

1. Introduction

1.1 AFTER A STATE OF COMPLACENCY

The 2008 crisis shook the state of complacency that predominated in the mainstream of the economics profession, epitomized in the description of the 1990s and 2000s as decades of the ‘Great Moderation’ (Stock and Watson 2002; Bernanke 2004), or in the eulogy of Milton Friedman at his 90th anniversary, again by Bernanke (2002). Statements from around this period by Robert Lucas, Jr. (2003) reflect his optimistic assessment of the state of macroeconomic thinking at the time, saying that ‘macroeconomics in this original sense has succeeded: Its central problem of depression prevention has been solved, for all practical purposes, and has in fact been solved for many decades’ (Lucas 2003, p. 1). A few years later statements like these were ridiculed, as the crisis exposed the widespread ignorance in the mainstream regarding the trends and developments that led to the Great Recession, because the prevailing and most popular models made no room for the effects of finance on economic growth, not to speak of income inequality, a non-issue for the conventional discourse in academic economics (with some notable exceptions).

In the years that have passed, there has been growing awareness about some ignored processes that have come to the front of the debate, in part due to new popular books (notably, Piketty 2014) or due to renowned economists making their cases (as will be discussed below, regarding Summers). The recovery out of the 2008 crisis, slow by historical standards, has cast doubts on the growth prospects of developed economies, while at the time of writing this book a geographical reconfiguration in the pattern of growth is taking place in developing economies. The sluggish growth rates observed in advanced countries, and the fact that even the satisfactory growth rates of the United States observed in the 1990s and mid-2000s have been characterized by unsustainable bubbles (Palley 2012), have fed a debate about the possibilities for higher sustained growth and fears about a possible ‘secular stagnation’, an idea which made headlines in the 1930s and which was revived by Lawrence Summers (Summers 2014a, 2014b; Backhouse and Boianovsky 2015). Sluggishness or outright stagnation had previously been observed, amid wild fluctuations, in many developing

countries during the 1980s and 1990s, with some notable and perceptible exceptions in East Asian countries, which were able to maintain high rates of growth during a substantial period of time.

One other major development refers to the growing disparities in income appropriation between different classes and portions of society in the last 30 to 40 years, mainly in advanced countries but also in emerging economies. Larger shares of income accrued to a minority of the population, dubbed 'the one percent' (Galbraith 2012; Piketty 2014). When we look at the 'functional' income distribution, that is, a typology that classifies earnings into those derived from wages and those derived from profits, we also observe that the labour share of income has been on a downward path since the late 1970s and early 1980s. Some graphs will be presented below, but with politicians making a campaign flag of these inequalities in many countries, and with the coverage given even in the mainstream media, the reader is surely aware of the tectonic split in the pattern of income distribution which has operated since the 1970s in most of the capitalist economies, which have become so established that these can be safely called a stylized fact.

With more recognition in the mainstream literature we can highlight the ever larger amounts of capital flows across the globe, growing at a faster rate than international trade. Restrictions on financial movements between countries have been progressively lifted since the early 1970s, mirroring the financial deregulation operated at the domestic level in most advanced countries and in several developing economies. In fact, there was a huge 'traditional' argument on the benefits of these policies as soon as they started to be adopted, as set forth in McKinnon (1973) and Fry (1980), among others. Just as financial (and banking) market deregulation would help in the development of those markets, increasing savings and canalizing them into more profitable and efficient investment, so would capital account openness enable access to foreign savings, supplying the necessary funding to develop domestic financial markets and compensate the existent lack of savings (and resources), alleviating at the same time the restriction of economic expansion due to low foreign reserves and deficits in the balance of payments, or at least the recurrent shortage of foreign exchange. And financial flows did increase, both to developed and emerging countries, but in a volatile fashion that the traditional argument could not explain. In addition, they did not necessarily flow where they were supposed to, and their volatility did not prevent balance of payments crises by disciplining borrowers and lenders; quite to the contrary, at times these were provoked or exacerbated by sudden movements of foreign capital.

