

# ON THE NATURE AND CAUSES OF THE COLLAPSE OF THE WEALTH OF NATIONS, 2007/2008: THE END OF A FAÇADE CALLED GLOBALIZATION

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## ABSTRACT

This paper investigates the 2007/2008 crisis which has been hailed as the most devastating (and complex) crisis of capitalism since the great depression of 1929. It further discusses the future trends in global capitalism with special emphasis on the expected future developments that are likely to be experienced in the world economy at large. The main argument of the paper is that the 2007/2008 crisis had not been the end result of a series of technical errors or ad hoc developments that occurred on their own, but should be regarded as the result of the systemic imbalances of capitalism in the last three decades. Thus, in order to evaluate the conditions of the global crisis more clearly, it is found pertinent that the underlying structural causes of the current crisis waves ought to be studied. The paper further follows the steps of the Marxian literature on crises, prominently of Rosa Luxemburg, pointing out to the necessity of a '*corrective war*' in order to break with the "old" institutions, "old" technologies, and "old" methods of accumulation.

**Key words:** Crises of capitalism; Bretton Woods system, golden age of capital; financialization; corrective war

### JEL Codes:

- E44 Financial Markets and the Macroeconomy
- F01 Global Outlook
- F02 International Economic Order

F5 International Relations & International Political Economy

G01 Financial Crises

## INTRODUCTION

The global capitalist economy is experiencing its worst crisis since the 1929 Great Depression. Initially dismissed as mostly a routine financial turbulence in the summer months of 2007, the crisis conditions accelerated slowly, yet secularly, to reach an officially declared full-fledged recession in US and UK by the last quarter of 2008. Over the course of 2008, the International Monetary Fund (IMF) had to revise its growth projections for the world for the upcoming year three times, down from a celebrated 4.4% initially, to 2.4% in November, and then to a mere 0.5% in late January of 2009. Many international financial institutions (IFIs) followed the suit. Considering the well-accepted notion that for the world economy a rate of growth below 2.5% is taken by many economists as the threshold for “global recession”, the grim reality behind these numbers becomes clear.

The global crisis is expected to take a heavy toll on the laboring masses and those heavily indebted and foreign finance-dependent economies. The International Labor Organization (ILO) warned in early 2009 that the openly unemployed will increase by as much as 50 million individuals by 2010, bringing total unemployed to 230 million, or to 7.1% of the global labor force.

What is more revealing in our conjuncture is that the current crisis had not been initiated in the so-called emerging markets of the global periphery, but erupted directly in the hegemonic centers of the capitalist world. What lie at the root of the crisis is not the usual common accusations of “corrupt” governments of crony capitalism, with their over-interference to the market rationality, but the upfront irrational exuberance of the “free” markets, with their unfettered workings guided by the private profit motive.

Thus, by whatever means the current crisis episode will dwindle into a new kind of austerity, one lesson remains clear: it is no longer possible for the global capital to return to the patterns of trade and finance constructed in the post-1980 era. The world economy has exhausted the fantasy tales of “free” trade, “liberalized” finance, and “flexible” labor markets where the motive for private profit seeking was taken as the unabated single rule for efficient allocation of resources leading to high incomes, human rights, civilization, prosperity, and so on. The post-1980 phase of capitalism, which is often characterized as *neoliberal globalization*, was identified by a wide-encompassing restructuring of both the economic realm consolidating the realm of the markets, and the political aspects of this realm —the states.

What lied at the heart of this restructuring was the ascendancy of finance over industry, a global process of *financialization* subjecting its logic of short-termism, liquidity, flexibility, and immense mobility over objectives of long term industrialization, sustainable development and poverty alleviation with social welfare driven states. *Financialization*, as it stands, is a loose term and no consensus yet exists among economists on its definition. However, starting from David Harvey’s seminal observation that “*something significant has changed in the way capitalism has been working since about 1970*” (Harvey, 1989: 192), a set of distinguishing characteristics of the concept can be unveiled. Krippner (2005:174), in line with Arrighi’s *The Long Twentieth Century* defines it as a pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production. According to Epstein (2005:3) “*financialization means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of domestic and international economies*”. In what follows, in a broader way, we can consider financialization as a phenomenon which can be described by increasing financial motives, volume and impact of financial activities within and among countries. As

Duménil and Lévy (2004a) underline, “*what is at issue here, are not markets and states per se, but the stricter subjection of these institutions to capital: on the one hand, the freedom of capital to act along its own interests with little consideration for salaried workers and the large masses of the world population, and, on the other hand, a state dedicated to the enforcement of this new social order and the confrontation to other states.*”

To these broad contours of capitalist expansion we will add two hypotheses in order to formulate a coherent analysis of the current global debacle: (i) crises, often followed by periods of wild expansion and euphoria are part of the anarchic characteristics of capitalist mode of production, whereby capital, historically speaking, has not hesitated to impose costly transformations often culminating in, what Rosa Luxembourge termed as, *corrective wars*; and (ii) since the main mover of capital is its quest for profit, it is of paramount importance that we understand the actual path of the profit rate in signaling the acceleration and demise of the capitalist accumulation episodes with recurring crises.

This paper will convene from these two principles in its attempt to inquire into the nature and causes of the current collapse of the wealth of nations. In what follows, I start with an investigation of the structural causes of the global crisis in the next section. Then, I offer and elaborate some of the key statistics on the global history of capitalism, both in its center and the periphery. The paper extends with taxonomy of the crises of post-financialization and concludes with an overview of the lessons distilled thus far, coupled with prognostications into the future.

