

FINANCIAL SUBORDINATION OF PERIPHERAL EMERGING ECONOMIES: A KEYNESIAN-STRUCTURALIST APPROACH

FMM CONFERENCE October 30, 2021

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Concept of financial subordination

- Subordinate financialization" (BONIZZI et al., 2019), "subordinated financial integration" (KALTENBRUNNER and PAINCEIRA, 2017), or simply "financial subordination" are concepts related to the subordinated way in which peripheral emerging economies are integrated internationally, given the pro-cyclical and unstable nature of capital flows, which generates macroeconomic instability in the periphery and reduces its policy space for domestic purposes.
- Our understanding is that such concepts are promising for understanding how these economies insert themselves in a subordinate way in the process of international financial integration, but they are still imprecise and lack greater analytical precision.

TWO CONTRIBUTIONS TO THE DEBATE ON FINANCIAL SUBORDINATION

- a) To develop a Keynesian-structuralist approach that takes into account both monetary asymmetry and financial asymmetry.
- B) To show that peripheral emerging economies have different degrees of financial subordination, which depends on: (i) the form of international financial integration, (ii) the type of productive structure, that is if they are more or less complex.

STRUCTURE OF THE PRESENTATION

- Monetary and financial asymmetries
- Latin American Structuralist approach of financial asymmetry
- Productive asymmetry between Latin American economies and some dynamics Asian economies (Complexity index)
- The nature of capital flows to emerging economies

MONETARY AND FINANCIAL ASYMMETRIES

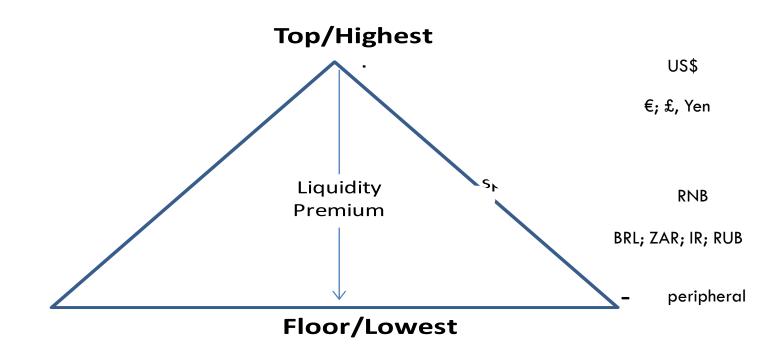
Monetary asymmetry is related to how different currencies are positioned in the currency hierarchy with different liquidity premiums, so that the degree of liquidity of currencies determines their position in the hierarchy and, consequently, their ability to perform the functions of the currency in the international level.

Financial asymmetry is related to the asymmetric international financial integration of peripheral emerging economies, subject to the instabilities of the international liquidity cycle, determined mainly by external factors.

In consequence of such asymmetries, peripheral economies have (i) to increase its interest rates to compensate low liquidity premium of their currencies; (ii) to borrow in key currencies ("original sin" problem); and (iii) greater volatility in exchange rate compared to advanced economies.

INTERNATIONAL MONETARY SYSTEM AS HIERARCHICAL AND ASYMMETRIC SYSTEM: Currencies are positioned hierarchically according to their degree of liquidity:

