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Financial Globalization, Social Exclusion and Financial Crisis

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ABSTRACT *This paper suggests one set of mechanisms that ties financial globalization processes to local dynamics of financial inclusion or exclusion. Specifically, this paper explores the worldwide reconsideration of financial firms' strategies that has accompanied financial globalization. It is shown that the neoliberal and asymmetric-information approaches to credit markets and financial crises in developing economies overlook these dimensions of financial globalization because of their tendency to focus on representative credit markets. Banks' strategic shift has led to the global homogenization and stratification of financial practices—and this in turn has been a key driver of processes of financial exclusion. Financial exclusion then involves bifurcation within financial markets, so that different markets serve different portions of the household and business population. This analysis suggests a reconstruction of Minsky's microfoundational model of the origins of financial fragility and crisis, which shifts from Minsky's emphasis on a representative borrower–lender relationship to a situation of borrower–lender relationships in bifurcated markets.*

KEY WORDS: Financial globalization, financial exclusion, financial fragility, banks, banking strategy

JEL CLASSIFICATIONS: D21, D82, F02, G10

Introduction

Every nation is increasingly integrated into global financial and trade flows; the financial sector in virtually every nation is in the midst of epochal change. In many nations, activists and social scientists are raising concerns about increasing financial exclusion. This paper asks two questions about these coincident phenomena. First, how are credit markets, especially in developing areas, being affected by the current phase of financial globalization? Second, what are the links between financial globalization and social exclusion? These two questions have received very different amounts of attention: the first, an outpouring; the second, very little.

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Globalization and Credit Markets in Developing Areas

Economists and policy-makers have largely interpreted financial globalization as involving the homogenization of formerly idiosyncratic national systems. One approach within economic theory has then been recruited to demonstrate the superior efficiency (hence logical necessity) of homogenized (and therefore modern) financial systems. This is the angle of insight of most IMF and World Bank economists.[1] Another approach, associated with the increasingly outspoken Joseph Stiglitz (2003a, 2003b), asserts that market-opening has led to financial crises and reduced economic efficiency.

So a debate has emerged, focusing on a policy disagreement about the effects of increased cross-border capital movements and a theoretical disagreement about the significance of asymmetric information in credit markets. The efficient-market view sees cross-border capital flows as means of instilling market discipline in systems that are otherwise prone to rent-seeking and excessive risk-taking. Stiglitz' approach denies that autonomous financial systems are necessarily dysfunctional; instead, they often embody effective nation-specific solutions to principal–agent problems in credit markets. Cross-border financial flows controlled by uninformed investors heighten the likelihood of a serious financial shock; these investors' flight response then magnifies any shock's severity. Thus, financial crises can trigger the dismantling of the information-intensive national financial systems that have facilitated development.

In the neoclassical/asymmetric-information debate, then, financial globalization has the primary impact of reducing national barriers to cross-border financial flows, leading to larger volumes of these flows; and what is at stake are the national financial systems' capacity to aid in development by solving asymmetric-information problems in their home markets. One approach attacks autonomous national banking systems, while the other supports them.

Globalization and Social Exclusion

Social exclusion in the financial realm—that is, 'financial exclusion'—refers to the failure of the formal banking system to offer a full range of depository and credit services, at competitive prices, to all households and/or businesses. The systematic exclusion of households and/or businesses from 'financial citizenship'—on the basis of race or ethnicity, geographic area, gender and so on—compromises their ability to participate fully in the economy and to accumulate wealth.

In contrast to the voluminous literatures discussed above, the question of how financial globalization processes have affected social exclusion has received little attention. This inattention may be due in part to the fact that while the term 'financial exclusion' is relatively new, the social phenomenon it describes is not. The world over, most lower-income households and areas have been served largely by informal financial institutions, at higher transaction costs and more onerous loan terms than others pay. In effect, large portions of many countries' populations have been chronically financially excluded.[2]

The notion of financial exclusion was implicit, though not named, in the long-established traditions of empirical work on informal credit markets in developing nations, and on racial discrimination and redlining in US credit markets.[3] The explicit notion of financial exclusion emerged as one of the key concepts in the emerging geography of money and credit in the last decade.[4] This new geography

of money and finance focuses in particular on the unequal distribution of credit and of banking services over space (Dymski, 1999; Reibel, 2000; Pollard, 2003); and it explores the role of financial institutional structures and credit flows in creating and transforming urban places (Dymski & Veitch, 1992, 1996). These dual emphases parallel the thematic concerns of the economic-development sub-literature on finance and development.

So the idea of 'financial exclusion' has provided a unified way of viewing financial processes and comparative institutional arrangements in lower-income and upper-income societies. Its articulation has involved a generalization of the idea of race-based discrimination in banking markets, to encompass customer–class distinctions other than race and ethnicity *per se*. This new terminology also opened the way to bolder and more extensive comparative analyses of national and regional credit and banking markets. For example, rural households in northern or western portions of England might be considered financially excluded as a result of structural comparisons with the financial services and terms and conditions of credit available to households in suburban London.

While the literature on financial exclusion has been growing explosively, the question of how financial exclusion *per se* has been affected by financial globalization processes has received surprisingly little attention. Some work on informal financial markets in Africa investigates the impact of financial liberalization on informal financial markets there (Steel *et al*., 1997; Nissanke & Stein, 2003). This work finds that liberalization has only marginally affected the scope and size of the informal market—in these authors' view, largely because the factors that have consigned many economic agents to this sector—such as highly variable and low income streams, and missing information—remain in place. However, this question has been largely overlooked in literatures that consider other areas of the developing world and/or that consider zones of financial exclusion within upper-income countries. Four reasons for this lacuna can be postulated: first, many who equate liberalization with financial modernization think they already know the answer to this question; second, many nations in the global South have been beset by macro-financial crises, which have lessened attention to micro-financial dynamics; third, cross-border lending to the global South, a defining feature of financial globalization, has itself declined since the Asian crisis; fourth, the explicit literature on financial exclusion postdates the onset of the age of financial globalization in the 1980s.