## ON THE STRUCTURAL ROOTS OF THE GLOBAL CRISIS

It is no doubt that an episode of expansion followed by a crisis at the global scale is not the first one experienced by the humans in their economic history. We have witnessed, over the course of somewhat 600 years of capitalism, many such episodes involving massive expansion of wealth led by accumulation of capital at the global scale, yet to be followed by severe crises with onerous adjustments, and quite often by devastating wars. It is important to note, however, that such processes of global expansion and crises had never been in the form of simple reproduction and cyclical recurrence. Under each cyclical expansion – crisis episode there had been an element of directionality with the emancipation of broader patterns of expanded accumulation, technological expansion, and financial depth.

The notions of waves of *long durée* were already noted by the modern Marxian framework, often regarded synonymous with the works of Nikolai Kondratieff. (See, *e.g.*, It would prove illuminating at this instance to pursue the conceptualization offered by Giovanni Arrighi in his 1994 work *The Long Twentieth Century*. Resting his theoretical framework on the Marxian notion of expanded production via  $M - C - M'$  circuit, Arrighi argues that capitalist expansion in material accumulation can be described by investments first in *liquid* capital,  $M$ , then to be transformed into *constant* capital,  $C$ . Led by new technological advances, investments in new industries necessitate capital to be tied up in irreversible fixed investments. It is the increasing returns of this irreversibility of  $C$  that sets the conditions for an upswing in profits and global expansion. As this process deepens, however, inter-capitalist rivalry sets in; fierce competition chokes up profit opportunities; technological innovations lose steam and mature; profit rates over constant capital fall. At this instance old industries need to be dismantled; new rounds of liquidification become necessary. Capital seeks for liquidity, mobility and malleability. This is when a new round of financialization is invigorated where constant capital is torn into new liquid capital,  $M'$ .

This process of *Schumpeterian creative destruction* is often accompanied —and is made possible— by a “*corrective war*” and replacement of the old hegemon with a new one. Thus, Arrighi maintains that the ascendancy of finance over industry is not a *new* stage of capitalism, but is a *recurrent* phenomenon, a phase of longer cycles of capitalist development that began in the late medieval and early modern Europe (Arrighi, *ibid*, p. xi).

Based on this vision Arrighi outlines four systemic cycles of accumulation — maturity — crisis, each dominated and administered under the auspices of a hegemonic state: a *Genoese* cycle (fifteenth to early seventeenth centuries); a *Dutch* cycle (late sixteenth to late eighteenth centuries); a *British* cycle (late eighteenth to early twentieth centuries); and a *US* cycle (early twentieth century to-date). Yet, as noted above, none of these cycles were regular cyclical recurrent movements. Arrighi argued that each new cycle was shorter; each new hegemon more powerful and bolder; and each new financialization was more complex. To these we must add a very significant distinguishing feature of the current crisis: *the current global crisis is the first such episode in human history in which “money” (and by extension all financial assets) does not have a standard unit of value, such as gold, against which its value can be objectively measured.* The crisis erupted under conditions where currencies have only “*fiat*” values, and financialization advanced under a “*make belief*” system of virtual values independent of a gold —or any metallic— standard.

In short, under the current crisis episode there does not exist any *anchor* for the nominal value of money.

This characteristic leads into a very basic problem for the capitalist world. Under conditions of indeterminacy of the “*true*” objective value of money in the global system it becomes virtually impossible to determine the values of all remaining financial assets —whether credible or “*toxic*”— in the global financial markets. Under conditions of fiat monies, valuation of a financial asset rests solely on expectations, a make-belief world of expected positive returns. Thus, in this world terms such as “*expectations management*”, or “*credible governance*” come to the forefront in all attempts to pull the system out of the crisis. Ultimately it is due to this impossibility that the “*true*” costs of the crisis cannot be measured, and the magnitude of the rescue plans cannot be computed.

In contrast, the financial architecture that had been designed in the aftermath of the Second World War in the *Bretton Woods* village of New Hampshire, US had succeeded in maintaining such a nominal anchor: the US dollar was tied to the gold standard, and all major currencies were tied to the US dollar via *fixed* rates of exchange. What’s more an International Monetary Fund (IMF) was established to oversee the prevalent exchange rates and to supply cheap credit (and advice!) to overcome any individual balance of payments problems. Thus, under the Bretton Woods system the nominal anchor that ultimately determined the objective value of money was the first exchange rate system indirectly tied to gold under the dominance of the US dollar. In this manner currency speculation, and thus, uncertainty and risk were disentangled out of the global financial system. In the words of the architect, *John Maynard Keynes* himself, “*finance has become, and ought to be, a national matter*”.

The post-1950 Bretton Woods system had also coincided with a *relatively* tolerant view towards wage earner incomes and a period of relative peace between capital and wage labor. Led and overseen by the philosophy of a social welfare state, the post-1950 period witnessed the emergence of *embedded liberalism*, where each nation state had assumed the primary task of fighting unemployment and provision of cheap and wide ranging public services such as free health and education to its citizens —yet all under the realm of the “market system”. The industrialization model of the period was ultimately *Fordist*, resting on the notion of

“*mass production for mass consumption*”. This model basically regarded wages not only as a *cost item*, but also —and perhaps more so— as an *income item*, giving way to more tolerant attitudes towards wage demands of powerful workers’ unions.

