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A Tribute to Ajit Singh

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Why corporations in developing countries are likely to be even more susceptible to the vicissitudes of international finance than their counterparts in the developed world: A Tribute to Ajit Singh¹

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Abstract

All things considered, anything up to US \$7 trillion of so-called quantitative easing (QE) funds has flooded emerging markets since the 2008 global financial crisis. These funds, created to stimulate a recovery in the OECD and to stabilise international financial markets, ended up mostly as emerging markets' corporate bonds and loans (often after being leveraged into many multiples of their original value). They were then either mainly invested (Asia), or used (as in Latin America and South Africa) at best to finance economic activities which do not enhance productive capacities, such as residential construction, or used to finance deficits, M&A, capital flight and all sorts of financial deeds – including as fuel for any conceivable asset bubble. The enquiries of these issues, especially how corporations financed their investment, and how much of it took place, were subjects that fascinated Ajit. He was the first to find out that corporations in emerging markets relied much more on external finance than those in the OECD (where retained profits played a major role). The implication was that they were likely to be even more susceptible to the vicissitudes of financial markets – and as these became ever more weird (the almost inevitable outcome of hasty deregulation cum excess liquidity), the financial balances of corporate sectors north and south of the Equator ended up moving in opposite directions further than ever before. This is a key (if not *the key*) difference between current global financial fragilities and those at the onset of the current global financial crisis in 2007. This highly asymmetric corporate balance scenario is part and parcel of such a low interest rate and highly financialised environment, as now (among other things) so-called "investors" in search for elusive yields, inevitably have to take on more risk, leverage and illiquidity. And emerging markets have always been their markets of last resort. This is a vital (yet only implicit) ingredient of the peculiar ideas behind super-accommodative monetary policy; but the downside is the risk of more volatile asset prices (including commodities), and uncharted financial fragilities all over. Closer regulatory scrutiny worldwide, therefore, should have been an intrinsic part of such risky reflationary and monetary policies. But try to get speculators, traders and rentiers (or politicians in need of donations) to understand something, when their (short-term) earnings, bonuses, share options and corporate-sponsored retirement plans depend on them not understanding it. The stakes for emerging markets' corporations, their economies, financial markets and wider society (and everybody else in the world for that matter) could scarcely be higher – but unfortunately these huge new challenges occur at the worst possible time, as our social imagination has seldom been so barren.

Key words: Ajit Singh; Asia; corporate bonds and loans; emerging markets; financial crisis and liberalisation; financial fragilities; ideology; Keynes; Kindleberger; Latin America; leverage; neo-liberal economic reforms; Quantitative Easing; Systemic market failure.

JEL classifications: B5, D3, D43, E2, F3, F6, G1, G2, G3, N16, N16, and O16.

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¹ This paper is written in honour of Ajit Singh, my amigo and Cambridge colleague for over 30 years, who died last June.

² Emeritus; also research faculty at the Universities of Santiago and Valparaíso. I would like to thank Geoff Harcourt, Alan Hughes, Jonathan Di John, Esteban Pérez, Ignês Sodré, and Robert Wade for their valuable suggestions.

Insanity is doing the same thing over and over again
and expecting different results.

Albert Einstein

Among the many subjects that always fascinated Ajit, one that always stood out was the question of how corporations financed their investment. While for the most part his work examined the role of finance in corporate behaviour of industrialised countries, in "Corporate Financial Structures in Developing Countries" (written in 1992 with Javed Hamid and others³) he looked at how corporations in developing countries financed growth. Ajit found a consistent pattern: these corporations relied much more on external finance than those in industrial economies (where retained profits played a major role). The implication was that corporations in emerging markets were likely to be even more susceptible to the vicissitudes of financial markets – and as these vicissitudes became ever more weird (the almost inevitable outcome of reckless deregulation cum excess liquidity), Ajit and I often talked about the subject.⁴

At its core, this issue relates to the fact that although corporations generate a large proportion of investment all over the world – e.g., in the G6, corporations currently account for between half (Italy) and just over two-thirds (Japan) of gross investment – they tend to finance this in very different forms north and south of the Equator. In emerging markets, corporations (in aggregate) tend to absorb the net savings of other sectors of their economies (including the foreign one), thereby helping to generate both aggregate demand and a dynamic supply. In the developed world, however, retained profits not only tend to finance corporate investment to a much larger extent, but currently – as profits are so strong and real investment so remarkably weak – the corporate sector has bizarrely become a net financier of the other sectors of the economy (such as the public and household ones).⁵ Not surprisingly, absurdly high levels of debt are (so far) easily financed, including huge public sector deficits and household debts.⁶ So is practically any type of mergers and acquisitions (M&A),

³ Singh, et al. (1992).

⁴ Among the many issues that drew our attention one that was the subject of one of our last conversations was the relentless increase of 'short-termism'; for example, in the UK and US the average holding periods of shares has fallen from around 6 years in the 1950s to less than 6 months today (Haldane, 2015).

⁵ On the extraordinarily high profit rates in the US, see endnote 1.

⁶ The public sector debt of just eight OECD countries (general government) increased by more than US\$ 20 trillion in the 7-year period after mid-2007. And the global liabilities of private households have increased by nearly US\$10 trillion since then. For the former see

share buybacks, executive pay, bonuses, political contributions, and corporate-sponsored retirement plans (in the US, retirement assets of just 100 CEOs add up to as much as the entire retirement account savings of more than 116 million people at the bottom of the pay scale).⁷ Furthermore, the combination of low levels of corporate investment and rising corporate net saving is one of the main factors driving the growing mismatch in financial markets between abundant liquidity and a relative shortage of solid financial assets – making the ease of performing a transaction in a hollow security or instrument the trademark of the current process of “financialisation”.⁸

The Fed has finally acknowledged its bewilderment at the existence of these combined trends in the G7 (swelling corporate net lending vs. dwindling investment rates), stating that “... from a surprisingly weak starting point, corporate investment in many of the G7 economies started falling below our models' predictions”.⁹ (Not a bad candidate for the understatement of the year!). However, for those working in the general area of the dynamics leading to growing financialisation (like Ajit, Wynne Godley and myself), these bizarre twin-trends in the North were already patently clear well before the 2007/2008 global financial crisis, as was the perverse logic leading to them in a world ruled by the tyranny of finance and an ever growing urge for inequality (an obsession now bordering on the pathological). It was also blatantly clear to us that these combined trends could be key contributors to a major debacle – which was likely to happen sooner rather than later, as financial markets became convinced that they could keep extracting an ever increasing amount of rents from the real economy in a sustainable way. Wishful thinking was rapidly becoming delusional.¹⁰

World Bank (2015); and for the latter, Allianz (2015).

⁷ See Anderson and Klinger (2015). On the current record levels of merges and acquisitions, see endnote 2.

