreted as an explanatory critique describing key features of reality and revealing false assumptions (ibid: 10). Equally, Lewis who contributed profoundly to the establishment of development economics as an academic discipline (Kirkpatrick and Barrientos, 2004), considered economic development in terms of an open system (Ghosh, 2007).[44] For him the aim was not to compose a deterministic system which would result in a perfect equilibrium and a faultless theory. Rather, the goal was to understand the essential mechanisms of economic processes which are the root

[43] In their article on intrinsic and instrumental aims of education, Clarke and Mearman (2003) advocate Marxist economics as an example of heterodox economics. The former helps to achieve intrinsic educational aims since it bears explanatory critique and has emancipatory effects. See footnote 62 in the subsection 4.3.2 for detailed explanation on the connection between Marxism and critical realism.

[44] Ghosh (2007) provides in-depth analysis of how an open system in the Lewis’s dual economy model was replaced with a closed system by the neoclassical economists.

causes of transformations. Commenting on Lewis's methodological approaches, Wisman (1986: 170) concludes that, "What he possesses in addition to the greater part of today's orthodox economists is a command of history and economic sociology, and practically complete freedom from the ideology of positivism".[45]

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Various studies have assessed the efficacy of methods of mathematical deductivist reasoning and the consequences of recognising neoclassical economics models and explanations as "true" representative of the domain of reality (Fleetwood, 2001; Bigo, 2008; Lawson, 2009b; 2012a; 2013; Hudson, 2010; Syll, 2010). For instance, in line with critical realist ideas, Syll (2010: 31) argues that using mathematics, mainstream economists construct closed formalistic-mathematical models and theories that describe imaginary worlds detached from specific contexts.

Based on this perspective, there are drawbacks associated with the use of formalistic modelling that are necessary to avoid in the study of the financialisation-income inequality nexus. Both phenomena, income disparity and financialisation, *are* a reflection of the social reality many countries experience at present. Similarly, their political and economic causes do not operate in a socio-economic vacuum or a closed system. To uncover and explain them, these assumed causes have to be set in a context *that reflects social reality embodied in causal-processual constructs* such as the dynamics of rental income from financial assets, the dynamics of private debt, and dynamics of labour share in GDP. At the same time these have to be interpreted within their historical context. I argue that no mathematical deductivist model can realistically achieve this. To argue otherwise means ending up with a formalistic, artificial and actually fictitious model-type structure. As Syll (2010: 31) highlights, false theories such as representative actors, rational expectations or equilibrium cannot bridge closed models with an open real world.

In other words, there should be "ontological reflection" (ibid) which is absent in mainstream economics' analysis and methods because social reality and long-term social transformations cannot be mathematised (Hudson, 2010). Besides, and as the

[45] In Lewis's (1984: 7) own comments on the importance of economic history in methodology, "[O]ne of the weaknesses of our subject, namely the widening gap between Economics and Economic History in Development Economics. If our subject is lowering its sights, this may be because the demise of Economic History in economics departments has brought us a generation of economists with no historical background. This is in marked contrast with the development economists of the 1950's, practically all of whom had had some historical training, and guided by Gerschenkron and Rostow, looked to history for enlightenment on the processes of development".

result of this lack of open system world truthfulness, contemporary economists engaged in deductivist mathematical modelling cannot be concerned with social evolution and transforming the status quo as their concern is about marginal practices within the closed system.[46] As Hudson (2010: 2) argues, "If today's economics has become less relevant to the social problems that formed the subject matter of classical political economy a century ago, its scope has narrowed in large part because of the technocratic role played by mathematics". This is what I call the vicious circle of the flawed methodology in the mainstream (neoclassical) economics' mathematical deductivism. Divorce from social ontology (reality) vindicated by and rooted in the philosophy of positivism has led to the use and abuse of mathematical modelling and overreliance on econometrics. These factors, in turn, have resulted in an even stronger technocratic role played by mathematical model-building in the mainstream economics to produce theories detached from, and irrelevant to, social reality.[47]

One of the major implications of the bigger role that mathematics plays in economics is that the *political* dimension was dropped from political economy since no mathematical formula can adequately capture the complexity of social and political dynamics that transform society. Hudson (2010: 5) – and this is an important philosophical-epistemological aspect to bear in mind for this study – convincingly concludes, "The key aspect of the mathematisation of economics has been its logical necessity of stripping away what the new economic orthodoxy sought to exclude from the classical curriculum: the socially-sensitive study of wealth, how it is acquired, and how its distribution (indeed, its polarisation) affects social development". Consequently, it is claimed that neoclassical economics scholars tend to use mathematics to provide a "scientific veneer" for their policy prescriptions, whereas

[46] In a broader sense, as mentioned in chapter 1 the neoclassical revolution of the 1870s gradually led to the shift from classical political economy's concerns with public policy-making to, for instance, neoclassical economics' marginalism theory stressing the importance of the consumer rather than the producer in the economic system and to theorising the issues of individual psychology rather than national industrialisation or financial development culminated in the modern Chicago School. Before "mathematisation of economics" took place application of mathematics to political economy was deemed unnecessary as the former dealt with technical modelling not relevant and marginal to the concerns' of the latter (Hudson, 2010).

[47] Lawson (in Dunn, 2009: 484-485) explaining the emphasis on formalistic and econometric models started in the late 1970s by some economists points that, "basically they were interested in influencing the policy debate…if you could put your view in the form of a model, you'd get it on the front page of the *Guardian* and it may have an influence on the Treasury, but if you didn't, no one would listen to you. They were quite pragmatic about it. I found all modelling groups basically knew in advance of any econometric analysis or model simulation the conclusions they wanted to get. If the models gave a different result they'd change a parameter value here or there and run the model again until the results were as desired. In other words, the modelling process was mostly a way of producing projections and forecasts they wanted to make anyway".

mathematical principles are rarely applied to analyse income and wealth polarisation or rent-seeking exploitation which need to be tested qualitatively (ibid: 10-11).[48] Thus, one of the central questions of the classical political economy – income distribution and, as a corollary, the financialisation-income inequality nexus as a modern phenomenon which has its origin in the concept of finance capital described by social scientists at the beginning of the twentieth century – is not recognised as structural problems in the mainstream economics dominated by marginalist theorising. This is because,

> "no structural problems are recognised, that is, no problems that cannot be solved by marginal quantitative adjustments in incomes, prices and wage levels, the money supply and the interest rate. It is in this respect that the mathematics of laissez faire monetarism are microeconomic, depicting the economy narrowly rather than broadly through the long-distance lens of historical development. The analysis may be valid as far as it goes, but it doesn't go very far, as it formulates problems marginally rather than with an eye for structural reform" (ibid: 8).[49]

Lawson (2012a) further develops a devastating critique of mathematical methods of analysis and its application as a major reason for mainstream economics' failure and combines it with some forms of ideological argumentation contended by heterodox economists. The latter claims (e.g. Kanth, 1999; Soderbaum, 2009) that mainstream economists employ flawed neoclassical economic theories to portray market economy as an efficient system for ideological reasons.[50]

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[48] Likewise, economics departments worldwide following the Western universities' curriculums concentrate on teaching mathematical and econometric modelling at the expanse of courses in the history of economic thought and economic history. Students trained in higher mathematics are not familiarised with alternatives to the mainstream economic orthodoxy (Lawson, 2003; Hudson, 2010).

[49] Hudson (2010: 6) takes issue further with the contention that, "Looking over the countries in which such theorizing [marginalist and monetarist equilibrium economics] has been applied, one cannot help seeing that the first concern is one of political philosophy, namely, to demonstrate that the economy does not require public regulation to intervene from outside the economic system. This monetarist theory has guided Russian economic reform (and its quick bankruptcy) under Yeltsin and his oligarchy, as well as Chile's privatization (and early bankruptcy) under Gen. Pinochet, and the austerity programs (and subsequent bankruptcies and national resource selloffs) imposed by the IMF on third world debtor countries. Yet the reason for such failures is not reflected in the models. Empirically speaking, monetarist theory has become part of the economic problem, not part of the solution".

[50] For instance, Kanth (1999) describes neoclassical economics as "the inherent charlatanism of economic ideology" (p. 189) and "the ruling ideology of the capitalist system" (p. 191). He further elaborates that "this crown jewel of capitalist ideology […] enjoys this extraordinary status of near total irrelevance in the realm of applications! To state the moral: *the entire enterprise of neoclassical economics is rigged to show that laissez-faire produces optimal outcomes*, but for the disruptive operation of the odd externality (a belated correction) here and there [his emphasis]" (ibid: 191-192). Similarly, Soderbaum (2009: 9) maintains that, "Neoclassical economics, as an example, is specific not only in "scientific" but also in "ideological" terms. "Ideology" stands for a "means-ends philosophy" and is not limited to more or less established political ideologies like socialism,

To vindicate the conspiratorial nature of this argument Lawson (2012a: 11) explains that, "it *is precisely the doctrine that all serious economics must take the form of mathematical modelling*" [his emphasis]. In short, for him the very insistence on employing methods of mathematical deductivism *is* a form of ideological matter which is based on a presumption of an event-regularity-seeking view of science where mathematical techniques are used to justify its prediction-oriented nature (ibid).[51]

Understandably, thus far, neoclassical economic theory as a distinctive school of thought dominating the mainstream has been subjected to considerable criticism (e.g. Arnsperger and Varoufakis, 2006; Bigo, 2008; Syll, 2010; Lawson, 2003; 2013).[52] Again, its root-cause failure is based on what Arnsperger and Varoufakis (2006: 12) term the neoclassical meta-axioms consisting of methodological individualism, methodological instrumentalism and methodological equilibration. In short, the combination of these neoclassical concepts assumes that socio-economic explanation must be pursued at the level of the individual agent which imposes a strict separation of structure from agency (ibid). In tune with this concept, neoclassical instrumentalism implies that all behaviour is driven by the goal of maximising preference-satisfaction. Finally, neoclassical theorists believe that there is a kind of equilibrium that can be analytically discovered and thus predicted. Aggregate behaviour, in other words, is regular enough because of the calculative agent's instrumental behaviour, and that leads to the ability to predict. This interpretation accords with a neglect of ontological reasoning in mainstream economics methods and the market-oriented epistemic shift advocated by neoliberal ideology and proliferated by neoclassical economics, through a kind of intellectual proselytism of mathematical deductivist models.

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social democracy, social liberalism or neo-liberalism. In this sense, neoclassical economics clearly qualifies as an ideology and as such is more specific and precise than the political ideologies mentioned. Neoclassical economics tells us about the relevant actors in the economy (consumers, firms and government); about how to understand markets (supply and demand of commodities and of factors of production); about decision-making (optimisation) and efficiency (usually a monetary concept or at best cost-efficiency). This way of understanding economics is clearly not neutral but specific in ideological terms". Interestingly, both these heterodox economists mention the most prestigious Nobel prize in economics (The Bank of Sweden Prize in Economic Sciences in Memory of Alfred Nobel) as a means to legitimate and sacralise monopolistic position of neoclassical economics and its unwillingness to facilitate a pluralistic approach in economics.

[51] "It is, to repeat, this unwillingness or apparent inability seriously to contemplate the idea that a serious, fruitful and explanatorily successful (science) of economics might be developed that does not rely upon the application of mathematical methods and techniques of some form that indicates the dominant form of the actually prevalent ideology" (Lawson, 2012a: 11-12).

[52] "Neoclassicism" in economics is even compared to racism: while being present and dominating, its guiding role is not admitted (Arnsperger and Varoufakis, 2006: 5).

In the same vein, Syll (2010) provides examples of some paradigmatic neoclassical economic approaches depending on these meta-axioms. It is demonstrated that, for example, in the business cycles theory and representative-agent models, social ontology and heterogeneity are ignored; and that in econometrics there is an over-concern with, and over-reliance on, measurable variables and stable causal relations allegedly ruling the real world.[53]

### 3.4. Conclusion

This chapter has described the key ontological and epistemological parameters within which the study was carried out. A critical realist orientation as a philosophical stance was adopted to capture the complexities of the financialisation-induced income inequality hypothesis.

A major advantage of this philosophical tradition is its ontological commitment and the perception of reality as an open system, in contrast to a closed system of the positivist school and neoclassical orthodoxy. The critical realist approach safeguards against committing the epistemic fallacy in the quest for the financialisation and income inequality relationship by illuminating causal mechanisms of the social realm. This, in turn, allows this project to claim a politically progressive epistemological position and highlight the emancipatory nature of the project.

The second benefit of critical realism theory is that it allows a truly pluralist approach to the study where different heterodox traditions can be employed in tandem. I argue, thus, that a conceptual paradigm of the research which is manifested in the assumed causal relations between financialisation and increased income inequality could only be tested within the philosophical context of critical realism and a pluralist methodological framework, such as the one described in the next chapter. One of the key features of this study is the use of different heterodox theories to avoid limitations of the orthodox epistemological assumptions. Indeed, I argue that, to provide objective, solid and profound findings, any political economy of the dynamic between

[53] One cannot help to cite John Kenneth Galbraith, who rejected the technical analysis and mathematical modelling of neoclassical economics as being divorced from reality: "Mr. David Stockman has said that supply-side economics was merely a cover for the trickle-down approach to economic policy – what an older and less elegant generation called the horse-and-sparrow theory: if you feed the horse enough oats, some will pass through to the road for the sparrows"; "The problem of the modern economy is not a failure of a knowledge of economics; it's a failure of a knowledge of history"; "Do not be alarmed by simplification, complexity is often a device for claiming sophistication, or for evading simple truths". (Retrieved from: http://www.azquotes.com/author/5279-John_Kenneth_Galbraith).

financialisation and income distribution needs to be studied from a variety of vantage points let alone limited by the neoclassical economic perspective.

# Chapter 4. Methods and research design: building the analytical framework

*“If this sounds like openness, eclecticism, and tolerance for ambiguity, I plead guilty. The alternative is premature closure, myopic determinism, and sectarianism. We have had too much of the latter and not enough for the former”* (Samuels, 2000: 312).

## 4.1. Introduction

The previous chapter served as the first part of the methodological strategy, presenting the philosophical principles and approaches within which the study was implemented. This chapter describes methods and techniques that were utilised in the research.

As argued, the critical realist approach is a necessary prerequisite in the study of the political economy of income inequality and finance capitalism. In order to comply with ontological commitments, a pluralist framework is needed to synthesise retroductive reasoning with the heterodox schools of thought. As will be demonstrated, the latter provide different perspectives and analytical tools to illuminate the financialisation-income inequality nexus and its causal relations. The methodological pluralism adopted in this investigation allowed for an application of the *causal-processual analytical constructing* technique. In this regard, it will be argued that a pluralist methodology combining different heterodox traditions is the best approach to explore the financialisation-induced income inequality hypothesis.

A qualitative research design was adopted to provide both descriptive and interpretive explanations. The case-study method was utilised to interpret descriptive and historical data across four different countries. As the final stage of the methodological process, an analytical framework for developing financialisation-induced income inequality theory was created. This served as a road map and mode of research to utilise the method of retroduction and to conduct the analysis through causal-processual observation of the analytical constructs.

## 4.2. A pluralist framework: synthesising critical realist-oriented causal-processual explanations with heterodox traditions

*4.2.1. Retroduction and analytical constructs of causal-processual explanations*

The previous chapter has demonstrated that the mainstream economics' deductivism and formalistic mathematical modelling that rest upon the philosophical underpinnings of Humean positivism are not capable of identifying and explaining increased income inequality and financialisation phenomena and their causal relations. As Lawson (1999b: 225) explains, in the mainstream project approach, "The priority given to the event regularity structure of explanation, which the acceptance of deductivism necessitates, entails that any depth to the ontology explicitly acknowledged always remains superfluous to substantive explanation".[54] Flawed neoclassical economics methods and deductivist models do not express *real life* phenomena, let alone their actual nature. In Lawson's words (ibid: 230) "they express nothing more than (possible) consistency properties of models". A modelling exercise is conducted for its own sake, where the beauty of formulas and equations seems to be more important than relevance to the analysis of the social phenomenon of interest.

From the perspective of methodology, critical realists (Lawson, 1996; Fleetwood, 1999; 2001) have also questioned empirical realism's methods of reasoning, such as *induction* and *deduction* and their focus on generalisations about conjunctions of events. Under critical realist methodology, the method of *retroduction*, as adopted in the current study, is asserted instead (Lawson, 2003: Chapter 4).[55] Retroduction stems,

> "from the fact that a certain hypothesis would explain the evidence, to the truth of that hypothesis. In general, there will be several hypotheses which

[54] Frank Hahn (1994: 246), a supporter of the deductivist method and mathematical modelling in the mainstream economics, claims that, "The great virtue of mathematical reasoning in economics is that by its precise account of assumptions it becomes crystal clear that applications to the 'real' world could at best be provisional… [E]veryone can see that we are not dealing with any actual economy. The assumptions are there to enable certain results to emerge and not because they are to be taken descriptively". No wonder, then, that this mainstream economist in a kind of Friedmanian style allows himself statements such as: "I have found the debates on this matter [the use of mathematics in economics] of little interest or consequence. There is indeed very little to discuss… [I]t is hard to think of examples where theorising was not either explicitly or implicitly mathematical. The injunction that such theories should always be translatable into English is so obviously foolish as to require no answer. After all, what sane person would translate the solution of a differential equation into English and what reasonable person would deny that such equations make natural appearance in economics?" (ibid: 245-246).

[55] This method is also called "inference to the best explanation" (IBE) (Syll, 2010). For a critique of IBE from the non-realist point in the philosophy of science, see Ben-Menahem (1990) and Douven (2002).

> might explain the evidence, so one must be able to reject all such alternative hypotheses before one is warranted in making the inference. Thus one infers, from the premise that a given hypothesis would provide a "better" explanation for the evidence than would any other hypothesis, to the conclusion that the given hypothesis is true" (Harman, 1965: 89).

Similarly, Syll (2010: 48) maintains that retroduction allows ranking competing hypotheses and examining beyond the implications and properties of a single causal relation, thus delineating the explanatory power of different accounts and hypotheses. New connections and meanings are discovered and re-contextualised, thereby constituting deeper knowledge.

This is a technique or procedure that allows the researcher *to observe* phenomena (here, income inequality) from the surface and logically *infer* mechanisms that uncover deep inaccessible causal social structures (here, financialisation-induced income inequality). Instead of starting from a general claim and then moving to a particular empirical example (deduction) or starting from a particular empirical observation and then moving to a general claim (induction), the critical realist method of retroduction facilitates moving beyond a specific ontic context to another (Downward and Mearman, 2007: 88) and thus generating an explanation of tendencies (here, *increased* income inequality). In other words, observation of a particular empirical regularity may help to identify whether there is a *tendency* that calls for further substantive investigation (Dow, 2003). Likewise, for Lawson (1996: 413) retroduction means "to move from the level of the phenomenon identified to a different "deeper" level in order to explain the phenomenon, to identify a causal mechanism responsible". Thus, from the critical realist methodological vantage point, capitalism does not necessary lead to income inequality, whereas there may be a *tendency* (of deeper causes) that *unconstrained finance* capitalism *increases* income disparity.

Based on this logic, for the investigation, having its secondary but not less important aim of understanding *the reality of finance capitalism*, an approach is proposed where both financialisation and increasing income inequality are of *ontological concern*, whereas the *causal-processual relations* between these two phenomena are of *epistemological concern*.

As Lawson (2013: 955) argues, a *causal-processual* or *causal-historical ontology*, needs to be approached with an appropriate set of methods within a critical realism-oriented framework. For this thesis, an alternative approach to the mainstream economics method was built. This method included developing three explanatory *causal-processual analytical constructs* derived from the conceptual framework of the study and different heterodox schools of thought (neo-institutional, neo-Marxist, and post-Keynesian). These analytical constructs comprise:

1) financial policies examined in the context of the recent history of each country-case;

2) rates of profit in the financial sector and labour's share of national income;

3) levels of the rental income and private debt.

Each causal-processual analytical construct was applied in the context of every case to analyse and explain each case's level of income inequality during circa 1980-2010. The benefit of this approach is that the central element of social reality, that is, "constitutive social relations" (ibid: 955), can be explained by applying proposed hypothetical explanations (analytical constructs). Thus, an ontology-centric as opposed to epistemology-centric principle of the investigation was met. Methods of formalistic deductivism were rejected in this analysis to meet the requirements of the critical realism approach in comprehending the conception of social ontology, which,

> "is processual in that social reality, which itself is an emergent phenomenon of human interaction, is recognised as being…highly transient, being reproduced and/or transformed through practice; social reality is in process, essentially a process of cumulative causation... Furthermore, social reality is found to be composed of emergent phenomena that (far from being isolatable) are actually constituted in relation (that is, are internally related) to other things, and ultimately to everything else (for example, students and teachers, *qua* students and teachers, are constituted in relation to each other; so are employers and employees, landlords/ladies and tenants, creditors and debtors and so forth; so, too, money, markets, firms and so forth are internally related under capitalism, and inherently transient)" (ibid: 954-955).

In addition, the *causal-processual analytical constructing* technique is beneficial, because it allows for exploration of the research questions of the financialisation-income inequality nexus from the perspective of "the social realm as emergent from, but irreducible to, human interaction" (Lawson, 2008[1999]: 445). As he explains, "I have argued for a theory of social ontology that includes forms of social structure, including social relationships, rules, positions, processes and totalities, etc., that *collectively constitute a relatively autonomous realm, being dependent upon and resulting from human interaction, but with properties that are irreducible to human interaction*, though acting back upon it" [emphasis added] (ibid: 445). By the same token, Fleetwood (2001) arguing that deductivism as a method is flawed because it presumes an ontology that is in conflict with reality, offers an alternative causal/explanatory mode of theorising. Priority should be given to investigating causal mechanisms that govern the events rather than the latter. It is the conditions that make action possible that are examined in the critical realist mode of causal-processual explanation, rather than the consequences or results of human actions (ibid: 210).

Another advantage of retroduction is what Downward and Mearman (2007) term *mixed-methods triangulation* which refers to commitment to multiple methods or combining several sets of insights in a research endeavour. This applies to the current investigation and might be classified as *theoretical*, *pluralist* or *multi-disciplinary* triangulation, where data are analysed from different disciplinary perspectives and theoretical traditions. Since the investigation required analysing different information (e.g. financial sector policies, level of wages, debt and rental income) the method employed can also be called *data* triangulation, which pertains to gathering different data types from various subjects. Overall, it is argued that triangulation helps to enhance "the persuasiveness of evidence" (ibid: 82). Triangulation makes retroduction more operational, facilitates pluralism and thus, is consistent with critical realism in terms of enabling an "interdisciplinary approach" in social science (Downward and Mearman (2009: 139).

Thus far, it has been argued that the main advantage of critical realism is that it encourages identifying and explaining the *real conditions* of the *real world*, where the *causal-processual constructs* are derived from *reality*. Specifically, in this study these are actualities, such as the levels of household debt and wages, rent and income, labour vis-à-vis capital power relations, and so on. Critical realism-based methods provide a means of learning and addressing phenomena *generated* in an *open social system* by analysing those actualities. It warrants against employing false assumptions not related to the real world and not manifested in the empirical domain. The generative mechanisms of the hypothesis are observed through the operation of regularities and structures/mechanisms in the analytical constructs and inferred from the tendency subsequently developed. It is important to note in this regard, and in line with the open-system logic, the financialisation-induced income inequality hypothesis is justified since it is related to the reality, which is drawn upon to build a framework for the analysis. The very hypothesis of the research was developed as a result of retroduction from observed provisional regularities, i.e. ideas and concepts discussed while creating the conceptual framework of the study (chapter 2). The hypothesis may be partial and provisional, which is in compliance with the fallibilism principle of the critical realist approach. In the current case, the most important goal is to generate knowledge on the financialisation-income inequality nexus *at the real level*, so as to understand the underlying causal mechanisms of the increased income disparity and its relation to finance capital and to offer policy alternatives.

Lawson (2012b: 346) calls for making meaningful social science feasible by identifying “causal factors, properties or/and entities that can reasonably be categorised as *social*, which possess their own distinct mode of being, yet are as real or objective [reference to explaining “objective” which is “existing independently of or at least prior to their being studied” (ibid)] as the objects studied within the traditional “natural” sciences, and in a relevant sense irreducible to the latter”. Thus, a major advantage of employing causal-processual analytical constructs is that the method contributes to identifying real and actual causal factors and relations that constitute the interconnectedness of financialisation and income inequality.

It can be argued that the approach of the study allows a *structural* explanation of causal relations, thereby preventing the ontological and methodological limitations that neoclassical economics retains. As such, the analytical constructs are aimed at revealing the *generative mechanisms* behind a phenomenon, thus, meeting the criteria of relevance and realism outlined by Syll (2010: 43-51). Moreover, the mode of analysis through causal-processual observation of the analytical constructs allows for capturing the complexity of the financialisation-income inequality relationship and dynamic instability of the (economic) system in terms of where these relations occur and how they interact. To avoid “an as-if assumption in the spirit of Friedmanian instrumentalism”, it was necessary to adopt the approach that was able to reflect the real and dynamic underlying causes of income inequality, which is pluralist in nature (ibid: 46).

### *4.2.2. Pluralism within heterodox approaches and the synergy effects*

This subsection delineates some central principles of a pluralist approach as a framework for employing three heterodox schools of thought to justify the manifold analytical and theoretical perspectives of the research.

Critical realists contend that methodology should not be pursued just for its own sake and that it is an *underlabouring* for an alternative to mainstream economics that should be emphasised instead, which links them to the heterodox stance (Lawson, *et* *al*., 1996; Fleetwood, 1999: Chapter 7; Nielsen, 2002). In the present study, underlabouring is defined as the descriptive task of clarifying and unravelling scientific concepts. Such description is analysed in historical and sociological context and open to transcendental inquiry into the ontological assumptions upon which they rest (Lawson et al., 1996: 141). As Lawson (2003: 177) elaborates, "critical realism, being a philosophically oriented project with results pitched at a high level of abstraction, does not itself carry any direct substantive claims or concrete policy implications. It is essentially an underlabourer for science including social science". It held in this study that the critical realist approach requires a pluralist application and analysis of existing bodies of works in political economy, economics, history, sociology, and international relations to understand the causal links between financialisation and income inequality in terms of ontology and epistemology. Under open-system pluralism, ideas of theoretical monism are rejected and instead, it serves as both a philosophical and methodological platform for the pluralistic application of heterodox traditions to research, thus achieving what Garnett (2006) terms "an egalitarian pluralism". The latter is understood as a commitment to intellectual diversity and tolerance and to reforms in economic education and scholarship (ibid).

The critical realist method encompasses a pluralist approach, an important element of the critical realist-oriented political economy (Dow, 2003).[56] It is maintained that a plurality of methodological approaches is central to heterodox economics (Van Bouwel, 2004; Garnett, 2006; Lee, 2011). Dow (2008: 81-84) highlights four arguments for methodological alternatives. First, the ethical argument is based on the requirement to recognise that reality may be understood differently and that there are different approaches and criteria for reasoning that should not be rejected just because they are different. No school of thought or scientific tradition can claim true knowledge since reality is intransitive, structured and ultimately inaccessible. Thus, one of the underlying tasks of this study is to escape a monist approach that is denial of variedness in recognising and understanding the reality.[57] Second, at the level of

[56] The term "critical realist-oriented political economy" is borrowed from Fleetwood (2017). The academic literature on pluralism has revealed the emergence of several contrasting themes, which are beyond the scope of the current analysis. See Dobusch and Kapeller (2012) for in-depth analysis on the varieties of pluralism.

[57] Regarding a monist and formalist orthodox methodology, as practised by mainstream economists, critics have also questioned the ability of its mathematical argument and expression to encompass shades of meaning and to combine pluralism of arguments (Chick and Dow, 2001; Dow, 2008). Since the distinctive and core activity of mainstream economics is constructing and testing formal models and the orthodox discourse does not even

knowledge systems, there is a recognition that plurality cannot be infinite (espousal of "anything goes" argument), but rather, should be understood as a form of a range of approaches, each with its guiding paradigms and principles ("structured pluralism" to be discussed in this subsection). Third, plurality is advocated on the grounds that any theory or discipline inevitably faces new developments and to survive, its proponents have to adapt by employing a diversity of ideas. This is especially applicable to financialisation and income inequality as comparatively new phenomena of modern economies that challenge different theoretical perspectives. The fourth argument rests on the nature of the subject matter as an open system in that the social realm is complex and constantly evolving. To identify causal mechanisms, it is necessary to appreciate a plurality of methodological approaches, not only at the epistemological level, but also, at the ontological one.

Conceptually, the methodological approach in this study was based on the notion of "structured pluralism" proposed by Dow (2004). Different epistemological categories employ various languages to conceptualise ontology, which opens up possibilities for different forms of categorisation. There are different schools of thought, with their distinctive paradigms for categorising and conceptualising ontology and "there is a practical limit to the number of paradigms which may be extant at any one time, so that the pluralism represented by schools of thought is structured" (Dow, 2004: 285).[58] Methodological pluralism, as a device for structuring the social reality, implies a structuring at the epistemological level. An important caveat, however, is that the benefits of methodological pluralism can be derived, only if there is a clear understanding of the need for some categorisation of schools of thought and that there are differences in language expressing meanings for distinct paradigms. Structured pluralism advocates a range of methodological approaches which are not infinite but provisional. In contrast to the "anything-goes" tactic in structured pluralism, there ought

include discussion on how to combine mathematical formalism with other methods, it is argued that there is no coherent core and "anything goes" in orthodox economics (Dow, 2008: 81).

[58] Commenting on Kuhn's (1970) concepts of normal and extraordinary science, where the former limits the scope of methodological pluralism and justifies a monist approach and the latter opens up possibilities of different methodological routes, Dow (2004: 287) explains that, "Paradigms, or schools of thought, provide the structure by which we categorise different approaches within a pluralist epistemology. But practitioners cannot stray far from extraordinary science in a pluralist environment, since sensitivity to the need for translation is necessary for successful communication and, potentially, persuasion, across paradigms. […] [T]he epistemological argument is equally compelling, that we cannot expect anything other than methodological pluralism, and it needs to be structured in order to have meaning. Schools of thought provide some important elements of that structure".

to be a community with *shared* beliefs, focus, categorisations, and understandings about the nature of reality (ibid: 287-288).

In the real social world, the mechanisms and regularities of financialisation and income inequality are subject to constant and complex external and internal influences. Not all variables may be identified and their classification as exogenous and endogenous may not be fixed; knowledge of relations between variables is not perfect and there may be interrelationships between agents and interdependency with structure (ibid: 283). As such, an open system is assumed under the critical realist ontology encompassing this research espouses pluralism, through recourse to various and yet, related heterodox schools of thought with shared ontological commitments, thus generating knowledge from different perspectives. Thus, on the one hand, methodological pluralism was required for this study, because there is no one best way of building knowledge and capturing causal mechanisms to claim definitive methods and theories. On the other, the propinquity of the heterodox schools chosen for this study helps to resolve the incommensurability problem of a pluralist approach, when the language and ideas of different schools of thought may be too far from each other to combine them into one analytical framework (ibid).

Similarly, Dobusch and Kapeller (2012: 1040) developing the notion of a pluralist framework in social research and arguing for "interested pluralism", summarise that to integrate various heterodox schools of economic thought under "a common pluralist umbrella", the question of a common conceptual and intellectual basis has to be resolved. Many recent studies (some already mentioned) propose solutions to this question by providing foundational pillars for combining heterodox schools of thought within methodological pluralism successfully and thus, achieving a synergy effect. These accounts include, for instance, ontological reflection (Lawson, 2006; Bigo and Negru, 2008), methodological similarities (Dow, 2004; 2008), as well as opposition to mainstream neoclassical economics (Arnsperger and Varoufakis, 2006; Syll, 2010) and neoliberal capitalism (Chang, 2003b; Lee, 2011). Collectively, these studies justify and outline the critical role of a pluralist method in synthesising different heterodox traditions into a single inquiry of the financialisation-induced income inequality hypothesis. For the current research, a pluralist approach allowed for combining the multi-faceted employment of different heterodox traditions through theoretical integration into one scholarship, thereby reconciling their meta-paradigms and thus, enabling their unification for a robust challenge to the neoclassical economics “anything-goes” approach.[59]

Having defined what is meant by pluralism and its importance for the research, I now move on to discuss heterodoxy and why three explanatory causal-processual analytical constructs derived from concrete heterodox traditions were used. In this investigation, the critical realist ontological commitments and open-system ontology helped to identify schools of thought – heterodox – that primarily stand up as practises that, first and foremost, take a view on the nature of social reality and reject methods of mathematical-deductivist modelling as being universally valid in the social realm (Lawson, 2003: 165).[60] Lawson (2013) elaborates that the causal ontology of openness and internal relationality is regularly recognised in heterodox schools of thought. For instance, post-Keynesianism recognises the open system by dealing with uncertainty; institutionalism focuses on social ontology through studying change and stability as well as emphasising technology and institutions; and the Marxian approach concentrates on a totality in motion, namely capitalism (ibid: 956-957).

This view is supported by Backhouse (2000: 153), who writes that heterodox economics is based on assumptions that are deemed to be true about the world and thus, in opposition to the features of orthodox economics. Heterodox economists propose theories about social reality, while orthodox ones engage in modelling. Likewise, in her analysis of the prospects for the progress of heterodox economics, Dow (2000) highlights the methodological distinction between heterodox and orthodox economics. As discussed throughout this and previous chapters, the orthodox (mainstream) involves employing *a closed-system approach*, where various variables and relationships between them are presumed to be knowable and represented in a single mathematical system. By contrast, heterodox schools of thought use *an open-system approach*, where the subject matter evolves constantly and the variables as well as the relationships cannot be knowable, whilst the methods used are not commensurate enough to be represented in a single mathematical model. Importantly, as Dow (2000: 158) highlights, a range of combinations of methods is possible in an open-system approach and even,

[59] Similarly, Brannan *et al.* (2017), when describing the meta-theoretical flaws of meta-analysis approach, propose “a critical-realist synthesis” as an alternative.

[60] Davis (2009), arguing for a more heterogeneous nature of heterodox economics, provides explanations of how concreate approaches become heterodox.

> "[…] incommensurate schools of thought potentially with incompatible notions of what constitutes progress. I have in mind as heterodox economics a collection of non-orthodox schools of thought such as post-Keynesian economics, institutionalist economics, neo-Austrian economics, behavioural economics, social economics, feminist economics, and Marxian/radical economics, all of which employ some form of open-system approach".

In his review of heterodox economics and pluralism, Mearman (2017) warns against defining "heterodox economics" as simply non-orthodox, mostly neoclassical material taught in the majority of economics departments. Heterodox theoretical schools are more than just opposite responses to orthodox ones, constituting alternative theoretical systems with distinct characteristics (Mearman, 2007: 3-4). These characteristics are compatible with the critical realist view and methodological approaches of the study. Thus, methodology is vital for comprehending economics that consists of complex and evolving systems, for this is unattainable with equilibrium models. This reflects that history and time are significant elements together with theories of individual and collective outcomes, which should not be considered in isolation from each other. Similarly, power plays an essential role in determining economic outcomes. The agency of human actors is central in the exercise of power and should be examined within cultural and traditional contexts, where facts and values are inseparable.

### 4.3. Building explanatory causal-processual analytical constructs: neo-institutionalist, neo-Marxian, and post-Keynesian perspectives

The employment of the three heterodox schools of thought – neo-institutionalism, neo-Marxism, and post-Keynesianism – also warrants against slipping into pure relativism.[61] Drawing from the perspectives of these three theoretical schools, three *explanatory causal-processual analytical constructs* were created to build an *analytical framework of the financialisation-induced income inequality hypothesis*. Analytical constructs – factors, aspects, categories, dimensions, etc. – are important elements for displaying the nature of the empirical evidence and analytic routes to reach an appropriate generalisation (Lewis and Ritchie, 2003). The analytical

[61] There is no agreed definition on what constitutes "neo" in institutionalism and Marxism and "post" in Keynesianism and, hence, there is a degree of uncertainty around these terminologies. However, as it is inferred from the prefixes "neo" and "post", these approaches are revised strains of the respective schools of thought and though heuristic, do indicate diagnostic and indicative connotation, as demonstrated in the subsequent sections.

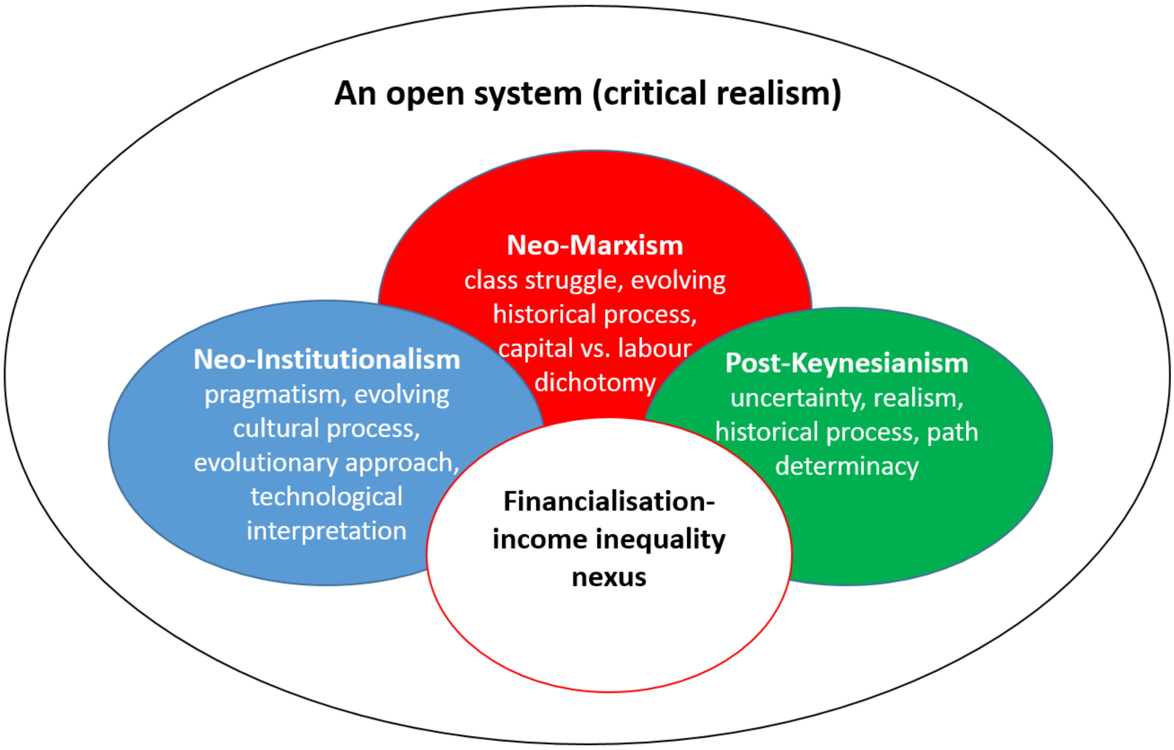
framework in this study, in turn, served to map the investigative route that identified the patterns, causal mechanisms and deterministic laws of the financialisation-induced income inequality hypothesis. In other words, this framework was essential for evaluation, interpretation and explanation of the causal link(s) between financialisation and rising income inequality.

Each of the schools of thought employed has its own traditions of analysis (on the epistemological level) and moreover, differing understandings of reality, i.e. different ontologies of income inequality and finance capital and the factors that externalise them. For instance, Marxian economists would see changing levels of wage and finance income in class terms, institutional economists in terms of evolution of norms and institutions and Keynesians in terms of transformations taking place in economy. Now, the main task is, from the vantage point of critical realism and a pluralist methodology, to *identify through observation of the abductive reasoning method the most important tendencies, relationships, powers, human behaviour and institutional interactions in an open system that constitute the causal mechanisms* between financialisation and income inequality. However, and this is important to highlight, in my method I did not "test" each "variable" (i.e. probable causal mechanism) alternately from the perspective of each school. Rather, using the method of retroduction, the three analytical constructs that were created each represent and manifest a separate school of thought and respective causal-processual explanation or a kind of sub-hypothesis. It is these sub-hypotheses in the analytical constructs that eventually constitute and support *the main* (singular) hypothesis and analytical framework that was utilised to examine the validity of the hypothesis. Thus, drawing together three different theoretical schools with their unique traditions into a singular methodological approach and analytical framework, the critical realist criterion of ontological commitment was met. In addition, as Dow (2008: 87) explains, even though there may be agreement on openness of the real social system, the various heterodox schools stand for different open-system ontologies with different knowledge systems. The informative and explanatory task of the study was to expand and complement the understanding of each school of thought, thereby offering new channels of analysis on the same subject. Commenting on the importance of a multi-faceted approach in social sciences, Dequech (2012: 360) argues that,

> “In my assessment of the state of the art in economics and (with less knowledge) in other disciplines, neither a single school of thought nor even a single discipline can provide a sufficiently adequate and broad approach to all relevant economic issues. It is necessary to combine contributions from different approaches and disciplines”.

Hence, one of the main contributions of this study is accumulating the synergy effect of *aggregation of factors* (aspects, categories, etc.) and explanatory power of all three theoretical perspectives through employing and utilising their analytical tools and theoretical concepts, which helped to unlock and explain the financialisation-income inequality nexus of the finance capitalism era (Figure 4.1). Consequently, this manifold deployment of analytical tools and theoretical perspectives facilitated comprehension and appreciation of the multifacetedness of the social reality of the financialisation and income inequality phenomena and their interconnectedness as complex products of the socio-political and economic milieu.

**Figure 4.1. A pluralist methodological framework for the financialisation-income inequality nexus study**




Source: researcher

Having discussed *why* explanatory causal-processual analytical constructs are necessary and *how* they constitute a pluralist framework of this study, in the following pages I briefly describe some general theoretical foundations of each of the three heterodox schools of thought, with unavoidable superficiality, to outline, define and describe the analytical constructs (sub-hypotheses) that were derived from them.

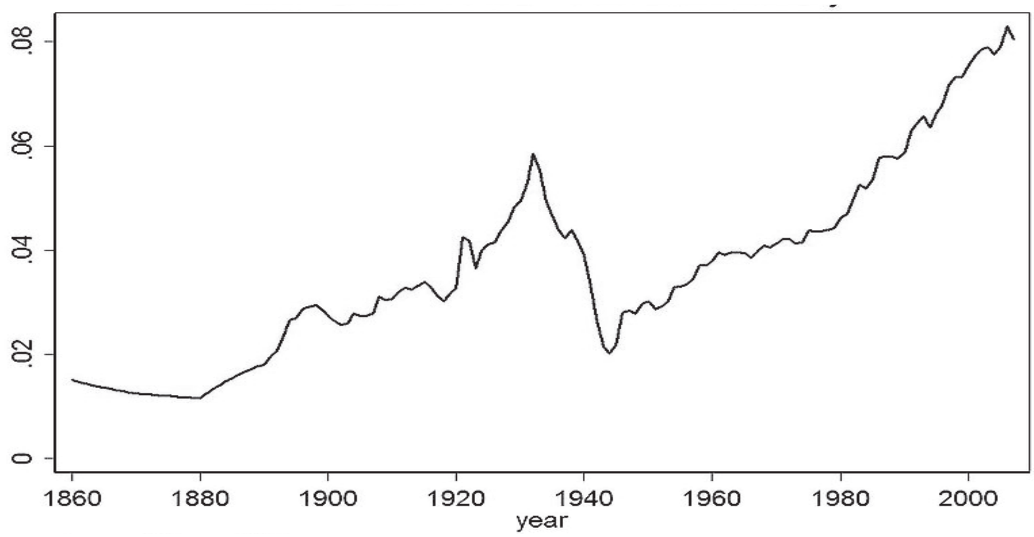
### *4.3.1. Neo-institutionalist perspective*

The philosophical foundations of neo-institutionalism can be seen as being within the *pragmatic* philosophy of John Dewey (1859-1952), an American philosopher and psychologist, which contrasts with the way orthodox economists understand the nature of economic reality as *idealism* (Gruchy, 1984). According to the pragmatic philosophy underpinning neo-institutionalism, the social world is not a static equilibrium, but rather, is a dynamic and complex pattern of institutions, values and habits, or, in Gruchy's words, "an evolving cultural process" (ibid: 548). A neo-institutionalist approach, with its pragmatic way of comprehending the nature of the real world enables investigating and interpreting "the economic system as a developing cultural product that is passing through a number of eras of development" (ibid: 548). This system is not shifting towards any pre-determined social or economic arrangements.

Another aspect of the neo-institutionalist framework is its anthropological and *evolutionary* approach to the study of economic issues. From the anthropological perspective, the economic system should be considered as a subsystem of the larger societal fabric (ibid: 548). Both have the common features of an evolving cultural process, where humans, as cultural products, are functioning and influenced by it. Hence, according to Ayres (1944 in ibid: 548) the "analysis of the neo-institutionalist is carried on at the cultural level and not at the individualistic level of the market place". It would be fair to suggest that an inquiry into the causes of income inequality requires investigation at the multi-dimensional level so as to embrace the spectrum of different social groups of a particular country and the political economy of different institutional actors together with their evolution and place in the distributional process.

The evolutionary approach of neo-institutionalism is also useful for investigating financialisation, as there is a tendency towards this in the development of market relations and this evolutionary process is intrinsic in a continuous flow of financial innovations (Vercelli, 2014). The reason for this constant tendency, is that an evolutionary process of financial innovations, even in different historical and cultural contexts, has been aimed at increasing the flexibility of decision makers to make self-interested choices, by removing the existing constraints to the flexibility of economic transactions. To understand the implications of financialisation, it is important to consider it as a recurring phenomenon, whereby episodes of its acceleration leading to structural change and modifying the operating rules of capitalism alternate with periods of de-financialisation. Two periods of acceleration are epochal and illustrate its evolutionary character (Figure 4.2). The first started in the second half of the nineteenth century and lasted until the beginning of the Great Depression. The second, began after the Bretton Woods period ceased in the 1970s, culminating in neoliberal financialisation (ibid: 21).

**Figure 4.2. An Index of financialisation: GDP share of the US financial industry**




Source: (Philippon, 2008 in Vercelli, 2014: 26)

An important aspect of neo-institutionalism concerns the understanding of the economic system (Gruchy, 1984). Different groups, with varying amounts of political and economic power, participate in a constant competition to increase their share of the national income and to present different interests. Thus, in the quest for financialisation-caused impact on income inequality and the consequences of neoliberalisation, it is important to conceptualise and operationalise the various factors and institutions involved in wealth creation and the distribution of the economic pie.

One of the main advocates of institutionalism, Clarence Ayres, maintained that one of the most important forces and agents of social change is the growth of technology (Ayres, 1951). Given the notion that technological development is the result of previous ideas and devices (Walker, 1979: 522), it can be argued, in an analogous manner and from the institutionalist perspective, that financialisation, as a phenomenon that embraces *specific* types of technological advance (financial innovations), is the consequence of financial liberalisation and deregulation as *specific* types of *new* ideas and policy change. Neo-institutionalist employment of a technological interpretation of economic evolution, thus, has contributed to explaining the different roles of a wide variety of factors and aspects, such as political development and its dynamics, shifts in power as well as external and internal socioeconomic events. Subsequently, the first explanatory causal-processual analytical construct, which addressed an underlying ontological enquiry on the causal link between financialisation and income inequality within neo-institutional approach was:

1) to analyse financial liberalisation and deregulation policies from the early 1980s in creating new institutional preconditions for the evolution of the financial sector and the development of financialisation as a new technological organisation instigated by neoliberal restructuring.

### *4.3.2. Neo-Marxian perspective*

There are common philosophical aspects that neo-Marxism shares with neo-institutionalism (Gruchy, 1984). Marx rejected the idealism of classical economic theory of the eighteenth and nineteenth centuries and instead, stressed the importance of the analysis of the factors at work in the real world.[62] The doctrines of the dialectic and class struggle – central elements of Marxism – were drawn considerably from Georg Hegel, but without idealist elements.

[62] The academic literature on the relationship between critical realism and Marxism has revealed the emergence of contrasting themes. However, according to Ehrbar (1998), Marx was a critical realist even before critical realism emerged. Fleetwood (2001) uses critical realism to show that rooting Marx's labour theory of value in an inappropriate deductivist mode of theorisation with quantitative interpretation of the theory, leads to the lack of explanatory power. Likewise, Josef (1998) explains that critical realism, as a philosophical underlabourer, clarifies Marxism's method acting not as an alternative, but as a complement. "[Social sciences] are a product of the very social formation which they seek to analyse… Consequently, the explanatory nature of social science must develop along the lines of an explanatory critique. Critical realism is given a radical edge in its debunking of certain ideologies and their relation to the social structures and material practices that produce them" (ibid: 81). Conversely, Roberts (1999) argues that critical realism creates the same theoretical problems it has claimed to have initially resolved and as such, engages in a different theoretical project to that of Marxism. Gunn (1989: 95), in his critique of critical realism, rejects the philosophy, arguing Marxism does not need it and implies instead, reflexive theorising. For debates on the relationship between critical realism and Marxism, see Brown, et al. (2001).

The views of the neo-Marxians, summarised in Howard Sherman's (1972) *Radical Political Economy*, include considering the economic system as an evolving historical process. To analyse different economic activities and the economic system as part of a larger cultural process, neo-Marxists is comfortable with the employment of the anthropological approach (Gruchy, 1984: 551). As with neo-institutionalists, neo-Marxists are also interested in a technological interpretation of the evolution of the capitalist system, which brings them together in their usage of the analytical tools. However, one of the main differences between these two heterodox movements is that, as in classical Marxism, neo-Marxism has a dualistic theory of the economic system, where two classes (capitalists and proletariat) struggle with each other. Contrary to this view, neo-institutionalism has a pluralistic theory of the economic system, where a number of competing power groups compete with each other for finite resources (ibid).

The neo-Marxist approach to the analysis of the contemporary capitalism, which highlights its variability, offers advantages for cross-country comparisons (Blim, 2000). The analytical tools and theoretical frameworks employed in Marxist approaches to financialisation, namely by Fine, Harvey, Lapavitsas and Dumenil and Levy, have been summarised in Chapter 2. For Dumenil and Levy (2011: 57), for instance, "Financial institutions are an instrument in the hands of the capitalist class as a whole in the domination they exercise over the entire economy". Consequently, it is important for the current discussion to place the financialisation and income inequality nexus within the context of class antagonism and the role of the state, where neoliberal financialisation is another stage of finance capitalism used by the upper class in its pursuit for income accumulation.

According to the neo-Marxist approach to the state, also known as the structuralist approach (Barrow, 1993), the state functions on behalf of capital and excludes itself from direct control over the means of production, which makes it dependent on the private sector and its revenues. The state is, thus, interested in ensuring the profitability of capital to secure its own survival, whereas subordinate classes enjoy material concessions only within the boundaries of the increasing profits of the capital. If the latter is threatened, then the share of the working class has to be reduced (Offe, 1984). Consequently, both financial capital and neoliberalism play crucial roles in restoring the power and income of capitalist class, thereby establishing economic class domination leading to a decline of a labour's share in income and hyperfinancialisation of everyday life (Jessop, 2012). Regarding which, recent attention focused on the relationship between financialisation and labour's share of income has revealed that an increase in dividend and interest payments, the capital share, comes at the expense of the share of wages in the GDP, the compensation of employees (Dunhaupt, 2017). Furthermore, capital accumulation is embedded in the modern economy, because not only capitalists, but also, workers and consumers, believe that money is the only solution to all problems, thus making the latter two work overtime and borrow constantly (Ehrbar, 2002). Capital accumulation, hence, is organised and promoted through a chain of state strategies, practices, structures, and institutions (Joseph, 1998: 98). Consequently, the second explanatory causal-processual analytical construct was aimed at capturing and exploring the domain of the reality of the dichotomy between income disparity and finance capital, as manifested in:

2) the dynamics of the rate of profits in the financial sector in comparison to the level of wages as shares of GDP between circa 1980 and 2010, thereby considering the evolution of finance capital historically.