Among geographers, discussion of financial globalization has revolved around a debate between those who assert that globalization signals the irrelevance of geographic place (for example, O'Brien, 1992) and those who insist on the continued significance of local dynamics in credit and money processes (Thrift, 1996; Leyshon & Thrift, 1997). If the local continues to matter and if local instances of financial exclusion are emerging, how do financial globalization processes *per se* affect these localized dynamics? This question has yet to be addressed. This paper suggests one set of mechanisms that ties financial globalization processes to local dynamics of financial inclusion or exclusion. Specifically, this paper explores the worldwide reconsideration of financial firms' strategies that has accompanied financial globalization and argues that it has led to the global homogenization and stratification of financial practices. This homogenization and stratification process is a key driver of processes of financial exclusion; its increasing importance in global financial markets suggests a reconstruction of the microfoundations of Minsky's financial fragility hypothesis.

We proceed as follows. The next section identifies the strategic and market-access dimensions of financial globalization, on which discussion here centers. The third section summarizes the neoliberal and asymmetric-information approaches to credit markets and financial crises in developing economies, and shows that they overlook these dimensions of globalization. This is followed by a section that describes how globalization in the sense defined here leads to bifurcation within financial markets, so that different markets serve different portions of the household and business population. The penultimate section reconsiders the microfoundations of financial crises in the context of this bifurcation process and the final section reaches conclusions.

Financial globalization as strategic imperative and as market access

Economists have tended to measure financial globalization by assessing whether financial flows across national borders are increasing in volume. Extensive empirical work has not clearly demonstrated that they are (see Bayoumi, 1997). Here we develop an alternative criterion for globalization, building on the work of Cerny (1994). He suggests that financial globalization also be measured by organizational changes: the development of both integrated worldwide market structures and of firms with the organizational capacity to center their activities on these markets. Globalization in this sense is well advanced: there now exist a set of globally mobile firms whose operations and strategies rely on, and help to extent, a set of integrated world financial markets.

It is useful to extend Cerny's insight to include the globalization of standard sets of financial practices and products. This brings in not just specifically globalized financial firms, as in Cerny's definition, but other financial firms and also the demand side of financial markets. To the extent that households and firms with given levels of financial resources and funding needs in any given country are able to obtain financial instruments that are closely similar—in terms of risks, contractual terms and costs—to households and firms in any other country, the global financial system can be said to be globalized. Examples of units 'with given levels of financial resources and funding needs' are wealth-owners with financial asset holdings totalling US $50–100,000 and high-technology startup companies seeking working capital. Financial globalization in this third sense involves the global homogenization of financial products for similar classes of customer.

We can then measure financial globalization according to the extent of firms' and/or households' *global financial-market access*: the extent to which any wealth-holder in any nation can, with minimal transaction costs, freely purchase any financial asset emitted anywhere else in the world. The spread of globalization in this sense corresponds to a decline in national governments' capacity (or willingness) to restrict their national wealth-holders' global financial access. An alternative measure of financial globalization can be derived by measuring the global spread of *financial citizenship*: the proportion of households and firms that have ready access to traditional banking services offered by formal-sector, financial-sector firms subject to regulatory oversight.

There is no question that globalization in the first sense is progressing steadily. The 'big bang' in Japan's consumer banking markets in July–August 2000 provided a dramatic instance of this type of globalization. With substantial fanfare (including a four-page spread in leading newspapers), Citibank introduced a new account offering free checking and many investment and other financial options

for upscale consumer customers. A million yen (about US $9000) was required as an initial deposit. This account was very similar in design and in its cost and return profile to accounts that have been widely available to US households with sufficient minimum balances in the previous decade. In effect, Citi's new Japanese account involved a large step toward the homogenization of upscale consumer banking markets.

The progress of globalization in the second sense—that is, the growing percentage of households with access to traditional formal-sector banking services—depends largely on how 'traditional banking services' are defined. The contrast between this second definition of financial globalization and the first definition is sharp, because homogenization within customer class does not mean homogenization across customer classes. To the contrary, homogenization in the latter sense is largely absent in contemporary financial markets: customers in privileged customer classes increasingly have expanding investment and debt options, which increase their expected returns and lower their transactions costs; customers in less desired classes have fewer savings and investment options and higher transaction costs. We can speculate whether the growth of homogenized classes of financial citizens at the top end of the income/wealth distribution is paralleled by homogenization of the terms and conditions of financial exclusion at the lower end.

Two Approaches to Developing Economies' Credit Markets and Financial Crises

As noted in the introductory section, financial globalization has been equated in most economic discourse with market-opening. Debate about the impact of financial globalization thus involves disagreements over how market-opening will affect the efficiency of market outcomes in developing economies. Shaw (1973) and MacKinnon (1973) gave definitive expositions of the neoliberal approach to financial markets and development; see Levine (1997) for an updated version. These authors and subsequent authors draw on the theory of efficient financial markets and on Goldsmith's (1969) empirical work on financial intermediation and growth to make several key points: (1) in nations that adopt policies of financial repression (that is, administratively determined interest rates), growth is savings constrained; (2) freeing interest rates from government control will induce households to increase their financial saving; (3) permitting the emergence of a diverse set of financial intermediaries and instruments, which can channel these savings into savings vehicles with appropriate liquidity/risk characteristics, increases the financing of investment and hence overall economic growth.