⁸ We are back to a scenario in which almost any financial asset would do – so much so that sub-prime mortgages now look comparatively reasonable (as there was at least some collateral). For example, there is now even a fast-growing market for sub-prime loans for hair extensions – no credit, no hair, no problema for a hair loan! Perhaps this new interest in hair weaves in some quarters is related to some sort of identification with Donald Trump! (<http://detroit.suntimes.com/det-news/7/77/230829/no-credit-no-problem-detroit-store-has-loans-for-hair-weaves>). Also, one of the biggest lenders of subprime mortgages in the run-up to the 2008 housing bust has just announced that is back in business. (<http://www.bloomberg.com/news/articles/2015-12-11/ally-returns-to-mortgage-business-two-years-after-total-exit>)

⁹ Gruber and Kamin (2015).

¹⁰ Goldman Sachs' CEO famous remark: “I'm just a banker doing God's work”, was one of the jewels in the neo-liberal ideology's crown of the time. For an early analysis of the dynamics leading to the global financial crisis, see Palma (2009); and on the role of growing inequality in the build-up of this crisis, Palma (2011). For the pioneer work of Wynne Godley in the general area of “sectoral financial balances”, see

One key difference between current global financial fragilities and those at the onset of the 2007/2008 global financial crisis is that the financial balances of the corporate sector in the industrialised countries and in emerging markets have now moved in opposite directions even further – in fact, probably further than ever before! (Please don't claim again, and again wrongly, that no one saw what was coming...).

In the case of corporate balances in the North, while in the early 2000s they were (as one would anticipate) in negative territory – approximately minus 4% of GDP in the US, and about minus 5% in most countries of the Eurozone and in the UK –, now corporate net saving runs up to (plus) 8% of GDP (Japan), and at about (plus) 3% of GDP in the rest of the G6 (except for France).¹¹ Not the soundest scenario for sustainable productivity-growth!

In the case of emerging markets economies, however, the corporate net-saving move has been in the opposite direction – and this has not been the result (as sometimes in the past) of falling profit rates swelling corporate deficits.¹² In these markets, the debt to equity ratio has shot up from just above 70% in 2007 to nearly 110% this year¹³ – in fact, according to IMF data in emerging markets economies the ratio of total liabilities to total equity during this period has risen even further¹⁴. And this took place despite stock markets bubbles all over the place after their collapse in 2008 – as the opportunity cost of capital has fallen to next to nothing, and liquidity is so plentiful, speculators have been able to bid up not just the share prices of anything in the OECD, but also in developing countries. As a result, almost everywhere in the World stocks are now more overvalued than in 2000 or 2007 *no matter how you look at things*.¹⁵ In fact, few hypotheses in Economics have proved to be such a load of wishful thinking as Fama's in this respect – such as his key point that if financial markets get misaligned, they will always 'self-correct'. Smart market players would simply force stock prices to become rational by doing exactly the opposite of what they

<http://www.levyinstitute.org/publications/wynne-godley>. For an acknowledgement of its relevance, <http://blogs.ft.com/martin-wolf-exchange/2012/07/19/the-balance-sheet-recession-in-the-us/>.

¹¹ Few statistics speak as loud as these regarding the insanity of the current scenario of financialisation – especially in its never-ending capacity to generate profitable alternatives to real investment.

¹² This was the case in East Asia before the 1997 financial crisis (see, for example, Palma, 2012a). The above quoted study (Inker, 2015) concludes that “[in emerging markets] profitability measures all seem to be saying that today's earnings are about normal.” (While in the US his best estimate was that profit margins were about 24% better than normal). See also IMF (2015).

¹³ <https://www.msci.com/emerging-markets>

¹⁴ See IMF (2015), Figure 3.2, p. 85.

¹⁵ See, for example, Inker (2015).

actually do in real life: take the other side of trades if prices begin to develop a pattern (as this is bound to have no substance). In other words, for the efficient market theology a 'rational surfer' is not the one that has fun riding waves, but the one that gets drowned trying to create undertows.¹⁶ Indeed, we now know that Alan Greenspan was even against tightening regulation against financial fraud, 'as rational markets can take care of themselves'.¹⁷

Therefore, to understand the fall in emerging markets' returns to equity during this period (these dropped from about 17% to 11%, respectively¹⁸) one has to look at changes in the denominator rather than in the numerator.

However, it is important to note that there is a huge difference among developing countries in this respect – one that is often overlooked¹⁹: while in many Asian countries too much borrowing has been led by high levels of real investment both in the build-up of too much capacity (the products of which are now flooding markets at a time when demand is faltering), and in a remarkable property boom, in Latin America an exploding corporate debt has not been associated with increasing capacity-enhancing expenditures. In fact, the share of investment in GDP has not only remained low and relatively stagnant, but also a large proportion of that disappointing investment rate has been made up by residential construction (which, no matter how many positive effects it may have, it does not enlarge productive-capacities). Indeed, even through the recent period of export bonanza, real investment per worker in Latin America (in constant dollars) has been on average systematically below its 1980 pre-economic-reforms level – and it is not as though that level was particularly high to begin with!²⁰ In the meantime, in this period (1980-2014) China has increased this statistic by a multiple of 26 – and India by 5; Korea by 4; Singapore and

¹⁶ Gene Fama's idealisation of financial markets efficiency, especially de-regulated ones – as in his 'efficient capital markets' hypothesis – surely helps find an answer to Krugman's question: How did economists get it so wrong? (http://www.nytimes.com/2009/09/06/magazine/06Economic-t.html?_r=0). And this was clearly evident well before the award of his Sveriges Riksbank Prize in Economic Sciences (which is as much a Nobel Prize in Economics as unregulated and over-liquid financial markets are perfectly efficient!); see <http://ciperchile.cl/2013/10/21/premio-nobel-de-economia-teatro-puro-teatro/>)

¹⁷ He allegedly told Brooksley Born, Chair of the Commodities Futures Trading Commission, that there was no need for a law against fraud (although he now claims that "he does not remember" that conversation...). (<http://www.forbes.com/sites/eamonnfingleton/2013/06/06/alan-greenspans-epic-incompetence-another-shoe-drops/>)

¹⁸ <http://www.ft.com/cms/s/0/46f42c36-8965-11e5-90de-f44762bf9896.html#axzz3rjS3syjt>

¹⁹ As in the *Financial Times* article just quoted.

²⁰ For data on investment, WDI (2015); for employment, GGDC (2015). For an analysis of this phenomenon, Palma (2010).

Malaysia by 3; Vietnam by 3 just since 1994 (the first year for which data are available), and so on.²¹

In fact, in Latin America, the rate of investment has struggled to reach even 20% of GDP since the beginning of economic reforms – less than half China’s recent levels; meanwhile, its GDP-share of household consumption, mostly the result of the exuberance of the few and the ever-increasing levels of debt of the many, is currently twice that of China. Needless to say, both China and Latin America (and none more than Brazil) now urgently need to rebalance their growth, but in opposite directions.²²

As emerging markets are now beginning to feel the nasty effects of a credit crunch, this raises an intriguing question: in these circumstances, as their corporations are beginning to find it difficult to repay loans and raise fresh cash, is it better for one’s corporate sector to be caught with over-capacity or just overweight? With white elephants, or trapped with financial assets that may end up not being worth the paper they’re written on? I once asked Ajit this question; no prizes for guessing what his answer was...