*4.3.3. Post-Keynesian perspective*

Post-Keynesianism can be defined as a set of economic theories in opposition to neoclassical economics, particularly to right-wing monetarist theories, and that does not agree in reducing Keynesianism to a tool for countering the business cycle (Lavoie, 2009; Dequech, 2012).[63] The emphasis is placed on financial instability; capitalist economies do not tend automatically toward optimal outcomes and markets often fail. Prices do not provide the right signals and uncertainty is a constant variable that should be taken into account, which is clear with the passing of time. Some post-Keynesians (Paul Davidson) are pro-capitalist with social democracy values, whilst others – influenced by works of Michal Kalecki – are more radical (Nicholas Kaldor,

[63] For discussion on the connection between post-Keynesianism and critical realism see, Lawson (1999c), Dow (1999), and Downward and Mearman (2002). For Lawson (1999c: 6), for instance, post-Keynesian features are insights systematised as critical realism and manifested in "a persistent opposition to mainstream contributions in economics; a heavy emphasis on explicit methodological reasoning; an enduring focus on uncertainty and historical processes; an acceptance of the reality of human choice understood as being able always to have acted otherwise; a prevalence of sets of competing substantive accounts of any given phenomenon; an association with the claims of certain classical economists".

Joan Robinson) and combine Keynesian theories of finance with a Marxian analysis of production, rejecting capitalism as a system (Henwood, 1997).

Post-Keynesian economics repudiates mainstream economics' core methodological foundations, in particular, its comparative static equilibrium-based theories (Hart and Kriesler, 2015). From a methodological point of view, post-Keynesianism embraces realism and is concerned with explanatory mechanisms, separating itself from deductivism and formalism (Dequech, 2012: 357). Static equilibrium analysis is rejected based on the logic of time and history (Hart and Kriesler, 2015). As explained by one of the most prominent developers of post-Keynesianism Joan Robinson,

> "A system of simultaneous equations need not specify any date and nor does its solution involve history. But if any proposition from it is applied to an economy inhabited by human beings, it immediately becomes self-contradictory. Human life does not exist outside of history and no one has correct foresight of his own future behaviour, let alone of the behaviour of all the individuals which will impinge upon his. I do not think that it is right to praise the logical elegance of a system which becomes self-contradictory when it is applied to the questions that it is designed to answer" (Robinson, 1974 in Hart and Kriesler, 2015: 322).

Similarly, Hart and Kriesler (2015: 322) argue that, from the post-Keynesian perspective, economic analysis should be concerned with observation of the stylised facts of capitalism, rather than applying the deductive reasoning of the assumed equilibrium.

Central to post-Keynesian analysis, is path determinacy involving historical time, because development of the economy ought to be seen as a historical process where no one can change the past, which influences the present (Lavoie, 2009; Hart and Kriesler, 2015). Hence, it is vital in the analysis of the current or future economic position of a country to know its history and how it came to a certain point. Post-Keynesianism proponents emphasise the importance of institutions, which is also distinctive to other heterodox schools of thought, most notably to neo-institutionalism (Chang, 2003b). Among the set of institutions that are highlighted, the most crucial one is money (and finance), which affects the real economy at the micro and macro levels. For post-Keynesians, money plays a leading role and has a real effect on production and employment (Lavoie, 2006). It influences the investment and consumption decisions of firms and consumers and, therefore, cannot be neutral.

Interestingly, there might be common ground for post-Keynesianism and neo-Marxism, which is not only about their both being against neoclassical economics and its orthodoxy, but an adaptation in their methodological propositions of a class-based approach. The so-called Kaleckian source of post-Keynesianism distinguishes between capitalist and workers, stressing the income distribution issue between them (Dequech, 2012). According to post-Keynesians, income distribution has shifted in favour of profits and away from wages under advanced capitalism (Kaletsky, 2010). This has happened because of technological progress and increasing monopoly power intrinsic to the capitalist system and importantly, because of the restrictions on organised labour. Also, both post-Keynesian and neo-Marxist economists argue that the main reason for financial crises is the distributional shift of national income between wages and profits (ibid).

Drawing on the analysis of Keynes and Kalecki, post-Keynesian theory emphasises that the level of effective demand is the fundamental factor of real output and employment (Hart and Kriesler, 2015). Hence, the level of employment is determined by the level of effective demand rather than real wages. An important implication from this theoretical perspective, is that real wages do not primarily depend on market forces. They are determined by pricing behaviour and the bargaining between wages, profits and rents for national income share. Now, as mentioned in Chapter 2, a rentier is defined by Keynes as “the functionless investor”, who generates income via ownership of capital. However, not all profits in the financial industry may be considered as rent. It is financialisation that causes and facilitates financial-market mediation and financial expropriation, thus, turning income from financial assets into growing rent revenues, thereby contributing to the rise of income inequality (Lapavitsas, 2009a). Much of the current literature emphasises that financialisation is a new era of rentier, whose rising income accrues through financial institutions and holding financial assets (e.g. Epstein and Power, 2003; Tomaskovic-Devey and Lin, 2011). Under the neoliberal policies created by the demise of the Bretton Woods regulative system and facilitated through finance liberalisation and deregulation, the construction of rent opportunities since the 1980s has become both an outcome and essential element of the financialisation framework. Financial rent and ever increasing revenues from capital from that time onwards have been attributed as being the *re-*

emergence of financial or rentier class.[64] Their capital rent-seeking edifice has been built with the help of monetarism, expansion of financial markets and more generally, the supremacy of financial interests that encourages debt-led growth (Stockhammer, 2009). At the same time, increasing private and public indebtedness has been linked to the growing disciplinary power of both global and national finance (Montgomerie, 2007). Thus, post-Keynesian analytics on income distribution and how this is affected by the financed rentier capitalism (Seccareccia and Lavoie, 2016) were useful tools for the methodological approaches of the current work. Accordingly, the debtor-creditor relationship, as a synthesis of Keynesian and post-Keynesian ideas employed within a critical realist vision of ontological considerations, as manifested in the declining incomes of workers/employees and increasing revenues of capital holders, was brought as the third explanatory causal-processual analytical construct to investigate:

3) the dynamics of the rental income from financial assets and the level of private/public debt between circa 1980 and 2010.

***

In sum, three dissenting schools of thought and their ontological stances and analytical apparatuses served to create *three explanatory causal-processual analytical constructs* and to build an *analytical framework* of the financialisation-induced income inequality hypothesis. This epistemological analytical framework, as discussed in section 4.5, is underpinned by the critical realist vantage point and pluralist methodological approach. It is important to recapitulate that, the principle objective and methodological knowledge-contributing element of this study behind this rather complex construction, was to avoid "the epistemic fallacy" of gaining and extending the explanatory power for the financialisation-induced income inequality nexus.

[64] One of the theoretical frameworks of this thesis is based on the account that the rentier class emerged from 19th century capitalism and used to be powerful throughout the 1920-1930s, before it was put on a leash by capital controls, the welfare state and powerful labour. In this sense, rentier or financial class has been resurrected and *re*-emerged since the 1980s (see, for example, Epstein and Jayadev, 2005; Pollin, 2007; Piketty, 2014).

### 4.4. Research design: qualitative method and case study approach

This study involved employing primarily qualitative methods embedded in a retroductive methodological approach, with a comparative case study design. Qualitative data were supplemented by quantitative information produced from secondary sources, such as data on the Gini coefficient. As Ritchie and Lewis (2003: 5) argue, "qualitative methods are used to address research questions that require explanation or understanding of social phenomena and their contexts". These methods are used effectively when exploring complex issues and to study processes that occur over time. In this regard, qualitative research is applicable to understand better the modern patterns of income inequality occurring in different countries, but under the same phenomenon. Qualitative research can help to follow up quantitative data so as to understand the mechanisms and links between causal theories or models (Creswell, 2013).

A cross-country comparative study approach was chosen to allow for a full range of issues to be considered in the research. The case study, as a research method, is used in social science and many other areas of scientific exploration, to investigate and understand complex social phenomena (Yin, 2009: 4). Case studies are appropriate for exploratory, descriptive, and explanatory purposes. At the same time, they facilitate the preservation of the holistic and profound features of real-life events within a critical realist approach. Another important point is that, as Yin (ibid: 13) argues, a case study approach has a distinct advantage when a "how" or "why" question is being asked about a contemporary sequence of events.

The critical realist stance and the logic of retroduction adopted in this study have been formalised in comparative historical analysis (CHA) (Saka-Helmhout, 2014). This method provides a case-oriented approach to data examination and helps to improve the generalisability of cross-case comparisons by recognising common associations and patterns of causalities. Under CHA, the presence of causes are identified and captured in cases to allow for the claim that specific conditions result in particular outcomes. Similar to international relations studies, CHA and comparative case study research facilitate generating knowledge about several cases about a hypothesis, by highlighting the use of narratives and in-depth description (Lamont, 2015).

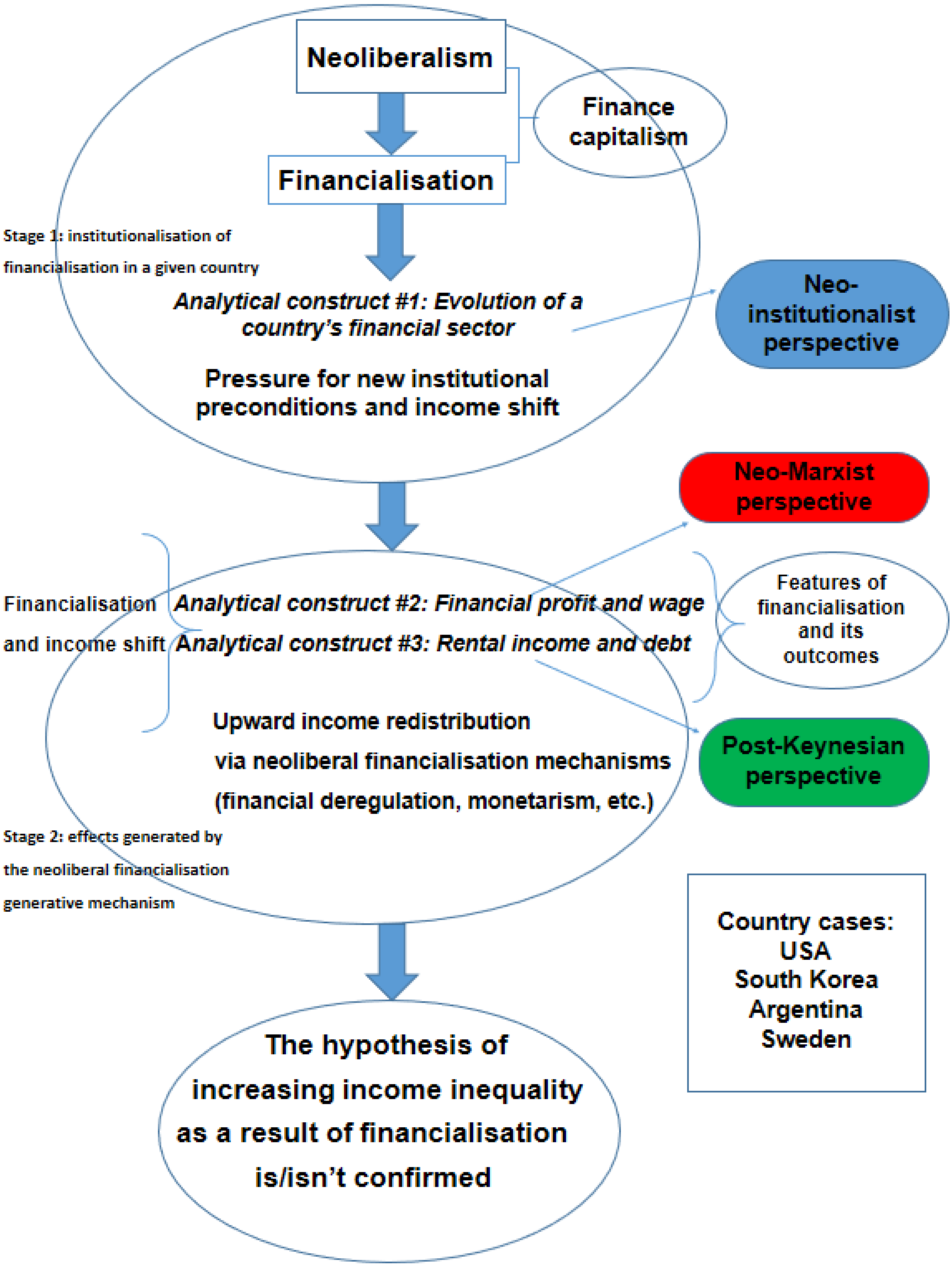
The research includes four countries: Argentina, Sweden, South Korea, and the USA. The rationale behind the choice of these countries is that they all have their unique historical, geographical, cultural, socio-economic and political aspects of development. They are all contemporary market economies in the latest stage of capitalism and in four different continents. However, since investigation covered recent events of the more interconnected world (1980-2010), the patterns, dynamics and causal links of the income inequality and financialisation phenomena provided not only national peculiarities but also universal ones. For these reasons, I employ an international political economy approach to understand the evolution of the financial capital and its impact on economic disparity.

This study involved dealing with information derived from literature, legislation analysis and descriptive statistics based on secondary-data. No interviews were conducted and no potential ethical dilemmas arose. However, ethical guidelines published by various social science organisations, such as the Economic and Social Research Council (ESRC), were taken account, which explicitly states that "research should be designed, reviewed and undertaken to ensure integrity, quality and transparency" (ESRC Core Ethical Principles in ibid: 81).

### 4.5. Analytical framework: developing financialisation-induced income inequality theory

Based on the conceptual framework discussed in Chapter 2, the ontological and epistemological approaches and the study proposition, the following *analytical framework* was developed to guide the research (Figure 4.3). This study was undertaken in light of the proposition that neoliberalism as an ascendant ideology that became dominant on the political agenda and public policy of various countries from the early 1980s onwards, has created an environment and preconditions for the emergence of finance capitalism. It was further believed that this form of capitalism is characterised by the financialisation phenomenon and *evolution of a country's financial sector* (first analytical construct), which, in turn, builds *pressure for new institutional preconditions* to be formed both for more financialisation and eventually, income shift. Contrary to the post-war era of "embedded liberalism" of the 1950s-1970s, the new institutions and mechanisms originating from neoliberal financialisation, have been designed for upward income distribution. This could be evident in *the rate of profits in the financial sector* and *the level of wages and debt* and *shift in the share of labour and capital in the national income* (second and third analytical constructs) of a given country over the 1980-2010 period. Redistributive mechanisms now serve to accumulate more income for the upper-class. These mechanisms and institutions embedded within neoliberal financialisation are presented and utilised in many different layers of public policy, state and society as a whole. In fact, these changes represent a neoliberal counter-revolution formalised in the Washington Consensus package of reforms, such as monetarism, financial deregulation and assault on labour unions as well as financialisation *per se*. As with any macrosocial phenomenon, upward income redistribution via financialisation for the last thirty-forty years has not been achieved through unique and fit-to-all circumstances. Moreover, income inequality may not be necessarily the unavoidable outcome of financialisation. Different cultural, political and socioeconomic conditions and peculiarities of various countries do matter, for they could mitigate or exacerbate the detrimental effects of financialisation. However, as the reasoning of the analytical framework of this study implies, the underlying logic of financialisation creates common patterns and deterministic laws and principles of the financialisation-induced income inequality hypothesis. The essence of this study was to capture and explain this logic and how and why income inequality has occurred in the era of neoliberal financialisation as well as what the generative mechanisms that regressively affect income distribution are. As it is shown in Figure 4.3, each analytical construct is used to capture and explain different stages of the financialisation-induced income inequality nexus. Analytical construct #1 is derived from the neo-institutionalist perspective to capture and explore the institutionalisation of financialisation in a given country (stage 1). Analytical constructs #2 and #3 are derived from the neo-Marxist and post-Keynesian perspectives respectfully to capture and explore the effects generated by the established neoliberal financialisation generative mechanism (stage 2). Both stages allow to confirm (or not) the hypothesis of increasing income inequality as the result of financialisation.

**Figure 4.3. The analytical framework of the financialisation-induced income inequality hypothesis and the mode of research**




Source: researcher

### 4.6. Conclusion

This chapter has described the methodological framework and research methods deployed in the thesis. The employment of three heterodox schools of thought incorporated in the form of analytical constructs was explained in the previous chapter from a philosophical perspective of the critical realism traditions and a brief critical account on mainstream economics theory. As explained, the philosophical-methodological defects of the positivist tradition embedded in the mainstream economics deductivist approach of the “if A then B” form and an adoption of formalistic modelling in dealing with the nature of reality, constrain adequate scientific investigation and analysis of social reality. A major problem with formalistic equations is that they are fictitious and cannot express real world conditions and the environment. Variables in these equations are model dependent, for in actuality, they are determined during mathematical modelling.

Three theoretical perspectives and factors within three heterodox approaches – neo-institutionalism, neo-Marxism and post-Keynesianism – were discussed to show their synergy effect. The study involved following the retroductive method of reasoning. In the traditions of the comparative political economy, this technique can serve as tools for generalisation to distinguish between nomothetic and idiographic explanations of the financialisation-induced income inequality hypothesis.

This cross-fertilisation between various schools is an advantage of the study and safeguards against relativism, whilst at the same time being justified since the incommensurability problem is solved owing to the shared ontological commitments of these heterodox schools. Cross-fertilisation leads to synergies, thereby enabling identification of the generative mechanisms of the financialisation-induced income inequality nexus. It is this combination of heterodox schools that constitutes the methodological contribution of the study.

Another purpose of this part of the thesis was to show the pathway adopted for the study. The rationale for the qualitative and country-case study research method was explained and justified together with conceptual and philosophical framework and research design that served to build the study proposition and its analytical framework.

## Chapter 5. USA: the birth of the global neoliberal financialisation order

"*There has been class warfare going on for the last twenty years and my class has won*" (Warren Buffet in Stiglitz, 2015: 95).

### 5.1. Introduction

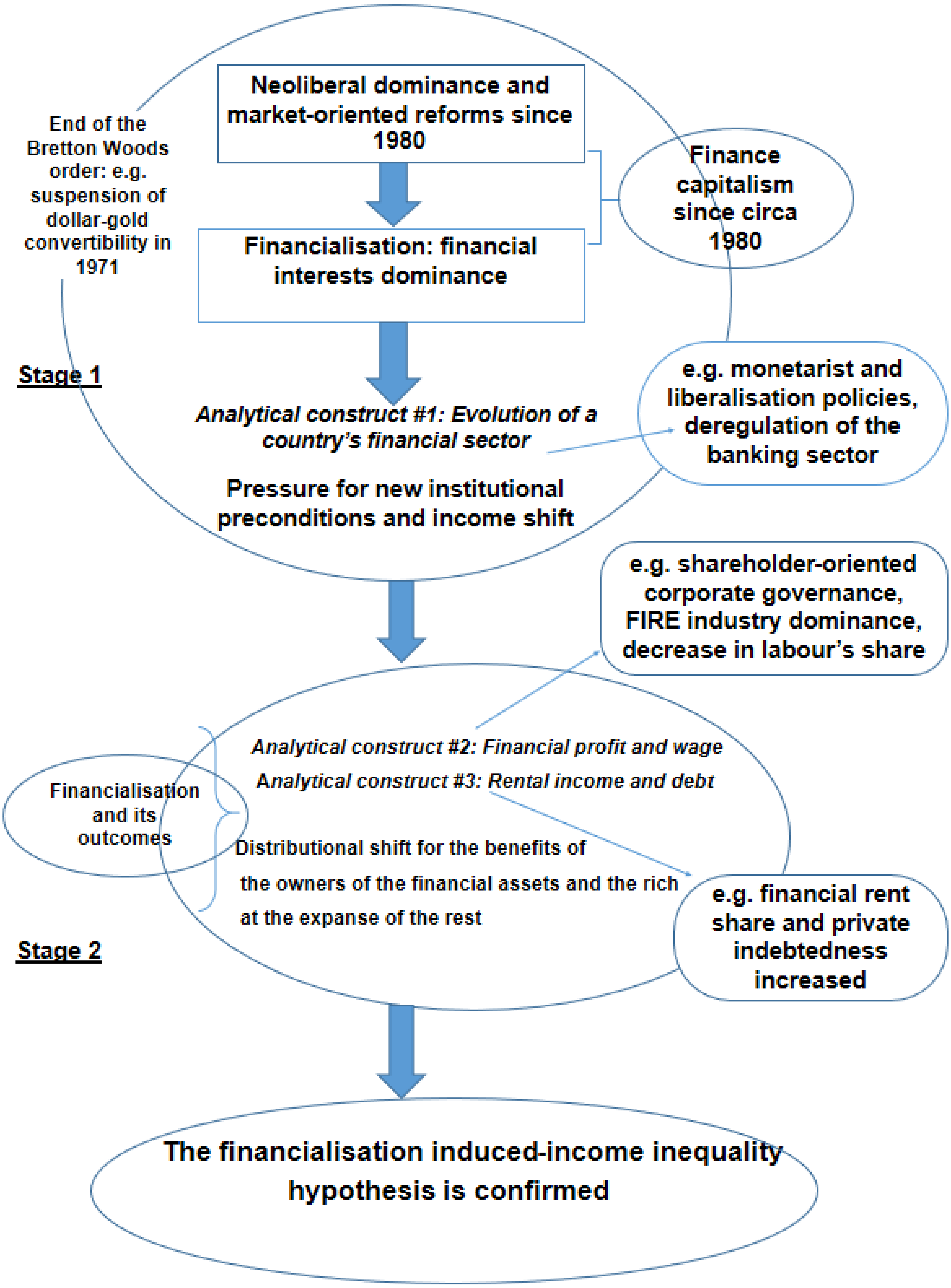
In the four chapters (5 to 8) that follow, I present the empirical evidence and data of the research. The chapters are construed in accordance to my analytical framework of the financialisation-induced income inequality hypothesis. As the theoretical conceptualisation of this study presupposes, for financialisation to occur in a country, first neoliberal ideological dominance has to be established and embraced by the politico-economic elite of that country. Accordingly, the logic of argumentation starts with discussing how a pro-market ideology replaced the post-war Keynesian embedded liberalism or national model in a particular country.

The US case is the first to be investigated, as it is the country of origin of neoliberalism and it is essential to analyse how the subsequent articulation of its fundamental concepts achieved a dominant level on a worldwide scale. Different aspects of how this dominance became possible in the US will be described to understand how later on it was adopted in countries as different as South Korea, Argentina, and Sweden. Subsequently, three analytical constructs are tested to show and analyse the causal effects between neoliberal financialisation and upward income distribution.

From the vantage point of income inequality, this chapter explains how a neoliberal pattern of income distribution is facilitated and maintained by financialisation once it is established. The analytical constructs used in this thesis provide an analytical sketch-map of these developments from neoliberalism to financial deregulation policies to financialisation, as a means of the most optimal income maximisation unconstrained by any social obligations and boundaries of the Keynesian welfare state. Again, the US case will help to understand and analyse the international organisations- and state-imposed neoliberal reforms in support of the economic interests of the upper-income earners in other country cases.

In this chapter, it will be argued that neoliberal ascendancy reshaped post-war US and other countries' strategies, with a new paradigm being built that allowed for financialisation to emerge. As it will be shown in this and the following chapters, similar outcomes, such as increased financial rents and decreased labour share, are all the results of the unleashed forces of finance capital. The combination of structural changes on the global level characterised by the collapse of the Bretton Woods order and neoliberal supremacy in domestic policy epitomised by the rejection of national developmental strategies, have led to financialisation becoming a new vehicle for upward income distribution. A summary of the main findings, together with the analytical procedures and the results obtained from them, is provided in Figure 5.1. The same road map of the research describing the analytical framework of the financialisation-income inequality nexus will be provided in each chapter on country cases.

**Figure 5.1. The analytical framework of the financialisation-induced income inequality nexus in the USA**




Source: researcher

## 5.2. Neoliberal turn and income inequality in the USA: 1980-2010

### *5.2.1. Ideas and institutions*

As Birch and Tickell (2010) have argued, the ascendancy of neoliberalism became possible because of the expansion and political success of the conservative movement in US. This transformation of the redistributive Keynesian welfare system of the post-war era into the neoliberal order would not have been achieved without the central role played by ideas consolidated and expressed by the business-led interest groups during economic crises. It was promoted by free market advocates and neoliberal-conservative think-tanks in the 1970s-1980s, being completely embedded in policy discourses by the 1990s.

Previous research has established that changing economic conditions in the 1960s and 1970s played a significant role in certain ideas and institutions (re)emerging in the USA (Helleiner, 1994; Eatwell and Taylor, 2000). Advanced capitalist countries and particularly the United States, faced a structural crisis from the late 1960s to the early 1980s, when economic growth slowed down, frequency of recessions and financial crises increased and inflation and unemployment became a constant concern. The government was unable to raise revenues and the bloated deficit led to higher interest rates and greater pressure on the dollar, with fundamental implications for the neoliberal ideology's ability gradually to prevail on the political agenda and in social and economic policy (Helleiner, 1994).

Inspired by Karl Polanyi's *The Great Transformation* (2001[1944]), Blyth (2002) describes how the post-war era of embedded liberalism faced with a crisis of capital accumulation was transformed in the 1970s and 1980s into neoliberalism. This *institutional change* of "disembedding liberalism" constituted the second great transformation, when the mobilised political power of business and capital brought to life ideas conceived "to replace the embedded liberal order" in the United States (ibid: 139). Drawing on Gramsci's (2005[1971]) view that intellectuals provide dominant classes with direction and guidance during crisis and mediate social transformations, it can be argued that the proliferation and proselytisation of neoliberal philosophy by think-tanks, academia, and research centres represented preparatory work for its future ascendancy.[65]

[65] For instance, Leonhardt (2002) claims that a rightist economist Martin S. Feldstein taught economics at Harvard University in favour of free market interpretation and thereby, influenced thousands of students, some of whom took prestigious positions in various governmental positions. In this regard, for the purposes of

In describing a bigger picture of the conditions for the neoliberal counter-revolution to happen in the USA, several major politico-institutional events, which constituted antibusiness measures and triggered its ideological and organisational consolidation, deserve to be mentioned. First, new regulatory institutions were introduced in the 1970s to enforce regulations on business and to ensure responsibilities of the industry towards society (McQuaid, 1994)[66]. This led to a shift of rents from business to the public, which in a time of an inflationary economy led to the consolidation of business for the first time since the 1940s "to act as a coherent social actor" (Blyth, 2002: 133). Second, the Nixon administration, contrary to what would be expected from the Republicans, decided to implement tax reform in line with a popular public demand to restrict business tax shelters.[67] This signalled to business that inflation was not the main priority of the new Nixon administration and led to a fall in stock values and corporate profits (Blyth, 2002). In addition, in order to control inflation, the new chair of the Federal Reserve Arthur Burns increased interest rates and tightened monetary policy in 1970, which only further depressed economic activity, leading to increased unemployment and intact inflation (ibid). The turning point that constituted the demise of the Bretton Woods regime and asserted the political transformation of post-war embedded liberal institutions into the free market framework, was the suspension of dollar-gold convertibility on August 15, 1971. To add further to the general socioeconomic deterioration, the Arab-Israeli war in 1973 resulted in oil prices increasing fourfold, which provoked an inflationary boost. As a result, a new phenomenon known as "stagflation" became the reality of the day.

In contrast to the 1930s, when new political ideas had been crafted to fight deflation, this time inflation and claims of excessive regulation and high taxes were declared "the number one enemies of freedom and humanity". To overcome uncertainty and reverse the institutions of Keynesianism, new ideas, such as

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analysing how neoliberal shift occurred in other cases of this thesis, it is important to bear in mind that American academia and universities having been considered as amongst the most prestigious, being dominated by neoliberal protagonists who have tremendously contributed to the global dissemination of free market ideas.

[66] In 1969, under the Environmental Protection Act, the new federal Environmental Protection Agency was created. In 1970, the Occupational Safety and Health Administration was established in accordance with the Occupational Safety and Health Act. As Blyth (2002) points out, even the timing of creation of these huge bureaucratic institutions was unsuccessful, adding burdensome costs on business at a time of high inflation and interest rates. In addition, President Nixon within his New Economic Policy introduced, in 1971, a package of controls, including a ninety-day freeze on wages and prices (ibid).

[67] The Tax Reform Act of 1969 was labelled "far and away the most anti-rich tax reform proposal ever proposed by a Republican president" (*The New Republic* in Blyth, 2002: 133).

monetarism, rational expectations as well as supply-side and public choice theories were employed by policy-makers. Notions, such as “sound finances” and “budget balances” that had been defeated in the 1930s, became the cornerstones of economic policy by the 1980s to ensure that socioeconomic crises, allegedly not treatable anymore by Keynesian social democracy, would be dealt with by market-oriented means (Blyth, 2002).

As explained in Chapter 2, it is important not to underestimate the role of advocates of neoliberal thought among academia and more generally, intellectuals, who influenced through various think-tanks policy-makers in the highest echelons of the US political and administrative power (Helleiner, 1994; Blyth, 2002; Peet, 2003; Birch and Tickell, 2010).[68] Supported by conservative business interests and clustered around political and policy elites, the network of “centres of persuasion” mostly created in 1970s have consistently disseminated and rationalised neoliberal ideas, ranging from the ideology of small government to free enterprise to monetarism (Birch and Tickell, 2010: 49). One of the founding-fathers of monetarism, Milton Friedman and his allies, were able to repudiate ideas of “embedded liberalism” successfully and spread the belief in free market principles of neoclassical economics, self-equilibration, adaptive expectations and the damaging effect of state intervention.[69] Consequently, these sets of new economic ideas unleashed theoretical attacks on the post-war order, which were aimed at discrediting Keynesian models and welfarism, castigating regulatory interventionism of the state, and denigrating the rationale behind the redistributive policies, such as high taxes on capital income.[70]

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[68] For instance, one of the leading members of the Austrian neoliberal school, Gottfried Haberler, was international financial issues advisor to the President Nixon; the Treasury secretary after mid-1972 George Shultz was affiliated with Milton Friedman and the University of Chicago, the School of Political Economy of which is the intellectual capital of neoliberalism; and other influential supporters of neoliberal ideas, included William Simon who succeeded Schultz as Treasury secretary, Thomas Willet who was a senior staff economist in the Nixon administration and director of international monetary research at the treasury Department, and Paul Volcker who headed the US Federal Reserve in 1979 (Helleiner, 1994: 115).

[69] Milton Friedman (1912-2006) was awarded in 1976, what is often mistakenly called the Nobel Prize in economics, but in fact is the Bank of Sweden’s prize under the control of banking elite. Friedman became an influential public figure as the president of the American Economic Association and as a *Wall Street Journal* editorial writer. In 1974, the award was given to Friedrich von Hayek (1899-1992), the author of *The Road to Serfdom*, who together with Ludwig von Mises (1881-1973) is a founding-father of neoliberalism (Harvey, 2005; Birch and Tickell, 2010).

[70] For example, one of the reasons for the supply-side theory to have become so popular and powerful is that it legitimised tax cuts and linked concerns over inflation with taxation. For a favourable explanation of the supply-side doctrine, see Wanninski (1978) and Roberts (1984). For a critique of the supply-side theory and more generally economic neoclassical orthodoxy, see Krugman (1994) and Chang (2003).

It might could argued that what happened was the mutually reinforcing concurrence and an alignment of the values of the right-wing conservative rhetoric, formerly marginalised economic ideas of the neoliberal orthodoxy and the top class interests of the American business and capital, the lattermost being both an initial source and final beneficiary of the neoliberal shift. As Peet (2003) maintains, the theoretical dogmas of the Chicago School were successfully translated into the apparently neutral, scientific mathematical equations of monetarist economics, thus promoting government spending cuts and low taxes in order to fight inflation. Some neoclassical economics ideas were popularised and even perverted in such a way as to turn Adam Smith's (2009 [1759]) belief in justice as a basis of society into individual selfishness as a motivator for economic behaviour (Fitzgibbons, 1995). At the same time, big American corporations and banks in the 1970s began to support neoliberal ideas on deregulation and reinvigorated their collective actions through business institutions, such as the American Chamber of Commerce (ACC), the National Association of Manufacturers (NAM) and the Business Roundtable (BRT) (Blyth, 2002).[71] Affiliated with the conservative movement of the Republican establishment, institutions and think-tanks, such as the American Enterprise Institute (AEI), the Heritage Foundation, the American Legislative Exchange Council, the Center for the Study of the American Business, and the Republican Study Committee were financially supported by the business community represented, for example, by the John M. Olin Foundation, the Smith Richardson Foundation, the Sarah Scaife Foundation and the Koch Family Foundation (Ricci, 1993; Beder, 2006). To popularise new ideas of "economic liberty" and to delegitimate welfare and regulatory institutions, funds from these affluent foundations were provided to support neoconservative and financial circles media, such as *Public Interest* and the *Wall Street Journal* as well as a television version of *Free to Choose* delivered by Milton Friedman (Blyth, 2002).

### *5.2.2. From ideas to policies*

It is now important to consider how these ideational changes reformulated legislative and executive economic policies and embraced new institutions in the USA.

[71] Regarding the growing political power and influence of these organisations, this can be evidenced by the fact that the number of members of the ACC quadrupled over 1972-1984 period and members of BRT controlled one half of the American GNP (Blyth, 2002).

New economic ideas became incorporated into the state also through deliberate strategies of “winning back the state” and “the corporate takeover of democracy” (ibid: 154). For instance, in 1974, just 89 so called political action committees (PACs) contributed $4.4 million to both Democrats and Republicans. By 1976, there were 433 corporate PACs, spending over $19.2 million for the 1980 presidential election campaign alone (ibid: 155). Concrete and planned actions were taken by the corporate community and their affiliates to secure implementation of policies inspired by market-oriented values at the legislative level. This is certainly true in the case of the American Council for Capital Formation (ACCF), which focused on lobbying US Congress on issues of taxation, with the ultimate goal of lowering taxes (ibid). In light of the increased popular mobilisation and general hostility to high taxes, by 1978, President Carter proposed to cut middle-class taxes and corporate tax rates as well as making permanent the investment tax credit that had been temporary (ibid). In the same year, the Steiger bill was passed, thereby leading to a cut capital gains tax to 25%, removal of capital gains from exposure to “minimum tax” schedules and index stock and real estate values (ibid). Overall, from now on, tax reduction became one of the most crucial topics on the neoliberals’ agenda.

Meanwhile, monetarism began to prevail in monetary public policy, with the appointment of Paul Volker as the head of the Federal Reserve in 1979 (Henwood, 1997).[72] Determined to fight inflation no matter what its consequences for unemployment were and with the Federal Reserve’s new mandate of monetary targeting granted in 1978 by Congress, Volker, within one year, increased the discount rate to 10.5% and then to 11.75%.

The election of President Reagan in 1980, in this logic of capturing the state, should be considered as the beginning of the neoliberal dominance becoming the new convention, where Keynesian welfarism and its institutions were further delegitimated and abandoned. From now on, economic policy was built around the new hegemonic paradigms of neoclassicist, monetarists, supply-siders, and free market advocates (Blyth, 2002: 172). Some examples of the “Reagan Revolution” include governmental initiatives, such as *America’s New Beginning: A Program for Economic Recovery* and

[72] As Martin (1991) demonstrates, there was not much opposition in the commanding heights of the Republican administration, as the Council of Economic Advisors was dominated by the new deregulators and conservative economists, the Treasury was managed by supply-siders and the Federal Reserve became the province of monetarists.

the 1981 *Economic Recovery Act* (ERA).[73] In the first, neoliberal concepts were expressed through federal spending and tax cuts, business deregulation, and the control of money supply to manage inflationary expectations (Stockman, 1986; Blyth, 2002). The second document of the Reaganomics era included measures of regressive taxation and tax reductions to such an extent that, according to some calculations it cost the state "$154 billion in lost federal revenues over six years and close to $500 billion over ten years" (Edsal, 1984: 226).

From the class interest perspective, Harvey (2007) points out the takeover of the US Congress by the Republican Party in the mid-1990s that culminated in a neoliberal "Contract with America".[74] Another historical moment in this implementation of the neoliberal class project concerns how fiscal crisis was used by New York bankers to impose monetary discipline on the city under the threat of bankruptcy in 1975.[75] As the underlining repercussion, that case built the model of neoliberal practices to be employed both domestically and internationally in the future (e.g. in South Korea and Argentina). The new principle of prevalence of the interests of the financial institutions and bondholders over the well-being of the population was established, thus restoring the path for upward income distribution.

To sum up, eventually, all areas of the political and socioeconomic agenda in the US were penetrated by the principles and values of neoliberal proponents. Successful propagation and implementation of the neoliberal project and its institutions, in this regard, was the outcome of what Blyth (2002: 201) calls "the ideational changes that have taken place since the 1970s". That ideological transformation, in turn, severely undermined the political and economic rationale for the redistributive policies and marginalised the egalitarian approach in politics (Duggan, 2003). In fact, it unleashed forces that encouraged maximisation of income

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[73] The spirit of *America's New Beginning* can be understood from the very first pages stating that "the most important cause of our economic problems has been the government itself" (OPS, 1981).

[74] Harvey (2007: 30) claims that with the incorporation of leading figures of the Christian right into politics, who represented a populist base of the so called "Moral Majority" from the mid-1970s, there was "the systematic capture of Republican Party as a class instrument of *collective* (rather than particular or individual) corporate and financial power".

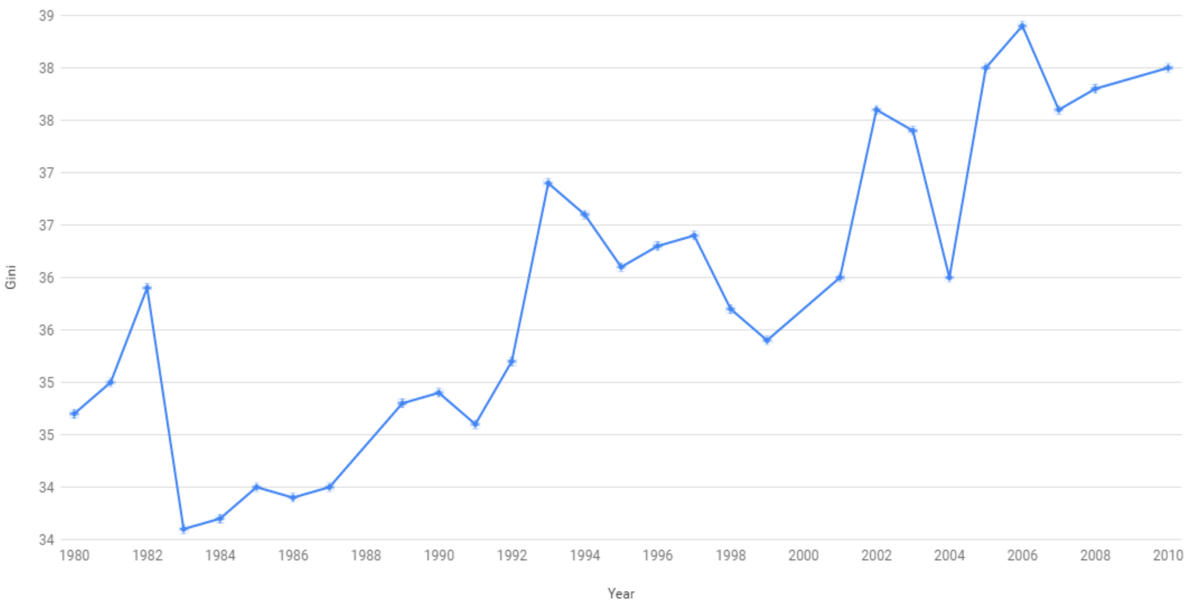
[75] In 1975, during the fiscal crisis the financial institutions refused to extend the debt of New York City, which allowed them to tighten control over the city and construct bailout conditions under which bond holders were entitled to city tax revenues to be paid first. Economic interest of the financial institutions, thus, imposed new rules of governance as opposed to municipal unions allowing wage freezes, cuts in social and public infrastructure spending, and introduction of user fees, culminating in a requirement that the city unions' pension funds were to be invested in city bonds (Harvey, 2007).

and legitimised upward income distribution. As I argue in this study, this neoliberal context and its intellectual and, more broadly, political-economy structure, is the necessary precondition for financialisation to emerge, develop, strengthen, and eventually reign. Before proceeding to examine how financialisation impacts on income inequality, a brief description of its level in the context of the US is necessary.

*5.2.3. The level of income inequality: 1980-2010*

Numerous research reports have demonstrated that income inequality in the United States has increased significantly from the 1970s onwards (Piketty and Saez, 2003; Kopczuk and Saez, 2004; Piketty, 2014; Saez and Zucman, 2016). The chart below reveals that there has been a steady increase of income inequality in the country over the 1980-2010 period, with the Gini coefficient rising from 0.35 in 1980 and 0.34 (the lowest level within this period) in 1982 to 0.38 in 2010, with a peak of almost 0.39 in 2006 (Figure 5.2).

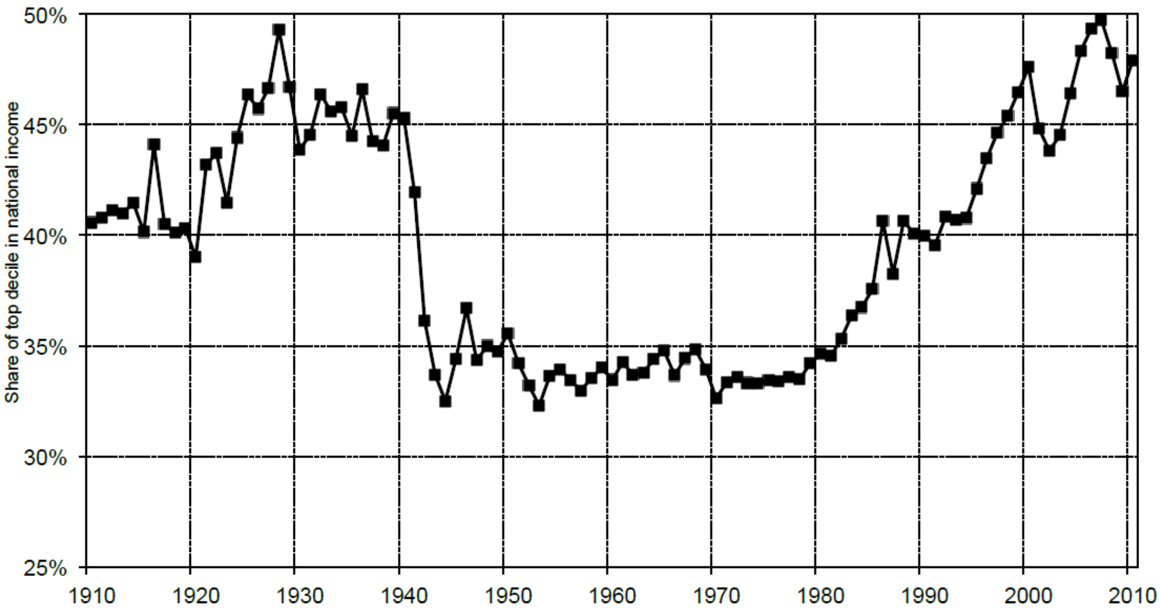
**Figure 5.2. The Gini coefficient level in the USA, 1980-2010**




Source: created from the World Income Inequality Database, United Nations University, 2017

Several features of rising income inequality in the USA can be highlighted. First, there is evidence that disparities of income and wealth have grown more sharply in this country than in any other developed nation (APSA, 2004). Starting from the early 1980s, the United States entered a new era of persistent and escalating inequality, which the country had also experienced at the beginning of the 20th century. The top 10% of income earners claimed up to 50% of national income in the 1910s-1920s. This proportion dropped to almost 30% in the late 1940s and during the Keynesian compromise phase of the 1950s-1970s economic disparity stabilised. Its rapid increase in the 1980s and onwards indicated the return of the pre-war era before the Great Depression, when the top decile's share again rose to the 45-50% level (Figure 5.3).

**Figure 5.3. Income inequality in the USA, 1910-2010**




Source: Piketty (2014: 24)

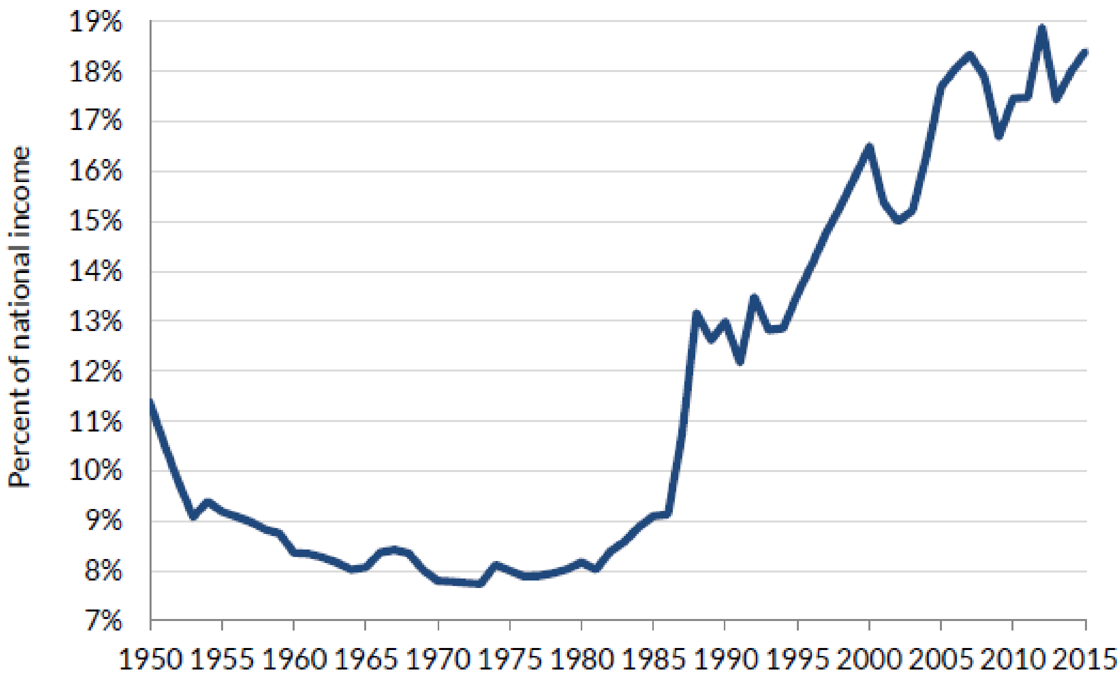
Second, there is evidence of increased concentration of income and wealth within the richest 1% of the American society from the mid-1980s onwards, according to data from Kopczuk and Saez (2004). The wealth share of the top 1% was less than 20% between 1976 and 1982, but increased significantly in the early 1980s, from 19% to 22% and remained stable in the 1990s.The wealthiest 0.1% and 0.01% experienced a decline in wealth in the 1970s and a considerable increase in the early 1980s. From 1982 to 1985, the top 0.1% increased its share from 7% to 10%, whilst the very top 0.01% became 60% richer, increasing its share from 2.5% to 4%. These top groups' wealth share remained stable in the 1990s. In a recent discussion on income inequality, Baker (2016) argues that the share of income (without capital gains) of the top 1% jumped from 7.7% in 1973 to 8.2% in 1980, 13% in 1990, 16.5% in 2000, and

18.3% in 2007 (Figure 5.4). Unsurprisingly, the reverse trend is also true. In his detailed examination of inequality in the US, Stiglitz (2015) provides an account that while the income of the top 1% has been on the rise, that of the middle-class has fallen 12% in the last quarter-century alone, thus revealing yet more evidence that the benefits of growth in the neoliberal decades have gone to the elite.

Third, and this is one of the key points of this research, from 1979 onwards there was an increased share of income paid out from capital (dividends and other capital gains), while the portion tied to wages and benefits declined. The source of income inequality being due to the increased top wage share or income derived from capital is debated in the current literature. Different dimensions of increased income inequality associated with financial industry are discussed. For example, Piketty (2014) (see Chapter 2 of this thesis) identifies both the rising share of the capital in national income and super-high salaries of the top managers, whilst Baker (2016) argues that the main source of rising income inequality in the US is rising wages of the high-end earners. For a more mixed and heterodox approach associated with financialisation, see Lin and Tomaskovic-Devey (2013) and Van Arnum and Naples (2013), whose accounts include a combination of a decrease in labour's share of income, growing power of rentiers, increased top executives' compensation and reliance on financial income, as reasons of the rising income disparity in the US. However, what is important in this investigation is that increased income might be associated with the financialisation factor, which pertains to either huge paycheques of the Wall Street traders or increased capital share in national income. Another important point, which supports the plausibility of the increased capital-derived income argument, is that there has been income polarisation even amongst the top 1%, whereby one has to reach the 0.1% level before income from capital becomes the primary source (Piketty, 2014). This is what Saez and Zucman (2016: 530) term "capital inequality", which has increased significantly.[76] For instance, the share of dividends increased from 35% in 1962 to 50% in 2012 and from 12% to 47% for taxable interest in the wealth of the top 0.1% (ibid).

[76] In Saez and Zucman's (2016: 530) definition of capital income includes "dividends, taxable interest, rents, estate and trust income, the profits of S-corporations, sole proprietorships and partnerships".

**Figure 5.4. Share of income of the richest 1% in the USA, 1950-2015**




Source: Baker (2016: 15)

To summarise, it has been shown that the trend of upward income accumulation in the US coincided with the post-1980 period of the establishment of neoliberalism. Important to note is that, the increasing economic disparity trend in the US also coincided with the advent of financialisation within and beyond that nation. The next sections discuss the financial sector to investigate the financialisation-induced income inequality hypothesis. This will be achieved by employing my analytical constructs to interpret data and historical events within the framework of this inquiry.

### 5.3. Analytical construct #1: the evolution of the US financial sector

In this section, I explore my first analytical construct to show how the finance industry has evolved in the USA in the context of neoliberalism. I explain how powerful actors from this sector promoted radical redesigning of institutions and how its dominance has emerged under new institutional settings. The sequence of the analysis is important here since, as it is argued in this thesis, it is under financial deregulation and liberalisation of the neoliberal order that financialisation of the economy is made possible. Changes in variables, such as increased rate of profit, depressed levels of wages and higher rental incomes, constitute prerequisites for increased income inequality and the process of financialisation becomes the generative mechanism for initiating these changes.

Changes in the international arena triggered fundamental transformations in the post-war economic order, severely undermining the Bretton Woods monetary system, which facilitated settlement between international interests and domestic Keynesian-style income distribution. When monetarism became the ruling convention of the financial markets, the autonomy of the Federal Reserve and the state was undermined. They became the guardians of finance's interests and, "[c]onsequently, the formulation and execution of economic policy moved from the elected representatives of the public to the unelected representatives of financial capital" (Blyth, 2002: 171). In line with this argument, during the 1980s and 1990s, further financialisation of the US economy was fuelled when three successive neoliberal governments continued to implement monetarist and deregulation policies, as opposed to Keynesian economic strategies.[77] After the reappointment of Paul Volcker as Chairman of the Federal Reserve in 1983, another well-known monetarist Alan Greenspan was appointed to that position in 1987.[78]

In 1978-1979, the Federal Reserve, faced with a crisis of confidence in the dollar, tried to reregulate the Euromarket. However, the banking community had begun to lobby in the late 1970s for both domestic banking deregulation and retaining the Euromarket to free itself from the financial regulation established during the interwar period. As early as in 1975, with deregulation of the New York Stock Exchange, nonbanking institutions had been allowed to enter bank-related activities, thereby increasing competition between securities companies and banks.[79] As a result of neoliberal deregulatory lobbying in 1979, the Eurocurrency Market Control Act was rejected by Congress. Moreover, in 1981 the Federal Reserve permitted the

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[77] In 2010, Mary Shapiro, Chairwoman of the Securities and Exchange Commission (SEC), admitted that, "I think everybody a few years ago got caught up in the idea that the markets are self-correcting and self-disciplined, and that the people in Wall Street will do a better job protecting the financial system than the regulators would. I do think the SEC got diverted by that philosophy" (in Tomaskovic-Devey and Lin, 2011: 538).