The capitalist world has lived through the 1950-74 period with unprecedented rates of growth. Led by an expansionary fiscal and monetary framework in the metropol, the world economy expanded at a rate of 2.9% per annum over this period. Furthermore, the poor nations of Asia, Africa and Latin America have, for the first time in history, experienced a global rise in their per capita incomes. Based mostly on these features, the 1950-74 episode of capitalism came to be referred to as the ‘*golden age*’.

However, simultaneous to these developments the iron laws of capitalism were at work. Intense capital accumulation invigorated unavoidable falls in the rate of profit. Furthermore, as production was carried on a massive scale based on the standard technologies of the Fordist assembly line, new competitors from Japan, and parts of the periphery such as Korea, Taiwan, Thailand, Brazil, and Spain emerged as new centers of fierce competition. Starting from mid-60s as the rate of profit start to dwindle all over the Western world, it was clearly plain that the end of the golden age was near. Expansion of capital accumulation necessitated ever higher rates of return; and yet, capital was held relatively immobile within the national boundaries under the Bretton woods system.

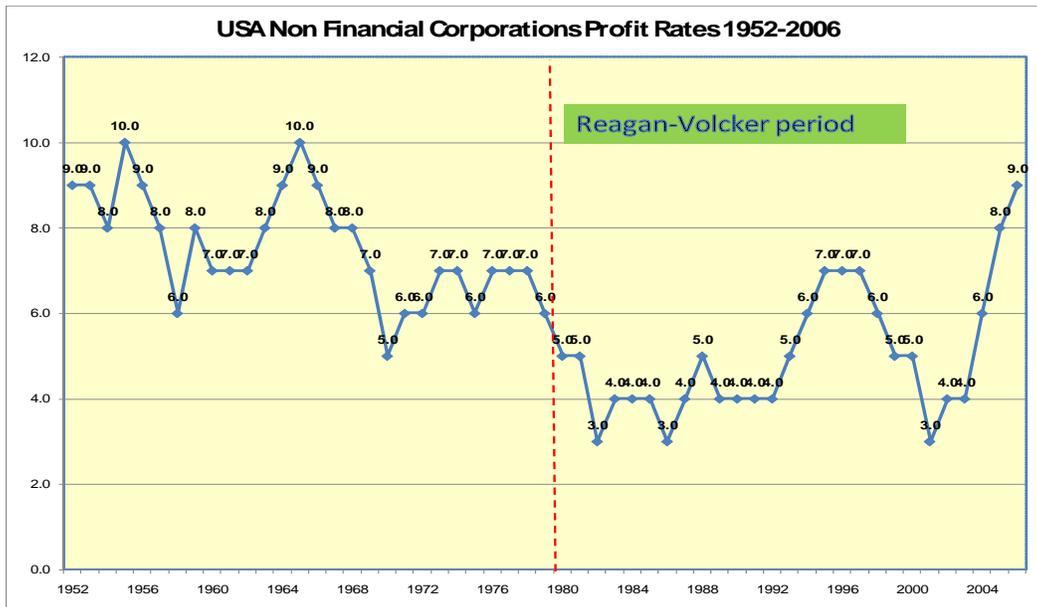
## THE END OF THE “GOLDEN AGE”, RE-FINANCIALIZATION OF CAPITAL

Recent history reveals that the inner conflicts of the Fordist production/accumulation fostering “*mass production for mass consumption*” and its financial accompaniment —the Bretton woods system, treating “*finance as a national matter*” had surfaced by early 1970s. The political and economic limits of the golden age were reached. By then the capitalist world was in search of new means of expansion in order to overcome the threat of under consumption and overproduction. Yet, it was an impasse between the requirements of sustaining high real incomes for the working class on the one hand, and maintaining profitability, on the other. Added to this dilemma, the financial system was not able to diversify its portfolios under a regime of fixed exchange rates and regulated financial markets. Finance capital was captivated with the dreams of full mobility as witnessed in the closing decades of the 19th century *belle epoch*.

It was further during this period that the Western banks hoarded huge sums of *petro dollars* originating from the OPEC revenues due to oil price shocks. A second source of piling idle funds was the ballooning retirement funds of the *baby boom generation*. All these funds were in search of exquisite rates of return, which, alas, were not formidable under the strictly regulated Bretton Woods system. It wasn’t long that the trumpets of “*End the financial repression!*” were to be heard from the works of McKinnon (1973) and Shaw (1973) calling for *deregulation, liberalization, and flexibility*.

Various indicators and levels of evidence had been advanced in the literature to account for these facts. Orhangazi (2008), for instance, rested his theories of financialization of the US economy on his calculation of the profit rate in the nonfinancial corporations over the post-War era. As disclosed in Figure 1, Orhangazi reports a secular decline of the profit rates of the nonfinancial corporations starting after the second half of the 1980’s. After an extended period of restructuring over the 1980’s under the supply side economics of Ronald Reagan and Paul Volcker, the profitability was observed to rise.

