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İSTANBUL, 2011

Marmara Üniversitesi
Sosyal Bilimler Enstitüsü Müdürlüğü

Tez Onay Belgesi

İKTİSAT Anabilim Dalı İKTİSAT (İNG.) Bilim Dalı Yüksek Lisans öğrencisi SEDAT DEMİR nın CURRENT FINANCIAL CRISIS THROUGH THE PERSPECTIVES OF INTERNATIONAL FINANCIAL ORGANIZATIONS adlı tez çalışması ,Enstitümüz Yönetim Kurulunun 01.06.2011 tarih ve 2011-10/24 sayılı kararıyla oluşturulan jüri tarafından oybirliği/oyçokluğu ile Yüksek Lisans Tezi olarak kabul edilmiştir.

	Öğretim Üyesi Adı Soyadı	İmzası
Tez Savunma Tarihi :	14/06/2011	
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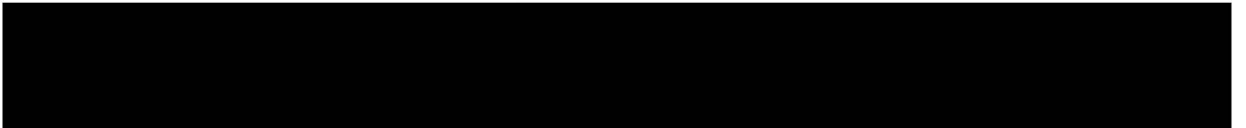

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Degree Awarded and Date : MA - June 2011
Keywords : Current Financial Crisis, Crisis Theories, Causes of the Crisis

ABSTRACT

CURRENT FINANCIAL CRISIS THROUGH THE PERSPECTIVES OF INTERNATIONAL FINANCIAL ORGANIZATIONS

The global crisis that gave its signals in August 2007 and was perceived its seriousness with the collapse of Lehman Brothers in 2008 had effected whole world economies through the finance markets and had became the competency of the dominant ideologies and ideologists open to debate. The crisis dragged a lot of companies into the bankruptcy that result in millions of people to be out of work. This was followed by the process of unrest and rebellion in many countries due to the poverty and increase in food prices. Therefore, a study aimed at understanding the causes of the global crisis has become an important and prudential issue. IMF, WB, WTO and Bank of International Settlements are global financial institutions shaping world economy, perceptions, assessments so the recipes of these institutions are really important for economists.

Perception that right diagnosis required for the right treatment is valid for economy as well as in medicine. In this study, aforementioned financial institutions, important economists and Marxist economists' diagnosis varied about the causes of the crisis are addressed in a comparative manner and a study that can form a basis for proposing a recipe is aimed.

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Tez Türü ve Tarihi : Yüksek Lisans - Haziran 2011
Anahtar Kelimeler : Küresel Mali Kriz, Kriz Teorileri, Krizin Nedenleri

ÖZET

ULUSLARARASI FİNANSAL KURULUŞLARIN BAKIŞ AÇILARI İLE MEVCUT KÜRESEL FİNANSAL KRİZ

2007 yılının Ağustos ayında sinyallerini veren ve 2008 yılında dünyaca ünlü yatırım Bankası Lehman Brothers'ın çöküşüyle ağırlığını iyice hissettiren küresel kriz, finans piyasalarından hareketle tüm dünya ekonomilerini sarsmış ve var olan hâkim ideolojilerin ve ideologların yetkinliğini tartışmaya açık hale getirmiştir. Yaşanan kriz, birçok şirketi iflasa sürüklemiş dolayısıyla milyonlarca insanın işsiz kalmasına sebep olmuştur. Ardından yaşanan yoksulluk ve yükselen gıda fiyatları haklı olarak birçok ülkede huzursuzluğa ve halk isyanlarına yol açmıştır. Dolayısıyla küresel krizin nedenlerinin anlaşılmasına yönelik bir çalışma ileriye dönük önemli bir konu haline gelmiştir. IMF, DB, DTÖ ve Uluslararası Ödemeler Bankası gibi küresel finans kurumlarının dünya ekonomisine yön veriyor olmaları dolayısıyla bu kurumların kriz algıları, değerlendirmeleri ve dolayısıyla çözüm reçeteleri ekonomistler için önemlidir.

Doğru tedavi için doğru teşhis gerekir anlayışı tıpta olduğu kadar ekonomi içinde doğrudur. Bu çalışmada adı geçen finans kuruluşlarının, önemli ekonomistlerin ve bazı Marksist ekonomistlerin krizin nedenlerine ilişkin çeşitlilik gösteren teşhisleri karşılaştırmalı olarak ele alınmış ve çözüm reçetesinin ortaya konabilmesine zemin oluşturacak bir çalışma amaçlanmıştır.

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ABBREVIATIONS

ADB	Asian Development Bank
BIS	Bank for International Settlements
CBOT	Chicago Board of Trade
CDO	Collateralized debt obligations
CDS	Credit Default Swaps
CEA	Commodity Exchange Act
CEBS	Committee of European Banking Supervisors
CESR	Committee of European Securities Regulators
CFTC	Commodity Futures Trading Commission
CITs	Commodity index traders
CMBS	Commercial Mortgage-backed securities
COT	Commitments of Traders
DJ-AIGCI	Dow Jones-American International Group Commodity Index
ECB	European Central Bank
FC	Finance Capital
FED	Federal Reserve System
FIH	Financial Instability Hypothesis
FRP	Falling Rates of Profits
FSA	Financial Services Authority
FVA	Fair Value Accounting
GATS	The General Agreement on Trade in Services
GATT	General Agreement on Trade and Development
GDP	Gross domestic product
IBRD	International Bank for Reconstruction and Development
ICE	Intercontinental Exchange
ILO	International Labor Organization
IMF	International Monetary Fund
LDC	Less-Developed Countries
LTCM	Long-term Capital Management
MBS	Mortgage-backed securities
NEER	Nominal effective exchange rate
NTBs	Non-Tariff Barriers
OECD	Organization for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
OTC	Over-the-counter
PEER	Price component of REER (PEER=NEER/REER)
PPP	Purchasing power parity
REER	Real effective exchange rate
RMBS	Residential mortgage-backed securities
S&P GSCI	Standard & Poor's Goldman Sachs Commodity Index
SEC	Securities and Exchange Commission

SIVs	Structured Investment Vehicles
SSA	Social Structures of Accumulation
TARP	The Troubled Asset Relief Program
TRIMS	The Agreement on Trade Related Investment Measures
TRIPS	The Agreement on Trade Related Aspects of Intellectual
UNCTAD	United Nations Conference on Trade and Development
VERs	Voluntary Export Restraints
WB	World Bank
WTO	World Trade Organization

1. INTRODUCTION

The collapse of the Lehmann Brothers on September 15, 2008 which was one of the oldest and most reputable investment banks in the world caused a great panic in financial markets and triggered the crisis in global economy. The global crisis gave its first signals on August 9, 2007 with spilling over of problems in mortgage and credit markets into interbank money markets. Afterwards, the bankruptcy and nationalization of world's most famous and reliable banks consecutively had led to an increase in the panic. The chronological flow of primary events can be summarized as follows (BIS, 2009):

On February, 2008; English Northern Rock was nationalized.

On March 16, 2008; JPMorgan Chase agrees to purchase Bear Stearns in a transaction facilitated by the U.S. authorities.

On September 7, 2008; Fannie Mae and Freddie Mac are taken into government conservatorship.

On September 19, 2008; The U.S. Treasury announces a temporary guarantee of money market funds; the SEC announces a ban on short sales in financial shares; early details emerge of a $700 billion U.S. Treasury proposal to remove troubled assets from bank balance sheets.

On September 25, 2009; the authorities take control of Washington Mutual, the largest U.S. thrift institution, with some $300 billion in assets.

On September 29, 2008; UK mortgage lender Bradford & Bingley is nationalized; banking and insurance company Fortis receives a capital injection from three European governments; German commercial property lender Hypo Real Estate secures a government-facilitated credit line; troubled U.S. bank Wachovia is taken over.

The world economy has entered an irreversible crisis through this bankruptcy and nationalization process that had spread to the global economy. At first, current crisis

was tried to be pass over by perceiving it as a routine financial turbulence. However, as the crisis spilled over into the real sector, as stated by UNCTAD; *"governments in many developed countries reacted with debt-financed increases in public spending and tax cuts. These were intended to counter the increasingly dramatic downturn in final demand, output and employment*." (UNCTAD TDR, 2009b, p.5) Then towards the end of 2008, it turned out to be severe, deep and a great recession affecting entire world beginning with U.S. Even though the global economy is accustomed to the crises, the current crisis is unique, not only in terms of its depth but also in the extent of its global reach: virtually it affected all economies. (UNCTAD TDR, 2009b) In other words, the current crisis just differs from the previous ones by its extent and profundity as Paul Mattick (1978) stated *"although all capitalistic crises are basically the same, each one varies with respect to its initiation, its length and depth, and the reactions evoked by it"*.

In other words, global economy is now facing with a huge unwinding inceptive based on real estate crisis that was triggered by a dramatic rise in mortgage delinquencies and foreclosures in the United States and led to emergence of adverse economic circumstances for banks and financial markets. Moreover, these circumstances are exacerbated for real-industrial sector that result in huge losses of prosperity. Therefore, as Michael Kidron (1975, p.29) implied with his words *"In order to kill the beast you have to understand its behavior",* it becomes vital to understand the underlying causes of crisis which can be possible by understanding characteristics of it.

Stuart Easterling (2003) stated that *"capitalism is an economic system that is inherently crisis-prone, it is driven by forces which cause it to be unstable, anarchic and self-destructive"*. If humanity does not do anything to change the system or put anything new instead of it, the capitalist economy will eventually recover from the crisis. As the Russian revolutionary Leon Trotsky once noted,

> *Capitalism does live by crises and booms, just as a human being lives by inhaling and exhaling. First there is a boom in industry, then a stoppage, next a crisis, followed by a stoppage in the crisis, then an improvement, another boom, another stoppage, and so on.... The fact that capitalism continues to oscillate cyclically...merely signifies that capitalism is not yet dead, that we are not dealing with a corpse. So long as capitalism is not overthrown by proletarian revolution, it will continue to live in cycles,*

> *swinging up and down. Crises and booms were inherent in capitalism at its very birth; they will accompany it to its grave* (1973, p.252).

In order to cover the causes, it is crucial to understand the crisis through the perception of institutions such as IMF, WB, WTO, BIS and UNCTAD, since these institutions are influential on economic system. Moreover, IMF, WB, WTO and BIS are regarded as the institutional embodiment of the Neo-liberal financial policies. UNCTAD differs from aforementioned institutions by having critical perspective to the Neo-liberal policies. On the other hand, it is also crucial to understand the perception of economists who are the members of Marxist political economy, since they provide an understanding of the crisis by focusing on the structural problems of the capitalist system. Additionally, to realize the roles of IMF, WB, WTO and BIS on worldwide economy, the foundation process of these institutions and dynamics of this process must be overviewed.

The time period after the World War II has been shaped by the capitalism's restructuring process which was provided by foundations of the institutions that are able to control capital movements on worldwide economy. As a result of this historic and societal process, capitalist accumulation of capital approach to a stage in which it becomes possible to make decisions on worldwide economy by taking into consideration the resources. Moreover, innovations on transportation, communication and information technologies facilitate this decision making process. However, internationalization of this sort of capital could be enabled by restructuring and integration processes of capitalism which was substantiated by foundations of IMF and WB with the agreement of Bretton Woods in New Hampshire, U.S.A., in July, 1944.

IMF has been conceived to realize the transnational mobility of finance capital and The International Bank for Reconstruction and Development (later on with another arrangement the name was changed to World Bank (WB) to arrange the transnational distributions of investments. Later on to complete these fields, consultation series was started in Havana Conference which was ended up with The General Agreement on Tariffs and Trade (GATT) in 1947. GATT lasted until 1993 and it was replaced by the World Trade Organization (WTO) in 1995. The original GATT text (GATT 1994) with

the modifications in 1994[1] is still in effect under the WTO framework. With this agreement, a new worldwide trading system has been established that ensures the transnational circulation of commodities. As a result, the restructuring and integration process of capitalism has begun with problem-free international circulation of finance capital, commercial capital and productive capital. Since aforementioned institutions established in the leadership of U.S. and England, industrialized western countries have been able to intervene poor countries under the name of international aid that legitimates the intervention through these institutions.

IMF and WB have been established under such conditions that whole countries were experiencing economic problems. Therefore, these institutions had been taken the responsibility of overcoming the balance-of-payments problems and the destructions emerged particularly in great depression and later on by the effects of the World War II, ensuring the stability of international monetary system (the system of exchange rate and international payments that enables countries and investors to transact with another), regulating contracts in foreign trade. Afterwards, IMF has taken the responsibility of surveillance and counseling structural problems of poor countries as well as funding them. In this context, it can be seen that why IMF and the other aforementioned institutions are still important since they had been established.

In this study, it is aimed to analyze the perceptions of the financial institutions in the perspective of mainstream economics and Marxist political economy comparatively. In this respect, in chapter 2, a general description of economic crisis will be given and the crisis theories will be overviewed through mainstream economic and Marxist views to clarify the thesis about crises.

Chapter 3 deals with world's most vital and major crises, great depression (1930) and oil crisis (1970). The causes and results of the crises explained in detail by mentioning the views of mainstream and Marxist economists.

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[1] World Trade Organization: WTO legal texts; General Agreement on Tariffs and Trade 1994

Chapter 4 constitutes the core of the study, since the current economic crisis is explained explicitly. Firstly the emergence of the current crisis is handled. Secondly, the causes of emergence are expressed under the perspective of Marxist political economy. And lastly, the perceptions of the institutions on causes of emergence are considered one by one: IMF, WB, WTO, BIS and UNCTAD. Chapter 5 sums up the critical findings and concludes the study.

2. CRISIS

2.1. CRISIS NOTION

In general a crisis (from the Greek κρίσις, krisis) is a sudden, unstable and sometimes dangerous social situation about economic, military, personal, political, or societal affairs. According to Seeger, Sellnow and Ulmer (2003), crises have four defining characteristics first three of them are specific, unexpected and extra-ordinary events that cause uncertainty and seen as a threat to important goals. The fourth one emphasizes the need for change as Steven J. Venette (2003) stated *"Crisis is a process of transformation where the old system can no longer be maintained."* Particularly, economic crisis can be defined as a sharp transition to a recession.

2.2. CRISIS THEORIES

The world economic system has a dynamic and renewing structure. Hence, crisis provides an opportunity for system to renew itself as mentioned in the fourth characteristic of the crisis. If a change is not needed, this event must be described as a failure rather than as a crisis. These failures can be overcome by transforming itself through regulating institutions and ideas. Moreover, at the end of this adaptation process the system would be stronger than before. On the contrary, there is an opportunity for system to its collapse and supersession by a new economic structure.

2.2.1. Mainstream Crisis Theories

Crises have been regarded by mainstream economists as problems that the markets can cope with those problems just by itself. The underlying argument of them was the demand and supply will find its own equilibrium at optimum price if the market let to be alone. This mentality assumes that the crises are not permanent problems rather they are temporary impediments for markets. Solving these instabilities will provide market efficiency and also remove so called external crises.

Beginning with the idea of Liberalism (from the Latin liberalism, "of freedom"[2]), quasi freedom had been reshaped and restructured. Firstly, it was derived as a wide arrange of views depending on liberal democracy, free and fair elections, human rights, capitalism, free trade, and the separation of church and state. These ideas had reshaped the main ideology of current economic system.

The expression of "laissez faire, laissez passer" remembered with Vincent de Gournay was first announced for the restrictions on trades which were implemented by French government. Later on, this expression has been perceived as if there is no intervention in any form; the markets will heal itself in case it faces with a crisis through supply and demand mechanisms. This is the basic principle of classical economists named after Jean-Baptiste Say[3]. According to them, by right policies the problems will be solved. All of these explanations expresses that the crises are exogenous to the system, therefore only the shocks from outside just can harm the structure and cause crises. In other words, crises are not caused by the contradictory structure of capitalism, thus they are not conceptualized.

To summarize, mainstream economics has denied the argument that the capitalist economic system produces crisis due to its nature, except some exceptional writers such as Malthus and Sismondi. This repudiation has taken the form of Say's Law in the era of classical school beginning with Adam Smith (1776) and David Ricardo (1817) and lasted until the 1870s. In that period it was assumed that all markets were mutually in equilibrium according to "Walrasian Equilibrium Theory" (General Equilibrium Theory) which constitutes the basis of the economics that has been taught in universities since classical economics (1870s) till now. Therefore, according to these schools neither over-production nor the excessive accumulation is possible, since markets clear their excesses mutually which makes impossible for crises to emerge.

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[2] Latin Dictionary and Grammar: Aid University of Notre Dame.

[3] Jean-Baptiste Say (1767–1832), who stated that "products are paid for with products" and "a glut can take place only when there are too many means of production applied to one kind of product and not enough to another". In Say's view, a rational businessman will never hoard money; he will promptly spend any money he gets "for the value of money is also perishable."

John Maynard Keynes differs from this tradition in 1930s when great depression emerged by claiming that there can be unemployment in economy when money and goods markets are simultaneously in equilibrium. Actually, the condition which Keynes defined as underemployment is exactly the crises of capitalism and it could be overcome through government interventions. Thus, it was the first time crisis had been accepted due to capitalism's nature by a mainstream economist. Furthermore, as Sungur Savran (2008, p.3) states also Keynes did not provide an explanation for "why capital accumulation necessarily produces crises", however mainstream economics which claims that the presence of crisis is not due to the structure of system, internalized the Keynes's theory and named it as Neoclassical Synthesis.

The Keynesian theory lost its popularity with the emergence of new crisis in 1970s and Neoliberal thesis has dominated the economics. Under the domination of neoclassical economics some economists that are not originated from neoclassical school and called heterodox economists such as Joseph A. Schumpeter and Hyman P. Minsky have been seriously interested in crisis. In 1970s, *the profit squeeze theory* was formulated by Andrew Glyn and Bob Sutcliffe (1971) whom were inspired by the labor movement in England. It is said that the theory was formulated against the Marxist theory of "*The law of The Tendency of the Rate of Profit to fall*" (FRP). In addition to profit squeeze theory the Marxist crisis theories will be handled under the following chapter such as underconsumption, FRP and Minsky's *Financial Instability Hypothesis* (FIH) since some of the precious economists explain the current crisis through FIH.

2.2.2. Marxist Crisis Theories

Capitalism is a historical societal system fundamentally which depends on accumulation of capital and profit phenomenon. In other words, "the essence of the system" is continuous maintaining of capital accumulation and making profits under all circumstances. Throughout the history of capitalism, crises have been integral compound of capital accumulation process and had emerged in the form of cyclical fluctuations or outstanding major crises around the world.

Since the capitalist production structure started to appear all over the world, it is seen that capital accumulation process is shaped through the crisis and within the framework of labor-capital relationship that is restructured in the post-crisis period. As the capital relations constitutes the economic and social structure of the world through crises, the theory of crisis has played a central role in the Marxist tradition, however at the same time it has been one of the weakest and least developed areas of Marxist theorizing.

The starting point of early economic studies of Marx and Engels is provided by tendency to crisis, however later on Marx resumed his early studies and presented a systematic worked out a theory of crisis in 1857 (Clarke, Simon 1994, p.7). Although Marx had not analyzed crises separately, crises had been defined as frequented places of capital accumulation process which arises through the contradictions produced by capitalist production as Clarke stated

> *At various times Marx appears to associate crises with the tendency for the rate of profit to fall, with tendencies to overproduction, underconsumption, disproportionality and over-accumulation with respect to labor, without ever clearly championing one or the other theory* (1998, p. 8).

To sum up, the way of understanding crisis in Marxist sense passes through comprehending the process of capital accumulation, since Marx considers the crisis as a consequence of contradictory nature of capital accumulation. Accordingly, every enterprise to create possibilities of more profit creates a series of obstacles and borders against profitability of capital simultaneously. In other words, capital accumulation is based on production of surplus value and every new method implemented to increase surplus value then turn out to be a border while producing surplus.

2.2.2.1. Reproduction of Capital and Capital Accumulation Process

Reproduction of capital consists of an expanding cycle of capital in which the capital invested in production process and finally realized again in the form of money. Reproduction of capital (M-P-M') process begins with Money (M) and ends up with increased Money (M'). Marx identified three different *circuits of capital*, corresponding to three interlocking segments of the economy supplying each other mutually. These

phases are distinct, but in conjunction they constitute the capital accumulation process by following each other. The crises emerge when this circulation breaks down or the system become to be unable to create more surpluses to profit.

