INTERNATIONAL FINANCIAL SUBORDINATION IN THE AGE OF ASSET MANAGER CAPITALISM

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BACKGROUND AND CONTRIBUTION

- Rise of large asset managers as key nodes of financial intermediation (e.g. The Big Three: Blackrock, Vanguard, State Street)
- Asset manager capitalism as a new regime of corporate governance (Braun, 2020, 2021)
  - Ownership heavily concentrated in a small number of very large institutions, which hold diversified portfolios across the entire investible world making them true universal owners (Fichtner et al. 2020)
  - Key goal is maximisation of assets under management: profits are fee-based, no direct interest in corporate profits

BACKGROUND AND CONTRIBUTION

Three implications (that matter for us in this context; Braun, 2020; 2021):

1. Diminished exit threat and potential to stabilize financial markets
2. Extensive financial accumulation: creation of new financial assets to maximise asset under management and institutional transformations to market-based finance (financialisation)
3. Structural power through voice and engagement (ESG and increased space for macro-policy)

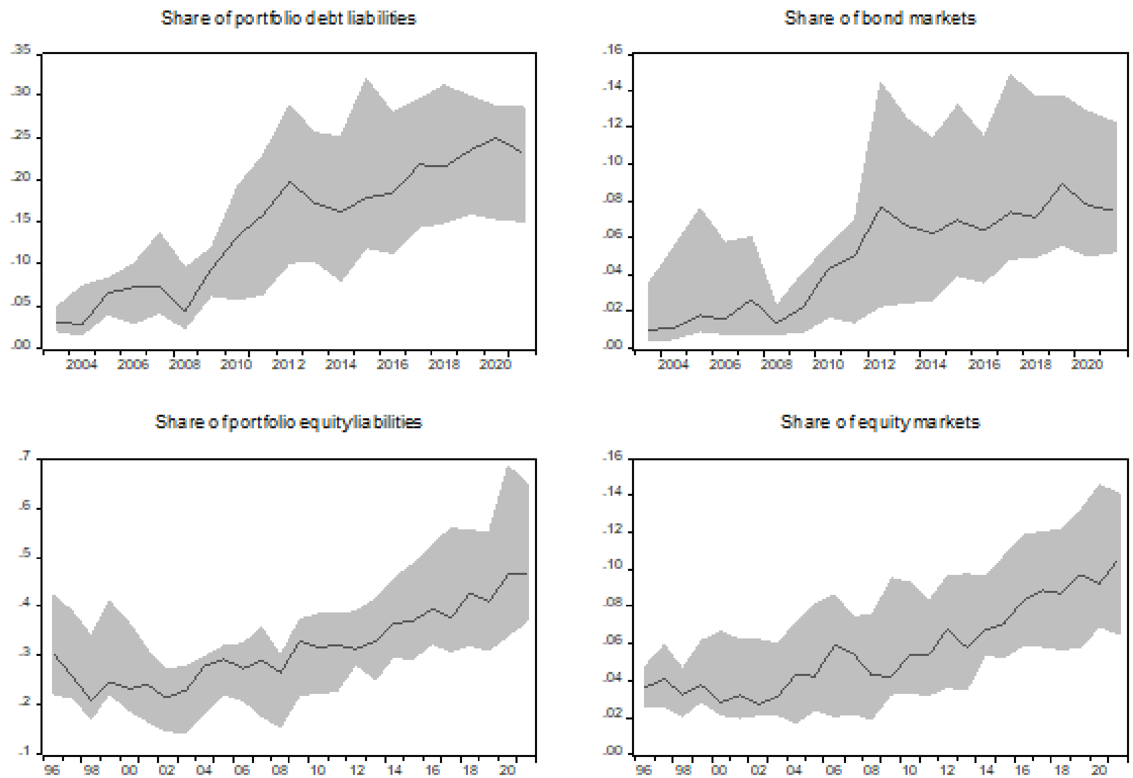
BACKGROUND AND CONTRIBUTION

- Asset managers are becoming more important in emerging markets – as of net no systematic analysis of implications exists
- We ask (empirical contribution):
  a) To what extent the propositions of asset manager capitalism hold in a different spatial and global structural context?
  b) How and whether asset manager capitalism reconfigures and changes emerging markets' international financial subordination?

