Financialization, Distribution, and Inequality

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I. Introduction

A distinguishing feature of economies over last three decades has been the widening income and wealth gap both within and between countries (Galbraith 2011). In addition to growing economic polarization, this period has witnessed a slowdown in economic growth rates (except for some Asian countries) and greater limitations on the state’s ability to promote rising living standards and social protection. Moreover, economies have experienced greater economic instability, with over 100 financial crises occurring since 1980 (Eichengreen & Bordo 2003).

The Great Recession, which began in 2008, is only the most recent disruption in an increasingly unstable global economy. Although the proximate cause of the Great Recession was the US financial crisis, prompted by the subprime mortgage debacle, its deeper roots can be traced to the widening income and wealth gap. Rather than hit the ‘reboot’ button in response to the crisis, there is both a brief space and a strong justification to rethink our previous path and to forge a new one. Policies that will move us to a sustainable path of improvements in living standards require that we operate from a macroeconomic policy framework that enables greater equity with growth.

This paper explores the role of inequality in contributing to the most recent global economic crisis, and the related tendency to ‘financialization’ – the increase in size and importance of an unregulated financial sector. I then discuss what an equity-led macroeconomic policy framework would look like, with suggestions for proposals to not only produce greater equality but also reduce economic instability, while stimulating rising living standards.

II. The crisis is not just a financial crisis

Many analysts identify the immediate cause of the Great Recession as the meltdown of the subprime mortgage market in the US. Facilitated by a period of financial sector deregulation, banks and investment firms seemed to run amok, with the development of exotic financial instruments and ‘teaser’ loans that bordered on predatory lending, which combined to
produce toxic assets.¹ The period of deregulation that began in the 1980s ushered in a new era of finance, with banks shifting their focus to more speculative financial activities and away from the necessary, if unglamorous, day-to-day business of accepting deposits and extending loans to facilitate firm investment and household consumption that fuel job growth.

Deregulation did not happen without a push from the financial sector itself. The accumulation of power (and wealth) by financial elites over the last two decades has been used to fund an anti-regulation lobby targeted toward policymakers, and as a result, regulatory agencies as well. The result has been tantamount to regulatory capture: public agencies charged with regulating in the public interest instead acted in favor of the financial sector (or turned a blind eye to the practices) they were charged with regulating. A steady flow of new financial products that received little scrutiny or oversight by government regulatory agencies increased the availability of finance and expanded the pool of eligible (if not viable) borrowers.²

One clear lesson that emerges from this crisis is that human economic behavior is not always and everywhere economically rational. Lack of information and imperfections in quantitative human reasoning (e.g., engaging in herd behavior, believing that housing prices will continue to rise forever, and thus failing to identify an asset bubble for what it is) underscores the necessity to regulate markets, especially in finance.

While it may have been irrational for investors and homeowners to assume that housing prices would continue to rise indefinitely, the economic fissures that led up to the crisis were related to the growing inequality within and between countries over the last three decades. Focus on the malfunctioning of financial markets has obscured inquiry into the deeper systemic roots of the crisis.

Table 1 provides data on inequality for the last two centuries, offering a historical perspective on trends. Two measures of inequality are represented there, the Gini index (with a value of 0 for perfect inequality and 1 for perfect equality) and the ratio of income of the top 20% of households to the bottom 20%. The Gini index, representing a measure of global inequality in household incomes, rose 5 points between 1980 and 2002, a sizeable jump. Similarly, while the income of the richest 20% of households was 74 times that of the poorest 20% in 1991, by 2005 the ratio increased to 103. Whichever measure is used, the trend towards greater inequality is evident.
Table 1. Global trends in income inequality