The almost inevitable slow-down of China (as already suggested, an economy desperately needing to put some order into its corporate finances, as well as to re-orient its growth towards the domestic market) has caused jitters in international financial markets. One of the many concerns relates to the fact that over-liquid and often imaginatively-challenged financial markets had sought refuge in commodities because of the shortages of minimally solid financial assets in which to park excess liquidity. Unwinding from this has been a major contributor to the collapse in global commodity prices. In emerging markets this has hurt corporations across the board and had brought many of their resource-rich economies to a sudden halt – and some, like Brazil, into deep recession.

And if over the past few months markets have become gripped by China’s economic outlook (as well as by the Fed’s “will it or won’t it?”), a now increasingly volatile political landscape (especially in Europe) could threaten even further the

²¹ In Latin America the exception is Chile, but only during its 12-year growth period (1986 to 1998), when its investment per worker trebled (although the latter level was only twice that already achieved in 1970). In Brazil and Mexico, meanwhile, their 2013 level (last year that data are available) is actually 20% below their 1980 one – and in the case of Mexico, this is so despite having had one of the highest (if not the highest) levels of FDI per worker in the World. For the whole of Latin America, this statistic fell (on average) 10% during this 33-year period (i.e., in constant 2005 US\$, it fell from US\$ 4,377 in 1980 to US\$ 3,924 in 2013 – commodity price boom and all). See Ibid.

²² As is well known, when international financial markets were reassured in 2003 by the strikingly neo-liberal orientation of the Lula government, it gave rise to a period of international elation with Brazil – not by chance this country was awarded almost simultaneously the men’s Football World Cup and the Olympics. At the time, few seemed to care whether Brazil’s economic growth could be sustainable (see Palma, 2012b).

stability of international financial markets.²³ In fact, 2016 may prove to be a year in which politics comes to the fore as a major driver of risk in (already highly fragile) international financial markets.

In emerging markets however, the main force behind current financial fragilities is the unprecedented surge of financial flows from the North – the already mentioned interconnecting factor between the different drifts of financial balances of both corporate sectors. According to the Bank for International Settlements, between 2009 and 2014, overall credit provided overseas in US dollars through bank loans and bonds hit the staggering amount of nearly US\$ 10 trillion²⁴. The irony of it all is that exploding emerging markets' borrowing was fuelled by funds that were initially released by the Fed's (QE) programme (followed later by the Bank of England, the European Central Bank, the Bank of Japan and others). By some estimates, (and all things considered) anything up to US\$ 7 trillion of QE funds flooded emerging markets since the Fed began buying bonds in 2008.²⁵ Those funds, allegedly created to stimulate a recovery in the high-income OECD economies and to stabilise international financial markets, ended up in significant amounts as emerging markets' corporate debt (often after being leveraged into many multiples of their original value).²⁶ Although all these numbers are very tentative estimates²⁷, what we know is that these funds were vast, and that they were either mostly invested (Asia), or used (as in Latin America and South Africa, Africa's honorary Latin-American country) mostly to finance capital flight, a variety of deficits, M&A and all sorts of financial deeds – including as fuel for any conceivable asset bubble. That is, the little that was used productively there was concentrated in residential construction, and in the financing of a build-up of productive capacities in commodity extraction – although, due to lack of industrial policies, corporations were often merely interested in investing in activities that would allow commodities to reach only the

²³ On the plethora of political problems hitting Europe at the moment, see endnote 3.

²⁴ See, for example, Avdjiev, et al. (2014); for the latest estimate, see McCauley, et al. (2015).

²⁵ <http://www.ft.com/cms/s/0/46f42c36-8965-11e5-90de-f44762bf9896.html#axzz3rjS3sytyj>; see also other above quoted references, and <http://www.bloomberg.com/news/articles/2010-11-17/bernanke-s-cheap-money-stimulus-spurs-corporate-investment-outside-u-s->.

²⁶ According to another source, the recent outburst in emerging markets US dollar debt was "...comparable ... to any of the biggest cross-border lending sprees of the past two centuries".

(http://www.telegraph.co.uk/finance/comment/ambroseevans_pritchard/11300454/Fed-calls-time-on-5.7-trillion-of-emerging-market-dollar-debt.html)

²⁷ See, for example, Lavigne et al. (2014); and the already mentioned McCauley, et al. (2015).

bare minimum level of processing required for exports. What a difference with what was going on in Asia!

In the words of the President of the Federal Reserve Bank of Dallas, when all's said and done QE was stubbornly going its own way:

"In my darkest moments I have begun to wonder if the monetary accommodation we have already engineered might ... be working in the wrong places. Far too many of the large corporations I survey ... report that the most effective way to deploy cheap money raised in the current bond markets or in the form of loans from banks, beyond buying in stock or expanding dividends, is to invest it abroad ... ".
(<http://www.dallasfed.org/news/speeches/fisher/2010/fs101007.cfm>)

A truly remarkable statement. QE was not just working "in the wrong places", but also for those large corporations it seems that the only way to deploy cheap and abundant QE money was just by 'buying in stock, expanding dividends, or speculating with it abroad'. The idea that the extra liquidity generated by QE could conceivably be used to finance investment at home – i.e., to be used to expand own productive capacities – does not even appear to be an option for those corporations.²⁸ How could 'just do with it something socially useful at home' possibly compete with shares buybacks, ever-expanding dividends, or riding the gravy trains of easy opportunities opened up by emerging markets. In the case of Asia (especially East Asia), these highly profitable opportunities are usually opened up by their almost uncanny predisposition towards the reality principle – with its insistence on high investment rates, its remarkable technological absorption capabilities, and its strong macro-policy stands. In the case of Latin America, however, the gravy trains of easy opportunities are usually opened up not by our predisposition to the reality principle, but rather our innate tendency towards the pleasure principle – so easily satisfied by an endless supply of low-hanging fruits such as effortless asset bubbles, highly profitable market failures, vast rents from natural resources, timid institutions, an obliging macro, a considerate progressive intelligencia (with a disturbingly high tolerance for inequality, an attitude that has always stink of meekness towards vested interests – but one that can be highly rewarding), and an instinctive aversion to competition or any other form of capitalist compulsion. Who needs sticks where there is such a plentiful supply of carrots for the few!