BACKGROUND AND CONTRIBUTION

- Conceptual Contribution: Bring together literatures on Asset Manager Capitalism and International Financial Subordination
  - Asset manager capitalism literature:
    - No systematic analysis of asset manager capitalism in emerging market context yet
  - International Financial Subordination (e.g. Alami et al. 2022; Bonizzi et al. 2022):
    - Some analyses how IFS is configured with the changing structures of global financial markets (e.g. Kaltenbrunner and Painceira, 2015; Bonizzi and Kaltenbrunner, 2019; Naqvi, 2018; Musthaq, 2021; Fichtner et al. 2021), however as of yet no systematic engagement with the rise of Asset Manager Capitalism

RISING EXPOSURE OF ASSET MANAGERS IN EMERGING MARKETS



Source: EPFR, Lane and Milesi-Ferretti (2018), IMF coordinated portfolio investment survey, BIS debt securities and World federation of exchanges.

MAIN ARGUMENT AND DATA

- Though the participation of large asset managers in EM has increased, their participation is still **too narrow and shallow** to speak of asset manager capitalism

- Though the rise of asset managers in EM might lead to similar financial and economic transformation as those observed in advanced capitalist economies, these transformations take particular forms and are fundamentally shaped by these countries' subordinate integration into the global economy > cement IFS

Data:

- Emerging Portfolio Fund Research (EPFR) asset manager flows and holdings for 23 emerging markets included in JP Morgan's EMBI and GBI-EM indices

- ORBIS data on company equity ownership of "The Big Three"

- Wold Federation of Exchanges, World Bank, IMF, BIS data

- Seven semi-structured expert interviews with global and EM asset managers and EM policy makers