Three developments happened concurrently: slower rates of growth, increased income inequality, and greater financial flows coupled with

financial crises. Is there a connection between them? Can these processes be accommodated into a comprehensive theoretical framework? Is there empirical value in pursuing this approach? What is the contribution we could make?

The relation between income distribution and growth is at the very foundation of Political Economy (and later, economics) as a discipline. However, with some exceptions the interaction between distribution and growth was excluded by the mainstream as a topic of discussion up until the crisis, revisited only by the heterodox fringe of academic economists, which comprises a rather wide variety of schools of thought. Within the heterodox literature, the Kaleckian approach stands out, as it represents (in our opinion) the most systematic attempt to tackle this interaction between inequality and growth (Rowthorn 1989 [1981]; Lavoie 1992, 1995b; Blecker 2002). Developed and enlarged precisely in the period to which we are referring, starting in the early 1980s, the Kaleckian approach, which will be revisited in the next chapters, has been providing insights into the multiple channels through which different patterns of income distribution may affect economic performance, even in a contradictory manner.

However, there is a gap in the (Kaleckian) literature, which refers to the absence of consideration given to 'hot money': financial flows of different duration between countries that affect not debts and credits but penetrate and distort the productive structure, investment decisions and income distribution in non-neutral ways. The objective of this book is to make a contribution in filling this gap, both at the theoretical and the applied level, showing and discussing examples and theoretical analyses, and performing our own empirical approximations with an analysis of different economies. The focus of the book will be on developing countries, because their rather limited financial markets tend to amplify the effects of financial inflows and outflows, even though the implications can be extended to some developed economies, as in the case of some European countries, for instance.

By way of introduction this chapter will present evidence on the three stylized facts that we have just mentioned. Thus we will first briefly summarize growth trends in different regions of the world, bringing out what in the view of this author is a notorious slowdown in world growth rates in comparison to the first three decades of the post-war period. Following this, we review evidence of recent distributional change. This book is not a thesis on the explanations of income inequality; however, some arguments regarding its development will be summarized. A politically charged topic has politically charged implications, and explanations are not neutral in terms of the implications for different groups of the population. Finally, we will revisit major trends in global capital flows, to give the reader an impression of the gigantic change in magnitudes that has happened in

the post-Bretton Woods period. At the risk of repetition, the main thesis of this book is that the contemporaneous coincidence of these three big changes has not been a coincidence, to make a redundant point.

1.2 FEAR OF STAGNATION?

In 2014 Lawrence Summers, former US Secretary of the Treasury, gave a provocative speech in which he revived a 1930s' discussion around the likely stagnation of the US economy and its causes (Summers 2014a). Summers manifested that the US economy proved to be unable to maintain persistently high rates of growth without being propelled by financial bubbles, that is, it was unable to grow while maintaining financial stability. Similar things could be said about other developed countries such as Japan, or the members of the Eurozone. The piece sparked a heated debate, though Summers was not the first to notice such slowdown. Heterodox authors had already pointed to the substantial change in the macroeconomic regime operated in the previous four decades, noticeable not only in GDP growth but also in other indicators such as gross fixed investment, productivity and unemployment levels (Stockhammer 2004; Carter 2007; Barba and Pivetti 2012; Storm and Naastepad 2012). Table 1.1 presents the rate of change of GDP for selected countries and geographical regions, drawing on the World Development Indicators Database from the World Bank.

There are of course some divergences between and within regions and countries, with some East Asian countries performing better than others and than other developing countries, but overall we can confidently con-

Table 1.1 Real GDP average growth rates

	1966–69 (%)	1970–79 (%)	1980–89 (%)	1990–99 (%)	2000–09 (%)	2010–14 (%)
High income	5.56	3.81	2.97	2.46	1.88	1.88
Middle income	5.67	6.00	3.77	4.03	5.94	5.86
Subsaharan Africa	3.78	4.06	1.75	1.87	5.10	4.42
Latin America and Caribbean	6.37	6.96	2.52	2.70	2.95	3.60
Developing East Asia and Pacific	5.13	7.25	7.71	8.18	8.86	7.95
World	5.57	4.04	3.07	2.68	2.61	2.80

Source: World Development Indicators Database, World Bank.