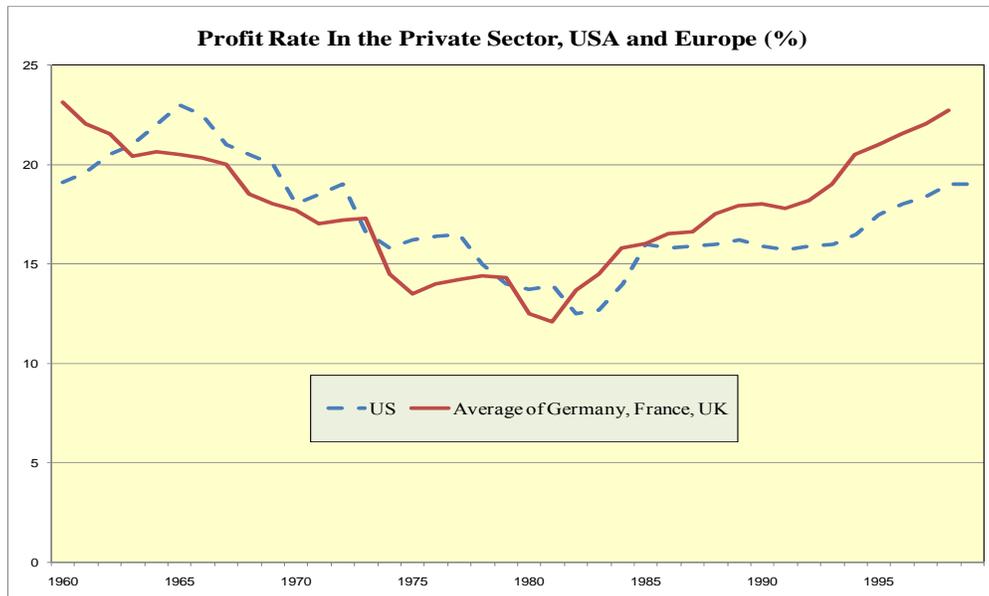
Figure 1.



Source: Orhangazi, Özgür (2008) *Financialization and the US Economy*, Edward-Elgar Publications.

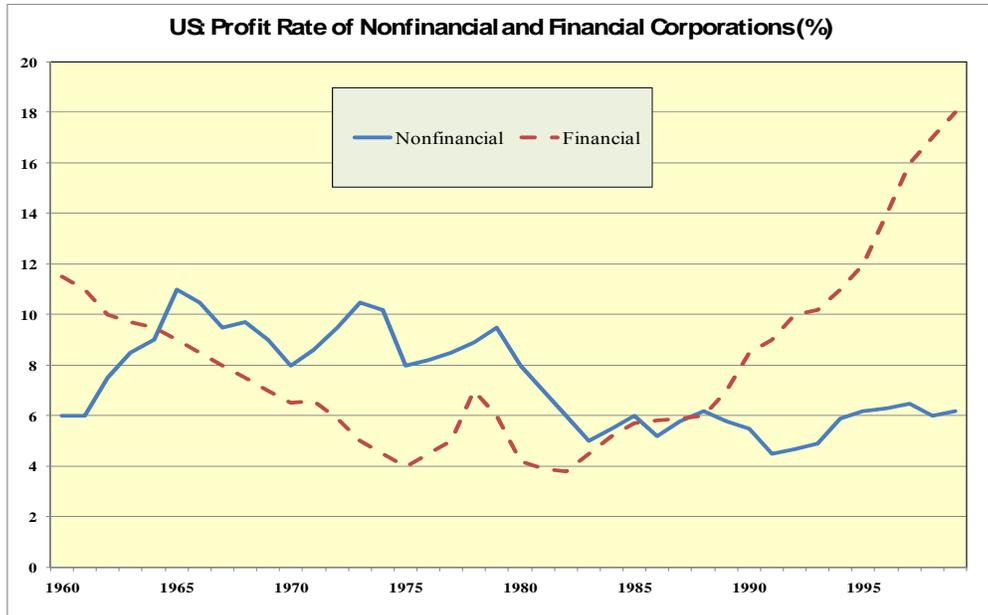
Orhangazi's findings were also resonated in Duménil and Lévy (2006, 2004a and 2004b). In their analysis of capital's profitability in US and Europe, Duménil and Lévy (2006) reported on the behavior of the rate of profit as measured by the ratio of net product minus total cost of labor to the value of the stock of physical capital. Duménil and Lévy's data also corroborate with Orhangazi's, even with a more pronounced tendency. The post-1980 patterns of profitability clearly reveal a breakthrough for capital.

Figure 2.