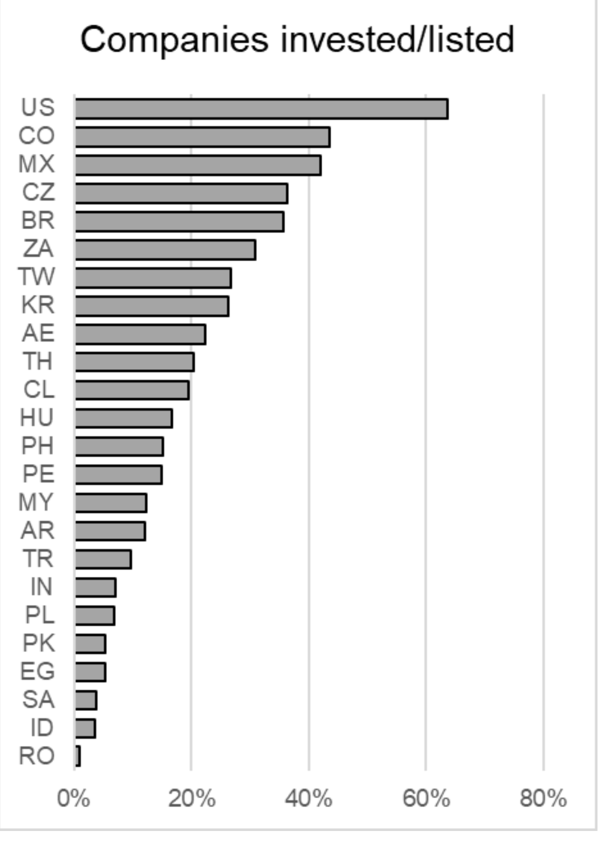
OUTLINE REMAINING PRESENTATION

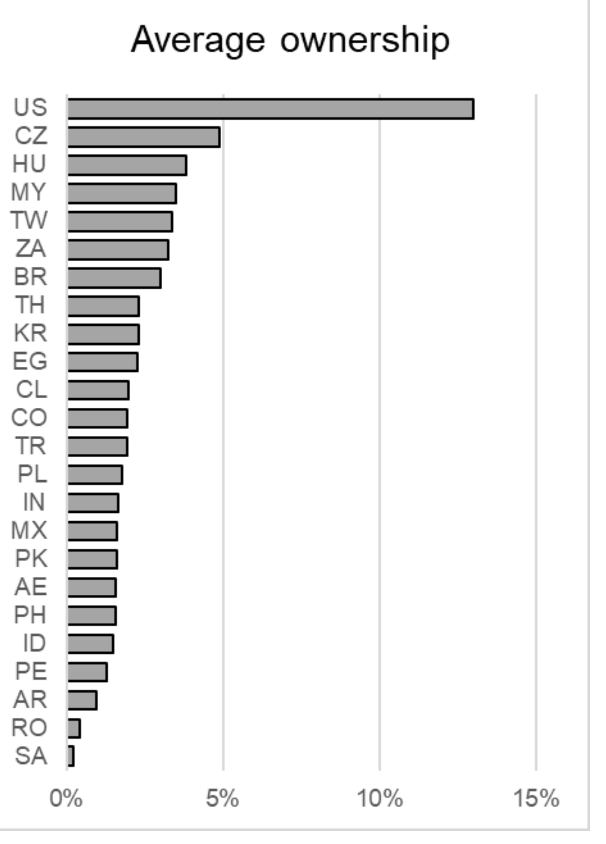
- Analysis of how three implications of asset manager capitalism both manifest in, and affect emerging markets' international financial subordination
  1. Financial (in)stability and external vulnerability
  2. Extensive financial accumulation/financialisation
  3. Structural power through voice and engagement

1. FINANCIAL (IN)STABILITY AND EXTERNAL VULNERABILITY

- Threat of exit remains due to still narrow and shallow exposure of asset managers to EM companies
- To the contrary, rise of AM in EM financial markets might increase vulnerability to global financial conditions and risk of large and sudden exchange rate and asset price movements, due to benchmark index following, global investment strategies, and specific liability structures (dollar and market-based; EM as growth assets)

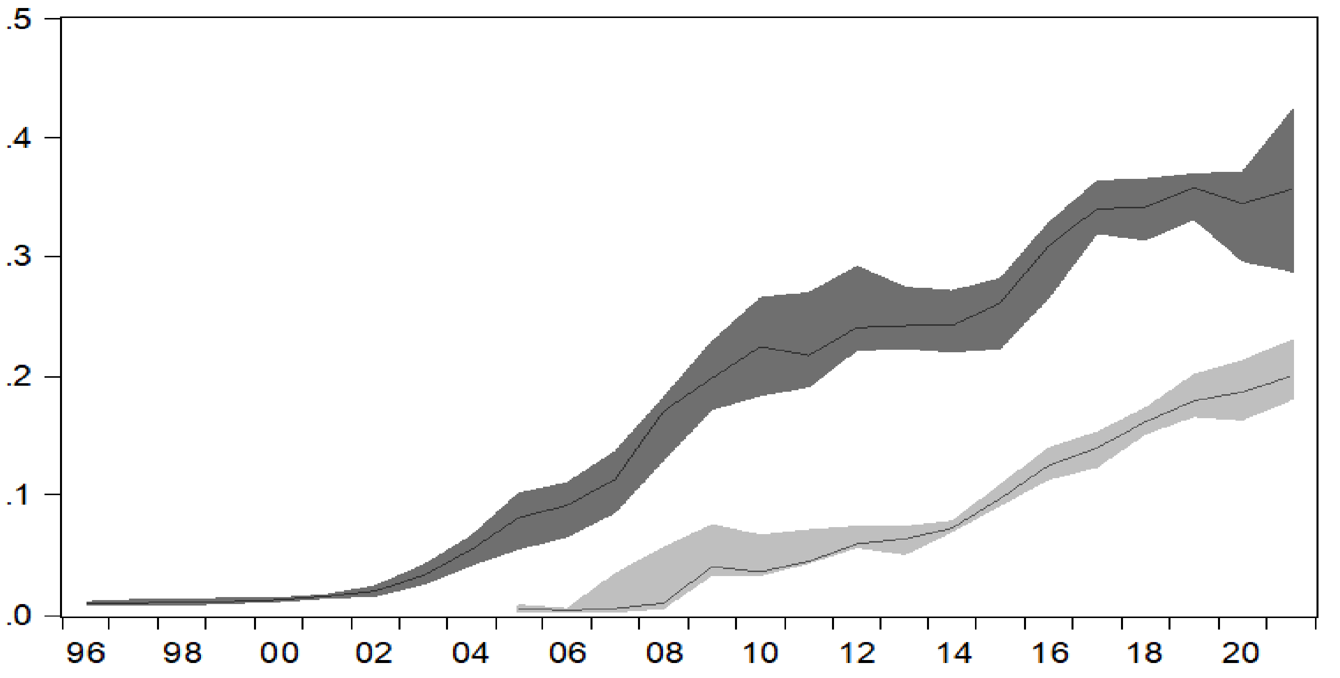
FINANCIAL (IN)STABILITY AND EXTERNAL VULNERABILITY – SHALLOW AND NARROW EXPOSURE