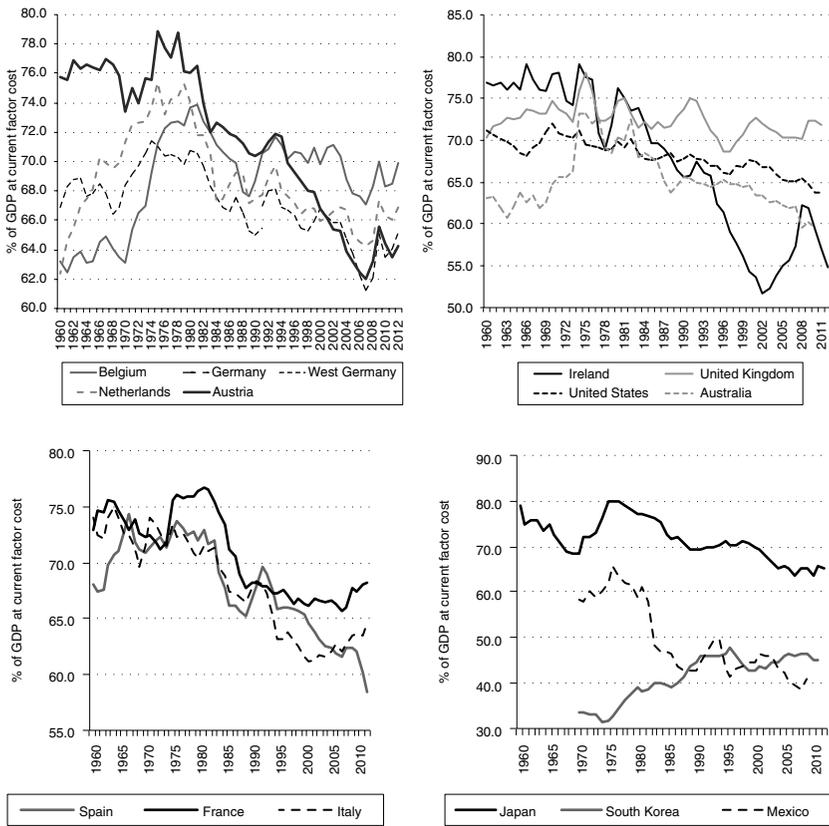
clude that the world economy has gone through a period of successive and more frequent crises (Arestis 2006) which, among other negative impacts, has diminished the rhythm of economic activity. However, this performance is not unexpected in the context of the big distributive shift that happened in the same period in many countries, according to the framework to be presented in the following chapters. It is time to describe this shift.

1.3 THE WAGE SHARE AND OTHER MEASURES

Figures 1.1a–d present the evolution of the adjusted labour wage share for several developed and some developing countries. In the first 12 countries presented, the series represent the evolution of the adjusted wage share of income, with data taken from the Annual Macro-Economic (AMECO) database of the European Commission. In the case of South Korea, the graph shows the evolution of the ratio of compensation of employees to GDP, both registered in won at current prices. The data are from the Bank of Korea. Finally, for Mexico, we use the Labour Income Share of the Total Economy for the wage share, drawn from the OECD database.

Most of the countries presented in Figures 1.1a–d are developed ones, and a significant change in income distribution is discernible in many of them (though not all) starting around the late 1970s to early 1980s. That change is found in countries with ‘strong’ labour market institutions (such as France and Germany) as well as in those ‘less-regulated’ labour markets (such as the USA and Ireland), but not in the UK, where there is no clear trend in the context of important fluctuations. Around that time, a decreasing trend is observable for the wage share. Those findings are corroborated by Jayadev (2005, pp.26–27), Bank for International Settlements (BIS) (2006), International Monetary Fund (IMF) (2007), OECD (2007), Rodriguez and Jayadev (2010) and Storm and Naastepad (2012, pp.116–122).