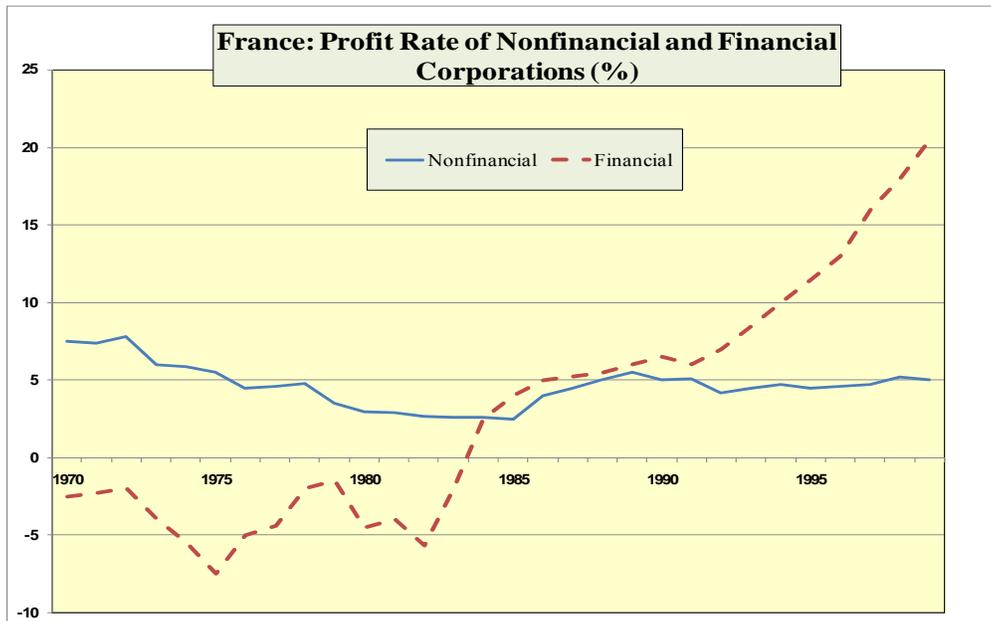


What is hidden beneath the path of aggregate profitability in Figure 2 is the ascendancy of finance over industry. To fully account for the divergent patterns of finance over industrial profitability, Duménil and Lévy (2006) offer a more detailed analysis. In Figures 3a and 3b, we are now confronted with another picture: it is actually the rise of financial returns that pull aggregate profitability. As stagnation of the industrial profit rates deepen, the rise of financial profit opportunities compensate for such losses. Financialization was, then, the major response of capital in its quest for expansion, for profits, and again for expansion...

**Figure 3a**



**Figure 3b**



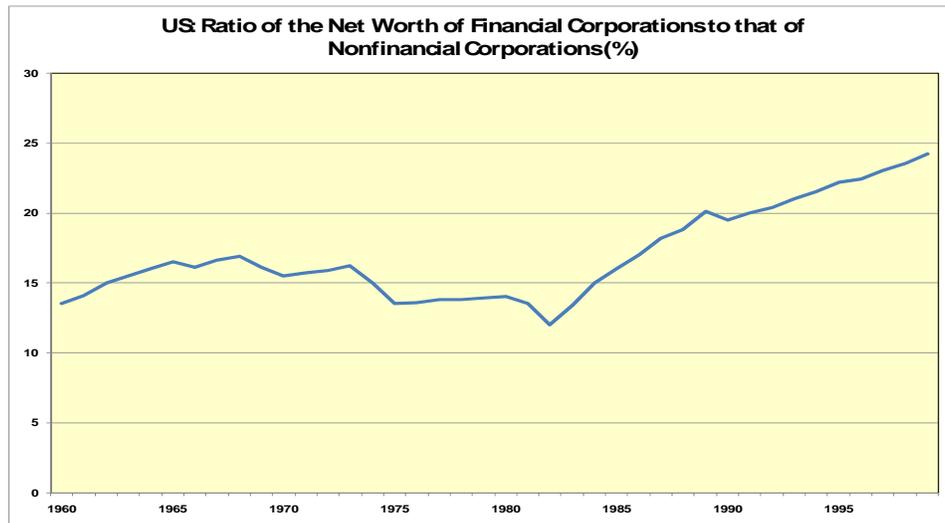
With the collapse of the Keynesianism, the onset of neoliberal restructuring set in. Concepts such as “credibility”, “governance”, “transparency” entered into the jargon of economics, as the term “developing economies” were replaced by “new emerging market economies”, and classes such as “industrial bourgeoisie” or “finance capital” were pushed aside to be replaced by the neutral concept, “players”.

In the meantime, with the advent of financialization the short termist and highly volatile expansionary nature of hot finance was vividly present. As Petras and Weltmeyer (2001: 17) reported, in the global markets during the late 1990’s, for every 1\$ of transaction carried out in the real sector, the finance sector was observed to utilize a transaction volume reaching to 25-30 dollars. As the main actor of international finance, the banking sector has diversified its international operations rapidly and increased its international credits to the developing world from US\$32 billion in 1972 to \$90 billion in 1981 (Strange, 1994. 112).

However, as the unregulated finance led into cycles of unsustainable bubbles, it laid down the anarchic nature of capitalism. As I had underscored in the introductory paragraphs of this essay, after 1971 human history has entered an entirely new phase of a monetary system in which there does not exist any objective standard of value to determine the price of money and other financial assets. Since 1971 the US dollar has been off the gold standard and all currencies in the capitalist world are operating with *fiat* values. As such, values are *fiat*; to be governed by “expectations” and by the “speculative games” performed in the financial casinos of capitalism. In such a world, it is unavoidable that bubbles would be driven by the runs of *bulls* to unprecedented heights based on positive expectations, to burst into veins by the *bears* gloomy views. Perhaps in the first time in human history capitalism was successful in creating monetary gains out of value without any discourse on production; that is, the circuit of  $M - M'$  apparently replaced the roundabout scheme  $M - C - M'$ . In the word of common folklore, the genie was out of the bubble.

Figure 4 illustrates these points succinctly. Adapted from Duménil and Lévy (2006 and 2004a) the Figure traces the net worth of financial corporations in the US in comparison to that of the nonfinancial corporations. Mid-1980’s are again revealed as a turning point where financial corporate values outpace nonfinancial values.

**Figure 4**



## THE RISE AND FALL OF NEOLIBERAL GLOBALIZATION

The term “globalization” stands out as the hegemonic concept of the neoliberal ideology, reflecting one of the main items in the current political economy agenda. This buzz-word seems to have a spiritual power in its own right as it provides a center-force directing our daily discourse on economic, social, political, and cultural relations.