Source: ORBIS, we are immensely grateful to Albina Gibadullina for sharing her data with us

FINANCIAL (IN)STABILITY AND EXTERNAL VULNERABILITY – RISE OF PASSIVE INVESTMENT STRATEGIES



Source: EPFR. Notes: The graph shows the proportion of passive funds holdings to total equities (darker grey) and bonds (lighter grey) over time.

FINANCIAL (IN)STABILITY AND EXTERNAL VULNERABILITY

		VIX		*Broad dollar index*	
		Bonds	Equities	Bonds	Equities
Full sample	Total	0.35	0.27	0.47	0.44
	Active	0.38	0.26	0.48	0.43
	Passive	0.37	0.19	0.42	0.35
2010-2021	Total	0.45	0.28	0.58	0.55
	Active	0.45	0.24	0.55	0.43
	Passive	0.36	0.27	0.54	0.54

Source: authors' elaboration based on EPFR, FRED and BIS exchange rates. Notes: the table shows the ordinary correlation coefficients between the first principal component of the equity and bond flows, including their breakdown by passive and active funds.

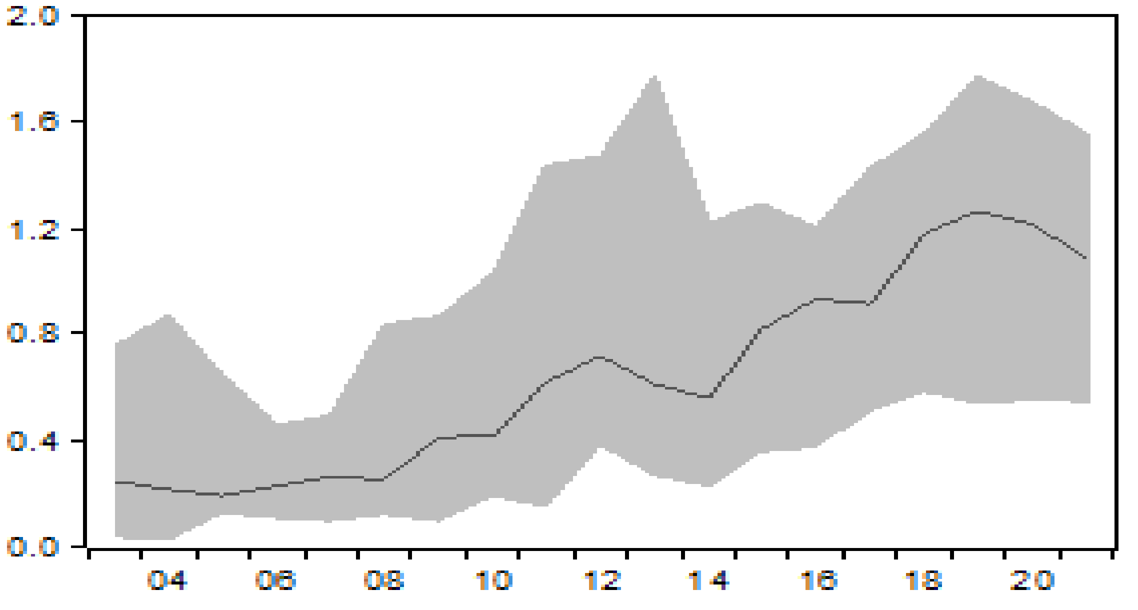
FINANCIAL (IN)STABILITY AND EXTERNAL VULNERABILITY – IMPLICATIONS FOR IFS

- Large asset price and exchange rate movements driven by global financial cycle undermine trust in local currencies and constrain domestic macroeconomic policy space
- At the same time, asset manager capitalism and market-based global financial system strengthen role of the dollar, for example:
  - investment funds are largely denominated in US dollars, independent of their location and headquarter
  - financial infrastructures and practices underpinning asset manage capitalism lead to a global segmentation of asset markets, which privileges the dollar as the safe assets