<table>
<thead>
<tr>
<th>Year</th>
<th>Gini index</th>
<th>Ratio of income shares: Top 20% to bottom 20% of households</th>
</tr>
</thead>
<tbody>
<tr>
<td>1820</td>
<td>43.0</td>
<td>3</td>
</tr>
<tr>
<td>1850</td>
<td>53.2</td>
<td></td>
</tr>
<tr>
<td>1870</td>
<td>56.0</td>
<td>7</td>
</tr>
<tr>
<td>1913</td>
<td>61.0</td>
<td>11</td>
</tr>
<tr>
<td>1929</td>
<td>61.6</td>
<td></td>
</tr>
<tr>
<td>1950</td>
<td>64.0</td>
<td></td>
</tr>
<tr>
<td>1960</td>
<td>63.5</td>
<td>61</td>
</tr>
<tr>
<td>1980</td>
<td>65.7</td>
<td>74</td>
</tr>
<tr>
<td>1991</td>
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<td></td>
</tr>
<tr>
<td>1997</td>
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<td></td>
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<tr>
<td>2002</td>
<td>70.7</td>
<td></td>
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<tr>
<td>2005</td>
<td></td>
<td>103</td>
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</tbody>
</table>


Of particular interest are the trends in inequality since the 1970s, marking the movement toward deregulation, privatization, and liberalization, that is, neoliberal macroeconomic policies. Data from the International Labour Organisation (2008) indicate that labor’s share of income (the share of national income going to wage earners) fell between 1996 and 2006 in a number of industrialized and middle-income countries. (These include most OECD countries and Brazil, India, and the Russian Federation). Typically, a declining wage share is evidence that while labor productivity may be rising, workers are not in a bargaining position to claim a proportionate share of the additional income that their higher productivity produces. Conversely, when the labor share is falling, the profit share of income is rising.

Before turning to a discussion of the causes of growing inequality, I want to first briefly identify the linkage between inequality and the financial crisis. Michael Kalecki, a contemporary of John Maynard Keynes, emphasized that an unequal distribution of income can have harmful macroeconomic effects on output and employment. Why is this so? Put simply, if income becomes concentrated in the hands of the wealthy, aggregate demand will
fall, and with it, employment and output. This occurs because the wealthy tend to spend a smaller percentage of their income than lower-income households. A redistribution of income to the wealthy, then, results in higher saving rates and as a result, a reduction in aggregate demand. In colloquial terms, ‘without buyers, there are no sellers.’ That is, businesses respond to slack demand (fewer buyers) by cutting back on production and laying off workers.

With the growth of inequality and thus inadequate demand, output and employment can only be sustained if a) households borrow in order to finance consumption (the US is a case in point) or b) countries pursue export-led growth strategies, with foreign demand for a country’s goods substituting for domestic demand (many developing countries have adopted this approach). Neither of these strategies is sustainable in the longer term. Moreover, inequality can also result in too little investment in people, in the form of education and health – both of which can limit a country’s ability to raise its overall productivity, and thus its living standards, in the long run. An understanding of the current crisis then requires an analysis that identifies the sources of growing inequality within and between countries and traces the linkages of inequality to the global economic downturn.

Several factors have contributed to the intensification of global inequality over the last three decades. A key aspect of this process is the slowdown in wage gains and in some instances, the decline in real wages. Several forces – economic and political – have reduced worker bargaining power, and as a result, held back improvements in wages. From the economic side, the twin policy shifts towards trade and investment liberalization have made it easier for firms to move production from high- to low-wage countries to reduce costs of production in order to bolster profits (Milberg & Winkler 2007). Trade liberalization has allowed firms to then export their goods back to high-wage countries. But at least some workers in high-wage countries are worse off since their jobs have been exported (Goldberg & Pavcnik 2007).

The negative effect of job losses spills over to depress the wages of workers in high-income countries who still have jobs. That is because a larger pool of unemployed workers makes it harder for employed workers to bargain for higher wages. With downward pressure on workers’ wages, spending falls in rich countries. This of course lowers a firm’s profits since profits are determined not only by the profit rate (the percentage firms can mark up the price of a good over its cost of production) but also by the volume of sales. With falling
sales, or a slowdown in the growth of sales, corporations push on to set up production in ever lower-wage sites as a means to buoy profits. Or they may reduce investment in productive capacity.