Figure 1 serves to summarize this view. The equilibrium is achieved at the intersection of the curves depicting the demand for and supply of credit in the banking sector, D_B^* and S_B^*; the economy's private-sector equilibrium interest rate is R_M. Under financial repression, the government establishes R_M^* as the maximum permissible interest rate. This facilitates government borrowing at interest rate R_G^*, because the premium between riskless government debt and risky private-sector debt is artificially small. R_M^* also leads to a savings-constrained level of financing in the formal market. Many borrowers are thrown onto the informal (curb) market, where lenders can extract monopoly rents by charging exploitatively high interest rates. The informal financial sector is artificially expanded in size and scope by these distortions—to a significant extent, the

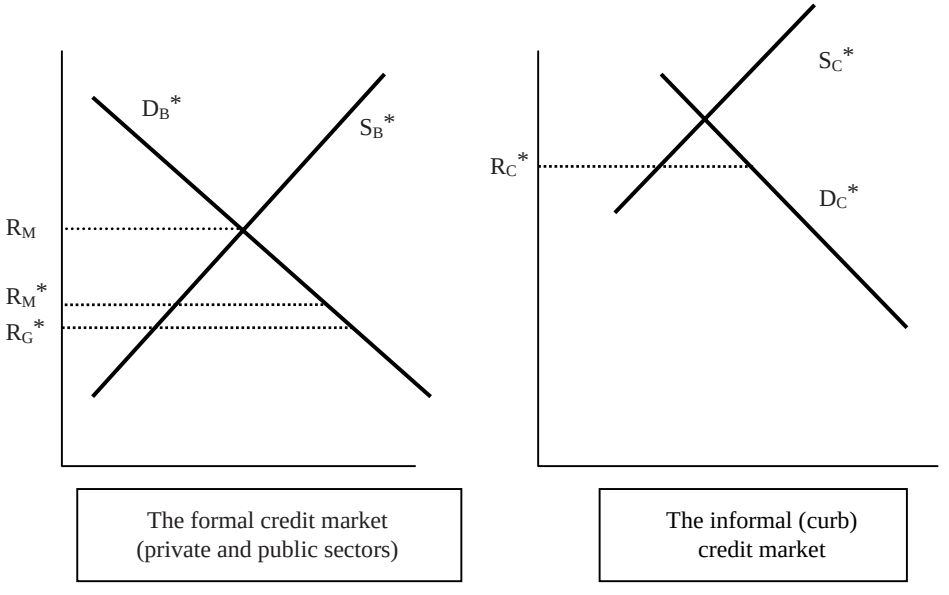

Figure 1. Credit rationing in the developing country

informal sector—and the financial exploitation it represents—exists because of government distortions of free-market relations.

Government repression of interest rates, then, represents a form of rent-seeking, distorts risks and returns in financial markets, reduces the growth rate and stands in the way of economic modernization. Over-reliance on the curb market squeezes out many otherwise-viable investment projects. The solution is to open the markets, permitting the growth of domestic savings and a wider differential on the returns to risky and riskless lending. When credit-market liberalization is accompanied by financial opening, an inflow of external funds is likely (as long as R_M exceeds the risk-adjusted world interest rate). This inflow will then shift the credit-market supply curve outward (not shown here), increasing the volume of loanable funds and driving down the private-sector borrowing rate. Further, the differential between formal- and informal-market interest rates should fall.

Many developing-country economies have experienced severe financial and economic crises after deregulating their financial systems and permitting large-scale cross-border lending. Proponents of this view do not think these recurrent crises condemn the fundamental premises of their approach; to the contrary, these crises are taken as evidence in favor of this view of financial-market development. Knight (1998) argues that the 1997–1998 Asian financial crisis primarily affected countries that lacked a fully developed set of financial instruments and institutions. This leads to less information about borrowers and to more uncertainty among overseas investors; the solution is tighter regulation and further financial-system development ('deepening') and opening.

There are many problems with this model. One is its contradictory characterization of government in financial markets—government is alternately depicted as too powerful and as too weak to permit the achievement of optimal credit-market outcomes. A second problem is the insistence that the existence of the informal

sector can be explained by government distortions in the formal sector; institutional evidence, however—like that amassed by Aryeetey & Udry (1995) and Aryeetey (2001) for several African nations—suggests that the informal sector has a dynamic independent from that of the formal sector. A third problem is this model's denial of any links between crises and market opening; see the critique by Eatwell & Taylor (2000). Suffice it to say, the repeated experience of cross-border lending crises—Mexico and then Latin America 1982, Mexico 1994, Thailand and East Asia 1997, Brazil and Russia 1998, and so on—suggested that another theoretical approach might gain influence. Ironically, the alternative approach that emerged, emphasizing asymmetric information in credit markets, was initially used to explain the occurrence of the Latin American debt crisis of 1982 (Eaton *et al.*, 1986).

The core idea of this alternative, whose definitive exposition is by Stiglitz & Weiss (1981), is that while borrowers need lenders' money, they often have informational advantages of two kinds over lenders: information concerning their competency, which affects their probability of success (their 'type'); and their plans for using and repaying the loans they receive, which affect the likelihood of repayment (their 'effort'). Lenders' optimal response is to ration credit and when possible to use signaling mechanisms to screen borrowers. In the efficient-markets approach, credit rationing does not occur because lenders can clearly differentiate between borrowers who are, and are not, creditworthy at a given cost of funds. The asymmetric-information approach would, for example, interpret Figure 1 in an entirely different way than did the efficient-markets view. In this figure, an equilibrium like R_M is not feasible. In the private lending market, potential borrowers far outnumber the available supply of credit and asymmetric information is rampant; lenders maximize profits by setting an interest rate such as R_M*, which involves credit rationing in equilibrium. The government then sets a rate for its funds, R_G*, reflecting the public–private credit-risk differential.

The informal market is not explicitly modeled, in this approach; implicitly, it is regarded as a second-order venue for credit supply, in which borrowers unable to qualify for credit in the primary market must seek out available funds. Asymmetric information challenges also arise there to be solved via signaling and other means, as authors such as Aryeetey & Udry (1995) and Nissanke & Stein (2003) have argued. The very portability of this framework may, ironically, explain the relative lack of attention to these markets in the developing-economy literature: that is, the key points regarding equilibrium under asymmetric information are already made with a single-market framework; adding the informal sector would only increase analytical complexity.