Process begins with the purchase of means of production and labor that would be transformed to productive capital by capitalist. Afterwards, the production process which leads exploiting surplus value begins and the produced commodities are named as merchant capital. The merchant (commodity) capital which includes surplus value is converted into cash (realization) by putting it on market and consequently for a higher circulation it has to turn out to be the money capital again. The close of this process leads accumulation of capital as seen in Figure 2.1 and it can be formulated as:

$$M - C(lp/mp) \ldots \ldots C' \ldots M'$$

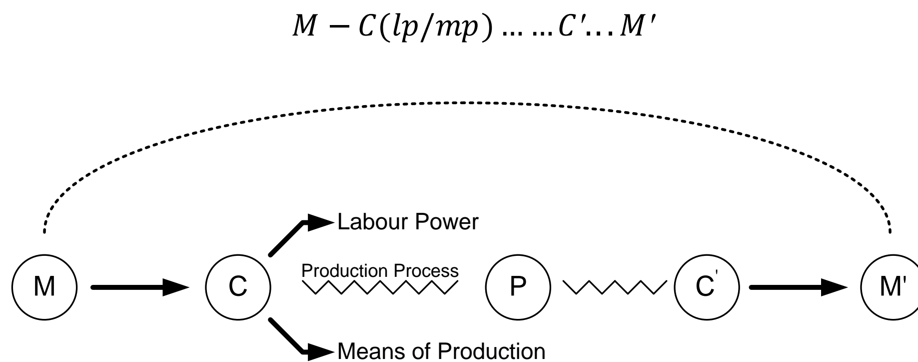

Figure 2.1: Capital Accumulation Process

Finally finance capital (M') which includes surplus value transforms to the productive capital again and gives a start for another expanded process. To a better understanding; for instance, capitalist (investor) has 100 units of money and pays 20 units for wages and 80 units for means of production. Moreover, he converts these produced commodities to cash in market and earns more than he invested initially, in our case 144 units of money after the circulation. Capitalist again restarts the circulation with 120 units of money after paying to the actors (interests, taxes etc.), let's say 24 units of money. This circulation is also called expanded production. Furthermore, due to its nature, capital drive to expand and on the way of its expansion there occur a growth both in the extent and the scale of production as seen in Figure 2.2.

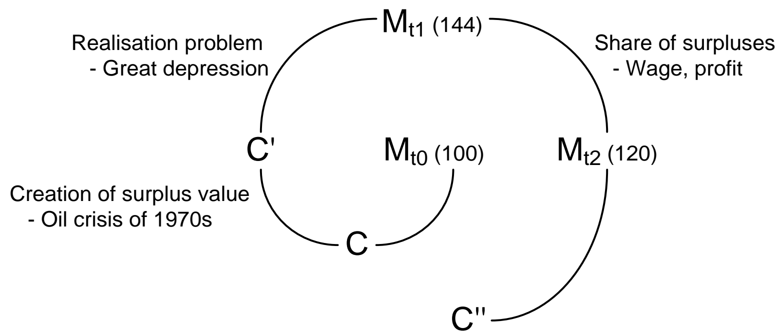

Figure 2.2: Capital Expansion Process

Additionally, within this process three different forms of capital indicate to the activity of three capital groups, while each of these forms also running along its own individual circuit, respectively indicating the activities of finance (M–C . . . P . . .C'–M'), industry (P . . .C'–M'–C . . .P), and commerce (C'–M'–C…P…C'), as Steven Kettel (2006, p.2) states *"each specific circuit nonetheless appears simultaneously as a partial movement of the reproduction process of the total social capital"*.

These three forms of capital named as finance capital, commercial capital and productive capital can exist at the same time and together. For instance, one part of commercial capital is able to be finance capital or can leave production process to circulate again in the form of commercial capital again. Consequently, the complete capital accumulation circuit is a process and a break in this process can break drown whole of the system and cause stagnation. Therefore, capital has not a static characteristic; it is a dynamic societal process that is able to reshape the societal structure through expanding.

On the other hand, whole process is composed of two phases. The first one is production phase in which surplus value is created and the second one is the circulation phase in which created surplus value is shared through distributional and consumption relations as seen Figure 2.3. In capitalist production structure, not only creating surplus value is a problem, but also sharing of this surplus value is an important problem too.

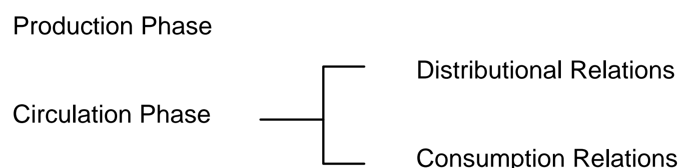

Figure 2.3: Phases of Capital

In the problem of sharing of surpluses, the distributional relations defines between which actors surpluses will be shared, meanwhile the consumption relations defines how much of surpluses will be get by which actor. Nevertheless, this cycle of accumulation always carries the potential of crisis and each phase of the total process is leave to prone. For instance, in case of a break in this circulation crises can emerge in many forms such as financial crisis, over production or effective demand deficiency. Acting with the incentive to achieve more profit, capital enlarges and come across with some impediments both in production and circulation process. Therefore, as the productivity increases, the organic composition of capital increases more than the technical composition of capital and leads rate of profits to fall in the process of capital accumulation (FRP) or it results in a realization problem (Underconsumption).

To summarize, the capitalist economic structure produces crises due to these breaks originated from its contradictory character of capitalist accumulation process. These mechanisms have traditionally been called "crisis tendencies". As mentioned above; underconsumption, the tendency of the rate of profit to fall due to a rise in the value of means of production relative to labor-power, the profit squeeze due to a declining reserve army of labor (Marx's term for unemployed workers), and over-investment (or over-accumulation) are some of crisis tendencies. According to Marxist analysts, capitalist structure produces main two types of crises as David M. Kotz stated:

> *1- One is the periodic business cycle recession, which is resolved after a relatively short period by the normal mechanisms of a capitalist economy, although since World War II government monetary and fiscal policy have often been employed to speed the end of the recession.*
>
> *2- The second is a long-lasting economic crisis that requires significant restructuring that is, institutional change -- if the crisis is to be resolved within capitalism and the capital accumulation process restored* (2010, p.2).

2.2.2.2. Theory of Underconsumption

An effort to convert commodities into cash named as the realization of produced goods. Since it is impossible to sell all of the produced goods in a capitalist economy, there will be deficiency in consumption. In other words "*underconsumption*" is the realization problem of the surplus value in the process o f circulation (Weeks, John 1977, p.282).

In the process of producing the consumption goods, as the production of surplus value improves, the demand for the produced goods has to improve too. However, the demand for produced goods is determined by the consumption of laborers and "deficient consumption" of these laborers constitutes the base of the realization problem. (Desai, Meghnad 1983, p.495)

$$W = C + S + V$$

In the above equation; (W) denotes the value of the produced consumption goods, (C) invested capital, (V) the value of labor-power (in other words wages) and (S) the surplus value created by laborer. In this manner, workers can only purchase the amount of the goods that their wages can afford where this value coincides with V. On the other hand, capitalists just purchase a little amount of total surplus value (S) which coincides with their consumption and invest most of the remaining value as a productive capital. Therefore, a little part of the mass of produced goods will be sold and most will remain that will result in deficiency in demand.

On the other hand, the theory of underconsumption is open to misunderstanding and criticism at two points. The first point is a delusion that the thought of emergence of crisis as bankruptcy of corporations which cannot sell all their produced goods due to the underconsumption shades and excludes the main mechanisms that generate crises. Indeed, the delusion here means the confusion of the shape and origin of crisis.

The second one is a criticism; the main mechanism of capitalist production is being based on consumption. In other words, the main determiner in this situation is more production of surplus value; however the problem is limited with consumption (circulation) instead of production (Öztürk, Melda Y. 2008)

2.2.2.3. The Law of the Tendency of the Rate of Profit to Fall (FRP)

Approach of the *"law of the tendency of the rate of profit to decline"* (FRP) asserts that profit rate exhibits tendency to decline due to the internal contradictions of capitalist accumulation and deals with the crisis as a result of *"law of the tendency of the rate of profit to decline"*. On the other hand, FRP is one of the most controversial subjects in Marxist literature. Marx pays attention as

> *This is in every respect the most important law of political economy, and the most essential for understanding the most difficult relations. It is the most important law from the historical standpoint. It is a law which, despite its simplicity has never before been grasped and even less, consciously articulated* (2005, p.748).

According to this law, crises are based on the falling rates of profits (FRP) in capitalist production. John Weeks describes the law as this inclination is not a trend moreover itself emerges because of the internal pressure of the capital. At this point, according to Weeks (1977, p.286) crisis is a result of internal contradictions and a criteria of an unwinding of these contradictions on an upper level of capital as a societal relationship. Before explaining the theory mathematically, it would be useful to explain about the terms that Marx used in expression. Marx defines three compositions of capital and the term of organic composition of capital is one of them. Increase of the organic composition of capital causes decline in the profit rates in long term and becomes an impediment on capital accumulation (Marx, 1992). Moreover, Marx expresses the relationship between the profit rate and the organic composition of capital as:

[...] this gradual change in the composition of capital is not confined only to individual spheres of production, but that it occurs more or less in all, or at least in the key spheres of production, so that it involves changes in the average organic composition of the total capital of a certain society, then the gradual growth of constant capital in relation to variable capital must necessarily lead to a gradual fall of the general rate of profit, so long as the rate of surplus-value, or the intensity of exploitation of labor by capital, remain the same. Now we have seen that it is a law of capitalist production that its development is attended by a relative decrease of variable in relation to constant capital and consequently to the total capital set in motion (1992, vol. 3).

Marx emphasize that the factors causing tendency to decline in the profit rate also creates the factors named as countertendencies that prevent or decelerate this decline simultaneously. These countertendencies weaken the effects of the general law by crossing and cancelling the effect of general law, and they only give the characteristic of a tendency. Walter Daum classified these countertendencies as:

1- the increasing intensity of exploitation, which increases surplus value,

2- the cheapening of units of constant, and especially of fixed, capital - which lowers the value of invested capital and therefore raises the profit rate as a percentage of it,

3- foreign trade, which enables capitalists to invest where profits are high because of low-paid workers (1990, p.32).

As Marx states (1992), this law works as a tendency, therefore its influences can only appear in long term. Empirical studies for different countries that prove this law can be seen in Figure 2.4, Figure 2.5 and Figure 2.6. In the case of decrease in the value of constant capital due to the increase in productivity so decrease in the rate of constant capital over variable capital, countertendencies can appear simultaneously or consecutively. Crisis is a result of these contradictory factors that shows in conflict burst in depression times. Depressions are always temporary and oppressive solutions of the existent contradictions. These are sharp (strong, heavy) explosions that build up the stability which was broken out for a while (Marx, 1992).

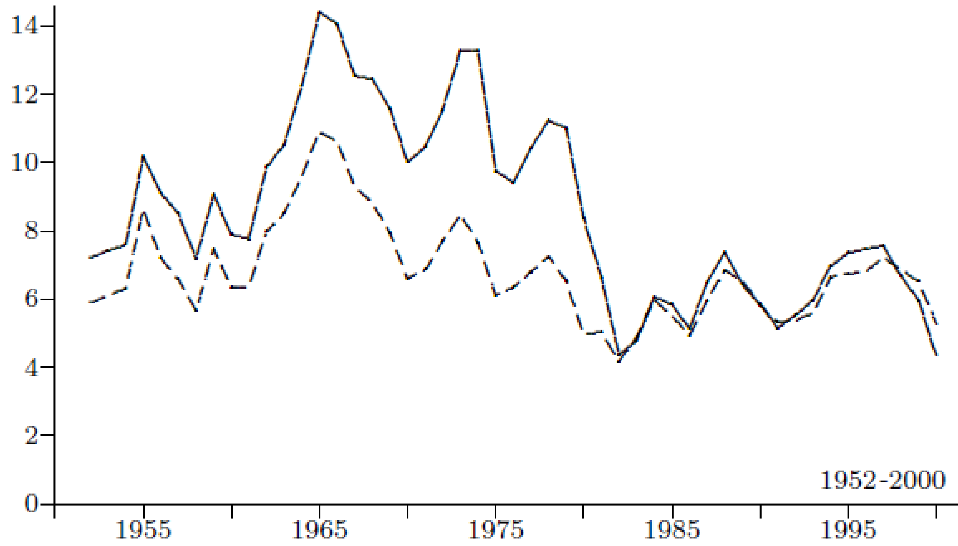

Figure 2.4: U.S. Profit Rates Accounting for (—) and Abstracting from (- -) the Impact of Financial Relations: NFR-Corporate Sector

Source: Dumenil, G. and Levy, D. (2005). The Real and Financial Components of Profitability. p.11 http://www.jourdan.ens.fr/levy/dle2004g.pdf

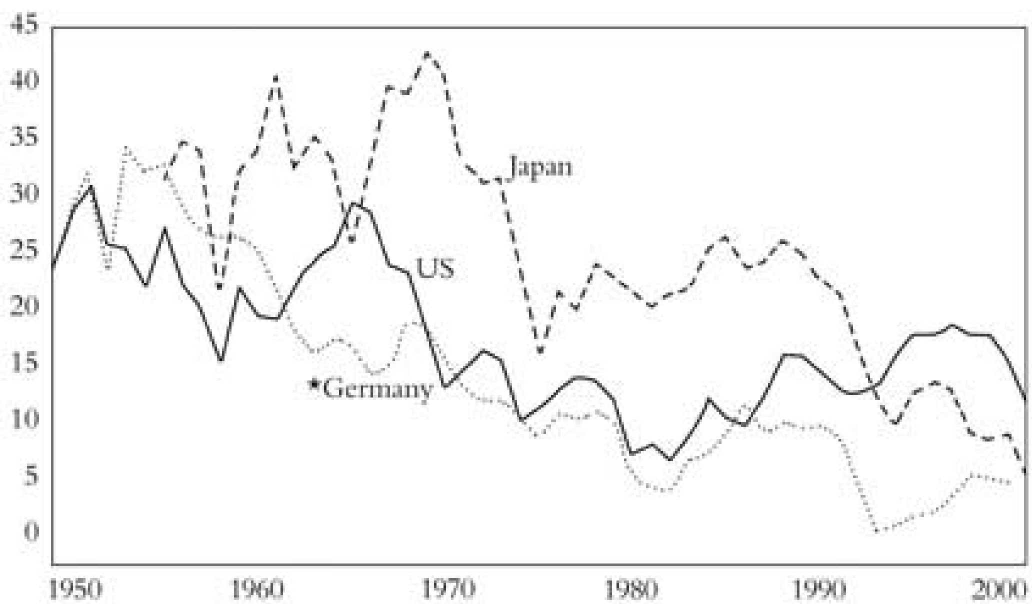

Figure 2.5: U.S., German and Japanese Manufacturing Net Profit Rates

Source: Brenner, R. (1998). The Economics of Global Turbulence. *New Left Review I/229*. Sp. Iss.. p. 7.

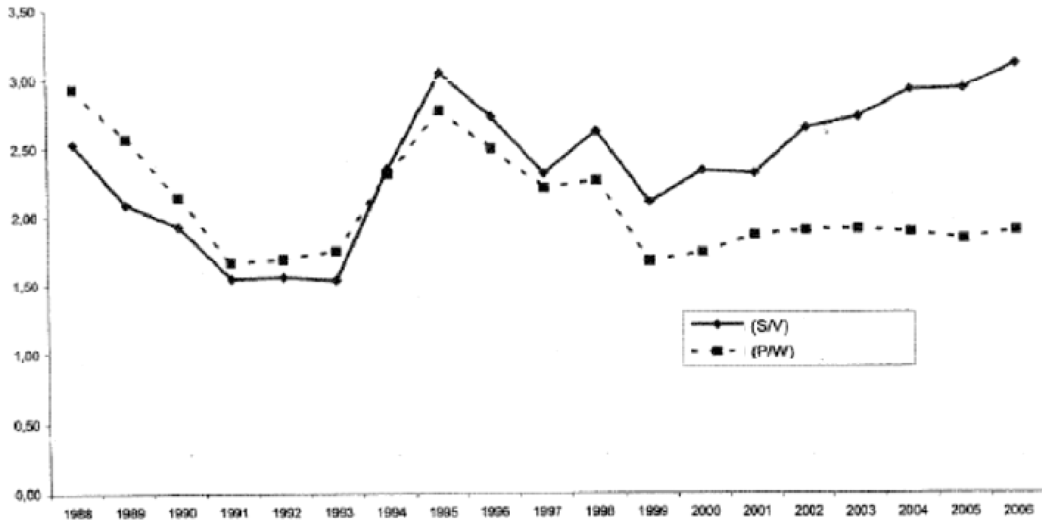

Figure 2.6: Surplus Value and Profit Wages Ratios Turkey, 1989-2006.

Source: Karahanoğulları, Y. (2009). *Marx'ın Değeri Ölçülebilir mi? 1988-2006 Türkiyesi için Ampirik Bir İnceleme.* Istanbul: Yordam Kitap.

As mentioned before, Marx distinguishes three different composition of capital. The first one is technical composition, second one is value composition and third one is organic composition. Technical composition of capital is expressed as the ratio of mass of means of production to required labor employed. In terms of value, this ratio so the relationship between constant and variable capital gives the value composition of capital. The value composition of capital is called as organic composition of capital when it is specified by technical composition of capital and reflects the variations in this composition (Marx 1992, vol. 1).

Marx relates the decline in the rate of profit with the increase in the organic composition of capital. Increase in organic composition of capital is a result of increase in technical composition of capital which necessitates increase in labor productivity by mechanization in production. As an algebraic formula, the rate of profit (R) can be expressed as:

$$R = [S/(C + V)]$$

where S stands for surplus value that can be considered as rate of profit, C for constant capital and V for variable capital that can be considered as wages. In the theory, C increases faster than S with respect to V over time. In other words, by dividing all the terms with the variable "V", equation is obtained as:

$$[(S/V)/\{(C/V)+1\}]$$

where (S/V) is surplus value ratio and (C/V) is organic composition of capital. Since (C/V) increases faster than (S/V), rate of profit decreases in long term., therefore the overall ratio decreases.

The law of the tendency of the rate of profit to decline regarded as one of the fundamental laws of accumulation of capital; however it was one of the most criticized laws of Marxist Politic Economy. The main criticism to this law is due to the statement that is surplus ratio will be increase with the increase in organic composition of capital and decline in rate of profits can be prevented with the increase in surplus ratio. Another criticism that is similar to previous one is upon the statement that is value composition of constant capital will be stable with increase in productivity. Since there is not an increase in organic composition, rate of profit will not be decline. Besides these two criticisms, third criticism is directed towards necessity of considering countertendencies in the mechanism of the law. The last criticism claims that the thesis which states rate of profit is declined by technical improvements is not rational. According to this, the way of mechanization chosen by capitalist is because of increasing profits; they do not choose this way if their profits would decrease.

2.2.2.4. Disproportionality

Law of disproportionality and the theory of underconsumption were mentioned together formerly. Unlike underconsumption theory, disproportionality is the theory that the overproduction of some commodities and the underproduction of others due to the capitalist anarchy. Especially, theory refers the disproportion between production of means of production (department I) and means of consumption (personal) (department II). The theory is developed through series of discussions between Tugan-Baranosky,

Kautsky and Engels; however it has not been taken account as a theory until Rudolf Hilferding has developed disproportionality as a theory in his book named *Finance Capital.* Moreover, Kautsky had retreated from this theory towards underconsumptionism in response to Bernstein's critique (Clarke, 1994).

Clarke (1994) stated that *"Hilferding studied on Tugan's criticism of underconsumptionism, that underconsumption is only a special case of disproportionality."*[4] The term underconsumption does not make any sense in economics except signing that society is consuming less than it has produced. However, it is impossible to conceive how that can happen if production is carried on in the right proportions. Like underconsumption and FRP, law of disproportionality refers the problematic structure of capitalism and cannot be taken into account to explain the periodic crises (Clarke, 1994). Marx's analysis shows that capitalism's drive to accumulate creates cyclical overproduction in all areas, even assuming disproportions between spheres. In his words:

> *[...]to say that there is no general over-production, but rather a disproportion within the various branches of production, is no more than to say that under capitalist production the proportionality of the individual branches of production springs as a continual process from disproportionality, because the cohesion of the aggregate production imposes itself as a blind law upon the agents of production, and not as a law which, being understood and hence controlled by their common mind, brings the productive process under their joint control* (Marx, 1992, vol. 3, p.365).

Disproportionality was the first alternative to underconsumptionism before World War I. It was held by theoreticians who hoped that the development of capitalism would moderate tendencies toward crises. Today, its implications are clearer: it is favored by Stalinists and social democrats that view the solution to capitalism's crises as state economic intervention, which can supposedly overcome the anarchic disproportions arising from an unplanned market.