Currency hierarchy



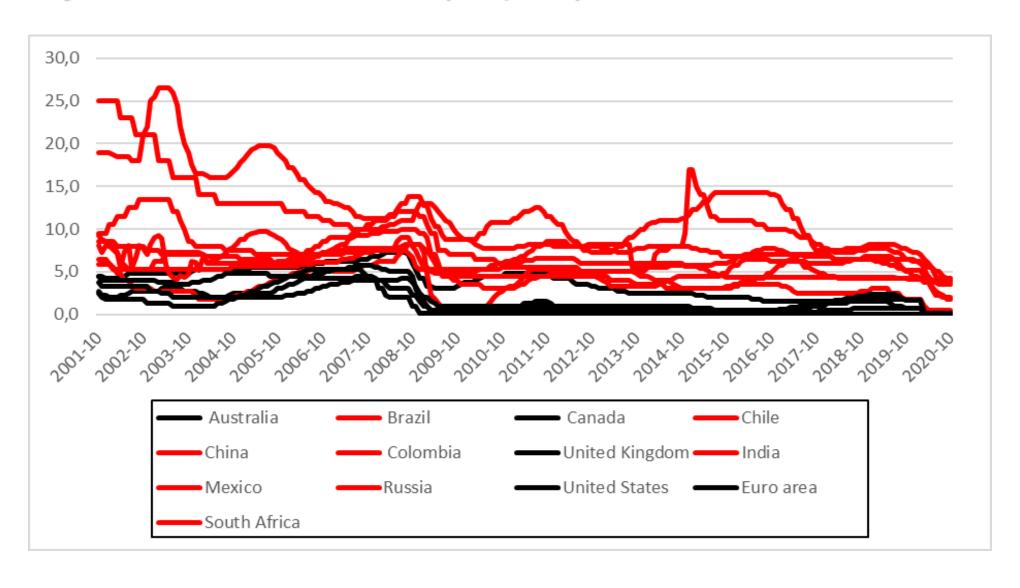
4. Currency hierarchy (Andrade & Prates, 2014; Paula et al, 2017)

✓ Foreign exchange markets at equilibrium (by arbitrage):

$$a_n + q_n - c_n + I_n = a_s + q_s - c_s + I_s$$
 (2)

- ✓ Variable *a as* exchange rate determined by expectations, not fundamentals
- \checkmark Variable q as interest rate
- ✓ Variable *c* as degree of financial openness
- ✓ Variable I as liquidity premium
- ✓ Currency hierarchy: I_s < I_n
- \checkmark To be compensated by $(a_s + q_s c_s) > (a_n + q_n c_n)$

Policy rate interest rates (% p.a.)



LATIN AMERICAN STRUCTURALIST APPROACH

Latin American Structuralist approach shows that there is not only a productive asymmetry between center and periphery that results in a tendency towards deterioration of the terms of trade, but also a financial asymmetry that reinforces the economic disparity between center and periphery as engenders macroeconomic instability and reduces policy space for domestic purposes. It also generates a stream of financial income from the periphery to the center.

According to Ocampo (2001), while center economies are "business cycle makers", peripheral economies are "business cycle takers", that is the center has more policy autonomy and is 'policy making', while the periphery is essentially 'policy taking'.

PRODUCTIVE ASSYMMETRY

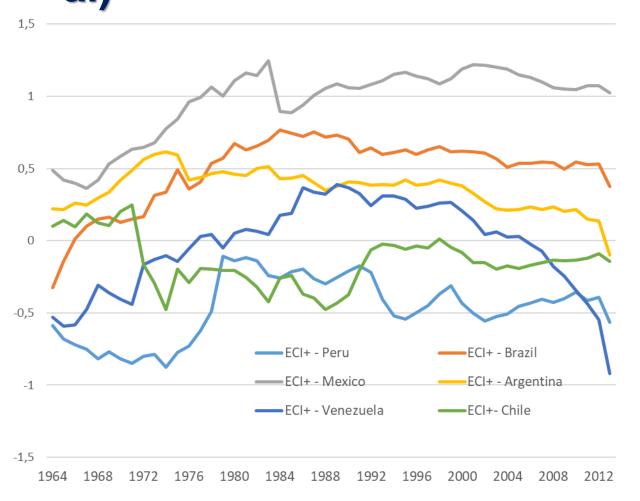
- Structural heterogeneity in a notion developed by Anibal Pinto (1970), in which modern and high productivity sectors (export activities) absorb a small proportion of workers in the periphery while the rest of the economy, featured by low-productivity sectors, absorb a large proportion of workers.
- Structural heterogeneity is a characteristic of Latin American economies, specialized in the production of commodities, while East Asian economies have a much more diversified productive structure with higher level of productivity and sophistication.