2. EXTENSIVE FINANCIAL ACCUMULATION

- Rise of asset managers leads to expansion of financial assets and institutional transformations to market-based financial systems in emerging markets (e.g. relative increase in capital markets; exchange traded funds; ESG), but in specific – subordinate – form
  - Somewhat skewed towards bond rather than equity markets
  - Concentrated in large firms and specific sectors (real estate and financials)

EXTENSIVE FINANCIAL ACCUMULATION – BOND VS. EQUITY



Source: EPFR. shows the median and interquartile range of the EPFR bond holdings to equity holdings over time. The right panel shows the same data for 2021 for all countries in our sample.

EXTENSIVE FINANCIAL ACCUMULATION – CONCENTRATION

	Top 5 concentration	Top Sector	Share of top sector
Argentina	0.95	Finance	70%
Brazil	0.43	Finance	28%
Chile	0.58	Wholesale and retail	42%
Colombia	0.75	Utilities	27%
Czech Republic	1.00	Finance	55%
Egypt	0.92	Finance	85%
Hungary	1.00	Finance	48%
India	0.40	Finance	37%
Indonesia	0.86	Finance	79%
South Korea	0.31	Manufacturing	59%
Malaysia	0.52	Finance	44%
Mexico	0.58	Manufacturing	26%
Pakistan	0.59	Mining	90%
Peru	0.98	Manufacturing	81%
Philippines	0.56	Real Estate	43%
Poland	0.55	Finance	43%
Romania	1.00	Finance	81%
Saudi Arabia	0.99	Real Estate	80%
South Africa	0.45	Finance	61%
Taiwan	0.42	Manufacturing	77%
Thailand	0.38	Finance	19%
Turkey	0.70	Finance	85%
United Arab Emirates	0.89	Finance	53%
United States	0.14	Manufacturing	42%

Source: ORBIS. The table is based on the investment of the 'big three' in EM equity. It shows the proportion of investments in the largest five companies to total equity investment, the largest NACED sector target by value of equity investment and its share to total investment.

EXTENSIVE FINANCIAL ACCUMULATION – IMPLICATIONS FOR IFS

- Asset manager investments concentrated in higher yielding, safe and liquid assets > no broad based financing for structural change
- Dualistic financialisation cements dualistic production structure
- New financial assets (e.g. ETFs) increase possibility of value transfer from emerging markets

3. STRUCTURAL POWER THROUGH VOICE AND ENGAGEMENT

- Little evidence that large asset managers exercise their structural power through active voice or engagement (neither corporate governance nor macroeconomic policy)
- Structural power through "writing the rule of the games" - both institutionally and ideationally - which circumscribe the operations of agents (Strange, 1998; Dafe et al 2022; Gill and Law 1989; Petry, 2021)

STRUCTURAL POWER THROUGH VOICE AND ENGAGEMENT

Interviewee 3: "*the policies are important, but the impact is not direct… they are just following rules. The rules are super clear, since the beginning … and if you don't fulfil your requirements, you are going to be out of the ETFs, that's it, it's super simple. So it's actually not the ETF trying to change your behaviour or your policies.*"