This result holds not only for major developed countries. The European Commission (2007, p.243) reports that since the mid-1990s, the labour income share has been on a decreasing trend for most new European Union member countries (Bulgaria, Estonia, Latvia, Poland and Slovenia, with weaker or increasing trends in the Czech Republic, Cyprus, Malta, Romania and Slovakia). Goldberg and Pavcnik (2007, p.54) affirm that ‘the evolution of various measures of inequality suggests that most of the developing countries experienced an increase in inequality during the past two decades’. The International Labour Organization (ILO) (2011, p.56) states that ‘since the early 1990s, the wage share . . . declined in nearly three-quarters of the 69 countries with available information. The decline



Source: AMECO database for Australia, Austria, Belgium, France, West Germany/ Germany, Ireland, Italy, Japan, the Netherlands, Spain, United Kingdom and United States; OECD database for Mexico; own calculations based on data from the Bank of Korea for South Korea.

Figure 1.1a-d Adjusted wage share as % of GDP

is generally more pronounced in emerging and developing countries than in advanced ones.' Stockhammer (2013, Figure 2) shows similar trends starting from an early period (roughly, early 1980s) for a number of developing countries, according to data availability.

These features also hold for different indicators of income inequality. Hein (2011, pp.8–9; 2015) notes a worsening of the Gini coefficient before taxes for the US, Japan, the UK, Germany, Italy and other developed countries, and similar results hold for the Gini coefficient after tax. Regarding the top income shares, the seminal work of Atkinson, Piketty

and Saez (2011) shows a clear increase in the share of income accruing to the top 1 per cent, a trend starting in the early 1980s, in the US, UK, Canada, Ireland, Australia and New Zealand (all English-speaking countries); China, India and Argentina. The trend in continental Europe is more nuanced, as well as in Japan. OECD (2008) also finds similar patterns. Half of Piketty's book (2014) is dedicated to analysing movements in inequality, as is the recent contribution of Atkinson (2015).

What arguments have been presented to explain these developments? Stockhammer (2009, 2013) carries through a thorough review of the literature, but we can present a sketch of the theories at stake, following his presentation. The explanations can be classified into four groups, with some degree of overlap, and which are not necessarily mutually exclusive. Since in neoclassical economics income shares are determined by marginal productivity (Hicks (1966) is the classic on the topic), this approach says that skill-biased technological change represented by the development of information and communication technology (ICT) is the main driver of the increasing disparities in personal distribution, as well as in functional distribution, since it is a labour-saving technical development. Among supporters of this argument, one can mention Bentolila and Saint-Paul (2003), Jaumotte and Tytell (2007), IMF (2007), European Commission (2007) and Rajan (2010, pp. 24–26 and the references quoted therein).

Two other key factors are globalization and bargaining power. On globalization, interpreted as increased trade openness and capital mobility, the above-mentioned work by Goldberg and Pavcnik (2007) provides substantial empirical support, though they caution that 'the particular mechanisms through which globalization affected inequality are country, time and case specific; [. . .] the effects of trade liberalisation need to be examined in conjunction with other concurrent policy reforms' (p. 78). Their results are in line with those of Wood (1997), IMF (2007) and ILO (2011), though in the latter case results are not so robust for Latin American countries when one takes into consideration labour market deregulation.

Globalization itself has diminished the bargaining power of labour, and coupled with labour market deregulation has affected negatively the labour income share. Globalization is not the only factor affecting bargaining strength, but the effect of labour market institutions is complex to measure. In general, a robust finding in most studies is that greater wage bargaining (not at a firm level but rather at a sectoral or higher level) increases the wage share (Checchi and García-Peñalosa 2005). The ILO (2011) finds a similar impact of union density, though European Commission (2007) and IMF (2007) do not get those results. The impact of labour market deregulation on income inequality has been defended, rather surprisingly, by the former Chairman of the Federal Reserve Board, Alan Greenspan,

in his testimony before the US Congress, in 1997, though he also stressed the impact of technical change on the bargaining position of workers and their 'job insecurity'. To quote at length:

A typical restraint on compensation increases has been evident for a few years now and appears to be mainly the consequence of greater worker insecurity, possibly owing to the rapid evolution of technologies in use in the workplace. Technological change almost surely has been an important impetus behind corporate restructuring and downsizing. Also, it contributes to the concern of workers that their job skills may become inadequate.