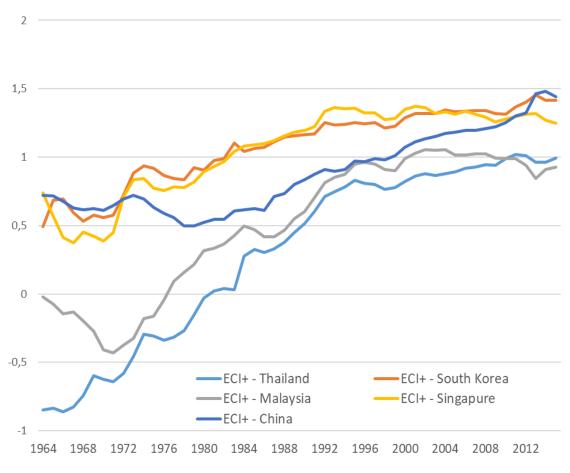
COMMODITY-FINANCE NEXUS (AKYUZ, 2020)

In peripheral commodity-specialized economies, commodity and financial cycles tend to move together and reinforce each other.

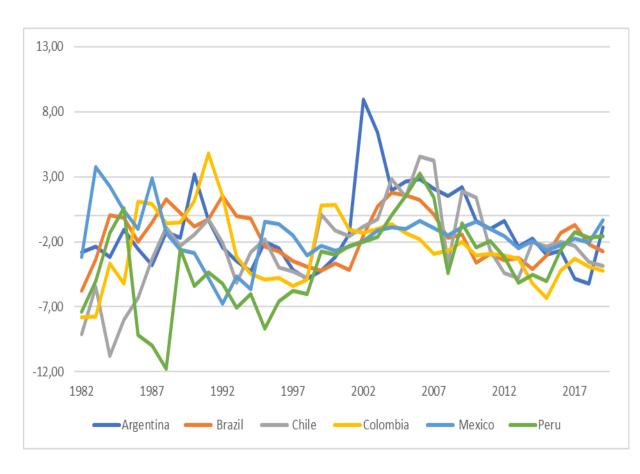
Commodity prices and capital inflows are strongly correlated: a raise (falling) in international commodity prices stimulate (discourage) capital inflows to EMEs.

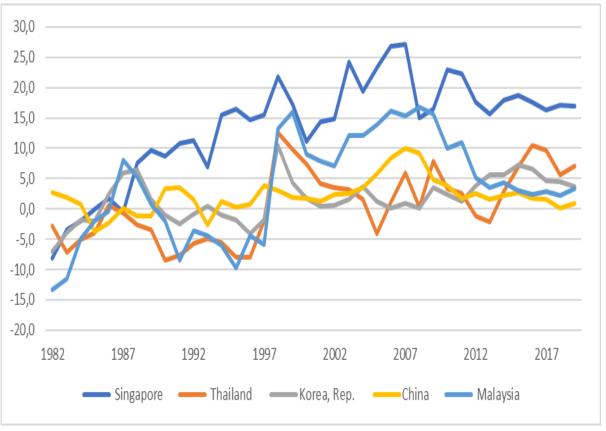
Economic Complexity Index (ECI): measure of the degree of complexity of each country (Hausmann et al)