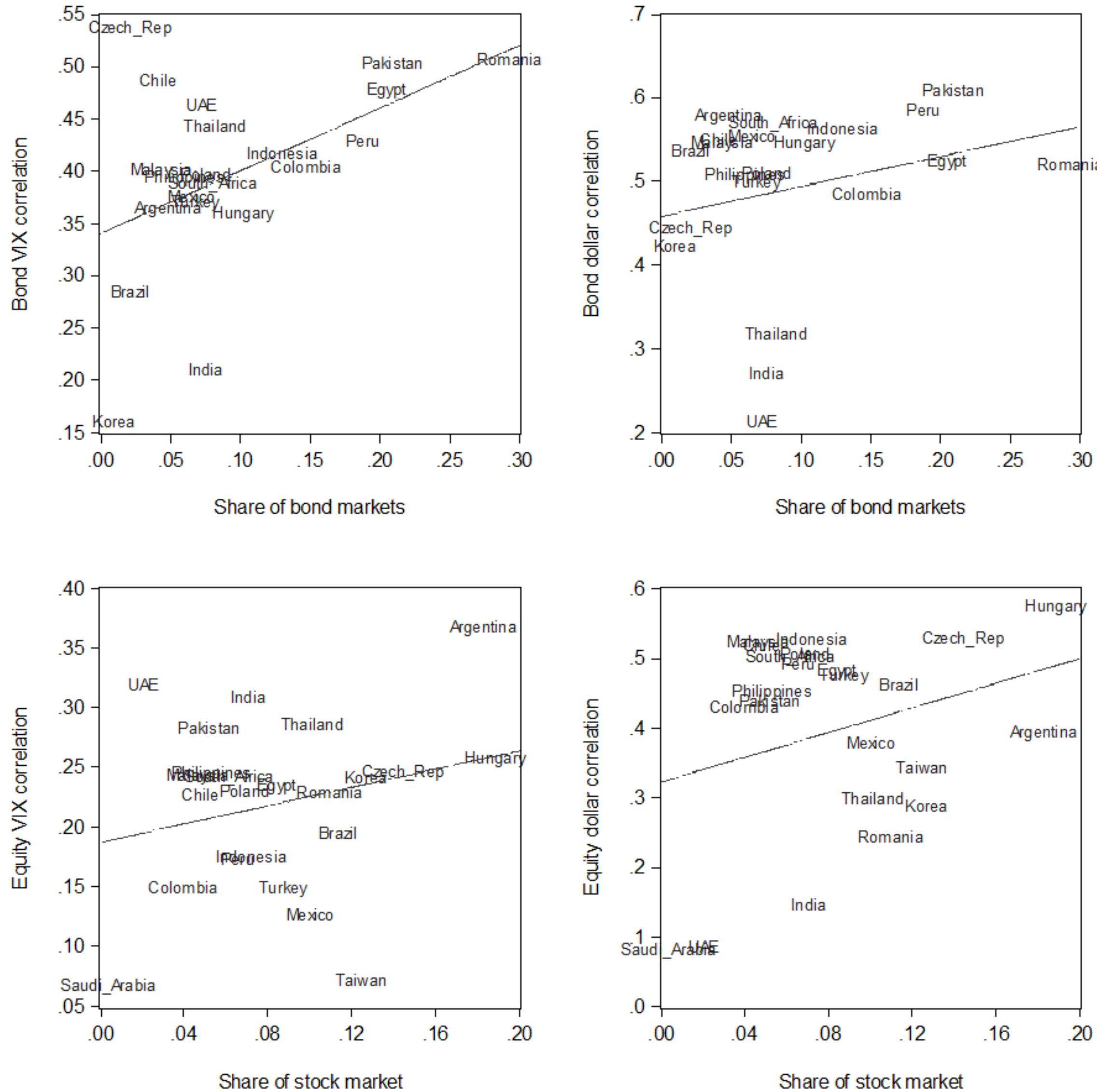
Also, Interviewee 5: "*But yeah, we're having a rules based system….where the implementation has been, there there's a track record of implementation, enforcement, etc.*"

STRUCTURAL POWER THROUGH VOICE AND ENGAGEMENT – IMPLICATIONS FOR IFS

- Potentially some more room for macroeconomic policy autonomy, but no fundamental questioning of rules (e.g. capital controls and/or defaults)

CONCLUSIONS

- Rise of asset managers in emerging markets, but not yet asset manager capitalism
- Some evidence that rising exposure of asset mangers to emerging markets cements external vulnerability, does little to provide finance for sustainable structural transformation, and further embeds emerging markets in the hierarchic structures of global finance