In the wake of the 1980s Latin American debt crisis, it was widely accepted that principal-agent challenges of the sort captured in the asymmetric-information framework permeated the developing world. The asymmetric-information model of the credit market became a mainstay of development economics. The high growth rates of the Asian 'tigers' was readily attributable to socially efficient government-led resolutions to asymmetric-information-related incentive problems. In the 'Asian model' of development, as embodied in Japan and Korea, the government may take the leading role in this scenario, even to the point of determining R_M* and of deciding which borrowers should get the available credit. If government planning and market guidance operates successfully, it can be considered that the government-guided borrowing rate anticipated what the profit-maximizing rate would have been. The idiosyncratic, nationally specific character

of private information makes it feasible for a lender with localized knowledge to make better choices than could overseas lenders using 'standardized' evaluative criteria for assessing borrowers' capacities and intentions.

The 1997 Asian financial crisis profoundly shook economists' ideas about international debt crises. The affected nations did not have the macroeconomic imbalances identified in 'first generation' and 'second generation' models of currency crisis (Bustelo *et al*., 1999). Some economists turned Stiglitz' microfoundational explanation on its head, suggesting that these nations' banking systems may have encouraged excess risk-taking (Krugman, 1998) or 'crony capitalism' (Guitián, 1998). In their survey of research on the Asian financial crisis, Corsetti *et al.* (1999) found that many economists acknowledged the presence of speculation and contagion effects, but asserted that moral hazard and poorly designed economic policies triggered these effects. This, of course, is consistent with the neoliberal approach set out above. Stiglitz defended the efficiency of idiosyncratic national systems both in a popular (2003a) and an academic book (Stiglitz & Greenwald, 2003).

Taken as a whole, the asymmetric-information approach makes some progress on the neoliberal model. The role of government in either improving or worsening credit-market outcomes is better articulated; and several (admittedly inconsistent) explanations of why market liberalization is often associated with crisis are readily developed. However, the relationship between formal and informal markets is handled very schematically: differences in the riskiness and information characteristics of borrowers implicitly explain the existence of informal as well as market relations; but no explanation of the origin of these differences, or of the criteria that determine the boundaries between formal and informal markets, emerges. A key reason for this lacuna is that financial firm behavior is reduced in the simplest versions of this model to the creation of optimal borrowing contracts. Financial firms of this type cannot have strategies.

Financial Strategic Shifts, Financial Globalization, Financial Exclusion

Both the neoliberal and asymmetric-information approaches to financial globalization and crisis have focused attention on the formal credit market: one side sees it as a cradle of growth, the other as a haven for government-funded iniquity; but both ignore the informal credit market, which is treated as a kind of residual for allocating marginal amounts of credit to marginal customers. Both ignore the strategic and market-access aspects of financial globalization that were sketched out in earlier. These lacunae are self-reinforcing. The process of granting credit in amounts and at rates that maximize profit is the activity of the 'lenders' in the credit market. The only factor that could affect profitability is, by assumption, the quality of the credits made. So these lenders neither have nor need strategies; they simply fulfill a simple economic function, badly or well.

However, credit market dynamics in any region or nation cannot be captured by one representative market; there are always two, or three, or more markets at work. Nor do these markets disappear after their risk–return conditions worsen, as Mankiw (1991) has argued; after being momentarily stopped, prices are adjusted (to the disadvantage of the riskier party) and borrower–credit exchanges continue. The reality is that borrowers and lenders are resilient and adaptive, and both take steps to protect themselves in difficult environments. Markets tend not to disappear—but they can become very distorted and operate very differently from the above textbook cases. After all, they are operated in real time and under

uncertainty, by agents with multiple economic goals and social relationships. Agents of this type need strategies—that is, they need plans for acquiring and using assets and income flows, for managing liabilities and for forming alliances or competing with other agents.

Large multinational banking firms are central to strategic shifts in credit markets.[5] Large banks have been engaging in cross-border financing and asset acquisition for decades. For decades, also, financial crises stemming from the over-extension of lending given the available pools of liquidity have been a component of global financial relations. Monetary theorists never tire of drawing analogies between John Law's tulip mania and contemporary bubbles. Public regulation of financial activities has developed in tandem with these crises, leading eventually to lender-of-last-resort arrangements on a national and international scale. Currently, the Federal Reserve and International Monetary Fund play the roles of lender-of-last-resort, however imperfectly.

Paralleling the ascent of the Federal Reserve was the rise of the Fordist regime of accumulation (Amin, 1994), especially in the quarter-century after the Second World War, in Western Europe and North America. Under Fordism, a relatively prosperous and secure working class emerged. These households, joined by the growing ranks of government workers and business-owners, made possible a revolution of mass consumerism in upper-income nations. This consumer revolution was accompanied by a media revolution that transformed cultural aspirations in every corner of the globe: those who have the means to choose the commodities they consume increasingly want access to commodities that are globally understood as symbols of social-status inclusion.

These shifts in household prosperity and consumption norms, combined with institutional changes necessitated by the era of the Great Depression, transformed the shape of financial intermediation. The 'public' had a demand for a growing range of financial products, including mortgages on real estate, savings accounts, educational and automobile loans, and so on; at the same time, regulations and laws put into effect in the Depression created a financial system that was (most notably in the USA) segmented on a functional and even geographic basis. Private commercial banks collected household savings and made loans to businesses; mortgage companies and savings and loan associations emerged to collect savings and meet mortgage demands. Meanwhile, the behavior of the aggressive and globe-straddling multinational banks was moderated by heavy legislative and/or central bank oversight, by the extensive involvement of public banks and/or subsidized loans in core banking activities. The dollar-based Bretton Woods exchange rate system ensured predictability in cross-border contracts and foreclosed the possibility of speculation in national currencies.

Large national banks and smaller regional banks, meanwhile, pursued conservative lending and deposit-market behavior. For one thing, their hands were tied by extensive rules governing the markets they could serve, the products they could sell and the prices they could offer on those products; for another, the stable macroeconomic milieu of the immediate post-War period assured stable cash-flows from 'following the rules'. In the USA, consumer banking emerged as one component of the consumerist norms of the Fordist period. California's Bank of America epitomized this trend: it absorbed the savings of a large share of those who migrated or immigrated to California and used their savings as leverage to finance consumer-oriented community-building on a massive scale.