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[4] Hilferding notes that the problem of realization cannot be solved by the expansion of consumption since the problem of disproportionality lies on the nature of capital. The capitalist society has its own contradictions between production and consumption which generates disproportionality. Also these contradictions develop into a crisis. (FC. pp. 241)

2.2.2.5. Profit Squeeze Theory

Profit squeeze theory becomes popular instead of underconsumption theory with the crisis that emerged early in 1970s and spread out the entire world. Different from previous crises, this crisis announced itself with high unemployment, high inflation and dramatic decline in rate of profit. Theory of profit squeeze associates crisis with actual decline in rate of profit and according to this theory, actual decline in rate of profit is the main cause of the crisis.

Theory of profit squeeze argues that increase in organic composition of capital could not be the main cause of decline in rate of profit. Therefore, the reason behind the decline in rate of profit is not a structural tendency as in the law of the tendency of the rate of profit to decline; it is struggling of working-class (laborers) on their wages. In this respect, crisis is based on distribution of surplus value between capital and working-class as profit rate and wages. Profit squeeze theory highlights the factors such as wages, profits, taxes and foreign trade rates as analyzing items, since these are the points where structure of this distribution is shaped.

Theoreticians of the profit squeeze theory suppose that countertendencies of the tendency of the rate of profit law would be dominant. Theoreticians study on if basic sum of tendency and countertendencies have an effect on decline in rate of profit in spite of relating tendency with contradictory structure of capitalist accumulation. As a result, a change in technical composition of capital does not lead to a compulsory change in value composition.

According to theoreticians, even if value composition of capital increases this would not result in compulsory decrease in profit rates (Fine, Ben and Harris, Laurence 1997, p.66). In other words, increase in wages is the main reason of decrease in rate of profit. The relation between struggling of work-class and rate of profit can be explained as follows. In the expansion phase of the capitalist accumulation process, productive investments kept up or continued and employment rises. Bargaining power of the laborers rises due to the fall in reserve army of industry, in other words decrease in unemployment increases the real wages (Öztürk, 2008, p.39). Finally, increase in wages

squeezes the rate of profit and lead to crisis to emerge the original profit squeeze theory is formulized by Andrew Glyn and Bob Sutcliffe (1971, pp.71-72).

2.2.2.6. Financial Instability Hypothesis (FIH)

Hyman Minsky[5] theorizes that, even in the absence of external shocks, the capitalist economy inherently tends to develop instability, which eventually reaches economic crises whereas all the mainstream economists express that crises are just because of external shocks. Minsky (1992) stated that the key mechanism that pushes the economy towards a crisis is the accumulation of debt.

In economy during booms, borrowers almost rewarded by lenders (Minsky labeled them as "merchants of debts"). Due to the solvency of borrowers and optimistic boom trend of economy, the lenders encourage lending and they assume that they will be repaid by borrowers with high levels of profits seamlessly. However, when the growth of debt burden increases rapidly more than the increase in redemption of debts and service of debts, this situation in general gives bad signals for entire economy.

Furthermore, Minsky (1992) theorized that financial fragility is a typical feature of any capitalist economy and. high fragility leads to a higher risk of a financial crisis. In other words, the longer period of boom the higher fragility the system is exposed to. To ease the analysis, Minsky classifies three approaches according to the risks that firms venture that are called as "hedge, speculative and Ponzi finance". The stability of financial structure is depended on the combination of those three. For instance, instability increases with the shift of finance from hedge, speculative than to Ponzi respectively. Minsky states the shift as:*"In particular, over a long lasting period of prosperity, capitalist economies tend to move from a financial structure dominated by hedge finance units to a structure in which there is large weight to units engaged in speculative and Ponzi finance"* (1992, p.8). These three cases of Minsky are summarized by Frank Shostak (2007) as:

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[5] Hyman P. Minsky (1919–1996), was a prominent member of the post-Keynesian school of economics

"1- The first type he defines as hedge borrowers who can meet all debt payments from their cash flows in every period both the principal and the interest loans."

In other words, when economy does not inspire confidence, firms choose only hedge, the safest. After wards, as the economy begins to inspire confidence with industrial growing and when profits rise, firms tend to believe that they can succeed in speculative financing.

"2- The second type is speculative borrowers who can fulfill interest payments but must continuously roll over their debt to be able to repay the original loan."

In the second case, firms estimates that profits will not purchase all the interest; however, believe that profits will rise and the loans will be repaid seamlessly. More loans lead to more investment, and the economy grows. Later on, lenders also tend to believe that they will be repaid seamlessly. Consequently, they tend to believe that they can lend to firms without full guarantees of redemption of debts. Moreover, due to the encouragement given by the growth of economy, investors preferred to invest in sophisticated instruments of finance market that promises high rates of returns. Actually, despite of giving high rates of return, these complex instruments (derivatives) have little substance especially subprime-mortgage-backed securities.

During boom, merchants of debts try to attract investors to buy the debts by means of innovations. Indeed, bankers (using the term generically for all intermediaries in finance), whether they be brokers or dealers, are merchants of debt who strive to innovate in the assets they acquire and the liabilities they market (Minsky, 1992).

"3- The third group of borrowers is defined as Ponzi borrowers; they can repay neither the interest nor the original loan. These borrowers rely on the appreciation of the value of their assets to refinance their debt."

In third case, credits became a bit risky and also many risky credits have been taken in economy. When economy starts to signal badly lenders stops to lend and

became more deliberative, since refinancing debts becomes impossible for many firms. These cases establish a cycle recursively; therefore, now it is the time for firms to hedge again because resources of money in economy are a bit closed for firms to refinance. Merchants of debts curtail their supply of funds and borrowers are pushed to bankruptcy, since they cannot renew their borrowing to pay debts — according to Minsky it is time for crisis to emerge (Shostak, 2007, p.2).

As a result, Minsky's Financial Instability Hypothesis claims that financial crisis comes through being reckless of borrowers and lenders as time passes. Despite the fact that Minsky is not regarded as a mainstream economist, the point that he was criticized is his not taking into consideration "the societal character of capital accumulation"

2.2.2.7. An Assessment on Crises Theories

Crisis theories or tendencies of capitalism expose different sides of capital accumulation and concentrates on different causes. For instance, the theory of underconsumption emphasizes the importance of consumption. If the commodities cannot be realized, this realization problem constitutes an impediment against the accumulation of capital. In other words, underconsumption or deficiency of demand forms the main dynamic and the borders of capital accumulation.

On the other hand, profit squeeze theory refers to the class struggle between workers and capitalists. At the same time it focuses on the problem of distribution of surplus value created in production. Therefore, the efforts of capitalists to make the production process more profitable come across with resistance of working class. Besides referring a class struggle, profit squeeze theory ignores the existence of the theory of FRP and the value theory of Karl Marx like underconsumption theory.

3. 1930s AND 1970s CRISES

3.1. 1930s GREAT DEPRESSION

The crisis which has emerged in 2007 and has affected the entire world is being accepted as the most intensive and severe crisis which capitalist world economy has faced since Great Depression. All long term booms in capitalist economic structure (system) have always been followed by a depression and could just been overcome with a transformation.

In other words, system had to be transformed to survive; therefore, experienced crises have caused some societal, hegemonic transformations. Moreover, to adopt and survive, some institutions had been established and some ideas had changed, etc. But all experienced major crises have been accepted as deep, severe and intensive by different writers due to their different features. Giovanni Arrighi (2010) explains aforementioned transformation by defining "signal crisis" as the beginning of each financial expansion and the "terminal crisis" as the end of financial expansion and asserting after the end of terminal crisis there would be a transformation by his words:

> *Although financialisation enables its promoters and organizers to prolong their leadership in the world economy, historically it has always been the prelude to the terminal crisis of the dominant regime of accumulation, that is, to its collapse and supersession by a new regime* (Arrighi, 2010, p.371).

The crisis existing between 1872 and 1896 was the first major capitalist crisis of known history. Afterwards, the great depression emerged not letting the humanity to prosper. Ingo Schmidt (2008, p.3) explains the emergence of the slump with the statement: "*The Great Depression that followed the stock market crash of October 1929 came after that U.S. just had started to dominate the world's politics and economy*" which put hundreds of millions out of work throughout the 1930s. Contrary to common vision on beginning of the Great depression, Chris Harman claims that accepting the great depression began with the Wall Street crash implies that the current crisis is product of financial crisis. Thus, Harman states that:

U.S. economy was moving into recession before the Wall Street Crash. There was the beginning of a recession in 1927, but this came to an end with a brief upsurge of industrial investment. By early summer 1929 this surge had come to an end, and by July and August production was falling. Business was in trouble before the crash (2009, p.1).

After the end of World War I, the world economy was boosted by a period of reconstruction under the leadership of U.S. The era of reconstruction caused an unprecedented boom in the U.S. which is called as the "Roaring Twenties". The growth of industry was also reflecting the Wall Street's rise as seen in Figure 3.1 and Figure 3.2; in May 1924, the New York Times Index was 106; by December 1925 it was 181. By December 1927, the index stuck in 245.

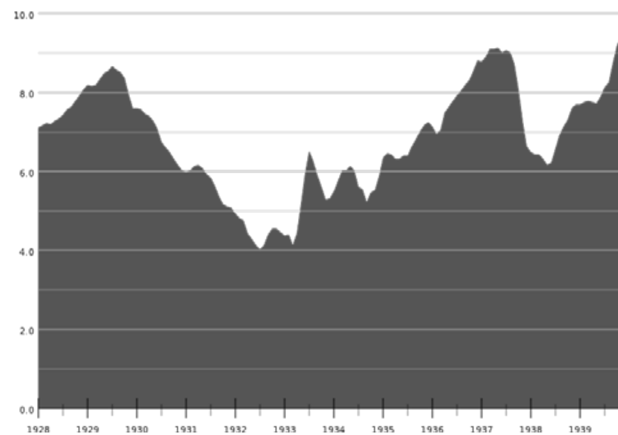

Figure 3.1: Graph of the United State's Industrial Production from 1928-1939.

Source: http://research.stlouisfed.org/fred2/data/INDPRO.txt

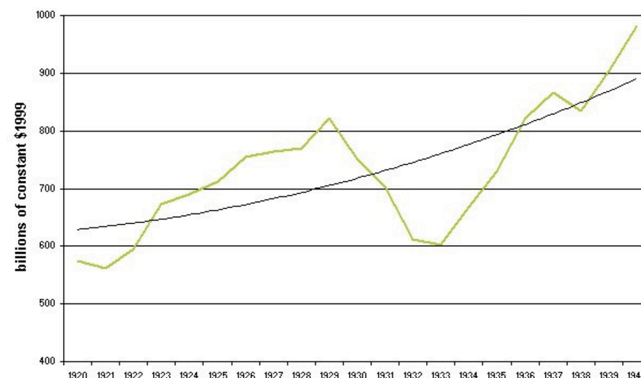

Figure 3.2: U.S.A GDP Annual Pattern and Long-term Trend, 1920-40.

Source: Susan Carter, ed. Historical Statistics of the US: Millennial Edition (2006) series Ca9.

Despite an exceptional level of productivity, laborers could no longer support the enormous mass of fictitious capital[6] which was created by speculation on the share market and unsecured bank loans. For instance, shares of Goldman Sachs which is one of the main actors of the current crisis, were being sold from 104$ then increased to 222$ in a few months. In the spring of 1932, shares of Goldman Sachs catastrophically declined to 1.75$ (Kozanoğlu, Hayri 2009, p.29).

Since U.S. economy was under the domination of private enterprise and free markets, there were not any regulations on markets and no practice of government intervention on finance and any other markets. In other words, there was not any imposition of economic sanctions by governments in general; thus, the economies were under the affects of market. As profitability declined on October 1929, share prices collapsed and a chain of bankruptcies and defaults were triggered and spread the whole world.

Output fell sharply, unemployment rose suddenly, and prices fell in a deflationary spiral as seen in Figure 3.3. Factories and businesses closed further, millions of workers plunged into poverty. By late 1932, share prices had fallen to 20 percent of their value in 1929 and 11,000 of the United States' 25,000 banks had collapsed, manufacturing output had fallen to half its level in 1929, and 25 to 30 percent of workers were unemployed throughout the world.

Moreover, the Great Depression spread rapidly from the U.S. to Europe and the rest of the world as a result of the close interconnection between the United States and European economies after the World War I. Since the European economies had been weakened by the war and needed credit to reconstruct their economies, the U.S. became the major creditor of the Europe. Therefore, when the U.S. economy slumped, credits and loans were called in and whole national economies were thrown immediately into bankruptcy. Germany and Great Britain, which were deeply in debt to the U.S. were

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[6] Bottomore, Tom: A dictionary of Marxist Thought. Fictitious Capital is value, in the form of credit, shares, debt, speculation and various forms of paper money, above and beyond what can be realised in the form of commodities.

smitten worst: nearly 40 percent of the German workforce was unemployed by 1932. By the 1920s, particularly as a result of American loans to Europe after World War I, the world had begun to develop towards a single market.

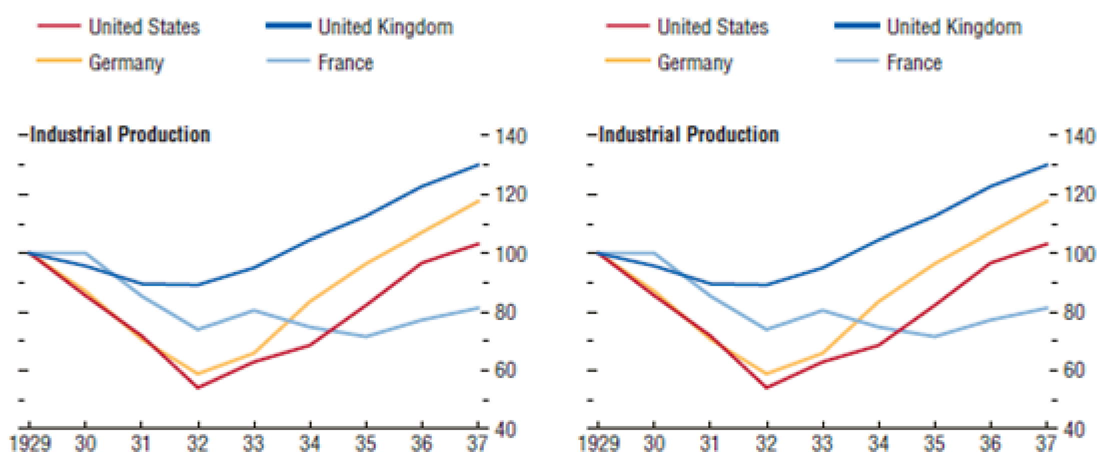

Figure 3.3: Activity and Prices during the Great Depression (1929 = 100)

Source: Mitchell, B. R. (2003). 5th ed. *International Historical Statistics: Europe, 1750–2000*. New York: Palgrave Macmillan.

After the collapse of many domestic markets, some countries wanted to dump their products into markets in other countries, searching at least to recover their costs. However, every country set tariff barriers and quotas to block foreign imports. Bankruptcies made international economy to trade on the basis of gold. The U.S. dollar was fixed at US$35/oz., where other countries such as Germany were suffering from hyper-inflation and their currency was worthless. As a result the total value of world trade had halved by 1932 due to the tariff barriers and export quotas. In 1932, Franklin D. Roosevelt was elected as president in U.S. Promising welfare and better conditions for workers under the name of New-Deal notion made easier for Roosevelt to be elected. Moreover, Roosevelt promised that government will be in an active position and prevent economy from destructive practices of business. Later on, with the help of these policies, economies began to recover slowly. On the other hand, escalating war spending made factories to employ workers which create conditions for World War II. War spending and weapon production made a lot of job opportunities for unemployed, nevertheless unemployed were sent off to war. Finally, a new economic doctrine which

emphasized the role of government in regulating demand and containing unemployment with public works programs took the place of the *laissez faire, laissez passer* doctrine.

Table 3.1

Timeline of Economic Events during Great Depression

Year	Tax Receipts	Federal Spending	GNP Growth	Unemployment Rate (%)
1929*	....	....	....	3.2
1930	4.2	3.4	- 9.4	8.7
1931	3.7	4.3	- 8.5	15.9
1932	2.9	7.0	- 13.4	23.6
1933**	3.5	8.1	- 2.1	24.1
1934	4.9	10.8	+ 7.7	21.7
1935	5.3	9.3	+ 8.1	20.1
1936	5.1	10.6	+ 14.1	16.9
1937	6.2	8.7	+ 5.0	14.3
1938	7.7	7.8	- 4.5	19.0
1939	7.2	10.4	+ 7.9	17.2
1940	6.9	9.9		
1941	7.7	12.1		
1942	10.3	24.8		
1943	13.7	44.8		
1944	21.7	45.3		
1945	21.3	43.7		

Source: http://www.colorado.edu/AmStudies/lewis/2010/econ.htm

Receipts: Tax receipts as a percentage of the Gross Domestic Product
Spending: Federal spending as a percentage of the Gross Domestic Product
GNP: Percent change in the Gross National Product
* Great Depression begin
** New Deal begins

3.1.1. Keynes and the Neoclassical-Keynesian Synthesis

Keynes differed from classical tradition in 1930s when great depression emerged. As a matter of fact that underemployment defined by Keynes responds the crises of capitalism. Although some economist classifies Keynes as not a mainstream economist, it was the first time it had been accepted that capitalism creates crisis inherently by a mainstream economist. However, Keynes also did not give an

explanation for the question "why capitalism is crisis-prone". Mainstream economics which rejects that capitalism inherently creates crisis, Keynes's theory internalized by the mainstream theoretical framework and named the new theory as *"The Neoclassical-Keynesian Synthesis"*.

With Keynesian economy policies, it has been claimed that the crisis can be overcome via government interventions. In order to clarify how Keynes has been carried and imposed into mainstream economics, the Walrasian equilibrium is needed to be understood. Walrasian equilibrium assumes that all markets money (M), bonds market (B), goods market (Y) and also labor market (L) are in equilibrium as seen following expression.

$$(M^d - M^s) + (B^d - B^s) + (Y^d - Y^s) + (L^d - L^s) = 0$$

An excess supply in one market corresponds to an excess demand at least in another market mutually, since total of the excess demands in all markets equals to zero. For instance, if there is an excess supply in labor market ($L^s > L^d$), there will be an excess demand in goods and services market ($Y^d > Y^s$) under the assumption that money and bonds market are in equilibrium. However, Keynes claimed that the labor market may not be in equilibrium meaning that there can be unemployment in the economy which was unacceptable for mainstream economists according to the Walrasian Equilibrium.

Keynes explains that equilibrium in labor market is prevented together with the rigidities in real wage which is referred as involuntary unemployment. In other words, equilibrium in labor market requires decline in real wages and even if the laborers are willing to work at a low level, an impediment for such a decline brings about disequilibrium in labor market.

By the post-war period, Keynesian ideas was reconsidered again and formalized by many economists under the name of the "Neoclassical-Keynesian Synthesis". IS-LM model is the core of Neoclassical-Keynesian Synthesis which was firstly introduced to economics by John Hicks (1937) as seen in Figure 3.4 and later on

expanded by Franco Modigliani (1944). The IS-LM model explains the main idea of Keynes with a form of system of simultaneous equations.

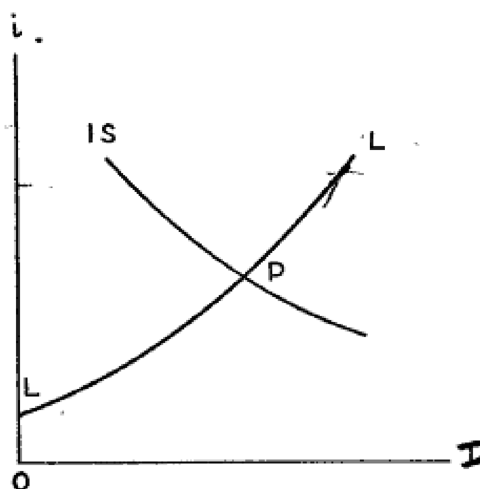

Figure 3.4: Drawing of IS-LM Curves

Source: J. Hicks' 1937 drawing of IS-LM from Econometrica

Solution of Keynesian analysis under IS-LM model generated a neoclassical result of full employment instead of unemployment equilibrium of Keynes. It was possible to obtain the Keynesian results of unemployment equilibrium only under the sticky wages assumption. Thus, rigid money wages appealed into the simultaneous system of equations by Neo-Keynesians and the resulting solution was Keynesian unemployment equilibrium. In other words, the system gave the solutions for perfectly working IS-LM in long run and imperfectly working solutions in short run which were Keynesian conclusions. Thus, the original implication of Keynesian theory was misinterpreted by neoclassical synthesis.

The Neoclassical-Keynesian Synthesis became successful and dominated macroeconomics for a long time. Together with Phillips curve mentality which implies a negative relationship between inflation rate and unemployment rate, provides a motivation for government intervention since unemployment rate can be reduced by an increase in inflation rate. However, the Neo-Keynesian system came across serious trouble in the early 1970s, when inflation and unemployment emerge both at the same time which is referred as stagflation. Keynesian policies were not able to generate

solutions for these problems. But monetarist school under the leadership of Milton Friedman (1968) proposed a "natural rate of unemployment hypothesis" which suggests that decline in unemployment with due to rise in inflation is only a short-run case. But in the long run, as inflation rate will be taken into account in the new wage contracts, nominal wages will become higher, leading to a return to higher unemployment. Natural rate hypothesis was formalized by Edmund Phelps, Robert E. Lucas, and Thomas Sargent and used as the basis of a "New Classical" macroeconomic theory.