Bond VIX correlation
Share of bond markets
.55
.50
.45
.40
.35
.30
.25
.20
.15
.00
.05
.10
.15
.20
.25
.30
Czech_Rep
Chile
UAE
Thailand
Pakistan
Egypt
Romania
Indonesia
Colombia
Peru
Malaysia
South_Africa
Argentina
Hungary
Brazil
India
Korea
Bond dollar correlation
Share of bond markets
.7
.6
.5
.4
.3
.2
.00
.05
.10
.15
.20
.25
.30
Argentina
South_Africa
Indonesia
Mexico
Hungary
Brazil
Pakistan
Peru
Egypt
Romania
Colombia
Turkey
Czech_Rep
Korea
Thailand
India
UAE
Equity VIX correlation
Share of stock market
.40
.35
.30
.25
.20
.15
.10
.05
.00
.04
.08
.12
.16
.20
Argentina
UAE
India
Pakistan
Thailand
Hungary
Czech_Rep
Korea
Chile
Poland
Egypt
Romania
Brazil
Colombia
Turkey
Mexico
Taiwan
Saudi_Arabia
Equity dollar correlation
Share of stock market
.6
.5
.4
.3
.2
.1
.0
.00
.04
.08
.12
.16
.20
Hungary
Indonesia
Czech_Rep
Peru
Egypt
Turkey
Brazil
Philippines
Pakistan
Colombia
Argentina
Mexico
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Thailand
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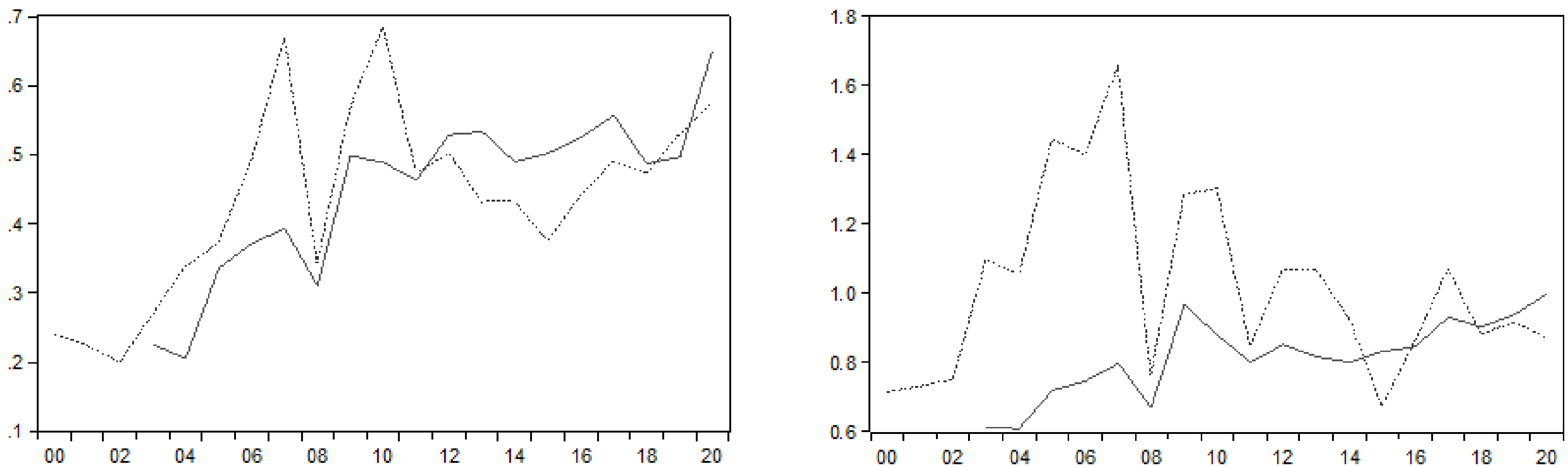
India
Saudi_Arabia
UAE

EXTENSIVE FINANCIAL ACCUMULATION – RISE OF LOCAL CAPITAL MARKETS



Source: World federation of Exchanges, BIS debt securities, World Bank World Development Indicators and Taiwan national statistical sources. Notes: the left panel shows median bond market (solid) and stock market (dashed) size to GDP, the right panel shows median bond market (solid) and stock market (dashed) to total credit to the private sector.