Certainly, other factors have contributed to the softness in compensation growth in the past few years. The sharp deceleration in health care costs, of course, is cited frequently. Another is the heightened pressure on firms and their workers in industries that compete internationally. Domestic deregulation has had similar effects on the intensity of competitive forces in some industries. In any event, although I do not doubt that all of these factors are relevant, I would be surprised if they were nearly as important as job insecurity. (Greenspan 1997)

The fourth argument presented as an explanation of the declining wage share and the increase in personal income disparity is financial deregulation, financial openness and the overall process of 'financialization' of developed and developing economies. The arguments are summed up in Hein (2012, Chapter 2) and extended in Hein (2015), where the author sketches the theoretical channels through which the wage share might be affected by the financialization process, defined as 'the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies' (Epstein 2005, p.3). A more detailed explanation of the concept, its bearing in the expansion of the financial sector and the process of debt accumulation by the private sector is provided in Palley (2008, 2013).

If the wage share of the financial sector is lower than in the non-financial sector, then a shift in the sectoral composition of the economy in favour of the former will tend to reduce the aggregate wage share. The increase in the size of the financial sector, along with its impact on real productivity, is treated in Cecchetti and Kharroubi (2012), who study the relation of different indicators of financial development (private credit growth, bank credit, financial sector share in total employment) to economic growth and productivity growth. They find that the relation is that of an inverted-U shape, which implies that too large a financial sector has negative consequences on the economic performance, in their view due to a competing force with the real sector for scarce resources (Cecchetti and Kharroubi 2012, p.14). The value added by the finance and insurance industry as

a share of the US GDP certainly rose from less than 4 per cent in 1960 to 8 per cent in 2011, according to data from the Bureau of Economic Analysis. Philippon (2012) reached similar results, and the same trend was found in the UK by Burgess (2011), at least since 1995.

In turn, Dühaupt (2012) finds that the wage share of the finance industry is lower than in the non-financial sector, which coupled with the structural shifts recorded by Cecchetti and Kharroubi (2012) among others provides some support for that thesis in which responsibility is assigned to a larger preponderance of the financial sector in the economy. Stirati (2010b) also counts the development of the service sector (including finance) as a major factor in the change of income distribution in Italy and other European countries.

Another stylized channel through which financialization has affected the wage share, and income distribution in general, is through the substantial increase in top management salaries, and capital gains on financial asset holdings. Lazonick (2011, 2012) and Lazonick and O'Sullivan (2000) analyse the changes in the management of corporations and their increased appetite for stock buy-backs, and therefore share price increase as a significant source of income. Wolff and Zacharias (2009) affirm that returns from asset holdings and different types of wealth associated with rentiers' income play an important role in explaining the evolution of income inequality in the US. Epstein and Power (2003), Epstein and Jayadev (2005) and Hein and Schoder (2011) highlight the importance of interest payments as an increasing proportion of the profit share for OECD countries, lending more support to the importance of higher rentiers' income for earnings inequality. Other studies with results broadly in line with those presented above are ILO (2011) and Orhangazi (2008), in the latter case dealing with the US economy.