Another strategy firms, especially those in the US and Europe, have adopted is to engage in offshoring, purchasing components from subcontractors located in countries with lower wage costs. This has led to a ‘hollowing out’ of manufacturing in rich countries. Increasingly, we are also seeing evidence of outsourcing of information technology (IT) services.

In both cases, firms have become more mobile, and with that mobility comes increased bargaining power to hold down or lower the wages of workers in both rich and developing countries. But it is those very same workers whom firms rely on to buy the goods they produce. Alas, with lower or stagnating wages, product demand falls.

A second factor contributing to growing inequality is the pressure on governments to reduce public sector spending, especially on much-needed physical and social infrastructure such as roads, immunization, rural health clinics, agricultural extension, and education. The impact of these trends is evidenced by the decline in global public investment as a share of GDP, which fell from 2.1% in 1980 to 0.81% in 2000 (Rathin, Heuty, & Letouzé 2009: 70).

The downward pressure on budgets in developing countries is in part attributable to the loss of tariff revenues as a result of trade liberalization. Governments are also pressured to cut spending and lower budget deficits as a way to reduce imports (thereby rectifying trade imbalances) and attract foreign capital. Wealth holders, it is argued, are unwilling to invest in countries where inflation is too high since it erodes the real value of their holdings. Government budget deficits are seen by wealth holders as contributing to inflation, hence the pressure to cut spending. Cuts in government spending further depress aggregate demand with negative effects on employment, making it harder for workers to bargain for higher wages.

Yet another source of growing inequality and the resultant shortage of aggregate demand is the shift in policy framework among central banks. The focus of policy has shifted from price stability and full employment to an almost singular concern with controlling inflation. This is done by raising interest rates which makes borrowing more expensive. As a result, private investment and consumer spending fall, depressing aggregate
spending in the economy. With this, unemployment rises. Thus, the focus on inflation targeting comes at a high cost in terms of employment.

The macroeconomic record of the last thirty years stands in stark contrast to an earlier time when wages rose along with GDP (the so-called golden age of capitalism from 1945-1973) and firms reinvested their profits in order to expand output to meet the rising demand for their goods. Simultaneously, firms hired more workers, creating a virtuous cycle of rising incomes for middle- and low-income families, increased demand for goods and services that benefits firms’ sales and thus profits, and, as a result, rising employment.

In contrast to the earlier period of wage-led growth, the dampened demand and stagnating wages (and by definition, rising profits shares of income) observed over the last three decades have contributed to a lack of profitable opportunities for firms to expand output. Moreover, increased risk has accompanied the process of globalization. This is due to volatility in exchange rates and financial markets due to financial liberalization that makes physical investment in new factories and equipment less attractive (Stockhammer 2010).

In response to this change in conditions, corporate strategies have shifted from ‘retain and reinvest’ (that is, retain profits) to ‘downsize and distribute’ (Lazonick & O’Sullivan 2000: 18). The last decade and a half has been witness to a variety of mechanisms by which firm profits have been funneled out of the productive sector of the economy to the financial sector. Mergers and acquisitions have absorbed a large chunk of firm profits. Share buybacks, whereby firms repurchase some shares from existing shareholders to concentrate ownership, have been one use of excess cash that firms decline to employ in expanding output.