The concept is mostly revealed as part of a modern project on “citizenship” along with references to such slogans as: “*being a citizen of the globalized village*” and “*adjusting to the needs of the global markets*”. In this sense, the term itself carries a dual conceptual meaning: a *definition*, and a *policy recipe*. As a *definition*, the term refers to the increased integration of the world’s commodity and finance markets and its cultural and social values. Within the context of this definition, liberalization of the commodity trade and financial flows yield the narrowest economic implications of the globalization process. At a more general level, this process entails “... a programme for destroying collective structures which may impede the pure market logic” (Bourdieu, 1998). In order to sanctify the power of the markets in the name of economic efficiency, this “*infernal machine*” requires the elimination of administrative or political barriers which limit the owners of capital in their quest for maximization of individual profit, which, in turn has been upheld as the supreme indicator of rationality” (*ibid*).

Thus, the concept also covers a list of economic-political- and social actions that is regarded necessary for a country to “embrace” globalization. Brought under the term “Washington Consensus”, these conditionalities are often imposed as part of the austerity programmes designed by the International Monetary Fund (IMF) and the World Bank.

Accordingly, in a market economy under capitalist competition, the profit rate (or, more generally, the rate of return to capital) is heralded as the supreme objective and the state apparatus is to be re-organized to ensure highest profitability of capital. This re-organization aims at reducing the role of the public sector in regulation of the economy, and is dressed with the rhetoric of terms such as “governance” and “market-friendly, credible governments”.

The main dictum of the globalization rhetoric rests its arguments on the allegation that “globalization is the natural product of human history and as such it is unavoidable”. Thus, all countries should follow the necessary policies (often termed as structural reforms) to take advantage of this magical process. Only then the bounties of globalization would follow to those countries that succeeded implementation of such reforms. Given this logic, the main responsibility of the developing countries is to open their economies to international capital and to implement the necessary reforms warranted by the transnational companies (TNCs) and international financial institutions (the so-called IFIs).

Thus, we can deduce three interlinked aspects of global capitalism in the current juncture: *neoliberal restructuring*, *neoliberal globalization*, and *financialization*. Neoliberal restructuring had been propagated with the counter attacks of monetarism and supply side economics in the hands of Ronald Reagan in the USA, Kohl in Germany, Margaret Thatcher in the UK, and Özal in Turkey. The assault reached its zenith in the 1990’s with the rhetoric of “*the end of history*” when all questions were declared to be answered, all unknowns were behind, and the world was on a sustained path towards global bliss.

With the rise of *globalization*, mobility of capital was enhanced on a world scale. It is estimated that China’s and India’s opening up to the global markets and the collapse of the Soviet system together have added 1.5 billion new workers to the world’s economically active population (Freeman, 2004; Akyuz, 2008). This means almost a doubling of the global labor force and a reduction of the global capital-labor ratio by half. Concomitant with the

emergence of the developing countries in the global manufacturing trade, about 90% of the labor employed in world merchandise trade is low-skilled and un-skilled, suffering from marginalization and all too frequent violation of basic worker rights in informalized markets (see, *e.g.*, Akyuz, 2008 and 2003, Akyuz, Flassback and Kozul-Wright (2006)).

Under these conditions, a large number of developing countries have suffered de-industrialization, serious informalization, and consequent worsening of the position of wage-labor, resulting in a deterioration of income distribution and increased poverty. Many of these phenomena have occurred in tandem with the onset of neoliberal conditionalities imposing rapid liberalization of trade and premature deregulation of the indigenous financial markets. Thus, across all economies, industrialized or peripheral, wage incomes collapsed; income share of wage labor in aggregate domestic product fell, and the appropriated surpluses fed the rising corporate profits. *Financialization* further meant the inflation of this bubble into make-belief values.

The assault of capital on wage labor incomes had been a common observation in all economies of the globe. But it was perhaps the most viable aspect of the US economy. Historically the United States was always been recognized as an economy with strong middle classes, thanks to the strength of its wage incomes. Yet, all of that had abruptly changed under neoliberal restructuring. Witness, for instance, the data portrayed in Figure 5. Adapted from data of the *Economic Policy Institute* (EPI) and calculations offered by Wolf and Resnick (2006), Figure 5 narrates the evolution of weekly wage rates in the US economy as ten-year averages since 1820.

Data portrayed in Figure 5 is astonishing. After a sustained secular rise in real wages for 150 years, US labor had, for the first time in its history, confronted a contraction in its remunerations. US labor had maintained *positive* wage increases even under conditions of the Great Depression of the 1930's, or under the turbulent days of the *age of the revolution* — the 1950's. The collapse of labor incomes under neoliberal restructuring had been carried on a massive and at an unprecedented scale along late 1970's and all throughout the 1980's.

Figure 5



Source: Resnick, S. A. And R. D. Wolf (2006) "Exploitation, Consumption and the Uniqueness of US Capitalism" in *New Departures in Marxian Theory*, Routledge.

Yet, the burning question ultimately resurfaces: as incomes of labor were to contract at such a scale, how would it be possible to ensure sufficient demand for the products produced? Given the logic of capitalism, wage labor is as much of a component of final demand, as it is also a cost item. Thus, pursuit of even higher profits by way of squeezing surplus out of suppressed wage costs necessarily led to periods of insufficiency of demand, culminating eventually into falling gross revenues. This dilemma of insufficiency of demand and overproduction is a direct manifestation of the anarchic character of capitalism.