In both regions, of course, speculators from the North can also get on board of this gravy train by profiting from all sorts of opportunities opened up by

²⁸ Well, we already knew that the availability of finance is not what determines investment!

corrupt behaviour. What a weird world economy is being built in memory of Reagan and Thatcher – especially in the Anglo-Iberian worlds!²⁹

There were several routes by which QE money emigrated to emerging markets. One involved the Fed buying US Treasury bonds from financial corporations such as pension funds, which hold them as long-term assets with low, but dependable yields. By doing this, the Fed raised bond prices and lowered yields, sending restless asset managers in search of higher yields (such as in emerging markets' corporate debt). And as I have discussed elsewhere in detail, when international financial markets find themselves with excess liquidity, developing countries usually become their 'financial market of last resort'.³⁰

At the same time, by buying so many Treasuries from commercial banks, the Fed pushed them to lend at least part of their newly acquired cash to hedge funds that like to play edgy games with emerging markets' money-market instruments.³¹ Worse still, some of that cash was also lent to leveraged funds that use their leverage capabilities to increase the (often highly destabilising) ability of speculators to navigate shifting emerging markets with bull and bear flexibility.³² Sometimes this highly leveraged dubious cash would seek high returns by scalping emerging markets with activities such as the carry trade (borrowing in currencies where interest rates are low and placing the proceeds where they are high). These, of course, could only remain one-way bets while these large amounts of volatile funds could also push exchange rates in emerging markets to overvalue, and while other automatic "destabilisers" work in their favour.³³ But, inevitably, this will eventually go wrong when the law of gravity finally begins to dominate³⁴ – and when this happens, as the title of my above quoted paper on the global financial crisis emphasises, what we often witness is "the revenge of the market on the rentiers".

²⁹ On these issues, see Palma (2014).

³⁰ See, for example, Palma (2012a).

³¹ Credit mutual funds have also benefited, tripling in size since the 2008 financial crisis (<http://www.bbc.com/news/business-34901904>).

³² Thomas Jefferson was surely right when he said: "I sincerely believe ... that banking institutions are more dangerous to our liberties than standing armies". "... Ought we then to give further growth to an institution so powerful, so hostile?" (<http://etext.virginia.edu/jefferson/quotations/jeff1325.htm>). Perhaps the only positive externality of current financial markets volatility is that it has brought down many (at best socially-useless, at worst highly destabilising) hedge funds. (<http://www.ft.com/cms/s/0/e1346df2-9cd3-11e5-8ce1-f6219b685d74.html#axzz3tfWcjSsy>).

³³ Emerging markets' corporations also issued bonds in international financial markets to jump onto this bandwagon.

³⁴ Perhaps this kind of scenario may be already too close for comfort as more than US\$ 1 trillion of US corporate debt alone has been downgraded this year as defaults climb to post-crisis highs, underlining fears that the credit cycle has entered its final innings.

And “markets” now have quite a lot to revenge themselves for, as

“... corporate debt of nonfinancial firms across major emerging market economies [has] increased from about US\$ 4 trillion in 2004 to well over US\$ 18 trillion in 2014. The average emerging market corporate debt-to-GDP ratio has also grown by 26 percentage points in the same period ...”. (IMF, 2015)

Is there anyone still left of the house of neo-liberalism who thinks that this corporate debt outburst makes economic sense – in the sense that this could possibly be the outcome of something that resembles some sort of ‘equilibrium’ (even a sub-optimal one, but one that could be at least sustainable)? That is, something that could resemble an efficient outcome of the free market-interplay of rational and intelligent agents? In fact, these days there does not seem to be even many practitioners (who have benefitted from it) who think so. According to one, “There's a worry that [currently] there's no buyers of corporate bonds and that on any given day everyone might want to sell”. And according to another, “There's always this nagging doubt that the money may leave [emerging corporate bonds markets] as quickly as it arrived; [so], the potential for volatility if there is a real reason to rush for the exit is much, much greater”. “[There is even the risk that] corporate bond fund managers ... may now have to keep hold of [these bonds] until maturity”. (What could be more unreasonable!). And when there is such market turbulence, not surprisingly, people ask the obvious: “it begs the question: who is the dealer of last resort?”³⁵

Well, in today’s world, with so many States fully endorsing the principle of ‘subsidiarity’ – a principle that has its real roots in the fact that subsidies, subsidies, and further subsidies are all that governments can think of at the moment when having to address a financial markets’ folly – there is an easy answer to the question of who is going to be the dealer of last resort: “Asset Management chief executive Martin Gilbert called for central banks to consider stepping in should the corporate bond market collapse, thus performing a similar role to its lender of last resort for banks”. In fact, speculators, rentiers and traders need not worry, as the European Central Bank is already planning to add corporate bonds to its massive (and ever-expanding) QE package – in the same way as in its last meeting it already added municipal bonds. In fact, market players have reported that this is what bond markets have already priced in. And these days “investors” are rarely disappointed, as central bankers now seem to think that “not upsetting the markets” is the only policy-tool left for them...

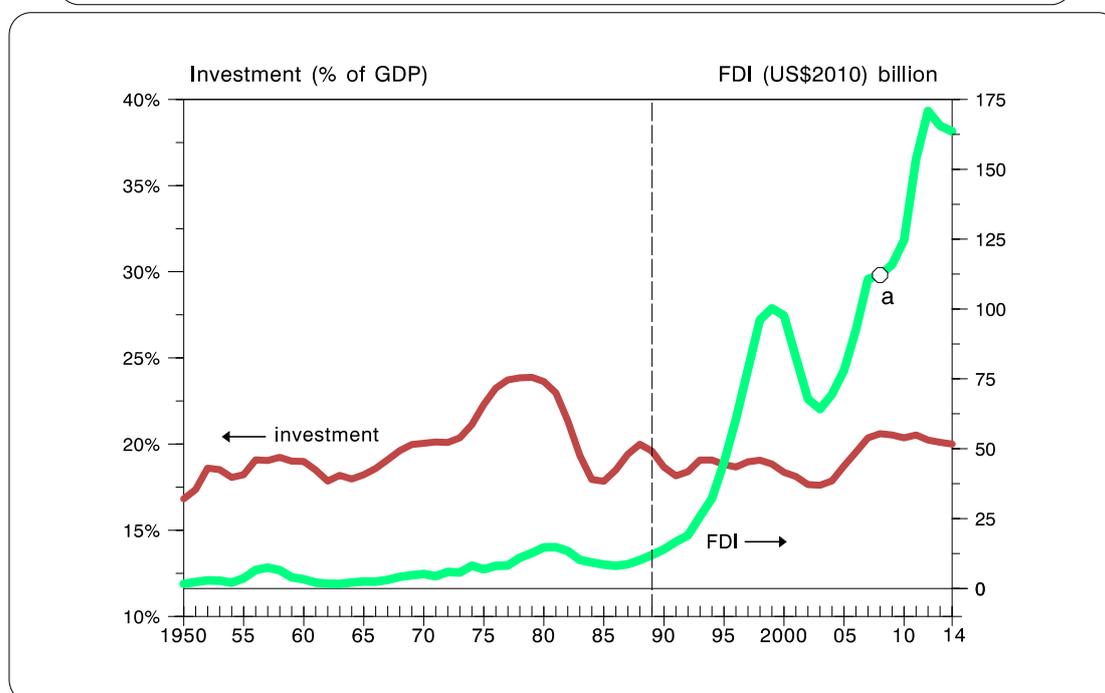
³⁵ For the above quotes, see <http://www.ft.com/cms/s/0/1730a378-8df0-11e5-a549-b89a1dfede9b.html#axzz3sxtfuNDA>; and <http://www.bbc.com/news/business-34901904>.