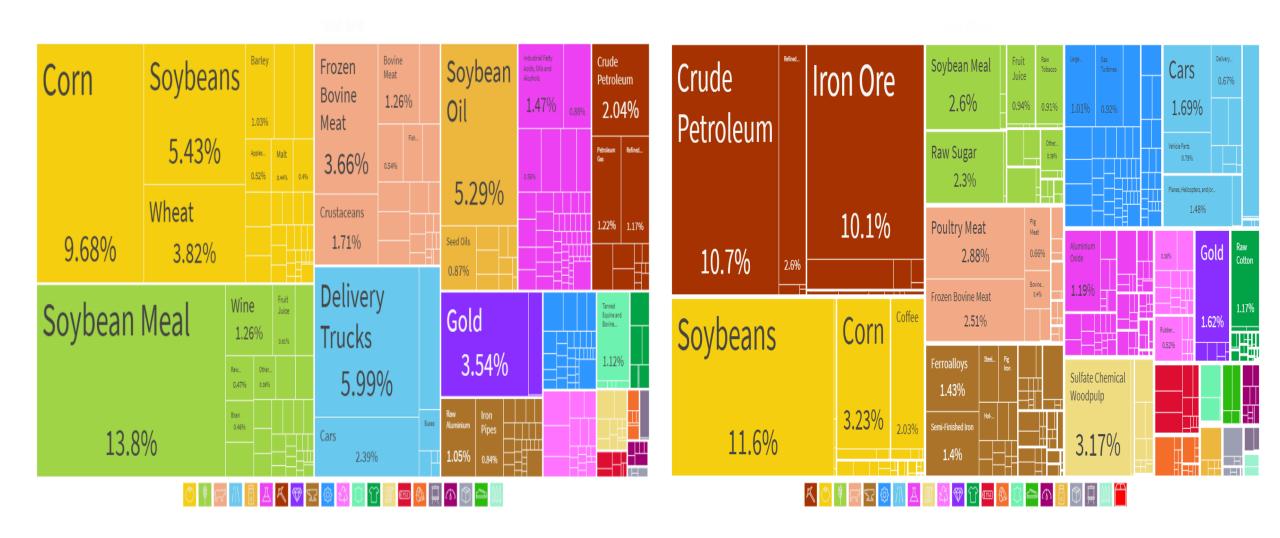


Current account's balance of payments (% GDP) – 1982-2017

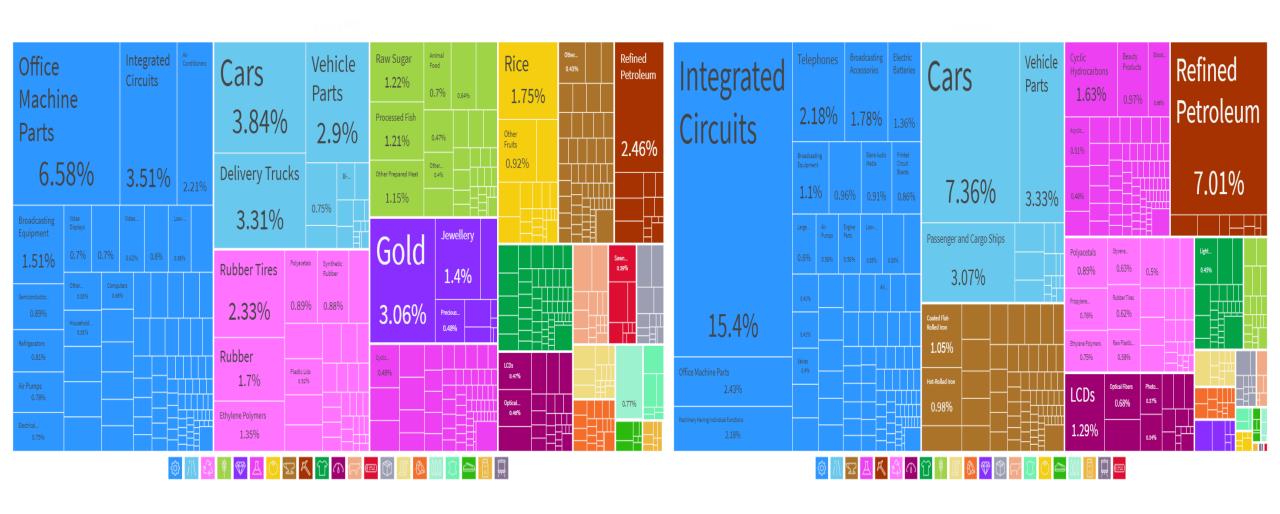