It was at this juncture that the introduction of debt instruments under the post-1980 financialization had enabled the middle classes to sustain their positions as a component of final demand. During a period of falling *current* incomes, newly created debt instruments with various options of indebtedness helped the American —and elsewhere— working class to be part of the consumerist culture. As private savings fell to *negative* ratios to the gross domestic product, household debts accumulated rapidly. Financialization, thus, was not an opportune moment only for the capitalists as a class in compensating the loss of industrial profitability, but it also meant expanded consumption power for the working class which otherwise experienced significant income losses.

In order to study the structural imbalances of this new episode, we have to note that *financialization* in fact refers to a process wherein previously created values are *re-valued*. In other words, financial activities do not create new values, but admit a revaluation of the values created elsewhere in the real sectors of agriculture, manufacturing, or construction. It is no doubt that this revaluation process creates positive financial profits; but such profits do not correspond in any manner to newly created values in the material world. It is this re-evaluation that is meant by financial bubbles.

This bonanza continued as long as this façade of paper towers could have been sustained. It was finally the 2007/2008 crash in the US housing market that ignited its collapse.<sup>1</sup> To appreciate the forces at work, let's recall the knife-edge properties of the world's production and trade flows as of 2006. In Table 1 the global economy is partitioned into three regions: North America supplies \$12.4 trillion of the world's aggregate gross domestic product (35%) and meets \$1.2 trillion of total exports (roughly 15%). European economies generate 31.6% of gross world product and 45.7% of the global trade. The new "*tigers*" of capitalism, South and East Asia, produce 20.2% of aggregate world income and sustain 24% of its trade.

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<sup>1</sup> Most accounts refer to the collapse of the Lehman Brothers in 15 September 2008 as the major twist of the global crisis; but in our view the initiating was way back in 9 August 2007 when the French Bank BNA refused to extend further credit to the US housing market given the faltering signals.

**Table 1**

	<b>Total GDP (Trillion \$)</b>	<b>As Ratio to the World Aggregate (%)</b>	<b>Total Exports (Trillion \$)</b>	<b>As Ratio to the World Aggregate (%)</b>
North America	12.4	34.1 (%)	1.2	15.9 (%)
Europe	11.5	31.6 (%)	3.3	45.7 (%)
South and East Asia	7.4	20.2 (%)	1.8	23.9 (%)

Source: Dicken, Peter (2007) *Global Shift: Mapping the Changing Contours of the World Economy, The Fifth Ed.* New York: Guilford Press.

The detail hidden in the data displayed in table 1 is this: as of 2006 the north American region, while producing a third of the global product, had \$188 billion worth of exports to Europe, and imports \$317 billion from it. Exports from North America to South and East Asia amounted to \$219 billion, while its imports were \$428 billion. These numbers meant, for the USA and Canada combined a trade deficit of \$129 billion with Europe, and \$209 billion with Asia. As the North America sponged these cheap imports to its domestic market, it also succeeded in maintaining lower wages and inflows of cheap intermediate goods for its producers. What the North Americans had to offer in return was loads of “*new instruments*” of finance and a “*fiat*” currency.

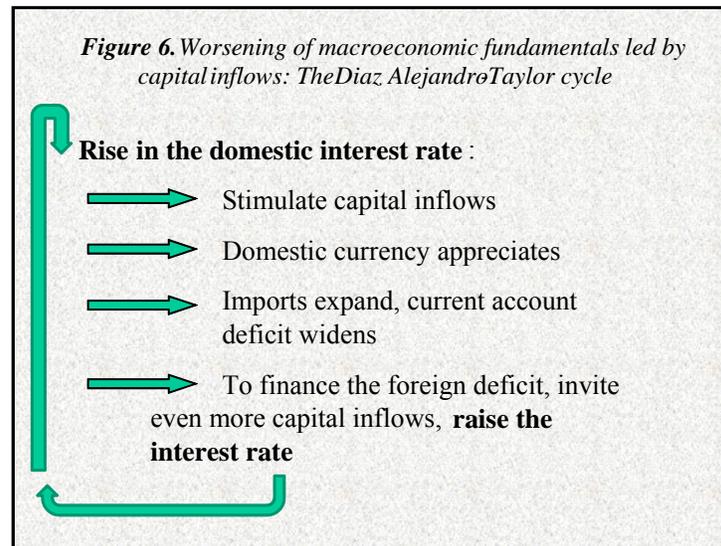
As America was transformed into a finance and services economy, production of manufactures has shifted to the factories of the world to be marketed at the export processing zones of Asia and *maquiladoras* of Latin America. Products manufactured in these peripheral regions, on the other hand, were exchanged with “*papers*” created in the casino tables of the *Wall Street*. However, the *valuation* of these *papers* ultimately rested on speculative expectations and imaginary beliefs of fictitious values. The 2007/2008 events meant the collapse of this make-belief fable, while concepts such as “*toxic assets*” and “*subprime credits*” emerged as the characteristic descriptions of this era.

## **TWO GENERATIONS OF CRISES UNDER THE AGE OF FINANCIALIZATION**

Mainstream economists usually tabulate the individual country crisis episodes in terms of *generations*, based on certain commonalities. To follow suit, I will propose that since the emancipation of financialization of global capitalism over roughly the last quarter of the 20<sup>th</sup> century, we had witnessed broadly two generations of financial crises. The first of these had typically erupted in the emerging market economies of Mexico 1994, Turkey 1994, and then again 2001, Brazil 1998, Argentina 2001, and of course, the Asian flu of 1997. Almost all of these were explained, one way another, by a form of *moral hazard*—lack of “prudential” regulation, and biased incentives emanating from the expectation that the risk-takers are *too large to fail*.