And in terms of the problems of domestic absorption in emerging markets economies of foreign funds brought in by corporate bonds and loans, their Central Banks, by taking these foreign assets on to their balance sheets, also had to create liabilities. So they printed money, and sometimes sold bonds to sterilise. But when fresh cash made its way into the local banking system, they could then lend more – in fact, they could lend multiples of those amounts (about four times in Brazil, eight times in Malaysia and 10 times in Chile).

Also, foreign direct investment was another route for QE to find its way into emerging markets. Last year, 40% of Brazil’s FDI took the form of intra-company loans. In China, about the same percentage took the form of “other capital flows”, including intra-company loans and payments.³⁶ As opposed to Latin America (and South Africa), in Asia some of this did end up increasing productive capacities significantly, but inevitably some just added liquidity to China’s shady shadow banking. And in the case of Latin America, the analysis above helps to understand why US\$ 2 trillion of FDI inflows since the “Brady Bonds” – especially the latest surge of FDI since QE – has had little or no impact on investment rates (see Figure 1).

FIGURE 1

LATIN AMERICA: investment as % of GDP and FDI infows, 1950-2014



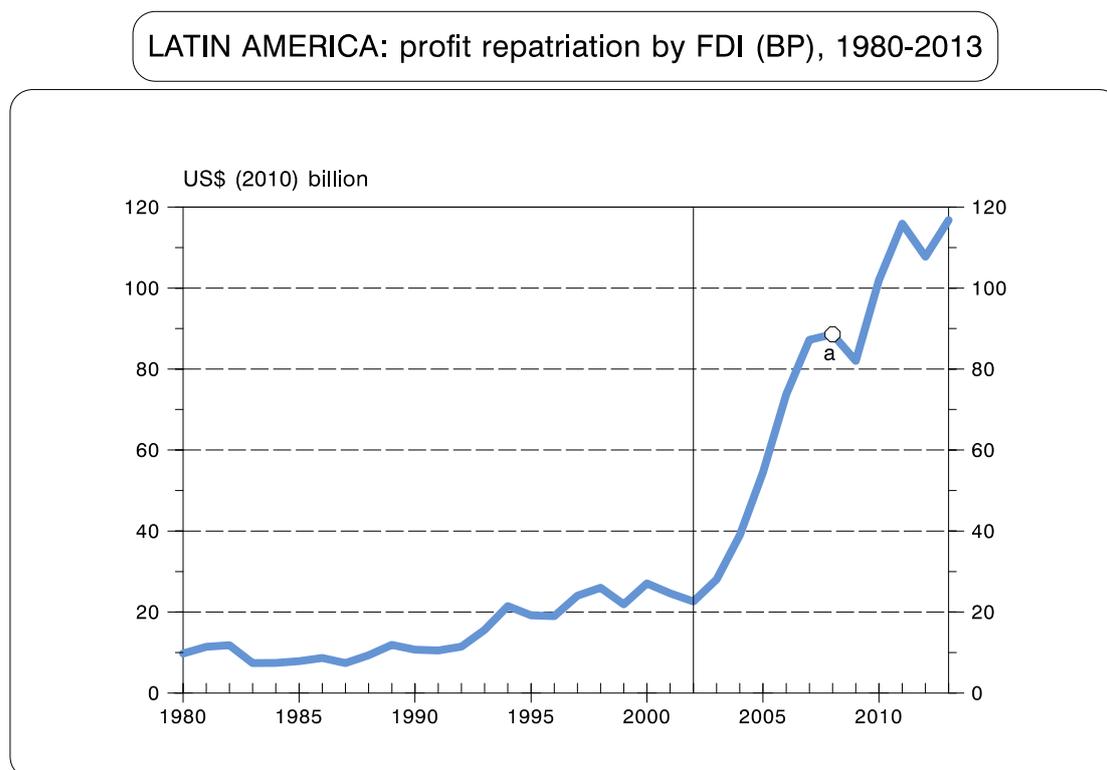
- a = the Fed began buying bonds in 2008. 3-year moving averages.
- Sources: WDI (2015); ECLAC (2015); and WEO (2015).

³⁶ Avdjiev, et al. (2014).

Not much evidence of over-capacities being built here (as in Asia) by this tsunami of (so-called) foreign direct “investment” – nor by the massive build-up of corporate debts. In fact, according to the economic complexity index (ECI), *given the levels of income per capita*, Latin American economies are now among the least diversified in the World – and none as much as Chile.³⁷

Although these huge FDI inflows (as well as foreign bank loans, and portfolio inflows – with its wide range of asset classes, such as equity securities, government bonds, corporate bonds, financial derivatives, real estate investment trusts, exchange-traded funds, mutual funds, certificates of deposit and so on) may have had a negligible positive impact on investment rates, they did have, however, a major negative one on the current account of the balance of payments. Taking into account only those associated with FDI since 2002, when commodity prices began their meteoric rise, a full US\$ 1 trillion has left the countries of the region in the form of profit repatriation by multinationals – as they tend to behave like Latino-corporations the moment they cross the Equator (see Figure 2).

FIGURE 2



- **BP** = balance of payments definition. **a** = the Fed began buying bonds in 2008. 3-year moving averages.
- Sources: ECLAC (2015); and WEO (2015).

³⁷ This is so if one excludes oil-economies. See <http://atlas.cid.harvard.edu/rankings/>.

In the case of Chile, for example, in the 12-year period between 2002 and 2014 profit repatriation by FDI, mostly copper multinationals, was seven times higher than during the previous, similar length one (1990-2002) – US\$ 186 billion and US\$ 27 billion, respectively (constant 2010 dollars). In fact, profit repatriation by FDI in this 12-year period (2002-2014) was six times higher than that of the whole previous 33-year period (1980-2002). In terms of the GDP of each interval, while the figure for the former is equivalent to 8% of that aggregate, the one for 1980-2002 is just 2% of GDP.