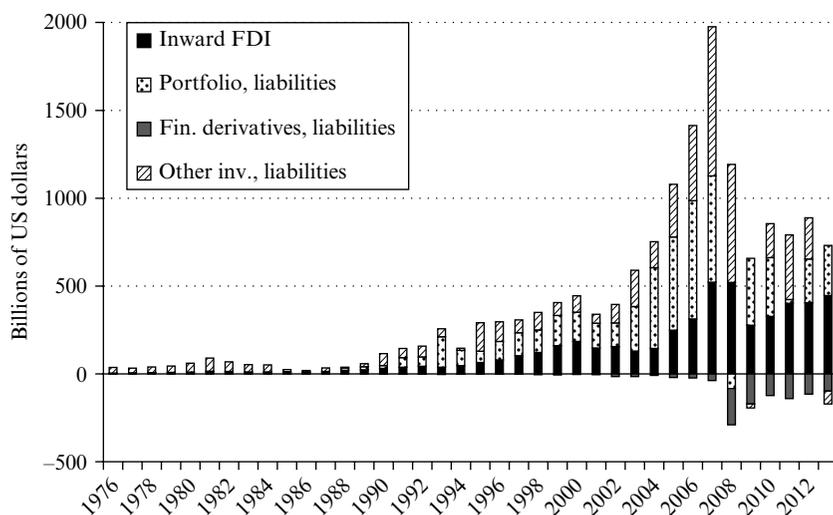
A recent study by Dabla-Norris et al. (2015) gives support to almost all the explanations listed above. Finally, Jayadev (2005, Chapter 2) finds a significant negative impact of capital account liberalization on the wage share for over a hundred countries, using panel data from the United Nations National Accounts Statistics Database. These results match those from Stockhammer (2009), who also finds a negative effect of financial globalization on income distribution, and the findings by Furceri, Jaumotte and Loungani (2015), a paper we will discuss in Chapter 5. But now we turn to see some characteristics of this 'financial globalization'.

1.4 INTERNATIONAL CAPITAL FLOWS

Following the breakdown of the Bretton Woods international payments system, there has been an upsurge in financial movements across the globe. The restrictive policies regarding the financial system that came up from the post-war agreements slowly but steadily eroded, and what Keynes called a new orthodoxy was replaced by its opposite, namely the belief in and the pursuit of liberalized financial markets (Helleiner 1994). The literature on the evolution of capital and financial flows since the 1970s is almost infinite, and so are the perspectives from which the subject is approached.

When we look at global financial flows, two important characteristics are evident to the naked eye: the increase in financial flows and their volatility, particularly when focusing on emerging markets. In Chapter 5 we will show in greater detail more disaggregated features.

Taking data from the IMF Balance-of-Payments Database, Figure 1.2



Note: Selected countries include: Argentina, Brazil, Bulgaria, Chile, Czech Republic, Greece, Hungary, India, Indonesia, Ireland, Israel, Malaysia, Mexico, Poland, Portugal, Russia, South Africa, South Korea, Spain, Thailand and Turkey. Data for all these countries are available only from 1994. From 2005 they follow the criteria of the Balance of Payments Methodology 6.

Source: Author calculations based on UNCTAD database and Balance-of-Payments Database, IMF.

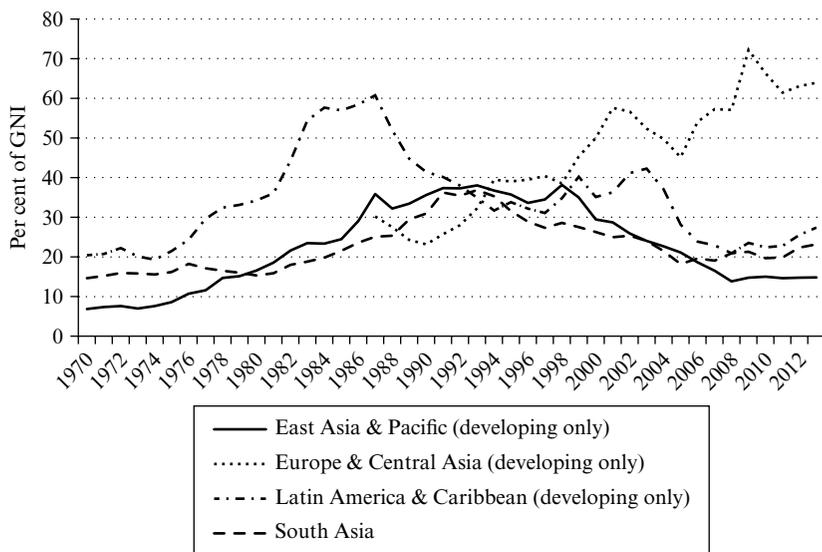
Figure 1.2 Change in foreign liabilities in selected countries 1976–2013