[78] Alan Greenspan served as Chairman of the Federal Reserve of the United States from 1987 to 2006. An ardent convert to the libertarian philosophy of Ayn Rand, who supported *laissez-faire* capitalism, he was one of the main developers of the idea that inflation is caused by deficit in the 1970s. The easy-money policies of the Greenspan years are believed to be a leading cause of the dotcom bubble and subprime mortgage crisis.

[79] Domestic securities companies began to offer unregulated instruments, which were more attractive than banking deposits. Other non-banking companies, such as American Express, Sears and Roebuck, also entered bank-related business and used market rate of interest instruments, thus cutting the banks' market share (Helleiner, 1994).

establishment of tax- and regulation-free international banking facilities (IBFs) on US soil (ibid).[80]

The deregulation trend in finance sector was also supported by the judiciary system, when in 1978 the Supreme Court allowed credit card companies to charge interest rates in the states where they were chartered. South Dakota and Delaware, which did not have usury laws, became states where most of the credit card companies opened their business (Tomaskovic-Devey and Lin, 2011).

Campbell (2005) points out that in deregulating finance capital neoliberals attacked the banking competition regulation of the embedded liberalism era. First, Regulation Q, which established ceilings on bank deposit interest rates, was abolished in 1980 by the Depositary Institutions Deregulation and Monetary Control Act. In 1982, the Garn-St. Germain Depository Institutions Act passed by the Democrat controlled Congress further deregulated credit markets by dismantling the New Deal regulatory policies. Second, interstate bank branching regulation, as prescribed by the 1927 McFadden Act to ensure the availability of credit to small-scale local firms, was eliminated in 1994 by the Riegal-Neal Interstate Banking and Branching Efficiency Act. Third, the restriction on "universal banking" (prohibition for a single company to undertake both banking and commerce), which is allegedly still intact, has in fact been circumvented, because the car industry is allowed to provide credit services for purchasing automobiles.[81] Finally, the famous Glass-Steagall Act (Banking Act of 1933) of the New Deal years signed by President Roosevelt, which was aimed at separating commercial and investment banking, was repealed by the Gramm-Leach-Bliley Financial Services Modernisation Act, signed in 1999 by President Clinton. Some symptoms from easing those restrictions appeared in 1996, when the Federal Reserve under Greenspan allowed banking companies to own investment banks with up to 25% of their business in securities underwriting (Steger and Roy, 2010). Thus, one after the other, the key mechanisms of domestic finance capital control of the

[80] To make domestic financial markets and assets even more attractive for foreign capital, in 1984 the 30% withholding tax on interest payments to foreign holders of US bonds was abolished. In 1985, to attract the finances involved in Latin American capital flight, the purchase of US Treasury bonds by foreigners was allowed to be made anonymously (Helleiner, 1994).

[81] For instance, General Electric Capital has become a rentier corporation operating as one of the major financial institutions. In this regard, another important issue concerns the capital requirements for banks, securities brokers and other financial markets institutions, but which are not applicable to companies that act as financial institutions and are not otherwise registered (Dodd, 2005).

Keynesian legacy were removed, thereby paving the way for neoliberal financialisation institutions to become embedded in the socioeconomic fabric of the American political economy.

Neoliberal reforms during the so-called Reaganomics era were also responsible for the Savings and Loans Industry (S&L) deregulation, which was intended to make this relatively secure and prudent sector more competitive in pursuing new forms of finance and higher short-term profits (Steger and Roy, 2010).[82] These policies encouraged a series of leverage buyouts and mergers and acquisitions (M&A) which, in turn, led to "innovations" in the financial industry to fund corporate takeovers. New financial tools such as "junk bonds", derivatives, credit default swaps, and financial futures were "invented" and became popular with the emergence of computer-based mathematical models, which allegedly guaranteed low risk for speculators and stockholders.[83] During President Clinton's era, whose team included so-called "deficit hawks" with strong ties to Wall Street, was marked by tax cuts for capital gains investments made in securities and stocks, thus further paving the way to the Roaring Nineties and what Luttwak (1998) called "turbo-capitalism".[84] For instance, in 1998 alone tax relief for capital gains and estate taxes reached a massive $100 billion (ibid).

As a result of a policy environment that became skewed in favour of finance capital and the adoption of a neoliberal mode of governance characterised by extensive privatisations and attacks on welfare, labour rights, and environmental protection, the position of the financial sector fundamentally changed. Here, building on data from emerging literature on the rising importance of finance in the post-1980 US economy and its financialisation, I provide evidence of the rise to dominance of finance capital in the US economy.

In his thorough analysis of how the modern economy has enabled upward redistribution of income for the last forty years, Baker (2016) points out that the

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[82] As the result, in 1991 when the real estate bubble that had expanded in the 1980s, burst, hundreds of S&L collapsed charging a bailout price of well over 100 billion dollars (Steger and Roy, 2010).

[83] Well-known American investor Warren Buffett described one of the most alarming categories of financial instruments, namely derivatives, as "financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal" (quoted in Glyn, 2006: 200).

[84] Among others in President Clinton's administration, were Robert Rubin, who spent 26 years at Goldman Sachs before becoming Secretary of the Treasury and Lawrence Summers, who worked as a managing partner at the hedge fund D. E. Shaw & Co. as well as a freelance speaker at Goldman Sachs, JPMorgan Chase, Citigroup, Merrill Lynch and Lehman Brothers.

financial sector expanded from 4.5% of GDP in 1970 to 7.4% in 2015, whilst the securities and commodities trading sector rose from 0.49% of GDP to 2.3% within the same period, corresponding to an additional $290 billion spending in that year (ibid). As an example of the highest point of financialisation of American economy, the ratio of its financial assets (the sum of the debt securities, bank assets, and stock market capitalisation) to GDP was 445% in 2007, which was even higher than the ratio of global finance to global GDP, at 440%.[85] Similarly, in the international bond markets sales and purchases of United States Treasury bonds increased from 30$ billion in 1983 to 500$ billion in 1993, whilst trade in bonds and equities between foreigners and US residents rose from 3% to 9% of US GDP between 1970 and 1980, reaching 135% in 1993 (Eatwell and Taylor, 2000).

One of the approaches to financialisation is to view it as the transformation of the massive financial assets held by four groups in the American economy as a percentage of GDP over the 1950s-2000s (Dumenil and Levy, 2011). The first group (banking, insurance, savings institutions, and credit unions) grew from 107% of GDP in 1980 to 157% in 2009. The second group (pension and mutual funds) increased its share from 33% in 1980 to 149% in 1999 and to 156% in 2007. Both the third and the fourth groups, notably government-sponsored enterprises (GSEs) such as Fannie Mae and Freddie Mac and private-label issuers of asset-backed securities (ABSs), also demonstrated a steep upward trend, especially in the post-1980 period.

To conclude, in this section I have employed the first of my analytical constructs to elaborate upon the processes that enabled the financialisation of the US economy. In the sections that follow, I will utilise the other two analytical constructs to explain how financialisation contributes to rising income inequality. The financialisation-induced income inequality hypothesis will be tested via comparing increased profits in the financial sector with the wage share for labour and through demonstrating the contrast between the levels of rental income from financial assets and those of private debt.

[85] It should be acknowledged, however, that this ratio was even higher for Japan (547%), for the European Union (581%), and Ireland, with its astonishing 900% (Birch and Mykhnenko, 2010: 13).

**5.4. Analytical construct #2: dynamics in the financial sector profit rates and labour's share of income**

*5.4.1. Increased financial profits*

In the early 1980s, a combination of tight monetary policy, low inflation and high interest rates attracted an influx of foreign capital into the US, thus creating the conditions for rising profits of private financial institutions and institutional investors such as pension and hedge funds.[86] At the same time, under the shareholder value concept, a fundamental shift occurred in managerial behaviour, when finance-oriented CEOs began to focus on short-term increases in stock prices, instead of long-term planning for investment and innovation (Orhangazi, 2008). This drift towards financial profitability was reinforced by linking top-management compensation to stock options (Stockhammer, 2004; Dobbin and Zorn, 2005; Davis, 2009). These institutional changes both furthered financialisation and accelerated income shifts into the expanded financial sector.

In a seminal study on the financialisation of the US economy, Krippner (2005: 185) found a "dramatic divergence in the structure of the economy between the immediate post-war period and the period beginning in the 1970s". The post-1980s pattern of increased income accumulation through financialisation corresponds to the account that "profit-making occurs increasingly through financial channels rather than through trade and commodity production" (ibid: 181). The group industry defined as FIRE (finance, insurance and real estate) took the dominant position after 1980, increasing its share of corporate profits from less than 20% of the US economy to more than 30% by the early 1990s and reaching more than 40% by the 2000s. A higher share of profits coming from financial relative to non-financial sources of revenue among non-financial firms was witnessed throughout the 1980s compared with the 1950s and 1960s, which is "consistent with a greater degree of financialisation" (ibid: 184).

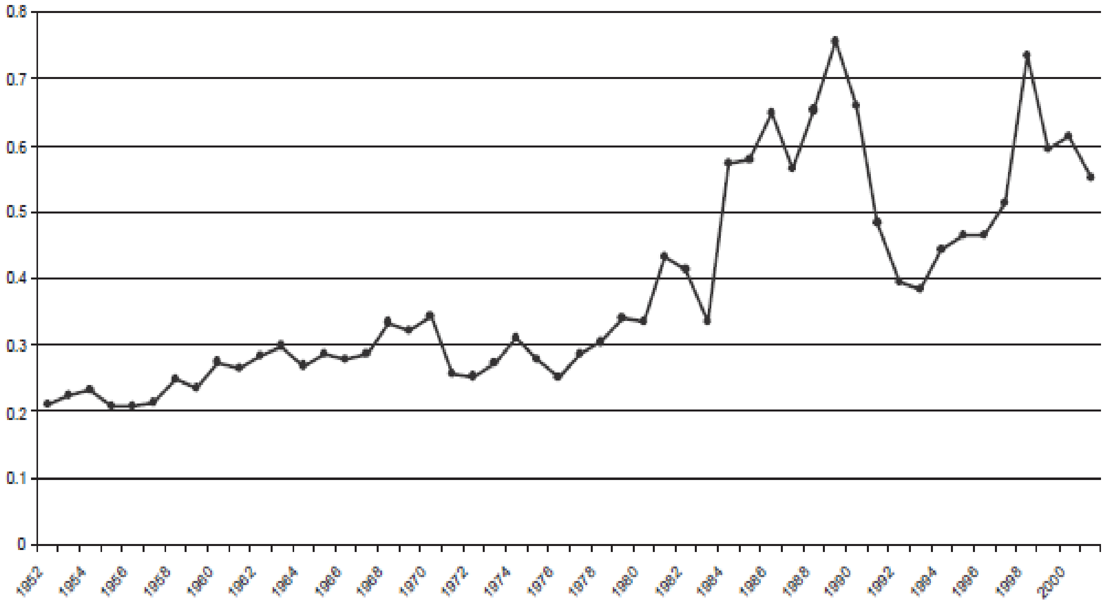
Crotty (2003; 2009b) points to the increasing amount of profit extracted from the US non-financial corporations (NFC) by finance capital, emphasising its changing nature, which shifted from the "patient" character of the post-war Golden Age of modern capitalism seeking long-term growth to an "impatient" one. Figure 5.5 shows

[86] The evidence shows that by 2008 up to 43% of all capital imports in the world were attracted by the US markets (Tomaskovic-Devey and Lin, 2011).

total NFC payments (the amount of net interest, dividends, and net stock purchases) to financial markets, which rose from relatively low levels in the 1950s to about 30% of cash flow in the mid-1960s through to the late 1970s. From 1984 to 2000, the NFC's payments were more than 50% of their cash flow and this ratio never fell below 50% from 1984 to 1990 and from 1997 to 2001. Moreover, it reached 76% and 74% in 1989 and 1998, respectively, evidencing the growing institutional influence and power of finance capital, under which the NFC have to disgorge the lion's share of their cash flow to financial agents.

As the result of this fuelled rise of profits in financial industry employee earnings in the FIRE group has soared dramatically since 1980. The average compensation in the financial sector was 60% higher than the national average by 2000 (Tomaskovic-Devey and Lin, 2011: 540). FIRE industry employees earned per week \$6,891, nationally and \$16,918 in Manhattan (New York), whilst the national average was \$884 per week (ibid: 549). It could be argued that the most highly compensated individuals are employees of Wall Street (hedge, private equity, and mutual fund investors and investment bankers) (Piketty, 2014; Flaherty, 2015). In support of this perspective, a study carried out by Rauh and Kaplan (2010) shows that Wall Street employees encompass a higher proportion of the very highest end of income brackets (0.0001%) than executives from nonfinancial public companies. Regarding which, in 2004, nine times as many hedge funds and other investors received in excess of \$100 million as other industries' executives. In 2004, there were twenty-five top hedge fund CEOs and in 2007, just five of the top hedge fund executives "earned" more than all five hundred S&P 500 CEOs in their combined income. Converted into currency, this means that these individuals received a combined total of \$5.2 billion in 2003, \$6.3 billion in 2004, and almost \$9 billion in 2005. Fees for managing financial assets, particularly in mutual funds, increased from \$1.3 billion in 1980 to \$31.1 billion in 1995 and to \$67.9 billion in 2004 (ibid: 1033). On average, from 1994 to 2004, a top Wall Street managing director rarely earned less than \$500,000 and at least one quarter of them earned in excess of \$2.5 million per year (ibid: 1018). All these findings support the notion that in the post-1980 financialisation era there has been a rising share of profits claimed by finance capital, both expressed as the increased share of finance in the national economy and according to the rising earnings of financial agents.

**Figure 5.5. Total payments to financial markets by the NFC as a percentage of cash flow**




Source: Crotty (2003: 278)

### *5.4.2. Decreased labour income share*

In the case of labour's share in national income, a reverse trend has been observed, which is well documented by a variety of studies on OECD countries (Kristal, 2010; Peters, 2011; Hein, 2015; Dunhaupt, 2017).[87] The ten-year average wage share as percentage of national income rose in the US by four points between 1950s and 1970s, reaching 75% in 1950s and 79% in 1970s (Atkinson, 2014: 69).[88] This rise was subsequently reversed and from the 1970s to the 2000s, the labour share dropped to the level of the 1950s. Explaining this capital-labour substitution, Piketty points out that "capital's share of income increased in most rich countries between 1970 and 2010 to the extent that the capital/income ratio increased" (2014: 221). This fact is also reflected in the evolution of minimum wage policy, which used to play a crucial role in reducing wage inequalities.[89] The federal minimum wage did not change from 1980 to 1990 and at the level of $3.35 an hour had a decreased purchasing power, if compared with 1969, when at the level of $1.60 it reached the

[87] The terms "labour share" and "wage share" are used interchangeably.

[88] To compare with other OECD members, within the period of the 1950s and the 1960s, labour share increased in Austria, Canada, and Denmark by 5 points; in Finland and Ireland by 6 points; in Belgium and the Netherlands by 7 points; and in Norway and Sweden by more than 10 points (Heidensohn, 1969).

[89] A federal minimum wage was introduced in the USA in 1933 as part of the National Industrial Recovery Act under Roosevelt's New Deal policies.

maximum level of purchasing power. In the 1990s, the federal minimum wage rose to $5.25 and stayed frozen until it was increased in 2013 to $7.25, a third below the French minimum wage, which used to be lower than in the US in the early 1980s (Piketty, 2014: 309).

The downward trend in the share of labour is also evident from a study by Jacobson and Occhino (2012), who argue that labour's share declined in favour of capital income between 1987 and 2007. Using various data sources, they show that a drop of 3% to 8% in wage share occurred since the early 1980s, with an accelerating trend during the 2000s. For instance, labour's income share stood at around 67% between the 1980s and the 2000s, but then declined to reach 63.8% by 2010. The drop is more significant according to income tax returns: from 75% in 1979 to 67% in 2007 (ibid).

Data from several studies suggest that the dynamics of labour's share in national income correlates with the working class's bargaining power (i.e. unionisation, strike activity), which declined persistently post-1980 (Wallace, Leicht, and Raffalovich, 1999; Blanchard and Giavazzi, 2003; Kristal, 2010; Peters, 2011). In most industrialised countries labour's share declined, on average, from 73% in 1980 to 64% in 2006 (Kristal, 2010: 733). Moreover, in the context of low union density, real wages grew, on average, only 0.2% between 1979 and 1995 for the American working-class, while it even fell by 9.8% for the bottom 60% of the labour force. Since 2001, real wage growth further declined to -0.5%, reflecting the overall decline in wage share from 72.8% in 1980 to 63.5% in 2005 (Peters, 2011: 91).

Thus far, as I have argued in this section that there is a direct link between the finance-dominated era of the post-1980s and the decline in labour's share of income in the same period and hence, the effect of financialisation on income inequality, as supported by other studies (Flaherty, 2015; Hein, 2015; Dunhaupt, 2017). It is important to highlight that the fall in labour's income share contributes to increased income inequality, since the former is more evenly distributed among American households than capital income and thus, this fall makes total income less equally distributed and more concentrated in the upper level of the distribution scale (Jacobson and Occhino, 2012). As has been estimated, a 1% decline in the wage share increases the Gini index by 0.15% to 0.33%. Thus, the 3% to 8% decline that labour share has experienced since the 1980s may be translated into an increase of the Gini index of up to 2.5% in the US (ibid).

## 5.5. Analytical construct #3: rental income from financial assets and private debt

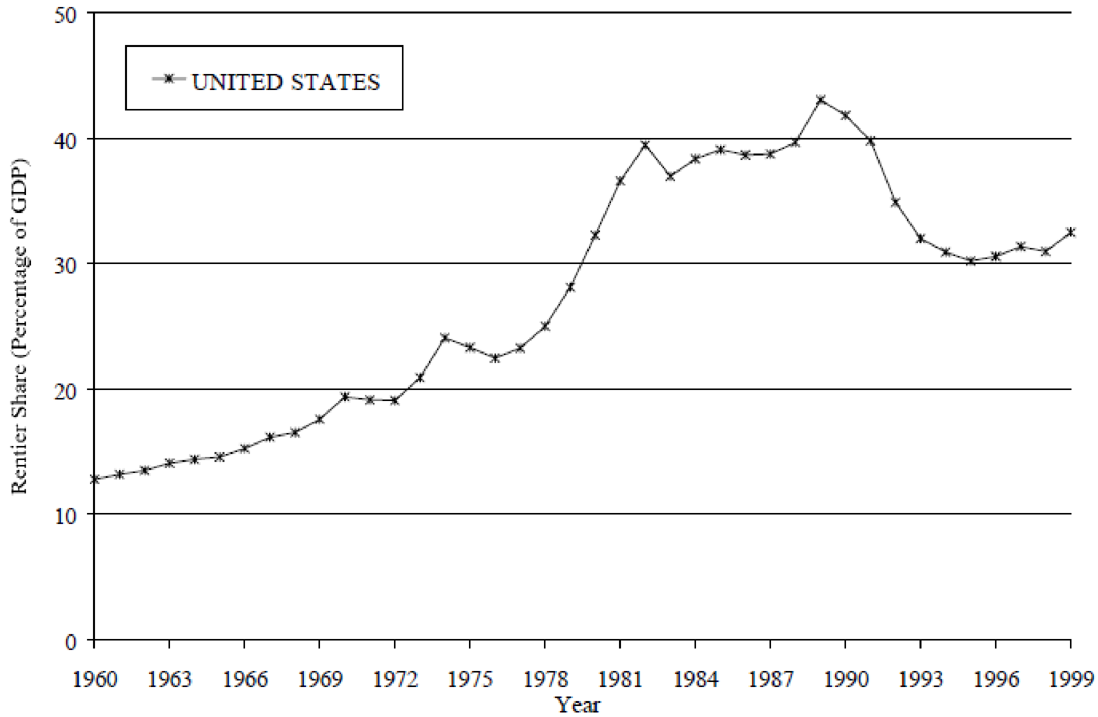
### *5.5.1. Rising rental income*

Several reports have shown that the rentier share of national income increased significantly in the US from the early 1980s onwards, constituting a sizable fraction of its private sector GDP (Power *et al.*, 2003; Epstein and Jayadev, 2005; Duenhaupt, 2012). For example, the average decade rentier income share increased from 22.47% of GDP in the 1970s to 38.26% in the 1980s and declined to 33.49% in the 1990s, which was still higher than in the 1970s. It is a much larger proportion of GDP, when compared with profits in the corporate non-financial sector, which rose from 10.65% of GDP to 12.18% within the same period. This is a 92.4% change in rentier share over the period 1960s-1970s and 1980s-1990s which radically outstrips miserable 0.89% change in the non-financial sector profit share (Power *et al.*, 2003: 6). The rentier share peaked in 1989 (more than 40% of GDP) and by the late 1990s had declined to the level it had been in the late 1970s (Figure 5.6). Rentier income grew even larger through the 1980s and the 1990s, when capital gains on financial assets are included: from the decade average of 58.94% in the 1980s to 59.19% in the 1990s (ibid: 51). This indicates the growing importance of capital gains on financial assets and that owners of those assets benefitted from the neoliberal financialisation regime.

These findings are in accord with another study reporting an increased financial rent share in national income. Tomaskovic-Devey and Lin (2011) found that from 1980 to 2008 between $5.8 and $6.6 trillion 2011 dollars were shifted into the finance sector as profits and employee compensation.[90] About half of this income transfer occurred after 2000 and 65% of it was taken by banks and banking holding companies. Before 1980, rents in the finance sector as a percentage of all profits in the economy, were either flat (as in insurance, securities, and real estate) or just growing slowly (as in banking business). From 1980 onwards, bank and insurance rents grew 300% to 400% and slightly less than 100%, respectively, over the next 38 years. Other FIRE industries (securities, investment banks, hedge and mutual funds) demonstrated growth in income after 2000.

[90] $6.6 trillion equals 73% of cumulative US federal debt in 2010 or about 13% of all increased income in the private sector between 1980 and 2008 (Tomaskovic-Devey and Lin, 2011: 553).

**Figure 5.6. Rentier income share in the USA, 1960-1999**




Source: Power, *et al*. (2003: 7)

In this subsection, one of the key aspects of the conceptual framework this thesis is rested upon, i.e. growing rental income accruing from financial assets, has been examined. The results shown suggest an association between neoliberal financialisation and a profound distributional shift to the benefit of the owners of the financial assets since the late 1970s. The post-Bretton Woods era of rentier capitalism has constructed a neoliberal framework of liberalised and deregulated financial institutions that enable the ruling class to maximise its income at the expanse of the rest (Standing, 2016). In line with this logic, in the subsection that follows, it will be argued that neoliberal financialisation is also responsible for the rising level of household debt.

*5.5.2. The level of household debt*

Rising household debt levels in the US are a significant economic and social trend of the financialisation regime (Montgomerie, 2007, 2009; Froud et al., 2010; Kim, 2013; Federici, 2014).[91] It is an inherent outcome of a system where finance is unleashed to ensure upward capital accumulation at the expanse of the ever diminishing incomes of the majority.

Household debt, as a share of GDP, increased from about 50% in 1980 to nearly 100% in 2006 (Kim, 2013: 676). This indicates a rise in the debt service burden, which is measured by household financial obligations and household debt service payments, both as a percent of disposable personal income. Both indicators show an upward trend: from 1980 to 2009 debt service and financial obligation ratios grew from about 11% to more than 13% and from 16% to more than 18%, respectively (ibid: 677). The mounting indebtedness of American households is also verified, if depicted as mortgage and consumer debt. The transformation is especially pronounced from the mid-1990s onwards, when mortgage debt reached almost $9.7 trillion in 2007 (73% of GDP) from $926 billion in 1980 (33% of GDP), whilst consumer debt jumped from an average 13% in the 1980s to almost 19% of nominal GDP in the 2000s (Montgomerie, 2007: 4, 6, 22).

Indebtedness as part of financialisation, is facilitated through "financial innovations", which extend and promote the consumer credit industry. For instance, it is claimed that the credit card industry is the most profitable financial service in the US, with more than $24 billion of after-tax profits in 2004 alone, a 50% increase from 2003 (Montgomerie, 2006: 301). As the result of the so called "democratisation of finance" through financialisation of personal income, profit-seeking retail banking has been able to conduct financial expropriation, i.e. extract profit out of personal income (Lapavitsas, 2009). Thus, when mortgage-lending became sated, borrowers from the poorest strata of the US working class became the targets of financial rentiers, who came up with subprime-mortgage lending. Low-income earners were offered such financial loans as Adjustable Rate Mortgage (ARM), which rose to $4.3 trillion just for the two years of 2004-2006 (ibid: 117).

By the same token, rising level of the household debt reflects another aspect of financialisation, i.e. a decline in personal savings. The latter declined from 9-10% of disposable income in the early 1980s to a staggering 0.4% in 2007, which is

[91] Household debt in this thesis comprises mortgage (or secured) and consumer debts, where the former is tied to an underlying asset and the latter covers cash loans or credit for assets with limited recuperative value (e.g. cars) (Montgomerie, 2007: 4).

extraordinary for the richest nation in the world (ibid: 118). In order to disguise the problem of declining incomes and widening economic disparity, a right-wing domestic political agenda successfully exploited the rhetorics of “individual emancipation”, “democratisation of finance” and “ownership society” to make credit available for the impoverished working class (Froud et al., 2010).[92] However, retail finance as “social innovation” is motivated by profit maximisation and is not aimed at resolving the socioeconomic needs of the middle-class. Hence, it takes advantage of the worsening economic position of the low-income individuals by providing them with “innovative” and “democratised” financial tools, which actually further indebt them. As a result of the financialisation of personal income and in accordance with the rent-seeking maximisation logic justifying the policy of credit availability, low- and middle-income individuals with ever stagnating wages are prone to increase their credit dependence (Froud et al., 2010). According to some estimates, non-revolving debt reached $1.54 trillion in 2006 composing the largest part of consumer debt outstanding; revolving debt was $886 billion in the same year and had been growing constantly since the mid-1990s (Montgomerie (2007: 7).[93] In 2008, unsecured credit reached $2.5 trillion, having steadily increased since the 1980s. There was an increase in personal consumption expenditure (PCE) from 20% in 1989 to 25% in 2008. This is a remarkable upsurge since PCE is the largest share of total US GDP. In comparison to all gross domestic investment, which was 16.5% of GDP in 1989, PCE was 65.5% of GDP in the same year. It grew to 70.5% of GDP in 2008, whereas gross domestic investment dropped to 15.5%, thus indicating consumption growth fuelled by a debt-led increase the same year as private investment declined (Montgomerie, 2009: 9).

In sum, credit in the neoliberal mode of governance is the *faux ami* of the middle-class, for it makes household debt expropriate income through interest payments and thus, diminishes living standards, thereby amplifying economic disparity. Regarding which, Scott and Pressman (2013) estimated income inequality

[92] Chairman of the Federal Reserve, Alan Greenspan, who was an influential advocate of this policy, claimed that, “Improved access to credit for consumers… has had significant benefits. Unquestionably, innovation and deregulation have vastly expanded credit availability to virtually all income classes. Access to credit has enabled families to purchase homes, deal with emergencies, and obtain goods and services… Credit cards and instalment loans are also available to the vast majority of households” (Greenspan, 2005 in Froud et al., 2010: 148).

[93] Both revolving and non-revolving credit are classified as consumer debt. The former mostly includes credit card loans, whilst the latter is composed of loans for cars, education, boats, trailers, and/or vacations, and may be secured or unsecured (Montgomerie, 2007).

before and after subtracting interest payments on consumption debt. They found that after borrowing, more and more household income had to be diverted to repay debt, with interest payments increasing significantly in the 1980s and 2000s. On average, household consumption debt interest payments increased from $400 in 1983 to $1,686 in 2007 and stabilised at $1,571 in 2010. The size of the middle-class decreased from 30.8% in 1983 to 26.7% in 2010 (13% reduction). Interestingly, however, when interest payments subtracted from income are taken into account, the number of middle-class families was reduced to 25.7% (16% reduction) (ibid: 330). Similarly, the effect of lost income from interest payments is observed in Gini coefficient changes: from 0.459 in 1983 to 0.618 in 2001 and 0.579 in 2010 (without subtracting interest payments from income) compared with 0.459 in 1983 to 0.622 in 2001 (0.60% change) and 0.585 in 2010 (1.02% change) (subtracting interest payments from income) (ibid: 328).

### 5.6. Conclusion

The case on the US provides a context through which one can understand the logic of the financialisation induced-income inequality hypothesis. The evidence presented confirms the association between the increased power of finance capital and rising income inequality. The neoliberal restructuring assault played an important role in the replacement of Keynesian welfare state institutions by the dominant finance capital. Initially conceived in a chaotic and disorganised manner, neoliberal ideology and its project became a dominant dogma by the 1980s. In this regard, it has been demonstrated how neoliberal ideology and policies were articulated and pushed for the ascendancy of financial interests in the USA. Combined and reinforcing each other, the neoliberal agenda and its liberalisation/deregulation policies created and ensured the preconditions for the financialisation of the US economy, where finance is favoured and promoted.

The dismantling of the Bretton Woods monetary system, which had restricted international and domestic finance, helped neoliberals to end the post-war compromise between international interests and the agreement of elites to protect the welfare state and its redistributive mechanisms. On the one hand, with the abolishment of capital controls in 1974 and establishment of IBFs in 1981, which were designed to capture offshore Euromarket business, the US became able to secure its hegemonic interests through financing its fiscal deficit by huge foreign private capital inflows.[94] On the other, the new right-wing economic policy encouraged and fuelled liberalisation and deregulation of finance capital to create the institutional preconditions for financialisation. High interest rates, for instance, originating from a mixture of loose fiscal and monetary policy together with very liquid US financial markets, further contributed to the attractiveness of the US financial and assets markets and New York's dominant position as a major financial centre.

This shift in income distribution benefitted the financial sector, which captured a greater share of national income. Weakened bargaining power of organised labour in the US is reflected in redistributional pattern of national income after 1980. A new stratum of the working rich concentrated in and around the Wall Street has been created since the 1980s at the expanse of labour's share. Neoliberalism has encouraged financial innovation to generate constant income streams through such mechanisms as, for instance, debt and securitisation.

In this chapter, I have also demonstrated the relation of debt and financial rent to the first two analytical constructs as well as how the conjunction of debt and widening disparities of income creates a vicious circle. Whereas deregulation/liberalisation policies create more opportunities for finance profits and rents to grow, stagnating real wages of the American middle-class has expanded the gap between the rich and the poor, causing household debt to escalate to cover the necessities of life (e.g. living, education, consumption). Servicing this debt further decreases gross household income, which raises income inequality even higher.

The chapter has shown the genealogy of financialisation, where neoliberal political agenda unites class interests with a set of neoclassical economics concepts and some libertarian values and beliefs in order to set an upward income distribution. In the chapters that follow, it will be shown to what extent the financialisation-induced income inequality logic is applicable to other country cases.

[94] In fact, some estimates show that by 1985 inflows of private foreign capital financed up to 50% of the US budget deficit, which kept interest rates as much as 5% lower than they otherwise would have been (Helleiner, 1994).

# Chapter 6. South Korea: transforming national model

*"In a depression, assets return to their rightful owners"* (Andrew Mellon in Wade, 1998: 1547).[95]

## 6.1. Introduction: domestic and global political economy context

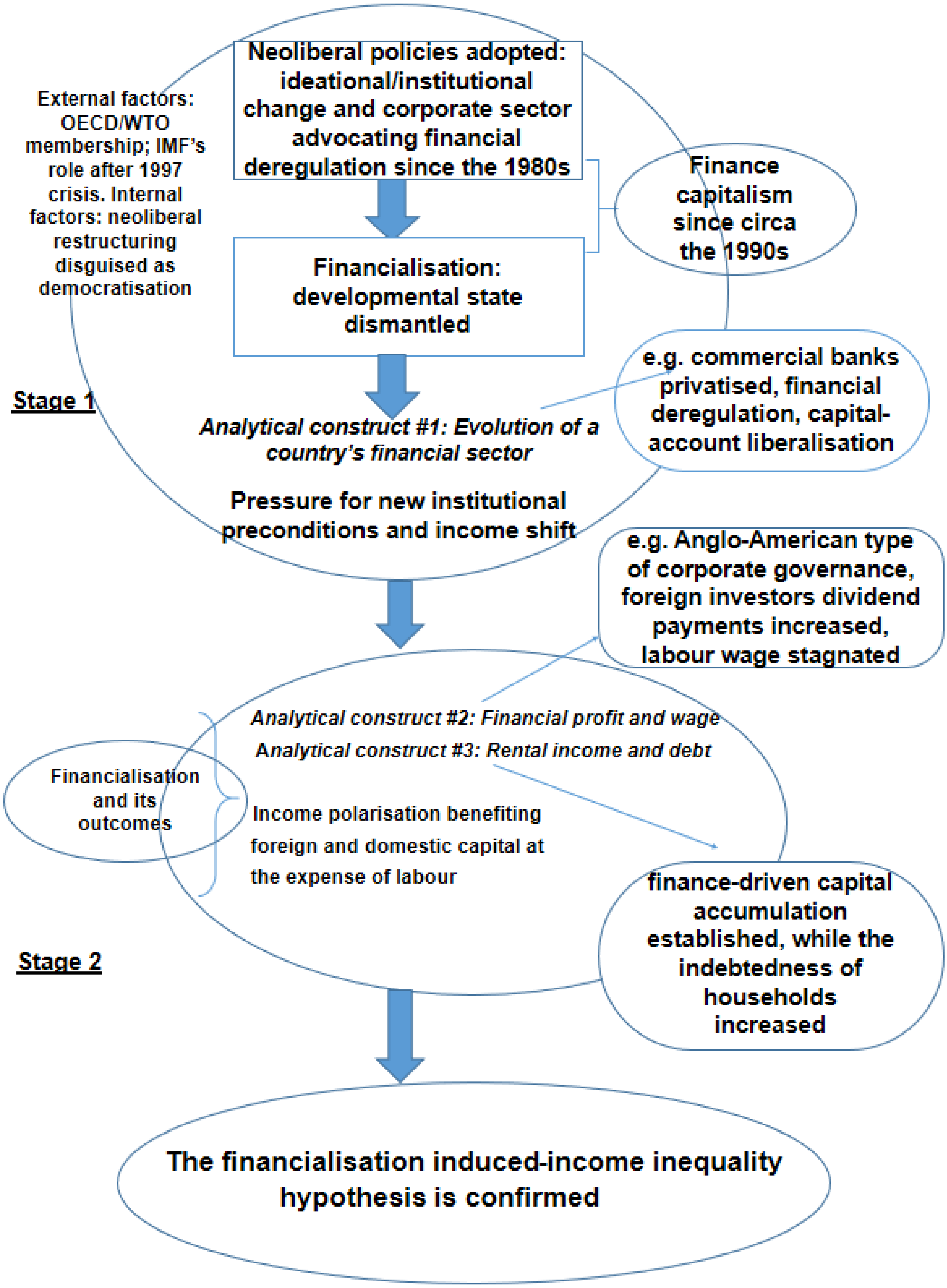
The main aim of this chapter is to show how neoliberal financialisation in South Korea affected the income distribution patterns.[96] It will be demonstrated that neoliberal reforms promoted an Anglo-Saxon model of capitalism causing financialisation of its economy, which, in turn, led to increased income inequality (Figure 6.1). After a brief historical sketch of the developmental model, an overview of the national and international context will be provided in this section, which constitutes an important narrative of the research. In the case of Korea an explanation includes how its developmental regime and "restrictive financial" order had been developing in the period before market-oriented reforms began. It will be pointed out that in addition to the capital accumulation problems faced by the ruling elite, the Asian developmental regime was confronted by the changes brought about by the post-Bretton Woods financial order.[97] A description of the neoliberal restructuring in Korea will be provided in the next section with more details on the two stages of this reform, namely, the *internally-induced* and *externally-imposed* aspects.

[95] Andrew Mellon was an American banker and US Treasury Secretary in 1921-1932.

[96] Throughout the text "Korea" refers to South Korea and/or its government.

[97] The term "developmental state" was first coined by Chalmers Johnson (1982) in his seminal study to describe the fast-industrialising strategies of Japan and then, by other scholars in the East Asian context. A full exposition of the developmental model concept is beyond the scope of this study. For a more thorough analysis, see Deyo (1987), Haggard (1990), Chang (1994), Evans (1995), and Woo-Cumings (1999).

**Figure 6.1. The analytical framework of the financialisation-induced income inequality nexus in South Korea**




Source: researcher

The shift from the developmental mode to neoliberal-led capitalism in Korea was largely brought about by the confluence of several factors. First, beginning from the late 1970s onwards, there was a decline of profit in Korea with a negative effect for its corporate sector, which tried to sustain a high level of investment to stay competitive. Second, political liberalisation that started in the late 1980s was associated with the neoliberal ideology, with its financial liberalisation intertwined in the logic of the "structural power" of the USA. Finally, the global agenda of open financial markets promoted by the IMF in the aftermath of the 1997 Asian financial crisis matched with the interests of domestic big business, which in turn, were in line with the interests of the transnational capitalist class interested in new financial markets and ownership transfer. This combination of factors led to radical neoliberal restructuring in Korea, including financial liberalisation and the establishment of new corporate governance modes, such as "shareholder value orientation". As the next sections demonstrate, subsequent financialisation changed Korean distributional patterns, with adverse effects on wages and household debt, whilst there were positive outcomes for profits and rents.

In line with the developmental state regime, the Korean government played a crucial role in industrialisation and its astonishing economic growth within the institutional framework of the "state-banks-chaebols" (family-owned conglomerates) (Amsden, 1989; Wade, 1990; Chang, 1996; Kim, 2010). Following the Japanese post-war growth and industrial promotion model, Korean bureaucracy launched active interventionist policies in terms of coordinating investments and technological upgrading, infant industry protection and export subsidies, regulation of firm entry and exit as well as pricing intended to "manage competition". Five-year plans were initiated in 1962 to achieve high growth rates through export-led industrialisation by developing light, labour-intensive industries aimed at overcoming a lack of natural resources and a small domestic market (Yul 1997:16). During the 1970s, under the Park and later, under the Chun government, Korea turned towards heavy and chemical industries, which led to a rapidly increasing manufacturing exports and GDP growth (ibid.). As a prerequisite of the developmental regime, the financial sector as well as capital inflow and outflow were under tight control. Commercial banks were not allowed to pursue solely profit-seeking, but rather, had to engage in supporting industrial investment (Kalinowski and Cho, 2009). State-led industrialisation and extensive intervention in the financial markets transformed Korea from a low-value and low-skill economy to a high-value and capital intensive one, where real GDP growth averaged 8% a year and real wages rose, on average, by 7% annually (Crotty and Lee, 2005). This was followed by remarkable improvements in income and social indicators (Chang, 2003c). In fact, per capita income increased in Korea from under $100 in the late 1950s to over $10,000 in 1996 (Park and Mah, 2011: 249).

This interpretation contrasts to that of Deyo (1989) and Kim (2010), who argued that the Korean economic miracle was possible due to the repression of labour and independent unions during military rule. Having said this, it should be stressed that Korean workers were better off economically than their Latin American counterparts, who in the 1950s-1970s also practised some developmental strategies, such as import substitution industrialisation (Soederberg, 2004). The real wages of the former nearly tripled between 1970 and 1984 compared with those in, for instance, Brazil where they declined and Argentina, where they grew only by 12% over the same period (Thomson, 1994).

Before proceeding to examine the neoliberalisation of the Korean economy, it is important to outline briefly two interlinked and mutually reinforcing aspects as sets of explanations. An important dimension that needs to be taken into account in exploring how Korea turned to the neoliberal mode of income distribution concerns the global political economy context. During the so-called Golden Age of modern capitalism (from World War II to the early 1970s), political consensus in favour of Keynesian demand management "allowed" Korea and other "Tigers" (Japan, Singapore, Taiwan, and Hong Kong) to pursue their developmental strategies in ways that did not pose an immediate threat to Western markets, especially the USA (Crotty and Dymski, 1998). In the wake of the Cold War, the lattermost had been actually interested in Korean economic success and provided grants and technologies to the country during and in the aftermath of the wars in Vietnam and on the Korean Peninsula. Crucially, financial capital was operating under the restrictive Bretton Woods regime throughout that period, thus providing additional justification for the Korean government's intervention in domestic financial markets. In line with this argument and as discussed in Chapter 2, once the US faced current account and fiscal deficits in the 1970s and competitive pressure from the rising East Asian economies, its international economic policy was reassessed. The neoliberal policies that predominated in the US began to confront the interventionist and restrictive financial policies of Korea and other economies to ensure market access for US financial institutions, which had become revenue sources for the American current account (Wade, 1998; 2000). In this regard, the IMF became the key intermediary in representing the Wall Street-Federal Reserve's complex interests and imposing Washington's imperatives, such as free capital mobility on other countries, thus securing US hegemonic power and transnational capital's income. This approach constitutes an *externally-imposed* explanation of the Korean turn to neoliberalism in this study.

The second important dimension for understanding the policy u-turn regarding the abandoning of the developmental model in favour of the free market and adherence to neoliberal policies by the Korean ruling elite lies within an *internally-induced* explanation. According to this perspective, neoliberal restructuring in Korea was instigated by democratisation that started in the late 1980s and was furthered by the financial crisis of 1997 (Crotty and Lee, 2005; Hyun-Chin and Jin-Ho, 2006; Kim, 2010). Close to this argument, is Thurbon (2003: 358), who employed an ideational framework, defined as economic policy makers' beliefs, which the author claimed put at the centre of Korea's shift to financial liberalisation "the ascendancy of new ideas about the appropriate scope, goal and methods of government intervention in the economy amongst powerful segments of the policy-making elite". In the following subsections, I describe in greater detail these two approaches of the Korean neoliberal turn and how they affected income inequality.

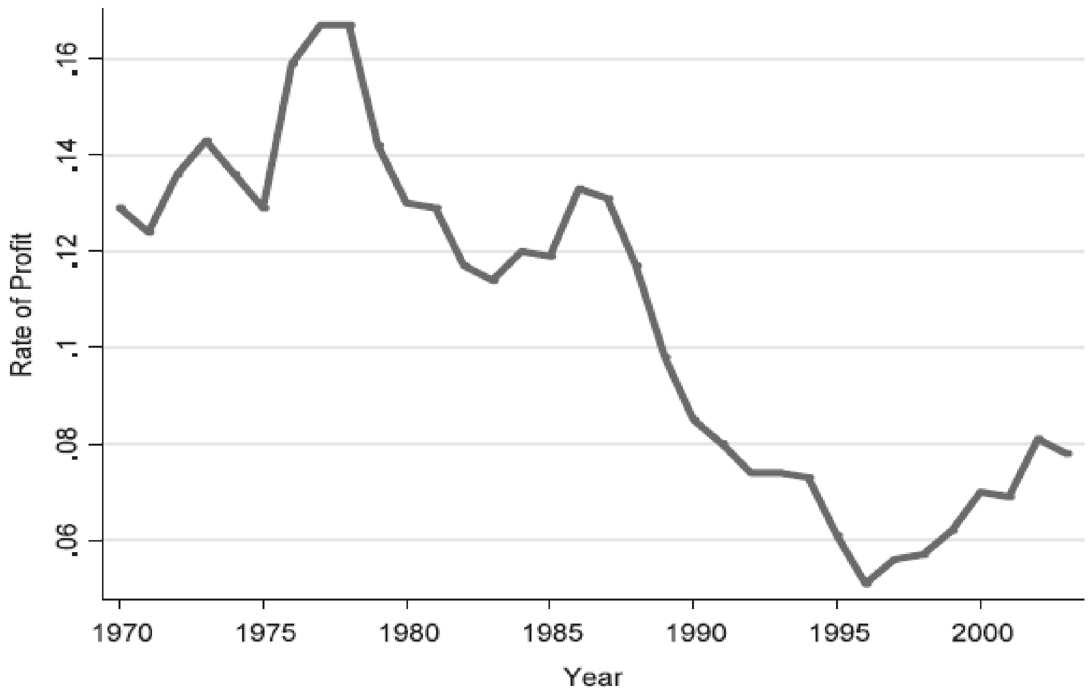
## 6.2. From developmentalism to neoliberalism and rising income inequality

### *6.2.1. The first stage of the neoliberal turn: decline of profit and democratisation*

From the vantage point of Marxian political economy, beneath the neoliberal restructuring of Korea were the same structural problems that advanced capitalist countries faced from the late 1960s to the early 1980s. That is, by the late 1970s the nation had experienced inflationary pressure, two major debt crises, and industrial overcapacity, all of which, undermined support for the regulatory mechanisms of the interventionist financial policies amongst the policy-making bureaucracy (Thurbon, 2003). In fact, by the mid-1980s the country no longer enjoyed rapid economic growth, which intensified the crisis of capital accumulation. For instance, Figure 6.2 reveals that there was a steady decline in the rate of profit in the non-farming business sector over the 30-year period (Kim, 2010). In light of diminishing profits, the corporate sector began to advocate business and domestic financial market deregulation long before the 1997 crises (Crotty and Dymski, 1998; Lim and Jang, 2006). In the same vein, Palma (2003a) argues that because of the declining profitability, caused largely by the collapse of prices for micro-electronics, the main export product of the chaebols, they were eager to switch to external financing to sustain their high level of investment. This is one of the main characteristics and prerequisites of the export-oriented developmental mode to remain competitive in the global markets. As Kim (2010: 11) maintains,

> "The developmental state sowed the seeds of its own destruction. To prevent further decline in the profit rate, the South Korean capitalist system needed to transform itself into a new organisation in the political economy. With strong support from the "US Treasury/Wall Street/IMF complex" (in Harvey's apt phrase), the Korean state and the chaebols adopted typical neoliberal policies step by step".

**Figure 6.2. Rate of profit in the non-farm business sector in Korea, 1970-2003**




Source: Kim (2010: 11)

Meanwhile, 41 years of authoritarian regime in Korea was ended by the June Democracy Movement of 1987 and the subsequent democratic transition, when the first civilian government since the early 1960s headed by Kim Young-Sam (1993-1998) came to power and launched what Kim (2010) describes as "simultaneous transitions", democratisation and neoliberalisation. However, the first steps towards ideational and institutional changes in the developmental state order were made in the late 1970s by the authoritarian Park-Chung Hee government and the two subsequent non-democratic regimes of Chun Doo Hwan (1980-1987) and Roh Tae Woo (1987-1993), which flirted with reconsidering traditional financial policy (Thurbon, 2003). Emerging in the context of declining profits and a crisis of capital accumulation in the late 1970s, were debates about financial liberalisation, which marked tensions between the market-oriented Economic Planning Board (EPB) and the conservative ministries of finance (MOF) and commerce and industry (MCI) (ibid). From 1978 onwards, the EPB tried to shift economic policy priorities from growth to stability and advocated reducing state intervention and reforming the financial sector by liberalising it.

As mentioned earlier, a number of studies investigating the Korean neoliberal restructuring reported that, ironically, it was democratic civilian governments that dismantled "Korea Inc." and launched a decisive move towards neoliberalism (Lim and Jang, 2006; Hyun-Chin and Jin-Ho, 2006). Kim Young-Sam's government initiated bold reforms to depart from the authoritarian past and to build a "New Korea". To "cure" the country from the "Korean disease" the globalisation drive was employed, where *seguehwa* (globalisation) pertained to a new national development strategy to reform almost all areas, including the economy, politics, finance, welfare, and labour (Hyun-Chin and Jin-Ho, 2006).

In May 1994, the first stage of the globalisation drive was introduced as *kukjehwa* (internationalisation) and later on, in November 1994, the second, as *seguehwa*. The need for internationalisation was justified as "an inevitable process which every nation must undergo to ensure sustained stability and prosperity" by "trying to induce foreign investment, *liberalising its financial market* and preparing to join the OECD" (Gills and Gills, 2000: 36-37; emphasis added). Globalisation, in this regard, was considered as "rationalising all aspects of life" and "a sweeping transformation of society", which required "productivity and flexibility" for the country to flourish (ibid: 38). Under the rhetoric of development policy, the first democratically elected administration introduced new market-based approaches and practices, thus altering Korea's traditional state-managed model.[98] This neoliberal shift was, in fact, a

[98] In one of his speeches, President Kim Young-Sam stressed, that "Globalisation is the shortcut that will lead us to building a first-class country in the 21st century. This is why I revealed my plan for globalisation […] It is aimed at realising globalisation in all sectors - politics, foreign affairs, economy, society, education, culture and sports.

continuation of the ideational battles about the role of the state that were associated with previous governments and their flirting with attempts to liberalise finance in the early 1980s (Thurbon, 2003). This time, however, those attempts coincided with the idea of the globalisation of production promoted by chaebols (Shin and Chang, 2003). Eventually, it was Korea's entry into the OECD, as its 29th member, that expedited financial liberalisation, one of the main conditions for entering the organisation. The country *had* to accept the national treatment principles, such as special codes and develop a financial reform programme (Kwon, 2004). OECD accession and *its prerequisite, financial liberalisation*, were considered by President Kim as the main cornerstones of transforming the interventionist state into a more market-friendly oriented one (Thurbon, 2003: 352). As such, the accession not only symbolised Korea's new status of being a developed country, but also signified the shift from the developmental state-orchestrated model to a financial opening of a *laissez-faire* one.

It is important to mention here the external "carrot and stick" policy and free-market ideological dominance on the global scale that began to play a considerable role in Korea's governments' endorsement of the neoliberal reform agenda. For instance, already in the early 1990s, the bilateral US-Korea Financial Policy Discussion Talks began to schedule market opening (ibid). By that time, neoliberal ideology was dominant on a worldwide scale following the collapse of the Soviet Union in 1991. Accordingly, the new buzzword of the 1990s "globalisation" was interpreted in the hegemonic political and policy discourse in Korea at the time, as an inevitable and beneficial economic phenomenon driven by a free market and cutting-edge technologies. The neoliberal agenda was viewed from this globalist vantage point, as articulated by world leaders, such as US President Clinton, transnational corporations' executives, mainstream academia, cultural elites, corporate lobbyists and think-tanks (Steger and Roy, 2010). This influential ideological narrative, encouraged by the global power elites, penetrated Korean society and furthered the shift away from the developmental towards the neoliberal model of economic policy. Following the creation of the WTO in 1995, the Kim Young-Sam government joined the organisation agreeing to open the country's market to agricultural products, which was a reversal

To this end, it is necessary to enhance our viewpoints, way of thinking, system and practices to the world class level […] We have no choice other than this" (Korea Times, January 7, 1995 in Hyun-Chin and Jin-Ho, 2006: 10).

of the 1992 presidential campaign's promise to protect Korean farmers (Hyun-Chin and Jin-Ho, 2006).

Another important transformation that indicated the demise of the developmental state and the rise of pro-market ideology in Korea, in the early 1990s, was the abandonment of the industrial policy, of investment coordination, and the five-year planning practice (Chang, 1998). In parallel, with the rising dominance of monetarist ideas the notion that inflation control is the most important policy goal was taking over investment and production coordination. At the same time, the more independent chaebols began to push for more financial openings to get access to the international financial markets.