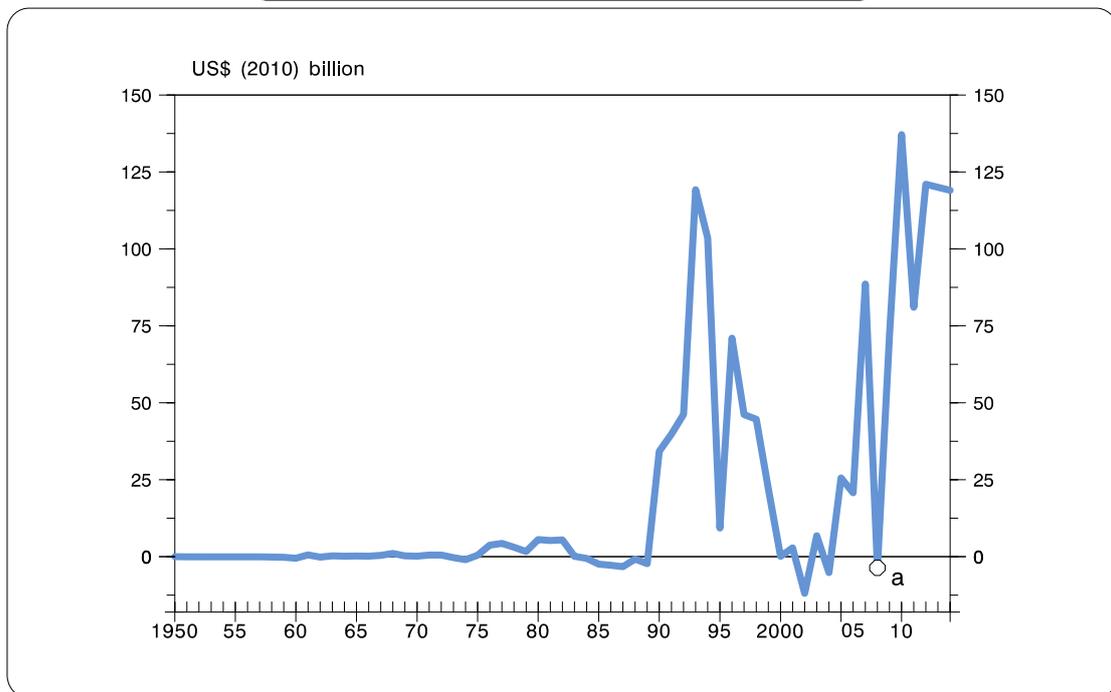
From another perspective, the amount that FDI took out of Chile in the form of profit repatriation only between 2002 and 2014 was larger than the stock of the entire retirement account savings of all Chilean workers (about 10 million people) that have little choice but to be affiliated to the (draconian) private pension fund system (AFPs) – about U\$ 190 billion vs. about US\$ 160 billion, respectively).

If that is a rather daunting thought, I wish I could spare you this next one: most of that massive profit repatriation was due to copper multinationals taking out of Chile in just 12 years an amount larger than the whole of the Marshall Plan – the one in which the United States gave US\$13 billion (approximately US\$ 130 billion in current dollar value) in economic support to help rebuild Western European economies after the end of Second World War. And all that for the great inconvenience of exporting copper concentrates – a mud with a metal content of about only 30%, which is the result of a rudimentary flotation of the pulverized raw copper ore. So, why bothering to do much processing at source if one can manage these colossal returns for doing so little? All this gives a whole new meaning (and one that is a bit more magical-realist) to that concept “picking the low-hanging fruit”.

And, in turn, the high levels and huge volatilities of portfolio inflows, not least since QE, brought in a remarkable (and gratuitous) extra degree of macroeconomic uncertainty, especially to exchange rates. See Figure 3.

FIGURE 3

Latin America: portfolio inflows, 1950-2014



- a = the Fed began buying bonds in 2008.
- Sources: ECLAC (2015); and WEO (2015).

In sum, in the 7-year period since the Fed began buying bonds in 2008, FDI inflows to Latin America doubled (to US\$ 1 trillion) vis-à-vis the levels reached during the previous similar-length period (one that was also part of the so-called commodity price super-cycle). So did, of course, profit repatriation by FDI (to US\$ 700 billion). In fact, Figure 1 indicates, oddly enough, that investment actually fell as a percentage of GDP during this QE-related tsunami of FDI. In turn, during the reign of QE, portfolio inflows jumped by a factor of nearly 6 (to US\$ 650 billion) compared to the previous similar-length period (all figures in constant 2010 dollars). Not the customary behaviour of international financial markets towards a dynamically-diffident developing region at a time of a global financial crisis. And the inevitable question is always the same: what did Latin America do with these additional funds? Figure 1 hints that in this milk and honey world of low-hanging fruits, not that much was done with them that could be considered socially useful... What have we done in my part of the world to deserve this endless loop!

All in all, and as a percentage of GDP, in emerging markets economies private sector debt (corporations and households) is estimated to be already well

over 100%³⁸. Therefore, it is now greater than in developed markets in the build-up to the global financial crisis. In fact, many of the commodity producing economies (emerging or otherwise) simply assumed that the commodity-price boom would last forever (of course, "this time it's different")³⁹ – and they adjusted their permanent income expectations accordingly⁴⁰. As a result, they mortgaged their expected higher income streams by embarking on domestic credit booms that have left many of these countries with serious debt hangovers. For example, five of the better-known commodity exporters increased their private bank debt from 50% of GDP to 80% during the years of the commodity-price boom⁴¹. In fact, according to the Institute of International Finance (IIF), when all's said and done overall emerging market debt is now probably fast approaching 200% of GDP⁴².

Thus, the so-called "Keynesian" QE-policy from the Fed and other central banks – Keynes must be turning in his grave at the crude exploitation of his name, as QE in the US, and later in the EU, was (and in the latter case still is) basically an attempt by monetary authorities to keep financial dinosaurs on life support – has left a legacy of all sorts of financial fragilities in the South, as well as over-capacities in Asia, and a highly futile over-financialisation in Latin America and South Africa, from which it will take many years to unwind.⁴³

From this perspective, the paradox is that QE was designed to help reduce systemic risks in the world economy – and specifically to facilitate an orderly process of deleveraging in industrialised countries. Instead, it has made possible the build up of a huge debt-bubble in emerging markets in both cross-border lending, and in bank lending – with the former now at serious risk of currency mismatches (especially concerning corporations operating in non-tradable activities), and the latter in one of liquidity mismatches. Accordingly, a credit crunch could mean a corporate dollar-debt crisis due to the former, or a domestic banking one due to the latter. In fact, bank lending conditions in emerging

³⁸ <http://www.ft.com/cms/s/0/46f42c36-8965-11e5-90de-f44762bf9896.html#axzz3rjS3sytj>

³⁹ <http://ciperchile.cl/2013/03/25/la-economia-chilena-como-el-elefante-se-balancea-sobre-la-tela-de-una-arana/>

⁴⁰ For example, during the four-year period of the last Chilean government (2010-2014), consumption not only absorbed the additional resources that were kept at home, but it even jumped from 71% of GDP to nearly 76% of it. Under this kind of scenario, populism can even resemble prosperity. See <http://si3.bcentral.cl/siete/secure/cuadros/home.aspx?Idioma=en-US>.

⁴¹ <http://www.nikkoam.co.nz/articles/2015/07/commodity-producers-year>

⁴² <https://www.iif.com/publication/html-publication/weekly-insight-waiting-game>

⁴³ For how QE has also left all sorts of market dislocations in the North, see endnote 4.

markets have deteriorated so sharply that some of the IIF's measures are at their worst levels since they began monitoring conditions in these markets.⁴⁴

As a result, heavily indebted emerging markets' corporations, and the banks exposed to them, are at risk of falling into a vicious circle of low profitability, increasing non-performing loans, and tighter credit conditions. Stating the obvious, we should not expect a demand-led recovery of the global economy to come from this end of the world anytime soon.⁴⁵

In actual fact, we should not expect a demand-led recovery to come from any part of the world unless a robust set of linkages between financial markets and the real economy is re-established (*à la* FDR); as Keynes said at the time of the 1930s crash,

“... there cannot be a real recovery, in my judgment, until the idea of lenders and the idea of productive borrowers are brought together again... Seldom in modern history has the gap between the two been so wide and so difficult to bridge.”⁴⁶

As the late Carlos Díaz-Alejandro (Ajit's great friend and mine) once said – following the intellectual lead of our common mentor, Charles Kindleberger – “Good-Bye Financial Repression, Hello Financial Crash.”