These arrangements began to break down and undergo transformation in the 1960s. Money-center banks developed more aggressive growth strategies and challenged regulatory restrictions on their sources of funds (succeeding in mid 1970). The Bretton Woods system broke down in 1971 and was abandoned in 1973: exchange rates began fluctuating wildly, leading to the birth of new speculative currency markets. Financial markets grew in function and complexity, outside of the close purview of government regulators. Larger firms increasingly began to obtain credit directly in these markets, leaving large financial intermediaries to seek out new borrowers. This search led to extensive cross-border lending from the mid 1970s onward and thence to the recurrent financial crises mentioned above.

This conjuncture, together with sustained macroeconomic instability in the 1970s, led to the dissolution of Depression-era banking structures. In the USA, the extensive government regulations that segmented financial product markets, limited banks' geographic expansion and governed many financial-market prices were eliminated in the 1980s and 1990s. An extensive wave of bank mergers was launched within the US banking system; the remarkably balkanized US banking system, a legacy of this nation's settlement by frontier expansion, was gradually reconfigured as a system of hierarchically-organized regional banks. In Europe, rapid advances toward monetary integration similarly led to the elimination of many idiosyncratic national rules governing financial product markets and the firms serving them. In the nations of the global South, financial crises often led to the elimination or softening of restrictions regarding entry by (and activities of) overseas banking firms.

For a time, it appeared that technological change, recurrent overseas-lending crises and the increasing ease of entry into financial activities would doom traditional banks, especially the large money-center banks whose operations overlapped investment-banking and broker–dealer activities. However, banks have remade themselves strategically, large banks most of all. The old idea of bank behavior—conducting the same sort of business for well-defined customer bases in familiar markets without substantial change for long periods—has been retired. Banks have learned how to use new information-based technologies, linked to sophisticated and extensive media outlets, to both create new financial products and market these products to highly desired customers. Banks have never recaptured the core borrowing-and-lending business of the larger and more established businesses that began to escape their balance sheets in the late 1970s, but they have identified other strategic directions.

Large banks have found other services to provide their large corporate customers. These services involve the creation and marketing of securities, residual arrangements for credit, especially a variety of mechanisms for transforming, underwriting and off-loading risk. Indeed, sophisticated information technologies together with a growing number of liquid resale and derivatives markets have permitted banks to enter credit markets ever more deeply—to extend the range of credit markets—without concomitant increases in their risk-taking. Risk has not disappeared from the borrowing–lending nexus; however, the risk exposure of lenders has been transformed due to the development of mechanisms for offloading loans and hence lending risks to secondary markets.

Taking advantage of the risk-management and information-technology tools that permitted banks to adapt to large corporate customers' changing needs, banks have re-engineered consumer banking even as technological change and income–wealth polarization has created growing numbers of sophisticated,

financially-independent, upper-income households. Large banks have taken the lead in creating standardized, mass-market financial products that meet the needs of large numbers of households, often conveniently located in near geographic proximity to one another in prosperous residential areas. They cross-sell services and aim at nurturing brand loyalty and 'one size fits all' services for the customers of their 'upscale retail banking' activities. Many mergers are undertaken with the aim of extending the merging banks' marketing reach and the captive audience its deposit-market instruments creates.

While the search in consumer banking is for more customers, not all customers are incorporated in the same way. Cross-subsidies within banking markets have been radically restricted—no longer do blue-chip borrowers, for example, implicitly support loans for 'mom-and-pop' customers (blue-chips have too many market options to be forced to absorb such subsidies). Instead, cross-subsidies are provided only across markets (and within customer classes), to customers whose business is sought for multiple financial products. Potential customers that lack the potential to be stable, multi-product consumers of bank services are not discarded; but they are offered restrictive sets of services for which they must pay full price or bear the risks. Bank cards, check-cashing and money-order services are increasingly being marketed to lower-income households not by independent suppliers or informal markets, but by subsidiaries of multinational banks. Because these households often are cash-short but have access to income flows (if more unstable and lower-level income flows than more prosperous households), they are targeted for short-term loans in a wide range of forms, including payday loans. Because these lower-income households lack competitive alternatives in many cases, the financial products they buy often build in substantial margins for the lenders.

The search for financial customers then is quite different than in even the recent past. Where banks once pursued thick sets of somewhat heterogeneous borrowers and depositors in well-defined geographic markets, they now pursue thin sets of well-defined and homogeneous borrowers and depositors in shifting sets of geographic markets. Especially for potential multi-product customers, an ever-increasing array of standardized information, readily accessible through centralized computer databases, helps financial intermediaries in their search for bankable customers. Increasingly, these customers may live and work in other nations. What counts is not their geographic locus but the extent to which these customers' risk characteristics, and their product needs and preferences, can be defined with sufficient precision to calculate the prospective return from an investment in marketing and core operations. The more prospective upscale customers there are, the more likely that one or more multinational banks will try to capture these customers. As noted, this competitive pressure will force a competitive response from domestic banks.[6]

It is important to contrast financial firms' behavior in savings/liabilities markets and in credit markets. We take these in order. The multinational banks entering Latin American markets, for example, have been interested primarily in securing savings from upscale retail customers, not in loan-making.[7] While Mexico, for example, has a modest median income level, it has a substantial number of upper-income households with substantial savings; these households are a target for deposit and savings instrument sales (as well as for insurance and other services) by the multinational banks entering the Mexican banking system

via acquisition. Lower-income Mexicans, both in Mexico and in the USA, are targeted for other fee-based financial services, such as money transfers and bank cards. It is not that multinational banks want to offer financial services only to upper-income households; because they offer diverse products for diverse customers, instead of one-size-fits-all products, they want to maximize their market reach—on their terms.

Credit markets are another matter. Credit relations increasingly do not involve risk-taking by lenders, but instead risk classification and risk neutralization. Customers not meeting these standards will not qualify for loans in the primary market. This does not mean they will not qualify for loans anywhere. As Vandenberg (2003) points out, borrowers in financial markets are not passive but are active: they will do what they must to find credit, the question being at what price and on what terms, and with what security and risk they will find it. Financial firms are continually becoming more flexible in their lending practices, but also more insistent in their search for those loan customers that have sufficient wealth (and access to other economic resources) that their loans are virtually default-free.