In turn, shareholders have funneled their increased earnings per share to financial markets, resulting in a flood of funds to the financial sector, which in some ways found itself in a situation akin to that of the big banks during the decade of the OPEC oil crisis. It will be recalled that the dramatic increase of oil prices in the mid 1970s left major banks awash with cash (so-called Petro Dollars) that they then were propelled to lend to developing countries. The banks’ tactics in lending Petro Dollars led them to be labeled ‘loan pushers’ by some, reflecting the pressure they applied to sovereign governments to borrow and their willingness to lend to authoritarian leaders whose track record for effectively using loan funds was at best doubtful (Darity 1988).
In the current period, financialization of industrialized economies which led to a surfeit of loanable funds in the hands of financial institutions—a surfeit we might label the *Bubble Dollars*—enticed banks and other financial institutions to develop exotic loans at teaser rates and other financial instruments to expand lending into the housing sector. Analysts have noted that many of the so-called subprime loans were ‘predatory’ (a term that refers to loans made under unfair, deceptive, or fraudulent conditions in the loan origination process), targeted to people of color and single female heads of households (Dymski 2009; Montgomerie & Young 2009).

These were the very same households that were struggling to cope with declining economic conditions of low or falling real wages, higher health care and education costs, and reductions in employer contributions to pension plans. Motivated by these economic stresses, many vulnerable families sought to refinance their homes as the housing bubble expanded, withdrawing the equity from homes in order to maintain their living standards. Many borrowers in the subprime crisis were not on a consumption ‘binge’; they were engaging in a coping mechanism to survive the declining fortunes of many middle- and low-income families in industrialized countries.

The financialization of the economy had other political economy implications beyond the housing bubble and subprime lending that ultimately endangered the entire system. The growth of the financial sector and redistribution of national income to the rentier class (wealth holders) translated into increased political power for that group. The increased wealth of this sector funded lobbying efforts to convince government officials to deregulate this sector and to provide less supervision and oversight of financial activities. The repeal in 1999 of the Glass-Steagall Act, legislation intended to create a firewall between everyday banking activities and financially risky speculative activities in the US, was only the culmination of a long period of deregulation that began under the Reagan administration.

Beyond the US, financial elites have had influence at the IMF, which has championed the elimination of capital controls (the movement of finance across borders), thus leading to increased global instability but also very large profits on speculation for wealth holders. At the same time, the IMF has pressured developing country governments to adopt ‘independent’ central banks—that is, central banks liberated from pursuing government development strategies, such as targeting loans to strategic sectors of the economy or employing asset-based reserve requirements to achieve employment and
investment goals. Instead, the IMF has used conditionalities on borrowing to require central banks in the developing world to pursue inflation targeting – with the resulting negative employment consequences noted above. This confluence of events – the financialization of economies and deregulation – has thus been fuelled by growing inequality and in turn propels the continued expansion of inequality. As a consequence, the global economy is more volatile. It is at the same time less secure due to the downsizing of governments, and with it, their ability to provide a social safety net for those who are most vulnerable to economic volatility.

Explanations of the crisis that focus on the emergence of an asset bubble (in this case, a housing bubble) explain only why negative effects of inequality were delayed. They fail to place sufficient emphasis on the underlying problem, which are the negative effects of income redistribution to the wealthy on economic growth and well-being as well as overall economic stability. The post-1973 period in industrialized countries can be considered one of profit-led growth. That is, it has been a period of a redistribution to profits that stimulated growth, but a growth that is distorted, only narrowly beneficial, and unsustainable. The 2008 crisis indicates exhaustion of that model.

III. A framework for transformational macroeconomic policy

This period of crisis in which mainstream economic theory has been called into question provides a critical moment to forge a new direction, both in theory and policy. Feminist economists and activists, and more generally, progressives in industrialized and developing countries have an opportunity to contribute to the definition of a transformational macroeconomic policy agenda.

The principles that guide such a framework should be sustainable and equitable growth that promotes the expansion of ‘green’ jobs and earth-compatible sources of energy. Such an agenda would emphasize not only reductions in inequality and poverty, but also pay particular attention to race and gender inequality. Sustainable equitable growth requires a set of macroeconomic policies that create the conditions for wage-led growth. This can be defined as a set of macroeconomic conditions in which redistribution to workers (and in agricultural economies, to small farmers) stimulates demand, and as a result, economic growth.
The liberalization policies of the last three decades have undermined the possibilities for wage-led growth. In part, this is because as wages rise, firms can respond by moving across borders or outsource. Further, higher wages (especially in labor-intensive industries) are likely to lead to a decline in export demand, and thus, employment losses. The downward pressure on wages in the current global macroeconomic environment has also hampered prospects for long-run growth, and thus, rising living standards. Why is this so? First, by depressing wages and incomes of middle- and low-income groups, the ability of families to invest in children’s well-being is lowered, and as a result, children grow up with fewer skills and readiness to be productive citizens.