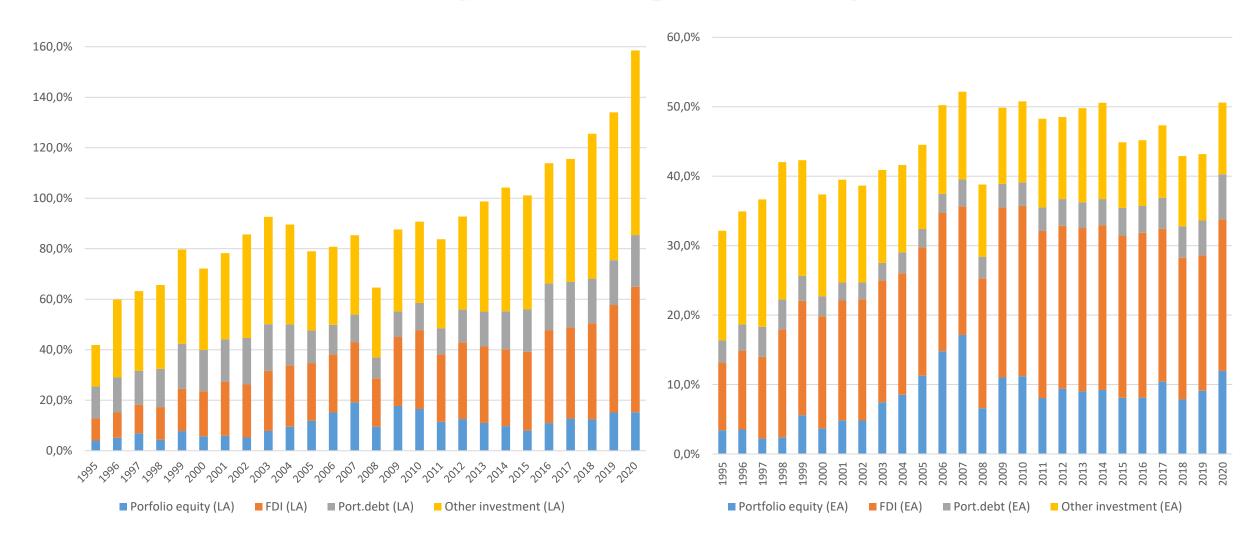
Exports' goods – Argentina and Brazil (2019)



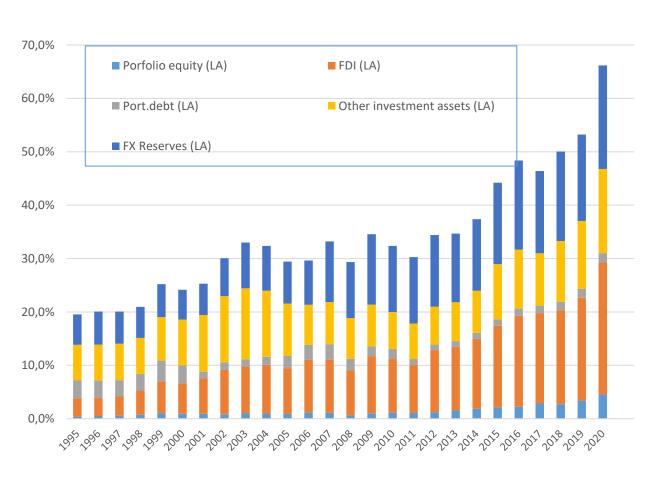
Exports' goods – China and South Korea (2019)