However, there are fewer (apparently) default-proof customers in a general population that also has an increasing proportion of lower-income households. The 'representative' credit-market scenario that Stiglitz and Weiss invite us to imagine breaks down: in any nation, greater inequality compromises the value of institutional mechanisms for detecting asymmetrically known differences in ability to pay (as per the Stiglitz–Weiss model); further, it generates a larger share of the population for whom the incentives normally used by lenders to induce willingness to repay are ineffective. The likelihood in market after market is that potential borrowers will break into two prototypical groups: one group whose assets and position are secure, and which both national and overseas lenders will regard as 'good risks' with whom they want long-term, sustained relationships; and a second group, whose wealth levels are so low that contracts are written with the hope of extracting sufficient returns in the short run to compensate for what will inevitably be (for most) longer-term insolvency problems. It involves class-based and sometimes ethnic differentiation as a result of the double pincers of the breakdown of publicly controlled credit-market institutions and the shifting strategies of large, modern-day banks.

Figure 2 sketches out one version of this scenario. There are two demand curves for credit, not one—a primary and a second-tier market. Customers enter the primary market by meeting a number of screening criteria based on standardized financial information. These customers have sufficient collateral to constitute virtually zero risks for the lender; loans made to them can readily be bundled and sold off in securities markets. These customers' demand for credit is completely met at the intersection of the demand and supply curves for primary-market credit, with equilibrium interest rate R_1. By contrast, there is substantial credit rationing in the second-tier market; Figure 2 shows this market equilibrating at R_2. In this scenario, second-tier customers are unable to enter the primary credit market and are also subject to credit rationing. The higher interest rates (and higher fees) charged to second-tier customers insure that loans made to them will remain profitable even if a fairly high default rate is realized. This market divide can be instantiated in many different ways: it could involve, for example, the spatial separation characteristic of credit-market redlining in

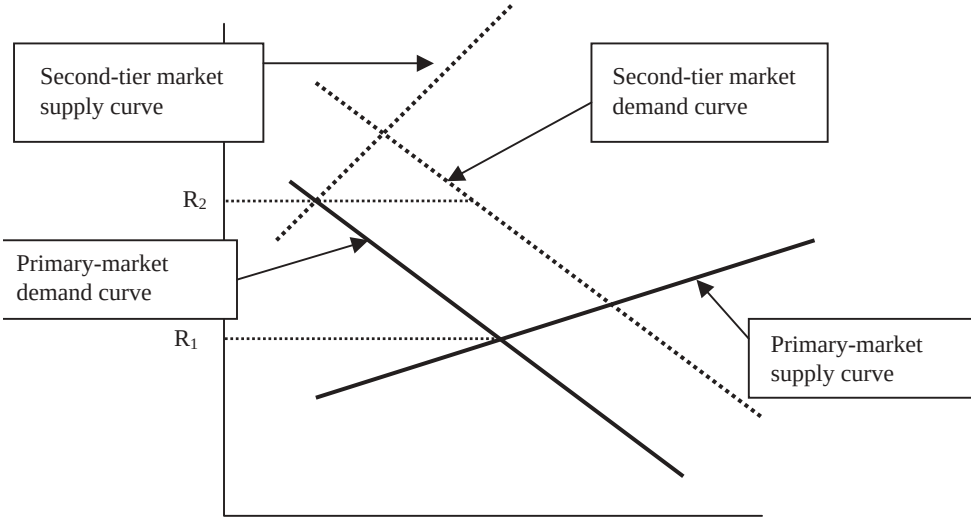

Figure 2. Credit market outcomes in a stratified domestic credit market

the USA, or the usury-cap-driven separation found in contemporary South Africa.

Figure 2 captures the idea that there are now households that are encouraged to borrow as much as they would like because they are perceived as virtually riskless. Of course there is no such thing, but paper capital gains on houses, possession of the right jobs, the right addresses and the right demographics, considerable income flows, all these may open the doors to apparently limitless spending. This is, in its origins, a distinctly American phenomenon: but more recently, elite households in nations around the world are finding their credit lines lengthening, as their properties rise in value and the globalized consumer goods they buy become ever more available.

In effect, the globalization process now involves the transformation of the process of speculation—from a system of lending based on the search for borrowers whose nations 'cannot go bankrupt' to the search for borrowers who themselves 'cannot go bankrupt'. The key is to find customers with impeccable balance sheets, whose assets are protected within 'safe harbors'. The latter have many manifestations: for financial holdings, the possession of assets in currencies that retain their value and that are issued by nations regarded as safe; for real holdings, the possession of property within prosperous suburbs in the USA, within gated communities, or even behind walled and protected compounds. Defining the primary credit market depends on maintaining a line behind which personal security and safety can be defined and priced, no matter how insecure and unsafe the lives lived outside that line.

Financial Crises, Financial Inclusion and Financial Exclusion

The historical process described in the previous section has, in effect, manufactured the problem of financial exclusion, as a dual to the financial inclusion strategies that define upscale retail banking and that have become core drivers for bank holding-company profitability. Financial exclusion does not mean the absence of credit for a portion of the population: far from it. Those who are

excluded need credit, are provided it and pay much more for it, than the financially included.

The linked, but independent credit-market dynamics of the financially included and excluded create a broader terrain of possibility for the outbreak, form and implications of financial crisis. To see this, consider Figures 3 and 4. These figures adapt Minsky's familiar microfoundational graph for financial boom and bust (see Minsky, 1975).