One of the main changes in post-1993 Korea that activated and cemented the paradigm shift towards a neoliberal-led model of capitalism, was the creation of the Ministry of Finance and Economy (MOFE) after the merger of the EPB and the MOF (Thurbon, 2003). This cabinet reshuffle along with the appointment of an ardent free-market advocate as a head of the MOFE was intended to strengthen the power of the neoliberally-oriented bureaucrats with a "globalist vision" and led to the influx of US-educated neoclassical economists, who were elevated to the commanding heights (ibid). To borrow Blyth's (2002) ideational approach in explaining fundamental changes in policy-making, the replacement of Korea's "embedded developmentalism" became possible, among other factors, due to transformations in the views about the state's role in governing the market. Consequently, in spite of ideological opposition and caveats from the "old" governmental institutions, such as the Bank of Korea (BOK), regarding, for instance, the dangers related to the volatile international capital flows, the country radically shifted towards neoliberal reforms and adopted "a rapid, reckless and ill designed approach to financial liberalisation in the 1990s" (Thurbon, 2003: 342).

Again, paradoxically, the neoliberal "Great Leap Forward" was also cultivated by domestic non-governmental organisations (NGOs), who popularised and institutionalised neoliberal ideas in the name of participatory democracy and economic justice (Lim and Jang, 2006).[99] In the early stages of the developmental regime, the

[99] The most prominent Korean NGOs that supported corporate-sector reforms were Citizen's Coalition for Economic Justice (CCEJ) and People's Solidarity for Participatory Democracy (PSPD). Founded in 1989 and consisting of liberal economists, CCEJ mostly campaigned against the chaebols' abuse of power as well as land speculation and promoted equal rights for SMEs. PSPD was founded in 1994, being led by a business professor

chaebols were subordinate to the state and the latter dominated its relations with capital. Over time, these family-owned conglomerates gained more economic and political power, becoming one of the main pillars of the nation's economic growth. In this "state-banks-chaebols" nexus, big Korean business provided funding for the military regime to sustain legitimacy, while the state apparatus allowed the chaebols to *control labour* and *accumulate income* (Kim, 2010). The power of the chaebols continued to grow significantly due to the "effects of democratisation" during the late 1980s. At the same time, neoliberal convergence of the policy and expert circles and, more broadly, the Korean public, was also based on the consensus of reducing the power of the chaebols given their historical legacy of cooperation with authoritarian governments. In the eyes of public opinion, in the complex relationship between democracy and neoliberalism to move towards the former it was necessary to accept the latter and thus, implement neoliberal reforms. In other words, neoliberal restructuring was considered as an essential part of democratisation. Consequently, the "nationalist" mode, as symbolised by powerful chaebols, had to be abandoned for the preference towards foreign capital. Disregarding potential destabilising effects of the transnational capital, this was associated with new, "democratic" institutions, while the chaebols were seen as representing the old ones that needed to be reformed (Lim and Jang, 2006). Thus, this democracy discourse presented neoliberal orthodoxy and rule as anti-authoritarian and anti-chaebol, helping to legitimise and further neoliberal transformation, especially after the 1997 crisis.

### *6.2.2. The global financial order: Wall Street-Federal Reserve-IMF complex*

In order to proceed further with the analysis on how the Korean developmental state shifted to a neoliberal model and uncover the interlocking imperatives that govern financialisation, it is necessary to recall the role of, what I term, the Wall Street-Federal Reserve complex, which has been influencing the post-Bretton Woods financial architecture. Borrowing from notions that describe global financial order (GFO) and

educated at the Wharton Business School, specialised in "economic democracy" by campaigning for minority-shareholder's rights. As in the case of US think-tanks, these NGOs contributed significantly on the ideational level for free-market orthodoxy to become a universal and mainstream agenda. Some of the members of CCEJ became high-ranking officials in political and economic circles and promoted the implementation of neoliberal reforms in Korea (Lim and Jang, 2006).

are developed by some scholars, I introduce the third actor in this composition, the IMF.[100]

This triad, *Wall Street-Federal Reserve-IMF*, constitutes an essential element in my analytical framework for investigating how neoliberal financialisation occurs through *the evolution of the financial sector* in a particular country influenced by the post-Bretton Woods global financial imperatives. In this context, there are patterns of inter-linkages between the interests of transnational capital represented by the Wall Street, US hegemony represented by the Federal Reserve and realised through its "structural power" of the "dollar seigniorage", and IMF as an institutional agent who reproduces, legitimises, and supervises neoliberal agenda embedded in GFO.

This post-Bretton Woods financial architecture constitutes a set of mechanisms that attempt to address the crisis of global capitalism through facilitating or imposing neoliberal policies in countries, such as Korea, Argentina or Sweden, by legitimising the power of global finance, where global capital mobility serves the interests of the transnational capitalist class in its pursuit for income accumulation. First, as was shown in Chapter 5, the USA, with its advantage of the "dollar seigniorage", is interested in maintaining the current global financial order, which it does by managing its trade and budget deficits with external funds facilitated by free financial flows. According to some estimates, US debt to other countries amounts to more than $2.7 trillion and to finance it the country needs a constant influx of around $2 billion per day (Soederberg, 2004: 123). Second, the IMF, as provider of the neoliberal orthodoxy, arranges implementation of the Structural Adjustment Policies (SAPs) in exchange for loans to debtor nations. As Soederberg argues when referring to the IMF (2004: 32), "the multilateral lending institutions are not neutral and independent authorities acting above states, but rather public authorities for transmitting the interests of the ruling classes in powerful states".[101] Third, declining profitability of the transnational capitalist class is addressed through neoliberal financialisation on a global scale. As it is claimed,

[100] The present international financial system has been widely described in the global political economy literature and is enriched with such concepts as Bhagwati's "Wall Street-Treasury complex" (1997 in Wade, 1998), Wade's "Wall Street-US Treasury-IMF complex" (1998), Gowan's "Dollar-Wall Street Regime" (1999), Peet's "Washington-Wall Street Alliance" (2003), and Soederberg's "New International Financial Architecture" (2004).

[101] The USA, with its 17% voting share, is the largest shareholder of the IMF and has veto power.

> “The reforms sought by the Fund are connected in one way or another with further opening up Asian economies to international capital. Why is the Fund insisting on capital account opening in countries that are awash with domestic savings? Why has the Fund done so little by way of organising debt *rescheduling* negotiations, preferring to administer bail out funds *in return for structural and institutional reforms*? James Tobin, the Nobel laureate in economics, observes that, ‘South Koreans and other Asian countries – like Mexico in 1994-95 – are … victims of a flawed international exchange rate system that, under US leadership, *gives the mobility of capital priority over all other considerations*” (Wade and Veneroso, 1998: 18).

Thus, the class-based approach helps in establishing the link between US global interests (the Federal Reserve) and transnational finance (the Wall Street) and how they tried to manage the capital accumulation crisis of global capitalism through international financial institutions (such as the IMF). The Wall Street-Federal Reserve-IMF complex works in unison to ensure settlement, i.e. imposition of the neoliberal order. For instance, in 1997, the IMF’s articles of agreement were amended to include obligatory requirements for member governments to accept capital account convertibility and eliminate capital controls (Wade and Veneroso, 1998). In her analysis of the New International Financial Architecture (NIFA) and its influence on Mexico, Chile, and Malaysia, Soederberg (2004: 2, 98) concludes that the transnational capitalist class and the USA pursue a class-based strategy in the global political economy to ensure that the countries of the global South “comply with the neoliberal rules of free capital mobility”. Through financial liberalisation and indebtedness countries are forced to introduce market-based policies, which “discipline” them, while high levels of profitability and the competitiveness of the US economy are guaranteed.

In the next subsection, based on the externally-imposed approach to neoliberal financialisation, it will be demonstrated how GFO through an IMF-managed crisis arranged the establishment of the standard neoliberal regulations (such as financial liberalisation and corporate governance with an emphasis on “shareholder value”) even in a country like Korea that formerly had had an economic model and policies antagonistic to free-markets’ ideology policies. The 1997 Asian crisis was used as a pretext to impose reforms that would better suit the interests of transnational capital and foreign institutional investors.

*6.2.3. The second stage of the neoliberal turn: financial crisis of 1997 and IMF reforms*

Much of the literature after the late 1990s emphasises how reckless and excessive financial liberalisation led to the under-regulation that lies at the centre of the Korean financial crisis of 1997 (Chang, 1998; Chang, et al., 1998; Wade, 1998; Palma, 2003a).[102] In the absence of a regulatory control system, the biggest Korean corporations and banks took full advantage of the relaxed controls on external borrowing and easy access to the international financial markets (Chang, 1998). In brief, there was a huge inflow of mobile capital in East and Southeast Asia, which suddenly outflowed after July 1997.[103] For instance, Korea's external debt rose from almost nothing in 1990 to around $150 billion by 1996, thus indicating a steady rise of foreign short-term credit, which increased from $12 billion in 1993 to $67 billion in 1996 (Crotty and Lee, 2005). The combination of the accumulation of short-term debt in the corporate sector leading to unprecedented levels of debt/equity ratios and low levels of reserves of the Korean Central Bank, culminated in a near default situation, when domestic banks and firms turned out to be unable to repay foreign debt after the outbreak of the crisis (Palma, 2003a).

Faced with the threat of a default, the Kim Dae-Jung government accepted a $57 billion loan from the IMF conditional for SAPs. Whilst many economics scholars, such as Joseph Stiglitz, Paul Krugman, and Jeffrey Sachs, acknowledged that there had not been fundamental deficiencies in the Korean economy, the Fund (supported by neoliberal economists) declared that national developmental institutions are in principle non-reformable and took a hard line in imposing an institutional overhaul (Wade, 1998).

From the ideational perspective, implementation of the radical neoliberal and IMF-coordinated restructuring, which in other times would have met fierce public resistance, became possible in an environment of a weakened and disoriented by the

[102] For neoclassical orthodox explanations of the 1997 Asian financial crisis criticising the "inherent instabilities" of the state-led capitalism and interventionist financial regulations born by "crony capitalism" which "misallocated" economic resources, see Goldstein (1998), Greenspan (1998), IMF (1998), and Lane at el. (1999). It is worthwhile noting that the "crony capitalism" notion has been used by neoliberals to derogatorily label what Wade (1998: 1540) calls "alliance capitalism" when describing developmental state strategies. The former is understood in *political* terms to have blamed corruption as allegedly the main cause of the Asian financial crisis, whereas the latter relied on *economic* rationale to explain the patterns of state-led growth, where state, banks, and domestic corporations cooperated closely to maintain high levels of investment by, for instance, controlling finance.

[103] A detailed examination of the causes of the Asian financial crisis is beyond the scope of this study but see Wade (1998) and Chang (1998).

economic chaos labour movement and general public as opposed to the favourable attitude of the President-elect Kim Dae-Jung and economic elite (Hyun-Chin and Jin-Ho, 2006). A long-time opposition leader, Kim Dae-Jung was, in fact, an enthusiastic supporter of the neoliberal reforms demanded by IMF and ran the country under the "Parallel Development of Democracy and Market Economy" slogan (ibid).[104] Apparently, little was conceived by the new administration on the inherent dichotomy between market rationales of competitiveness and efficiency and social democratic ideas of equality and inclusiveness. This was the natural outcome of the growing convergence of the domestic policy-makers and elite to neoliberal orthodoxy. In the world climate of the dominating pro-market ideology pushing for full-throttle business deregulation and financial liberalisation since the 1980s, for small countries such as Korea, with a relatively modest intellectual tradition of its own, it was difficult to resist such ideological shifts (Chang, 1998).[105] As Peet points out, "Economic policies stemming from the neoliberal perspective are promoted by global institutions regardless of national circumstance, such as cultural tradition or social structure, and regardless of previous tradition in the political economy of development" (2003: 14). Again, as with democratisation, there was an idealisation of the Anglo-American stock market-centred financial system as allegedly being more transparent, whereas the "old" institutions of the coordinated investments of state-led capitalism were condemned and accused of being the main cause of the crisis (Lim and Jang, 2006). Besides, newly converted pro-market bureaucrats were afraid to consider other policy options than those "recommended" by the IMF so as not to harm the country's international credit-rating, on which the Korean state was increasingly dependent and which reflected its growing dependence on transnational capital.

Apart from the neoliberal dogmatism at the ideational level, the chaebols and the Korean economic elite generally welcomed neoliberal restructuring under IMF supervision so that to moderate increasing labour's power and get even more access to the international financial markets. It is important to stress the substantial impact of

[104] In 1985, Kim Dae-Jung wrote a book, "Mass-Participatory Economy: a Democratic Alternative for Korea", in which he argued that "maximum reliance on the market is the operating principle of my program" (1985: 78 in Crotty and Lee, 2005: 335). In 1999, he even said that "the crisis will be remembered as a blessing because it is forcing essential economic changes" (ibid: 335).

[105] To be fair, even in the big countries with a presumably strong intellectual tradition, such as Russia, a neoliberal agenda and restructuring was the central idea directing intellectual debates over the development model in the early 1990s.

externally imposed neoliberal reforms on the financialisation of the Korean economy. As some scholars have argued, profitability and investor returns on investment became the main priorities of Korean firms, in contrast to market-share maximisation in the past (Jung, 2011). This indicates a shift from the industrial policy of long-term coordinated accumulation of the developmental state to the shareholder-value concept of the liberal stock-market capitalism, which emphasises short-term shareholder profits (Kim, 2010).[106] Regarding which, the gross domestic investment ratio declined from 39% in 1996 to 29% in 2006 (ibid: 12). As in the case of the USA, both domestic and foreign capital began to engage in corporate mergers and acquisitions (M&A) as their investment preference, in contrast to productive investment. In 2006, for instance, the inflow of foreign investment in M&A-type investments amounted to $0.79 billion, compared with $0.47 billion invested in "greenfield" type projects (Jang, 2011: 51). It could be argued that under the smoke-screen of the "good corporate governance" presented as "universal principles", an Anglo-American type of corporate governance was advanced in Korea by the IMF (Soederberg, 2004).

The IMF's structural adjustment programme was implemented in Korea in the standard form that it had been executed in the 1980s in Latin American and African countries as well as in the early 1990s in Eastern Europe and some former Soviet Union republics, i.e. with destructive consequences for socioeconomic development and the social fabric (Wade, 1998; Crotty and Lee, 2005; Lim and Jang, 2006; Lee and Han, 2006). The Korean government had to agree to an austerity macro policy, high interest rates (up to 30%), and tightened fiscal policy.[107] The list also included the termination of loans and tax privileges to domestic firms, further trade and capital-account liberalisation, and the introduction of a flexible labour-market, the establishment of western prudential standards along with, elimination of the government-directed lending decisions and restrictions on foreign borrowing by commercial banks. Overall, the Korean financial system was to be transformed into a Western one by allowing foreign financial institutions to own domestic firms. In regard

[106] Indicators, such as return on assets (ROA) and return on equity (ROE), became more important than the gross domestic investment ratio (Jung, 2011).

[107] Indeed, the IMF's harsh measures were criticised by many and called by Jeffrey Sachs "folly" and an "indiscriminate punishment" of Korea, whereas Paul Krugman even claimed that national default would have been a better option than the IMF's reforms (Crotty and Lee, 2005: 336).

to “shareholder value” in corporate governance and free capital mobility, Soederberg (2004: 132) maintains that they are part of the disciplinary strategy and serve to protect the interests of foreign capital and Western institutional investors, with there being no alternative.

In retrospect, it can be argued that the IMF-led radical neoliberal restructuring was mainly aimed at destroying and then, reshaping Korea’s developmental path, by substituting it with an Anglo-American finance-led model, which would inevitably lead to finance’s ascendancy. This, in turn, has to be seen as the inevitable logic and outcome of the GFO, serving the interests of the global powers and the transnational capitalist class by creating conditions for neoliberal financialisation to legitimise upward income distribution. Before proceeding to testing whether my analytical constructs confirm the financialisation-induced income inequality hypothesis in Korea, it is important to consider the dynamics of income inequality in the post-neoliberal period in this country.

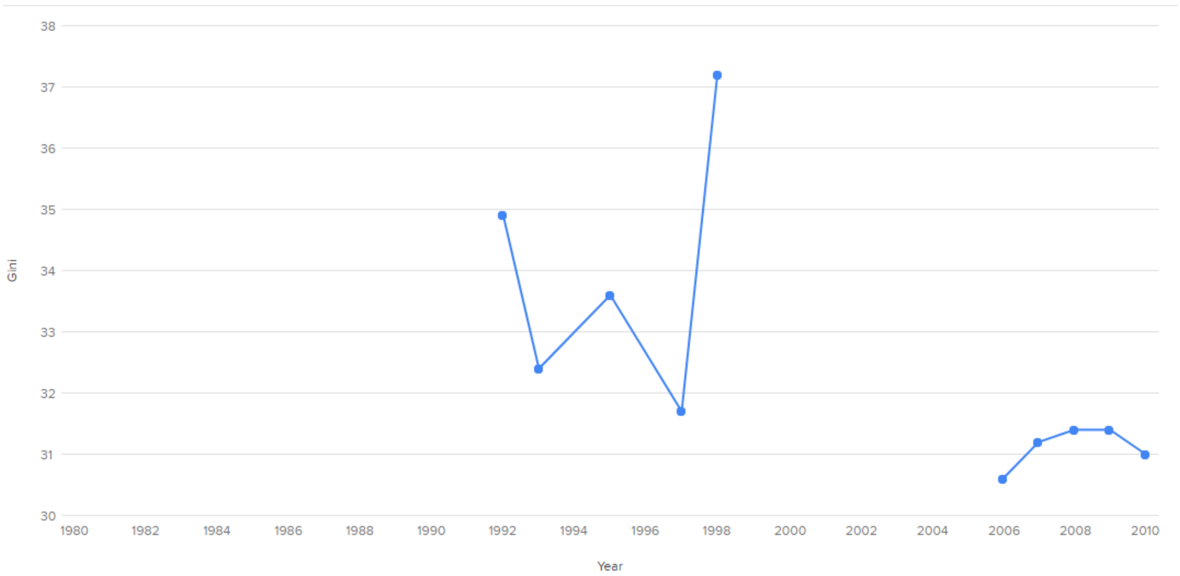
### *6.2.4. The level of income inequality: 1980-2010*

Many recent studies (Kim, 2004; Lim and Jang, 2006; Jang, 2011; Park and Mah, 2011) have shown that the financial crisis of 1997 and the paradigm shift from developmental state to neoliberal restructuring negatively affected the socioeconomic conditions in Korea. Detailed examination of the bipolarisation of income in Korea by Park and Mah (2011) proves that after embracing neoliberal reforms and financialisation in the 1990s, the nation faced adverse consequences for income distribution.[108] For instance, in the 1980s and early 1990s, before neoliberal restructuring, the Gini coefficient steadily declined from 0.319 in 1982 to 0.257 in 1992, the lowest level in modern Korean history. It remained below 0.3 throughout the 1990s, until 1998, when it jumped to 0.310 from just 0.274 in 1997, most probably as the result of the financial crisis. It mostly remained higher than 0.3 throughout the 2000s and reached 0.325 in 2007, the highest level in the 30-year period (ibid: 251). The decile ratio replicates these tendencies in Korean income distribution, which dropped from 6.10 in 1982 to 4.72 in 1992 and remained below 6.0 during 1985-1996. In 1997 and 1998, the decile ratio skyrocketed to 8.09 and 10.28, from just 5.06 a year earlier.

[108] In their study (Park and Mah, 2011), bipolarisation is measured by the decile ratio, this being the two ends of the distribution scale, i.e. mean incomes of the top 10% and bottom 10% of households.

Throughout the late 1990s and early 2000s, it stayed at around 6.0 and then increased again, reaching 14.10 in 2006 and 14.55 in 2008 (ibid). The curve in Figure 6.3 illustrates these rapid changes in income inequality in Korea.

**Figure 6.3. The Gini coefficient level in Korea, 1980-2010**




Source: created from The World Income Inequality Database, United Nations University, 2017

This sharp increase in income gap between the rich and the poor is especially startling for a country that had been praised for its relatively equal income distribution (Kim, 2010). Another interesting finding is that income inequality widened in just one year, from 1997 to 1998 and became the third worst rating for an OECD member after Mexico and the USA (Lim and Jung, 2006).

Jang (2011: 54-55) also confirms the idea that income disparity widened during the post-crisis neoliberal reforms by comparing the Gini index for “market income” and “disposable income”. Both indicators increased from 0.302 and 0.298 in 1996 to 0.374 and 0.358 in 2000, respectively. The difference in hourly income between the top 10% and the bottom 10% (decile ratio) reached 5.6 times and was the largest among OECD countries in 2003. Moreover, the “relative poverty ratio” rose from 7.7% in 1996 to 11.5% in 2000[109], whilst the number of citizens with high incomes (3,000,000 won a month) increased threefold between 1999 and 2003. The growth rate of Korean

[109] The term “relative poverty ratio” refers to the proportion of households whose disposable income totals less than 40% of the average income of all households (Lim and Jang, 2006: 456).

millionaires became the third highest in the world in 2003, indicating that widening income disparity is not only the result of poverty increase, but changes in the distributional patterns.

Before proceeding to the next section, it is important to highlight one significant aspect of income inequality in Korea. According to Cheon, *et al*. (2013), income polarisation has been steered by the worsening labour market conditions and wage inequality, with the latter being the highest after the US in 2006 (ibid: 33). In this regard, income polarisation in the late 1990s and early 2000s, not only reflects shrinking of the Korean middle class, harmed by neoliberal reforms, but also, the ruling class's new opportunities for upward income distribution. It is to these new income distributive institutions that the discussion now turns.

### 6.3. Analytical construct #1: the evolution of the Korean financial sector

Different authors have explored financial liberalisation in Korea in a variety of ways.[110] As is implied from the previous section, neoliberal financial liberalisation in Korea was a product of the cumulative effects of different political and economic factors, both internal and external, of a voluntary and enforced nature, such as democratisation, neoliberal indoctrination, and post-crisis IMF-led financial restructuring.

Kwon (2004), applying system theory and three levels of analysis (international, domestic, and individual), argues that Korean "financial repression" was removed both under pressure from the foreign players (USA, OECD, and IMF) and domestic ones (chaebols).[111] As was mentioned in the subsection 6.2.1, by the early 1980s, to sustain high levels of investment, dependence of the chaebols on debt financing under the protection of the state's financial regulation, bank control, and credit policy reached a critical point. Constant bailouts of the troubled industries increased the volume of the

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[110] For example, Thurbon (2001, 2003), in her two different studies employed a comparative analysis of financial liberalisation in Korea and Taiwan and the domestic structures of the governance framework; Kwon (2004) and Kalinowski and Cho (2009) utilised the political economy approach; Crotty and Lee (2005) provide accounts of financialisation of the Korean economy and its consequences; and Lee and Han (2006) offered a partial analysis, with an emphasis on policies related to foreign investments in understanding Korea's paradigm shift from a developmental regime.

[111] A system theory is defined by Dougherty and Pfaltzgraff (1997: 101-102) as "a series of statements about relationship among independent and dependent variables, in which changes in one or more variables are accompanied, or followed, by changes in other variables or combinations of variables". It investigates distribution of capability of different international players and their behaviour patterns (ibid).

non-performing loans in commercial banks, which were constantly forced by the government to bail out those industries (ibid). Thus, influential domestic players became interested in the free access to capital markets and financial market liberalisation, which began in the early 1980s and accelerated in the 1990s (Kalinowski and Cho, 2009).

The first concreate financial liberalisation reforms were launched by President Chun Doo Hwan, who seized the power in the 1980 military coup and tried to gain political legitimacy both from the US and big domestic corporations, which favoured financial markets restructuring (Kwon, 2004). From 1981 to 1983, all commercial banks were privatised and the scope of their business spheres was expanded. Non-bank financial institutions (NBFIs) were partially allowed to enter banking activities and foreign security companies could operate in Korea. Restrictions on foreign direct investments (FDI) and foreign banks' activities were relaxed in 1984 and 1985, respectively. In the late 1980s, some measures were taken to liberalise capital outflows and domestic banks were allowed to have subsidiaries overseas, whilst domestic institutional investors, from 1988 onwards, could invest in the foreign stock markets (ibid).

American and European banks were eager to expand their operations in the Korean market to get their share of pie from the fast growing wealth of the Asian tiger and strongly lobbied the Reagan administration for more financial deregulation (Chang, 1998; Wade, 1998).[112] In fact, the pressure from the US, which had a significant influence on Korea as its largest trading partner and main security ally is believed to have been the main factor behind implementing financial liberalisation policies in the late 1980s (Wade, 1998; Kwon, 2004). Regarding which, using investigation Section 301 of the US *Trade Act* as leverage, American firms got access to the Korean insurance market in 1987 (Kwon, 2004). Also, Korea was accused by the US Treasury Department of manipulating its exchange rate to get export advantages and had to agree to the Financial Policy Talks to further financial reforms (ibid: 82). As has been shown in the previous sections, the only difference with the 1980s period, is that in the 1990s and the post-crisis period, the push towards

[112] Returns on investments in Korea of the foreign banks, such as Citibank, Chase Manhattan, Bank of America, Lloyds Bank, and Manufacturers Hanover, amounted to 359%, after the first measures of financial liberalisation and in 1984, their net profit grew 26.6% more from the previous year (Kwon, 2004: 81).

accelerated financial deregulation and liberalisation was mostly conducted by international organisations (IMF, OECD, and WTO), but still under the sponsorship of the US (Kwon, 2004; Soederberg, 2004).

By 1988, foreign exchange controls had been relaxed and the Korean government had agreed to remove restrictions on payments and transfers for current account transactions in accordance with the IMF's Article VIII. In 1989, the US dollar call market was created and in 1990, the *Foreign-Exchange Management Act* was amended to liberalise further the capital account and to revoke restrictions on FDI. Under the 1991 *Four-Stage Plan for Interest Rate Regulation* prepared under the US pressure and in accordance with the World Bank's recommendations and backed by a $100 million loan, all lending, interest, and deposit rates were to be deregulated and freely determined by financial institutions by 1997 (Kwon, 2004: 82). In addition, in 1993, another four-stage financial market restructuring plan was enacted, with the focus being on the elimination of the credit control system, further deregulation of interest rates, and relaxation of the long-term and short-term capital flows. All of these measures ensured openness of the Korean financial market and "reciprocal national treatment" of the US financial institutions, as demanded by the US Congress and negotiated by both the Bush and Clinton administrations (ibid: 83).

By the 1990s, after chaebols were granted free access to financing from NBFIs and external financial markets, big business began to lobby successfully for interest rate deregulation and more liberal international financial transactions regulation. This period coincided with the OECD accession, when the Korean government had to broaden financial restructuring and develop a special financial reform plan, which included endorsement of the national treatment principles. These principles included *Codes of Liberalisation of Capital Movements* and *Codes of Liberalisation of Current Invisible Operations*, which stipulated removal of restrictions on capital movements, FDI in financial services, foreign portfolio investment, and financial services in cross-border trade (ibid). Korea also had to agree to further capital inflow liberalisation and M&A of national corporations by foreign ones. Immediately after coming to power in 1993, the Kim Young Sam administration declared the *1993 Blueprint for Financial reform* and the *1994 Foreign Exchange Promotion Act*, which "provided the most comprehensive vision for financial reform in Korea to date and, most importantly, signified a fundamental rethinking of the relationship between the state and the economy" (Thurbon, 2003: 350).

As discussed, the conditions of the IMF loan following the 1997 financial crisis included even more measures for financial restructuring. Overall, to implement uncompromising financial restructuring, thirteen various laws concerning finance sector were enacted in December 1997 alone (Lee and Han, 2006). For example, Korea had to eliminate all restrictions on foreign access to domestic corporate bond market and money market instruments as well as the interest rate ceiling on foreign residents' exchange accounts (Kwon, 2004). As has been highlighted in this study, much of the current literature emphasises the US and more generally, transnational capital influence and their support for the IMF-managed neoliberal-driven restructuring, which was not an exception in the case of Korea (Wade and Veneroso, 1998; Stiglitz, 2002; Soederberg, 2004). It is claimed, for instance, that the design of the IMF's SAP for the country "had already been decided in advance in consultation with the US Treasury, Wall Street's commercial and merchant banks as well as with major banking interests in Japan and the European Union" (Chossudovsky, 1998 in Kwon, 2004: 85). Under strong pressure from the US Deputy Treasury Secretary Summers, followed by an $80 billion loan from the US and G-7 countries, in 1998, Korea rescinded the *Foreign-Exchange Management Act* and agreed to hostile M&A (Kwon, 2004). Ultimately, financial market restructuring accelerated with IMF-led reforms after the crisis and by 2000, Korea's financial market opening reached the level of the OECD countries (ibid).

Overall, the full-scale financial opening in Korea resulted in the growth of market capitalisation as a percentage of GDP from 35% in 1998 to 97% in 2006 (Kalinowski and Cho, 2009: 237). Other fundamental consequences of the IMF-led reforms and neoliberal shift were the lifting of almost all restrictions on foreign business, including financial and the increasing dominance of finance capital, which led to the transfer of ownership in Korea (Crotty and Lee, 2005; Lee and Han, 2006; Jung, 2011). Given the lack of financial resources in domestic firms and the general governmental policy of attracting foreign capital as the main priority in the post-crisis period, foreign ownership in Korea increased swiftly.[113] In pre-crisis 1997, FDI had reached $8 billion, but this number increased to $62 billion in FDI and foreign portfolio just in the two years from 1998 to 2000 (Crotty and Lee, 2005). However, many scholars argue that

[113] Devaluation of the Korean won and other Asian currencies in the region also contributed to probably the largest peacetime transfer of assets from national to foreign firms in modern history.

this number signifies the increased volume of foreign takeovers of Korean assets rather than "greenfield" investments (Crotty and Lee, 2005; Kalinowski and Cho, 2009). Foreign market capitalisation in Korea increased from 2.7% in 1992 to 12.3% and 36.2% in 1997 and 2002, respectively (ibid). In 2006, foreign investor shareholdings reached 57%, providing foreign control over strategic domestic industries, such as finance, autos, telecommunications, semiconductors, electronics, and petrochemicals (Kim, 2010). For instance, foreign ownership of the Korean commercial banks reached 32% in 2000, whilst the market share of foreign financial companies accounted for 11.6% of securities sector, 13.4% of the life insurance sector, and almost 21% of the banking business (Lee and Han, 2006). Foreigners owned over 50% of the capital of the eight largest Korean banks and five of them became foreign-controlled in the mid-2000s (Crotty and Lee, 2005).[114] The average foreign ownership of the traditional Korean top seven corporations accounted for 47% by the late 1990s, but by the early 2000s foreigners possessed 59% of Samsung Electronics, 67% of POSCO,  57% of Hyundai Motors, 49% of SK Telecom, and of Korea Telecom (ibid: 346, 352). In general, therefore, it seems that in Korea implantation of various elements of the Anglo-American-type financial system facilitated not only upward, but also *outward* income distribution in the interests of the transnational capital.

Another important finding is that annual portfolio inflows and outflows averaged $95 billion after 1999 compared to between $1 and 5$ billion over the 1992-1999 period. Being the highest in developing countries, this "turnover" has made the Korean stock market very speculative and reflects movements in the US stock market, rather than the real picture of the Korean economy (Crotty and Lee, 2005). According to the Futures Industry Association, "in 2003 more futures and option gambling was done on Korean stocks than on anything else in the world!" (ibid: 351-352).

It could be argued that with the rising ascendancy of the shareholder-oriented corporate governance and financial sector as a new industry for economic development, the institutional preconditions for financialisation of the Korean economy became manifested by the 2000s. Regarding which, Roh Moon Hyun administration's

[114] Foreign ownership of the Korean banks increased by 2005, accounting for 63% in the Shinhan Bank, 74% in Korean Exchange Bank, 76% in the Hana Bank, 84% in the Kookmin Bank and 100% in the Korea-America Bank and Korea First Bank (Park and Mah, 2011).

(2003-2008) central policy was to create a “Northeast Asian Financial Hub” in Korea, a distinct move towards the 1986 British-like “Big Bang” of radical financial liberalisation. To support this strategy and cement the establishment of a stock market-oriented financial system, in 2007, a new law was enacted, which further restructured financial regulation (Jang, 2011: 51). Another indication of the progress of financialisation is that the share of the financial sector in country’s GDP increased from 6.6% in 1998 to 8.0% in 2002 and was never lower than 7% in subsequent years (Park and Mah, 2011: 257).

To sum up, it can be inferred from these findings that by adopting the rules of global capital and through adhering to free-market principles, complete dismantling of the developmental “repressive finance” institutions was realised and neoliberal financialisation was institutionalised in Korea. In the sections that follows, it will be shown that, as in the case of the US, there is a causal link between a deterioration in income inequality and rising financialisation.

### 6.4. Analytical construct #2: dynamics in the financial sector profit rates and labour’s share of income

All accounts agree that penetration of transnational capital and intensified financialisation, combined with an increase in labour-market flexibility, led to increasing income polarisation in Korea from the late 1990s onwards (Jang, 2011; Park and Mah, 2011). It is worth recalling Figure 6.2, describing the rate of profit, which began to recover after 1997 during the neoliberal-driven restructuring and after radical IMF-led financial liberalisation. As in the case of the US, employing Marxian analysis, it could be contended that “the neoliberal restructuring after 1997 represents nothing more than the restoration of capitalist profitability through the intensified exploitation of the working class” (Jeong, 2007: 60). That restructuring also led to the replacement of the developmental state with stock-market capitalism in Korea and facilitated financialisation. As Kim (2010: 11) maintains, in line with this study’s narrative, with regards to the Korean capital internationalisation and shareholder value legitimisation, first, the capital-account was liberalised in the early 1990s to enable access to international credits. Second, in 1996, a law was passed stipulating labour “flexibility”.

However, as suggested above, internationalisation of finance in Korea favoured by foreign speculative capital also enabled *outward* income siphoning off. Thus, in this country, not only domestic capital, but the transnational one, became the beneficiary of the US-style shareholder capitalism, the one who is ultimately behind the neoliberal restructuring. Criticising the "financialisation-as-wealth-drain" notion, Park and Doucette (2016: 538) admit that "Korea's dividend payments to foreign investors have increased enormously in the post-1997 period". For instance, it is estimated that, on average, 10$ billion was paid in dividends annually to foreign investors in the 2000s, in contrast to $269 million in the 1980s and $956 million in the 1990s (ibid). Moreover, the share of dividends in overall investment income skyrocketed to 45.8% in the 2000s, from just 3.6% in the 1980s and 9.9% in the 1990s (ibid). Regarding FDI inflows and pro-FDI policies, Park and Mah (2011: 256) claim that there is a correlation between foreign investments and deterioration of income inequality in Korea. This correlation was higher during the 1998-2008 period, when FDI surged into the country (0.24), than during the 1982-1997 period (0.04).

It may therefore be concluded that, in the case of Korea, financialisation has had an indirect effect on changing the patterns of income distribution, in the sense that increased profit making has been generated not only in the FIRE industry, but also, in the non-financial sector. These findings raise intriguing questions regarding the nature and extent of the financialisation-induced income inequality hypothesis. Even if income is not generated in the FIRE sector predominantly, it can be argued that, in Korea, the shareholder value concept as a new type of corporate governance was established *after* financial liberalisation and represents one of the important features of financialisation. Shareholder-oriented corporate governance is inherently linked to neoliberal financialisation (Lazonick and O'Sullivan, 2000). This new regime of corporate governance, being of a neoliberal nature, in turn, has facilitated both upward and outward income drain to the benefit of the domestic ruling class and transnational capital and thus, has contributed to widening income disparity.

Turning now to the actual profit of rate in the financial sector, it should be noted that it became higher than in the manufacturing industry after 1997, a decisive moment in the Korean neoliberal restructuring. Whilst the rate of profit in manufacturing remained between 7% and 8% during the 1997 and 2002 period, in the FIRE industry profits grew from less than 10% in 1997 to 13% in 2001 and 16% in 2002 (Jeong, 2007: 63-64). There was an increase in the operating surplus in the financial sector, which rose from 9.9 trillion won in 1998 to 33.2 trillion won in 2002 and 38.5 trillion won in 2006. The banking sector, after a $6.3 billion loss in 1999 and the post-crisis governmental bailouts, reported net profit of $9.2 billion in 2006 (Kalinowski and Cho, 2009: 233).[115] FDI flows into the FIRE industry also increased from 8.1% during 1990-1997 to 21.4% since 1998 (Park and Mah, 2011: 258).

By the same token, the compensation rate became much higher in the financial sector than in other industries. For instance, in 2002, the average monthly wage in the finance and insurance industry was 49% higher than in any other sectors and by 2007, this had further increased to 61%. In 2009, on average, the annual starting salary level was 13% higher in financial firms than in other corporations; 35 million won as opposed to 31 million won (ibid).

Many recent studies (Crotty and Lee, 2005; Chang, 2005; Park and Mah, 2011; Jang, 2011) have shown that the overall rise of profitability in the financial sector came at the expanse of labour's share in income distribution in the financialisation era. It is estimated that the number of the non-regular and part-time workers increased rapidly, with more than half of Korean employees having temporary work contracts in the 2000s, thus deepening the wage polarisation.[116] In 2003, for instance, the ratio of non-regular workers reached 55.4%, the highest in the OECD (Crotty and Lee, 2006; Jang, 2011). The wage level of the non-regular workers is half that of regular ones and this is without taking into account that they are discriminated against in terms of pension plans, insurance, and bonuses. Moreover, the real wage in the non-financial sectors kept decreasing for five years after 1997: in 2001 it was 98.1% of the 1997 level (ibid). This is a direct effect of the shareholder-centred corporate governance, where capital demands a "flexible" labour market to increase profitability and attract potential buyers for privatisation of state-owned enterprises (SOEs) (Chang, 2005).[117]

Crucially for this study and as in the case of the USA, examination of inequality in Korea by Cheon, *et al*. (2013), shows that labour's share in national income decreased or stagnated beginning in the mid-1990s and throughout the 2000s (Figure 6.4). Before the neoliberal-driven restructuring and the 1997 Asian crisis, there was a steady increase in both labour's share and the ratio of wage workers since 1980.

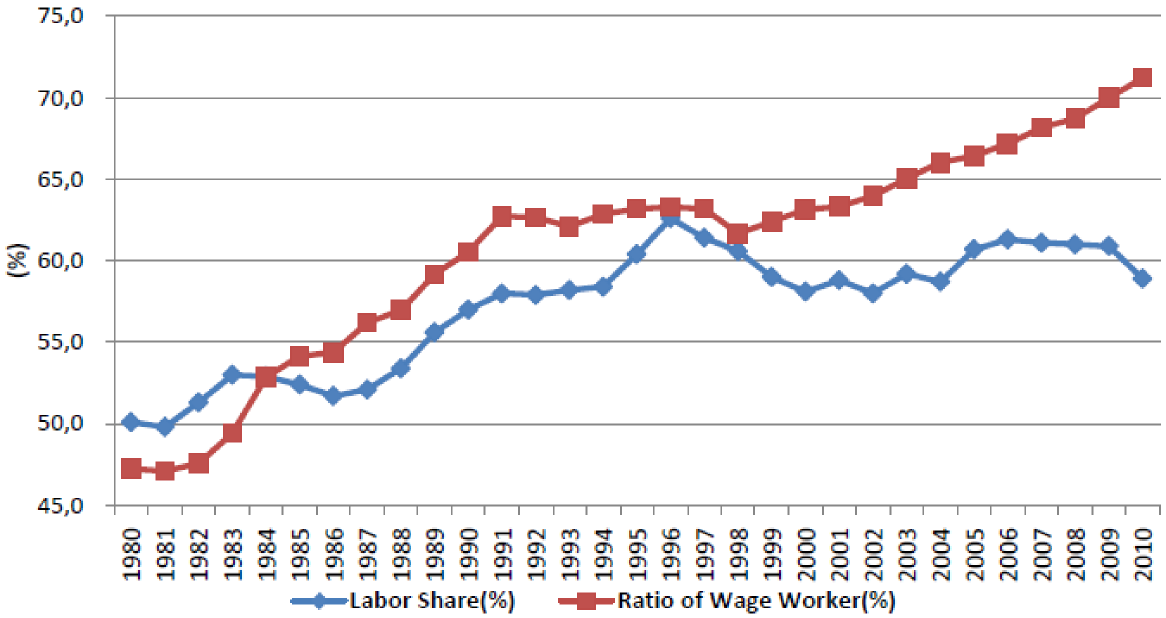
[115] The Korean government nationalised troubled banks in its effort to stabilise the financial market by spending about $176 billion, which was equal to 28% of national GDP in 2000 (Kalinowski and Cho, 2000).

[116] In accordance with neoliberal measures, in 1998, the Korean government enacted additional legislation changes to promote more labour-market "flexibility" (Park and Mah, 2011).

[117] Large scale privatisation of public assets began in 1998, when twenty out of the 109 SOEs were privatised and continued in the 2000s, when big Korean SOEs, such as Korea Telecom, Korean Electric Power Corporation, the Korea Gas Corporation, and the Korea National Railroad, were privatised. In the process, mass lay-offs were practised and by 2000, for instance, 41,700 workers had lost their jobs (Chang, 2005).

However, after the mid-1990s labour's share in income distribution ceased to grow and this may be explained by the growing number of low-wage workers with non-regular and part-time jobs.

**Figure 6.4. Labour's share and wage worker's ratio of national income in Korea, 1980-2010**




Source: Korea National Statistical Office in Cheon, *et al*. (2013: 10)

### 6.5. Analytical construct #3: rental income from financial assets and private debt

Studies by Epstein and Power (2003) and Power, *et al.* (2003) offer in-depth empirical analysis of the rentier share of national income for OECD countries, including Korea, within the 1960 and 2000 period and its relation to financial liberalisation. The pattern of income share for rentiers in Korea generally repeats the main trends found in the US case, when the rentier shares increased significantly, beginning in the late 1970s and early 1980s, i.e. after the neoliberal counter-revolution. For instance, between the decades of the 1960s and 1970s and the 1980s and 1990s, the rentier income share, *not including capital gains on financial assets* (as percentage of GDP), increased in Korea by 112% (Epstein and Power, 2003: 237). Within the same period, the increase in non-financial profit share was much smaller, at only 9.90%. The average decade rentier income share increased from 4.69% of GDP in the 1970s to 8.64% in the 1980s and 11.28% in the 1990s (ibid). This is a dramatic increase, when compared with non-financial profit shares, which experienced a modest growth in the same period, from 7.32% of GDP to 7.93% (ibid).

The change in rentier income share, *including capital gains on financial assets,* also reinforces the general conclusion that, as in the case of the USA, rentier shares increased in Korea in the 1980s and 1990s (Figure 6.5). This income share declined in the early- and mid-1980's, grew in the late 1980's, declined in the early 1990's and then, grew again in the late 1990's. Rentier income share with capital gains dropped significantly again in 1998 as the result of the 1997 Asian financial crisis. Overall, it is estimated that rentier income share, including capital gains on financial assets, increased from the decade average of 41.40% in the 1980s to 72.14% in the 1990s, which is an impressive 74.25% change over the 1980s and 1990s period (ibid: 238).

The account given in this research follows the core idea, according to which both domestic and global rentiers have built an alliance to establish finance-driven capital accumulation: a powerful national and international capitalist class has pushed for neoliberal policies and financial liberalisation (Soederberg, 2004; Epstein, 2005). Thus, in Korea, the ruling capitalist class seized the opportunity to amalgamate with the transnationalised capitalist class (Park and Doucette, 2016). Another important point is that there has not been a conflict between finance and industrial capital. On the contrary, both finance and industrial capital, representing big conglomerates (chaebols), have been interested in transforming into the rentier class, which explains the growing importance of the "shareholder value" concept, the growth of speculative finance projects, the expansion in household debt, and the overall financialisation of the non-financial corporations (ibid: 545).

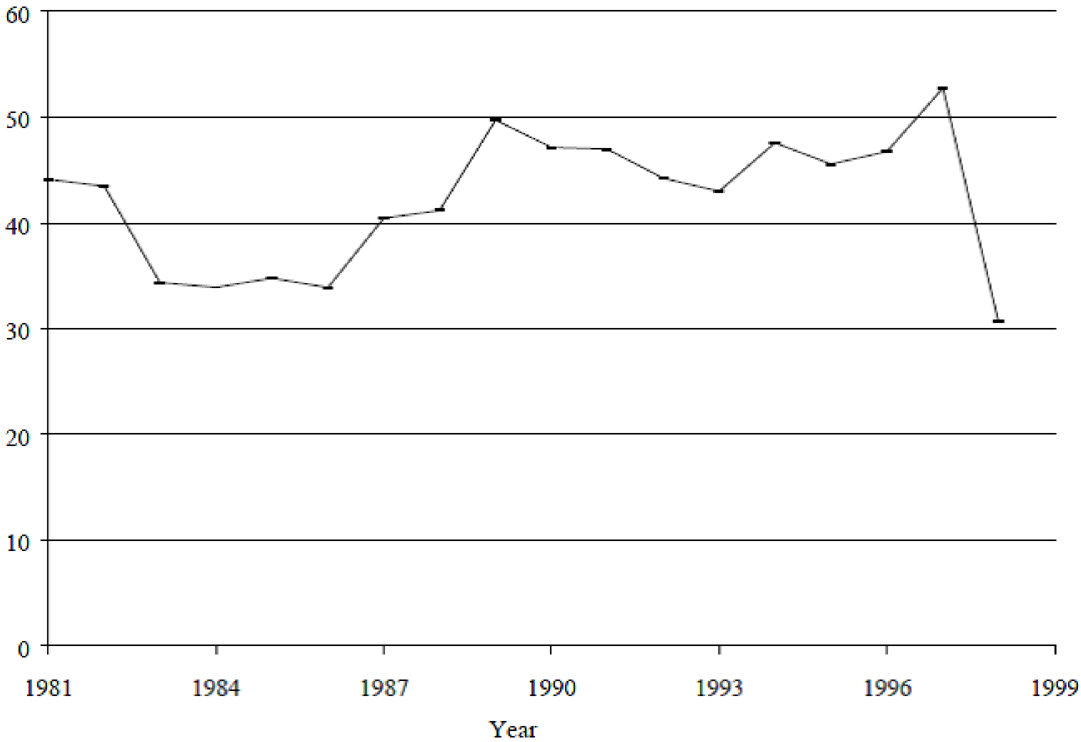
Evidence presented in the previous section on the labour's income share and the overall deteriorating conditions in the labour market, suggests that the main losers, as in the USA, have been working and middle class. Declining wages of the Korean working class on the one hand, and more sophisticated and deregulated financial institutions, on the other, have opened new opportunities for the financial rentiers. It is admitted that increased indebtedness of households in many countries has been linked to the financial "deepening" and deregulation implemented since the 1980s and Korea is no exception (Karasulu, 2008).[118]

After many years in the red, Korean commercial banks became profitable in 2001, with IMF and government-orchestrated bailouts and shifting to household lending business. That year alone, 91% of all new bank credit was provided to

[118] IMF avoids the term "financialisation" and instead, persistently uses the "financial deepening" euphemism.

households: from 1999 to 2001 household debt rose by almost 50% and by 63% during the 2000-2001 period (Crotty and Lee, 2002). Facilitated by the expansion of credit card use since 2000, household borrowing grew from 38% of GDP in 1997 to 66% in 2007 (Karasulu, 2008). Household debt, as a share of GDP, increased from 41% in 1998 to 74% in 2002, which led to an explosion in credit card defaults in 2003, when increasingly loans were being used to cover basic consumption (Crotty and Lee, 2006). According to Jones and Kim (2014), by 2012, household debt in Korea had risen to 164% of disposable income, which is well above the average level of 133% for OECD countries.

**Figure 6.5. Rentier income share as a share of GDP in Korea, 1981-1999**




Source: Power, *et al.* (2003: 57)

## 6.6. Conclusion

This chapter has provided some evidence of the correlation between neoliberal financialisation and increased income inequality in Korea, by demonstrating how changing institutional and functional income distribution factors affected profits and rents in the financial sector, labour's share and household debt. The first dramatic upward turn in the Korean Gini coefficient occurred after the 1997 Asian financial crisis, which in turn, had been caused by financial liberalisation. This process was inspired by the epochal shift in government policy in the early and mid-1990s, from a developmental model of the "restrictive finance" towards a neoliberal Anglo-American type of economy. It is important to highlight that even after the recovery from the crisis, a deterioration of income inequality continued in Korea, which supports the financialisation-induced income inequality hypothesis. As has been shown, the post-crisis period was marked by even more radical convergence into neoliberal-led capitalism facilitated by the IMF and the Korean ruling class, who were concerned with restoring its profits. It can be contended, thus, that the deep and *first* reason for abandoning the nationalist-protectionist development strategy is a part of the distributional conflict between capital and labour.

Neoliberal restructuring has undergone two phases in Korea. During an *internally*-induced stage, it was triggered by a crisis of capital accumulation and was characterised by ideational changes among policy makers. The first steps towards dismantling of the state-guided economic model were made in the early 1980s. This period coincided with political liberalisation that facilitated attacks on the "old" institutions of the authoritarian era, restrictive domestic financial order and the chaebols.

The *externally*-imposed phase, after the 1997 Asian financial crisis, was characterised by IMF-led neoliberal reforms. The real motives for this neoliberal-driven restructuring lies at the heart of the GFO, the *second* important aspect in understanding the transformation of the Korean developmental model. As has been shown, the powerful Wall Street-Federal Reserve-IMF complex was pivotal in the post-crisis financial liberalisation in Korea and the unmitigated abandonment of its developmental model. In this regard, it can be suggested that the interests of the foreign and domestic capital classes coincided in establishing a finance-dominated economy rooted in the market-based neoliberal ideology. The principal theoretical implication of this finding complements the notions of the transnational capitalist class (Sklair, 1997; 2000; Robinson and Harris, 2000).

In exchange for new upward income distribution opportunities for the national elite, external capital, as represented by foreign investors and international banks, gained access to the Korean national wealth. Crucially, government policy shifts resulted in the rise of the finance sector power and shareholder profit orientation in domestic firms. This explains the logical nexus of the US hegemony, transnational capital and IMF united by the common aim of addressing the capital accumulation problem, being enabled by the structural power of the US, which has "the power to shape and determine the structures of the global political economy within which other states, their political institutions, and their economic enterprises have to operate" (Soederberg, 2004: 7-8).

In this context, backed by transnational capital, neoliberal financialisation in Korea "resolved" the distributional conflict between capital and labour by maximising short-term profit and implementing labour market reforms. Traditional Korean corporate culture with its cultivation of system of age-graded seniority, familial structure, and life-time employment was changed into more Western-type corporate governance (Kim, 2004). At the same time, with the growing power of finance, the rentier share in the national income increased in parallel with the growing indebtedness of households, thus further widening income inequality. Consequently, as I argue in this thesis, the logic of neoliberal financialisation has created institutions incompatible with the developmental regime, the primary purpose of which is to enable and boost upward income distribution.

In line with the comparative political economy perspective, the Korean case shows that there are important differences in how neoliberal financialisation became dominant compared with the US case. However, the main outcomes – notably, income polarisation – and actors, such as the domestic ruling class and transnational capital, remain the same, constituting important elements in the financialisation-induced income inequality hypothesis. The Korean case shows that, as in the USA, financialisation facilitates the achievement of the same goal of upward income accumulation, where inequality becomes embedded into the distributional patterns of a country's political economy.

## Chapter 7. Argentina: entrenching income inequality

*"All the banks we've spoken with are confident that we can raise the money we need in the market"* (Luis Caputo in The Economist, 2016).[119]

### 7.1. Introduction

Over the past three decades, between 1980 and 2010, the average income practically failed to grow in Argentina, while there was a significant increase in income inequality. Despite periodic political and economic crises in the past, the country used to have the lowest income inequality in Latin America, which is illustrative given that the Gini coefficient rose from an already high 0.37 in 1980 to 0.58 by 2002 (Alvaredo, 2010).