3.1.2. Mainstream Explanations for the Slump

During the Great Depression period, the prevailing ideology was the mechanism of supply and demand. Therefore, most of the explanations by mainstream economists were being made through the broke of this mechanism. Since underconsumptionist theories were popular in between both Marxist and mainstream economists, most of the explanations were shaped through the theory of underconsumption. An English economist Arthur Cecil Pigou provided an interpretation through the break of the supply and demand mechanism due to the labor market in which workers did not except the cuts from their wages and giving it up.

A monetarist explanation was provided by a neoclassical economist Irving Fisher, who claimed that the money supply was too low which leads to falling prices, over-indebtedness and bankruptcies. Referring to this explanation, many monetarist economists blame on the U.S. Federal Reserve Bank because of tightening money supply.

After the end of World War I, the world economy was boosted by a period of reconstruction under the leadership of U.S. which is called as the "Roaring Twenties" and led a boom in U.S. economy. Friedrich von Hayek and the "Austrian school" of economists argued that because of unprecedented boom there was excess credit which had led to disproportionately high level of investment. This situation could only end up with a slump. Contrary to Keynesian explanations, in this explanation government interventions can make things worse (Parker, Randall E. 2007).

Many other economists criticized policy of government that was efforts of maintaining the gold standard. Keynes and his followers such as Alvin Hansen and Paul Samuelson saw an excess of saving over investment leading to a lack of "effective demand" for the economy's output. (Parker, 2007, p.14)

3.1.3. Marxist Explanations for the Slump

In general, the slump of 1930s has been mostly interpreted as a realization problem both by Marxists as well as mainstream economists. Since the thesis of underconsumption theory was a dominant argument in that era, suggestions were mostly on solving the problem of the realization of produced commodities which had not been sold in the market. The main suggestion for the problem was interventions by the hand of government that is proposed by Keynes who was in fact a member of British Liberal Party.

In addition, the Marxist economists provides an understanding of the great slump different from mainstream economists who cannot by focusing on a central element in Marx's theory—the tendency of the rate of profit to fall (Harman, 2009). Marx argued that this tendency is caused by the lack of coordination of investment decisions through the capitalist economic system. The capital accumulation proceeds faster than the growth of the productively employed labor force through the mechanism of falling rate of profit (FRP). Moreover, those laborers are the source of surplus value. Therefore, the ratio of surplus value to investment—the rate of profit—tends to fall (Harman, 2007). Additionally, as the rate falls, incentive for investment diminishes and leads to a slowdown in accumulation in the long period. Consequently, recessions will get deeper as the system gets older. According to many of the precious economists the slump of 1930s was due to the FRP.

In conclusion, the Great Depression has proved that circulation process is the weakest link of the capital accumulation process. Moreover, since the link could not have been fixed, the Great Depression had emerged and throughout the depression some factors evolved that eventually established the U.S. hegemony. "The first was a wave of

labor unrest in the new mass production industries that led to industrial unionism and the New Deal" as Schmidt (2008, p.5) stated.

3.2. 1970s OIL CRISIS

After the great depression which began in 1929 and continued throughout 1930s, the world economy faced with a serious crisis again in 1970s. In general, it is accepted that an oil shock triggered the crisis and then it turned out to be a world-wide economic crisis. Before explaining the causes of the crisis, it will be sensible to analyze the conditions that led to crisis and the oil crisis which shaped 1970s, i.e., so-called the cause of the slump of 1970s.

On 15th October 1973, Organization of Petroleum Exporting Countries (OPEC) which was firstly founded in 1961 by five Middle East countries as a counterforce to power of "Seven Sisters" (Standard Oil, Texaco, Chevron, Mobil, Exxon, BP, and Royal Dutch Shell) to set oil prices[7] announced that the institution will lay embargo on oil in response to U.S.A for supporting Israel in the Yom Kippur[8] war. Moreover, OPEC declared that they will no longer export oil to not only U.S.A but also the countries which defined their attitudes on the side of Israel which meant a five-month oil embargo on aforementioned countries. For instance, Netherland was completely under the OPEC embargo of oil but England and France were being able to buy their oil seamlessly[9]. Nevertheless, OPEC member countries decide to increase the sources flowing into their countries through oil exports by raising the oil prices. This was a response to Western countries that had been buying raw materials such oil nearly at zero cost and reselling at overcharged prices. Because of the dependence of their domestic industries as seen in Figure 3.5, the developed countries were the leading customers of

[7] J Lawrence Broz. "The Turbulent 1970s and 1980s" also is avaliable on http://weber.ucsd.edu
[8] The war began between Israel and Egypt on October 6, 1973. It is the fourth one of Arab-Israel wars.
[9] England and France had supported Israel during the war of 1967; but this time, in the Yom Kippur War (1973) they demanded from Israel to retreat to borders of 1967.

OPEC[10]. These increases in oil prices and the collapse of the stock market in 1973-74 lead the world economy into a severe crisis again.

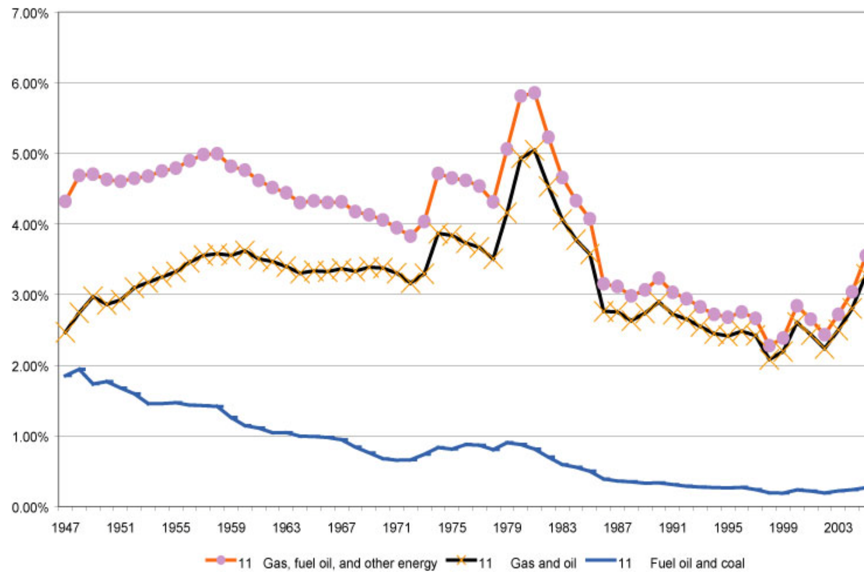

Figure 3.5: U.S. Energy Spending as Percent of Total Consumption from 1947-2005.

Source: http://marketpower.typepad.com/market_power/2006/04/index.html

OPEC had doubled the price of oil to $3 per barrel on the eve of the war and in January, 1974 increased the price to $11.60 per barrel. As seen in Figure 3.6 and Figure 3.7, increase in oil prices had led affected western countries deeply since the prices of their own exporting commodities decreased and had to pay more for oil from now on. Moreover, oil revenues which had flown into Western countries for years began to flow into Middle East Countries.

[10] The Organization of Petroleum Exporting Countries was actually founded in 1960 by Middle Eastern countries and Venezuela, although its membership grew to include developing nations across the world.

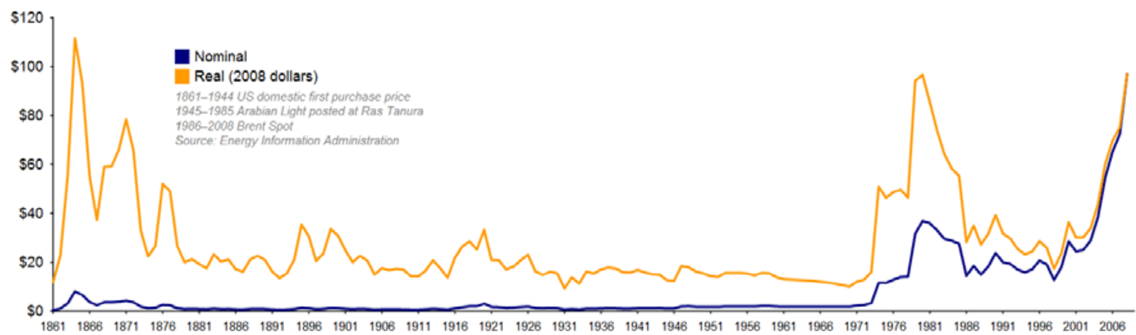

Figure 3.6: Oil Prices from 1861–2007.

Source: http://www.eia.doe.gov/emeu/cabs/OPEC Oil price chronology-june2007 /OPEC.html

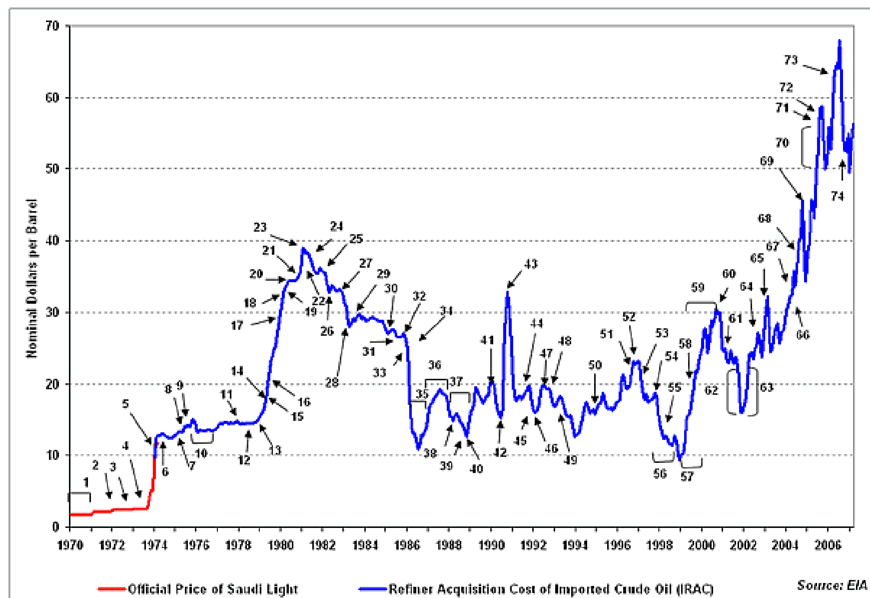

Figure 3.7: Oil Price Chronology - June2007

Source: http://www.eia.doe.gov/emeu/cabs/OPEC Oil price chronology-june2007 /OPEC.html

Furthermore, as the OPEC was producing most of the oil (Figure 3.8) increasing prices meant gaining more revenues from oil (Figure 3.9). For instance, the gallon price of gasoline which was 38.5 cent in May 1973 rose to 55.1 cent in June 1974. During this period, the New York Stock Exchange has lost 97 billion dollars. Between 1974 and 1979 the oil prices stabilized, but in 1980 OPEC again pushed the price up to more than $30 per barrel.

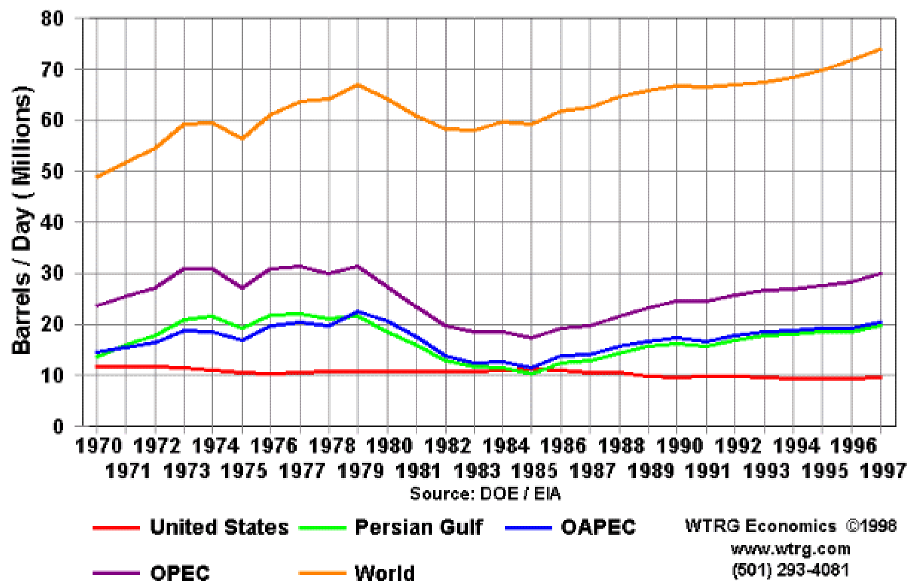

Figure 3.8: Crude Oil Production: World

Source: http://marketpower.typepad.com/market_power/2006/04/index.html

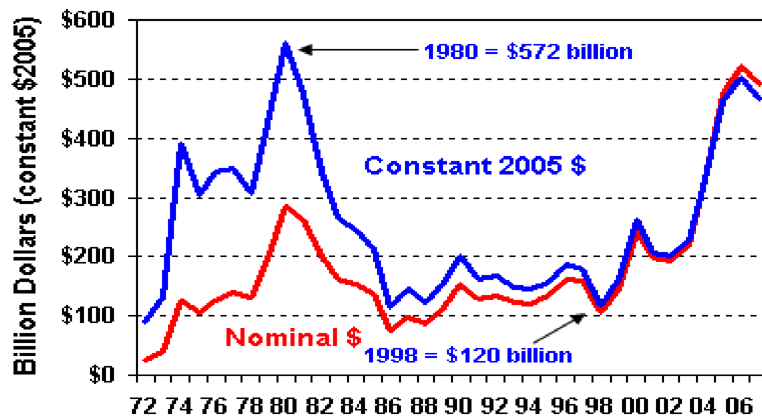

Figure 3.9: OPEC Net Oil Export Revenues, 1972 – 2007.[11]

Source: http://www.eia.doe.gov/emeu/cabs/OPEC_Revenues/OPEC.html

[11] The price data graphed above are in nominal terms, meaning they are in "dollars-of-the-day" and have not been adjusted for inflation.

In addition to the disastrous impact of increase in oil prices on capitalist world economy, break-down of Bretton Woods's arrangements gave rise to the crisis. The breakup of the post-war international monetary system had produced huge inflationary pressures so the prices of all "commodities" (i.e. tradable goods, especially primary produce) had increased. On the other hand, the energy-dependent industries in major capitalist countries had made progress and significant growths due to the cheap prices of oil. After decades of this process, the crisis created vast balance-of-payments deficits in industrialized countries, led to a huge transfer in revenues from the oil-importing nations to the oil-exporting countries, and placed massive sums of "petrodollars" in the hands of a few Middle Eastern states. These "petrodollars" which were invested on the Western banks, especially in U.S. and generated interest liabilities lead to a full-scale recession, and the new phenomenon of "stagflation" in economics by added to the inflationary crisis. The same process also involved the exporters of other "commodities".

The slump of 1970s was not just a passing accident due to the oil crisis following the Middle East War in 1973 (Harman, 2009). Before 1970, oil prices had been kept artificially low by oil companies; however by 1970, most of the Arabian countries had nationalized their oil production. To summarize, after the temporary disruption of supplies due to the war and the ever-increasing demand for oil and declining production in the U.S. forced up the price of oil. Furthermore, these conditions will lead a situation causing unemployment and recession together. The term "stagflation" was started to be used for this situation by the economists; however, the explanation of stagflation existed neither in classical economists nor in Keynesians.

In order to cure the crisis-prone system from the increasing effects of the crisis and also to overcome from the crisis, Western countries convinced the underdeveloped, primary good producing, countries to buy large-scale development programs. Through these trades Western countries will be able to sell products and services such as hydro-electric power stations and dams, roads and bridges and all kinds of new factories to these aforementioned countries. The cost of these products and services were only could be afforded by continued high incomes from exports of primary products, and almost all

of them turned out to white-elephants which completely failed in delivering an economic development.

In addition, the crisis which so-called because of oil price shock was not the only crisis in 1970s. There were two more main recessions in oil-importing countries in 1974-75 and 1980-82 that led adjustments to reduce the reliance on cheap energy. Moreover, the U.S. dollar was devaluated and monetarist policies implemented in the U.S.

Finally, although the oil-exporting countries remained solvent, most of other countries, especially in Latin America and Africa, became completely dependent on interest payments that were exceeding export earnings. At that time, the situation of world economy interestingly coincides with the developing new role of IMF by which it takes the control of the economies and social policies of the governments of the debtor countries. On the other hand, the effects of the crisis in Europe were more destructive than others especially in England where the miners' strike in winter of 1973-74 led to a government change, more importantly development of an economic crisis theory named as "*Profit Squeeze Theory*" by Andrew Glyn and Bob Sutcliffe. Theory of profit squeeze has been the main argument for mainstream economist to explain the crisis of 1970s against the Marxist explanations, *Falling Rate of Profit Theory*.

3.2.1. End of Bretton Woods

The era after the World War II has been shaped by the capitalism's restructuring process on worldwide. This worldwide restructuring process has been possible with the ability of controlling some capital movements and foundation of some institutions that can lead this control like IMF, WB, etc. Bretton Woods was the agreement on how to determine this post war restructuring in 1944.

According to this treaty, U.S. Dollar was the only exchange unit which was valid in U.S. gold stock market and its value was fixed. However, after three decades of economic boom, it started to crack and firstly U.S. withdrew from the treaty on August 15, 1971 which led to fluctuation in the value of dollar. Following the U.S., the other

industrial nations with similar decisions carried their currencies to float. These countries increased their currency reserves through issuing money at unprecedented levels. Consequently, industrial nations especially U.S. that were engaged in commerce with under-developed countries' raw materials, became obligated to make higher rates of export to get same rates of crude oil as their currencies depreciate. Therefore, oil-producing countries became obtaining less net-income revenues for the same price as the oil is priced in dollar.

Additionally, OPEC had declared that the price of crude oil will be calculated over the value of gold, not U.S. dollar before the Yom Kippur war. Therefore, it can be said that the crisis actually began with this declaration. Following periods after the year 1971, OPEC acted slowly to compensate the loss due to the devaluation of U.S. dollar. Between 1947 and 1967, price of oil in U.S. dollar had increased less than 2% per year. Oil prices had been relatively constant until the "Petroleum Shock"; however it became quite unstable after this shock.

As a result, since governments of OPEC nations could not had developed mechanisms that can update rapidly enough to keep up with changing market conditions, their real income lagged at all.

3.2.2. Recession + Inflation = Stagflation

Stagflation[12] refers to the simultaneous existence of high inflation rate and recession, i.e., general slowdown in economic activity. In this situation, the rate of unemployment also rises which leads to a dilemma for policy makers since actions designed to lower inflation may worsen economic growth and vice versa. This happened to a great extent during the 1970s, when world oil prices rose dramatically; fuelling sharp inflation in developed countries including the U.S. which further led to a contraction since oil is a crucial input in production.

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[12] Stagflation is derived from combining the words "stagnant", which means not moving or not advancing in economics, and "inflation", which means a continuing rise in the general price level (generally based on increasing the volume of money and credit relative to available goods and services).

Stagflation is a paradoxical situation both in the classical economics and in Keynesian theory. Phillips curve suggests an inverse relationship between inflation and unemployment; however, stagflation refers to a rise in both. It is impossible to explain stagflation through the framework of neither classical economics nor the Keynesian theory. Inflation is the result of the increase in aggregate demand more than the increase in aggregate supply. Aggregate supply could not provide the increase in aggregate demand since there are not any labor forces to employ for increasing production in the economy due to the level of full employment. However, stagnation is the decrease of employment in economy.

Low employment level is chronically observed in under-developed countries. Even if aggregate demand increases in under-developed countries, where there is always excess aggregate demand, aggregate supply cannot be increased because the investors does not have enough finance to purchase the means of productions and workers. Differently from developed countries, there is not enough supply of capital to accommodate the demands of capital. Therefore, the conditions of these under-developed countries will be as if there is full employment and increase in demand will cause an inflationary effect.

Whereas in developed countries, increase in aggregate demand leads to increase in aggregate supply and the price level stabilizes. If economy is on full employment level, i.e., since there could not be an increase in employment, all of the labor force is used, so increase in aggregate supply cannot sustain where increase in aggregate demand will cause an inflationary effect. In the situation of stagflation domestic economy gives the reactions of both developed and under-developed countries together. Moreover, since stagflation was a new phenomenon, none of the economic policies had been able to solve it.