Figure 3 shows Minsky's portrayal of the planning process for a firm or household for a given time period. The borrower unit wants to implement an income-earning plan; to do so, it has available some liquid resources (shown by locus *EE*). If its plan encompasses more resources than *EE*, it must borrow. It expects to earn a return given by the curve ER_B^1; this expected return declines as the scale of the unit's operations increases, because of what Keynes termed 'borrower's risk'. This borrower confronts a lender in the credit market. That lender has a base-line cost of funds, assumed constant; in considering a loan to the borrower, it increases the loan rate with the size of the loan to reflect its (lenders') risk. The result is a loan offer curve of F_L^1. Initially, the market equilibrates where ER_B^1 meets F_L^1, with the borrower paying L_1.

Minsky discusses financial crisis as a symmetric event, wherein both borrowers' and lenders' risk curves adjust inward owing to a loss of confidence, a bad income draw, or another shock. However, it is the lenders' unwillingness or inability to maintain loan commitments at L_1 that actually triggers a crisis: the borrower is locked into financing an asset position. Note further, contrary to Minsky's portrayal, that the lender will hold the borrower to its original return commitment; so the loan rate will—after the deterioration in lenders' liquidity or confidence (or both), be re-contracted at L_2. In Minsky's terminology, this increasing level of debt commitments can shift a borrower unit from being financially robust (a situation in which available cash always exceeds debt obligations) to being financially fragile (cash may or may not exceed debt obligations) to even being a 'Ponzi' unit (cash

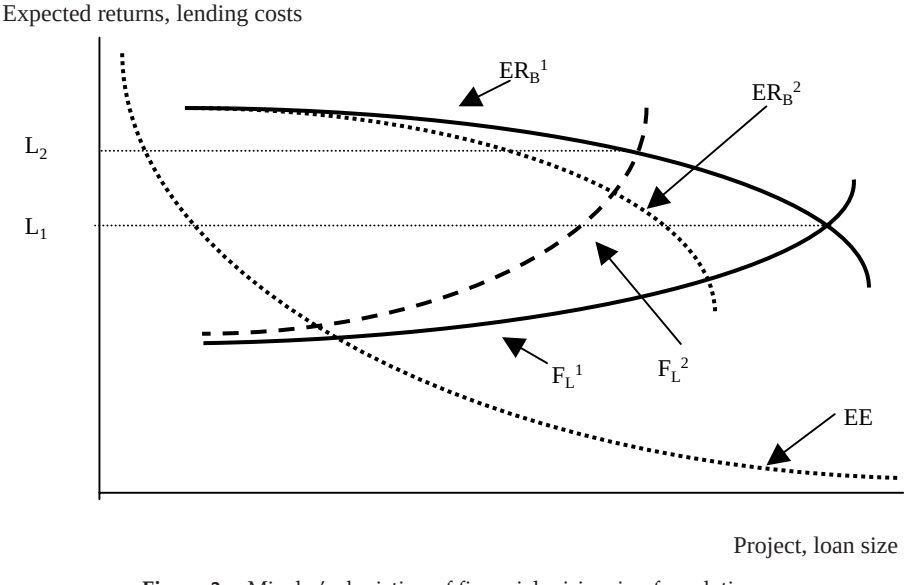

Figure 3. Minsky's depiction of financial crisis microfoundations

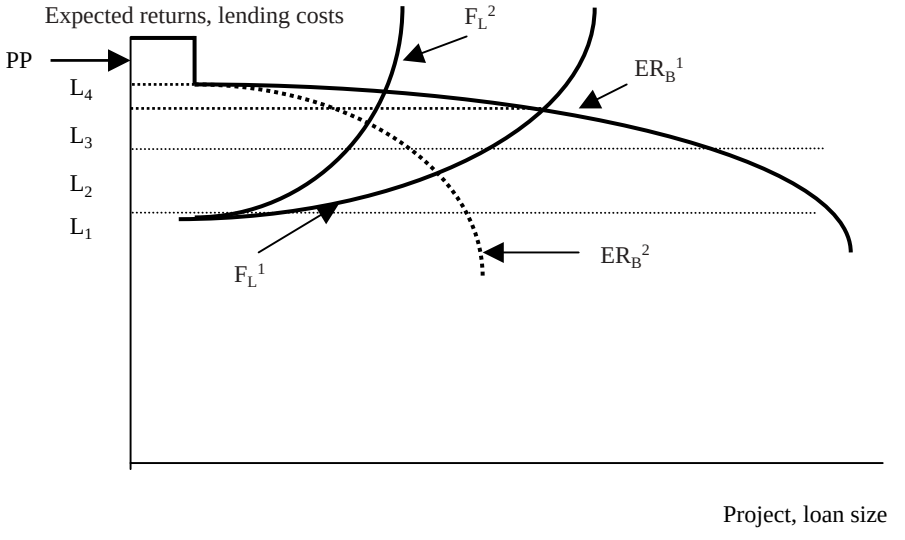

Figure 4. Microfoundation and crisis for the financially excluded

will definitely not retire debt obligations). Kregel (1998) showed how this model could explain the East Asian financial crisis.

Minsky's microfoundational model, like the neoliberal and asymmetric-information models, focused only on one representative market—implicitly the formal market. However, explicit attention to the situation of the financially excluded opens the way to perceiving new dimensions of financial crisis. Figure 4 sets out a suggestive situation. First, the excluded have no equity or reserves, so EE collapses. This means that the borrower's entire 'project'—which could simply involve sustaining oneself through a payroll cycle—must be financed. Thus, the F_L^1 curve is positioned higher than in Figure 3. Further, the lender raises the interest rate at a faster pace than for formal market borrowers. The borrower, for her part, faces upfront fees *PP* imposed by the lender; so her return is reduced immediately by this amount. Given the tighter stance of the borrower, the market initially equilibrates at L_3. The equilibria L_1 and L_2 in Figure 3 are left in place to illustrate the differences in Figure 4. Note that the return margin with which the borrower is working in the informal market is much smaller than in Figure 3. When lender confidence dissipates and the lending curve shifts inward to F_L^2, the borrower's return margin virtually disappears at the new interest rate level of L_4.