This is especially true in a negative real interest rate environment, as speculators, in their desperate search for elusive yields, inevitably have to take on more risk, more leverage and more illiquidity. This is precisely a vital (yet implicit) ingredient of the peculiar ideas behind super-accommodative monetary policy; but the downside (among many) is that this policy – leading speculators to take on more risk, leverage and illiquidity – is likely to bring more volatile asset prices globally (including commodities), and more unchartered financial fragilities all over. Closer regulatory scrutiny worldwide, therefore, should have been an intrinsic part of such risky reflationary policy. But try to get speculators, traders and rentiers (or politicians in need of donations for that matter) to understand something, when their (short-term) earnings, bonuses, share options and corporate-sponsored retirement plans depend on them not understanding it.

My own part of the world, Latin America, tends (unfortunately, and as usual) to be the worst in this respect – with its close relative in southern Africa not far behind. In their neoliberal model, the hub of accumulation has been located in speculative finance, and in exploiting market failures, privileges, lack of

⁴⁴ <https://www.iif.com/publication/html-publication/weekly-insight-waiting-game>

⁴⁵ On the demise of the BRICs, see endnote 5.

⁴⁶ Keynes, J.M. (1930). See also Mazzucato and Perez (2014). In the words of a monetary regulator (the Chair of the UK's Financial Service Authority): “Swollen' financial markets tend to produce socially useless products and innovations”.

competition, timid institutions, and the helping hand of a so-called progressive *intelligencia* (full of conflicts of interest – and one who would always blink first in a political staring game with those at the top). Only such a context can reward “investors” (once upon a time “to invest” meant something to do with adding productive capacities), traffickers of political influence and insider trading so generously, and with such impunity. How else could the top one percent in Chile end up appropriating more than 30% of national income?⁴⁷ And there is little doubt that this context also punishes real investment, productive diversification, technological absorption and industrialisation. In fact, in Latin America productivity has hardly increased since pre-economic reforms – it is almost difficult to believe, but (with the customary cycles and significant diversities, such as Chile in the 1990s) output per worker in the region has been *on average* stagnant since 1980 (with an annual rate of growth of just 0.1% for this 35-year period⁴⁸). And since 1990, it has grown by just 0.9% per year. In the meantime, in China these statistics reach 7.1% and 8.2% *per annum*, respectively; in Korea at 4.2% and 3.5%; in Taiwan at 3.9% and 3.4%; in Vietnam at 3.5% and 4.4%; in India at 3.4% and 4.1%; in Thailand at 3.7% and 3.3%; and so on.⁴⁹

So, again, the unavoidable question arises: Where has all that exploding corporate debt gone in Latin America? Especially in countries like Chile, which now ranks number three among all emerging markets economies in terms of swelling corporate debts since 2007 as percentage of GDP (only after China and Turkey). And in Brazil (which now ranks number four)? And in Peru (number six)? And in Mexico (number eight), or Colombia (number 12)? In the case of Chile, the increase in corporate debt was equivalent to about 20 percentage points of GDP; in Brazil and Peru about 15 points; and in Mexico and Colombia about 10 points⁵⁰. In the meantime, if private investment (despite a commodity-price boom and easy finance due to QE liquidity) managed to raise much above 15% of GDP, the capitalist élites of the region started experiencing feelings of vertigo.⁵¹ And what about those US\$ 2 trillion of FDI flows that have come in since the onset of economic reforms in 1990 – and especially since the Fed began buying bonds in 2008? All this is a stark reminder of how little still we really

⁴⁷ Figueroa and López (2013).

⁴⁸ Again, for the *Guinness Book of World Records*, section ‘countries not in political turmoil’.

⁴⁹ GGDC (2015).

⁵⁰ See IMF (2015).

⁵¹ During the period of rapidly rising corporate debt in Latin America (i.e., since 2004), private investment averaged just 15.9% of GDP (see ECLAC, 2013; arithmetic mean of 19 countries. Data available until 2010. In Latin America, data on private investment are notoriously difficult to obtain. See also WEO, 2015).

understand about what has been happening inside Latin America since our (remarkably unsophisticated and highly corrupt⁵²) neo-liberal economic reforms.⁵³ Not least due to the (somewhat garciamarquian) intricacies involved. Paraphrasing Einstein, perhaps in Latin America difficulties in understanding have to do – more than anywhere else in the world – with the fact that unfortunately not everything that can be counted counts (for this understanding), and little that counts can be counted.

And for those who still believe that total factor productivity (TFP) is the key, in Chile, for example, a country that is so often highlighted as the best performer of the region, the average annual rate of growth of this statistic since 1995 has actually been nil!⁵⁴ At least in the case of Chile this has been so for a period of 'only' 20 years, as the average TFP-growth rate for the whole region has been zero for much longer – in fact, for the 34-year long period since 1981 (i.e., the end of the previous development strategy of State-led industrialisation).⁵⁵ And the prospects ahead for the region do not look very promising either. Evidence like this sometime makes me wonder how those who carried out the particular set of economic reforms that has characterised the region since – and take this statistic (TFP) so seriously, as my neo-liberal colleagues – can they sleep at night. There is little doubt that during the 1980s there was a lot of re-engineering needed in the region as far as development strategy was concerned, but the chosen one seems to have had more to do with passions of pure ideology (and conflicts of interests) rather than with social reality.

Not surprisingly, in a context such as that of Latin America inequality is as much a twin of inefficiency as the law of gravity is of the apple. Emerging markets that are such a paradise for (domestic and foreign) rentiers, speculators and traders can only be a purgatory for their real economies and consumers. (Douglas North's last major contribution to Economics, its "limited access order" notion, attempts to look a bit in this direction⁵⁶).

⁵² See, for example, Mönckeberg (2001); and <http://ciperchile.cl/2015/11/03/el-tpp-o-como-ceder-soberania-por-secretaria/>.

⁵³ Should we just keep pretending that "there was no alternative" – or "TINA" – to them? And regarding what we still do not understand about Latin America's remarkable poor performance, it reminds me of that famous quote – perhaps the hallmark of an era: "there are things that we now know we don't know. But there are also things we do not know we don't know"...

⁵⁴ CORFO (2013).

⁵⁵ ECALC (2013).