Thus, under this *first generation crises* of financialization crises erupted mainly due to premature financial liberalization; lack of governance; lack of the rule of law; etc. Typically countries which had been lured into the calls of the trumpets of “*end the financial repression; hail to the free financial markets*” (a la McKinnon, 1973 and Shaw, 1973), liberalized their financial sector too prematurely, and too hastily without any respect to their macroeconomic fundamentals. In these economies the aftermath of capital account deregulation often led to increased interest rates. Based on the motive to combat the “fear of capital flight”, this

commitment stimulated further foreign inflows, and the domestic currency appreciated inviting an even higher level of short term capital and hot money inflows into the often shallow domestic financial markets. Under these conditions the initial bonanza of debt-financed public (*e.g.* Turkey) or private (*e.g.* Mexico, Korea) spending escalates rapidly and severs the fragility of the shallow financial markets in the home country. Eventually the bubble bursts and a series of severe and onerous macro adjustments are enacted through very high real interest rates, sizable devaluations, and a harsh entrenchment of aggregate demand accompanied by the short term “hot money” outflows. Elements of this vicious cycle are further studied in Adelman and Yeldan (2000), Calvo and Vegh (1999), Dornbusch, Goldfajn and Valdés (1995), Diaz-Alejandro (1985), and more recently referred to as the *Diaz-Alejandro-Taylor cycle* in Köse, Şenses and Yeldan (2008) (following Diaz-Alejandro (1985) and Taylor (1998)). A schema of such events is portrayed in Figure 6.



The characteristics of the first generation variety of crises typically involve the following: (i) International capital market has been the major source of shocks; (ii) Flows have largely originated from and been received by the private sector; (iii) The financial crises have mostly hit emerging market economies that were considered to be highly credible and successful; (iv) The rise of capital inflows has been characterized by a lack of regulation, on both the supply and the demand sides.

Not much of a hint can be distilled from the above to prognosticate further for the current global crisis. The current crisis has clearly gone beyond the narrow geographies of the Third World of the emerging markets, and its origins lie not at the roots of standard moral hazard anecdotes, but go deep to the very structure of the global financial system. Even though the spheres of production, trade and finance are obviously inter-connected, the origins of today’s financial crisis are not rooted in the falling rates of profitability as was the case with the crisis of late 1970’s, nor in the patterns of trade that emerged since then. It is an amalgam of all these spheres in operation; it is mix of all elements of the system; it is, in short, the capitalist logic itself!

To highlight the significance of both the depth and the complexity of the current crisis episode, I will phrase the term, “*second generation crises of financialization*”. In addition to many aspects that were be highlighted in the above pages of this paper, one key difference in

the modes of adjustment is clear: the first generation crises mostly reflected the excessive risk taking behavior based on *moral hazard* opportunities and led to a *spectacular* collapse of the financial markets with a heavy dose of currency depreciation, skyrocketing interest rates, and an abrupt contraction of output. The swings of the crisis were deep but narrow, the contractions were steep and yet their duration was relatively short. What we observe over the phase of the current second generation crisis, however, is that its impact is prolonged and slow; rather than a spectacle fall, we experience a long retrenchment; adjustments are slow in coming. To depict these course of events, many analysts point to the analogy that the mode of adjustments will likely entail a “U” type of a turn, rather than a quick “V”, while many others extend the analogy to an “L” type of a prolonged stagnation, with adjustments yet to be seen...

### CONCLUDING COMMENTS: WHAT IS NEXT FOR CAPITALISM?

What does await for the capitalist world following the current global crisis? Within a broader perspective one might conjecture two possible trajectories. *First*, given the global collapse of the financial value system, reconstruction of the trade patterns might be forced through coercion. The *economic surplus* that has been created constantly in the cheap labor abundant workshops of South and East Asia ought to be *burned up*. If the market sale of this surplus in exchange of the now intoxicated financial papers eventually fails, then their ‘*consumption*’ will necessarily call for non-economic coercive measures within a possible war. At such conjunctures of the previous financialization episodes of capitalism, cycles of under-consumption/over-production had been “resolved” by way of a globally devastating war. The Marxian literature on crises, prominently Rosa Luxemburg, points out to the necessity of a ‘*corrective war*’ in order to break with the “old” institutions, “old” technologies, and “old” methods of accumulation. In our current context, the local wars that erupted in late 1990’s in the Balkans and continued with the ‘*war on terror*’ rhetoric in Iraq and Afghanistan, possibly extending over Iran and Pakistan are cited as signals to such corrective wars.

A *second* possible shift out of the current crisis might also involve a global restructuring of not only the production centers, but also the financial/administrative centers of global capitalism to new geographies. This entails a process that one might call the emergence of *third world capitalism*. Yet, given the characteristics that such a shift signal thus far, the third world capitalism entails aggressive exploitation of not only of labor, but also of the natural resources and environmental richness’s of our planet. The environmental threats and human costs of such a violent assault of capitalism will prove devastating and horrendous. Furthermore, such a restructuring shift of the centers of global capitalism will probably not be a smooth transition and will most likely trigger counter-offensive measures by the current hegemonic powers —the US, UK and Europe.

Whatever the options, one can envisage within capitalism, a realistic re-evaluation of the possible scenarios seem to exhaust all calls for optimism. One cannot help to recall Rosa Luxemburg’s cry from almost 100 years earlier: “*either barbarism, or socialism*”.

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