3.2.3. Marxist Explanations for the Oil Crisis

In the 1970s, when the oil crisis occurred, stagflation was not predicted in the prevailing theory. Monetary and fiscal policies those implemented by states after Second World War, had not delivered the wealth, growth, and stability promised by the

Keynesians (Wolff, Rick 2009). At the same time, firms began to lobby to revoke the state activities since state interventions had been an obstacle on increasing profits. Finally, Reagan elected as president with the support of corporations, since he provided the pre-1929 conditions of private enterprise and free markets.

Since the mid-1970s, workers' average real wages stopped rising due to displacement of workers through capitalists' computerization of production. In this manner, the oil price shock and the war of Yom Kippur was not the real cause of the crisis but just a mechanism that triggered the crisis. Under these conditions, capitalists also decided then to move most of their production process to foreign countries in order to get higher profits. Consequently, since employers thus needed fewer workers in the U.S., they became able to end the historic (1820-1970) rise of U.S. wages as seen in Figure 3.10. However, workers' productivity kept rising (more machines, more pressure, and more skills).

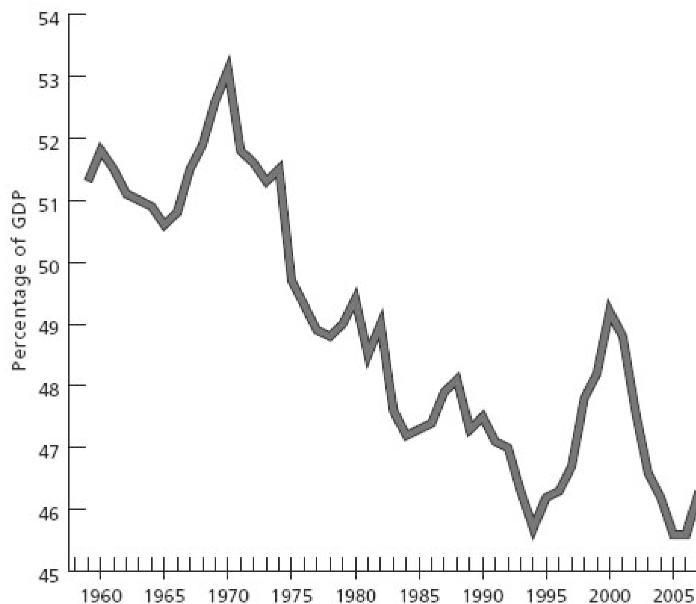

Figure 3.10: Wage and Salary Disbursements as Percentage of GDP

Sources: Foster, J., Magdoff, F., "Financial Implosion and Stagnation Back to the Real Economy", Monthly Review 60.7, December, 2008.

Corporations in the U.S.A produced more than the employers can sell. Meanwhile, workers' wages were stagnant because employers paid them no more. Wolff (2009) states the following circumstances as:

> *The surpluses extracted (exploited) by capitalist employers – the excess of the value added by each laborer over the value paid to that laborer – rose. The last 30 years realized capitalists' wildest dreams. Yet, stagnant wages and huge surpluses eventually plunged US capitalism into deep crisis.*

As a result, Leo Panitch and Sam Gindin (2008) assert that to overcome 1970s crisis, markets attempted efforts on competition, innovation and flexibility which led corporations to grow and became stronger. Moreover, the role of finance in disciplining and integrating labor assisted while defeating and encountering the crisis of 1970s, since pressures on labor led firms to seek more profitable areas such as finance. Yet, according to many economists, stagnant wages and booming surpluses also eventually plunged U.S. capitalism into today's severe crisis. Furthermore, as the explanations signed the slump of 1970s had been accepted as a severe crisis between the Marxist writers due to the falling rate of profits.

3.2.4. Mainstream Explanations for the Oil Crisis

The neoclassical school of economic thought does not provide an explanation for economic crises. Instead, mainstream economists cover up crises by blaming external factors such as human nature, natural disasters, wars, revolutions, "supply shocks," or government intervention. Barring such "exogenous" factors, the "self-adjusting power" of the market mechanism is said to be capable of fending off major financial instabilities and/or economic crises (Hossein-zadeh, Ismael 2010). Since mainstream economics assumes that the causes of crises are exogenous factors, most of the mainstream economists refer to the oil embargo that OPEC declared as causes of the crisis.

It was very hard to explain the falling rates of profits for economists until the profit squeeze theory which was developed against the law of the tendency of the rate of profit to fall (FRP) explaining crisis on the side of Marxists as a counter theory. In

addition, Kidron states that the theory is an interesting example of reformism and adds that;

> *[...] they argue that the rate of profit has been in decline – but for accidental reasons. They locate the source of that decline in a chance combination of increasing international competition and an increase in the militancy of workers. So their argument implies that if, for a period, workers were less militant, or international competition became less sharp, then the rate of profit would go up* (1974, p.1).

In the theory of FRP, the organic composition of capital (C) increases more than the increase of technical composition of capital (S) so the rate of profits tends to decrease in long term. On the contrary, profit squeeze theory asserts that the rising worker class movement's give rise to increase in the wages and this increase lead the workers to be able to have more shares from the produced products, consequently asserts that the (S) also grows like (C) and not slower than it (Öztürk, 2008). As a result, increase in wages squeezes the rate of profit and lead to crisis to emerge. Finally, after the 1970s drawing inspirations from this theory, it is claimed that capitalism disciplined and integrated worker class and building a new financial structure leading today's crisis.

4. DIFFERENT PERCEPTIONS OF CURRENT FINANCIAL CRISIS

4.1. EXPLORING THE CURRENT FINANCIAL CRISIS

Sufficient protectors of the economic system were performing their duties; hence nobody thought that the financial system would be broken down. The safe guards were IMF, WB, WTO and developed countries who have been nourishing from the system for years. In general, the mechanism was based on safety net: central banks that would lend when necessary, deposit insurance and investor protections that freed individuals from worrying about the security of their wealth, regulators and supervisors that watch over individual institutions and keep their managers and owners from taking on too much risk (BIS, 2009). Since the Oil Crisis from the 1970s, there has not been such a major crisis for the world economy, the welfare and economic stability of developed countries has made everyone to think that the economic system is working properly. Also the growing rates were high and also the inflation was low. These are the conditions of the industrial countries and have been accepted as the reality of the whole economy, because it has been thought that the emerging countries follow the industrial ones. But all changed after August 2007 when the global economic system faced with critical failures in succession.

The complexity of modern life is because of the complexity of its economic structure. Considering modern economy as a living organism, some implications can be made. Main implication will be that a part of the organism has broken down which is the blood stream in this situation. Like circulation of blood in human body, the economic system needs the circulation of money (or derivatives of money) through intermediaries as defined in the BIS's 79th Annual Report in 2009 *"every day, money circulates as flow financing; through banks, insurance companies, securities firms, mutual funds, finance companies, pension funds and governments"*.

Circulation of money in economy requires sophisticated mechanism. In the industrial world, through the combination of individual savings in financial institutions

and the mortgage, many people purchase the house in which they live. However, mechanism is not as simple as it is seen. Taking out the mortgage almost required covering fire insurance from an insurance company. Moreover, most of the payments such as electricity, water and heating bills are paid each month using funds of the house owner's account at a commercial bank. Furthermore, public transport which is financed partly by bonds and taxes or an insured car on a publicly or privately financed road is used while going to work. BIS defines the dependence of modern life to finance as; "*Modern life requires the smooth operation of banks, insurance companies, securities firms, mutual funds, finance companies, pension funds and governments*" (BIS, 2009, p.3). These institutions channel resources from the savers to the investors and they are also supposed to transfer risk from those who cannot afford it to those who are able to bear it.

To sum up, the signals of unwinding shown up with unwillingness of some banks for lending other banks, since they were unable to know the price of both their and counterparty's assets. Intermediaries tried to fill the gap by the central bank lending but it did not hold so long. Beginning with August 2007 and continuing with the rescue of Bear Stearns, problems increased until the bankruptcy of Lehman Brothers on 15; and by the end of September, this bankruptcy was the legal ring bell for the global financial system itself that was on the verge of collapse. Besides, the naive belief on financial system is purely based on trust, and in the wake of the Lehman failure that trust was lost.

4.1.1. Housing Bubble

An extended period of unusually low real interest rates, easy credit conditions, low volatility in financial markets and widespread increases in asset prices since early 2000s and generated large-scale but hidden vulnerabilities in economy followed by the crisis in 2007. In fact, these conditions of low interest rates, easy credit conditions were the result of a series of events such as Dot.com bubble, 9/11 attacks and increasing unemployment rates. In response, as seen in Figure 4.1, FED kept interest rates lower in order to be able to intervening a possible stagnation and a crisis. These conditions

allowed banks to borrow funds from other banks, lend them out, and then pay back less than they had borrowed once inflation was taken into account (Kliman, 2008).

Figure 4.1: New Mortgage Debt as Percent of After-tax Personal Income and Real Federal Funds Rate (U.S.)

Source: Bureau of Economic Analysis; Federal Reserve; Bureau of Labor Statistics

The strategy of "cheap money, easy credit" unfortunately led to the aforementioned bubble. After the collapse of stock prices, the huge amount of money flowed largely into the housing market. In addition to these conditions, the high consumption rates and low saving rates in Anglo-Saxon world has made every individual consume more than the income they earned. These are explained by the global savings glut by some institutions whose reality is controversial. Most of the institutions say that huge flow of money from abroad especially from East Asian countries played an active role in this situation. But this was not the main cause, if the argument from a different perspective like Marxist literature is considered there are really precious inferences. In Marxist literature, production/industry defines the borders of market since the value created in production establishes the real economy. Basically, created value in production has to find its respond in market; however, in this situation this created value in production through their main income, wages were not able to guarantee repayments of mortgages due to the dramatic increase in house prices.

Moreover, increase in house prices led real estate owners to think that their income level increase so as to demand more credits. As seen in Figure 4.2, individuals were not able to make any saving for many years in U.S. Therefore, actually this was a misleading which pulled individuals into a debt spiral, since increase in disposable income of house owners has been so poor when compared to increase in house prices as Kliman stated:

> *[...] but from 2000-2005 after-tax income (not adjust for inflation) rose just 34.7 percent, barely to one third of increase in home prices. This is preciously real-estate bubble proved to be a bubble. A rise in asset prices or expansion of credit is never excessive in itself. It is excessive just in relation to the underlying flow of value* (2008, p.6).

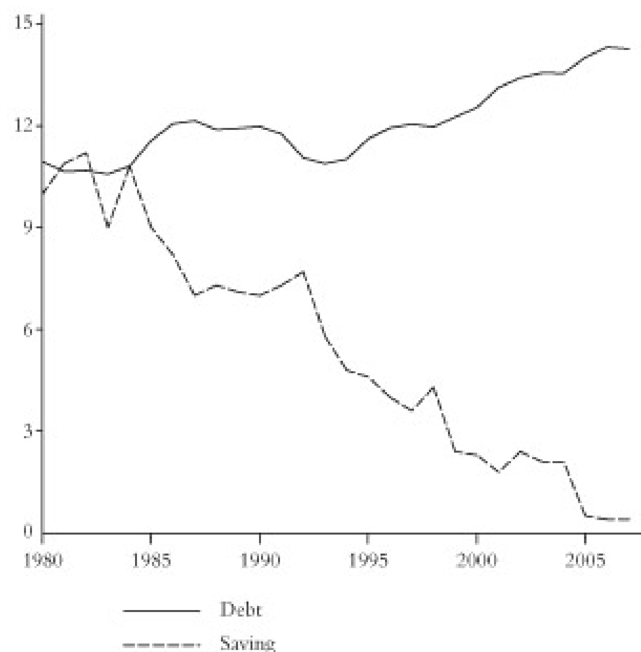

Figure 4.2: Household Debt Service (required payments on mortgage and consumer debt) and Personal Saving as a Percent of After-tax Income (U.S.)

Source: Bureau of Economic Analysis (NIPA data); Federal Reserve

On the other hand, no one thought that such a severe crisis would emerge, for instance expected trough in housing prices was a few percent even in a worst scenario. Due to this assumption, high ratings were given to huge amount of pooled and repackaged mortgage debt or mortgage backed securities which are now called as "toxic papers". Together with the collapse of the housing bubble total values of all mortgage backed securities declined which were accepted as safe investments.

4.1.2. Toxic Papers

The crisis in the housing sector is not the sole cause of the financial crisis. Like many other economists Alan Greenspan (2010, p.3) claims that *"it was the global proliferation of securitized, toxic U.S. subprime mortgages that was the immediate trigger of the current crisis."* Basically, these mortgage-backed securitized papers are packaged and repackaged as various kinds of derivatives; these papers become toxic in case there is failure in repayments. A simple example of this process is given in Box1[13].

Box-1: A Toxic Asset

If an individual called John Smith purchases a house and takes out a $200,000 mortgage loan with a 4% interest rate through Bank X, the bank now holds an asset - a mortgage-backed security (MBS). Bank X is now entitled to sell the asset to another party (Bank Y). Bank Y, now the owner of an income-producing asset, is entitled to the 4% mortgage interest paid by John. As long as house prices increases and John keeps on paying his mortgage, the asset is accepted as a good asset.

Anywise, if John could not repay his mortgage, the owner of the mortgage (whether Bank X or Bank Y) will no longer be able to receive the payments to which it is entitled. Normally, the house would then be sold, but if the house price has declined in value, only a small portion of the money would be regained. As a result, to sell the securities based on this mortgage becomes nearly impossible or even selling will be losing money. Meanwhile no one would pay for an asset that is guaranteed to lose money. Finally, the mortgage-backed security becomes a toxic asset.

Due to these repacking processes, it was impossible to identify which mortgage loans were underlying these securities. But values of these securities depend on whether the underlying loans are still likely to be repaid or not. Additionally, buyers of these

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[13] http://www.investopedia.com/terms/t/toxic-assets.asp (May 6, 2011)

securities do not really know what the sellers are offering them. Finally, period that triggered by a dramatic rise in mortgage delinquencies and foreclosures in the United States resulted in such bad consequences for banks and financial markets around the globe.

As mentioned above, easy credit conditions, low interest rates make many people save a portion of their income each month in a financial institution, and then combine those savings with a mortgage to purchase a house. Thus, in 2005-2006 when the house bubbles peaked, nearly 80% of these mortgages issued to subprime borrowers were adjustable-rate mortgages (ARMs) (Dodd, Chris 2007). ARM is a type of mortgage in which the interest rate paid on the outstanding balance varies according to a specific benchmark. The initial interest rate is normally fixed for a period of time after which it resets periodically, often every month. The interest rate paid by the borrower will be based on a benchmark plus an additional spread, called an ARM margin. Furthermore, there are examples of ARMs called 2/28 and 3/27 mortgages.

> *A 2/28 mortgage's initial interest rate is fixed for a period of two years and then resets to a floating rate for the remaining 28 years of the mortgage. In A 3/27 interest rate is fixed for three years and then floats for the remaining 27 years of the mortgage. An adjustable rate mortgage is also known as a "variable-rate mortgage" or a "floating-rate mortgage.*[14]

Between the years of 2006-2007 particularly when interest rates began to rise and housing prices started to drop suddenly, it became more difficult to refinance the credits for households. As initial terms of contracts expired, house prices trended downward unlike forecasts and due to the highly-reset interest rates of ARMs, the foreclosure activities increased. Initially, house prices were surely more than the mortgage loans, but later on the situation became reverse which made borrowers desperately entering foreclosure and caused deterioration on the consumers' prosperity.

[14] http://www.investopedia.com/terms/2/228arm.asp (May 6, 2011)

Mortgage-backed securities (MBS) [15] which derive their value from mortgage payments and in which banks, institutions and individual investors invest in the U.S. housing market. Housing prices greatly increased before the crisis, with the decline in housing prices, major global financial institutions that had invested in subprime MBS reported huge losses. As the crisis spread from the housing market to other parts of the economy defaults and losses on other types of loans increased, too. Generally, total losses were just estimated by the numbers of 2007 with trillions of U.S. dollars globally (Geithner, 2008). On the other hand, estimated losses in worldwide by October 2007 was 250 billion dollars as seen in Figure 4.3 (Blanchard, Oliver 2009, p.3).

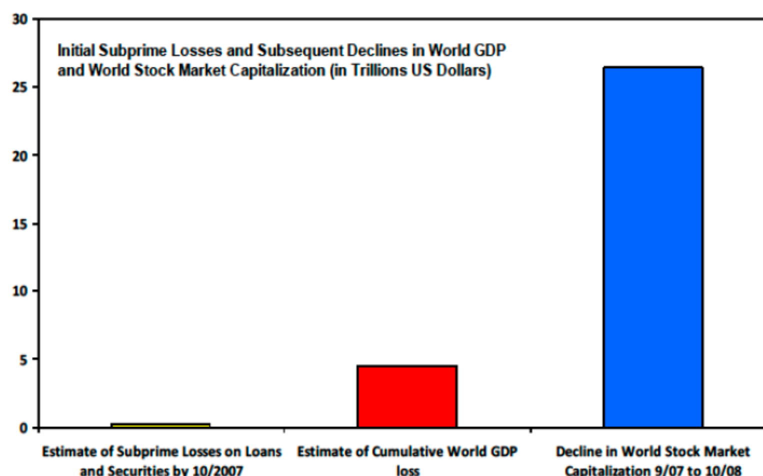

Figure 4.3: Initial Subprime Losses and Declines in World GDP and World Stock Market Capitalization

Source: IMF Global Financial Stability Report (2008); World Economic Outlook November Update and Estimates; World Federation of Exchanges.

Initially, policy makers did not discover the role of financial institutions and investment banks and hedge funds which are referred as shadow banking system (Figure 4.4) which was holding nearly more than $16 trillion, about $4 trillion more

[15] Mortgage backed securities (MBS) are a type of asset backed security. The asset that they are backed with mortgages: more precisely the pooled cash flows from mortgages. The simplest mortgage backed security is a pass-through MBS which simply distributes received interest and repayments of principal to the holders of the security, with a deduction for a servicing fee. This usually goes to the originator. The pool backing an MBS commonly contain either only residential mortgages, or only commercial mortgages. The two types are distinguished by the use of the terms CMBS (commercial mortgage backed security) and RMBS (residential mortgage backed security) http:// moneyterms.uk

than regulated deposit-taking banks in U.S. (UNCTAD, 2009a). They discovered the fragility of the system as the housing and credit bubbles built, a series of factors caused the financial system to fragile.

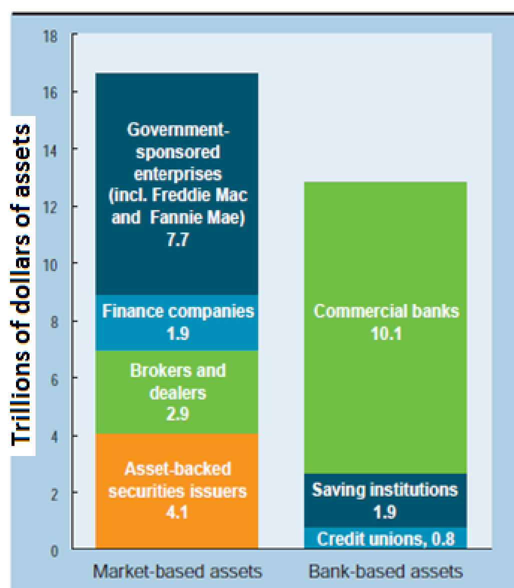

Figure 4.4: Size of the Banking System and the Shadow Banking System in the United States, 2007 (2nd quarter) *(Trillions of dollars of assets*

Source: Shin, H. S. (January 24, 2009). Nature of Systemic Risk: Where Should Regulation be Aimed? Presentation at: The Fundamental Principles of Financial Regulation. *11th Geneva Conference on the World Economy.*

According to Timothy Franz Geithner (2008), current United States Secretary of the Treasury, financial institutions that were not subject to same regulations as commercial banks became as important as commercial banks in providing credit to U.S. economy. Regulated banks and these institutions had burden significant amount of debt while providing the loans and did not have a financial cushion to deal with large loan defaults or MBS losses (Greenspan, 2009). Financial institutions also affected losing the ability of lending negatively. Housing market crash and after financial market crisis made governments take some serious decisions and central banks begin to cut interest rates and explain stimulus packages to encourage the financial institutions. For instance, during the early stage of the crisis, U.S. explained 787 billion dollars of a package desperately hoping to overcome the crisis.

4.1.3. Global Savings Glut

Another key that led the crisis to emerge is global savings glut, because of large-scale of foreign money to flow into the U.S. from Asia and energy-exporting countries (Bernanke, Ben 2009). Since the dollar is reserve money, aforementioned countries built up huge currency reserves that are invested mainly in U.S. Until the crisis nobody was in doubt that dollar will lose its confidence. In this manner, inflow of funds combined with low U.S. interest rates from early 2000s contributed to easy credit conditions, which fuelled housing and credit bubbles. Mortgage, credit card, and auto loans were given in easy conditions and consumers got under an unprecedented debt loan. To summarize, some economists address this global saving glut as the cause of crisis.