As it will be demonstrated, Argentina is an emblematic case of massive redistribution in favour of the capitalist class, who not only applied typical neoliberal reforms, but also, managed deeply to embed state-led and debt-driven monetarist policies in the Argentine political economy. The ruling class of the country managed to insert themselves into the niche of the GFO to enjoy the benefits of the constant influx of foreign capital facilitated by the transnational debt architecture of the post-Bretton Woods system at the expense of increased income inequality. As Dumenil and Levy (2006a: 1) highlight, "the history of Argentina since the late 1970s, and the succession of growth and crisis, provide an interesting illustration of a political configuration emblematic of the new course of imperialism in the era of neoliberalism, what we denote as the neoliberal-imperial mix, characteristic of contemporary capitalism".

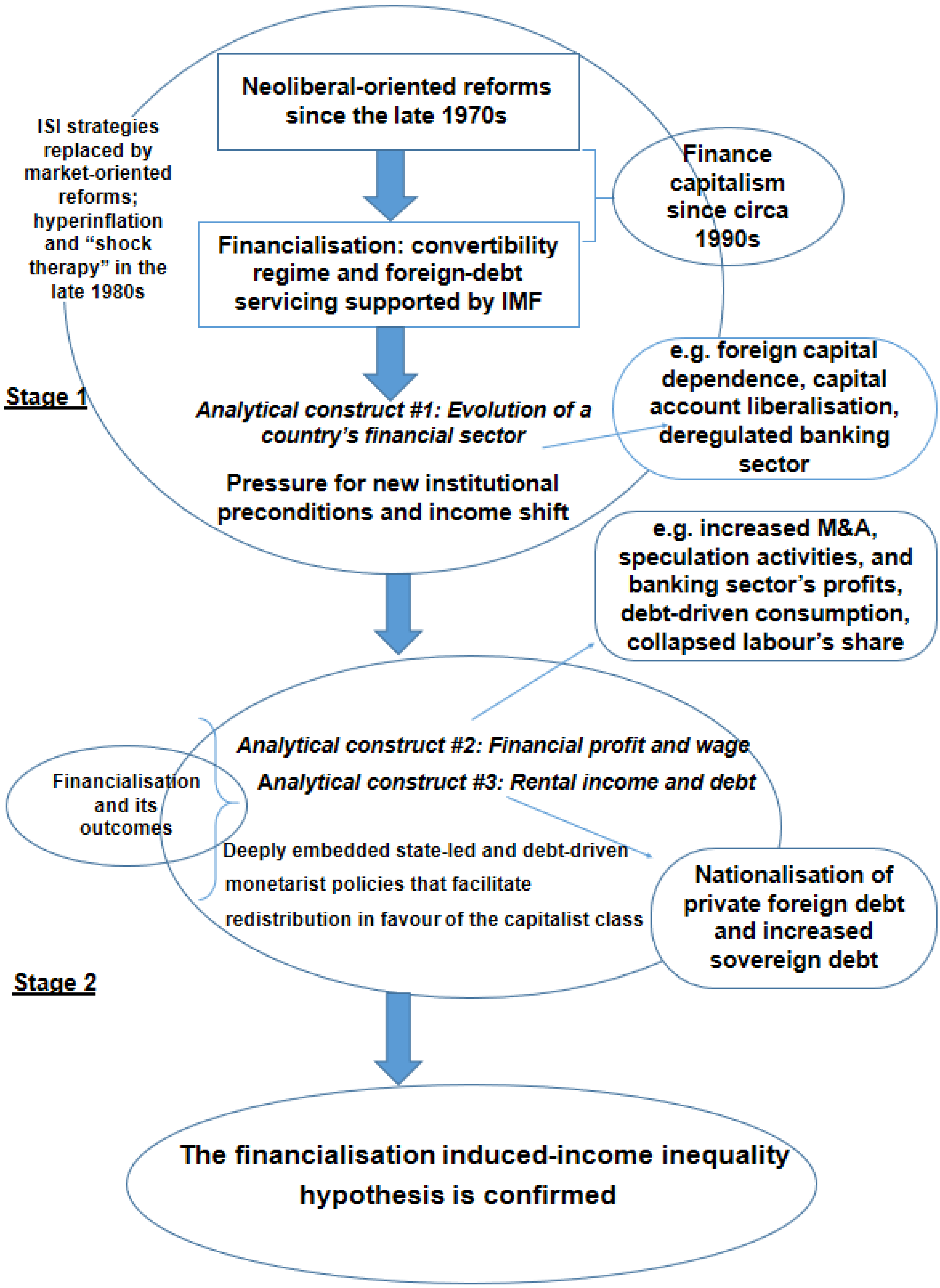
Financialisation in Argentina can be described as *state-led* and *debt-driven*, where a convertibility regime took the central role in sustaining a neoliberalism-inspired strategy to accommodate upward income distribution. Two periods will be highlighted in the separate subsections of this chapter: from the late 1970s until the one peso-one dollar exchange rate was established in 1991 and the period during and after this convertibility regime. The section below investigates how a neoliberal structural adjustment shift, from import substitution industrialisation (ISI), occurred in

[119] Luis Caputo, Argentina's finance secretary in 2016, replying when asked if the government was able to attract up to $15 billion in bond issuance to pay creditors.

Argentina, gradually becoming the dominant framework, being imposed by both the IMF and supported by the local oligarchic groups. Structural adjustment programmes were biased in favour of transnational capital as deteriorating the Argentine economy increasingly came to rely on foreign debt. The vested interests of the economic conglomerates and financial circles prevented the abandonment of the convertibility regime for long enough escalating the amount of the sovereign debt. It will be argued that the convertibility regime under finance capital led to the doctrine of financialisation becoming embedded in Argentine political economy.

As in previous two cases, three analytical constructs will be analysed to demonstrate that under the neoliberal regime a significant concentration of capital and consolidation of power within the local and transnational capitalist classes occurred, as in the USA and Korea (Figure 7.1). Some peculiarities are idiosyncratic to Argentina, in particular, no substantial increase in the household debt can be traced. As will be demonstrated, this is because deeply embedded neoliberal financialisation in Argentina turned the entire nation into a sovereign debt-creating factory redistributing income in favour of the transnational capitalist classes.

**Figure 7.1. The analytical framework of the financialisation-induced income inequality nexus in Argentina**




Source: researcher

## 7.2. Implanting neoliberalisation and entrenching income inequality

### *7.2.1. From ISI to hyperinflation-debt crisis to structural adjustment to a convertibility regime-debt crisis*

The existing literature on Latin America particularly emphasises how the region has been a site for the set of neoliberal policies promoted by domestic capitalist oligarchies and international financial institutions (Palma, 2003b). This is especially true in the case of Argentina, where the ascendancy of neoliberalism was expressed through liberalisation and deregulation of the financial system, which first began during the last military dictatorship (1976-1983) and culminated in a cycle of financial crises and instability (Giarracca and Teubal, 2004; O'Connell, 2005; Cibils and Allami, 2013).

As discussed in previous chapters, the shift from one mode of development to another – in Latin America from ISI to neoliberal SAP – was instigated by a general capitalist crisis in the 1960s and 1970s, amplified in the case of Argentina by a decline in capital accumulation caused by the deficiencies of ISI. The latter was an essential part of "developmentalism" dominating the Latin American region in the 1950s, being aimed at achieving economic and social progress (Steger and Roy, 2010). The ISI-led strategies included high tariffs, nationalisation of key industries, and public subsidies for the state-owned enterprises. Domestic capital and state-owned banks participated in the provision of credit to diversify economy and create jobs in manufacturing. In Argentina, this industrial development led to stable economic growth between the 1950s and 1970s, with the creation of a comparatively large and affluent middle-class as well as powerful trade unions, in the 1960s (Teubal, 2000; Steger and Roy, 2010).

However, the cumulative effect of the ISI policy limitations from the mid-1960s onwards, meant that the nation was not able to overcome deeply rooted socioeconomic and structural problems, which led to chronic balance-of-payments difficulties and fiscal deficits, inflation and rising debt in the 1970s. In Argentina, these policy inadequacies were the scarcity of foreign currency, fragility of the national financial system, persistent fiscal instability, and lack of policy coordination (Saad-Filho, 2005: 223).

The military junta, which seized power in 1976, under the influence of the home-grown, so-called, "Chicago boys", initiated neoliberal-oriented reforms, but did not privatise key public industries.[120] It has been suggested that the turn to market-oriented policies more resembled Fascist corporatism and these were resisted by the "corporatist" society inherited from Peronism (Rock, 2002; Steger and Roy, 2010).[121] The military regime banned trade unions activities and abolished various regulations and subsidies, which helped to maintain the previous wage-led economic growth. Importantly, under the dictatorship rule, the first structural changes favourable to financial interests and foreign capital were implanted to such an extent that it made it difficult to return to the "national popular" alliance of the Peronist era (Teubal, 2000). For instance, not only was there a reduction of tariffs (from an average 90% rate to 50%), which led to deindustrialisation and opened up the economy, but also, a new system to manage the foreign exchange rate – crawling peg – was introduced by the financial reforms of 1977-1979.[122] This facilitated liberalisation of interest rates, where domestic ones were to be above international levels, thus making foreign financial market operations for the business establishment more profitable than domestic manufacturing industries (ibid). Meanwhile, between 1980 and 2004 Argentina experienced stagnant annual economic growth of 1.3% on average, compared with a robust 3.3% between 1950 and 1980 (Dumenil and Levy, 2006b: 390). From the mid-1970s onwards, with the new regime of capital accumulation, economic conglomerates (*grupos economicos*) became more influential and eventually, hegemonic in Argentine politics (Teubal, 2004).[123] Finance capital and large

[120] The developmentalist model adopted by many Latin American countries was strongly opposed by neoliberal academics in the USA, who in the 1950s began to attack Keynesian macroeconomic governance. Sponsored by large American corporations and led by the University of Chicago and US State Department, academic programmes were established in South America, one of them being the so called "Chile Project". Subsequently known as "Chicago boys", students were trained in accordance with the curriculum of free-market principles. These programmes expanded covering Argentina, Brazil, and Uruguay, while their graduates later rose to influential political and academic positions in their countries (Steger and Roy, 2010).

[121] Peronism, as a political phenomenon, is named after Juan Peron (1895-1974), who served as the president of Argentina in 1946-1955 and 1973-1974. Often described as left-populist, this political movement's ideals appealed to economic independence and social justice and has had an ongoing influence even in 21st century Argentine politics. Redistribution of income to the working-class and state involvement in strategic industries and the public services have been essential elements of Peronism (Rock, 2002).

[122] Crawling peg is an exchange rate system where a currency's value is allowed to increase or decrease by small amounts within overall limits. In line with the arguments presented in this research, it may be the case that in Argentina crawling peg regime was the first precursor foundation that led to the convertibility regime creation in the 1990s.

[123] These economic groups consisted of both national and transnational corporations in the banking, petroleum, agro-industry, electricity, telecommunication, and water sectors. Large conglomerates included locals, such as Soldati, Rocca, Perez-Companc, Bulgheroni, and Macri, and transnationals, such as Phillip Morris, Nabisco, Unilever, Danone, Parmalat, Heinz, and Nestlé (Teubal, 2004).

conglomerates became interested in neoliberal restructuring, which facilitated income transfer in their favour. Before the neoliberal era and under the ISI, large corporations had to share power with small and medium-sized business supported by the power of labour. As Teubal (2000: 485) concludes, “[t]he fear of the advance of the alliance of labour with the national bourgeoisie was what induced the financial interests and the so called *grupos economicos* to support wholeheartedly the military coup of 1976”.

Following the defeat in the Malvinas (Falklands) war in 1982, the dictatorship collapsed, while the country experienced hyperinflation of more than 300%, de-industrialisation, economic slowdown and an increase of external debt from $7 billion in 1976 to $46 billion by 1983. A return to the Peronist method by the first democratically-elected government of Raul Alfonsin (1983-1989) produced a brief consumer-boom, but ended up with economic slowdown and soaring inflation, from more than 600% in 1984 to 1,000% in 1985 and 3,000% in 1989 (Rock, 2002). The Alfonsin government initially pledged to reduce income inequality and increase real wages, but under pressure from the business and international financial institutions eventually followed Washington Consensus recommendations to serve foreign debt nationalised during the military regime. As a result, there was further economic stagnation and marginalisation of the workforce (Teubal, 2000).

It is important to remind the reader here, that in line with the arguments presented in the chapters on the USA and Korea, Argentina’s shift towards a neoliberal model in the 1980s was also part of the global transformation from post-war social democratic Keynesianism to neoliberal Hayekianism prompted by the international economic slowdown and breakdown of the Bretton Woods order (Saad-Filho, 2005; Streeck, 2014). By that time, the Argentine elite had reached a consensus that ISI should be replaced by the neoliberal policies that were being promoted by the US government, the World Bank, and IMF, all of which had been applying both ideological and economic pressure on the Latin American region. Under their consolidated influence, the Argentine business elite and technocrats advocated orthodox economic policies favourable to foreign investment, deregulation of the financial markets, privatisation, “flexibilisation” of labour markets, and free exchange rates (Cypher, 1998). Thus, national development strategies, such as ISI were abandoned and a stabilisation package was imposed consisting of tight monetary policies and wage freezes. Public spending was cut and there were attempts to privatise state-run companies. The combination of the fragility of ISI, inadequate tax and speculative financial systems exposed Argentina to the 1982 international debt crisis. More foreign credit was borrowed to prevent sovereign default in 1984, while GDP shrank by over 5% or 15% per capita between 1981 and 1988 (Rock, 2002: 63).

The hyperinflation, which paralysed production, drastically reduced the real wages and living conditions of the poor and the middle-class and helped Carlos Menem's administration (1989-1999) come to power in the 1989 "economic coup" (Teubal, 2000). Once in office, Menem radically changed his discourse, from increasing the living standards of all Argentinians (*salariazo*) to a "shock of hyper-credibility" (Rock, 2002: 64).[124] The neoliberal Washington Consensus policies involved a severe structural programme imposed by the World Bank and IMF and implemented by Menem, who was granted by the Congress emergency powers to execute economic policies by decree (ibid). A "shock therapy" strategy was presented as the only way to curb hyperinflation and thus, "save the country". Further removal of barriers to capital flows, privatisation of local industries, deregulation, cuts of social and welfare provisions, elimination of export promotion and industrial policies, such as advantages for local manufacturers in state purchases, and consumption taxes, which affected the middle class, were all introduced (Teubal, 2000; Rock, 2002). The privatisation programme in Argentina was one of the most intensive and swift, transferring the core state-owned enterprises (SOEs) – more than thirty public companies in less than three years – into private hands (Teubal, 2000: 479). Almost all areas of economic activity underwent privatisation, including petrochemicals, petroleum, communications infrastructure, such as telephones and airline companies, the transport system, the steel, coal and iron industries, water, electricity, hydroelectric dams, ports, television channels, hotels, and even firms in the area of defence (ibid). The government earned about $15 billion, which was much less than the net worth transferred and in accordance with neoliberal orthodoxy did not bother to create regulatory boards (ibid).

During the triumphalist phase of neoliberalism in Argentina, in the 1990s, the country was named as a "star" country that had implemented policies prescribed by the World Bank and the IMF, becoming their "best pupil" (Beker, 2015). After IMF-

[124] During his election campaign, Menem even hinted that he might default on the foreign debt, which he never did, but instead, applied extreme neoliberal policies without considering the social costs or to put it in his own words, "without parachutes or anaesthesia" (Teubal, 2000: 477).

supported market-oriented reforms, Argentina achieved short-lived and fragile macroeconomic stability, with consumption-led growth financed by an influx of foreign capital. However, it is estimated that in this debt-driven growth the net transfer of funds evaporated quickly, because of the constant foreign debt servicing and profit repatriation by the FDI (Palma, 2003a).

Neoliberal advocates claimed that, in 1993, for the first time in decades, there was no deficit in the Argentine public sector. But this is mainly because after reforming the social security system, most of its revenues were transferred to the private sector, while the expenses were left in the public one (Beker, 2015). Moreover, from 1994 onwards, even in the years of economic growth (1990-1997) the federal budget was in deficit, constantly incurring new debt, which had already reached $75 billion, while GDP was just $257 billion the same year (ibid). Employing the concept of the neoliberal-imperialist mix, which describes the relationships between the ruling classes of the centre, as represented by the hegemonic US and the periphery, Dumenil and Levy (2005; 2006b) point out that the Argentine capitalist class incorporated itself into the new global capitalist economy or what I term the GFO. Within this order, Argentina’s rich class became a rentier class investing in the centre (the United States), whereas the country was made to service the foreign debt.

As in case of South Korea, the Argentine economy became susceptible to severe economic crises, which hit the country in 1995 and between 1998 and 2002. This is because after shifting to a neoliberal monetary regime the economy developed an addiction to the constant external influx of capital, thus increasing its dependency on volatile capital inflows and vulnerability to external shocks (Palma, 2003a). Thus, Beker (2015) argues that the role of the IMF cannot be underestimated in building Argentina’s ability to access capital markets. During the 1990s, it continued to amplify its debt burden issuing sovereign bonds, popular among investors, who were reassured by the IMF’s approval of the country’s economic policy. It can be argued that it was financial capital’s interest, both domestic and transnational, that promoted neoliberal anti-inflation-focused policies and kept the IMF supporting the sustainability of the “convertibility regime” in Argentina during 1991-2001, which enabled the country to maintain its ephemeral “creditworthiness” and thus, get into a continuous state-led debt spiral. To support this argument, the following section is an account of the monetarist orthodoxy embedded in the Argentine political economy.

*7.2.2. The convertibility regime: hyperinflation, finance capital, and the Wall Street-Federal Reserve-IMF complex*

The instrumentalisation of inflation control in Argentina, as in other countries that had undergone tight monetary policies, labour squeeze, full-throttle financial liberalisation, and full-scale privatisation, was often used to justify and disguise radical neoliberal restructuring. Imperatives of inflation control presented as "technical anti-inflationary measures" were easy to impose on a society suffering from a 3,000% annual inflation rate, as in Argentina in 1989 (Saad-Filho, 2005: 225). On the ideational level, that also helped to facilitate the transformation of the country's political economy from ISI policies to monetarism, reach consensus among the ruling classes and to avoid a pluralistic approach in scrutinising the consequences of a radical transition.

In order to eliminate any devaluation expectations and bring down inflation, Menem's minister of the economy, Domingo Cavallo, introduced the Convertibility Plan in 1991.[125] The Convertibility Law established a fixed exchange rate on the basis of one peso to one dollar, while price indexing was prohibited. The government was deprived of its discretionary power to print money as well as to manage monetary and foreign exchange policies. The Central Bank's functions were *de facto* transformed into Currency Board ones. Any money created had to be backed by foreign exchange reserves or by the inflow of foreign capital. In essence, this was a regime similar to the Gold Standard of 1930s only now it was the Dollar Standard, matching money supply to dollar reserves (Teubal, 2000; Rock, 2002).[126] It was believed that the new monetary regime would bring stability, encourage savings, attract foreign investments, and recreate the credit system.

With hyperinflation having ended, trade liberalisation and an overvalued domestic currency led to an increase of imports in just two years from $6.8 billion in 1990 to $19.3 billion in 1992, with devastating consequences for local industries, employment, and the balance of payments. For instance, the ratio of value added as a proportion of manufacturing to GDP declined from 31% in 1989 to 17% in 2001, whilst the labour force in industrial sector dropped from 33% in 1991 to 25% in 1996. Contrary to mainstream economists' expectations, after financial liberalisation,

[125] Cavallo, who earned his PhD degree in economics at Harvard, had close ties with the Argentine financial establishment and a reputation as a wizard among international financial circles (Giarracca and Teubal, 2004).

[126] The same mode of convertibility regime was employed in Bermuda, Estonia, Gibraltar, Hong Kong, and Lithuania (Teubal, 2000: 478).

savings rates declined from 22% in 1989 to 17% in 1999, while funds for investment decreased by one-third, to less than 20% in GDP, within the mid-1980s and the late 1990s period (Saad-Filho, 2005: 226).

The convertibility regime created excess demand fuelled by foreign capital inflow and appreciation of the Argentine peso pegged to dollar, which eroded competitiveness of the national tradable sectors. As a result, the current account deficit increased from $5.5 billion to $12.1 billion in 1992-1997 (Beker, 2015). To support its foreign exchange reserves, Argentina needed to attract more than $10 billion annually for its capital and financial account (ibid). This was easy to achieve during periods of growth, when the convertibility regime amplified domestic credit, but during slowdown the very same regime would magnify the effects of deficit, thus intensifying the recession. Rock (2002: 65) points out that in 1991 – the year the Convertibility Law was enacted – the United States was in recession, its interest rates were low and capital flew to emerging markets, such as Argentina, which had high interest rates. Thus, it was the influx of external capital – $11 billion in 1992 and $10.7 billion in 1993 – that facilitated the stabilisation of the economy and provided legitimisation towards the ideological and political shift to neoliberalism.

Under the convertibility regime, the Argentine economy became highly dependent on foreign capital and at the same time unable to regulate its foreign reserves by managing interest rates so as to avoid recession. The first warning came in 1995 during the "Tequila crisis" in Mexico, then, in 1997, there was the East Asian crisis, followed in 1998 by the Russian default and in 1999, there was devaluation of Brazilian real. In all these cases, Argentina suffered external shocks and was unable to respond adequately owing to it being constrained by the Convertibility Law. Ironically, back in 1914 and 1929 Argentina had cancelled the gold standard to avoid a deflationary spiral of lower spending, economic slowdown, and rising unemployment (ibid). This time neoliberal-driven convertibility became deeply embedded in the Argentinean political economy and its social fabric, thus deforming the country's institutional order. Castagno (2014: 816), discussing monetarism as a form of social control and state regulation by the Menem's government, argues that, "It turned monetary policy into the centre of the government's ideological regulations with the aim of assuring more radically than in the past the unity of economic structures to Northern capital". As Argentinean economy was revitalised throughout the 1991-1994 period with annual GDP growth around 7%, long-hoped "stability" helped to get support from Argentinians legitimising currency-convertibility system and growing external debt but not resolving deep structural deficiencies (Teubal, 2000). Foreign capital inflow supported higher consumption but not production. Between 1985 and 1998, the consumer goods imports and foreign travel deficit increased from $242 million and $671 million to $0.5 billion and $4.2 billion, respectively (Saad-Filho, 2005: 227). Castagno (2014: 827) defines this period as a narcissistic and infantile imitation of the Western consumers' habits that helped to negate the reality in Argentina.

A substantial part of finance from privatisation and resources, induced by the inflow of foreign capital and increased import consumption, was channelled to service the foreign debt (Teubal, 2000; Soederberg, 2005; Beker, 2015). Public debt in Argentina grew from $61 billion in 1991 to $145 billion in 1999, with the external debt-to-GDP ratio growing from 32% to 51% in the same period (Beker, 2015). This is especially noteworthy given the fact that the country's default lasted until 1992 following Latin American debt crisis of 1982 and external capital, in accordance with neoclassical orthodoxy, should have avoided the nation owing to its serial defaults.[127] As Beker (2015: 36) points out, Argentina was a potential defaulter even in 1991 and yet, in the subsequent ten years was "allowed" to borrow almost $80 billion. In fact, the convertibility scheme, relentlessly advocated and ideologically legitimised by the neoliberal discourse in Argentina, further facilitated constant borrowing and servicing the ever expanding external debt, thus transferring net wealth abroad, from debtor to creditor.

In this regard, it is essential to consider the role of the Wall Street-Federal Reserve-IMF complex, whereby the latter institution (as in case of Korea) played the key role in preserving the *status quo* of the newly developed monetarist regime and thus, the implantation and embeddedness of neoliberal financialisation, by reassuring its confidence in the Argentine economy to capital markets eager to lend.[128] The US raised its interest rates several times between 1994 and 1997 and dollar appreciation created an immense pressure on the economy addicted to a constant influx of foreign capital. External debt repayments were guaranteed by the Central Bank's reserves

[127] For the account of mainstream orthodoxy claiming that countries that do not honour their debts have difficulties in borrowing on external markets, see Reinhart and Rogoff (2004).

[128] In fact, to restore the confidence in Argentina's creditworthiness, the IMF provided both technical and financial assistance, having organised about fifty missions during 1991-2002 period and approved two Extended Fund Facility arrangements in 1992 and 1998 as well as two Stand-By arrangements in 1996 and 2000 (Beker, 2015: 33).

through a budgetary deficit magnified by the effect of the currency-convertibility scheme. These repayments increased from $1.3 billion in 1995 to $5.6 billion in 1996, while rising debt-service costs put Argentina in a "debt trap" (Rock, 2002: 79).[129] Nevertheless, the IMF kept praising Argentina's convertibility regime and the mantra of "liberalise, privatise, and stabilise", while the government became profoundly dependent on the external capital markets (Setser and Gelpern, 2006). Under the IMF's umbrella, the country continued its "bond festival" until the 2001 default and was even offered $40 billion loan from the organisation under the conditions of the austerity measures. However, as back as 1994-1995, it should have been clear that Argentina had not weathered the Mexican crisis, when, because of the rigidity of the convertibility regime, unemployment jumped from 10.7% to 18.4% between 1994 and 1995 (Beker, 2015: 39-40).[130] Now deeply embedded in the political economy of the country, the convertibility regime was also supported by the domestic vested interests tight to the GFO. Argentine private companies borrowed heavily in dollars from external capital markets, while the middle-classes kept their deposits in hard-currency in local banks. Even during the 2001 crisis devaluation was not popular as it would increase debt and deplete savings.[131]

In her analysis of the existing transnational debt architecture, where since the mid-1980s private loans to countries overshadowed public ones, Soederberg (2005: 928) argues that through the power of credit capital accumulation a form of social discipline is recreated where donor states coerce debtor states to implement neoliberal policies. In effect, Argentina became the victim of a neoliberal-led global credit system

[129] Fearing the collapse of the convertibility regime, capital flight began and there was a run on the banks, which lost 18% of their deposits, while GDP shrank by 7.6% between 1994 and 1996 (Rock, 2002: 78).

[130] The IMF's Independent Evaluation Office (IEO) reluctantly admitted that, "The catastrophic collapse of the Argentine economy in 2001-2002 represents the failure of Argentine policymakers to take necessary corrective measures at a sufficiently early stage. The IMF on its part, supported by its major shareholders, also erred in failing to call an earlier halt to support for a strategy that, as implemented, was not sustainable. … The IMF played a constructive role in the first half of the 1990s, when its support gave credibility to Argentina's stabilisation and structural reform efforts. Although the IMF was initially sceptical as to whether the convertibility plan would work, it supported the authorities' commitment to pursue supportive policy measures with two successive financing arrangements" (IMF, 2004: 64-65). From this schizophrenic account of an attempt to shift part of the responsibility onto the Argentine government, it is nevertheless clear that, in the IMF, at times of vital decision-making the political vested interests prevailed.

[131] Argentine president De la Rua pledged in July 2001: "I give my life to the fight. I will never devalue", while in December that year withdrawals from bank deposits reached an astonishing $1 billion per day (Rock, 2002: 84). Consequently, devaluation of the peso and the largest sovereign default in history happened in December 2001. The ensuing political turmoil was ended by Nestor Kirchner, during whose presidency the economy stabilised and gained rapid growth and by the late 2000s Argentina was able to repay its debt to the IMF (Galbraith, 2012).

using the “Golden Noose” comprising securitised debt and neoliberal ideology (ibid: 928-929).[132] It could be argued that this system, originating from the GFO, helped to create the convertibility regime (by the monetarist anti-inflation doctrine), nurture it (through the debt-led model), sustain it (with increased consumption-led growth at the expense of the domestic industries), and protect it (via IMF-led patronage of the capitalist class). For instance, in 1977, the IMF was granted surveillance powers (Article IV), which in addition to general observations of the member states’ financial and economic policies, serve as an indication and seal of approval for private creditors to lend to the countries of the Global South (ibid). It thus guarantees constant functioning and facilitation of the global credit system of the Wall Street-Federal Reserve-IMF complex. As has been demonstrated, the shift from ISI and Keynesian-led economic policy to neoliberal-driven SAP in Argentina was one of the most radical and forceful, which also served to embed the nation in the global debt architecture. An indebted state gets integrated into the global financial architecture to such an extent as to become not only dependent on private and public loans, but also, on the general stability of the whole capitalist system (ibid: 936).

In general, therefore, it may be argued that the reasons behind the long delay of the cancellation of the convertibility regime in Argentina lays within both the internal and external financial capital vested interests. Since the mid-1970s, when ISI strategies were abandoned, foreign indebtedness facilitated by the convertibility regime became an essential instrument to promote the domestic oligarchic and transnational financial interests as well as being the means to channel upward income accumulation (Teubal, 2004). By 2001, the system that enabled access to external financing became an organic part of the country’s politics and no alternatives were considered possible. It is estimated that half of the country’s $90 billion in bonds were owned by domestic financial institutions, such as banks and pension funds as well as the upper class with offshore accounts (Setser and Gelpern, 2006). It is claimed that “the IMF got both the economics and politics wrong by continuing to support Argentina’s attempts to cling to its peg” (ibid: 481). However, that system was not “failure”, but rather a “success” of the Wall Street-Federal Reserve-IMF complex,

[132] Securitisation of debt means lending of capital not through bank loans, but by selling stocks and bonds usually characterised as short-term loans as opposed to long-term ones (Soederberg, 2005: 936).

which, in alliance with domestic capitalist class and in accordance with the GFO, implanted neoliberal financialisation in Argentina.

*7.2.3. The level of income inequality: 1980-2010*

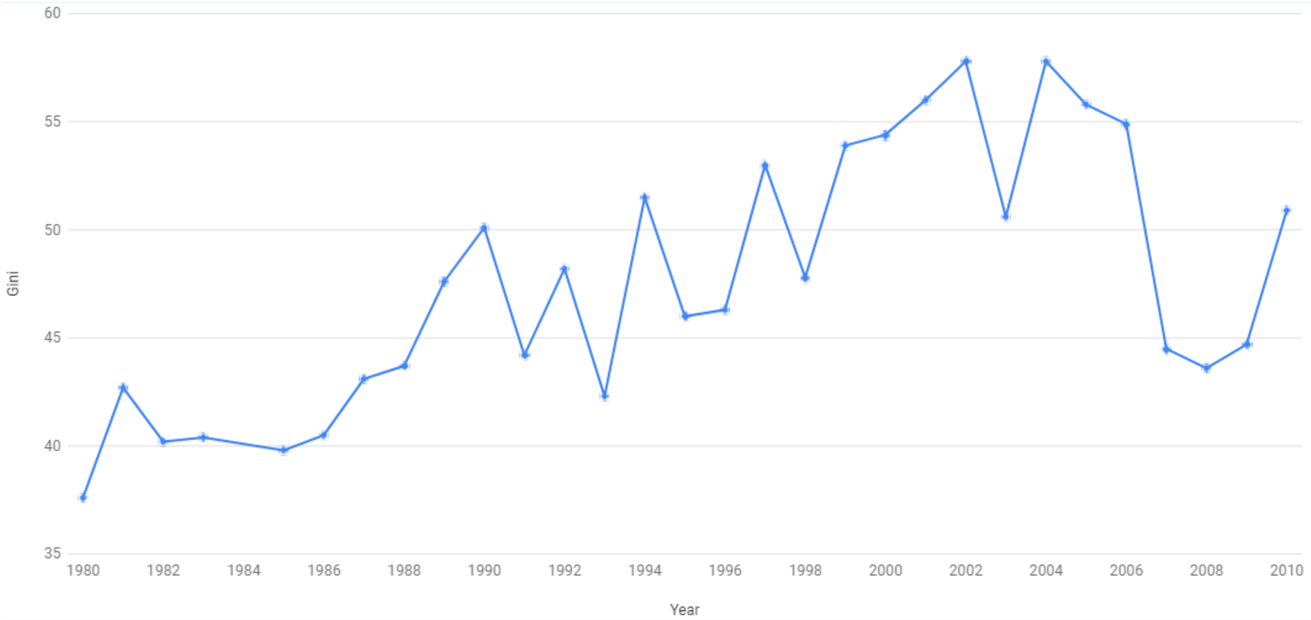
Besides making Argentina more vulnerable to external shocks and depleting sustainable economic growth, the neoliberal economic policy model and SAP policies of the 1980-2002 period established a process that generated greater regressiveness in income distribution (Giarracca and Teubal, 2004). For instance, in 1974 the richest 10% Argentinians received 28.2% of national income, which was 12.3 times more than the poorest income decile, whilst the lower 30% and the lowest 10% absorbed 11.3% and 2.3% of GDP, respectively. In two decades, by 1997, the top 10% received 37.1%, while the remaining two groups got only 8.2% and 1.6%, respectively. By the same token, if in 1974 only 7.7% of households were officially defined as “poor”, that number in 1996 had reached 20%, declining from 48% in 1989 (Teubal, 2000: 481-482). The Gini coefficient skyrocketed from 0.37 in 1980 to 0.50 in 1990 and from 0.44 in 1991 (0.42 in 1993) to a shocking 0.58 in 2002 (Figure 7.2).

In his thorough study of the top income shares in Argentina covering the 1932-2004 period, Alvaredo (2010) points out that the market-oriented structural reforms and rigorous monetary policy of the convertibility regime between the late 1980s and the early 2000s were not neutral to income distribution. For example, between 1997 and 2003 the top 1% and 0.01% shares rose from 12.4% and 1.4% to 16.8% and 2.8%, respectively (ibid: 280). The tendency of upward income transfer continued at the beginning of the new millennium. In 2002, the upper 10% received 37.6% of GDP, which is 33.6 times what the poorest 10% received, 1.1% of GDP. In 2000, the number of people living below the poverty line was 30% of the population, growing by 3.8 million more between January and May 2002 alone. In June 2002, the proportion of the officially poor was more than half the population (Giarracca and Teubal, 2004: 76-77).

As evident from Figure 7.2, there were two noticeable trends in the 1980-2008 period in income distribution in Argentina distinct for almost all Latin American countries (Gasparini and Lustig, 2011). First, as has been described, a steady deterioration of income inequality is observed during the “lost decade” of the 1980s, neoliberal restructuring of the 1990s, and the financial crises at the turn of the century. Second, beginning in 2002 and up until 2008, income inequality declined significantly.

That is, the Gini coefficient fell from 0.533 in 2002 to 0.474 in 2006 and further down to 0.458 in 2009 (ibid: 14). However, after 2009 the previous upward trend continued, with it becoming higher than 0.50 in 2010 (Figure 7.2).

**Figure 7.2. The Gini coefficient level in Argentina, 1980-2010**




Source: created from The World Income Inequality Database, United Nations University, 2017

A systematic study of the main patterns and trends in income distribution in Argentina from the mid-1970s to the mid-2000s was conducted by Gasparini and Cruces (2008: 7-11), who divided three decades of income distribution change into six episodes, from 1974 to 2006. The first episode comprises the 1974-1982 period of the last two years of a democratic regime and the subsequent military dictatorship, which was characterised by wholesale trade liberalisation and assault on labour. During dictatorial rule financial liberalisation was initiated, while social policies were cut, which is reflected in sharp increase in the Gini coefficient, from 0.345 in 1974 to 0.430 in 1981. The second episode covers most of the 1980s, being associated with the restoration of democracy, trade union activity and increased social spending, but weak economic growth and macroeconomic instability. Income disparities remained stable during most of this period. The third episode encompasses the macroeconomic crisis of the late 1980s, starting in 1988 with two episodes of hyperinflation culminating in adoption of the convertibility regime. This period is characterised by the first structural adjustment reforms of the Washington Consensus, when both a severe increase and a consecutive sudden fall in income inequality occurred after hyperinflation was halted. During the fourth episode pertaining to the 1990s, the Currency Board "reined" and the economy continued to undergo deep neoliberal reform, with liberalisation of the capital markets, deregulation and privatisation. A pay-as-you-go pension system was transformed into individual capitalisation accounts, while labour institutions were weakened. The upward unequal trend in income distribution continued: the Gini coefficient, for instance, in urban areas rose from 0.452 in 1992 to 0.507 in 2000. The fifth episode includes the recession, which started in 1999, the end of the convertibility regime, followed by devaluation and the 2001 crisis. Again, this period witnessed sharp increases in income inequality and its slight fall after stabilisation. The sixth episode began around 2004 and is characterised by the implementation of policies of the left-of-centre Nestor Kirchner government (2003-2007), which rejected the neoliberal doctrine in Argentine socioeconomic policy-making. Labour institutions were strengthened and social spending was increased. As has been mentioned above, there was a substantial decline in income inequality: the Gini coefficient dropped from 0.507 in 2000 to 0.458 in 2009. It is assumed that a different logic corresponds to each episodic story of inequality change in Argentina (ibid). Accordingly, various factors both macroeconomic and microeconomic have been highlighted, including openness to international trade, technological change, unions and labour institutions, and social protection.

However, from a political economy perspective, the whole 1980-2002 period could be defined as an era of drastic neoliberal ascendancy, when orthodox adjustment policies provided mechanisms through which regressive income distribution effects were operating. Conversely, the 2003-2010 period witnessed the reverse in Argentinean politics, when President Kirchner, with a progressive redistributive platform rebuffed the neoliberalism that had reigned for decades. For example, Montecino (2012) demonstrates that under the left of centre government of Kirchner income inequality was reduced significantly.

To summarise, income distribution changes in Argentina during the 1980-2010 period appear to have been primarily dependent on the choice of policy-making preferences, either right-wing market-oriented or left-wing redistributive ones. In this regard, I argue that neoliberal financialisation implanted in the country entrenched drastic regressiveness in income distribution during the 1980-2002 period. Given the return of the upward unequal income distribution trend after 2009, it could be argued that state-led and debt-driven financialisation favouring the interests of the oligarchic groups and transnational capital never loosened its grip, which raises important questions about its nature.

Having depicted and considered how during the neoliberalisation era the respective institutions were established and their consequences for income inequality, I will now move on to examine whether particular variables of the three analytical constructs signifying financialisation and representing functional distribution of income can be applied to Argentina.

### 7.3. Analytical construct #1: the evolution of the Argentine financial sector

A growing body of literature has investigated the process of financialisation and its impact on the socioeconomic development of developing and emerging economies, maintaining that, to a varying degree, these countries have experienced this phenomenon (Demir, 2007; Lapavitsas, 2009; Becker *et al*., 2010; Bonizzi, 2013; Karwowski and Stockhammer, 2016). In the case of Argentina, over the 1991-2001 period, financialisation was a result of the availability of high profits from the financial markets following capital account liberalisation. Also, there has been a tendency among nonfinancial corporations to become rentiers (Demir, 2017).

In the following subsections, in line with arguments presented in subsection 6.2.2. (Chapter 6), I will show how during the neoliberal era of the late 1980s and the early 2000s, a state-led and foreign debt-driven financialisation process was built in Argentina. In essence, after shifting from the ISI strategies this country functioned in a matrix of the global debt architecture, where its role was to meet the "creditworthiness" standards of the Wall Street-Federal Reserve-IMF complex, which involved securing the transfer of wealth in favour of the transnational capital and domestic oligarchic conglomerates.

Admittedly, Argentina has had one of the most extremely liberalised financial systems in the world, with absolute free inflow and outflow of capital without any registration requirements (O'Connell, 2005). Interest rates were fully liberalised and interests on deposits were exempted from income tax. A deregulated financial and banking sector was opened to foreign entry and almost all provincial banks were privatised, while a large proportion of the operations were conducted in foreign currency. In 1994, the pension system was partially privatised allowing earners to channel their payments to private funds. In the post-1995 crisis, the banking sector became more concentrated, while the number of foreign banks increased: 73% of total bank assets were represented by 39 foreign-owned banks by 2000. Between 1994 and 2001, bank deposits doubled with a brief episode of an 18% fall during the 1995 "Tequila crisis" (ibid).

Financial policy regimes have been at the centre of political debates in Argentina since the 1950s. In his report to the military government on what kind of national capitalism the nation should build, an internationally acknowledged economist, Raul Prebisch, argued that,[133]

> "Foreign capital has been a controversial subject in Argentina and it is advisable that public opinion should be enlightened as to its role. In order rapidly to overcome the present crisis affecting the country's economic development, foreign loans and capital investments are required. [T]he country (…) will have to create favourable conditions for the influx of foreign capital by curbing inflation and taking severe measures to achieve equilibrium in the balance of payments". (Prebisch, 1955 in Castagno, 2014: 814).

As Castagno (ibid: 814) argues, this indicates the historical connection between the neoliberal austerity measures to be implemented in the country decades later and "the entanglement of Argentina's economic structures with transnational capital". With the convertibility regime in place, the Argentine Central Bank shifted from providing credit and financing the national government, whereby its monetary policy priority was to attract foreign capital and protect its value against inflation. It is estimated that foreign investment increased from $5.8 billion in the 1980-1989 period to $67.6 billion in the 1990-1999 period (ibid: 818). Monetary stability and the free movement of capital important for transnational capital, in this regard, became fundamental concern of the government.[134] For example, foreign transfers of all external capital and profits were guaranteed in 1991 by the special Decree 1853/1991 (ibid: 817). Accordingly, monetarism as one of the ideological foundations of the neoliberal project and doctrine, played a crucial role in financialisation becoming deeply entrenched in Argentina. In this sense, the neoliberal way of governance legitimised and

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[133] Raul Prebisch (1901-1986) was an Argentine economist, who contributed to structuralist economics and dependency theory. He served as an executive director of the Economic Commission for Latin America and in 1950 released his study *The Economic Development of Latin America and its Principal Problems*. From 1964 to 1969, he was the founding secretary-general of the United Nations Conference on Trade and Development (UNCTAD).

[134] As Minister of the Economy, Domingo Cavallo noted, "We will assure stability by establishing a monetary system that will keep Argentina linked to the world" (Cavallo, 1991 in Castagno, 2014: 817).

institutionalised financialisation as an outcome of pro-finance capital macroeconomic policies. The 1991 Convertibility Law, as an instrument of this monetary regime to attract external capital, also maintained the framework of constant and legitimate income transfer in favour of the ruling and transnational classes. For instance, interest payments grew from $2.5 billion in 1991 to $9.5 billion in 2000, which was increase from 1.2% to 3.4% of GDP (Soederberg, 2005: 943). Argentina went beyond the mere financial liberalisation and deregulation that had occurred during the military dictatorship and Alfonsin administration. The convertibility regime became a new mode of absolute control that deprived a sovereign state of an independent economic policy in favour of transnational capital and the local oligarchic conglomerates. For this reason, it could be contended that the financial sector became dominant in Argentina through securing the interests of transnational capital, in particular, and of finance capital, more generally.

In addition to maintaining monetary stability and free movement of capital, which is pivotal for finance capital, the Argentine state (as well as other countries of the Southern Cone), in 1993, represented by the Menem's administration, signed the Brady agreement with the IMF and the US commercial banks to signal its creditworthiness to the external creditors.[135] As the result, Argentina swapped its debt in loans to government bonds (Brady bonds) worth $16.97 billion. Together with securitisation, this meant that Latin American and Argentine debt became tradable and indicated commodification of the sovereign debt on global financial markets (Castagno, 2014). Developing countries got access to external capital markets, thus escalating their debt burden, while commercial banks received additional protection from risks: now they could trade government bonds on the secondary market or exchange large unbearable debts for equity investments. It is contended that these arrangements "have had the effect of transferring wealth from debtors to creditors and multilateralising huge debts incurred by US banks" (Soederberg, 2005: 937). Whilst in the early 1980s, 55% of the Argentine sovereign debt was in commercial bank loans,

[135] The Brady agreement was named after the US treasury secretary Nickolas Brady and stipulated reduction of the actual value of the part of outstanding debts owned by US private banks. Some of the write-offs were financed by the IMF and the World Bank and the rest was converted into new sovereign bonds, Brady bonds. The key point is that the scheme allowed these banks to exchange their claims on developing countries into tradable instruments and get the debt off their balance sheets (Soederberg, 2005).

by 1999, 78.7% of the foreign debt was made out of issuing government bonds (Castagno, 2014: 818).

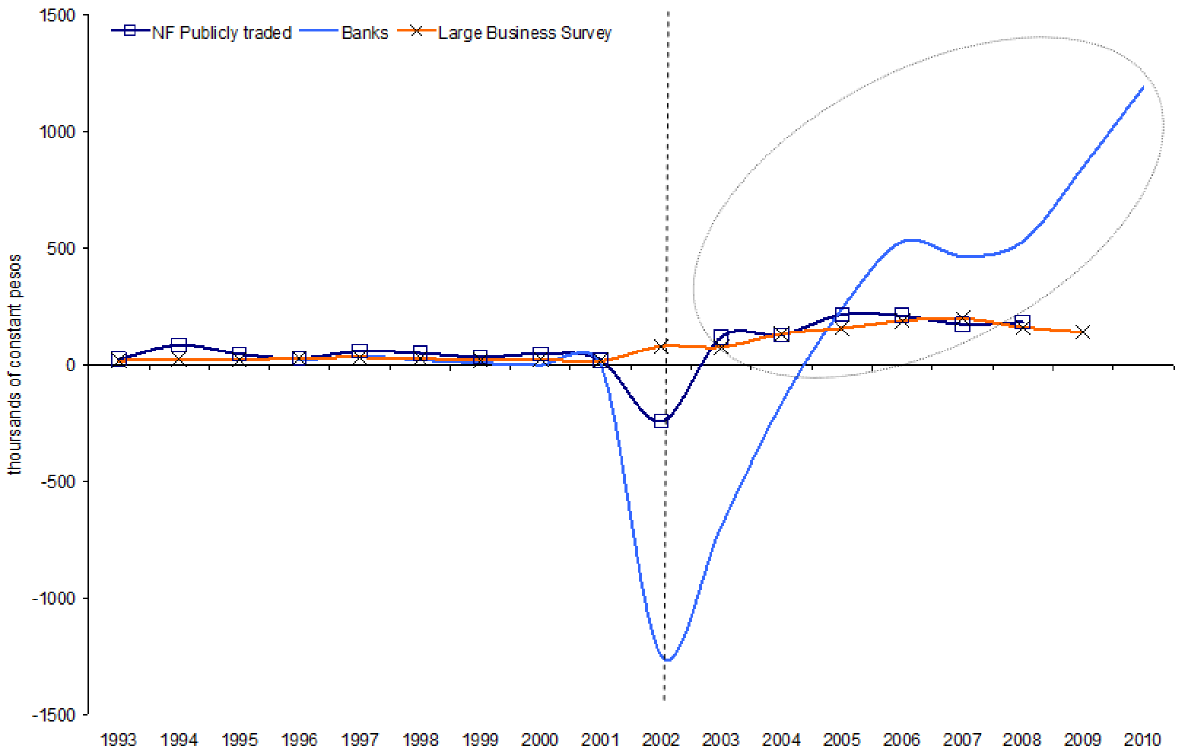
Borrowing from global markets also means voluntarily getting under the supervisory and "disciplining" power of the global financial market prerequisites, such as the size of the budget deficit or implementation of austerity measures to meet "creditworthiness test" requirements. The Argentine state had to concentrate on how to maintain debt servicing, rather than on equalising redistribution or other welfare policies. Strict fiscal disciplinary measures had to be "self-imposed" and resources accumulated to pay debt. Thus, it could also be reasonably contended that in order to trace the financialisation process the size of the national financial sector is not as important as in other cases. That is, in the Argentine case, it was its sovereign debt and its ability to borrow new debts (through issuing government bonds and maintaining the convertibility regime) that manifested financialisation.

As Teubal (2000) argues, even the deindustrialisation was to some extent deliberate so that the finance establishment could engage in financial activities and speculation with, little if any, investment in manufacturing. This transfer of resources into speculation, in turn, substantially changed the structure of the Argentine economy and furthered the hegemony of financial interests in the country (Giarracca and Teubal, 2004: 71). This is echoed and reflected in implication that the financialisation of the Argentine economy actually increased in the post 2001-2002 crisis period. Employing Krippner's (2005) accumulation-based approach, Cibils and Allami (2013) point out that during the 2003-2010 period profit shifted in favour of the banking sector significantly away from non-financial corporations. This is because in spite of anti-neoliberal rhetorics of the Kirchner left-wing government the financial liberalisation and deregulation framework, which had been implemented within the 1977 financial reform, was not changed. The Financial Entities Act, for instance, enacted by the dictatorial regime to liberalise national and international financial markets and get rid of "financial repression" was left untouched. Another example that reveals the state-led and debt-driven nature of financialisation in Argentina, is that to protect banks from collapse and a run on deposits during the 2001-2002 crisis, bank deposits were converted into government bonds, the nominal value of which increased in the post-crisis period. This was a form of state subsidy and a major source of profits not available to other sectors or social groups, especially taking into account that public bond holdings reached more than 30% in 2004-2005 of total bank assets (ibid).

## 7.4. Analytical construct #2: dynamics in the financial sector profit rates and labour's share of income

In a study conducted by Chortareas *et al*. (2011), which covered nine Latin American countries from 1997-2005, including Argentina, it was shown that the large banking market of this country (along with Brazil and Chile) had much higher than average profits. The most important factors explaining this are capital ratios and bank size. As it has been discussed, the Argentine banking sector experienced profound deregulation and liberalisation, which promoted foreign investment and M&A activities by the foreign financial institutions. The financial crises of the 1990s resulted in a wave of consolidations and there was a swift upsurge of market concentration in the banking system, which increased banks' market and political power, thus having detrimental effects on productive investment and consumers in Argentina. For instance, the average net interest margin in Argentine banks, which is 6.18%, is higher than in industrial countries, being 4.17% in the US and 2.79% in the UK. The profitability ratios, such as return on assets (ROA) and return on equity (ROE) are lower than the average in the region, 0.63% against 1.89% and 6.53% against 16.44%, respectively (ibid). Most probably, this is the result of the banking crises experienced by Argentina in 1999 and 2001 and the impact of the negative GDP growth. Still, as Figure 7.3 demonstrates, after incurring losses during 2001-2003, the banking sector's profits skyrocketed compared with non-financial ones. Such a tremendous profit behaviour has been interpreted as an explicit pro-financial sector redistribution of income (Cibils and Allami, 2013).

**Figure 7.3. Real average profit of the financial and non-financial sectors in Argentina, 1993-2010**




Source: Cibils and Allami (2013, Figure 2)

In the case study of finance and power in terms of their impact on income inequality in Argentina in the early 1990s and the late 2000s, Galbraith *et al.* (2007) and Galbraith (2012) assert that the largest single contribution to pay inequality originated from the financial sector. By implication, this is also evident from data on pay inequality in Buenos Aires City, the region which contributed to income inequality the most in the 1994-2005 period. This is the region where 74% of its GDP accounted for the services sector, of which 48% was the financial sector in 2001 (Galbraith *et al.*, 2007: 13). Conversely, it is argued that income inequality fell in Argentina as the share of revenues allocated by the financial sector declined (ibid).

The labour share of national income in Argentina clearly indicates that it was the working and middle classes who bore the main burden of the neoliberal era and shift to financialisation. Frankema (2009), in his study of Argentina during 1870-2000, highlights that the average labour income share of the country during the 20th century was 49.5% fluctuating extremely between 29% and 61%. In the late 1970s, it experienced an enormous collapse in the aggregate labour income share, which plummeted to 29% in 1977 from its peak of 61% in 1950 (ibid: 35-36). This share underwent sluggish growth in the 1980s, varying between 38% in 1980 and 45% in 1990, with an average of 42%. During the convertibility regime in the 1990s, the aggregate labour income share increased slightly due to macroeconomic stability, but it never reached the 60% threshold with 44% in 1991 and 56% in 2000 (ibid). Overall, the average labour income share between 1980 and 2000 was just 45% and its dynamics correlates positively with the pattern of rising levels of the Gini coefficient in the same period and the early 2000s, i.e. reflecting a greater regressiveness in income distribution during the neoliberal era (Figure 7.2).