shows the increase in foreign liabilities of selected countries, that is, foreign inflows/outflows, for the period 1976–2013. We include among the countries some emerging economies such as Argentina, Brazil, India, South Africa and Turkey; former Soviet or communist countries such as Bulgaria, the Czech Republic, Poland and Russia; and high-income countries such as Israel, South Korea and Spain, among others. The components of liabilities, as reported by the IMF, are portfolio flows, direct investment, financial derivatives and other investment liabilities. We will explain the main driver of ‘other’ liabilities in a moment, but first we present the overall picture.

Several conclusions can be extracted from Figure 1.2. First of all, private financial flows to emerging economies have increased substantially, particularly in the last two decades. In second place, even though net direct investment seems to constitute the bulk of foreign flows, the other two components (portfolio and other private flows) have the most volatile behaviour, with fluctuations widening with the lapse of time. Thirdly, it must be remembered that these are foreign inflows. Possible outflows by residents, which can be acute in episodes of crisis, are not measured. And finally, when we examine what those ‘other’ liabilities are, we see that they are strongly correlated with periods of expansion and contraction of international bank lending, particularly related to US banking exposures. Since the decade of the 1980s in which US banks were in difficulties due to the Latin American debt crisis, the expansion of US (and other developed countries’) banks has been a major driver of the international liquidity, with the crisis episodes clearly reflected in the data (Chandrasekhar 2008, pp.9–11). The recent divergence between the claims of US banks on the rest of the world and the decline in other private flows is likely to be a reflection of the Eurozone crisis and the retraction of foreign lending by and to European banks.

Figure 1.2 has already given some indications regarding the widening in the fluctuations of capital movements. One explanation is that current account deficits and surpluses have reached magnitudes unseen in previous decades, both in nominal terms and in real terms, and in proportion to economic activity. Another feature that can appear in the data is that private flows did not necessarily flow to countries that need the funds to equilibrate their foreign balance, but also to countries that do not require in principle foreign savings, since they are becoming net creditors (as implied by a positive current account). That is clear in Asian countries but also in many Latin American and Middle East countries during certain periods.

The opposite side of this explosion of financial flows is an explosion of foreign debt. External debt peaked at different times in different regions, since the opening of the capital account and the internal



Source: World Development Indicators Database, World Bank.

Figure 1.3 External debt as percentage of gross national income

financial deregulation process did not occur at the same time everywhere, but the timing and the changes leave no place for doubt. Figure 1.3 shows the evolution of external debt as a percentage of gross national income (GNI).

In the 2000s, external debt fell as a share of GNI in the regions presented above, except for developing Europe and Central Asia. However, the debt build-up during the 1990s coincides with the integration into world financial markets, and that can also be seen in the East Asian countries and Latin America as well. The 1980s were a decade of economic stagnation for Latin America, and the increased foreign borrowing of the late 1970s (jumping from 22 per cent of GNI in 1975 to 36 per cent in 1981) was a major cause of such breakdown, and it was the ensuing long-lasting recession that kept the debt constraint at such high levels. In the East Asian case, something similar occurred during the 1990s, but the channels of transmission were different, something that will be analysed in greater detail in Chapter 5. The current account surpluses of the 2000s helped to ease the burden of foreign debt. But the number of balance of payments crises in the last 30 years is too high to be ignored. Mexico in 1982 and 1994; Argentina in 1980–1982, 1995 and 1998–2001; Brazil in 1994 and

1998; Chile in 1981–1988; South Korea, Thailand and Indonesia among others in 1997; Russia in 1998; Turkey in 2001; and the list continues.