On the other hand, unfortunately it seems that the global crisis will put the burden of the cost of crisis on the laboring masses and those heavily indebted and foreign finance-dependent countries. The International Labor Organization (ILO) noticed in early 2009 that the openly unemployed may increase nearly 50 million individuals, moreover it was estimated that the number of total unemployment would be nearly 230 million. Moreover, global stock markets were affected from the crisis intensively. Just in the year of 2008, owners of stocks in U.S. corporations had suffered about $8 trillion losses. In addition, losses in the stock markets and declines in housing value decreased consumer spending which can be accepted as a positive indicator for economy. In early stages of crisis, U.S. subprime mortgages were estimated at $1.3 trillion, with over 7.5 million first-lien subprime mortgages outstanding (Bernanke, 2007). Mortgage Bankers Association (2007-06-12) in press release stated that: "*In the third quarter of 2007, subprime ARMs making up only 6.8% of USA mortgages outstanding also accounted for 43% of the foreclosures which began during that quarter.*" Later on, by October 2007 nearly 16% of subprime ARMs were either 90-days delinquent or the lender had begun foreclosure proceedings. By the first month of 2008, the delinquency rate had risen to 21% and by May 2008 it was 25% (Bernanke, 2008). After that by August 2008, 9.2% of all U.S. mortgages outstanding were either delinquent or in foreclosure, by September 2009, this had risen to 14.4%. Between

August 2007 and October 2008, roughly a one million of U.S.A residences completed foreclosure (Clifford, Catherine 2008, pp.11-13).

4.2. MARXIST EXPLANATIONS OF CURRENT CRISIS

Marxists political economy that has been closely interested in economic crises also has taken an important place in literature. Contrary the mainstream economic literature Marxist political economy analyses the crises of capitalism through crisis theories such as FRP, the theory underconsumption or other valuable theories and also develops their analysis. As stated by Choonara (2009, p.1); "*just as medical science progresses through pathology, Marxist political economy develops through the analysis of the actual crises of capitalism*". In addition to analyze economic crises as a scientist there are some other predictable reasons of why Marxist political economy is so close to crises of capitalism. For example Kotz defines one of them such as; "*the belief that a severe economic crisis can play a key role in the supersession of capitalism and the transition to socialism*" (Kotz, April 2010 p.2). Maybe mankind can prevent such severe crises that led countries to the brink of bankruptcy, millions of worker to unemployment and made them to face increasing food prices. Also consequences of such severe crisis would prepare the conditions of that transition as being hoped by some, since there is no guarantee for the transition but in such an idea too it has to be clearly understood what is happening to the global economy.

There are two main distinctions Marxist accounts; since the crisis triggered with the bursting of the subprime mortgage bubble in the U.S., most of the Marxist accounts have been concentrated on the logic of "financialisation" and others on the underlying problems of "real" economy that drove the expansion of finance. (Choonara, 2009)

4.2.1. Financialisation and Robin Blackburn, Peter Gowan

According to the Robin Blackburn financialisation permeates every region in our life from corporate strategies to personal finance. Student debt or personal pensions, marketing of credit cards or the arrangement of mortgages are the examples of how it becomes indispensable and part of modern life (Blackburn, 2006, p.39). Moreover, today getting this financial support and being a part of this structure is much easier. For instance, formerly getting a bank loan was hard and took a long time since one had to

prove his solvency in order to get it. However, now solvency is not the real issue in fact it can be get on line and become an arm's length process as described by Costas Lapavitsas (Thomas, M. 2008).

Blackburn analyses the crisis by associating it with the concept of financialisation rather than traditional Marxist political economy which is criticized by Geoff Mann (2009, p.10) with the statement that *"the analysis of value, money and capital...are not part of Blackburn's discussion, but they remain an essential part of the political-economic stakes"*. Although Blackburn concentrates on financialisation, he regards poverty as the basic reason of the crisis which is the point that he coincides with Marxist politic economy since poverty represents limited capacity of workers to consume.

Blackburn states that financialisation was nourished by two processes, first one is new principles of consumer credit, and second one is the rise of institutional finance and fund management (Blackburn, 2008, p.85). This statement emphasizes the autonomy of finance by giving the impression rise of finance leads to finance itself.

Peter Gowan (2009, p.5), another Marxist associated with journal New Left Review, interprets autonomy of finance: *"An understanding of the credit crunch requires us to transcend the commonsense idea that change in the so-called real economy drives outcomes in a supposed financial superstructure"*. According to Gowan, problems faced by U.S. capitalism could be clarified with financialisation. Moreover, he argued that U.S. and U.K. elites were aware of the problems of financial bubbles; however they believed that banks aided by state authority could cope with the consequences.

Blackburn (2006, p.39) states *"As a percentage of total US corporate profits, financial sector profits rose from 14 percent in 1981 to 39 percent in 2001"* which shows experienced swollen in financial system can be observed empirically. Additionally, Gowan writes *"In 2006, no less than 40 percent of American corporate profits accrued to the financial sector"* which is a large ratio if it is taken into account that the U.S. economy represents only about one quarter of the world system. However,

estimating profits by looking at balance sheets in which price of assets are rising in such a period that was characterized by a series of bubbles is called "fantasy valuations" by Blackburn. In order to valuate financial sector fairly, effects of growth in financial sector on real accumulation must be taken into account rather than measuring it in its own terms. This is because finance does not create new value; therefore eventually its profits must be obtained from the productive sector of the economy.

As a result, Gowan (2009, p.21) denotes that crisis introduces two alternatives with respect to the goal of financial sector with his following statement: *"A public-utility credit and banking system, geared to capital accumulation in the productive sector, versus a capitalist credit and banking system, subordinating all other economic activities to its own profit drives"*.

4.2.2. Autonomy of Finance and Costas Lapavitsas

Another Marxist, Costas Lapavitsas asserts that financialisation is an important concept that has to be considered in order to analyze the current crisis. He put crisis in 1970s to 1990s down to problematic productivity growth; he avoids rooting this long term rate of profit to fall theory as it can be seen from his words:

> *It is not so much that real accumulation does not generate enough profitable avenues for banks to lend. Rather, productive capitals can increasingly meet their financing requirements either by retaining profits or by borrowing directly in open markets... Banks have been edged out of this business, and have to seek other avenues of profitability* (2007, p.19).

Therefore, when the growth in consumer finance in last decades is taken into account it is clear that a new profitable area for banks is arisen. Lapavitsas (2007, pp.17-18) mentions about the break from production: *"Banks have moved into areas that are not directly connected with the generation of value and surplus value...finance has become relatively autonomous from productive enterprises as well as growing rapidly"*

Innovations in communication and information technologies render many operations possible that were previously impossible for finance. The new capabilities of finance are apparent in terms of the internal organization of financial institutions, the speed of transactions, the feasibility of financial engineering, the links between financial markets, the techniques of pricing and risk management, and in particularly dealing with huge numbers of individual borrowers (Lapavitsas, 2009b, p.1). Even if technological innovations can open up new profit making areas, it should not be considered as a process that is independent of productive economy. Furthermore, Panitch and Konings (2009, p.69) states that *"in particular, it is necessary to account for the flows of surplus value into different areas of the economy that spur waves of restructuring and innovation."* Explaining the reasons behind explosion in finance and declining investments on productive area will be easier when the long-term decline in profitability in the productive economy is considered.

Exploitation is defined in Marxist literature as the extraction of surplus value that is a result of the gap between the new value created by labor over a given period of time and the wage although the commodity they supply, their labor power, is obtained by the capitalist at its value (Marx, 1970, pp.164-172). Even though financialisation mechanisms do not generate surplus value, Lapavitsas has argued that consumers are exploited directly through the process by which financial institutions extract profits directly and systematically out of wages and salaries, and named this process as "financial expropriation". It is direct because there is not any production in this mechanism and it is exploitation because finance becomes compulsory to survive for many workers (Lapavitsas, 2009b, p.8). Lapavitsas (2009b, p.13) stated that this situation represents a *"systemic transformation of the capitalist economy"*.

Lapavitsas (2007, p.19) mentions that 19,3 percent of disposable income went towards debt-servicing in the U.S. by 2007 which means reproducing labor power for the system has become more expensive. Therefore, mechanism shifts surplus value from production to lending money. In such a case, an arbitrary rise in prices would end up with increase in profitability of lending money. In conclusion, in an economy under the conditions of wage repression, a worker that maintains his life by lending money would

be either source of profit for financial markets or cause of decline in a market in fictitious capital if he defaults on his debts whether credit cards subprime mortgages.

4.2.3. Increased Exploitation and David McNally

David McNally argues that crisis cannot be understood by only focusing on financialisation and he points out its interconnection with the problems of global over-accumulation since 1970s (McNally, 2009, p.4). Furthermore, McNally (2009, p.3) also rejects the notion that crisis *"is just the latest manifestation of a crisis of profitability that began in the early 1970s"*.

David McNally has been identified that there is a decline in profit rates by referring to empirical studies such as Andrew Kliman giving average rates of profit in the U.S. of 28.2% for 1941-1956, 20.4% for 1957-1980 and 14.2% for 1980-2004 (Kliman, 2009, pp.3-4). Delay in emergence of crisis while there was such a decline in rates of profit can be only explained by increased exploitation which underpins a new period of accumulation specifically from the recession of the early 1980s through to the current crisis (McNally, 2009, p.4). According to McNally, this accumulation run into a new period with East Asian crisis and that continued growth was based on a bubble of credit, particularly credit supplied by the same East Asian economies. In other words, after the period Asian crisis, credits supplied by East Asian economies speed up accumulation process.

4.2.4. Limited Consumption and Monthly Review School (John Bellamy Foster and Fred Magdoff[16])

The authors point out to the excessive growth of finance by examining consumer debts in U.S. and mechanisms behind financial speculations. However, unlike many other writers pointing financial growth, they do not regard this financial growth as representing a new phase, since the basic problem of accumulation within production remains the same (Foster and Magdoff, 2009, p.77).

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[16] Writers associated with *Monthly Review* which is an influential journal of the US left.

The accumulation problem mentioned by Foster and Magdoff was identified as an inherent tendency towards stagnation in 1960 by Paul Sweezy and Paul Baran. According to Sweezy and Baran, in post-war period the formation of monopolies which were able to manipulate prices caused this problem. For the writers of *Monthly Review,* crisis has emerged as a result of limited consumption, this inference based on Sweezy's writings:

> *The process of production is and must remain, regardless of its historical form, a process of producing goods for human consumption...means of production are never produced except with a view to their ultimate utilization, direct or indirect, in turning out consumption goods... The real task of an underconsumption theory is to demonstrate that capitalism has an inherent tendency to expand the capacity to produce consumption goods more rapidly than the demand for consumption goods* (1970, pp.162-186).

In an economy, total demand is composed of demand for consumer goods and demand for means of production from Marxist perspective. Especially the demand for means of production is determined by estimated rate of return of investors. In other words, if rate of profit is high, so does the demand for means of production which will increase investments; otherwise investments will be stagnant. Underconsumption is regarded as a symptom of crisis instead of the cause (Carchedi, 1991, pp184-186; Carchedi, 2009; Fine and Harris, 1979, p.79). In summary, Foster and Magdoff assume that monopolies manipulate prices in order to boost their surplus. This seems as referring to a problem that can be solved with a Keynesian government intervention.

It is useful to mention about writers of International Socialism, since there is conceptual analogy between them and Monthly Review School. From the perspective of International Socialism writers, arms spending are seen as new area that is developed to reduce the suppression which cause decline in rate of profit. However, Monthly Review School sees arms spending as a mechanism that can balance underconsumption by increasing the demand.

4.2.5. Low Profitability and Robert Brenner

Robert Brenner, another Marxist, analyzed the current crisis by considering the recent empirical studies in detail in his articles and records. Also Brenner (2009) criticizes explaining crisis by only notion of financialisation:

> *It's understandable that analysts of the crisis have made the meltdown in banking and the securities markets their point of departure. But the difficulty is that they have not gone any deeper. From Treasury secretary Paulson and Fed chair Bernanke on down, they argue that the crisis can be explained simply in terms of problems in the financial sector. At the same time, they assert that the underlying real economy is strong, the so-called fundamentals in good shape. This could not be more misleading* (2009, p.1)

The period since 1970s as many other Marxist, Brenner (2008) observes that declining investments are caused by declining rates of profit with his words "*The declining economic dynamism of the advanced capitalist world is rooted in a major drop in profitability, caused primarily by a chronic tendency to overcapacity in the world manufacturing sector, going back to the late 1960s and early 1970s*". Similarly, Anwar Shaikh expressed that the amount of profits is increased, however rates of profit is decreased, which hypothesis are related to real sector. The decline in investment and repression of wages which almost has not been increased since 1970s resulted in increasing levels of debt of workers. But rates of profit were only partially improved as stated by Brenner (2008) *"Non-financial corporations [...] raised their profit rates significantly, but still not back to the already reduced levels of the 1990s."*

From the International Socialism tradition point of view, the emergence of crisis is delayed from 1980s to today. Even though there are similarities between Brenner's framework and the IS tradition, according to Brenner low profitability is rooted in overproduction and overcapacity which arouse as a result of competition between blocs of capital with investments of fixed capital of differing age and efficiency (Brenner, 2006, pp.27-40).

The significant competition from Japanese and German exports from mid-1960s which affected U.S. manufacturing destructively causing decline in rate of return on total investments. By considering the U.S. manufacturing, Brenner defined the

reduction in economy as it is originated from this competition. This theory basically very similar to Baran and Sweezy's theory in Monopoly Capital, since in both theories rate of profit is determined by the degree of competition or monopoly in the economy which affects only the distribution of the total amount of profit in individual sectors not affect the total amount of surplus value or the general profit rate according to the Marx (Moseley, 1999, p.139). Brenner's argument that intensified competition in manufacturing could raise the rate of profit in other areas of economy since it would reduce the input prices for who uses these manufactured goods, led to misleading feeling that reduction of competition in manufacturing would solve the capitalism's problem (Moseley, 1999, p.145). Moreover, in Anwar Shaikh's empirical study this illusion can be seen:

> *There is little evidence of any impact on relative prices from over-competition, and their movements do not in any case correlate with those in profitability. Equally importantly, persistent overcapacity cannot explain the secular fall in profit rates, because they exhibit persistent downward tendencies even when (partially) adjusted for variations in capacity utilization… The empirical results strongly indicate that secularly falling profitability is an intrinsic feature of post-war accumulation in all three dominant capitalist countries [Germany, Japan and the US]* (1999, p.115).

Marx bases his theory of tendency for profit rates to fall on a rise in organic composition of capital would be higher when compared to a rise in technical composition of capital (S/[C+V]). On the other hand, Brenner does not agree this explanation since he believes that capital can be adopting itself to this situation (Brenner, 2006, pp.14-15).

4.2.6. Rate of Profits and Andrew Kliman

Andrew Kliman takes place in Marxist writers who assert (2009, p.1) that emerge of the crisis is delayed from 1970s to today due to the capitalist structure with his words: "*The crisis is rooted in the fact that capital was not destroyed to a sufficient degree during the global economic slump of the mid-1970s.*" This assessment namely assumption that capital is not damaged largely in 1970s stands for the result that capital restored itself in any wise. In other words, accumulation of capital is a contradictory

process, in which if accumulation of capital is interrupted, it can restore profitability and overcome the difficulties due to the contradictions temporarily.

The collapse in the price of machinery, raw materials and other inputs during a crisis, along with the failure of whole companies can assist in restoring the profitability of firms that survive or get stronger by Merger and Acquisitions. In addition to this, with a dominant theory that insist on decreasing wages and worsening the labor standards as in profit squeeze theory accepted by main stream economists in 1970s, firms can easily restore themselves. Kliman states as;

> *If a business can generate $3 million in profit annually, but the value of the capital invested in the business is $100 million, its rate of profit is a mere 3 percent. But if the destruction of capital values enables new owners to acquire the business for only $10 million instead of $100 million, their rate of profit is a healthy 30 percent. That is a tremendous spur to a new boom. Thus the post-war boom which followed the massive destruction of capital that occurred during the Great Depression and World War Two came about as a result of that destruction* (2009, p.1).

According to Kliman, the rate of profit is determined by two variables. First one is the rate of living labor and the second one is rate of which value is accumulated. In order to make this explanation Kliman follows a mathematical method in which mathematical proof gives the direction of rate of profit rather than concrete movements. According to Kliman, tendency of accumulation rate and expansion of living labor to fall is less in long term with respect to short term. Moreover, Kliman points to the reluctance of policy makers to allow the current crisis to destroy capital.

4.2.7. Decline in Interest Rates and Anwar Shaikh

Anwar Shaikh, a Marxist professor of New School University Economics Department, asserts that the current crisis is a structural crisis and the problem of capital accumulation has been lasting during the period since 1970s. The amounts of profit generated by the system have risen but rates of profit have been essentially stagnant in this period. The main source of the accumulation has been net cost of borrowing. For Shaikh (2008), this situation ended up with a false boom based on profit of enterprise that can be inferred from his words *"The long decline in interest rates also allowed*

consumer debt to grow for a period without, at least initially, massively increasing the debt repayments made by workers."

4.2.8. Deferred Crisis and Joseph Choonara

Choonara asserts that the emergence of crisis was deferred due to some mechanisms and in order to understand the crisis, first these mechanisms should be understood. According to Choonara, there are two mechanisms that cause the deferring the emergence of crisis.

The first mechanism is process of concentration and centralization which defer the emergence of crisis by clearing out and restoring the system as Marx stated. Due to the mechanism, sufficient destruction of capital certainly did not take place in the 1970s or early 1980s as Kliman and Brenner argue, instead mechanism came into play and deferred the emergence of crisis by generating growing contradictions that permeated the system (Choonara, 2009).

The second mechanism deferring the emergence of crisis is "growth of finance", since capitalists and some states preferred invest on more profitable finance rather than productive economy which had following three effects (Choonara, 2009).

The first effect was preventing emergence of crisis due to limited consumption in other words the inability of firms to sell their output, since if profit rates are high, limited consumption by workers is not a problem. Thus, it has been a solution for realization problem (Marx, 1972, p.244).

The second effect was creating the illusion of profitability and dynamism through asset price bubbles. Process of accumulation called as "fictitious capital" by Marx came into play with profits that was searching an outlet in the world of finance. Fictitious capital is investment in "paper claims" over a share of value to be produced. Marx points out that if one dealing in shares in a productive enterprise, the paper is merely a "title of ownership which represents this capital" and he asserts that titles are not the actual capital by stating:

> *Capital does not exist twice, once as the capital-value of titles of ownership (stocks) on the one hand and on the other hand as the actual capital invested, or to be invested, in those enterprises* (Marx, 1972, pp.465-467).

On the other hand, since fictitious capital can be traded, the price of fictitious capital can fluctuate and is open to speculation by investors. In this manner, shares in a company can be pushed well above the level represented by the actual value of its assets that creates the illusion of profitability. Furthermore, Choonara (2009, pp.12) states that "*although fictitious accumulation in itself produces nothing, it could spur some development of productive areas of the economy, which can add to the sense of dynamism.*"

The third effect was to further reduce the pressure for declining profit rates. The reason for this is that the investment going into buildings or wages in the financial sector does not generate new surplus value, so it is only a burden on productive capital and constitutes a "leak" from the system. However, "fictitious accumulation" can become real accumulation when industrial capitalist are loaned from banks to generate surplus value at the expense of interest. But, generally markets in fictitious capital created or expanded almost independent of generation of surplus value so process of value creation resulting in speculative bubbles (Choonara, 2009).

Choonara (2009, pp.13), points out that *"the destruction of fictitious capital goes hand in hand with the wider devaluation of capital through crisis"*. Theoretically, this can prevent future expansion due to the burden on productive capital and excessive claims on future values (Perelman, 1987, pp.29-31). However, collapses taking place in finance are worsening the situation of productive sectors of the economy. Therefore, financial expansion can be best seen as deferring the emergence of crisis in a temporary manner, since features of the pre-crisis period help explain why, when the delayed crisis eventually broke (Choonara, 2009, p.13).

4.2.9. Minsky Crisis and Fred Moseley

Fred Moseley is a Professor of Economics at Mount Holyoke College in Massachusetts, U.S.A. Also Moseley is an author of a distinctive Marxist account of the

decline in profit rates which brought crisis in the 1970s and 80s. According to Moseley, the rate of profits is a determinant of business investment and so a key barometer of the capitalist economy. Firstly, investments and investment spending determine and reshape growth of economy. Another key is that the relative proportion of profits and debt payments determines and shows whether corporations are strong or not. If debt obligations are more than profits, this is a signal of vulnerability to bankruptcy. To summarize, Moseley states the crucial importance of profit rates both on investment and financial sides.