⁵⁶ North et al. (2007). For him and his co-authors, "A common feature of limited access orders is that political elites divide up control of the economy, each getting some share of the rents. ... [but] adequate stability of the rents and thus of the social order requires limiting access and competition – hence a social order with a fundamentally different logic than the open access order [of advanced industrial countries]". For an analysis of North's

In sum – and unfortunately – Ajit was right; corporations in developing countries tend to be even more susceptible to the vicissitudes of international finance than their counterparts in the developed world. In fact, and not surprisingly, unregulated and over-liquid international financial markets have proved to be as destructive and self-destructive as anything Freud could have ever imagined – especially in emerging markets, where domestic financial markets are particularly “thin”. The idolization of finance – i.e., the worship of a thing: money – has dominated the desire to create life-producing economic activities; and rent-seeking accumulation has dictated the path of other creative, innovative activities – and has inevitably placed a strait-jacket on them.⁵⁷

Ajit would have surely agreed with me that it is certainly time to make a *margin call* to the guardians of financial de-regulation – i.e., it’s about time to ask them to put a lot more substance into their arguments. The stakes for emerging markets’ corporations, their real economies and financial markets, and wider society (and everybody else in the world for that matter) could scarcely be higher – as (quoting the great Portuguese poet Camoes) we are now definitely “em mares nunca dantes navegados”.⁵⁸

But unfortunately (and as opposed to that era that brought us a good deal of civilisation – the one characterised by the New Deal, *The General Theory*, the Bretton Woods agreements, The Marshall Plan, the British National Health Service and the Welfare State), this new challenges are happening at the worst possible time, as our current social imagination (north and south of the Equator) has seldom been so barren.

ideas in the Brazilian context, see Di John (forthcoming).

⁵⁷ For how economic theory has followed a relatively similar path with its switch towards the idolatry of a ritual (mathematics), see <http://ciperchile.cl/2013/11/12/por-que-la-economia-ortodoxa-transfiro-su-obsesion-por-un-concepto-mercado-a-un-ritual-matematicas/>.

⁵⁸ Across never before sailed seas.

Endnotes

1.- A recent study of profitability in the US concludes: "The clearest driver of the surprisingly good profitability [in the US] is the rise in corporate profits as a percent of GDP ... This series had a ... mean-reverting look to it [as] there had been no obvious trend for the close to 50 years of data, despite plenty of good times and bad in the interim. And the appearance of long-term stability still seemed strong as late as the early 2000s. [After that] the new highs of profitability ... [were related to] the housing boom and bubble in risk assets. Afterwards profits ... [fell] through the old average in the financial crisis, although not to the lows we saw in prior recessions. And since then, ... we saw them rise well beyond anything the U.S. has ever seen. On this measure, profitability ... is higher than any point in history before 2010. ... Our best estimate is that profit margins are about 24% better than normal. ... From a macroeconomic perspective, maintaining such high levels of profitability [in the US] in the face of low investment rates implies ever-increasing wealth inequality in this country." (Inker, 2015)

2.- In terms of current trends of global mergers and acquisitions, according to Thomson Reuters the total value of these operations so far this year (mid-November) amounts to more than US\$ 4.2 trillion (and counting). This surpasses the previous record set in 2007 on the eve of the financial crisis. The latest one, Pfizer's US\$ 160 billion takeover of Allergan, the third-largest deal in history, will create the world's biggest pharmaceutical group by sales. It will also save Pfizer at least US\$ 21 billion in its tax bills by allowing it to move the combined group to Ireland (as Allergan, once based in the US, is now already a Dublin-based corporation). This "inversion" will also free more than US\$ 130 billion of offshore earnings that Pfizer has shielded from the US authorities. The ease with which companies can shift profits like this to low-tax countries has been estimated to cost up to US\$ 240 billions in lost tax revenues (a black hole described euphemistically by the OECD as "base erosion and profits shifting"). Pfizer has also announced the beginning of a process of share buybacks that is expected to reach huge proportions. And following the divergent trends mentioned above – ever higher profits (especially after-tax ones) associated with ever more mediocre levels of investment – Pfizer also announced a large cutback in R&D spending (including, among several other closures, one of a facility in Cambridge, which focuses on R&D in pain therapies). This reminds me of what Einstein once said: "Only two things are infinite: the universe and human stupidity" – "although [he added later] I'm not sure about the universe". For the above Pfizer scheme (including why the transaction will be structured as a reverse merger, with Allergan technically buying Pfizer), see <http://www.ft.com/cms/s/0/c65488bc-91db-11e5-bd82-c1fb87bef7af.html#axzz3sJ8r5bPJ>; and <http://www.ft.com/cms/s/0/7ee22f58-99cd-11e5-987b-d6cdef1b205c.html#axzz3tG3bXaZm>

3.- Among the plethora of political problems hitting Europe at the moment the better known ones are the dread of ISIL's vicious-style terrorism (which can only get worse given Europe's rather mechanical bombing-response), the current tsunami of refugees, the re-emergence of fascists-leaning political parties, the growing likelihood of a Brexit (British exit from the European Union), the ever expanding debt of the Eurozone periphery, the (increasingly forgotten) crisis in Ukraine, and Volkswagen's crimes and misdemeanours – as well as those of so many other large corporations, as now those of the real economy start mirroring the behaviour of their relatives in financial markets (as if saying "look at me; I'm the same as you. I feel the same way and share the same attitudes"). To these one should add, as Robert Wade does, the Eurozone fiscal compact treaty, signed by in 2012. This treaty "tightly restricts the fiscal policy space of member governments, which have already given up national control of the key prices of interest rates and exchange rates". (<http://www.ft.com/cms/s/0/91d496e4-66b7-11e5-a57f-21b88f7d973f.html>). This treaty, a fiscal straightjacket, will make sure that the Eurozone continues to have recessionary pressures, and their politically destabilising effects, for the foreseeable future.

4.- QE has also left all sort of market dislocations in the North as well; for example, on the eve of the Fed's likely rate increase, the first one since 2006, the Financial Times reports that tighter policy will probably mean even lower bond yields, "reflecting a world fraught with risk and economies still struggling to recover, burdened by previous excesses" (<http://www.ft.com/cms/s/0/23232c52-9a7d-11e5-a5c1-ca5db4add713.html#axzz3tt87kK4I>). Also, the latest BIS (2015) points to a rather odd price relationship in the fixed income market; US dollar swap spreads (i.e., the difference

between the rate on the fixed leg of a swap and the corresponding Treasury yield) have turned negative in the US. Given that counterparties in derivatives markets, typically banks, are less creditworthy than the government, swap rates are normally higher than Treasury yields because of the additional risk premium. Hence, the negative spreads point to a possible dislocation – or maybe someone knows something that we don't! Or, perhaps, it is simply that, as Warren Buffett remarked, "When you combine ignorance and leverage, you get some pretty interesting results".

5.- Those looking for symbolism can turn to this month's decision by Goldman Sachs to end its long-running BRIC- soap opera (Goldman coined the BRIC concept in 2001), as the excitement generated by the concept had waned and died. So, it pulled the plug on its nine-year-old product, the BRIC fund (for Brazil, Russia, India and China), and merged it into its broader emerging markets fund (as it had lost 88% of its assets since a 2010 peak). For example, in terms of exchange-traded funds' returns divergence, the four BRIC countries have had nearly 100 percentage points variation over the last three years – with India up 43% while Brazil is down 52% (<http://www.bloomberg.com/news/articles/2015-11-04/etf-investors-are-unbundling-emerging-markets>). No much evidence of a BRIC 'asset class' here. So, R.I.P. BRIC.

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