Labour precariousness continued in the post-2001 crisis period, with unemployment reaching 23% and underemployment 22%, by June 2002 (Giarracca and Teubal, 2004: 76). This tendency of a deteriorating position of the working and middle classes had started in the early 1990s as an outcome of the drastic orthodox stabilisation programmes and exchange-rate overvaluation, with the average real wage subsequently declining by 16% between 1994 and 2001 (Saad-Filho, 2005: 226). In fact, the average real wage of the 1990s was 15% lower than in the 1980s (O'Connell, 2005: 296).

Average annual economic growth of 8.5% between 2003 and 2008 was accompanied by inequality reduction. For the first time, in contrast to the previous decades, real wages grew 46% in the 2003-2012 post-neoliberal era. Increasing employment and labour market formalisation following the repudiation of the neoliberal doctrine had an equalising effect on the level of income inequality: the Gini coefficient level declined from 0.553 in 2003 to 0.425 in 2012 (Beccaria *et al*. 2015).

**7.5. Analytical construct #3: rental income from financial assets and private debt**

The peculiarity of the Argentine case is that rental income has been extracted not necessarily for the benefit of financial institutions and from financial assets only as the state became captured by different economic conglomerates (*grupos economicos*) operating in the country. For decades, beginning in the 1970s, foreign debt was one of the principle sources employed by the entire political and economic structure of the state to accommodate capital accumulation for the benefit of the ruling class (Teubal, 2004). Neoliberal-driven policy measures of financial liberalisation and deregulation adopted during the dictatorship (1976-1983) were associated with increasing foreign indebtedness and capital flight as well as favouring financial speculation. A free exchange rate and full mobility of capital ensured the integration of Argentine finances into international markets. Foreign indebtedness, in this regard, is the result of strengthening the connection between domestic and transnational capital (ibid: 175). Regarding which, 90% of the borrowed revenues were used for financial activities not associated with productive investments, being transferred to foreign exchange markets for speculative purposes. From 1976 to 1983, interest on foreign debt rose from $515 million to $5.4 billion, while the aggregate accumulated interest totalled $19 billion (ibid: 176).

Most of the foreign loans were made by private companies under the guarantees of the Argentine government, which later had to "nationalise" the debt not honoured by these firms, thus creating strong incentives for the escalation of sovereign indebtedness. In addition, the 1978 exchange rate regime, the "crawling peg", also facilitated increase of the debt by guaranteeing speculation was profitable: local interests rates were higher than international interest rates, thus inviting fictitious capital to the local financial markets. If this was not enough, in 1981, after a 500% devaluation to "compensate" for the losses of the large corporations, exchange rate insurance was provided, contracted after the fact and private foreign debt was "nationalised". The IMF supported and legitimised this scheme by providing a new stabilisation loan to the Alfonsin administration (ibid). It is estimated that as a consequence of these policies, capital flight reached more than $31 billion in the 1978-1981 period, while 64% of private foreign debt latter to be transferred to the government was made by 28 domestic economic conglomerates and 102 international corporations (ibid: 178-179). In total, it is estimated that in the 1981-1989 period state subsidies in the form of various transfers for the benefit of *grupos economicos* amounted to $105 billion, which equalled Argentine yearly GNP (ibid: 180). Moreover, the convertibility regime (1991-2001), with its fixed peso-dollar parity, kept devaluation expectations under control and led to an overvalued peso, which together with increased import consumption and deindustrialisation, created a chronic trade and fiscal deficit. The latter necessitated and "justified" increased foreign borrowing both by the government and private companies to cover expenses.

After the privatisation of the pension system, between 1994 and 2003 more than $30 billion were shifted to private pension funds, thus enriching the financial establishment. Another $10 billion was charged by the transnational and local banks (ibid: 183). Also, during the Menem administration, both foreign debt and privatisation complemented to concentration of capital. This led to the marginalisation of small and medium-sized business as large conglomerates began to dominate the market in almost all areas of the Argentine economy.[136]

There is no evidence that household consumption in Argentina was financed at the expense of the increasing private debt. After the neoliberal decades of debt- and consumption-driven economic policy, followed by the 2001-2002 crisis, consumer spending decreased from 70% of GDP in 1999 to 57% in 2012. It is suggested that this is because either the leftist government was spending more or Argentines spent less or both (Scott and Mitchell, 2014). Nevertheless, the number of Argentines with a bank account in the formal banking system reached 76.5% of population by 2013 from 41.7% in 2002. Banks benefited enormously from this customer upsurge in that the usage of credit cards rose by 478% over the 2003-2013 period, from less than 7 million to 40 million cards. Issuance of debit cards grew by 175%, from 11 million to almost 30 million cards in the same period. The annual total retail value of the credit and debit card industry skyrocketed by 767%, from $10.1 billion to over $61 billion over this period (ibid: 65).

In contrast to the 1990s, in the post-default Argentina private indebtedness has not been increasing as most of the households have used consumer credit (in pesos not in dollars) to reduce inflation costs. That is, in a high-inflation economy (estimated around 25% in 2014) it is better to buy goods today and pay later with cheaper currency. Moreover, in addition to the larger consumer base with constant merchant fees (usually 3%) in the banking system, lending financial institutions profited from interest rates on credit cards. It is estimated that the average annual interest rate was 30.1% during the late 2000s and 2010s (ibid: 68). Ironically, it is implied that the increase in the number of Argentines in the formal banking system is the result of the enforced payroll scheme, which, in turn, was caused by the government policy change in consumption taxation. Argentina used to have the lowest tax revenue-to-GDP ratio in the region between 1978 and 1998, but managed to transform into the highest, with a consumption tax revenues to GDP increase from 6.5% to 13% (ibid: 63).

It is possible that in Argentina household indebtedness was never as high and critical as in the cases of the USA and Korea, since other socioeconomic factors, such

[136] It is argued that after systematic assault against trade unions even during the restoration of a democratic regime in the 1980s-1990s, the Confederacion General Economica (CGE) representing small and medium-sized business was completely ousted by the powerful Union Industrial Argentina representing big business (Teubal, 2004).

as unemployment and a poverty rate up to 54% in 2002 manifested one of the worst regressive models of income distribution. This inconsistency with the analytical construct, which suggests an increased level of household debt in the financialisation-induced income inequality hypothesis, may be also due to low accessibility to credit by the impoverished population in the poorly developed banking infrastructure of the 1980s and 1990s. However, I would argue that, unlike in the cases of the USA and Korea, the rigorous monetary policy of the convertibility regime "substituted" the household indebtedness factor in Argentina for the high foreign debt to be serviced by the whole country. Deeply entrenched and institutionalised neoliberal financialisation has been facilitating a constant increase of the sovereign debt and its servicing such that not just the impoverished middle and working classes' income has been extracted, but the entire nation has been made to sustain fully regressive income redistribution.[137]

### 7.6. Conclusion

The results of this case study support the idea that embedded neoliberal financialisation leads to entrenched income inequality trends. From a class-interests perspective, Argentina presents an emblematic case of how both the national and transnational capitalist classes, after the structural crisis of capital accumulation of the 1970s, gradually, but eventually, utterly, adopted a path that ensured income transfers for their exclusive advantage. The changes in the Gini coefficient that the country experienced were among the largest and most abrupt in contemporary history, placing Argentina in the same league as some of the most unequal nations of the region, justifying the reference to Latin America's experience of the late 20th century as "a lost quarter of a century" (Dumenil and Levy, 2006b: 390). The increasing gap in the income distribution can be traced to the policies of abandoning ISI strategies in the

[137] In 2014, Argentina technically defaulted again, because the country refused to pay "vulture fund" investors, mostly US hedge funds, which had bought Argentine debt cheaply after the economic crisis (Watson, 2014). Even though they represented the minority bondholders (the so called "hold-outs"), the New York courts blocked payments to other bondholders, who had agreed to settle the case with Argentina, until agreement was reached with the "hold-outs". "Vulture funds" demanded interest payments on the debt, which was defaulted in 2001 and had been bought at less than face value. In 2016, during the new right-wing Mauricio Macri administration, Argentina "agreed" to pay $7.1 billion (!) to the small group of hold-outs. This is yet another example of how the country under restoration of the neoliberal order is diverting income from its people to "honour" foreign debt in favour of the finance transnational class, which is supported by the mighty Wall Street-Federal Reserve-IMF complex. After being absent from the international credit markets for more than a decade, *The Economist* victoriously announced that Argentina "hopes to raise up to $15 billion through a bond issue, which it will use to pay creditors" (Economist, 2016).

late 1970s and early 1980s, the first financial liberalisation under the 1976 dictatorship, the debt crises of the 1980s and thorough to the embracement of the neoliberal ideology as manifested in the convertibility regime of the 1990s and which culminated in the new escalation of foreign debt during the financialisation era in the 2000s.

The data from this case study suggest that household debt is not a necessary aspect of the functional distribution of income such that there is a correlation between financialisation and increased income inequality. For instead, in the case of Argentina, the evidence presented shows the connection between neoliberal monetarist financialisation of the country and its enormous public and private debt and how it was latter "nationalised" under the pressure of the domestic rentier class. As in Korea and the USA, ideational changes can be traced in Argentina when the establishment faced a capital accumulation crisis and employed new strategies offered by the GFO, which were facilitated by the Wall Street-Federal Reserve-IMF complex.

The most salient finding to emerge is that the Argentine case offers an additional explanation for the financialisation-induced income inequality hypothesis by providing the *state-led* and *debt-driven* aspect. First, the country underwent a full-scale neoliberal economic restructuring, climaxing in the adoption of a fixed peso-dollar parity. Second, an overvalued exchange rate brought "stability", which was important for the "creditworthiness" test of the GFO to embed the country in the transnational debt architecture. Third, Argentina's ruling class in this new environment switched to the new sources of income accumulation through finance speculation and foreign debt building, with subsequent "nationalisation" causing income distribution to become much more regressive. During the 1990s, Argentina managed to become the fourth largest recipient of foreign finance and at the very same time to build its huge external debt. Thus, a Currency Board right at the beginning, established as a part of an anti-inflation package, facilitated the embeddedness of financialisation in the Argentine political economy. This was when the neoliberal ideological project was successfully implanted by the oligarchic establishment to serve transnational capital and thus, to maintain constant, guaranteed by the state, upward and outward income and wealth transfer.

On its part, the GFO secured various mechanisms for servicing the debt to safeguard the interests of the Wall Street-Federal Reserve-IMF complex. In addition to the long support of the convertibility regime, the IMF provided funds to Argentina and facilitated various arrangements, such as the Brady Plan and securitisation, to make sure that the debt was constantly refinanced.

The principal theoretical implication of the *state-led* and *debt-driven* dimension of the neoliberal financialisation is that it helps to explain why and how this financialisation survives even after radical changes in the political orientation of a country. In the case of Argentina, after the 2001 crisis and the subsequent turn to the leftist governments of the Nestor Kirchner and then Cristina Kirchner, who had repudiated the neoliberal project, income inequality began to rise again in 2009 after some slowdown during 2004-2008 period. In this regard, one may describe Argentina as capital's best role model in embedding neoliberal financialisation. As Gago (2015: 13, emphasis added) argues with regards to financialisation in that nation,

> "However, neoliberalism survives as a set of conditions that are manifested, from above, as the *renewal* of the extractive-dispossessive form in a new moment of financialised sovereignty and, from below, as a *rationality* that negotiates profits in this context of dispossession, in a contractual dynamic that mixes forms of servitude and conflict".

Thus, the Argentine case supports the idea that once neoliberal financialisation is implanted in a country, distribution of income is facilitated in favour of a capital entrenching income inequality.

## Chapter 8. Sweden: defending economic democracy

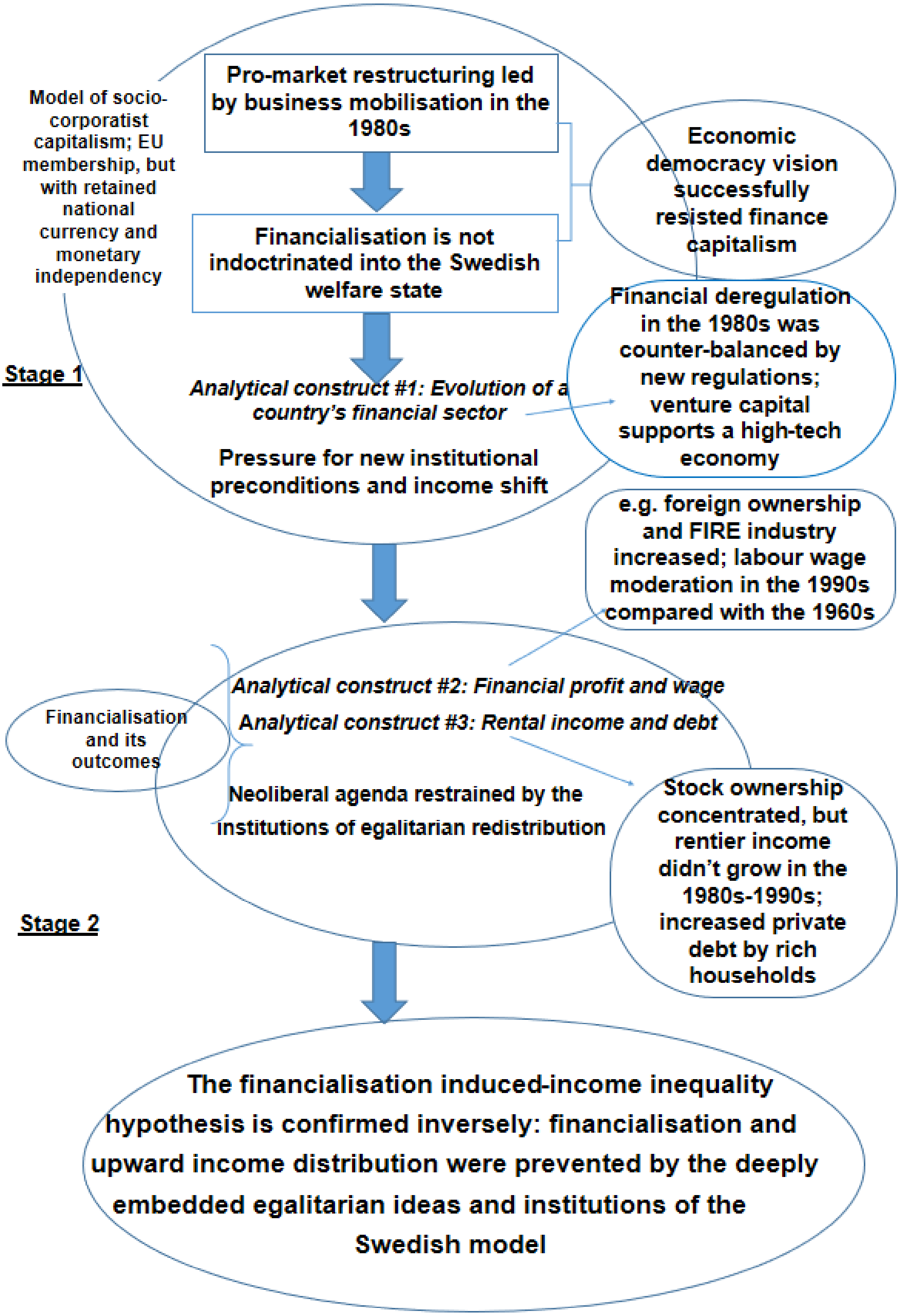
*"We have never lost sight of our goal, which points beyond a bourgeois society and toward a socialist order"*. Hjalmar Branting, Swedish Social Democratic Party leader, Parliamentary debate, December 17, 1918 (in Steinmo, 1988: 403).

### 8.1. Introduction

The objective of this chapter is to investigate whether neoliberal financialisation over the 1980-2010 period was able to penetrate the Swedish social democratic institutions of egalitarian and universal coverage, to the extent of changing its pattern of income distribution. It will be shown that financialisation was not embedded in the mode of governance and social fabric of the country at such a level as to radically transform the Swedish model. The explanation offered in this study, in accordance with its analytical framework, is that Sweden and its welfare state embody an example of a coordinated market-economy with deeply embedded egalitarian traditions and a vision of economic democracy, which has been able to, thus far, resist the rise of financial capitalism (Figure 8.1).

The sections below follow the same descriptive-interpretive and explanatory analysis as in the previous three cases. In the next section, the Swedish model is briefly described and the context in which the neoliberal assault on that model began. By the mid-1970s, the drop in top incomes in Sweden was the largest among the developed Western countries, thus indicating a remarkably equal distribution of income. To achieve these results, Swedish socio-corporatism included instruments such as solidaristic wage policy, active labour market policies, centralised collective bargaining and high levels of the trade union membership. The lattermost is one of the most crucial characteristics of the Swedish model, signifying the importance of strong and powerful labour vis-à-vis capital. Backed by radical elements and truly committed to the ideas of economic democracy trade unions, the Swedish Social Democratic Party tried to implement reforms that could definitely be interpreted as being socialist. Employing a Marxist interpretation of the pivotal events, it will be demonstrated how the attempt to socialise ownership arranged in the form of wage-earner funds was confronted by capital's counter-strike in the form of pro-market restructuring. However, business elite revisionism of the Swedish model in the 1980s did not lead to a neoliberal ideational transformation.

**Figure 8.1. The analytical framework of the financialisation-induced income inequality nexus in Sweden**




Source: researcher

Whilst beginning in the early 1980s there was a tendency towards increased income inequality, this was not cemented. Based on the evidence and data generated for this study, it can be argued that, in Sweden, increased income inequality in the late 1980s and the 1990s was mainly the result of credit market deregulation, where capital income became responsible for this uneven distribution. However, it was temporal and devaluation- and recession-driven, the later ones being the outcomes of financial liberalisation. No significant disproportion was found in the rate of profit in the financial sector vis-a-vis labour's income share and rental income from financial assets vis-à-vis household indebtedness. Thus, it can be argued that when finance was deregulated relatively lightly in Sweden, income inequality increased, which supports the financialisation-induced income inequality hypothesis. However, as will be shown, finance capital's attempts to restructure the domestic political economy towards its full-scale financialisation in Sweden were restrained.

## 8.2. The Swedish model: embedding income equality

### *8.2.1. Corporatism, unionism, and egalitarianism under the neoliberal assault*

It is now well established from a variety of studies that the Swedish model of socio-corporatist capitalism represents the most expansive Keynesian welfare state of the post-war era, which helped to create one of the most egalitarian and wealthy societies in the world (Lundberg, 1985; Meidner, 1992; Ryner, 2002; Steinmo, 2003). In his seminal article, Lundberg (1985: 10) accurately demonstrated that the fundamental and ambitious goals of income equalisation and full employment in Sweden have been the results of "a clear element of consistency between the Keynesian (or Stockholm School) policy attitudes and the desire for social reforms involving income equalisation". Swedish social democrats had an organic distrust towards unregulated free market system, particularly the financial one, and believed that to avoid underutilisation of resources and achieve efficient coordination, government intervention was necessary along with a large public sector and universal social insurance system (ibid).

As early as the 1940s, the "Myrdal Commission" outlined some elements of what was to become the cornerstones of the Swedish welfare state.[138] The report of

[138] Gunnar Myrdal (1898-1987) was an internationally recognised Swedish economist and politician, who contributed to social democratic thinking and is considered as a founding figure of social policy through his studies exploring the notion of the welfare state. Ironically, he shared the Nobel Memorial Prize in Economics

the commission recommended government planning, control and stimulation of private investment, i.e. “socialisation of consumption”, meaning the expansion of social policy reforms and control of the financial system. In addition, low interest rates and high tax rates became almost a creed for the Swedish social democratic governments for decades (ibid). Around this time, important and innovative concepts, such as mobility of labour, occupational training, investment in human capital and *a solidaristic wage policy*, as an essential element of justice to increase the income and wages of the unskilled workers, women, and farmers, were proposed. These notions became firmly embedded in the political economy of Sweden, thus confirming a strong political and socio-cultural back up for the democratisation of economic life. For instance, the 1944 programme of the labour movement explicitly stated the goal of the socialistic transformation of the economic system and had a lasting influence on subsequent social democratic governments in Sweden. To achieve these aims, policies mitigating the negative effects on the distribution of income, such as progressive taxation, wealth tax and pension reforms, were proposed, while conservative ideas on the necessity of uneven income accumulation as a prerequisite for savings were rejected (ibid).

In 1951, two trade union economists, Gosta Rehn and Rudolf Meidner, developed the Rehn-Meidner Model (RMM), which summarised four main policy targets: full employment; wage solidarity and income equality; competitiveness of the export-industry sector; and the control of inflation (Schnyder, 2012: 1127). In order to attain these, at times, contradictory goals, the Swedish coordinated corporatist capitalism consisted of various institutions compensating for each other’s limitations, the so called “supplementary complementarity” (Deeg, 2007). For example, a “liberal” attitude can be traced in trade openness and corporate governance, where a few powerful Swedish families were allowed to control several highly productive companies and were protected against foreign take-over in exchange for higher wages for the workers (Henrekson and Jakobsson, 2001). At the same time, state intervention was extensive in the labour market, where active labour market policies were practised to offset market-driven restructuring in industries (Schnyder, 2012). This system of active labour market policies is considered by some observers as a significant contributor to both economic growth and income equalisation, thus creating, in

with Friedrich Hayek in 1974 and he subsequently argued for its abolition, because it had been given to such reactionaries as Hayek and Friedman.

combination with other social policies, an egalitarian society in Sweden (Steinmo, 2003).

The Swedish political economy has also been described as a bank-oriented system, in the sense that private ownership was highly concentrated in the hands of a few families and bank-centred business conglomerates. In this model, the capital market was strictly regulated and was characterised by close relations between financial and corporate leaders under the auspices of the state. As Reiter (2003: 108) points out, "The state, trade unions and bank-related business groups were all part of an explicit tripartite negotiating culture which characterised Swedish democratic corporatism. This corporatism constituted an institutional mechanism for mobilising consensual support for Sweden's economic model and strategies".

The Social Democratic Labour Party (SAP), which ruled without interruption from 1932 to 1976, was persistently determined to implement progressive reforms with the ultimate vision of economic democracy and reaching consensus between labour and employers (Henrekson and Jakobsson, 2001). Their relations were "sanctified" by the "Saltsjobaden spirit" of coordinating wage policies and the conditions of the labour market.[139] This highlights another distinctive feature of the Swedish model, that is, it was grounded on the strong and powerful position of the trade union movement, which cooperated closely with the government. From the 1930s and up until recently, the degree of unionisation in the country has been one of the highest among industrialised states, thereby ensuring class compromise between labour and capital and a corporatist system of wage-bargaining, which in turn, guaranteed that substantial revenues were channelled back to labour, thus promoting solidarity and equal distribution of income (Wilks, 1996). In this regard, the Swedish model progressed into three successive phases: from political democracy to social democracy to *economic democracy* (ibid: 96). It is suggested that this push for economic democracy emerged in labour demands for increased collective ownership and ultimately, towards socialism. This has been identified as key among the factors that caused the first

[139] In 1938, representatives of the trade union federation (*Landsorganisationen*, LO) and the organisation of employers (*Svenska Arbetgivarforeningen*, SAF) met in Saltsjobaden to reach an agreement concerning settlement of collective contracts and peaceful resolution of labour market conflicts (Olsen, 1991). The agreement also formed the basis for a class compromise, where private property would be secured in exchange for welfare state expansion and high incomes for workers (Wilks, 1996: 95).

"cracks" in the Swedish model, which eventually led to the triggering of a crisis (Ryner, 1999; Henrekson and Jakobsson, 2001).

Much of the literature since the 1990s has criticised the Swedish social democratic regime, emphasising the alleged dismantling of the egalitarian and universalist welfare state, unable to withstand the pressure from neoliberal restructuring (Olsen, 1991, 1992, 1996; Wilks, 1996; Lindbeck, 1997; Ryner, 2002). Deteriorating economic conditions, a sharp rise in unemployment (up to 14% in 1994) and increased budget deficit in the early 1990s led to premature conclusions, such as: "The depth of Sweden's current economic problems indicate that the apparent "success" of the SAP in the 1980s and its return to power in 1994 cannot be regarded as evidence of the resilience of the Swedish model" (Wilks, 1996: 94). Even Rudolf Meidner (1998: 87) sounded pessimistic, claiming that privatisation of the pension system in the 1990s was yet another "example of some of the new neoliberal ideas that have been taken over by the Social Democratic party".

As with some Western economies, Sweden faced structural deterioration of its competitiveness in the late 1960s; low productivity growth and current account deficits relating to the general debacle of the Fordist capitalist paradigm and crisis of capital accumulation (Belfrage, 2008). There is a consensus among social scientists that wildcat strikes in the iron mines of Kiruna (Northern Sweden) in 1969 signified the critical juncture for the social democratic principles of egalitarian redistribution (Ryner, 1999; Steinmo, 2003; Schnyder, 2012). Radicalisation of workers, which spread to other parts of Sweden during 1970 in the form of strikes, has been interpreted as a uprising against a perceived discrepancy of the egalitarian rhetoric of the trade union federation (*Landsorganisationen*, LO) and the SAP and the declining working conditions of miners compared to white collar-workers (Schnyder, 2012).[140] In response to the crisis of legitimation and representation of the Swedish model and in line with the doctrine of a "gradual socialist transformation" of the ruling SAP, further leftist reforms were offered.[141] For instance, more financial support was allocated to

[140] Labour demands included tackling problems of alienation and working life conditions, environmental degradation and uneven regional development. Inadequate labour representation in the workplace was also an important part of the claims from the left (Ryner, 1999).

[141] It is worth mentioning that, in 1974 constitutional amendments were introduced to make Swedish democracy more direct and more responsive. The upper house of the Riksdag was eliminated, which transformed governance model in the sense that even small changes in election outcomes would influence who held the reins of government. In fact, the SAP lost the election in 1976 for the first time in 44 years (Steinmo, 2003).

labour market policy and interventionist investment measures were provided, such as the creation of a state investment bank. New progressive legislation included the Employment Protection Act and the Work Environment Act (1974), the Codetermination Act (1976), and the implementation of parental insurance and day-care programmes. Social and total public expenditures increased from 18% in 1965 to 35% in 1978 and from 37% to 60%, respectively (Ryner, 1999: 54). Most importantly, the SAP in alliance with the trade unions agreed to adopt policies that would promote economic democracy and the socialisation of ownership and capital through the establishment of the so-called *wage-earner funds*. In 1976, the “Meidner Plan” was proposed by the LO, which designed “a mechanism to socialise the economy and reverse the trend towards the concentration of economic power in private hands” (Steinmo, 1988: 431).[142]

This spurred on a counter-mobilisation of capital and employers represented by the Swedish Employers’ Association (SAF), which declared in 1976, the death of the “Saltsjobad spirit”, since, in its view, the “historic compromise” of the corporatist system of wage-bargaining had been undermined (Belfrage, 2008). From a Marxist perspective, it can be argued that the attempt to move from “social democracy” to “economic democracy” and subsequently to “democratic socialism”, was interpreted as a clear threat to business interests and to capitalism as a system: the sanctity of private ownership was seen as being challenged, if not jeopardised. Thus, during the 1980s, the SAF, representing the interests of the business and finance capital, began to delegitimise Swedish institutions that sustained egalitarian distribution long before inflation and capital mobility was on the agenda (Blyth, 2001: 2).

From a comparative vantage point, it can be safely argued that the crisis of capital accumulation of the 1970s was *not* the main cause of this ideational shift in Sweden. Blyth goes on to claim that, in Sweden, sluggish economic growth and

[142] According to the plan, a 20% profit tax would be imposed on corporations and the revenues would be used gradually to buy out major business interests. The funds would be controlled by the unions and “facilitate capital accumulation consistent with the new terms of the moral economy, by pre-empting “excess profits” either going into the hands of capitalists or being distributed only to a privileged (especially white-collar) section of the workforce” (Ryner, 1999: 71). Also, this would cement commitment to a solidaristic wage policy for workers in high profit sectors, who were getting frustrated with “wage solidarity”, because allegedly, the more productive they were, the more they had to sacrifice an increase in their wage in the name of solidarity with less productive workers. Hence, Schnyder (2012: 1131) has even termed “wage solidarity” as the Achilles heel of the Swedish model of economic and social organisation.

increased deficits in the 1960s were dealt with "within the existing institutional framework" (ibid: 8). However, unlike in the cases of Korea and Argentina, more resembling the case of ideological transformation towards neoliberalism in the US in the 1970s, in Sweden, its political economy model was destabilised, at least initially, endogenously, i.e. without an *external* ideological assault and pressure (ibid). Nevertheless, it must be underlined that business' outright resistance to labour's proposals started *because* the former began to question the foundations of the Swedish socio-corporatist model of *gradual socialisation*. In other words, capital began to question the *ideas* behind the proposal on wage-earner funds which, if fulfilled, would have put limits on its share in capital accumulation and income distribution. Still, such a proposal should not have come totally as a surprise. After all, the SAP's doctrine, the ruling party from the 1930s, had, at least *implicitly*, a thesis on *changing the relationship between capital and labour*. It was this ideological position that was raised *explicitly* in 1976 by the biggest trade union, the LO.[143]

In response the SAF began a powerful "crusade" to contest the ideological and institutional arrangements of the state-managed welfare capitalism and Keynesian consensus of "embedded liberalism" (Blyth, 2001; 2002). To begin with, it doubled its resources and by the 1980s had over eight times the strategic reserves of the LO which, in 1987 prices, meant having $1.5 billion at its disposal. Having more financial resources than perhaps any business organisation in the world, the SAF began from the 1970s onward to increase spending on what effectively was pro-business propaganda: from 15% to 25% of its budget (Blyth, 2001: 10). It is estimated that, in 1982 alone, just on the issue of wage-earner funds, the SAF spent 55-60 million krona: this was an enormous amount given that all five political parties spent in total 69 million krona for the Riksdag election in the same year (ibid). The effects of political influence gradually began to be effective. While in 1977 the SAF's attempt to organise a lockout involving 220,000 employees was unsuccessful, by 1980, in the name of employer solidarity, three million workers were locked out (ibid).

[143] In this regard, it should be also noted that to achieve "economic democracy" as one of its aims, Swedish social democracy in the 1970s *had* to implement concrete measures and escape a warning envisioned in Ernst Wigforss's (1881-1977) slogan in the 1920s that, "democracy cannot stop at the factory gates" (Blyth, 2001). He was a Swedish politician and a prominent member of the Social Democratic Workers' Party and Swedish minister of finance. He was one of the main theoreticians in the development of the Swedish social democratic movement's revision of Marxism, from a revolutionary to a reformist organisation.

Whilst during the 1976-1982 period a centre-right coalition was in power for the first time in 44 years, it was unable to offer a clear alternative to SAP policies except for distancing itself from the wage-earner funds. Even an increased deficit as a result of additional expenditure was financed by larger borrowing (ibid). This "cognitive locking" by the conservative parties in the ideas of social democratic Keynesian demand-management has been interpreted as being as a result of the deeply embedded nature of these concepts and values in the very fabric of the Swedish socio-political terrain. As one Swedish observer noted, "For the first time in forty-four years there was a bourgeois government. Every conservative person, politicians, and employers said, "Why couldn't our government, the bourgeois government, rule by bourgeois policies? Why did they have to be social democratic policies?" (in Blyth, 2001: 12). Blyth (2001: 12) concludes, "the bourgeois governments of 1976-82 were prisoners of the *ideas* of the LO" (his italics).

Faced with this reality, the representatives of Swedish business began to assault the very foundations of the Swedish welfare-state institutions, in particular its pillars, such as the solidaristic wage policy and collective bargaining (ibid). First, even before the new round of LO-SAF wage-determining negotiations in 1983, the SAF officially announced that it would not negotiate within centralised bargaining institutions. In the same year, the *Metalworkers Union* defected from the LO, lured by an agreement with the engineering employers' federation that it would offer more than the union members would receive within central bargaining arrangements. Thus, important mainstays of the Swedish solidaristic wage policy, namely demand restriction and the solidarity wage, were undermined (ibid: 14). From 1985 onwards, corporatist institutions of consultations between the LO, state, and SAF over economic governance were further challenged by the lattermost and by 1991, companies representing business had unilaterally departed from those institutions.

Second, beginning in 1983, the SAF launched an ideological campaign to delegitimise the ideas of the Swedish model and to popularise alternative economic ideas (ibid). To promote the new economic beliefs, think-tank organisations, such as the *Center for Business and Policy Studies* (SNS) and *Timbro* were established, which propagated neoliberal thinking like monetarism, while raising concerns about the size of the public sector. In line with orthodox neoclassical thinking, SNS scholarship argued for a diminished role of the state, which it claimed distorts "effective market exchange". According to SNS, full employment above the "natural rate" guaranteed by the social democratic government was a real problem, as it causes “allocative distortions” (ibid: 18). To fix these problems, the state should withdraw from managing the budget, the interest rate, and the exchange rate. The “system failure” thesis, as one of the strands of public choice theory, was widely popularised in Sweden, with the argument being that with enlarged Swedish model institutions and the public sector, these institutions would ultimately lead to the collapse of the whole system. As a result, according to at least one study, there was a shift towards a pro-market discourse by what was called “a neo-liberalisation of the debate”. References to “new liberal” ideas increased from 30% to 70% in the conservative daily *Svenska Dagablet* during the 1975-1989 period (Boréus, 1997). Numerous *ad hoc* events were sponsored by the SAF in the 1980s on the topics of inflation and the wage-earner funds, with neoclassical economics interpretations.[144]

Third, as in other cases, many Swedish academic economists began to adopt the very pro-market and anti-collectivist ideas that have contributed to demonising the welfare state and its size. They began producing and promoting scholarship on rational expectations and monetarism, which soon became the new orthodoxy.[145] For instance, it is believed that the prominent Swedish economist Assar Lindbeck was the first to turn his back on Keynesianism in the 1980s. His work was influential in shifting the economics discipline in Sweden towards a neoliberal orientation, for through his work he persistently criticised the Swedish model from this perspective (ibid). For instance, in his analysis of *The Swedish Experiment*, Lindbeck (1997: 1273) questions the feasibility of the whole model, claiming rather categorically that, “It is quite clear that the institutions and policies built up in the 1960s and 1970s were highly vulnerable to domestic and international shocks, including policy mistakes that can never be wholly avoided”. In the traditions of the neoclassical economics discourse, he goes on to contend that expansion of the public sector was as a result of the populist politics and that the welfare state has been “overshooting” (ibid: 1280). Considering the relation between income inequality and social conflict, Lindbeck implies that there is unnecessary “*politicisation* of the distribution of income” (his italics) and instead, the

[144] For instance, in 1983, the SAF orchestrated a rally in Stockholm of almost 100,000 businessmen against the wage-earner funds.

[145] In 1968, the Central Bank of Sweden established a new award, “The Central Bank of Sweden Prize in Economic Science in Memory of Alfred Nobel”, also known as the very prestigious Nobel Prize in economics. According to Harvey (2005), Friedrich Hayek and Milton Friedman as well as other neoliberal pundits were awarded the prize in the early 1970s to legitimise the new neoliberal orthodoxy.

latter should be regarded "as fulfilling important functions for the allocation of resources and economic efficiency" (ibid: 1297). This is an example of how neoliberal ideational discourse gradually began to revise the Swedish model in the 1980s and 1990s in order to deploy blueprints for new arrangements favourable to capital. This was evidenced in the debates about the Swedish tax system, when during the 1980s, pressure from the Swedish economic elites began to build up to reform the traditional high tax system – using the argument that it created problems for the economy and thus, contesting the very spirit of a strong progressive tax system (Steinmo, 2003).

Under the SAF leadership, big business was able to mobilise a political agenda against the corporatist institutions of social solidarity, egalitarianism and universal coverage of the Swedish model (Ryner, 1999). Subsequently, the deployed (neoliberal) narrative involved blaming the welfare reforms of the 1970s and the fiscal expansion to fight "stagflation" of that period for Sweden's economic crisis. Crucially, SAP state managers began to adopt economic policies designed by what Ryner (1999: 49) terms "compensatory neoliberalism" and executed in the 1980s by the Ministry of Finance and the Central Bank. Thus, the SAP's political agenda in the 1982-1990 period turned into "the third way", a course between Thatcherism and Keynesianism (ibid).[146] To boost an export-led recovery, after devaluation of krona for 16% in 1982, a tight fiscal and monetary policy was implemented. However, active labour market policy and implicit income policy were also practised to ensure an increase in tax revenues and full employment as well as maintaining high levels of social benefits and services (ibid). The struggle over the realisation of the wage-earner funds idea was replaced by new neoliberal initiatives of *Tax Fund* and *Public Savings Schemes*, while the contest over forms of ownership was substituted by the mass popularisation of private saving schemes, thereby creating the bases for a "mass investment culture" (Belfrage, 2008). This indicated that a shift of power away from labour towards capital and business had begun to take place (ibid). Furthermore, the PSS initiative was followed by increased growth of mutual fund and life insurance capital. In the 1980s, the neoliberal proselytising of the SAP led to austerity programmes and the prioritisation of inflation control over full employment (Ryner, 2004). Dramatic

[146] The programme document "A Future for Sweden" was presented at the 1981 SAP congress by the party's "Crisis Group", which reformulated traditional social democratic values into a neoliberal objective (Belfrage, 2008).

liberalisation of the financial markets, removal of foreign exchange controls in 1989 and transnationalisation of domestic companies, further signified the predominance of the interests of both Swedish corporations and the financial sector over those of labour (Bieler, 2003). The top marginal tax rate on income was consistently reduced from 58% in 1980 to 50% in 1985 to 45% in 1988 and to 35% in 1990 (Steinmo, 2003: 38). In 1990, corporate tax rates were reduced from 55% to 30%, while the investment funds system, which allowed allocation of companies' 50% pre-tax profits to be transferred into investment projects subject to government approval, was abolished (Schnyder, 2012: 1136).

In 1991, when the SAP lost office for the second time, a bourgeois coalition government (1991-1994) pegged the krona to the ECU (European Currency Unit) in an attempt to tackle inflation and employ pro-market ideas (Blyth, 2002).[147] Pegging, which was supposed to increase credibility, led to the belief that devaluation was impossible. However, as in the case of Argentine convertibility regime (though on a smaller scale), this currency policy combined with tax breaks for saving instigated speculation and interest rates hikes. Economic growth slowed, while the budget deficit increased until the krona was eventually floated (Belfrage, 2008). The crisis was exacerbated by austerity measures aimed at the public sector, since the government was now locked in monetarist ideas, where "too generous welfare state and too much government" were blamed for the state of the economy (Blyth, 2001, 2002). In 1992, a housing bubble created in the housing market by liberalisation policies and credit and tax reforms collapsed leading to a severe banking crisis.

Thus far, therefore, it seems that in Sweden, these results matched those observed in the cases of USA, Argentina and Korea. The "radical neoliberalisation of the economy and the magnified exposure of daily life to financial markets from the early 1980s to the early 1990s were elite-driven processes endorsed by both the SAP and the bourgeois parties and supported by much of the increasingly transnationalised corporate economy and the financial services sector" (Belfrage, 2008: 286).

Deepening of neoliberal dogmas and policies have been associated in the case of Sweden regarding membership of the European Union (EU) and pension reform

[147] The new coalition government led by the Conservative Party pledged that, "During the next few years economic policies, with all their strength, will have to aim for a permanent reduction in inflation. This task must take precedence over all other ambitions and demands" (quoted in Blyth, 2001: 20).

(Blyth, 2002; Bieler, 2003; Belfrage, 2008). Blyth (2002: 231) claims that, "Sweden's attempt to join the EU was therefore perhaps best understood as an attempt by business and the Conservatives to let the economic ideas and institutions of EU achieve by international convergence what they had failed to do through domestic reforms". With the LO and unions on the defensive, neoliberal institutions and values had to be cemented by embedding them in a new Swedish model, away from "restrictive" social democratic policy, based on the principles of income equality and commitment to full employment, towards a model based on privatisation, deregulation and tax cuts. For example, the leader of the Conservative Party Carl Bildt, made it clear when commented on joining the EU, by saying that membership would warrant tax cuts "more or less inevitable" (in Blyth, 2002: 232). Thus, as in the cases of Korea joining OECD and Argentina locking itself into the financial elite-led and IMF-supported convertibility regime, it was hoped that in Sweden a new neoliberal "path-dependency" would be secured by EU membership, "as an external disciplinary environment would be imposed on economic and monetary policy-making" (Belfrage, 2008: 287). In outlining the neoliberal character of the European integration, Rudolf Meidner (1992: 168) prophetically asked,

> "What will be the fate of the Swedish Model if the country is forced to adjust its policy to EC conditions and politics? ... Can we keep our commitment to full employment in a group of countries which tolerate mass unemployment? Do we have to reduce our taxes and cut down our public welfare? Must we give up the wage policy of solidarity which is a strange philosophy in the eyes of the unions in Western Europe?"

Similarly, Milios (2005: 209) claims that European unification and its "convergence criteria" were transformed into a political and ideological weapon against labour for the benefit of capital.[148] Neoliberal restructuring was considered as a prerequisite for integrating with the EU, where the reduced role of the state would not be able to impede upward income distribution. This "vehicle for neoliberalism" would be used in Sweden as it was in other European countries to endorse monetarism, with its priority of tackling inflation over full-employment and implementing policies of

[148] The most important documents legitimising neoliberal restructuring of the EU member-states include the 1992 Maastricht Treaty on European Union, the Stability and Growth Pact of 1996-1997 (SGP), and the unratified European Constitution. The SGP particularly stipulated membership of the Economic and Monetary Union (EMU) and its single currency, the Euro, on the condition of meeting the criteria of budgetary restrictions, low inflation, a public deficit not exceeding 3% and government debt no higher than 60% of GDP (Milios, 2005: 210).

privatisation, austerity, and market deregulation (ibid). This capitalist offensive against labour had been successful in the EU-15, where the share of labour in the net GDP was reduced from an average of 73.9% in the 1971-1980 period to one of 68.3% in the 2001-2005 period (ibid: 212).[149]

### *8.2.2. Withstanding, not dismantling*

There is little doubt that the Swedish social democratic elite changed its ideals towards more market-oriented direction. Having said this, I will support the argument that when the evidence is carefully examined, the welfare state, with its egalitarian redistributive governance aimed at achieving socioeconomic justice has been, to a large extent, preserved (Steinmo, 2010; Pontusson, 2011). There has been an increasing amount of published studies that have demonstrated the continuous feasibility of the Swedish welfare state, its adaptiveness to the realities of the global political economy and its resistance to upward income distribution as well as the imposition of the Anglo-American type of corporate governance (Lindbom, 2001; Steinmo, 2003; Belfrage, 2008; Schnyder, 2011, 2012; Jonnergard and Larsson-Olaison, 2016).

In a seminal study on retrenchment politics by Pierson (1994), it is revealed that, in Sweden, the coalition government in the early 1990s showed little desire, if any, for radically restructuring the welfare state. In fact, in its state management, it was careful enough to avoid accusations of dismantling the extensive and redistributive regime of the Swedish model, in contrast to more ideologically committed neoliberals in Korea and Argentina, where there were open demands for restructuring of the “old institutions”. It seems that as with the 1976-1982 period of conservative ruling, in the early 1990s, the coalition government followed the same pattern of not daring to exercise the *laisser-faire* liberal economic order. This is especially striking taking into account that this coalition government with a rightist majority came to power at a time of fiscal crisis after 1990 and could have used this as an excuse for social policy remodelling. But, it did not. Rather, existing welfare programmes were preserved and even expanded (ibid). For example, the number of eligibility days of unemployment

[149] Sweden joined the EU in 1995 but refrained from joining the EMU. In 2003, in a referendum on introducing the Euro, the majority voted against joining the single European currency (Bieler, 2003).

and sickness benefits were expanded, while negative adjustments in child allowances and plans to raise the retirement age from 65 to 66 were frozen (ibid).[150]

Likewise, Lindbom (2001) examining the Swedish welfare state in the 1990s, claims that its major characteristics, such as generosity and universality, remained intact and that the model was not dismantled between 1980 and 1998. Using indicators, including the expenditure on means-tested benefits, the importance of private pension schemes relative to total pensions, and the proportion of private expenditures to public ones, it is concluded that a wholesale retrenchment of welfare programmes was avoided in Sweden. The distinctive attributes of the Swedish model, especially when compared with other countries, still do not resemble the "liberal" welfare models of the neoliberal era (ibid).

Investigating the politics of taxation in the 1980s and the 1990s, Steinmo (2003) demonstrated that Sweden did not substantially roll back its tax burden either, let alone its generous welfare state. It is suggested that, "while important aspects of the corporatist decision-making model are no longer viable, the essential features of the Swedish social welfare state as policy outcome are healthy and perhaps even thriving" (ibid: 32). Whilst the tax reform introduced in 1991 ("Tax Reform of the Century") was intended to boost economic efficiency in accordance with monetarist neoclassical canons by reducing tax rates, it actually contributed to the economic crisis in Sweden in the early 1990s. Faced with economic decline, the government did not cut social programmes, such as welfare and child payments, housing support and sickness benefits. Ironically, due to deeply embedded welfare traditions, but also so as to survive politically, it was the bourgeois coalition government that actually increased public spending at that time, which resulted in the budget deficit reaching 13% of GDP (ibid).

When, in 1994, the SAP returned to power the tax reform was reassessed. To reverse and remedy its regressive nature, the top high-income earners' marginal rate of tax was increased by 5%, whereas the VAT rate on food was reduced by 50%. It is estimated that revenues from additional taxing on capital income brought in 60.4 billion krona in 1995 and 35.1 billion in 1999 (ibid: 40). It is important to mention that these

[150] However, this did not help the bourgeois coalition to stay in power, as it was revealed that the Swedes did not tolerate even the slightest assault on social programmes and the SAP triumphantly returned to office in 1994. Moreover, the party's platform included provisions to increase taxes and halt budget cuts (Pierson, 1994).

tax increases did not hinder Sweden's economic recovery in the 1990s. On the contrary, unemployment was reduced, the budget was in surplus and investment increased. Despite the opposition of the right demanding the use of budget surpluses to cut taxes on mobile capital, the social democratic finance minister increased spending on child support and continued to use the surpluses to service Sweden's public debt, thus sustaining public spending at over 50% of GDP (ibid).

Thus, it can be reasonably argued that neoliberal "path dependency" had not been embedded deep enough in the 1980s in Sweden to erode the welfare-oriented elements of the social democratic Keynesian regime. As Steinmo (2003: 42) asserts, "the ambition and the political support for a largely egalitarian polity with a very large welfare state (and the taxes to support it) live on quite healthily in Sweden today… [The Swedish model] enable[d] the construction of a kind of social welfare state that now has its own political force".

However, as the posed 1995 economic recovery proved, the Swedish economic model was not totally intact, for to resist neoliberal globalisation and preserve distinctive elements of the welfare arrangements, the country had had to undergo reforms. Indeed, economic restructuring involved a shift from Fordist mass production to a more knowledge-intensive economy based on such sectors as biotech, information and communication technologies (ICT) and services (Schnyder, 2012: 1133). Between 1980 and 2007, the share of high-tech manufacturing in total industrial value added increased from 10.16% to 16.46%. As a result, clusters of small- and medium-sized firms specialising in life science sectors and the ICT mushroomed, becoming the new "motor growth" of the Swedish economy (ibid). In the 2010s, Sweden was praised for its new economic model and success it brought in terms of sustained growth rates and budget surplus, being labelled as the "Nordic miracle" (Kristensen and Lilja, 2011). Crucially for this analysis, it is argued that the "enabling" nature of the welfare state that had been established back in the 1950s and preserved throughout the 1980s and 1990s contributed to this success (ibid). The former meant accentuating welfare services that enabled individuals to re-enter the labour market, rather than providing them with cash benefits.[151] In addition, to support this new

[151] Also important to note, is that in the 2006 election campaign even the centre-rights mostly focused on employment issues and achieving "the goal of full employment", rather than controlling inflation. Unemployment rates in Sweden increased from 5.6% in 2000 to 7.7% in 2007 and then declined to 6.2% in 2008, which is the subject of envy of most of the OECD countries (Schnyder, 2012: 1138).

knowledge-intensive economy, spending on education was increased from 5.3% of GDP in 1990 to 7.4% by 2000. During the same period, spending on higher education doubled, from 1% of GDP to 2% (Schnyder, 2012: 1134). Public investments also included modernising the vocational training and apprenticeship systems to provide the business community with a higher-level skills workforce aimed at securing higher-wage jobs. For instance, the “Knowledge Lift” initiative in the 1997-2002 period involved 10% of the total Swedish workforce and was intended to raise the skills of the lowest skilled social group (ibid).

In 1997, the trade unions and employer associations from manufacturing industry concluded an *Industrial Agreement*, which marked the return to coordinated forms of wage bargaining that was equivalent to the centralised system of the 1960s and the 1970s. Other industries followed the pattern where the export-oriented sector played the role of norm-setter contributing to the renewal of the collective bargaining system and thus, strengthening political power of the labour. In 2000, a new state agency was created – the *National Mediation Office* – to facilitate collective bargaining and wage policies formation and coordination (ibid). This is yet another indication that the Swedish model of solidaristic wage policy has not been converted into a market-based one.

These conclusions seem to be consistent with other research, which found that, in the 1990s, Sweden successfully resisted the imposition of the Anglo-American corporate governance model aimed at adjusting the national system to the requirements of finance capitalism (Schnyder, 2011; Jonnergard and Larsson-Olaison, 2016).[152] Interestingly, pro-shareholder corporate governance reforms were opposed in Sweden by a coalition uniting both centre-right and centre-left parties (Schnyder, 2011). In 1990, the SAP tried to reform the Stock Corporation Law of 1975 (SCL) to adapt traditional corporate governance to EU legislation in view of joining the EU in 1995. As aforementioned, insider-control in Swedish corporations is based on the mechanisms of *voting right distortions* and *stock pyramids*, which allows a few

[152] In the corporate governance theories, there is a distinction between an “insider-oriented corporate governance regime” and “shareholder-oriented regime”. In the former, which is characteristic of the Swedish model, ownership is concentrated with loose legal protection of minority shareholders’ rights; the latter is distinctive of the Anglo-American model (Roe, 2003).

families to control a large number of firms.[153] Whilst the reform changed the Swedish SCL by abolishing “bound shares” by which foreigners could be prevented from taking control in Swedish firms, the insider control mechanisms, such as *share pyramids* and *dual class shares*, **were left intact** (ibid). In addition, Anglo-American ideas of minority shareholder protection, which gained prominence in many European countries and mainly stemmed from foreign investors, were interpreted differently in Sweden. As Schnyder (2011: 194) explains, the Anglo-Saxon “shareholder primacy” concept was interpreted in Sweden as an “active ownership” meaning influencing and monitoring companies rather than better protecting minority shareholders’ interests. As such, the Anglo-Saxon version of the concept was rejected and the interests of the traditional Swedish blockholders were protected, when the introduction of a mandatory bid rule for investors buying a stake in a publicly traded corporation was excluded. Crucially, the influence of Swedish labour on preservation of the post-war corporate governance played an important role in this resistance given it had an institutionalised influence at the company-level. The Codetermination Act of 1976 stipulated representation of employees at board-level; two or three representatives of workers on the one-tier board of directors (ibid). In other words, since the political economic institutions, particularly corporate governance structures in Sweden in the 20th century, were shaped in cooperation and negotiation between the employers and labour, both the left and the right did not favour the dismantling of the Swedish model.