There are different ways of measuring profit rates, for example; Moseley's estimates are for the total economy and Robert Brenner's are for the non-financial sector. The recovery of profits in the non-financial sector is less than for the total economy even for non-financial sector. Therefore, in Moseley's estimates it can be seen that basically there is a substantial recovery of profit rates but not as close as to full recovery for the total economy. To sum up, he argues today's profit rates are by any measure better than they were in 70s and 80s because of holding down of wages. The average real wage in the U.S. economy has almost been the same as it was in the early 1970s namely for an average worker, there has been little or no increase in the real wage (Moseley, 2008).

Additionally, three decades of stagnant real wages and increasing exploitation have substantially restored the rate of profit at the expense of workers. Moreover, debt-to-profit levels for non-financial corporate business have come down (except for the leveraged buyouts), so most of these companies are in decent financial shape, and are not at great risk of bankruptcy. The higher profit levels have not resulted in a significant increase of investment. Instead, capitalists have chosen to pay themselves more dividends and higher salaries—as is clearly evidenced by higher dividend/profit ratios and the large stock buybacks which increases the incomes of executives who have stock options. This means that there is even less of a "trickledown effect" of higher profits for Moseley.

Moseley argues that the main problem in the current crisis is the financial sector and the crisis is not due mainly to the bankers' greed and short-sightedness. He adds that the problem is more fundamental—the nature of the capitalist financial system, which is inherently speculative. Furthermore, Fred Moseley advises Minsky's theory of "Financial Instability Hypothesis" for analysis of the modern capitalist financial system.

Finally, Moseley asserts that the current crisis is more of a Minsky crisis than a Marx crisis. The main cause of the current crisis is not insufficient surplus labor in production, but rather excessive risk-taking by financial capitalists searching higher returns which was based on the wrong assumption that housing prices would continue to rise.

4.2.10. Falling Rate of Profit and International Socialism Tradition

From the International Socialism tradition point of view, the current financial crisis has been channeled through the neoliberal economic policy regime that was established in the late 1970s and the early 1980s, in particular with the deregulation of financial markets and their greater power to engage in large-scale speculation across state borders.

According to IS tradition, causes of the crisis underlies in the long-term crisis of profitability. On the other hand, there has been a little recovery in the rate of profit during the late 1980s and early 1990s thanks to capital restructuring and a sharp increase in the rate of exploitation. IS tradition states that, U.S. has tried to prevent a major economic crisis through flooding the American and world economy with cheap credit. In addition to these conditions, workers real wages were stagnant and they have been encouraged to borrow in order to maintain demand for goods and services. It was the burst of the resulting speculative bubble based on the housing market which exploded in onset of the credit crunch in August 2007 (IS, 2008).

Unlike the earlier financial crashes those were originated in periphery, the current crisis originated in the centre of the capitalist system in the U.S. It affected the

entire world economy. IS (2008) states that; *European banks were major customers of the mortgages which repackaged as complex financial derivatives that have now gone toxic. The big exporting economies such as Germany, Japan and China are being sucked into the crisis as the markets for their goods shrink*.

According to the IS crisis has aggravated by a sharp increase in the rate of inflation in energy and consumer goods. The inflation which has been threatening the living standards of many poor countries was a result of boom in the world economy driven by the credit bubble in the mid-2000s. Additionally the process was strengthened by the speculative activities of investors in many markets.

After the emergence of the crisis, many capitalist states have tried to support the financial system through state intervention including the nationalization or government-organized rescues of major banks and other financial institutions. According to IS, these policies have blown an enormous hole in the neoliberal ideology of the free market. On the other hand, these interventions did not aim to protect the jobs, and did not care about living standards and houses of workers. Instead, they were about to protect the capitalist system and to protect the chiefs of the big banks that survive the process of reorganization from the consequences of their speculative gambles (IS, 2008).

4.3. CURRENT CRISIS UNDER THE PERSPECTIVE OF FINANCIAL INSTITUTIONS

4.3.1. IMF, WB, WTO

International Monetary Fund

International Monetary Fund (IMF) is an international financial institution following the macroeconomic policies of its member countries[17]; especially those experiencing problems on exchange rate and balance of payments. IMF was conceived

[17] 187 members as of June 2010

in July 1944 with World Bank (WB) after World War II in Bretton Woods, New Hampshire, United States. The origins of WB and IMF were based on ideas of U.S. Treasury Secretary Henry Morgenthau, his chief economic advisor Harry Dexter White, and British economist John Maynard Keynes. The Bretton Woods Conference is dominated by U.S. and U.K. so the notions of consensual decision-making and cooperation in the realm of trade and economic relations; the resulting agreement was the requirement of a multilateral framework to overcome the destabilizing effects of the previous global economic depression and World War II.

Basically, IMF's original objectives are to promote international monetary cooperation, stabilize international exchange rates, facilitate development and balance growth of international trade and provide short-term assistance to its members through the liberalizing economic policies as a condition of loans, debt relief, and aid in other countries (IMF, 2002; Sullivan, Arthur and Sheffrin, Steven M., 2003). Mechanism was based on a pool system in which each member has to contribute and can borrow from in case dealing with payment imbalances.

However IMF supervises the macroeconomic stability of member countries through multilateral and bilateral surveillance and publishes under the name of World Economic Outlook (WEO), Global Financial Stability Report (GFSR) and Financial Sector Assessment Program (Article IVs FSAPs), a series of major financial crises in the latter half of the 1990s and current crisis showed that there is an exact failure on predicting or effectively managing. That is why Simon Lee stated that

> *IMF has become one further casualty of the capital liberalization it has promoted in partnership with the World Bank and the World Trade Organization (WTO) as part of the liberal financial policies* (2002, p.283).

Additionally, Lee advanced his criticisms about the nature and effectiveness of IMF's role in the international financial architecture through the argument of IMF has expanded far beyond its original purpose. Firstly, it is asserted that IMF has been interfering in domestic policies of particularly the poorest states legitimately through imposing major structural and institutional reforms as conditions of loans. Moreover, imposed monetary tightening and trade liberalization policies not only have failed in

delivering promised development or economic growth but also undermined the market discipline and privileged the interests of private creditors. Furthermore, IMF has been criticized due to its lack of transparency, accountability and legitimacy. U.S. has been equipped with an "*effective veto power*" over IMF policies with the possession of a 17.5 percent quota, since more than 85 percent of the total IMF quotas are required to amend according to Articles Agreement of IMF (Lee, 2002, p.284).

IMF, World Bank and, later on WTO have been widely regarded as the institutional embodiment of the neoliberal financial orthodoxy of the "Washington Consensus" which focuses on liberalization -of trade, investment and the financial sector- , deregulation and privatization of nationalized industries. John Williamson originally created the phrase "Washington Consensus" to refer to the lowest common denominator of policy advice being addressed by the Washington-based institutions to Latin American countries. These policies[18] were:

- *Fiscal discipline*
- *A redirection of public expenditure priorities toward fields offering both high economic returns and the potential to improve income distribution, such as primary health care, primary education, and infrastructure*
- *Tax reform (to lower marginal rates and broaden the tax base)*
- *Interest rate liberalization*
- *A competitive exchange rate*
- *Trade liberalization*
- *Liberalization of inflows of foreign direct investment*
- *Privatization*
- *Deregulation (to abolish barriers to entry and exit)*
- *Secure property rights* (Williamson, 2000, pp.252-253).

As a result, IMF offers loans particularly to under-developed countries with varying levels of conditionality through the "Washington Consensus" which is often used interchangeably with the phrase "neoliberal policies." Savran and Balkan states that these neoliberal policies are based on four keystones:

- *Deregulation, minimizing the intervention of government on market operation which is contradictory to capital accumulation process,*

[18] Dani Rodrik proposed additional items and named it as "Augmented Washington Consensus". (Rodrik, D. 2010)

- *Privatization in order to minimize the government activities in production sector,*
- *Commercialization of social services such as health, education and retirement to prevent increase in power of resistance of working class and labor,*
- *Increasing elasticity of labor market and prevention of unionization* (2004, p.30).

Consequently, the process of integration of poor countries to the global economic system is being made by the hands of these institutions through the structural adjustment policies to lead the international capital movements seamlessly.

World Bank

The World Bank Group describes its mission; to fight poverty and improve the living standards of people in the developing world. It is a development bank which provides loans, policy advice, technical assistance and knowledge sharing services to low and middle income countries to reduce poverty. The Bank promotes growth to create jobs and to empower poor people to take advantage of these opportunities.

The time period of reconstruction of capitalism after the World War II; cases on exchange rate stability and macroeconomic balances had been left under the responsibility of IMF. Meanwhile, cases of reconstruction and development were left to the WB after ruins of the war. Established in 1944 from the Bretton Woods meetings, and commencing operation in 1946, the World Bank issued its first loan of US$250 million to France in 1947 for post-war reconstruction.

On the other hand, the condition of being a member of WB is also being a member of IMF. The voting power of the members is determined by the level of a nation's financial contribution. Moreover, in order to take a decision in executive committee, there has to be 85 percent vote majority where the U.S. has a possession of 16.98 percent which is enough to veto. In other words, just like IMF case it is impossible to take a decision without the agreement of U.S. in WB, too.

World Trade Organization

World Trade Organization has been established as a formal institution after a long period like IMF and WB. Due to the demands of industrialized countries, negotiations started in Havana Conference to reduce imposts and remove all obstacles on international trade of industrial goods and ended up with The General Agreement on Tariffs and Trade (GATT) in 1947. GATT lasted until 1993 and it was replaced by the World Trade Organization (WTO) in 1995.

WTO differs from other financial institutions with its so-called "one member one vote principle" that makes it apparently more democratic. Director-General Pascal Lamy (2010) describes the difference of WTO as *"[…] it is a fairly democratic institution where the voice of the small cannot be ignored. No board, no quotas. One member, one vote, is the background rule against which the WTO forges its consensus."* By being a member of WTO countries, a country has been signed and accepted the conditions of "The General Agreement on Trade in Services" (GATS). One of GATS's general principle is if a country opened its own private sector to take advantage of the service, this advantage also has to be provided to foreign companies. These services can be business services, communication services, construction and related engineering services, distribution services, educational services, environmental services, financial services, health-related and social services, tourism and travel-related services, recreational, cultural and sporting services, transport services. Moreover, being a member of WTO countries, a country has been signed to The Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) and The Agreement on Trade Related Investment Measures TRIMs, too.

In general terms; lack of targeting development policies, a provision on the free mobility of labor, arrangements on labor rights, environmental protection and also the full liberalization on agriculture that demanded from poorer countries clarifies that WTO is not far from aforementioned neo-liberal policies of Washington Consensus. (Kozanoğlu, 2008, p.47)

Understanding the crisis from IMF's perspective

The policies pursued by IMF, WB, WTO are controversial due to the their failure in delivering promised prosperity, it is clear for many that they have been practitioner of neo-liberal policies through IMF-WB based structural adjustment policies that eliminate the obstacles on international capital movements. Since common denominator of these institutions is liberal policies, their crisis perception does not differ from one another too much. Thus, IMF's crisis perspective is handled which mainly represents the other institutions, too.

In Fund's Annual Report 2009, IMF points its analysis to the failures in the global architecture, surveillance and regulatory frameworks. IMF claims that financial regulators were not equipped to see the risk concentrations and flawed incentives behind the financial innovation boom. Neither market discipline nor regulation was able to contain the risks, resulting from rapid innovation and increased leverage. Furthermore, macroeconomic policies were not sufficient enough to cover growing macroeconomic imbalances that contributed to the buildup of systemic risks in the financial system and in housing markets. On the other hand, IMF claims that financial supervisors did not pay enough attention to the risks building in the shadow financial system while Central Banks (CBs) had been focused on inflation instead of concentrating on risks associated with high asset prices and increased leverage. But the main objective of CBs is to provide price stability not to focus on high asset prices and increased leverage.

According to IMF, the crisis triggered by a long period of high growth, low real interest rates and volatility, and policy failures in financial regulation, macroeconomic policies and global architecture. In detail, low interest rates stimulated investors to seek for high returns further down the credit quality curve and low volatility prompted investors to act optimistically. In other words, the demand for new instruments over the financial system was increased. Therefore, demanded derivatives were become much more risky then they were perceived as Blanchard, Caruana and Moghadam (2009, p.2) stated "*in this setting, market discipline failed as optimism*

prevailed, due diligence was outsourced to credit rating agencies, and a financial sector compensation system based on short-term profits reinforced the momentum for risk taking".

Every regulation will bring an innovation for whole system thus; institutions can soften the severity of crises with new policy frameworks with respect to IMF. Moreover, IMF staff addresses the failures of economic actors and their policies as the cause of the crisis, by underlying the following fragments:

> *Financial regulation*: *Similar activities conducted by various types of institutions were regulated differently.*
>
> *Macro-prudential policies: Macroeconomic and financial stability were generally treated separately, the former focused on preserving low and stable inflation as well as growth, the latter on firm level supervision of the formal banking sector.*
>
> *Global architecture: This crisis was a story of fragmented surveillance in silos of expertise; of a policy debate dispersed in numerous fora (BIS, Gs, FSF, and IMF) [...]* (Blanchard, Caruana and Moghadam, 2009, p.3).

4.3.1.1. Financial system

The lack of efficient financial regulation is regarded as one of the main causes that led the market failure. Securitized assets and complex instruments were products of the false assumption chain that led to market confidence. This model was encouraged by credit rating agencies with optimistic statistical analyses which made investors and loan brokers to act in an optimistic manner and led to decrease in asset quality. Moreover, Blanchard, Caruana and Moghadam point to the firm-centric structure of regulation and supervision as the most important missing point of the policy makers (2009, pp. 2-3).

Regulatory perimeter and Market discipline

The "shadow banking system" which includes over-the-counter derivatives, off-balance sheet entities, and other non-bank financial institutions such as insurance companies, hedge funds, and private equity funds has been regulated by a patchwork of agencies and generally not supervised. Under these conditions in which only insured

deposit-taking institutions were tightly regulated and supervised, the shadow banking system had grown nearly as large as the formal banking system, since banks tried to avoid regulations by either hiding risk or by removing some leverage outside the bank. As seen in Figure 4.5, decrease in the leverage ratio of commercial banks was accompanied by an increase in the leverage ratios of non-bank financial institutions, resulting shift of leverage created a "shadow banking system". *"Thanks to credit derivatives, these new players can replicate the maturity transformation role of banks, while escaping normal bank regulation."* (UNCTAD, 2008, p.13).

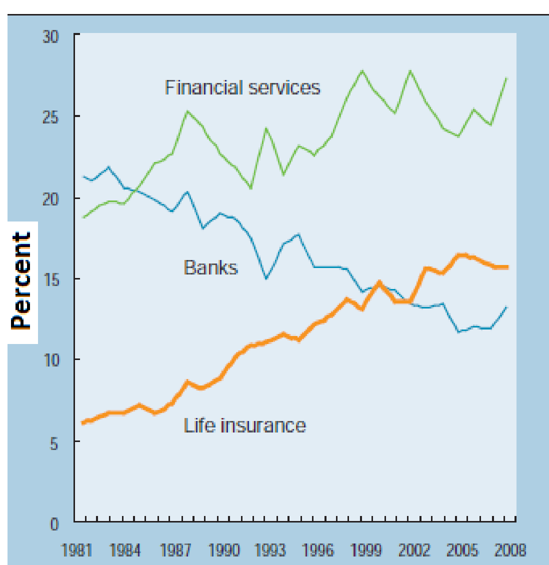

Figure 4.5: Leverage of top 10 U.S. Financial Firms by Sector

Source: UNCTAD (2009a)

Note: Leverage ratio measured as share of shareholders equity over total assets. Data refer to 4 quarter moving average

Until the emergence of the crisis, credit rating agencies were referred to monitor market discipline and guided investors with their prestige and analysis. However, the missing point of the investors and regulators was the growing conflicts of interest in credit rating agencies. *"Generous fees for structured finance products, combined with low underlying risk spreads, diluted assessments, even as agencies sold advice on how to structure products to maximize ratings"* (Blanchard, Caruana and Moghadam, 2009, p.4).

Pro-cyclicality and Information Gaps

IMF addresses to a constellation of regulatory practices and incentives which have pro-cyclicality behavior as causes the magnified credit boom and market turbulence. Loan loss provisioning rules which were largely backward looking, rewarding employees based on generation of annual profits, and rise in bank's net worth and encouragement of banks to invest more due to the increasing asset prices which is called Fair Value Accounting [19] have pro-cyclicality behavior.

Moreover, weakness in the application of accounting standards and gaps associated with the valuation and financial reporting of structured products contributed to the current crisis (IMF, 2008). There were disparities such as risks embedded in complex structured products, the degree of leverage and risk concentration in systemically important financial institutions, the difficulty of assessing liquidity and counterparty risk, and on-balance-sheet risks and links with off-balance-sheet risks between the data's used by markets and regulators (Blanchard, Caruana and Moghadam, 2009, p.3). This situation also emphasized by Priewe (2010, pp.21-22) who stated there was an "information asymmetry" in market between banks and all their customers that prevent to notice the risks behind the structured products. Moreover, the reality and the share of information are other cases and also non-transparent structured products caused by informational gap.

4.3.1.2. Macroeconomic Policies

A long period of high growth, low real interest rates due to the large scale of net capital flows into the U.S. reflecting high savings in Asian countries, low short-term rates reflecting accommodative monetary policy limited volatility were the conditions of the period prior to the crisis. In general, this economic situation was perceived healthy.

---

[19] Fair Value Accounting (FVA): A valuation principle that stipulates the use of a market price, where it exists, or an estimation of a market price as the present value of expected cash flows to establish the balance sheet value of financial instruments. http://www.ecb.int/home/glossary/html/index.en.html

However, a systemic risk has been build up through these conditions. Low interest rates with excessive optimism about the future increased asset prices, from stocks to housing prices. Low interest rates and limited volatility prompted a search for yield and underestimation of risks led to the creation and the purchase of ever riskier assets (Blanchard, Caruana and Moghadam, 2009, p.7). Additionally, Central banks mainly concentrated on inflation and aggregate activity rather than on risks associated with high asset prices and increased leverage and did not perceive the implications of the growing risks until it was too late (IMF, 2009a).

Monetary and fiscal policy

Federal Reserve System has been implementing the policy to increase the amount of money available to banks for lending. That policy is called accommodative monetary policy; because of the policy the short-term interest rates were low.IMF assesses because of concentrating on inflation and aggregate demand central banks and regulators missed the importance systemic risks associated with the increase of asset prices and growing leverage.

Global imbalances

"Global imbalances" defined by Priewe (2010, p.30) as *"the confluence of high and increasing current-account surpluses in some countries and the huge current-account deficit of the United States, along with some other smaller countries"* Global imbalances also played an important role in the emergence of crisis through building up systemic risks.

As seen in Figure 4.6 and Figure 4.7, deficit of the U.S. had been continuously growing until the crisis and the U.S. had been turned into an ever-growing net debtor country with absorbing 60 percent of all surpluses at its peak in 2006.

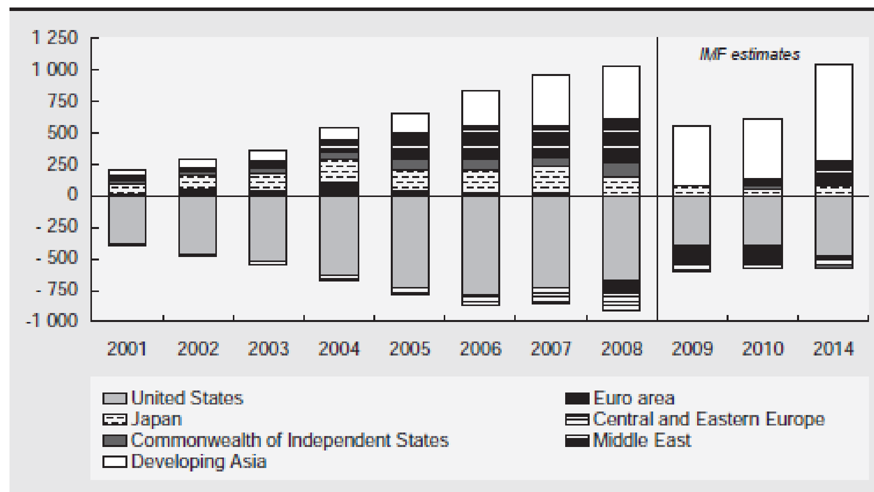

Figure 4.6: Current-account balances, 2001–2014 (Billions of dollars)

Source: IMF, 2010a.