Secondly, a firm’s ability to rely on cheap labor, when coupled with the absence of labor regulation (or other forms of regulation), makes it easier to take what is sometimes called the ‘low road’ to competitiveness. That is, by shifting the burden of cost reduction to workers’ compensation, the environment, or governments (in the form of corporate tax reductions), firms are relieved of the obligation to compete on the basis of ingenuity and innovation, thus further slowing the rate of productivity growth and improvement in living standards.

Seguino (2007) provides empirical evidence of the depressing effect of firm mobility on productivity growth for a group of 37 semi-industrialized economies over the period 1970-2000. This finding is consistent with the view that investment and trade liberalization, by increasing firm mobility and reducing worker bargaining power and wages, has also made firms ‘lazy,’ leading to a low-wage, low-productivity trap in a number of developing countries.

To exit the low-wage, low-productivity trap in which many countries find themselves requires policies and methods to discipline the financial sector. A number of progressive economists have advanced proposals for financial sector reform. Here I want to focus more broadly on defining an equity-focused development strategy and the requisite tools governments can avail themselves of to implement such a strategy. Such policies, appropriately applied, can lead firms, both financial and non-financial, to align their profit goals with broad development goals.

Whatever the set of policies adopted, they must address not only the problem of a shortage of jobs, but also must assist developing countries to escape their inferior position in global commodity chains. Macro-level policies that shift the economy to domestic demand-
led growth in place of reliance on exports (and thus global commodity chains) can enhance the possibilities for economic stability and wage-led growth. Clearly, many countries rely on exports to generate the foreign exchange to purchase much-needed imports. This is not to suggest therefore that an economy should close itself to international trade, but it should not serve as the primary source of employment generation. As a corollary, the promotion of import substitution would be required. Appropriately applied infant industry protections give domestic firms breathing space to ‘catch-up’ to industrialized countries, allowing them to move up the industrial ladder to production of higher value-added goods, which ratifies higher wages. Targeted credit is another tool for developing domestic productive capacity, but with an incentive structure that requires reciprocity from private firms – such as access to credit in return for achievement of performance goals (these could be investment, employment, or export targets, for example).

More generally, rather than ends in themselves, export and import policies should form part of the toolkit to implement a country’s industrial policy, the central goal of which would be to help domestic producers develop productive capacity and eventually compete in international markets (Memis & Montes 2008). One of the benefits of this approach is that economies that produce higher value-added goods with a larger share of demand coming from the domestic market do not experience the negative effects of higher wages on employment that economies reliant on labor-intensive exports as a primary source of demand do.

Strategies in agricultural economies would differ from those in developing countries with larger manufacturing sectors. In sub-Saharan African countries for which agriculture is a large share of GDP, governments could use public spending to shift investment to the agricultural sector. Policies that promote greater access for women farmers to inputs and credit are likely to yield increases in productivity, expand output, raise incomes, and reduce reliance on imported food. This reduces pressure to export in order to earn foreign exchange to buy imports, and thus, lessens the economic instability that comes with integration in global markets. It would also reduce the need for developing countries to hold such large foreign exchange reserves (to protect against volatility in import and export earnings), thereby freeing up funds for public investment in the domestic economy.