Likewise, in his analysis of the impact of financial globalisation on Swedish corporate ownership, Reiter (2003: 108) maintains that the tripartite (state-trade unions-business) negotiating culture of the Swedish democratic corporatism provided support for the model. The central element of the Swedish corporatist model lay in the concentrated ownership structure secured through *differentiated voting rights* and the *golden shares* which, in turn, served to preclude extensive foreign ownership in national corporations and enhance the work of trade unions through stable national

[153] Voting right distortions, stock pyramids, and dual class shares are arrangements that enable a controlling shareholder to maintain control of a company, while holding less than a majority of the cash flow rights associated with its equity. These instruments along with state tax policies, favouring the emergence of the Swedish companies, have helped to concentrate private ownership in a few hands. A limited number of “capitalists”, such as the Wallenbergs family and the Svenska Handelsbanken bank, have thus had a dominating position in the Swedish economy since the 1970s (Collin, 1998).

owners.[154] In Sweden, this structure of ownership and control reflected both the configuration of a country's financial and industrial system as well as the relationship between the state and market, thus facilitating both the corporatist economic policies and consensus-based politics (ibid). Simply put and to highlight the importance of this state-corporatist-trade-unions nexus for the Swedish model, "[i]f the economic structure of a country changes, the form of capitalism will change with it" (Reiter, 2003: 109).

By the same token, Steinmo (2003) does not support the "convergence" hypothesis and instead, argues that there is no evidence of Sweden rolling back its welfare state and its tax burden to end egalitarian policies, even under the pressure of the financial circles and foreign investors looking for lax governmental regulations and lower taxes. As the author claims (ibid: 31-32),

> "it appears that the Swedes are continuing their historical path of manipulating some kind of middle ground between the rampant liberalism of free markets and controlled markets in the hands of a large and powerful state. The Swedish welfare state is adapting to the realities of the new political economy, but it is not dying because of it".

It is a unique type and politics of taxation that has prevented the Swedish elite from changing its values, with respect to preserving an egalitarian society and distributive welfare state, because capital taxation has never been a critical source of revenue and redistributive policy (ibid: 42). Taxes have never been used directly to "redistribute" income between social classes in Sweden. There was a historical compromise reached between organised labour, capital and the Swedish social democrats. Accordingly, big export-oriented capital firms were provided with explicit tax incentives, while labour was granted special wage strategies aimed at advantaging lower paid workers over higher paid ones (ibid: 33). This "corporatist compromise" also included big unions and an interventionist state, full employment policies and

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[154] *Differential voting rights* (DVR) shares are like ordinary equity shares, but are different in that they give the shareholder fewer voting rights compared with the rights that an ordinary shareholder has. Companies usually issue these shares to stop a hostile takeover and the dilution of voting rights. The issue of DVR shares also helps those investors who do not want control and are just looking at a sizeable investment in a particular company. A *golden share* is one in a company that gives control of at least 51% of the voting rights, especially when held by the government. It is afforded special voting rights, giving its holder the ability to block another shareholder from taking more than a ratio of ordinary shares. Moreover, ordinary shares are equal to other ordinary shares in terms of profits and voting rights. These shares also have the ability to block a takeover or acquisition by another company.

expanded welfare programmes. As a result, in the 1980s and the 1990s Swedish governments successfully resisted upward income redistribution tendencies that have been typical of public policies throughout the world and instead, continued with policies of high taxtion (particularly income taxes) and high social welfare expenditures (ibid: 40).

*8.2.3. The level of income inequality: 1980-2010*

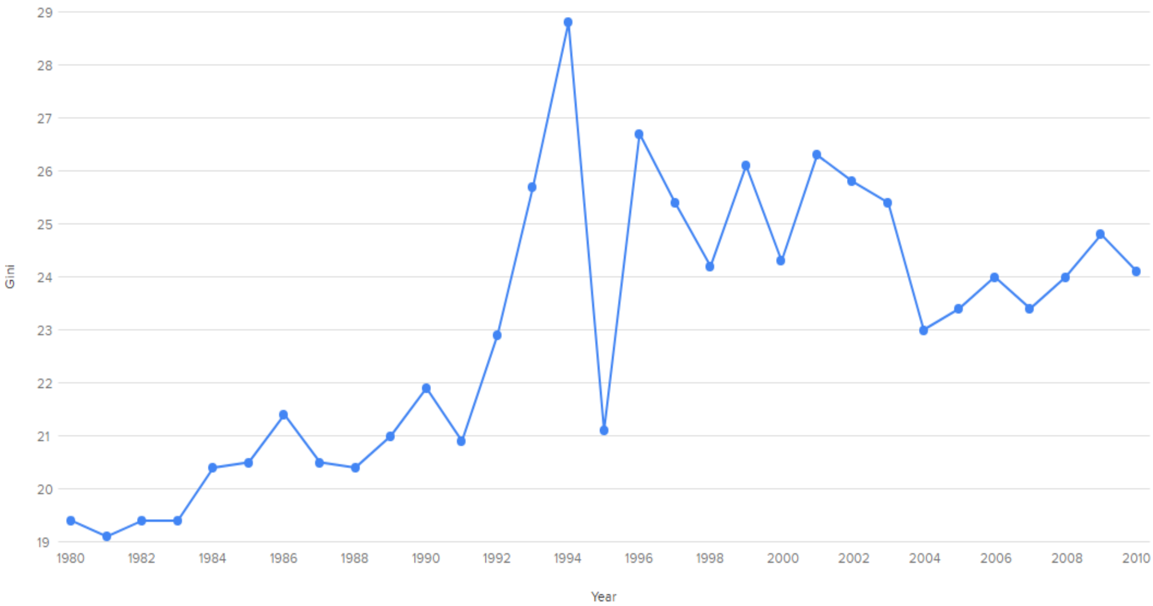
Most researchers investigating the Swedish case support the view that the country has achieved an exceptionally egalitarian distribution of income, high rate of employment, and marked poverty elimination (Meidner, 1992; Bjorklund and Freeman, 1997; Palme, 2006; Roine and Waldenstrom, 2008, 2010). As shown in Figure 8.2, during the 1980-2010 period, the Gini coefficient never exceeded the 0.29 threshold and was at the remarkable level of 0.19 in 1981. Interestingly, both in the 1980-1983 and the 1991-1995 periods Sweden experienced recession, but the outcomes for the income distribution were different. A trend towards higher income inequality began in the early 1980s, when the Gini coefficient steadily increased to 0.22 by 1990, slightly declining to less than 0.21 in 1991. Deregulation of the credit market and excessive bank lending in real estate led to a housing bubble, which burst in 1990 (Gustafsson and Palmer, 2002). As the result, from around 2% in 1989, unemployment increased to 14% in 1993, whereas the Gini coefficient skyrocketed to almost 0.29 by 1994, the highest level in the modern history of Sweden. It is worth noting that whilst the 1991-1995 recession put great strain on the welfare system, the Swedish safety net preserved the previous years' successful elimination of poverty and the Gini coefficient declined to 0.21 in 1995. In 1996, it again increased to almost 0.27 and fluctuated around 0.24 between 1998 and 2010, jumping to more than 0.26 in 2001 and decreasing to 0.23 in 2004. Overall, the redistributive effects of specific social policies and labour market institutions were not offset by the early 1990s rise in earnings inequality in Sweden (Edin and Topel, 1997; Domeij and Floden, 2010).

In their study of the evolution of income concentration in Sweden from a historical perspective, Roine and Waldenstrom (2010) revealed that top income shares decreased significantly in the country in the twentieth century. However, depending on how *realised capital gains* are treated, either included or excluded, after the mid-1980s the income share of the top 10% increased substantially or remained quite stable.[155] Nevertheless, in 1980 the top decile's share was 23% of national income, which is significantly lower than, for instance, in the US, where it was up to 35%. After the tax reform, there was an upward trend in the share of the top 10% of income earners, with a peak in 2000 when their share reached more than 30%, if capital gains are included and around 26%, if they are excluded (ibid: 307). The income share of the top 5% (P95-9) dropped sharply in the 1970s and in the early 1980s was around 10%. The top percentile (P99-100) income share dropped from around 7% in the 1950s to 4.7% in the beginning of the 1980s (ibid). Decomposing the top decile reveals that during the 1990s the pattern did not change much for the top 10% (P90-5), 5% (P95-9), and 1% (P99-100). It is only when capital gains are included that the share of the top 1% becomes about twice as large, if compared with excluding them over the 1990 and 2000 period: about 4% in 1990 and 6% in 2000 (when capital gains are excluded), about 5% in 1990 and more than 10% in 2000 (when capital gains are included) (ibid: 308). Similarly, the share of the very top 0.01% increased from about 0.17% in 1980 to about 2.5% (including capital gains) or just 0.61% in 2000 (excluding capital gains) (ibid: 309). However, by 2006 this share had declined to 1.59%, when capital gains are included, but had nudged up to 0.83% when they are excluded (ibid: 335-341).

By 2006, the share of income for the top 10%, 5%, and 1% had increased to 27.30%, 17.73%, and 6.61%, respectively, from 22.73%, 13.44%, and 4.05% in 1980 (excluding capital gains). If capital gains are included, the share of income for these three groups between 1980 and 2006 increased from 22.82%, 13.55%, and 4.13%, respectively, to 30.72%, 21.07%, and 9.53% (ibid). This indicates the importance of the impact of capital income on inequality once finance capital becomes influential enough to contribute to it. In the next sections, the focus of the study will shift to investigating to what extent, if any, finance capital in the form of financialisation has been able to undermine Swedish principles of egalitarian income distribution.

[155] Capital gain is the profit made out of selling a capital asset (stock, bonds, or real estate) that gives a higher worth than the purchase price. Consequently, the gain is not realised until the asset is sold. It is difficult to allocate information on realised capital gains correctly and it is usually excluded from the income concept, like in the influential Luxemburg Income Study. Nevertheless, where possible, studies have presented top income shares both including and excluding realised capital gains (Roine and Waldenstrom, 2012).

**Figure 8.2. The Gini coefficient level in Sweden, 1980-2010**




Source: created from The World Income Inequality Database, United Nations University, 2017

## 8.3. Analytical construct #1: the evolution of the Swedish financial sector

Even though during what Olsen (1991) terms the Social Democratic Keynesian Era in Sweden economic democracy was achieved, a real structural transformation into socialism was stalled in the late 1970s and early 1980s.[156] It is argued, instead, that the Swedish working class was not powerful enough vis-à-vis capital to change the system to the extent implied by the wage-earner fund programme (Olsen, 1991: 110). However, from the perspective of income distribution and as demonstrated in the previous subsection, neoliberal restructuring with its upward income distribution had not taken a dominant place. The Swedish welfare institutions, with their equalizing and universal coverage effect, successfully resisted the Anglo-American version of *laissez-faire* capitalism to preserve socioeconomic solidarity.

[156] Olsen (1992: 11) terms "economic democracy" as "the collectivisation of ownership and control", which did not happen in Sweden. The view proposed in this study is to define "economic democracy" as extending democratic values into economic management and capitalist relations, where workers would have more control over the means of production within a market economy. This implies powerful labour which, in turn, would facilitate and secure a stronger foundation for equal distribution of income (see Dahl, 1985; Archer, 1995). In line with this interpretation, in this thesis it is held that Sweden managed to advance towards achieving this goal during the Social Democratic Keynesian Era. As Eduard Bernstein (a revisionist who advocated a reformist path to socialism) stated, "'the final goal of socialism'…is nothing to me, the movement is everything" and "there can be more socialism in a good factory law than in the nationalisation of a whole group of factories" (in Olsen, 1992: 4).

To what extent finance capital was able to shape the processes of financialisation can be judged by considering the process of financial deregulation which started in the early 1980s. This, in turn, may serve as an indication of the cause and effect relationship in the financialisation-induced income inequality hypothesis to be manifested in the case of Sweden in a reverse logic, i.e. the absence of institutionalizing neoliberal financialisation prevented the upward income distribution outcome.

It is argued that the large budget deficit, on the one hand, and large financial savings in the private sector, on the other, led to the Swedish government swinging towards financing its deficit in the emerging money market (Englund, 1990). As a result, highly regulated financial markets and restrictive monetary policies were gradually replaced by deregulation. Contrary to this interpretation and using a Marxian approach, it could be argued that the 1989 abolition of foreign exchange controls was due to the interests of the Swedish financial circles and transnational corporations wanting to get access to new markets and international finance (Bieler, 1999). Nevertheless, the trend for financial deregulation in the 1980s was counter-balanced by new regulations and this is one of the most important characteristics of the Swedish case, which makes it different from other countries in the era of neoliberal dominance. For instance, regulations that were abolished included (Englund, 1990: 386):

- requirements to hold bonds by banks (1983) and insurance companies (1986);
- ceilings on bank and finance companies loans (1985);
- ceilings on issuance of new bonds by private companies (1982);
- ceilings on bank deposit interest rates (1978) and loan rates (1985);
- regulations of capital movements (the mid-1970s);
- restrictions on foreign bank subsidiaries (1986);
- restrictions to buy Swedish shares by foreigners (1980) and to buy foreign shares by Swedes (1988-1989). In addition, Swedish krona-denominated bonds were first issued internationally in 1988.

Regulations that were not lifted or newly introduced included (ibid: 386):

- credit card contracts (further tightened in 1988 and 1989);
- reserve requirements for banks were extended to finance companies (1988);
- indexing loans and bonds;

- tax on the turnover at the stock exchange (at 0.3% of transaction value) was first abolished in 1979, but then reintroduced in 1984 at 1% and raised to 2% in 1986;
- tax on money market transactions (at 0.03% of transaction value) (1989).

Introduction of special taxes on the share and money market transactions can be considered as evidence of government commitment to the policies of egalitarian distribution of income and an attempt to moderate the effects of high profits in the rapidly growing financial sectors. This is also an example of a strategy to prevent excess volatility and financial crises caused by speculative activities. Thus, the total value of transactions in the stock exchange fell by 12% between 1986 and 1987 and by a further 8% between 1987 and 1988, though the total stock value increased by 42% during the 1986-1988 period. The forward contracts market, which in 1987 reached a daily volume of 25 billion Swedish krona, was closed in 1988, while transactions on the spot market began to fall by 50% after 1987. It is important to note that the Swedish central bank (Riksbank) preserved its legal framework to reintroduce regulations and resisted market-oriented monetarists' demands in the 1990s to restrict its power to employ controls, if necessary (ibid).

In spite of some regulatory measures being intact, rapid financial deregulation was a fundamental cause of the Swedish banking crisis intertwined with a currency crisis in the early 1990s (Englund, 1999). Deregulatory measures led to rapid credit expansion, when in just five years between 1986 and 1990 lending from financial institutions increased by 136%. These institutions also expanded, banks by 174%, mortgage institutions by 167% in the same period followed by an increase in asset prices (a "price bubble"), especially for commercial properties in Stockholm, up to 140% during the 1985-1990 period (ibid: 84, 88). By 1989, the economy was overheating and with the sudden and sharp increase in interest rates a crisis broke in September of 1990, followed by the bankruptcies of some finance companies. The crisis spread to the banks, when credit losses over the 1991-1993 period reached almost 17% of lending (ibid: 90). Eventually, the government guaranteed all troubled banks' obligations including debts and paid, in total, about 66 billion Swedish krona of taxpayers' money. Crucially for the current analysis, the Swedish government in its bailout policy "followed the principle of saving the banks but not the owners of the banks", with the aim being to preserve the financial system without any wealth transfer of the benefits of private shareholders (ibid: 92). Out of these 66 billion krona, only 2 billion were paid to the old bank owners, while the rest was used to take over the banks.

In an analysis of the 1999 public pension reform (the "Income Pension") in Sweden, it is suggested that to encourage financial savings and universalise equity ownership, a state-sponsored financialisation had taken place since the early 1980s (Belfrage, 2008). The promotion of the neoliberalism-inspired Tax Fund initiative and Public Savings Scheme marked a break in the relationship between labour and the SAP and also, the delegitimisation of the wage-earner funds idea. The financial industry launched a campaign for "individualised" and market-based solutions to receive "better" pension benefits, describing them as superior when compared with collective insurance arrangements. As a result of the introduction of a funded pension system, around 90% of employees had obligatory funded pension schemes and supplementary pension schemes, 94% of population saved in mutual funds, and 47% saved in shares (ibid: 283). Mutual funds and private life insurance companies mushroomed in the 2000s. By 2001, around 70% of Swedish households had private pension savings and 94% held financial assets (ibid: 288). In this regard, it is argued that the pension reform represented a clear shift towards recommodification and contributed to a long-term process of financialisation, the outcome of which is yet to become clear. Also, as in the case of Korea, in the late 1990s the Swedish government was lobbied by the financial sector elite, who became interested in creating a financial centre in Stockholm for the Baltic region. In 2017, it was ranked in 39th place among the 92 other financial centres in the Global Financial Centers Index (GFC, 2017).

However, Belfrage (2008: 278) claims that, "neoliberal restructuring had not enabled the complete unleashing of financialisation in daily life… and thus financialisation lacks legitimacy in Sweden". The banking crisis and its socioeconomic costs were comparatively quickly offset and the level of income inequality was high only by Scandinavian standards, with this only being during a very short period of time from 1992-1994, after which it returned to the usual pattern (Figure 8.2). Evidence presented suggests that it may be the case that unlike in other case-studies, in Sweden there was not full-throttle financial liberalisation and retaining of national policy tools prevented neoliberal financialisation in reaching a point of no return.

Another interesting aspect of the Swedish financial sector evolution is that after it was opened up, the nation developed one of the largest venture capital (VC) markets in the world, which implies that the country has a deep and liquid stock market (Armour and Cumming, 2006). This form of financial intermediation particularly fosters the development of innovative and high-tech products in the knowledge-intensive economy and thus, contributed to the Swedish “Nordic miracle” in the 2010s. It is estimated that in the 1990-2003 period Sweden shared second place to the US in terms of total private equity as a percentage of GDP, 29.6%, which is far above the average 16.8% of GDP among the other fifteen developed countries (ibid: 608).

Taken together, these findings suggest that, in Sweden finance capital has not been totally unleashed to engage in its usual speculative activities, such as debt creation. It has been actually directed towards funding new sectors of a high-tech economy with high wages. The interventionist state policies played an important role in this process by guiding finance capital and public funds towards VC firms. For instance, in addition to regional development funds created during the 1970s-1980s period, throughout the 1990s various investment vehicles were established to provide and channel capital to new productive sectors, such as start-ups (Schnyder, 2012).

### 8.4. Analytical construct #2: dynamics in the financial sector profit rates and the share of labour

However viable and resistant the Swedish model has been to neoliberal restructuring, deregulation of the 1980s took its toll in terms of increased income inequality, as evident from Figure 8.2: from 1983 onwards there is a tendency towards a higher Gini coefficient, which has never been lower than 0.2. The following sections investigate whether this upward income distribution happened at the expense of labour’s share and to what extent the financial sector fostered income and wealth transfer.

In Sweden, liberalisation and deregulation of the financial sector along with the opening of stock markets led to an increased inflow of investment and equity financing. The turnover on the Stockholm Stock Exchange increased dramatically from 1980 onwards and experienced a twenty-four-fold increase in the 1990-1999 period, amounting to 2,600 billion krona compared with 7 billion turnover in 1980 (Reiter, 2003: 113). This indicated a change in the distribution of domestic ownership, whereby financial actors (insurance and investment companies, banks, and funds) replaced non-financial institutions. In fact, the latter’s share of ownership declined from 22% in 1990 to 7% in 1998. Interestingly, however, the share of financial institutions did not increase significantly and for each category either declined slightly or stayed rather stable even decreasing when combined, from 36% in 1990 to 28% in 1998 (ibid: 115). It is foreign ownership that increased dramatically, from 8% in 1990 to 35% in 1998 and further to 43% in 2001 (ibid). Moreover, Sweden experienced a 25-fold increase in FDI debt and stock flows over the 1980s and 1990s (OECD, 2005: 17).

To demonstrate new opportunities for finance profits, the growth of FDI, stock traded, and market capitalisation as percentage of GDP increased over the 1980-2005 period from 5% to 104.1%, 28% to 189%, and from 40% to 113%, respectively (Peters, 2011: 78). Mergers and acquisitions as a means to increasing market share grew from 377 over the 1990-1994 period to 804 over the 2000-2005 period, which correlated with a decline in union density (ibid: 82). As a result, the share of the FIRE sector and businesses services as value added in the economy increased from 16.1% in 1980 to 24.8% in 2003, i.e. an 8.7% change (ibid: 92). According to Power et al. (2003: 43), the decade average financial sector profit share increased from 7.85% of GDP in the 1970s to 8.56% in the 1980s and to 9.41% in the 1990s.

It is estimated that, in Sweden the wage share declined from its peak of 89% (the highest rate alongside Austria) in the early 1980s to 65.1% in 2005 (the third highest rate after Canada, with 66% and Austria with 65.4%), which is the largest drop anywhere else, thus indicating that more income went to finance and business (Peters, 2011: 92). Bengtsson (2014), using the power resources approach in his analysis of labour's share dynamics from 1900 to 2000, maintains that during the third structural break in the early 1980s its share decreased from its peak level at the end of the 1970s. To cope with a profit squeeze and increase industrial competitiveness, the Swedish government devalued the krona between 1976 and 1982, when it was lowered by 22%. As the result, despite productivity growth increasing, real wages declined. As trade union militancy became contained labour shares decreased by 5% in the manufacturing sector from 1980 to 1985, anticipating a decade of wage moderation. In the 1990s, the average level of labour's share was 5% lower than in the 1960s, being 85.4% and 90.7%, respectively (ibid: 305).

Nevertheless, it seems that Swedish labour was comparatively successful in resisting the tendency of finance capital towards maximising profits and maintained much of its bargaining power. Sweden, along with Finland and Norway, are the only countries among 13 OECD economies where trade union density actually increased over the 1980-1990 period. In Sweden, union membership increased from 78% to 81% of the wage and salary earners in employment. By comparison, in Finland this number changed from 69% to 72% and in Norway from 58% to 59%, whereas in other countries there was a strong tendency towards declining in union membership over the same period: in the US from 22% to 15%, in Austria from 57% to 47%, in France from 18% to 10%, and in the UK from 51% to 39%. By 2005, trade union density in Sweden dropped to 76%, which was still the highest level among developed economies (ibid: 82). Subsequently and as an exception, while the average real wages growth was less than 1% over the entire 1980-2005 period in these countries, only in Sweden (and Finland) this number was 2.8% during 2001-2005 (ibid).

Similarly, Kristal (2010) claiming the causal link between increased income inequality and growing capitalists' profit vis-à-vis decreasing labour's compensation, shows that, on average, labour's share in Sweden was 73.5%, which is third after Austria (79.1%) and Belgium (77.1%). The average net union membership, as a sign of working-class bargaining power was also relatively high, at 70.1%, which is second highest after Denmark, 70.8% (ibid: 743).

Thus far, it can be argued that even though Sweden did not avoid a finance-driven restructuring completely, its impact on labour's bargaining power and wages was not as significant as in the US, Korea, and Argentina to claim an unreserved shift in income distribution. From the inverse logic point of view, it can be reasonably contended that it was because financialisation did not become so powerful and all-encompassing as in the other national contexts, which meant that the redistributive institutions of the Swedish model continued to function and thus, secured a comparatively narrow income distribution over the 1980-2010 period.

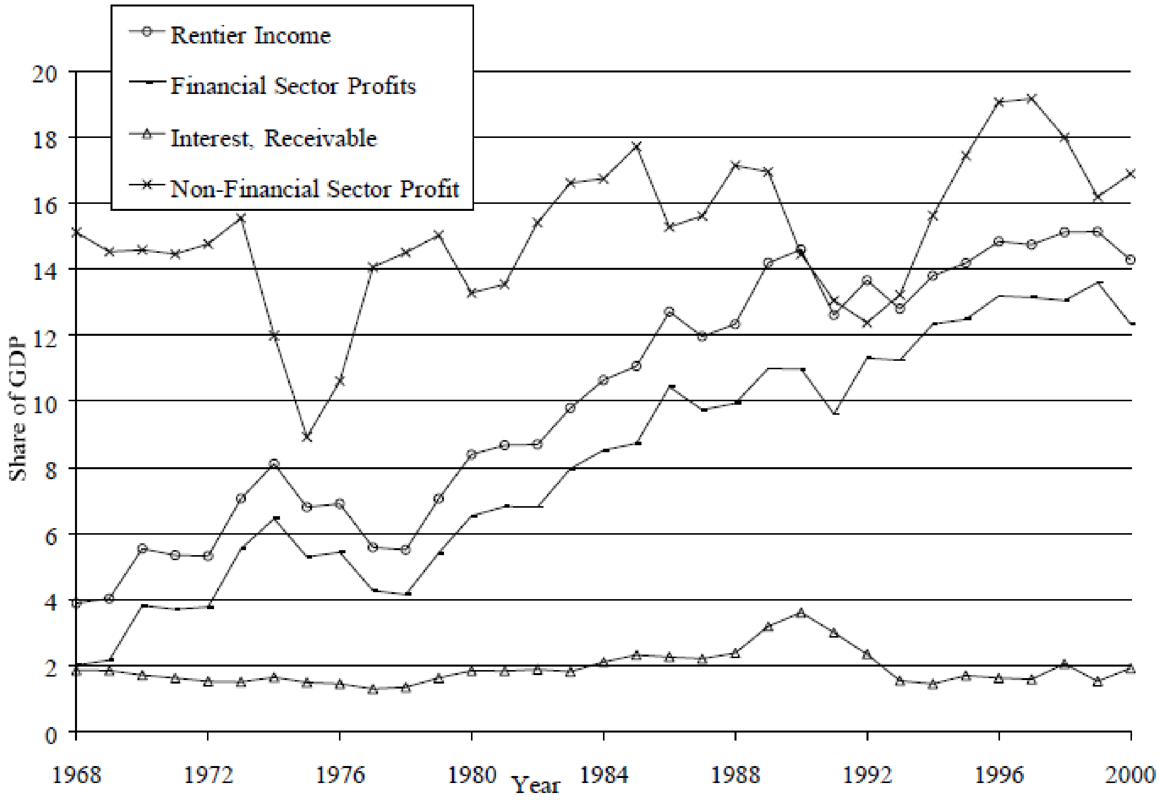
### 8.5. Analytical construct #3: rental income from financial assets and private debt

It is maintained that realised capital gains has played an increased effect on top income inequality since 1980 in Sweden (Roine and Waldenstrom (2012: 570). However, "[w]hile capital gains are, of course, also earned at lower income levels, they make virtually no difference for the income *shares* of groups below the top percent" (ibid: 585). In other words, when contrasting high wage earners and rentiers, whilst bringing capital gains to the overall income distribution, there are no trends over time in their shares of total capital gains. Overall, it is suggested that whilst the distribution of capital gains is usually highly skewed, the inequality-increasing impact of capital gains has been relatively minor in Sweden. Another critical finding is that capital gains have become a more important source of income in the Swedish economy (ibid: 581).

Accordingly, it is estimated that whilst income from interests and dividends has declined steadily since the early 1980s, from 4% of total income to about 2% in the 2000s, realised income has increased from below 1% of total income in 1980 to almost 8% in 2008. These changes became possible because of the so-called "Swedish Transition" in the 1980s, starting with the deregulation of capital markets, which led to massive growth of Swedish stock market values. The stock market's annual real prices increased, on average, by 13% in the 1980s and to over 16% during the 1990s compared with just 3% and 6% increases on the New York Stock Exchange during the same periods (ibid: 583). As one would expect, stock ownership has been relatively concentrated: in 2000, over 80% and 88% of the Swedish top 10% and top 1% of income earners, respectively, held corporate stock, with average values of 584,000 krona and 2,484,000 krona, respectively (ibid: 584).

It seems that financial liberalisation of the 1980s did not result in the increased power of the Swedish rentier class, as was the case for the US, Korea, and Argentina. Thus, the crucial finding is that rentier income share (not including capital gains on financial assets as of average decade share) did not grow over the 1980s and 1990s period (Figure 8.3). This share actually declined and stagnated from 13.61% of GDP in the 1970s to 12.34% and 12.30% in the 1980s and 1990s, respectively (Epstein and Power, 2003: 237). Sweden is a very rare case (along with Iceland and Spain) among 17 OECD countries, where the percentage change in the rentier income share over the 1960s-1970s and 1980s-1990s was negative, standing at -9.5%. Also, in contrast to the US, where (the average decade share of) the non-financial sector profit declined from 12.18% in the 1980s to 9.97% in the 1990s and modest growth in Korea (from 7.93% to 8.23% in the same period), in Sweden, over the same period, this share grew from 2.95% to 5.51% (ibid: 237). There are no data on (the decade average of) rentier income share, including capital gains on financial assets for the 1980s for observing its dynamics, but in the 1990s this number was 37.54%. Compared with the US (59.19%) and Korea (72.14%) in the same period and where the institutionalisation of financialisation took place, this serves as another indication that "rentier capitalism" has not taken over the Swedish model.

**Figure 8.3. Components of rentier income and non-financial sector profit share in Sweden, 1979-1999**




Source: Power et al. (2003: 43)

Nevertheless, the traces of a shift towards a tight fiscal and monetary policy implemented in the early 1980s and 1990s by the centre-right coalition and the SAP to lower inflation and increase interest rates can be observed, which was beneficial for the holders of financial assets, i.e. rentiers. Regarding which, in Sweden, the decade average inflation rate declined from 8.57% in the 1970s to 7.94% in the 1980s and 3.07% in the 1990s, whereas the decade average real interest rates increased from 2.14% to 3.72% and then, to 4.54% in the same periods. The same course of the anti-inflation-focused monetary policy contributing to the rise of rentier shares can be seen in the US and Korea during the periods, when they underwent their process of institutionalising financialisation.

Turning now to the issue of private debt, the most obvious finding to emerge from the analysis below is that Swedish household debt has unique characteristics, which can explain why the inequality-increasing impact of financialisation has not been evidenced in this country.

Many recent studies have shown that the financial deregulation started in the early 1980s instigated a high level of household indebtedness in Sweden (Johansson and Persson, 2007; Persson, 2008; Finocchiaro et al., 2011; Ahnland, 2015). It is claimed that the ratio of private debt-to-GDP increased substantially, whilst the average credit level reached 102% of GDP in 1985-2013 compared with 61% in 1940-1984 (Ahnland, 2015: 309). Likewise, according to Persson (2008: 124), aggregate household indebtedness almost doubled from the 1970 level and by 2008, was about 70% of GDP, which was still not as high as for other Scandinavian countries, the US and Korea. After the banking crisis in 1992-1993, household debt declined, but then increased again from 90% of disposable income in the mid-1990s to almost 170% in 2010 (Finocchiaro et al., 2011: 6).

In the early 1990s, housing mortgage companies became the largest suppliers of credit to Swedish households. In fact, rising housing credit spurred by low interest rates is considered as being the main factor in increased private indebtedness, with mortgages representing about 80% of household debt by the 2000s (Finocchiaro et al., 2011: 6). It is important to mention that Swedish households held assets worth three times their debts in the mid-1990s, four times in 2000 and again three times by 2010, i.e. debt was not made by the poor to make ends meet (ibid: 8). Whereas, for example, in the US rising private debt also coincided with decreasing savings, in Sweden's savings had a **positive** trajectory and even increased at the time of rising debt. It is suggested, therefore, that the Swedes, at least, did not refinance their mortgages for consumption purposes (ibid: 22).

Moreover, the debt pattern reveals another striking feature of the Swedish private indebtedness. Crucially, in 2004, it was the highest income category (top 20% of income earners) that held 57% of the total household debt. The same income group held 35% of the financial assets and 49% of the real assets. In addition, the majority of the private debt seems to have been used to accumulate real estate assets and only 0.1% of indebted households were considered to be vulnerable under potentially changing credit market conditions (Johansson and Persson, 2007: 238). Likewise, Persson (2009: 129) found that only 3% and 5% of total household debt in 2005 was held by the two lowest income categories, respectively and the majority of loans belonged to the high-income households, who also owned most of the real and financial assets.

## 8.6. Conclusion

It has been argued in this chapter that the social democratic welfare state in Sweden has withstood neoliberal restructuring. Market-oriented reforms in the 1980s did not lead to a paradigm change away from a redistributive welfare state towards neoliberalism-led upward income distribution. Among the four cases, Sweden is the only one that has not experienced a sharp increase in income inequality, first and foremost because the institutionalisation of wholesale neoliberal financialisation appears to have been avoided in this country. Hence, it can be argued that the financialisation-induced income inequality hypothesis is also confirmed in the Swedish case, from an inverse logic stand point: the preclusion of the dominance of finance capital in Sweden has prevented the shift towards regressive income distribution patterns and large rises in income inequality have been avoided (Figure 8.1).

Deeply embedded institutions and traditions of social democratic Keynesian (Stockholm school) demand management and values of solidaristic wage policy, with centralised collective bargaining, have ensured that the Swedish welfare state could not be easily restructured in accordance with neoliberal orthodoxy. Moreover, financialisation has been contained due to the inability of capital to embed its neoliberal agenda and mode of governance in the Swedish institutions and social fabric. In other words, because Sweden has not undertaken a full-throttle embracement of finance capitalism, even after some liberalising measures in financial markets, finance has remained under control and directed towards productive activities, not speculation and rent-seeking.

Likewise, the spread of retrenchment policies elsewhere in the 1990s did not take place in this Nordic country and did not dismantle its redistributive regime. Some welfare programmes were even extended, acknowledging their universal coverage, whilst Swedish social security remained by 2000 pretty much as generous as it had been in 1980. By the same token, the shareholder-oriented concept of the Anglo-American type of corporate governance has not supplanted the traditional insider-oriented corporate governance regime. The Swedish state-corporatist-trade-unions nexus was a force that stood behind the resistance against the imposition of foreign corporate practices. This was due to the historical role of labour, which was institutionally included in the construction of corporate governance arrangements, thereby successfully being able to protect its interests and solidaristic wage principles. The mechanism of labour influence at the firm-level was institutionalised through the board-level representation for employees. In other words, in contrast to other countries that implemented shareholder-oriented reforms, in Sweden there were no incentives to increase the control over firm management.

It is crucial to underline here the unique balance of power between labour and capital in the Swedish political economy, where the former was powerful enough to withstand capital's assault in the 1980s and 1990s, thus preserving its commitment to income equality. As Vartiainen (2001: 22) claims, "the Swedish social democracy was not a hegemony of an enlightened technocracy, but that of a labour movement, which sought to conquer state power while remaining an autonomous political actor". Indeed, data on the labour share and union membership support the view that the Swedish working-classes' bargaining power was not diminished in the 1980s and 1990s, unlike in other countries and they successfully guarded against radical pro-capital transformation.

The GFO and international financial organisations, such as the IMF, an important factor that contributed to Korean and Argentine financialisation and the subsequent transfer of income, did not manage to influence the unleashing of finance capital in Sweden. Neither did the accession to the EU fundamentally alter the Swedish political economy since the country retained its national currency and monetary independence. It would not be too speculative to suggest that had Sweden joined the EU common currency, the feasibility of the Swedish welfare state model would have been under constant and unbearable threat. Some changes did happen as the rise of venture capital and the creation of a financial center in Stockholm indicate. However, rental income from financial assets has not grown much, whereas household indebtedness though relatively high is found mostly among upper income strata.

Thus, Sweden presents an illustrative case when pursuing economic democracy allows for the embedding of distinctive institutions and ideals, which preserve the high standards of equal income distribution. Those institutions and traditions prevented neoliberal financialisation from penetrating the Swedish model and safeguarded it from having to give up egalitarian values and practices.

# Chapter 9. Discussion: conceptualising the financialisation and income inequality nexus

## 9.1. Introduction

This research project was designed to investigate the causal relationship between neoliberal financialisation and income inequality, i.e. to what extent the rising importance of the financial sector is a cause of increased income disparity. To address this main question an analytical framework for exploring *the financialisation-induced income inequality hypothesis* was developed (Figure 4.3). The main finding to emerge from examining each of the four case studies is that all four political economies went through a phase of neoliberal restructuring, where (except Sweden) finance capital increased its influence. However, despite the apparent correlation between the rising influence of finance and the growing income gap between ruling classes and the rest of the population, the level and trend of this gap was by no means uniform across the four cases. This indicates that any causal links are not straightforward and are very likely mediated by important domestic factors.

Indeed, the second aim of this project was precisely to investigate how far and in which manner financialisation facilitates upward income distribution, irrespective of a country's political economy. In particular, the aim was to identify the key properties of the generative mechanisms of financialisation-based capital accumulation, and how far regressive income distribution is an inevitable outcome of this type of capital accumulation.

The study also contributes to the understanding of how finance capitalism should be researched methodologically to comprehend its effect on income disparity from the ontological perspective of critical realism. In this research, heterodox-based methods provided an alternative means of investigating and conceptualising the complex causal relationships of widening income inequality and its relation to the financialisation phenomenon. Another main benefit of this approach is that different heterodox schools of thought, such as neo-Marxian, post-Keynesian, and neo-institutional combined in one analytical framework helped to achieve theoretical synthesis and the ontological aims through a mode of inference. The epistemological stance of this study and its contribution to knowledge is that it is from this pluralist perspective of the critical realist ontology and the boundaries between the methods of various heterodox traditions, that can provide a well-rounded and comprehensive explanation of the financialisation-induced income inequality nexus.

In this chapter, comparative analysis across the four cases is deployed, exploring the similarities and differences in: a) the processes of institutionalising neoliberal financialisation as a model of capital accumulation; and b) the functioning and properties of its generative mechanism in facilitating and securing upward income distribution as well as how far these are affected by domestic institutions and process. Factual and conceptual conclusions of this study will be synthesised to highlight *components* of the generative mechanism of upward income distribution in finance capitalism, which according to this study, is the culmination of the financialisation-driven income accumulation process as part of a neoliberal mode of capital accumulation. In this context, this chapter will provide explanations of the causal links assumed in the financialisation-induced income inequality hypothesis that appear to be supported by comparative empirical evidence.

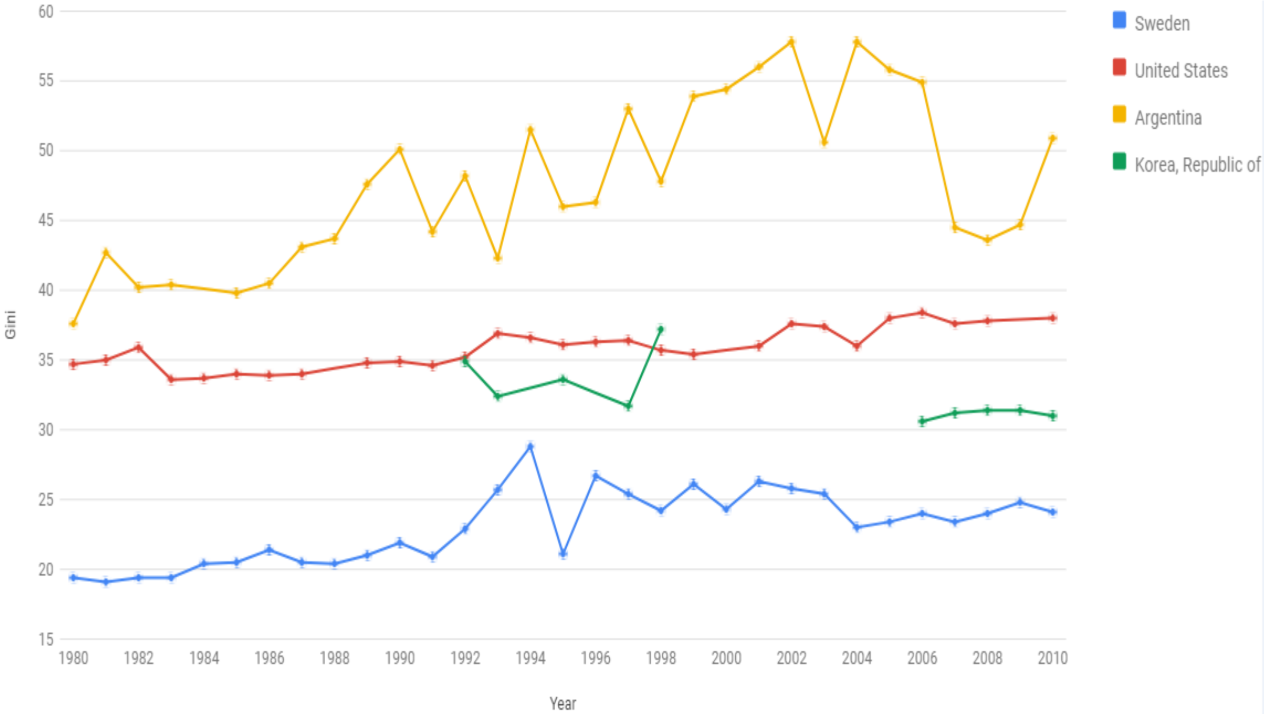
## 9.2. Neoliberal restructuring as precondition for the financialisation-induced income inequality nexus

Throughout the post-1980 period, there has been a dramatic increase in income inequality in both high- and low-income countries. This tendency is not a completely new phenomenon and has a historical equivalent in the 1920s. From the perspective of the global political economy and history, there are many similarities in the capitalism of the beginning of the 20th century and what has happened in the post-Bretton Woods era beginning in the 1980s. This period is characterised by the dominance of neoliberal restructuring towards market-oriented monetary policy, which enabled upward income distribution leading to rising income inequality. Contrary to this *laissez-faire* liberal economic order, the post-World War era of the 1950s and the 1970s, was marked by a restrictive financial regime, whereby the emerging welfare state facilitated redistributive policies and expansive social reforms in most of the developed capitalist countries and in some industrialising economies.

According to the analytical framework developed for this research, the rise and expansion of financial institutions are conditioned by a particular political economy order, namely neoliberalism, which has come to dominate politics, economics as well as social, and international relations. The dynamics of modern capitalism appear to be governed by similar mechanisms to those in parts of 20th century when profound transformations were taking place due to *crisis*, which changed the relationships of production and brought in a new social order (Dumenil and Levy, 2004a). The interventionist state of the “Keynesian compromise” era provided mechanisms for the contract between capital and labour in the 1950s and late 1970s, where full employment, social welfare and an increase in wages and regulation of finance were recognised. This “mixed economy” compromise impacted upon the mode of production and, more importantly, distributional patterns, being reminiscent of Marx’s emphasis on the interdependency of productive forces, transformation of the relationships of production and class struggle. In line with this interpretation, I argue that the *crisis of capital accumulation* is responsible for critical changes in the *modus operandi* of “embedded liberalism” and that it is the dominant capitalist class, who has been ultimately interested in those transformations *to be able to engage in particular forms of revenue accumulation freed from other political and social obligations*.

It is apparent from the data on the Gini coefficient that, beginning in the early 1980s era of neoliberal counter-revolution, income inequality was constantly rising, which was in sharp contrast to the Bretton Woods period of a Keynesian mode of regulation, when explicit redistributive policies were applied (Figure 9.1). In parallel to this process of widening income disparity, incomes of the ruling classes in both high- and low-income countries have been constantly increasing, first and foremost due to the shift to the new post-Bretton Woods framework of finance capitalism.

**Figure 9.1. The Gini coefficient level in Sweden, the USA, Argentina, and Korea, 1980-2010**




Source: created from The World Income Inequality Database, United Nations University, 2017

Another important finding, interconnected with the abovementioned argument, was that concentration of income in the financial sector has been facilitated and maintained by the finance capitalist class in countries where the neoliberal economic regime prevailed over the social democratic principles of redistribution and full employment (USA) and/or national developmental strategies (Korea and Argentina). Conversely, where resistance to the imposition of a free-market agenda and finance-led accumulation regime has been successful, deterioration of the level of income inequality has been prevented (Sweden). Thus, the new social order – neoliberalism – that has been emerging since the late 1970s and the early 1980s in various countries, "is actually a new social configuration in which the power and income of ruling classes was reestablished after a few decades of partial repression in the wake of the Great Depression and World War II" (Dumenil and Levy, 2004b: 660).

In the context of the conceptual framework of the study, the findings have three main implications. *First*, neoliberal ascendancy is a precondition for financialisation to occur and the former is usually established through various means and yet, the same patterns of radical socio-political and economic reorganisation (this section). *Second*, once neoliberal restructuring achieves a dominant position as a mode of economic and political governance, financialisation articulated and expressed through the dominance of finance becomes the most effective way of capital accumulation for upper income groups (subsection 9.3.1). *Third*, this mode of income accumulation due to its very nature and characteristics develops patterns of upward income distribution, leading to widening income inequality and in this regard, constitutes *a generative mechanism* **after** it has been institutionalised (subsections 9.3.2 and 9.3.3).

Turning now to the first claim, the case of the USA is both explanatory and demonstrative as it shows *why* and *how* the Keynesian-oriented policies of "embedded liberalism" were replaced by market-oriented monetarism culminating in the sudden increase of interest rates by the Federal Reserve in 1979. It could be argued that what had happened in the USA in the early 1980s and the way the Anglo-American version of financial capitalism had been established, was used as a blueprint for other countries.

During a transitional decade between the late 1960s and the 1970s the American ruling class faced *a structural crisis of capitalism* marked by the deficits in the balance of trade and the necessity to devalue the dollar to sustain competitiveness with catching-up European countries and Japan. The post-war Bretton Woods era was characterised by the expansion of the welfare state in the advanced economies and ever diminishing incomes of the top income strata and the capital more generally who became interested in changing the *status quo*. By employing new tools, such as a floating exchange regime in 1971 and liberalisation of capital flows in 1974, the restrictive financial regime of the Bretton Woods financial architecture was ended. Crucially, two goals were achieved: the USA preserved its hegemonic and autonomous position and economic sustainability, whereas the capitalist class and other economic elites created a neoliberal framework to develop and legitimise new mechanisms for upward income distribution. This explains why US capital and the government became interested in advocating and promoting a *new global financial order*, with its liberalised and deregulated finance and *laissez-faire* economic mode of governance on the global scale. In this new framework, the interests of *finance capital* represented by the Wall Street and Federal Reserve became central and later on, were supported by the IMF and other global institutions (e.g. WTO, OECD, and EU), internationally to bring into the GFO other countries, both from the centre and periphery. This finding has important implications for developing the conceptual premise that there is an intrinsic connection between an emerging transnational capitalist class and its interest in embedding neoliberal financialisation as a mode of social production in the political economy of different countries.

There are different dimensions in the way neoliberalism has become a dominant political-economic model. In the US, for instance, it has been an inextricable part of the conservative movement establishing the cornerstone of a neoliberal-conservative order (Birch and Tickell, 2010). Whilst different right-wing groups have their own political motivations and goals, their marriage created a mixture of intellectual strands heralding an extremely powerful and coherent political movement. For instance, the libertarians bring to the table the intellectual grounds for free market policies, strong opposition to state intervention and, most importantly, the redistribution of income. This libertarian faction has shifted from an adherence to *laissez-faire* dogma towards a neoliberal concern with state-orchestrated mobilisation of the market rule, as a result of close alliance with business and corporate interests, the prime concern of which is deregulation and low taxes, rather than individual liberty (ibid). It is this wing of the conservative political movement that constitutes its *epistemological foci* and dominates in research institutes, think-tanks, and universities funded by business and that provides a proliferation of neoliberal ideas and their embeddedness in policy-making circles (Mirowski and Plehwe, 2009). In parallel to the dissemination of neoclassical ideas of supply-side economics validating monetarism and echoing the Mont Pelerin Society's philosophical concepts, the principles of Keynesian demand-management and progressive tax system were demonised, with the idea of welfare state being attacked as an ideological pathology of a "totalitarian" nanny state and vilifying the very concept of egalitarian redistribution.

Eventually, it was this domination of the free-market doctrine and Anglo-American type finance capitalism based on the alliance of radical neoliberalism with neoconservatism that shaped a Wall Street-Federal Reserve-IMF triad. This has become responsible for promoting and advocating neoliberal-driven and anti-inflation-focused monetary policies, capital mobility and deregulation throughout the world. That is, this triad and its model have been replicated and exported at the global level. As has been demonstrated, in all the observed countries, fundamental ideas of neoliberalism that are essential for financialisation to occur, including an independent central bank, predominance of inflation-control over employment, and the creation of financial centres have become a part of national governance. The IMF's responsibility to guard this model of governance is further facilitated by membership in global governance organisations, such as the WTO, OECD or EU. Taken together, these results suggest that *financialisation is intrinsically linked to neoliberalism* and the latter constitutes fertile ground (in terms of ideology, governance rationale and institutional restructuring) for the former to emerge. Generally, the same logic and reasons behind the rise of neoliberal financialisation has been traced in other cases. Through a combination of political, ideological, economic, media and legal pressures, backed up when necessary by international blackmail, a neoliberal mode of governance was imposed in a target country (Saad-Filho and Johnston, 2005: 1-2). As in the USA, the study has evidenced that a full-scale assault to erode and marginalise welfare state institutions and the redistributive policies associated with them was carried out to ensure an *ideational turn* towards a neoliberal agenda in Korea, Argentina, and Sweden. The lattermost stands out among the four cases as unique, with its socio-corporatist model of egalitarian redistribution being able to resist a full-blown pro-market restructuring in the 1980s and 1990s, thereby avoiding financialisation-induced income inequality.

What follows is my critical reflection on the idea that neoliberal restructuring is a prerequisite for financialisation and for such social reorganisation to occur various objective and subjective economic and socio-political conditions have to develop. An implication of this is the questioning of the proposition that neoliberal hegemony basically follows the same – almost “algorithmic” process – in all countries and, though with some variations, once established leads to financialisation. I will briefly discuss the relevant conceptual premises using specific themes outlined below.

### *9.2.1. Crisis of capital accumulation*

Marxist political economy provides explanation as to why neoliberalism as the ideological project of improving profit rates came to replace the Keynesian compromise (Harvey, 2007; Dumenil and Levy, 2011). As Dumenil and Levy (2004a: 13-14) explain, the crisis that began in the 1970s and manifested itself in the decline of capital profitability shaped the conditions for profound transformations that led to a new social order with different relationships of production. In all the focal cases, a radical U-turn towards neoliberalism, both successful (USA, Korea, Argentina) and unaccomplished (Sweden), occurred in the context of and, indeed, because of declining levels of capital accumulation. Thus, during the stagflation crisis falling rates of profit were observed in the US in the early 1970s, Argentina in the late 1970s, and

Korea in the 1980s. In the case of Sweden, what Ryner (2004: 106) calls "class struggle in reverse" occurred in the early 1970s, as a response to further movement towards economic democracy implying further progress towards equalisation of income as a reaction, in turn, to stagflation crisis. Policies, such as solidaristic wage and wage-earner funds, as part of the broader policies of socialisation of the Swedish economy would inevitably, first and foremost, affect the capitalist class's income.

My research has provided evidence that supports the arguments of authors like Harvey and Dumenil and Levy that the *structural crisis of capitalism*, displayed most notably as the *capital accumulation crisis*, is the point of departure for neoliberal financialisation to begin its ascendancy. This happened in the early 1970s, leading to the transforming of previous social orders and establishing an economic system, which favoured the interests of the ruling capitalist classes. Financial capitalism, which replaced Fordism (aka industrial capitalism), with its comparatively more equitable distribution of income, became attractive to the ruling class to increase its revenues, notwithstanding its socio-political consequences for the distributional patterns manifested in growing income inequalities. Only when it is transnationalised and freed from any socio-political obligations – let alone engaged in sustaining national welfare systems (USA, Sweden) or participating in national developmentalist projects (Korea, Argentina) – can finance capital promise such high returns to its holders.