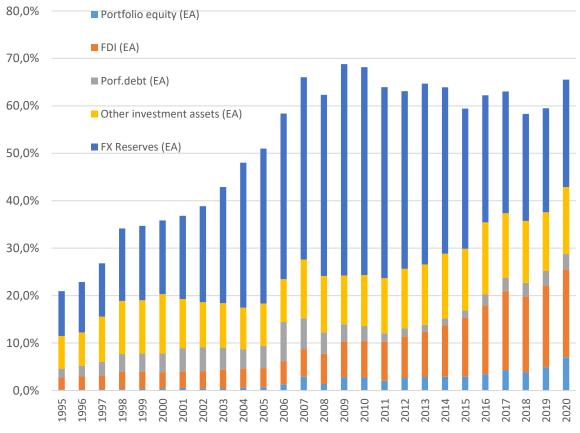


External liabilities – selected countries of Latin America and Asia (percentage of GDP)

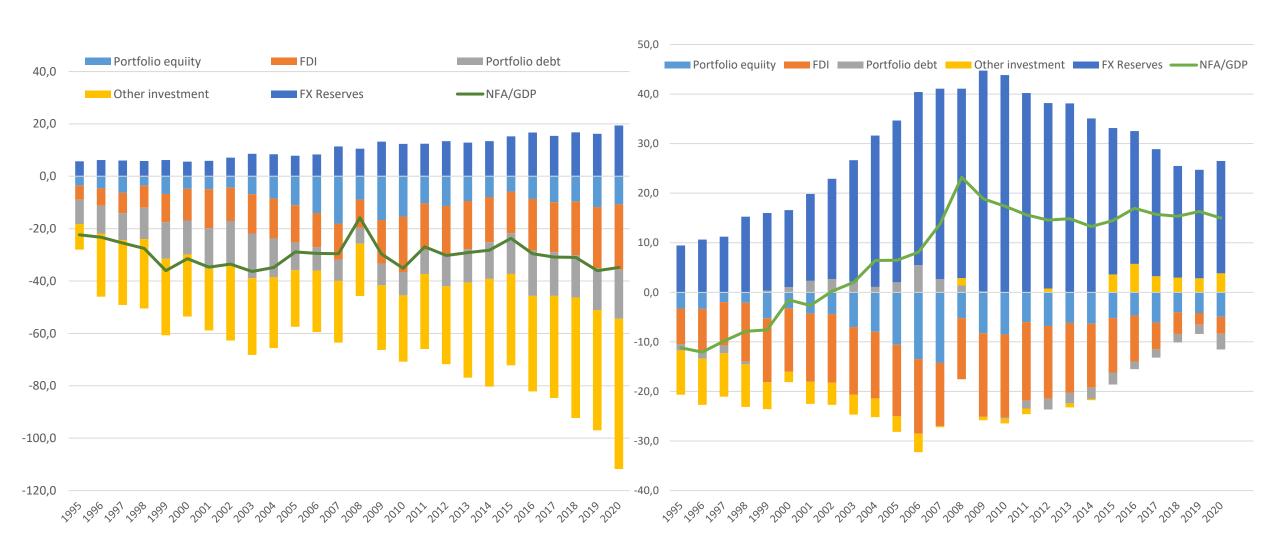


External assets – selected countries of Latin America and Asia (percentage of GDP)





Net financial assets – selected countries of Latin America and Asia (percentage of GDP) – 1995-2020



Conclusion

- Productive and financial asymmetries are related to each other, they are two sides of the same coin. The overlap of these asymmetries define the financial subordination of emerging peripheral economies.
- Commodity-exporting countries (Latin America ones) have an economy that is not very diversified and complex, used to have strong dependence on foreign capital and a volatile current account balance, and are very dependent of the commodities cycle.
- In turn, emerging Asian economies are diversified exporters of manufacturing products with high added value, which allows them to have a strong position in their balance of payments, with current account surplus, less dependence on capital inflows, and high accumulation of foreign exchange reserves.
- So our analysis concludes that we cannot see emerging economies as a similar group of countries. Indeed there are different patterns of international financial integration and financial subordination.

Thank you!