In another example of how to rein in global commodity chains and multinationals, take the case of the Caribbean, a region for which tourism is a major source of foreign
exchange. Multinational hotel chains, many of which rely on food imports to supply their chains, are a major source of investment in the tourism sector. Food supplies used in all-inclusive hotels, for example, are commonly flown in from the US to the Caribbean, despite the fact that food could be purchased locally with a direct employment effect. Caribbean countries that agree to negotiate as a block with foreign-owned hotels could impose local content requirements as a condition for foreign direct investment in the region.9

China, a country with a good deal more bargaining power than the small Caribbean countries, uses its bargaining power to shape foreign direct investment to promote technology transfer and target spending to key areas that meets the employment and technology goals of the Chinese government (Braunstein & Epstein 2005). WTO restrictions place limitations on country-level collective bargaining, but in this era in which neoliberal policies have failed, it becomes clear that it is time to challenge the WTO framework.

Equality-led growth also requires a reformed central bank, geared toward employment creation rather than inflation targeting. Most inflation in developing countries is due to supply-side bottlenecks – poor infrastructure, inadequate policies to smoothen agricultural prices, insufficient investment into the agricultural sector, and a population that is poor and in ill health. Those problems, which can raise costs of production and thus contribute to inflation, are best remedied by the judicious use of fiscal, not monetary policy.

Racial and gender equality must be addressed explicitly. Traditional macroeconomic policy can help to some extent by ensuring full employment. This would benefit women and ethnic minorities who are frequently shoved to the back of the job queue, thus putting downward pressure on their wages and reinforcing negative gender and racial stereotypes. Gender and racial equality will be helped by moving the economy up the ladder to the production of higher value-added good so that those lower on the social hierarchy are not saddled with bad jobs, reinforcing unequal norms and stereotypes.

In the end, there are no one-size-fits-all policies to achieve the goal of intergroup equality since the pathways by which inequality is reproduced differ between countries. Broadly speaking, however, affirmative action policies to address the problem of job segregation, as well as state-level policies to redistribute the care burden more equitably from women to men and the state are required.

Finally, attention must be paid to mechanisms that will finance development. A number of scholars underscore the importance of capital controls as a way to stabilize
developing economies, and more generally, the global economy. Mechanisms to slow financial capital mobility can be constructed so as to serve as a pollution tax, thus inhibiting destabilizing mobility and at the same time generating a pool of resources to be used to finance a global social insurance fund. Such taxes, labeled currency transactions taxes (CTTs), or alternatively, Tobin taxes, are economically well-targeted. They are progressive (weighing more heavily on the wealthy), and they tax economic behavior that has negative externalities. This follows ‘the polluter pays’ principle in environmental economics, which requires those who create negative externalities to pay for the cost of damages. A global CCT could generate a fund to be used to provide social insurance to those groups that had no hand in creating the crisis itself, while simultaneously discouraging agents from engaging in systemically risky behavior.

This is just one example of how to generate funds to finance development, which depends on regulation of firms and financial instruments. Once we accept the principle that regulation of unbridled firm and financial mobility is socially beneficial and systemically necessary, that is, that regulation will allow governments to ensure that businesses align their profit interests with broadly-shared societal well-being, we can begin to develop a variety of mechanisms in addition to CCTs which will support this goal.

Simultaneously, activist groups and academics must begin to elaborate participatory methods for ensuring the equitable use of such funds. For example, feminist activists are well-positioned to define how a social insurance fund might be used to promote gender equality. This would require precise proposals on how to use such funds. To successfully engage in the debate, activists and academics must begin developing proposals now. With these in hand, representatives acting on behalf of gender and racial equality can insist on a seat at the decision-making table, shaping a more equitable future.

IV. Conclusion

One of the central tenets of this paper is that the Global Recession that began in 2008 has its roots not only in financial market deregulation but also in the global expansion of economic inequality. Neoliberal policies that led to downward pressure on wages and livelihoods also contributed to ‘financialization’ – that is, the rise in the importance of the financial market, with the attendant global economic instability that we have witnessed over the last 25 years.
The argument that neoliberal policies in the form of trade, firm investment, and financial liberalization contributed to inequality is not new. What is less well understood, however, is how this inequality interacts with the decisions of firms to shun productive job-creating investment, responding instead to financial sector incentives to produce short-run profit gains at the expense of long-term investment. What is clear is that unregulated financial markets do not yield optimal social and economic outcomes, and that growth based on inequality is unsustainable.