In this regard, financialisation might be considered, first, as a sign of dominance of finance capital over productive capital in reconstructing the mode of production to cope better with crisis of capital accumulation (Sweezy, 1994). Second, in its development and evolution, just to sustain itself, financialisation inherently and inevitably needs constant expansion and cannot tolerate spatial and national boundaries. This explains its pursuance of transnationalisation.

### *9.2.2. Interests of the ruling class and its transnationalisation*

Neoliberal ideas provide the necessary legitimisation for the ruling classes in different countries to attempt the establishment of a renewed regime of capital accumulation in the sense that a similar regime had been established prior to the two world wars in advanced capitalist countries of the West, before being curtailed during the social democratic era of Keynesianism. Neoliberal ideology in the 1980s became a common ideology of the capitalist class, as it helped to consolidate and mobilise their *class consciousness* to reintroduce the *laissez-faire* policies of the Belle Époque to ensure the transformation of the capitalist political economy from redistributive Keynesianism to the neoliberal financialisation of Hayekianism. In the new environment of the more globalised world, these common interests of the ruling class are intrinsically linked to and dependent upon the free circulation of capital, new forms of corporate governance, financial innovations, upward and outward wealth transfer and, importantly, the new GFO.

During the finance-led era, the shift towards neoliberal strategies was rapid and supported by the ruling class, who quickly abandoned the "old" policies (USA, Korea, and Argentina) or tried to terminate them (Sweden), favouring new opportunities for upward income distribution. Even more important, however, the interests of the national capitalist class from different countries appeared not to contradict each other, as in previous eras of capitalist development (Sklair, 1997; 2000).[157] As finance capital needs constant commodification of financial instruments and mobility free of any restrictions, *transnationalisation of finance capital* is now supported by the previously rival interests of the national ruling classes in different countries. Thus, there is a new globally integrated financial system, which has grown phenomenally since the 1980s (Robinson and Harris, 2000). It is estimated, for instance, that between 1980 and 1990, as national stock markets almost disappeared, the volume of cross-border transactions in equities grew from $120 billion to $1.4 trillion or 28% per year. In the same period, cross-border bank lending rose from $324 billion to $7.5 trillion, whereas offshore bond markets increased from $259 to $1.6 trillion or by 537% (ibid: 36-37).

Ascendancy of financial capitalism prepared by and brought about by neoliberalism increased revenues of the top income strata in all the cases analysed. At the same time, drawing on extensive secondary literature, the evidence shows that the incomes of labour and other lower income strata stagnated (USA), declined (Korea and Argentina) or were not as rapidly rising as for the top deciles (Sweden). Liberalisation of capital as a means of new capital accumulation for national capitalists is by definition conditioned by liberalisation from spatial constraints and barriers of territorial nation-state jurisdiction. Hence, there has been a demand from national and foreign capital for *mutual support and adaptation of the appropriate neoliberal policies* at the national level and their internationalisation to insure financial liberalisation. As

[157] This is not to argue that there is no national competition or different factions within various national capitalist groups, but this is beyond the scope of the current analysis.

Robinson and Harris (2000: 16) claim, "National capitals have increasingly fused into transnational capital. The rise of transnational capital out of former national capitals is having a similar transformative effect on what were national capitalist classes. These are drawn by globalisation into transnational chains that reorient the determinants of class formation. The leading capitalist strata worldwide are crystallising into a TCC [transnational capitalist class]". Having their vested interest to coincide organically and actually being dependent on each other through the necessity of capital mobility and deregulation, national ruling classes are increasingly committed to following and disseminating ideas of neoliberal restructuring at the *transnational level* and in the process turning, indeed, into the TCC.

### *9.2.3. Ideational transformation and ideological hegemony*

This transnationalisation of interests of the national capitalist classes of the USA, Korea, Argentina, and Sweden has been having a profound effect on how similar strategies employed to insure ideational transformation in these countries are. All countries studied have experienced very similar business-led, well-designed, and amply financed long-term propaganda campaigns aimed at recruiting new market-oriented policy entrepreneurs in decision-making agencies, changing public opinion and legitimising market-friendly policies.[158]

For the current study, it was found that to ensure a neoliberal social and economic mode of reproduction as well as to achieve ideological hegemony, ideational transformation had to be implemented on two different levels, *abstract* and *operational*. The first deals with *epistemic shifts* in the philosophic-ideological beliefs and values, such as economic and political theory and practice, ideology, and culture. The second concerns particular policies and measures in *policy-planning and governance* in the sense that it is not only being the outcome of the first (which is often the case when concrete effects are caused by certain ideas), but also, as an equal contributor to the main goal, i.e. ideational and ideological change and its hegemony for neoliberal financialisation as the legitimate mode of upward income accumulation. Here, as

[158] Prior studies that have noted the importance of business-funded think-tanks in influencing public perception and dissemination of neoliberal ideas include, for example, Desai (1994), Miller (2010), and Medvetz (2012). These and other studies on corporate power (Robinson and Harris, 2000; Beder, 2014) provide clear explanations of how big business and capital can influence governments in the interests of the ruling class, effectively rejecting accusations in "conspiracy theories".

mentioned in the chapter on the US, Antonio Gramsci's (2005[1971]) view that civil society represented by think-tanks as "collective intellectuals" of the ruling class is a powerful analytical tool, which helps to explain how ideological hegemony favouring unequal income distribution was achieved, thus making the latter a new "normal".

Previous research into the corporate class and global elite has shown how business, both national and transnational, is mobilised and politicised to further its interests (Sklair, 1997; Robinson and Harris, 2000; Carroll and Sapinsky, 2010; Beder, 2014). As has been demonstrated, in the US, Korea, Argentina and Sweden various planning think-tanks and research institutions have been responsible for articulating neoliberal ideas and modes of governance as well as mobilising business interests, in ways that reveal an attitude of near "siege mentality" by the ruling class (Sklair, 1997). Such mobilisation and politicisation, manifesting itself in the mushrooming of "centres of persuasion" in countries going through neoliberal indoctrination, can be traced from the US, a core country of global capitalism and the GFO, along with such organisations as the Mont Pelerin Society and the American Enterprise Institute (Birch and Tickell, 2010).

Ideological consolidation of the ruling classes around a neoliberal political vision was achieved through either "necessity" to "fight hyper-inflation" (Argentina), "keep up with globalisation" (Korea) or "sustain competitiveness" (Sweden). In addition, in Korea and Argentina neoliberal ideological and socio-cultural domination was facilitated by social movements, often from both top-down and bottom-up as well as organic intellectuals, constituting epistemic shifts. It is important to note that, neoliberalism is "flexible" and opportunistic, in the sense that it is able to implement radical restructuring either by manipulating by mobilising such notions as "democratisation" and "globalisation" or exploiting a political momentum of "power consolidation" in a country where neoliberal reorganisation is under way or is about to start. For instance, political liberalisation was used in Korea in the late 1980s to abandon the national developmental project associated with its authoritarian regime and to open up the country for transnational capital. In Argentina, the first market-friendly deregulation and dismantling of redistributive institutions began under the military junta in the late 1970s and continued under the Menem rule, who was granted "emergency power" in the early 1990s to be able to implement the "shock therapy" reforms prescribed by the Washington Consensus. Remarkably, in the early 1980s the first-democratically elected Alfonsin administration had followed the same neoliberal recommendations.[159] What is common in all cases is that in order to achieve hegemony neoliberals presented in their discourse labour- and social-prone counter-arguments (e.g. against repression of trade-unions or for equal income distribution) as "unnecessary politicisation", whereas monetarist orthodoxy in favour of free financial markets would appear as purely "technical" or by means of the rhetorical device of "there is no alternative" policy. To delegitimise the reconstruction of national welfare and developmentalist institutions and to enable future incorporation of institutions of private profits accumulation through neoliberal financialisation, notions of "competitiveness", "creditworthiness", "consumption as a human right", "public choice", and "inefficient rent-seeking state" opposed to allegedly "efficient market principles" had to occupy public discourse as a kind of "common sense" and "internationally recognised best practice".

In Sweden, in the early 1980s, like in the US in the 1970s, where the "Committee on the Present Danger" was established by conservative forces backed by corporations, an alarm-driven type of mobilisation can be traced after a labour assault, most notably presented in the form of wage-funds, was launched against private capital (Boies and Pichardo, 1993). Again, falsification of Keynesian ideas, delegitimisation of the redistributive welfare state and validation of monetarism to achieve ideational transformation was mostly undertaken by research think-tanks funded by big business. Neoliberal Swedish academics also contributed to the popularisation of right-wing neoclassical economics and paved the way for a political shift of the social-democratic ruling party to the right by legitimising its move as a "Third way".

Subsequently, the "commanding heights" in the main economic and financial agencies of state apparatus and central banks as well as senior positions in economics

[159] Post-soviet countries, such as Kazakhstan and Russia, which underwent radical neoliberalisation, experienced the same combination of opposite strategies employed by neoliberal advocates. In the early 1990s, "shock therapy" and privatisation were justified in the name of democratisation and dismantling of the institutions of the "Soviet legacy" and totalitarian regime, such as state planning and welfare provision. In the late 1990s, when these political regimes began to consolidate political power, turning into authoritarian ones, "super-presidential" form of governance was justified on the grounds that "progressive" market-oriented reforms can be implemented only by a "strong hand". Similarly, the "Chicago boys" in Chile in the 1970s could implement their neoliberal anti-social policies, because of the absolute support of the Chilean strongman, Pinochet.

departments of universities would be staffed by neoliberal converters and free-market advocates trained in, for instance, IMF-funded research institutions. They would contribute to rejecting national models and promote the ascendancy of *laissez-faire* liberalism and monetarism in economic and governance policies.[160] As Sklair (2000) and Beder (2014) demonstrated, it was not a mere coincidence that many top-ranking politicians and bureaucrats in the cases they studied had degrees from prestigious American universities, serving the interests of their ruling classes by promoting neoliberal agendas and implementing neoliberal economic policies

### *9.2.4. External support and imposition*

The discussion above highlights the transnational and hegemonic ideological character of neoliberal financialisation. Its global ascendancy is vital for its survival and its promotion as the legitimised mode of upward capital accumulation. Hence, the importance of external ideological support and, when necessary, even enforced imposition of institutions and rules, aimed at safeguarding the embeddedness of Anglo-American-type of finance capitalism in new territories.

The evidence from this study suggests that both ideational transformation and operational changes in governing policies and national strategies have been the results of high levels of international ruling class consciousness, which was manifested in the class solidarity across borders. This international class solidarity is a crucial component for finance capitalism to be established and embedded in formerly protected territories and when necessary, to employ external support and imposition.

[160] As a former state bureaucrat, who has worked in various finance and socioeconomic state agencies, I can confirm that one of the most prestigious training programmes was facilitated by the Joint Vienna Institute of the IMF (JVI) in Austria. JVI was established in 1992 and specialises in "training to officials and managers from former centrally planned economies to assist them with the transition to market-based systems". The main addresses are employees of ministries of economy, finance and central banks from countries in Central, Eastern and Southeastern Europe, the Caucasus and Central Asia. Sponsors of the JVI include BIS, EBRD, OECD, the World Bank, the IMF, and WTO and all costs including living allowance and accommodation are covered by the JVI, which makes its courses very popular among public officials and certainly helps to disseminate "right" knowledge (see official website, available at https://www.jvi.org/about/what-we-do.html). From my personal experience, attending several times over a fifteen-year period (2000-2015) the one-to-two week courses and a 7-week course on Applied Economic Policy, the curricula has been biased towards the neoclassical orthodoxy of monetary policy and macroeconomic adjustment programme. No alternative or heterodox theories have ever been offered when discussing topics on macroeconomic stabilisation, public debt, fiscal rules, and international capital flows.

One of the issues, therefore, that emerges from these findings is the role of the USA and the Wall Street-Federal Reserve-IMF complex behind the GFO. As the main beneficiary of the neoliberal financialisation on the global scale, the American ruling class is the most interested one in transnationalising capital and dragging national finance capitalists into the GFO system. It is this very system that safeguards reproduction of neoliberal financialisation and compliance with its rules, such that when necessary it employs coercion.[161] For neoliberal financialisation, external support and imposition displayed by international organisations and global think-tanks, especially witnessed in Korea and Argentina and to some extent in Sweden, are crucial for overcoming resistance and getting institutionalised in a country and transform its model into a new political economy.

This, in turn, provides yet more evidence of the high political mobilisation of the transnational capitalist class and its deeply-rooted and organic relation to the GFO and Anglo-American finance capitalism. As such, the neoliberal agenda was promoted and advocated by corporate lobbying organisations of the *national* capitalist class in the first place, whilst often having resources mobilised through, what Sklair (1997) calls, “elite social movement organisations”, in regards to promotion of the *global capitalist class’s interests*. Again, the evolution of national business classes into a transnational capitalist class is an important element in constructing a common global class consciousness sharing a common ideology, which is, in turn, a vital component for providing class-focused support for incorporating institutions of neoliberal financialisation on a global scale.

At the centre of this *external support and imposition network*, I place the *GFO matrix* consisting of regional and global cooperation (e.g. OECD, EU, G7), economic and financial (e.g. the IMF, WTO, the World Bank) and global policy planning organisations and groups. The lattermost provide the necessary intellectual support to the epistemic shift and lobbying of capital interests on the global level and include such centres as the World Economic Forum, the Bilderberg Group, the Trilateral Commission, and the International Chamber of Commerce (Miller, 2010; Carroll and Sapinsky, 2010; Mirowski, 2014). Taken together, the primary goal of this web of

[161] The issue of the US geopolitical power and its ability to shape the structure of the global political economy has been discussed in the literature. For details see, Strange (1986; 1994), Gowan (1999), and Soederberg (2004).

institutions and groups is to achieve total neoliberal ascendancy in a particular country via the successive formation of a financialisation-led capital accumulation regime.

In Korea, neoliberal indoctrination went hand in hand, not only with the democratisation discourse, but also, with a promise to be granted membership of the OECD and WTO; a kind of benchmarking of a "successful" and "competitive" economy. In the aftermath of the Asian crisis, the IMF-led free market-oriented campaign became more aggressive and even turned into blackmail, as conditions for loans to help the Korean economy included radical restructuring of the national developmentalist strategies.[162]

In Argentina, using the financial crises and economic turmoil as a pretext, the transnationalised capitalist class began as early as in the 1980s to embed the whole country into the GFO-supported neoliberal financialisation regime. The long-term attachment to a convertibility regime became possible and was supported, first and foremost, by a constant inflow of transnational capital facilitated by the IMF and legitimised by the preceding radical neoliberal restructuring led by the World Bank. For a while, the ruling class could buy legitimacy by increasing the consumption levels of the population and in parallel dismantling all former redistributive institutions. But ultimately, this regime supported by the GFO structures favoured both the national and transnational capitalist classes in their constant pursuance for upward income distribution by embedding state-led and debt-driven financialisation in the social fabric and political economy institutions of the country.

By contrast, it could be argued that in Sweden, despite the external support and imposition mechanisms of the GFO web, the total dismantling of the consensus-oriented relations between capital and labour could not be achieved. The social democratic principles of equal income distribution have been preserved, because the epistemic shift was not completed due to the powerful influence of the national trade unions and deeply embedded solidaristic and egalitarian values in Swedish politics and society. Importantly, the Swedish corporate governance type was preserved, thus indicating the confluence of interests of both national capital and labour, which effectively opposed the imposition of the Anglo-American shareholder-oriented

[162] That is why Lawrence Summers, an undersecretary of the US Treasury Department in 1998, noted "In some ways the IMF has done more in these past months to liberalise these [Korean, Indonesian] economies and open up their markets to US goods and services than has been achieved in rounds of negotiations in the region" (cited in Bello, 1999: 138).

corporate governance regime interested in transferring national wealth out of the country for the benefit of transnational capital. Likewise, a balanced approach by Sweden towards its EU membership, with preservation of its national currency, prevented restructuring of the welfare institutions.[163]

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To summarise, through the current study, it was found that neoliberal restructuring is a very important stage, predetermining and encoding successive upward income distribution of the financialisation-based generative mechanism, which leads to widening income inequality. First, for financialisation to occur, neoliberal ascendancy in the context of changing the socio-political and economic environment had to take place resulting in a new paradigm of political economy. Second, this new form of social production, which I call in the theoretical framework and throughout the text, neoliberal financialisation, affects the functional distribution of income in terms of creating unequal redistributive effects.

In the context of the crisis of capital accumulation and consolidation of the capitalist class interests along with its further transnationalisation, neoliberal hegemony, supported and facilitated by the ruling class, has helped to establish a particular mode of capital accumulation – financialisation. This is an outcome of the constant development of the once unleashed finance capital. In the neoliberal financialisation unity the former is a precondition for the latter. Importantly, it is within the neoliberal context, which is characterised by the dominance of the financial sector, by the mobility of capital, by the retrenchment of the welfare state, by the right-wing economic policies and monetarism, and by the diminishing power of the labour vis-à-vis increasing power of the capital, that the *generative mechanism* of the financialisation, which induces income inequality, can emerge as a possibility. In this regard, financialisation may be viewed as the latest stage of neoliberalism and its

[163] Several reports have shown that integration into the EU monetary system of comparatively smaller economies had serious implications for these countries, which had to bear high socioeconomic costs (see, for instance, Lapavitsas et al. (2010), Hall (2012), and Papadopoulos and Roumpakis (2018)). Lapavitsas *et al.* (2010: 322) claim that “The institutional mechanisms surrounding the euro have been an integral part of the crisis. To be more specific, European monetary union is supported by a host of treaties and multilateral agreements, including the Maastricht Treaty, the Growth and Stability Pact and the Lisbon Strategy. It is also supported by the European Central Bank (ECB), in charge of monetary policy across the eurozone. The combination of these institutions has produced a mix of monetary, fiscal and labour market policies with powerful social implications”.

mode of income accumulation to echo Lenin's (1999[1916]) *Imperialism, the highest stage of capitalism*.

The results of this part of the comparative study have demonstrated that neoliberal financialisation was a prerequisite for the widening of income inequality and showed how its institutionalisation involved both ideological and operational aspects. This finding has important implications for supporting the hypothesis that increased income inequality is an outcome of the neoliberal financialisation regardless of where this takes place: in the financially most developed USA, newly-industrialised Korea, developing Argentina or corporatist Sweden. A more detailed account of the generative mechanism is given in the following section. This combination of findings provides support for the conceptual premise and generalisation about the *components of upward income distribution in the neoliberal financialisation and causal links in the financialisation-induced income inequality nexus* also conceptualised in the next section.

### 9.3. Financialisation as the generative mechanism of increasing income inequality

This study has found that a neoliberal financialisation regime generates unequal distribution of income, where finance capital plays a pivotal role. From the perspectives of the critical political economy literature and the theoretical framework employed in this thesis, the relationship between increasing income inequality and financialisation is complex and has a positive correlation. The causal link between financialisation and regressive income distribution has both a medium- and a long-term trajectory, as it requires institutional change. This requires transformation in the mode of income accumulation beneficial for the ruling class and also changes in the relationship between capital and labour, whereby the former (financialisation) has to gain more power vis-a-vis the latter (institutional change). The upward income accumulation of financialisation, thus, is manifested in the same patterns of regressive functional distribution of income and in similar mechanisms, where income inequality occurs not only in the high-income advanced capitalist countries, but also, in middle- and low-income ones.

The new paradigm of the neoliberal counter-revolution replaced the social democratic Keynesian era when supply-side policies, the retrenchment of the welfare system, and the rejection of the national developmental models were brought about by an Anglo-American version of finance-led capitalism. In parallel, the Bretton Woods fixed exchange rate system of restrictive and regulated monetary and financial policies was demolished to be replaced by the new and hegemonic GFO. This, in turn, enabled the employment of the new *financialisation-based mechanism of capital accumulation* by the ruling classes in different countries, not only advanced capitalist ones, as the top-income earners managed to incorporate themselves and adhere their economies to the global capital accumulation chain (USA, Korea, and Argentina). To find their niche in this global chain and to, indeed, offer something in exchange, the national ruling classes embedded a financialisation-based mechanism in their own countries. Hence, the need for neoliberal restructuring that legitimised "shareholder capitalism", the development of stockmarkets, and the explosion of financial activities. Once embedded in the GFO, these countries had to follow its rules to sustain what was now a domesticated financialisation-based mechanism. The "pressures of financialisation" (Blackburn, 2006: 42) require them to cut social spending to keep up with "creditworthiness" and to be able to borrow from external capital markets (Argentina), to sustain "competitiveness" and "foreign investment attractiveness" by downsizing the labour force (Korea), or to "rationalise" corporate governance by promoting the development of stock markets (Sweden), or to "democratise" finance by introducing the "ownership society" agenda and fostering investment banking (USA).

The findings from this study strengthen the idea that financialisation impacts on income inequality through these mechanisms, which are intrinsic to and essential for the very functioning of neoliberal financialisation. The financialisation-based mechanism has been institutionalised and embedded in the social production of the countries studied, most notably USA, Korea, and Argentina, and has affected their income distribution regressively. It can thus seem reasonable to conclude that it is this very mechanism that generates increased income inequality. An implication of this is the possibility that unequal income distribution of the financialisation-based mechanism is laid down in the very genesis of neoliberal financialisation. As revealed through the examination of the analytical constructs, after financial liberalisation and deregulation, the rate of profit in the financial sector began to rise constantly at the expense of labour's income share, while capital rents grew, thus enriching the ruling class even further. At the same time, ever augmenting household and public debt has served to siphon income from the working and middle classes upwards.

*9.3.1. Components of the financialisation-based mechanism: implications of financial liberalisation and deregulation*

Financial liberalisation and deregulation (FLD), as the first components of the analytical construction that explains institutional transformations, are crucial basic elements of the financialisation-based mechanism of capital accumulation and its effect in generating income inequality.

To become a new mode of social production and to embrace and sustain structural power, first and foremost, finance capital had to be freed from socio-political obligations and spatial constraints. This power and pursuance of certain mechanisms of redistribution in favour of the capitalist class, were advanced by national finance elites, projects of economic integration and international organisations. As already highlighted, these projects have been supported by the hegemonic power of the US-based Wall Street-Federal Reserve-IMF complex and are capitalist class-biased. Thus, describing how neoliberalism has advanced the interests of the American ruling class on a global scale, Gowan (1999: viii) maintains that, “these changes in the internal and transnational linkages of states are consolidated into a new regime, which in turn tends to make state leaderships want what American state and business elite want”.

It is reasonable to suggest that the relationship between expanding income inequality and financialisation can be attributed to FLD policies, which encourage financial engineering and “innovations” as well as diversion of capital from production and the real economy, whilst the removal of financial regulations facilitates speculative activities. The deregulation of financial markets has created an environment prone to instability and risks essential for the operations of various hedge and mutual funds to make profits out of arbitrage trading with various futures and derivatives (Blackburn, 2006). In the 1990s, hedge funds mushroomed, reaching 8,000 by 2006 and controlling almost $1.5 trillion of assets in addition to $7 trillion being controlled by mutual funds (ibid: 46). This financial revolution, in turn, fostered investment banking practices and the creation of exotic financial devices and products, such as hedging, derivatives, special-purpose entities/vehicles (SPE/SPV), CDOs, and swaps. It is estimated that in 2004 alone the scale of financial derivatives reached $196 trillion in the global money supply, of which $2.4 trillion dollars of money were transacted daily (BIS, 2005:16).

By the same token, FLD has boosted securitisation, shareholder-oriented corporate governance with an M&A cult and an obsession with creating financial centres and national stock markets even in countries with a developmental path never dependent on them in the past. As for the general development and its association with financial liberalisation, Singh (1997: 780) argues that, "Stockmarkets are potent symbols of capitalism but paradoxically capitalism often flourishes better without their hegemony". Historically, the advanced economies of continental Europe, Japan, Korea, and Taiwan achieved their high-income status without developing stockmarkets and even now low- and middle-income countries cannot afford such a luxury let alone to employ it for progressive redistribution.[164]

These findings may be somewhat limited, but the important analytical point here is to recognise the connection between FLD policies and their role in institutionalising the neoliberal financialisation mode of capital accumulation and thus, in creating the generative mechanism of increasing income inequality. This observation could further strengthen the idea that FLD strategies are required by the processes of neoliberal financialisation to unleash finance capital and to transnationalise it, as this is "a means of resolving problems of accumulation" (Robinson and Harris, 2000: 27). Finance capital needs to be transnationalised to reinforce "the reproduction of global capitalist relations of production and at the same time the reproduction (or transformation) of political and cultural institutions favourable to it [capitalist's class] rule" (ibid: 27). That is why, for instance, securitisation or investment banking, while becoming the common business in all the observed cases, are vital for the transnationalisation of finance as they help to free assets from national boundaries (Minsky and Wray, 2008).

### *9.3.2. Effect of the financialisation-based mechanism: increased profits in the financial sector and a decrease in labour's share*

In the past few decades, FLD strategies have facilitated a transition from restricted financial institutions to more market-based financial systems. Wray (2009) describes this process, pointing out that considerable concentration of finance power

[164] As Keynes (2016[1936]: 154) pointed out, "When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done. The measure of success attained by Wall Street, regarded as an institution of which the proper social purpose is to direct new investment into the most profitable channels in terms of future yield, cannot be claimed as one of the outstanding triumphs of laissez-faire capitalism - which is not surprising".

occurred in the developed countries, with the US taking lead and where neoliberals, who he calls neoconservatives, took over the state to act in the interests of money managers. I suggest that a similar process has taken place in the middle- and low-income countries. As argued throughout this thesis, together with the hegemony of the neoliberal doctrine, this has led to a significant concentration of financial power in the high-income (USA), newly industrialised (Korea), and developing (Argentina) countries. Sweden stands out from this tendency, which can be explained by the fact that the country's political economy has managed to constrain neoliberal finance somewhat and hence, the distribution has not shifted towards capital.

Increased power of finance capital enables financial rent-seeking and at the same time, contributes to the replacement of processes and institutions that aim to reduce inequality (progressive redistribution) by regressive redistribution policies. Further lifting of the nation-state constraints on the financial markets combined with the retrenchment of social programmes and neoliberal supply-side economics doctrines of low taxes on capital gains to allegedly boost savings and investment, added to the concentration of assets in the top financial institutions (Wray, 2009). This creates the vicious spiral of neoliberal financialisation: growing power of finance capital vis-a-vis labour leads to an increased ability of the former to influence policy-makers further and to concentrate even more assets in order to make even greater profits. In the light of data concerning the shrinking share of labour in the national income and growing importance of the financial sector in all the observed cases, it would seem reasonable to argue that this pattern of generating income inequality through financialisation is relevant for the mature democracies of the USA and Sweden, but to a significantly lesser extent, for the abovementioned reasons, as well as the newly-democratised countries of Korea and Argentina. To take one example, by 2009, the ten largest US financial institutions held 50% of the financial assets, whereas in 1990 it was only 10%.

Thus, one of the main consequences of neoliberal financialisation and its generative mechanism of regressive redistribution of income and wealth is a decisive shift in the power asymmetry between labour and finance capital in favour of the latter (Kus, 2012). The empirical evidence from this study suggests that due to the promotion of finance interests at the expense of labour, pro-labour policies and institutions have been constantly weakened in all the focal cases, except Sweden. In addition, the combined effects of decreasing profitability of the non-finance sector and decreasing membership of trade unions (that traditionally relied on workers in relatively secure jobs), has led to a continuous trend of decreasing real net wages for middle-class workers, as evidenced in prolonged real wage moderation (Stockhammer, 2009).

The new patterns of income accumulation were also facilitated by new models of corporate governance, especially in the cases of the USA and Korea. Shareholder-oriented and FDI-centred strategies have invariably focused on short-term profits and "growth by acquisition", which has provided incentives for labour cuts and allowed for "exorbitant remuneration" for top executives (Blackburn, 2006: 49, 53). It is estimated that their pay in 2005 was 262 times the average worker's pay compared with 38 times in 1979 (Mishel *et al*., 2007). In addition, monetarist inflation-focused policies have been prioritised by the neoliberal mode of governance to sustain banks' profitability, since inflation undermines the creditor's ability to lend money to investors. These finance-biased policies have been especially evident in Argentina, where the convertibility regime combined with austerity measures prescribed by the IMF, created redistributive mechanisms in favour of finance capital, with devastating consequences for employment and the level of income inequality.

### *9.3.3. Effect of the financialisation-based mechanism: increased rental income from financial assets and augmented debt*

Through this study, it has been found that after FLD strategies were implemented in the USA, Korea, and Argentina, and to a lesser extent in Sweden, rent-seeking and "the resurrection" of the rentier occurred in the financial systems of these countries. These results are consistent with those of Lapavitsas (2009a: 143), who maintains, that "the ability to extract rent-like income through financial operations is a by-product of the transformation of finance rather than its driving force". In other words, the logic of the neoliberal financialisation-based mechanism generates a system where the owners of finance capital and agents related to the financial sector (e.g. financiers, lawyers, and investment bankers) invariably receive higher income. Moreover, that very system creates a structure designed for and aimed at, reproducing "financial expropriation" (ibid), thus affecting the functional distribution of income in favour of higher income groups. It has been shown that, in all cases, the share of income gained from capital, investments, and other financial assets has increased over the past few decades, especially for the top-income strata, findings that match those observed in earlier studies (e.g. OECD, 2011).

Financial activities that generate rental gains, promoted and supported by the policies of FLD, have been traced in all four cases. For instance, one of the decisive characteristics of financialisation is the possibility for national corporations and states to borrow directly in open markets, which has contributed to the transformation of traditional bank lending into investment banking. That, in turn, has boosted M&A and IPO activities, speculation and securitisation of debt, and more importantly, has enabled the financial institutions to use the revenues of the middle-class and workers as a source of profit. Combined with other aspects of the neoliberal financialisation era – shrinking wages and declining personal savings – the process has facilitated and indeed, "encouraged" the integration of the low- and middle-income strata (USA, Korea) into the financial system, by means of the concomitant growth of household debt: the stagnation of wages and incomes and the withdrawal of a "social wage" that included affordable, subsidised or free provision of public goods (e.g. housing, education, health). This has resulted in large sections of populations turning to heavy borrowing to satisfy their needs and/or maintain their status (Lapavitsas, 2009a). For example, in this new "debt economy" (Lazzarato, 2012) American college students' loans grew from $2 billion in 1996 to $17 billion in 2007, reaching $1 trillion in 2012 (Standing, 2016: 155). In the case of Argentina, escalation of the foreign loans was facilitated by the convertibility regime of the deeply embedded monetarist doctrine, which was supported by the IMF. This generated a *modus operandi* of the capitalist class to rip off revenues through debt peonage. In Sweden, financial deregulation did facilitate increased lending and credit expansion, which resulted in a housing bubble and banking crisis in the early 1990s, but in this case, it was mostly high-income groups that generated debt to accumulate real estate assets and engage in speculation. As Wray (2009: 809) asserts, describing Hyman Minsky's "money manager capitalism",

> "With little regulation or supervision of financial institutions, money managers concocted increasingly esoteric instruments. It is largely the capital gain – not the underlying income flow – that rewards the money manager. Capital gains, in turn, are relatively easy to fabricate given the opacity of the underlying assets – what Warren Buffet termed 'financial weapons of mass destruction'".

Thus, it could be concluded that financialisation has provided opportunities for the financial and corporate elites to enrich themselves at the expense of the wage share (Sweden) as well as rising private (USA, Korea) and public (Argentina) debt.

From the perspective of international political economy, the important implication of the rising household debt is that it explains why global finance is interested in creating a particular socio-cultural environment that justifies consumption even by low-income wage-earners. As Montgomerie (2007: 3) claims, "financialisation and debt-led consumption meet as economic conditions such as stagnant income growth coupled with the growing supply of credit available to households, served to integrate households' future income and spending habits into financial market expansion".[165] In line with this interpretation, the cumulative effects of the constant finance rent-seeking and active targeting of the indebted middle-class, on the one hand, along with wage stagnation and the growing availability of credit, on the other, explain how rising household debt is built into the logic of upward income distribution of neoliberal financial imperatives. Indeed, these are key components of the generative mechanism of regressive income distribution set in action by the institutionalisation of financialisation.

In the neoliberal era, the financialisation-based mechanism of debt-creating is also a device, not just to discipline workers (USA, Korea, and Sweden), but entire nations (Argentina), so that their incomes are channelled to and accumulated by the resurrected rentier class. As Federici (2014: 233) explains, what is specific about the new use of individual debt is that it "changes the relation between capital and labour and among workers themselves, making exploitation more self-managed and turning the communities that people are building in search of mutual support into means of mutual enslavement". In this respect, financialisation relies on debt not only to reproduce an illusion of prosperity and to maintain consumption by the working class (whose income has stagnated since the early 1980s), for it also operates as a powerful disciplinary device. Combined with job insecurity in increasingly more precarious labour markets, debt is a key component of neoliberal governance, where the inability to service debt can have catastrophic effects for people's wellbeing and their dependents. In this context, the costs to undertake political action or resist the functioning of the generative mechanism are asymmetrically high, not just for individuals, but even whole countries. Indebtedness mechanisms are at the centre of

[165] Earlier studies on the rising power of global finance focus on how pension and mutual funds are increasingly embedded within the neoliberal design of income distribution (see Harmes, 2001; Dumenil and Levy, 2004c; Langley, 2004).

this process, which first and foremost, ensure that debt servicing guarantees constant and unstoppable upward income distribution.

### 9.4. Conclusion

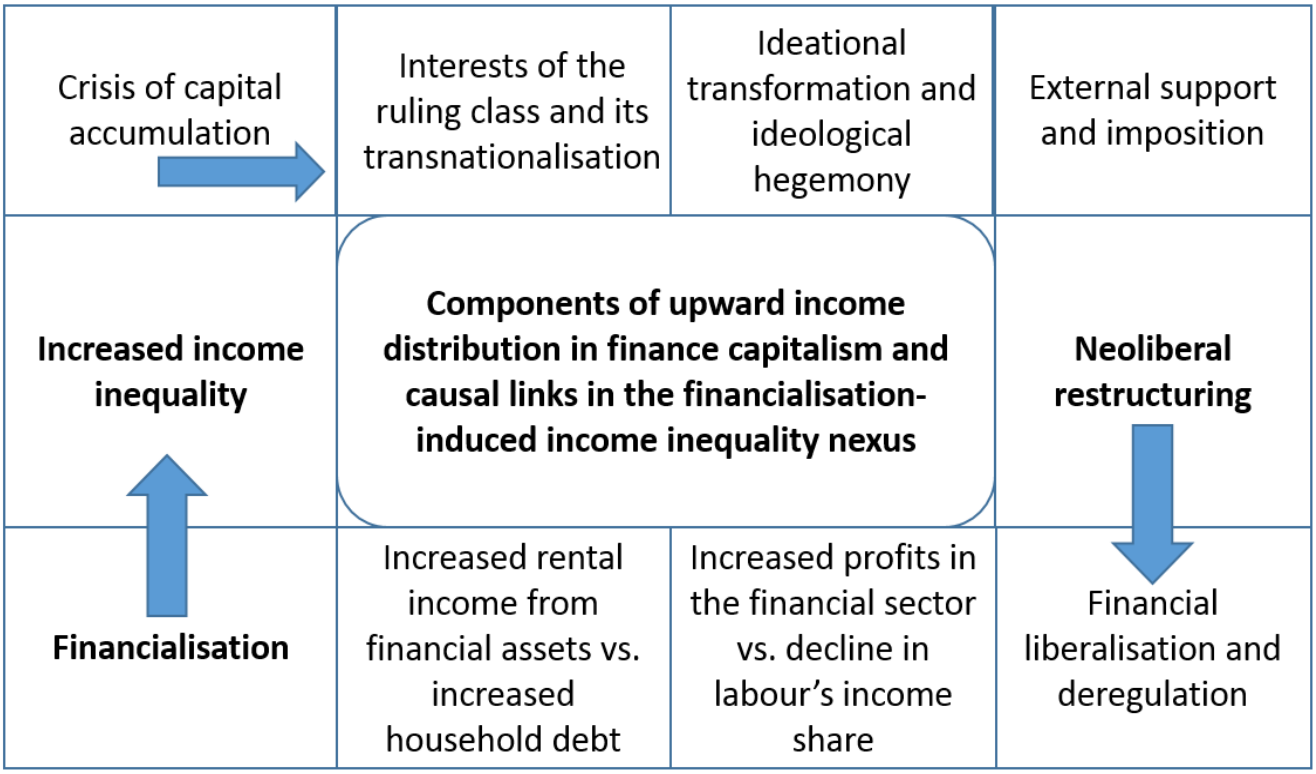
In this chapter, the main findings from the four case studies have been comparatively revisited to explore the similarities and differences in a) the processes of institutionalising neoliberal financialisation and b) the *components of the generative mechanism of upward income distribution,* to explain *causal links in the financialisation-induced income inequality nexus* (Figure 9.2). Four key aspects of neoliberal restructuring have been reviewed and financialisation as the generative mechanism of increasing income inequality has been explained. Taken together, the following conclusions can be drawn from the present study.

First, the general conclusion from the available evidence is that neoliberal ascendancy precedes financialisation and the former is a prerequisite for the latter. I have argued that this is true for various types of capitalist countries, the high-income USA, or corporatist Sweden, or developmentalist Korea or middle-income Argentina. In all four cases, a crisis of capital accumulation or threat to the capitalist mode of production resulted in the mobilisation of the ruling class' interests. This led to ideational transformation and, except in Sweden, a radical shift towards neoliberal policies. In all four cases, external support from the transnational capitalist class to embed a country in the new GFO was traced and, where successful, such an aim was achieved by imposing on a country particular rules and modes of social production of finance capitalism. As the result, in the context of neoliberalism as a hegemonic ideology and a mode of governance, *financialisation has developed as a vehicle of upward income distribution* and, thus, *regressively impacted the level of income inequality*.

Second, drawing on secondary literature and synthesising various categories of the analytical constructs, such as FLD, dynamics in the rate of financial profit and rent vis-à-vis labour's share and debt, *financialisation as the generative mechanism of upward income distribution* has been conceptualised. This has helped to explain the causal links in the financialisation-induced income inequality hypothesis and, thus, supports the idea that neoliberal financialisation leads to regressive redistribution.

Third, as a by-product of the research, my secondary finding unveiled that the *transnationalisation of finance capital and capitalist classes* is essential as an additional precondition along with neoliberalisation, for establishing and embedding financialisation in the political economy of a country as a mode of upward income distribution. Having their interests to coincide and being actually dependent on each other through the necessity of capital mobility and its liberation from the national social and spatial constraints, national ruling classes are increasingly committed to disseminating ideas of neoliberal restructuring at the transnational level and in the process turning, indeed, into a financialised transnational capitalist class. An important analytical lesson can be drawn from this experience, with major implications for the discussion of future trends in the development of contemporary capitalism and the dynamics of income inequality. Taken together, these results suggest that such notions as, for instance, interests of the ruling class, ideational transformation, and external support might be employed in researching other cases to provide a base for future studies and claim for generalisability.

**Figure 9.2. Components of neoliberal financialisation and its income inequality generative mechanism**




Source: researcher

## Chapter 10. Concluding remarks and final reflections

This final chapter provides a retrospective view on the research, with the evaluation of its contribution, generalisability, limitations, and agenda for future work. A brief reflection is provided to highlight my positionality that has influenced the development of the theoretical framework and research questions.

Initially, this project was set out to investigate the main causes of increasing income inequality in different countries over the last thirty to forty years. My research journey then turned into the study of contemporary finance capitalism, which according to the accounts provided in this thesis, exacerbates inequality as an outcome of upward redistribution. As I engaged with theoretical concepts on finance capitalism and its distributional effects, the complexity and multifacetedness of social reality around the topic arose. Partially, this was an outcome of the realisation of the importance of methodological matters viewed from an ontology-centric perspective, without which it would have been impossible to address the research questions. Accordingly, this project was undertaken by employing the philosophy of critical realism, which questions mainstream economics essential approaches to social reality at the level of method. Critical realism which provides an alternative ontology helped to explain and describe in this thesis the mechanisms, structures, powers and tendencies active in the financialisation and income inequality nexus.

### 10.1. Contribution

As explained in Chapter 2, there is a knowledge gap on the neoliberal financialisation-income inequality nexus. The possible causal links between the two have not been studied in a systematic and analytically construed design employing functional distribution of income categories connected to finance capitalism as a distinct type of political economy. Rather than putting forward a single causal relationship construed with some kind of formalistic mathematical modelling, income inequality has been viewed in this thesis as a product of the cumulative effects of different political, social and economic factors that occurred during period spanning the 1970s to the 2000s. Process and effects associated with financialisation were then analysed through particular analytical constructs providing the explanation and hence, the justification for the connection between neoliberal financialisation and increasing income inequality. This thesis, thus, has provided a deeper insight into the assessment of whether, how and why finance capitalism has instigated rising disparity in income distribution through comparative historical accounts of different national political economies. This work contributes to existing knowledge on financialisation by addressing the structural drivers of increasing income inequality in the era of finance capitalism.

To my knowledge, this project is the first comprehensive investigation of the connection between neoliberal financialisation and increasing income inequality based on the ontological foundations of critical realism. This approach helped me to reveal the ontology of finance capital and increasing income inequality, i.e. the reality that has been inaccessible, because of the disjuncture between it and the methods employed in mainstream economics. An open systems ontology, as advocated by the critical realist view and employed in this study, helped me to avoid the epistemic fallacy usually committed by mainstream economics. In that case, the underlying mechanisms would not have been explored and discovered or would have been rejected (*actualism*), because the empirical stratum would have been conflated with the real stratum, resulting in *empirical realism* or the "flattening of ontology" (Mearman, 2006b: 53). These epistemological flaws (the epistemic fallacy, actualism and empirical realism) are avoided by critical realism. Instead, from the open system perspective of critical realism the research was focused on investigating the underlying mechanisms and emergent causal structures to explain the role of agents and the boundaries between them as well as how they interact with each other (Mearman, 2002). The open system approach of critical realism also predetermined the application of a case study in historical time and engagement with explanation rather than predictivism.

The conceptual framework of this study is based on the hypothesis-proposition, which constituted a theoretical point of departure according to which financialisation, as the latest stage of neoliberalism, facilitates upward income distribution for the benefit of the ruling classes, thus resulting in increased income inequality. This proposition, in turn, helped to develop the research design and the discrete measures of the relationship between financialisation and income inequality, thereby contributing to the originality of the research. It is not claimed here that the financialisation-induced income inequality hypothesis has a law-like generalisability regardless of historical contingencies and institutional legacies. The apolitical and ahistorical approaches of mainstream economics have been rejected and the hypothesis can be used as an analytical framework to describe and interpret what has happened in the financialisation-income inequality nexus.

Despite some recognition in recent literature that there is some sort of link between financialisation and increased income inequality, the nature of this link, how it actually works and its implications for understanding the finance capitalism of the current era and its reproduction of income disparity have not been explored in detail. Partially, this is because mainstream economic orthodoxy lacks adequate methodological and theoretical tools to understand the ontology of the dynamics of finance capitalism and to explore the possible causality between financialisation and its negative socioeconomic consequences. Thus, to compensate for these analytical and theoretical inadequacies in studying income inequality and its relation to contemporary capitalism, for this research, a pluralist approach employing heterodox schools of thought was deemed necessary. These schools, being polyvalent and in contrast to the prevailing orthodoxy in income inequality studies, encompass the multifaceted and interconnected elements of the political economy of income inequality. The insights gained in this project, thus, contribute to the understanding of how distributional patterns might be transformed and may be of assistance to policy-makers in recognising and appreciating different strategies suitable for national development.

By employing analytical constructs based on the critical realist ontology and a combination of heterodox traditions, the research was able to uncover and decipher the conditions that govern neoliberal financialisation irrespective of the country where finance capitalism prevails. Thus, another major advantage of a critical realist perspective combining heterodox traditions is that it helps to explain and conceptualise the financialisation phenomenon as *the generative mechanism of increasing income inequality*. This method challenges the mathematical-deductivist approach of the neoclassical orthodoxy by proposing different conceptual strategies for explaining finance capital’s logic in creating regressive income distribution.

A country cases study approach was adopted to conduct this exploratory inquiry and to gain a detailed understanding of the complexities of the phenomenon of interest. The number and choice of countries were especially conditioned to allow for the investigation to reveal similarities and differences between the cases, in particular, discover whether or not there are similarities in the emergence, institutionalisation and operation of the regressive distributive mechanism. A typical case from each well-known model/variety of national capitalism (Amable, 2016: 33-34) was chosen to engage in comparative political economy analysis: the USA, as probably the most advanced capitalist economy (neoliberal model); South Korea, as a typical case of a former developmental state (Asian model); Argentina as a developing country, resembling strongly a semi-peripheral mixed political economy like those of Southern Europe (southern model); and Sweden, as an emblematic example of an egalitarian social democracy (social democratic model). The qualitative comparative case-study design of this research also contributed to comprehensibility of comparison across cases, as the hypothesis of this study was explored through applying the same analytical constructs in the same order in all cases, to uncover the patterns of similarities and differences across historical time and political geography. That, the hypothesis was "tested" diachronically, not synchronically and across different models of national political economies.

**10.2. Limitations of the study**

One of the limitations of this thesis is that it has not been possible to be very precise with the qualitative estimation of the levels of income inequality that could be directly attributable to financialisation. Notwithstanding these limitations, the study, as process-oriented research, offers valuable insights into the causal mechanisms of the financialisation-income inequality nexus without a calculable ratio. This would be a fruitful area for further work.

The project was ambitious in that it covered four different countries and thus, could be criticised as being an exploratory account of neoliberal restructuring in those countries. Whilst this study involved interrogating the research questions from a case study perspective, it did partially substantiate the hypothesis in its own right and developed *components of upward income distribution in finance capitalism and causal links in financialisation-induced income inequality nexus* (figure 9.2 in chapter 9). As the study was undertaken from the vantage point of comparative political economy, the comparative analysis across cases that provided derivation of the components of neoliberal financialisation also warranted that the findings can, potentially, be generalised. As Yin (2009: 15) notes, case studies "are generalisable to theoretical propositions and not to populations or universe". In this sense, one of the goals of this study was "to expand and generalise theories (analytic generalisation) and not to enumerate frequencies (statistical generalisation)" (ibid: 15). The empirical evidence from these countries case studies is intended to be generalisable to a political economy of income distribution, which inevitably intersects with such phenomena as financial capitalism, neoliberalism, power relations and economic democracy, transnationalisation and the dominant political class. As an unavoidable shortcoming of many phenomena intertwined in one research endeavour, a variety of data from secondary sources discretionarily mixed in with the analytical framework of the hypothesis had to be analysed. This might be considered as another limitation and yet, it contributes to originality of the study since it secured the requirements of critical realism and its ontological commitments.

### 10.3. Positionality and further research

Different aspects of my background affected the choice of research topic and shaped the ontological foundations of my study. As the project developed, I began to reflect more seriously on the epistemological implications of my own positionality and how it could undermine my impartiality. Since this study's implicit aim has been to challenge the methodological hegemony of positivist empiricism, reflexivity played significant role in preserving objective neutrality. As England (1994: 84) explains,

> "reflexivity is self-critical sympathetic introspection and the self-conscious analytical scrutiny of the self as researcher. Indeed reflexivity is critical to the conduct of fieldwork; it induces self-discovery and can lead to insights and new hypotheses about the research questions…the reflexive "I" of the researcher dismisses the observational distance of neopositivism and subverts the idea of the observer as an impersonal machine".

I cannot and should not claim that I was totally value-free. This inquiry has special connotations given my background, as someone who experienced a relatively egalitarian life in the past in the former Kazakh Soviet republic and has witnessed completely the opposite during the period of unequal and unjust redistribution of income and wealth taking place over the last thirty years. My positionality has been affected by this experience as I became interested in understanding what was going on. I started to ask: How is it possible to end up with so many poor people in such a rich country? Who benefits? Who loses? Why? Are there any alternatives? Yet, in 2015 Kazakh authorities made it illegal to reveal and disseminate information on wealth and income by introducing a new criminal offence (in law articles disguised as a prohibition of "incitement of class feud") in an attempt to protect those who have benefitted from what may be characterised as a kleptocratic regime.

The research, therefore, has had not only been informative to me, for it has also had a transformative effect by providing me with a deeper and more critical understanding of the developments in Kazakhstan. In addition to the transferable skills gained during the doctorate study, the philosophy of critical realism, heterodox alternatives and the theoretical concepts developed in the course of this research project provide me with a solid analytical and methodological frame to conduct future research into economic injustice and authoritarian kleptocracies of the former Soviet republics, which seem to have quickly adopted neoliberal prescriptions. In terms of my intellectual research programme, I see my goal as formulating progressive policy proposals and offering alternatives from within political economy, criticising mainstream right-wing economics and addressing the nature of the contemporary capitalism and current political regimes of the post-Soviet countries. Kazakh universities' curricula docilely follow recommendations of the Western mainstream economics departments with no place for the history of economic thought, political economy and pluralist views in the text books of Kazakh students, let alone heterodox accounts. Disseminating knowledge that I have gained through writing this thesis would be a fruitful area for further work in popularising alternative views in my home country and beyond.

More broadly, the insights gained from this study (through critical realism's method of retroduction) can contribute to the efforts of explanatory social science in having an emancipatory effect and developing critical world views (Clarke and Mearman, 2003). I believe my study offers valuable insights into contemporary capitalism and its relation with the increasing level of economic inequality experienced in many countries over the last thirty-forty years. The dichotomy of increasing income inequality and economic democracy cannot be separated from a theory of the dynamics of capitalism, its evolution and the interrelations between market, democracy and the role of the state. The risks that rising income disparity poses on any society necessitate the inquiry into the trajectories that particular countries have undertaken and global forces that stand behind these courses. In other words, the patterns, effects and causes of increasing income disparity are the reflections of the current state of affairs, which manifest themselves in the developments taking place at a deeper level of social reality with profound implications on societal norms and the political realm in the future. One can anticipate with the help of the evidence presented here that those repercussions have been already occurring within contemporary capitalism in the form of a neoliberal counter-revolution that results in continuous increase in economic inequality. As experienced throughout the 20th century, maintaining socioeconomic justice and equality is a necessary prerequisite for a secure, stable and prosperous world.

The agenda for future work, thus, is to raise these issues in research focusing on Kazakhstan and countries in the Eurasian region, which are still mostly “black boxes” for academia and policy-makers. Signs of the effects of neoliberal financialisation are now evident in the institutionalisation of the worst forms of income and wealth inequalities in these countries. Kazakhstan, for instance, is carrying out an extensive programme of privatisation of its public services; has enacted numerous austerity measures; pursues illusive projects like the creation of a financial centre in the middle of the Eurasian steppe; uses Kazakh taxpayers’ money to inject capital into private banks; and has experienced at least three devaluations of the national currency in less than ten years (between 2009 and 2018), all justified by reference to monetarist orthodoxy. The result has been widening income inequality in countries like Kazakhstan, now reminiscent of the class gap between the haves and the have-nots of the first decade of the 20th century, which this time may lead to social revolt against the calamities of market fundamentalism. Ironically, these countries are facing the same dilemma they encountered in their past history: oppression to enrich the tiny minority or liberty with prosperity shared with all people. 2017 commemorated the 100th anniversary of the Russian revolution, when radical socialists and Bolsheviks, came to power to bring hope for a better life for millions of people. They drastically changed the course of history, but the final outcome was the discrediting of the ideas of egalitarian socialism, not least because of the untold oppression of the Gulags and economic incompetence. Today, as progressive social movements and public figures declare that “inequality has been a choice, and it is within our power to reverse it” (Stiglitz, 2015: 12), ideas of economic democracy, socialism and freedom evoke the same hopes and fears. The choice, once again, is between emancipation and enslavement, between resistance and submission, between justice and inequity.

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