In sum, the informal market operates with higher interest rates, lower project levels and much tighter return margins for borrowers than does the formal market. The borrower does not begin as a robust financial unit and then, after adverse shocks, shift toward being a financially fragile unit; instead the borrower begins as a fragile unit and moves inexorably toward being a Ponzi unit. If (income-earning) activities facilitate asset accumulation in the formal market that Minsky emphasizes, in the informal market, assets facilitate activities. Assets are positioned to gain in value in the former case and are pledged to the pawnshop in the latter case. The key difference between the wealthy and the poor and unbanked, in this scenario, is not time horizons, but rather the unequal mechanisms available for reproduction in real time. What the transformation of financial practices by global

financial competition has done is to create more and more a world in which the financial services (the mechanisms for reproduction in real time) made available to one or another household are determined first of all on the basis of income and wealth levels. In a world in which how customers are treated increasingly depends on their financial capacity, it is no surprise that the distribution of financial capacity across economic units itself becomes a product of banking firms' customer-market strategies.

We can then readily see that market bifurcation suggests new forms of financial crises or threatened crisis. The financial crisis that is familiar from Minsky's work involves the collapse of expectations and of conditions for refinancing in the formal market. Reproduction of asset-building and wealth accumulation is jeopardized. A second type of crisis, however, involves a collapse of the conditions required for financial reproduction in the informal market. Since the margins are much tighter in the informal market, this market is more prone to break down and generate consistently negative cash flows for its participants. This does not mean that these participants will cease to function or to borrow: they have no choice but to borrow and to get ever deeper into hopelessly high levels of debt. When asset exhaustion makes it impossible to renew activities, so that more time cannot be bought, then life and financial crisis can become indistinguishable. A third type of financial crisis involves a situation in which a large number of people are thrown from the formal to the informal sector. Given the endogenous cycles of wealth accumulation or decumulation that accompany the era of globalized finance, this shift can both adversely affect growth rates and lead to less robust institutional development.

Some polarization of precisely this type is occurring or emerging in many nations. To take just two examples, the Federal Reserve's Surveys of Consumer Finance show that debt, growing for all portions of the US income distribution, has been growing at the fastest pace for households with the lowest incomes, a third of whom are unbanked (Aizcorbe *et al*., 2003). In South Africa, the credit market increasingly operates to fill the void left by the shortage of currency in low-income (socially excluded) communities. To the contrary, those who are subject to financial exclusion are invariably involved in credit relations—but credit relations at exculpatory rates, involving loan contracts that are sure to detract from net worth rather than build it and that buy time in the present at the expense of options in the future.

In some nations, financial exclusion is a transhistorical component of social life, which persists even as market relations are transformed in real time: only elites operate in formal financial markets, now and in the past. In other nations, financial exclusion for some households results from the process of financial stratification and homogenization: the division of customers into ever-more-precisely defined segments, which are internally homogeneous but subject to vastly different terms and conditions in the loan market. There are other possibilities still. The principal points are these: credit markets are no longer unified (if they ever were), but instead are fragmented and diverse; and financial exclusion grows as do the wealth/income and security/insecurity divides.

Conclusion

This paper has brought into focus an overlooked aspect of financial globalization: the worldwide reconsideration of financial firms' strategies that has accompanied

financial globalization and led globally to the homogenization and stratification of financial-market practices. Financial firms operating globally are both reacting to the increasingly polarized distribution of income and wealth around the world, and also behaving in ways that worsen that divide. Consequently, putting up barriers to foreign capital entry and evening the terms of North–South trade will not suffice to salvage functional financial systems in the nations of the South. Financial firms themselves are turning to strategies based on the profits to be made from the segmentation of markets for financial services; these strategies are based on the inability of lower-income households and small businesses to find competitive alternatives.

In some nations of the South, the poor and small businesses have never succeeded in winning access to lower-cost formal-sector credit and money services. In these cases, the current trends in banking strategy are hardening the lines between the formal and informal financial markets—between financial citizenship and financial inclusion—even while sometimes creating situations in which large banking organizations see business opportunities in expanding their activities into new arenas of informal financial service provision. In other nations of the South, governments are withdrawing from the provision of universal formal financial services, or from their withdrawing rules insisting on universal access to formal financial services. Financial globalization operates at both ends of this chain of causation: global financial firms are supplying financial services directly in some developing-economy markets (for example, Mexico); in other markets, these firms' threats of reduced credit or service flows, or even of market entry, has the effect of weakening governments' commitment to universal financial access (for example, China). In effect, this financial homogenization/stratification process is eating away idiosyncratic features of many national financial systems from the inside out, regardless of whether financial crises are wreaking havoc from the outside in.

Notes

1. Levine (1997) provides an overview of the academic literature on this topic; IMF (2000) reviews financial regulation and financial system liberalization in the world economy, especially the global South.
2. Steel *et al*. (1997) discuss informal financial relations in several African nations; while Dymski & Veitch (1996) and Pollard (2003) analyze the informal financial sector in Los Angeles. Analysts who have evaluated informal financial arrangements (including Steel *et al*.) do not necessarily take the view that they are sub-optimal or exploitative relative to formal-market practices.
3. Recent surveys of this large literature are Austin, Turner and Skidmore (1999) and Dymski (2005).
4. The term originated in Leyshon & Thrift (1995). This literature has been summarized by Leyshon (1995, 1997, 2000) and by Martin (1999).
5. The discussion of the interaction between market structures, banking strategy and macroeconomic conditions told here is specific to the US context (Dymski, 1999), and to a lesser extent to the European context. Arguably (Dymski 2002), strategic shifts by US banks have largely shaped the landscape of financial competition, especially as recurrent financial crises have opened new markets to overseas banking competition.
6. This point was dramatically made in a discussion with Japanese bankers in Tokyo in August 2000. Asked whether there could be unbanked Japanese, a representative of the Japanese Bankers Association replied, 'We are searching for the profitable customers'.
7. A notable example is the case of Santander and BBV, into Argentina. These two Spanish megabanks, who are competing with Citibank for market share in many Latin American markets, both were determined to undertake aggressive middle-market lending in this nation. However, extensive losses in the midst of Argentina's recent crisis led to a reversal of this commitment.

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