The central challenge we face in moving forward is to clearly identify the role of the state in influencing resource allocation and productive activity in market economies in ways that promote greater equality. In order to do that, we need a clear sense of what our primary economic goals are. A basic principle is that policies should be geared to pursue the goal that families can provide for themselves and their children with dignity and economic security. This implies that economic well-being should be broadly shared, with full employment a key vehicle for attaining that goal.

There is no single set of policies that will achieve this goal since conditions vary across economies with different production capacities. The broad contours of such an approach, however, are clear: controls on capital, a clearly delineated industrial and agricultural development strategy, and an approach to managing incentives of the private sector to induce innovation-enhancing investments that yield long-run benefits. Moreover, efforts to eliminate racial and gender inequality will require macroeconomic policies beyond the Keynesian toolkit with which many policy makers are familiar. Macroeconomists have tended to be both gender- and race-blind in their theoretical understanding of how economies function, and as a result, there is a dearth of policy proposals that integrate such concerns. We can advance the agenda of broadly shared well-being by developing and airing specific proposals that are both gender- and race-equitable.

REFERENCES


A financial asset is considered toxic if its value has fallen significantly so that there is no resale market since the asset cannot be sold at a price satisfactory to the holder. The fall in the value of the asset in the case of the financial crisis may be triggered by the sharp decline in the collateral backing of the underlying mortgage loans.

Igan, Mishra & Tressel (2009), indeed, provide evidence that lobbying lenders also engaged in riskier lending in the run-up to the 2008 crisis.

In the US, household debt as a percentage of GDP almost doubled in just 25 years, from 49.8% in 1979 to 94.0% in 2005 (Palley 2007).

There are varying perspectives on this point. Some observers attribute ‘financialization’ (defined as the increasing importance of financial markets, motives, and elites in the operation of the economy) primarily to changes within financial markets. One such change is the increasing share of stocks held by institutional investors (rather than households) whose profit horizons are short- rather than long-term. According to Crotty (2005), a second fundamental change has been in management’s reward structure from one that links CEO pay to the long-term success of non-financial corporations to one based on short-term movements in a firm’s stock price. Whether the growth of inequality and its attendant effects on aggregate demand triggered shifts in the financial sector or vice versa is difficult to disentangle. A more likely explanation is that these trends are mutually causative, suggesting that it will not be sufficient to merely focus on rectifying imbalances in the distribution of income.

The IMF has recently considered a modification of its stance on capital account liberalization, although with serious constraints. Their plan would be to use loan conditionality to require borrowing countries to employ capital controls only as a last resort, after first trying other tools, such as raising interest rates and cutting government budgets, both of which are deflationary (that is, cause aggregate demand and output to fall).

Some might argue that rather than the pursuit of growth, a redistribution of existing income and wealth is sufficient to ensure broadly shared well-being. While this might be the case, the political limits of redistribution without growth are clear. Economic elites are more likely to resist efforts to reduce their absolute level of income and wealth than they are to oppose a growth strategy that leaves them absolutely no worse off, even if relatively worse off (as the incomes and wealth of the poor rise more rapidly). Moreover, economic growth is not of necessity resource-intensive. Growth in services is an example of a type of production that does not contribute so greatly to overusage of natural resources as, for example, production of material goods might. Economic growth driven by R&D investments to identify new sources of renewable energy is another example.

A large body of evidence finds that inequality results in intergenerational poverty. For a particularly expansive discussion of these issues in a cross-country context, see Wilkinson and Pickett (2009).

There are numerous role models that both developed and developing countries can pursue, one of the most salient being that of South Korea from 1965 to 1995 (Amsden 1989, 2003).