1.5 ORDER AND AIM

The book studies the interaction between economic growth, income distribution and (private short) financial flows in an integrated analysis within a Kaleckian framework, which draws inspiration from the work of Michal Kalecki, a Polish economist contemporaneous to Keynes.¹ Lavoie (2014, Chapter 2) sets out the main differences between the Kaleckian approach (and generally post-Keynesian economics, of which Kaleckianism is a branch) and the mainstream or orthodox economics. Even though this book does not aspire to be a treatise on epistemology, it is important for our purposes to highlight some significant differences between the Kaleckian approach and mainstream economics. In particular, Kaleckian economics rejects the optimizing approach to agents' modelling, due to procedural capabilities, uncertainty about the future and multiplicity of objectives, all concerns for a realistic understanding of the economy (Lavoie 2014, p. 12). Secondly, as will be explained in Chapter 3, Kaleckianism adopts an institutional classification within a holistic approach, in which interactions between agents can generate results totally distinct from the original aims of the individuals, so called 'paradoxes'. A typical paradox is the 'paradox of thrift', in which individual attempts to increase savings will reduce income if the objective is pursued by everybody at the same time, frustrating the original intent. Kaleckian economists (as will be explained and developed in the next chapter) emphasize another paradox, the so-called 'paradox of costs': attempts to increase profits by reducing wages may cause abrupt drops in aggregate demand, reducing overall profitability.

The fact that the outcome of the interaction between income distribution and growth is ambiguous and can go in several directions is the core insight and major innovation of the Kaleckian approach. It also provides the justification for our attempt to use it as the ship in which we set out to navigate the study of the impact of financial flows on economic expansion and the sharing of such effects among the different sectors of the society. In order to put that in context, then, Chapter 2 will review how different schools of thought dealt with this interaction of economic growth and income distribution, one of the earliest and most defining fields of political economy as a discipline.

Chapter 3 will go deeper into the contributions of the Kaleckian approach to growth and distribution. The chapter will not only try to show the theoretical underpinnings of that framework, plus some

discussions it elicited, but also how it gave place to numerous empirical studies to assess the relationship between income distribution and growth. We will also present our own empirical analysis, using two different econometric modelling approaches to the topic based on Argentinean data (1950–2006).

Chapter 4 is a first step into analysing in detail the interaction of global finance with growth and income distribution. In that chapter, we develop a Stock-Flow Consistent model, in which ‘everything comes from somewhere and goes somewhere else’. We can also call it a ‘follow-the-money’ model, for that very same reason. It is a model in which we depict two countries that trade goods and financial assets between them. The defining feature of the model is a structural (core–periphery) asymmetry between these two countries. In particular, the government and the firms of one country can borrow not only in their own currency but also in the other country’s currency, something very common in emerging economies, whereas the other country can always borrow in its own currency. The asymmetry is that the first country holds foreign debt denominated in the currency of the other country, while the second country holds debt in its own currency. We must note here that the stock-flow modelling methodology is not introduced as a *deus ex machina* into the analysis. A review is conducted in Chapter 4 presenting its characteristics, origins, developments and pertinence for the aim of this book.

With this model in hand, we perform several simulations which give us insight into the interactions and interdependence of distribution, savings and financial constraints of developing countries when faced with external debt accumulation in a foreign currency, as well as a more generally valid picture of fiscal performance, domestic savings, current account imbalances and financial flows.

The simulations made in Chapter 4 allow us to draw important conclusions to include in the model presented in Chapter 5, an authentic one-country Kaleckian model that incorporates foreign private debt, which has been markedly on the rise since the turn of the century, as shown by a more thorough revision of global financial flows presented in that chapter. After analysing how well this model can explain developments of certain countries and analysing its usefulness for empirical purposes, we review the challenges and policy options for emerging economies that are immersed in the ebb and flow of ‘hot money’, speculative capital that travels from one destination to another in a non-neutral way. Novel ways to protect one’s economy from the dangers that these flows pose will be presented. The last chapter will present some final thoughts on the general philosophy and most important ideas that the book tries to convey.

NOTE

1. Well known biographies of Kalecki are Feiwel (1975), López G. and Assous (2012) and Toporowski (2013), among others.