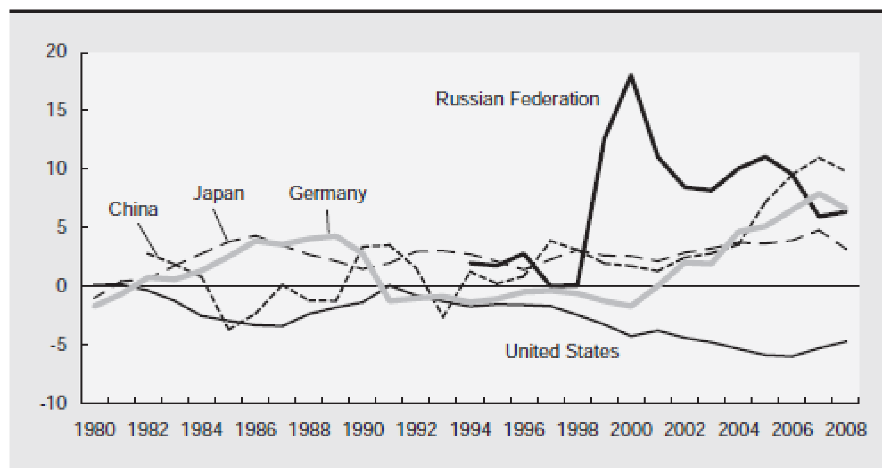

Figure 4.7: Current-account balance, 1980–2008 (Percent of GDP)

Source: World Bank, 2009.

Even if capital flows reflect the financial globalization, most of the arguments about global imbalances focus on trade in goods. This is a misleading argument for Priewe, since exchange rates and budget constraint are determined through the capital flows in deficit countries (Priewe, 2010, p.33). Prior to the crisis, official reserves of the central banks of surplus countries were increased due to their fixed or managed exchange rate regime that resulted in large scales of capital inflows into the financial system of the U.S.

A capital inflow to deficit countries does not necessarily lead to higher aggregated demand. These savings were representing preference for foreign financial assets, not demand for domestic goods. Moreover, if effects of these flows are not eliminated by robust growth they will slow down the growth of economy as Priewe explains it through the case of U.S.

Fluctuations in the amount of private capital flows to U.S. with respect to the return expectations from differentials promote the exchange rate volatility, while official reserves of the U.S. stabilizing the exchange rate of dollar. The two reverse forces determine the real effective exchange rate in which fluctuation will be limited. In this respect, concerning U.S. current account deficit seen in Figure 4.8, it can be clearly said that U.S. dollar is overvalued in real terms since the dollar has not been really depreciated for the past 25 years. A new export originated structural transformations to compensate the disadvantage exchange rate due to the overvaluation result in burst of the “new economy” bubble in 2001. The structural changes after this failure led to expansion of finance sector (Priewe, 2010, pp.35-36).

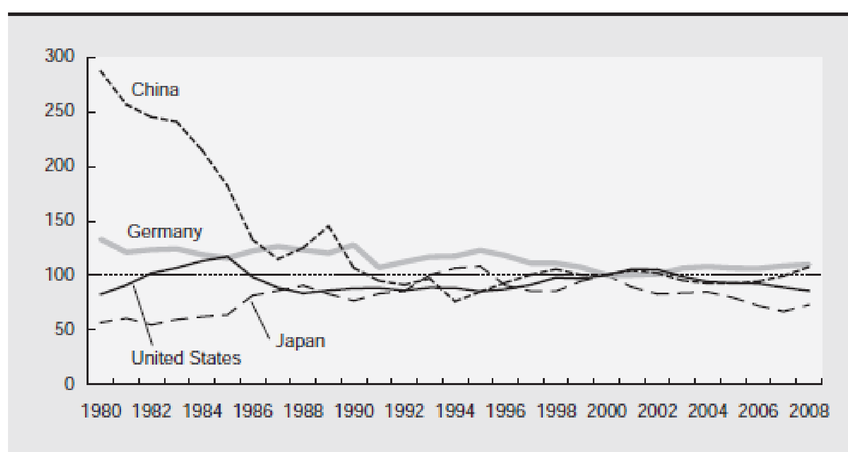

Figure 4.8: Real Effective Exchange Rates in China, Germany, Japan and the United States 1980–2008

Source: World Bank, 2009.

According to Priewe (2010), there are three main opinions about the risks of the global imbalances. First, that the United States deficit is without risk as it reflects

the "saving glut" in Asia and other oil exporting countries, coupled with a high level of trust in the stability of the U.S. economy (Greenspan, 2004 and 2010; Bernanke, 2005 and 2008). Secondly, deficit and surplus countries constitute a highly stable currency system which is fixed to U.S. dollar rather than gold as in the case of original "Bretton Woods", since U.S. dollar is accepted as the most reliable reserve money. This currency system is called as informal "Bretton Woods II" (Dooley, Folkerts-Landau and Garber, 2004). Thirdly, risky imbalances would harm the entire economy particularly growth of surplus countries through leading devaluation of the dollar.

A simultaneous growth all around the world is a very hard case in a globalized economy as seen in (Figure 4.9 and Figure 4.10), i.e. the higher worldwide growth rates the more imbalances. IMF organized a Multilateral Consultation in the apprehension of sudden reverse in decisions of investors that can lead to a disorderly adjustment, including in the value of the dollar (Blanchard, Caruana and Moghadam, 2009, p.8). Due to the aforementioned mechanism, global imbalances contributed to low interest rates and to large capital inflows into U.S. and European banks, pushing up the asset prices, leverage which turned to be a crucial factor in the crisis, a search for yield, and the associated creation of riskier assets.

More specifically, China and other surplus countries accused of their neo-mercantilist exchange-rate policies, while the United States accused of huge household consumption and high budget deficits.

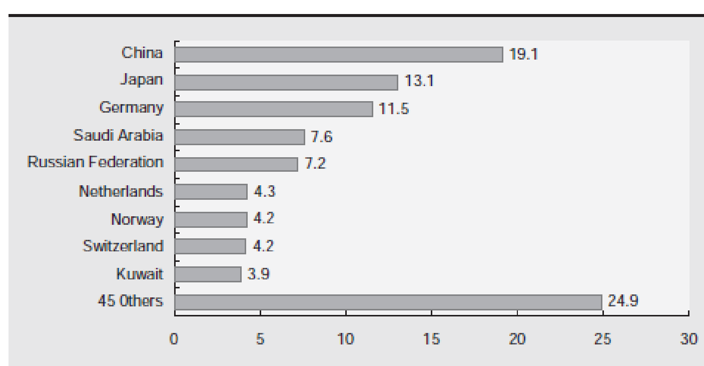

Figure 4.9: 54 Current-account surplus Countries, 2006 (Per cent of aggregate surplus)

Source: World Bank, 2009.

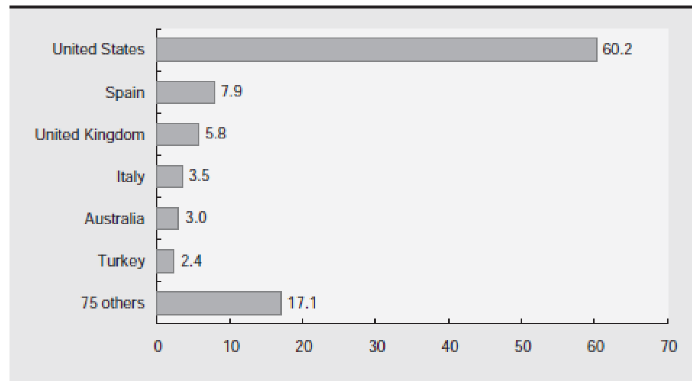

Figure 4.10: 81 Current-account deficit countries, 2006 (Per cent of aggregate deficit)

Source: World Bank, 2009.

4.3.1.3. Global Architecture and the Institutions

For Blanchard, Caruana and Moghadam (2009, p.8) *"the term global architecture refers to the official mechanisms that facilitate financial stability and the smooth flow of goods, services and capital across countries"*. This explanation refers to the mechanism as mentioned in early chapters that IMF, WTO, WB together to establish the global architecture through surveillance, multilateral coordination, financial regulation, financing.

Surveillance

International surveillance could be really an important case for giving some warnings before the crisis. According to IMF, surveillance aims to identify domestic and, in particular, cross-border vulnerabilities that could cause systemic problems. Many other financial institutions have similar functions such as the Bank for International Settlements (BIS), the Organization for Economic Cooperation and Development (OECD), and the World Bank (WB). Unfortunately, as Yılmaz Akyüz[20] states:

[20] Yılmaz Akyüz was the Director of the Division on Globalization and Development Strategies and Chief Economist at the UNCTAD until his retirement in 2003. Now he is chief economist of South Centre, an intergovernmental think tank of developing countries headquartered in Geneva.

[...] the IMF has generally been unable to identify build-up of financial fragilities, predict instability and crises and issue early warnings in large part because of its blind faith in markets. In the sub-prime turmoil it has missed the biggest crisis of its lifetime" (Akyüz, 2010, p.1).

IMF's role based on its universal membership, mandatory bilateral Article IV consultations. After the Asia crisis, Fund was focused on financial analysis through establishing the Financial Sector Assessment Program (FSAP) together with World Bank to examine macro-financial linkages, and the newly minted Financial Stability Forum (FSF) promoting information exchange and cooperation in financial supervision and surveillance across the major financial centers. None of these arrangements provided sufficiently robust warnings prior to the crisis (Moghadam Reza, 2009b).

Even though many key points and vulnerabilities were subjected in the Fund's multilateral surveillance publications such as the World Economic Outlook (WEO), the Global Financial Stability Report (GFSR) and bilateral surveillance reports (Article IVs, FSAPs), they failed to deliver effective and serious messages due to not taking into account the combined impact and interconnections between them. For instance, surveillance has missed the risk of a house price collapse, danger from dispersed risk, housing-financial feedbacks, spillover from subprime mortgages to finance and to the real economy, limits of inflation targeting, and risk of systemic failure. Moghadam summarizes some of important key weaknesses of surveillance as;

Failure to uncover aggregate implications of individual risks: macro-financial issues were often viewed in isolation, and spillovers and feedbacks inadequately explored.

Lack of follow-through: when risks previously flagged (e.g., in 2002–03) failed to materialize, concerns were not voiced more loudly, but rather downplayed. Also, exploration of "tail risks," consideration of "what if" questions, and emphasis on "known unknowns" were all inadequate, with scant reappraisal of sanguine baselines or formulation of specific remedial advice.

Optimistic bottom-line assessments and hedged messages encouraged complacency: analysis was too often inclined to believe "this time is different (Moghadam, 2009b, p.3).

Multilateralism

Multilateralism is another important part of setting stability on global scale through the global architecture. But it is said that the mechanism and commitment for coordinated actions were not sufficiently qualified, even when warnings run up and problems noticed. For instance, after the onset of the crisis, the initial policy response of all countries acted to protect their own banks with guarantees. These types of acting show that there is no trust for international financial institutions. On the other hand, this type of acts defined as lack of multilateralism by IMF.

Financial regulation and Financing

In times of crisis, there is not any formal understanding and diagnosis about risks between national regulators. Therefore, different policies have been implemented by nations due to the different perceptions. For instance, a given risk may be minor to a large foreign bank, but huge to the host country.

Moreover, during the crisis the absence of standing dollar liquidity facilities was strongly felt in interbank markets around the world and in emerging markets. Many of the emerging market countries have drawn on Fund resources to access the adequate liquidity and financing. It is said that without the insurance provided by IMF, emerging market countries would try to self-insure through building up excessive reserve, potentially distorting the global pattern of current account balances for many years.

To summarize, a surveillance system which is lack of multilateral coordination and collaboration failed in to noticing growing systemic risks. On the other hand, there were not any rules governing cross-border resolution or burden sharing. Therefore, when interbank markets around the world froze up, economy was out of liquidity insurance leading to discriminatory and inefficient responses.

4.3.2. United Nations Conference on Trade and Development (UNCTAD)

The United Nations Conference on Trade and Development (UNCTAD) has been established in 1964 as a principal organ of the United Nations General Assembly

which concentrates on trade, investment, and development cases. Organization objectives are problems of developing countries over the multi-national corporations, and great disparity between developed and developing nations. The view of that, institutions like WTO, IMF, and World Bank does not properly consider particular problems of developing countries led to establishment of UNCTAD. Furthermore, UNCTAD has been criticizing the neo-liberal policies those implemented through WB-IMF based structural adjustment programs that failed to deliver economic growth or provided a route out of poverty promised. UNCTAD has 193 members and its primary objective is to formulate policies relating to all aspects of development including trade, aid, transport, finance and technology.

There are explanations about the causes of the crisis like claiming "government failure", "too much liquidity" as a result of expansionary monetary policy in U.S. and "global savings glut" or individual misbehavior. These explanations commented as simplistic by organization, since they are lack of explaining the breakdown of the financial system properly. Moreover, unlike the interpretations made by all authorities, organization points to the greed of economic agents and states as; "*no doubt, without greed of too many agents trying to squeeze double-digit returns out of an economic system that grows only in the lower single-digit range, the crisis would not have erupted with such force.*" (UNCTAD, 2009a, p.1) In addition organization asserts that, effective policies should have predicted that human beings can be greedy and short-sighted. Actually, it is right that human nature is greedy, if huge returns on equities for little invests is promised, people would undoubtedly believe its possibility and would not care about individual risk and much less about the risk of systemic failure. The modern history is full of such examples which have always ended in economic downturn and crash. But it is not the only problem that policy makers forget the lessons of the past, also they have undoubtedly believed in the idea that the economic system could care and heal itself. According to organization, policymakers have clearly failed to take a lesson from the experiences of previous crises. Similar to the earlier financial crises, this crisis emerged after a typical sequence of expansion, euphoria, financial distress and panic. (UNCTAD TDR, 2009b, p.3)

Prior to the crisis, there was huge credit expansion in US that financed real estate purchases and fuelled asset prices through increasing demand and ended with debt financed private consumption. Furthermore, UNCTAD states that this credit expansion was channeled to "*real estate acquisitions rather than investment in productive capacity that could have generated higher real income and employment in a sustainable manner.* (2009b, p.3) From 2000 to the current crisis the household debt increased because of easy credit conditions and stagnant wages. The financing process of compensating deficits from abroad and the huge flows into US lead to buildup of external liabilities.

Indeed, organization claims that the causes of the current crisis which turns it to such severe and deep is financial deregulation, "innovation" of many products and incompetence of credit rating agencies raised credit leverage to unprecedented levels. There was unquestioning belief to efficiency of deregulated financial markets which organization defines as "blind faith". In addition, as stated by organization; "[…] *this "blind faith" led authorities to allow the emergence of a shadow financial system and several global "casinos" with little or no supervision and inadequate capital requirements"*. (UNCTAD TDR, 2009b, p3) As a result, the unwinding of speculative positions of the financial market was triggered by the burst of housing price bubble and those speculative bubbles were not reflecting the real economy and were unsustainable. Furthermore, UNCTAD (2009a, p.1) states that: "*For policymakers who should have known better to now assert that greed ran amok or that regulators were "asleep at the wheel" is simply not credible."*

Finally, there are three interrelated issues according to organization that must be considered by international policy-makers. Organization explicated that these issues have multilateral dimensions since they have systemic failures:

> *How the ideology of financial deregulation within and across nations allowed the build-up of pressures whose unwinding has damaged the credibility and functioning of the market-based models that have underpinned financial development throughout the world;*

How the growing role of large-scale financial investors on commodities futures markets has affected commodity price volatility and fed speculative bubbles; and

The role of widespread currency speculation in exacerbating global imbalances and fuelling the current crisis in the absence of a cooperative international system to manage exchange rate fluctuations to the benefit of all nations (UNCTAD, 2009a, p.1).

4.3.2.1. Blind Faith on Market Efficiency

Financial deregulation driven by an ideological idea of neoliberal policies has allowed "innovation" of financial instruments that are completely detached from productive activities in the real sector of the economy. Those complex instruments were reproduced by speculative activities due to convincing information which in reality is nothing other than an extrapolation of trends into the future. The information based on credit rating agencies and economic agents has misled investors, and assets were packaged and repackaged through the trust on market belief. According to Organization, speculations based on high returns cannot be sustainable for long time.

In mainstream economic ideology, the efficient financial markets would solve the economic problem of the transformation of the today's savings into tomorrow's investment through the assumption that efficient financial markets were sufficient to convince some people to save and others to invest it into the future despite the fact that in the real world the investor is faced by "objective uncertainty" identified by Keynes. Therefore, while expecting return it must be taken account the fact that the more people save the lower would be the actual return (UNCTAD, 2009a p.2 and UNCTAD, 2006).

In order to understand the tendency of the investments into financial market instead of real market, one needs to look at the rate of returns. For instance, low interest rates meaning low rate of return money stimulate to invest. However, in financial markets, particularly structured products give higher rate of return. Considering the situation of economy including huge amounts of money, it can be understood that why too much financial investment has been made on these structured products.

Investment in fixed capital is risky, since one cannot be sure about if the new products/innovations of the investment coincide with the requirements of potential clients. Even it is easy to imitate the new goods and services, in the event of coincidence the investor became a monopoly for a short time if he or she invests in a new area. Even in the case of existing imitations, this does not cause a systemic problem. Additionally, innovations diffuse to society very quickly through information sharing and always increase overall welfare and income gained. Consequently, increase in productivity would promote a continuous increase in prosperity if there would not be any obstacles on the way of equal distribution such as institutions. Finally, demand will compensate rising supply of products due to increase in productivity.

In financial markets, investors act in the respect of information get from agencies with existing assets. Financial actors don't enter the zone that they have no information about it. This information lets them to earn arbitrages basically; however, this situation does not shift the production curve up and does not increase society's wealth up, just make good earnings for the investors (UNCTAD, 2009a). In financial markets "herding effect" is fatal situation since it can lead to break down of whole system.

> *The fatal flaw in financial innovation that leads to crises and collapse of the whole system is demonstrated whenever herds of agents on the financial markets "discover" that rather stable price trends in different markets (which are originally driven by events and developments in the real sector) allow for "dynamic arbitrage", which entails investing in the probability of a continuation of the existing trend* UNCTAD (2009a, p.3).

If the most of economic agents shift their investments towards the same destination (like rising prices of real estate, oil, stocks or currencies), they force the market power to move these prices far beyond sustainable levels. Contrary to the arguments based on the mainstream theoretical literature, Organization asserts that speculation of this kind would severely affect and destabilize the prices in subjected markets since speculations cannot be stabilized in the condition of not known "true" prices which is valid for a world characterized by objective uncertainty.

In the current crisis, since the funds have not been invested in the productive base of the real economy, real income has not been increased. Instead, it has only created the short-term delusion of ceaselessly high returns and a "money-for-nothing mentality. In this respect, organization clarifies the global economic crisis due to the slow growing economy contrary to faster growing financial sector and its expectations: *[…] the harsh reality of a slowly growing real economy catches up with the insistent enthusiasm of financial markets such that an adjustment of exaggerated expectations of actors in financial markets becomes inevitable* (UNCTAD, 2009a, p.4).

In fact it is impossible to adopt the insistent markets enthusiasm. The economy grows conditional to the outstanding debt particularly governments and households. Households, investors, banks, and other economic agents are directly involved in speculative activities with funds that they borrowed previously. Moreover, since they faced with greater deleveraging rate, it became more difficult to pay back the borrowed funds, and Fisher (1933) called it as "debt deflation".

Fisher describes the adjustment as a painful process, since debtors try to improve their financial situation by selling assets and cutting expenditure, thereby driving asset prices further down, cutting deep into profits of companies and forcing new debt deflation elsewhere. The situation identified by Fisher will be concluded with a deflation of prices of goods and services as well as investments and consumption altogether. Moreover, in the situation of debt deflation, as Paul de Grauwe (2009) stated "*the attempts of some to service their debts make it more difficult for others to service their debts.*" In this position, only governments can stabilize the economy by government debt deflation.

Prior to the current crisis, "investment banking" has been synonymous to "financial modernization"; however, according to UNCTAD (2009a), this is only a new term for an old phenomenon. Investment banks do not contribute to the real economy in reality, since nearly most of the investment banks do not prefer to invest in production sector. In addition, they served the speculative activities as an innovation in finance. On the other hand, the only new thing for organization was *"the dimension through which*

private households, companies and banks have collectively engaged in what amounts to gambling" (UNCTAD, 2009a, p.4) These relied on the deregulations and freedom of capital flows and the efficient allocation of "savings" is the most important ingredient of successful economies.

4.3.2.2. Global Imbalances and Lack of International Monetary System

Prior to the current crisis there were some evidences of imbalances according to organization and those were large current account deficits in some developed countries such as U.S., U.K., Spain and several East European economies. Contrary to these countries, there were also large growing surpluses in some countries such as China, Japan, Germany and some oil-exporting countries. In addition, organization states that; *"particularly in U.S. growth of economy was driven to a large extent by debt-financed household consumption, made possible by reckless lending and growing bubbles in the housing and stock markets"* (UNCTAD TDR, 2009b, p.3). Because of the role of imbalances in current economic crisis some economists recall global system of Bretton Woods that of the gained prosperity and monetary stability provided after it. Since then, the occurrence and size of imbalances and of financial crises have dramatically increased and peaked in the current crisis. One of the facets of the crisis is the logic of unrestricted capital flows and unlimited freedom to exploit any opportunity to realize short-term profits. This kind of short-termism has been major driving force of the economy of the world for decades, but the current crisis brought out damaging impacts of short-termism.

On the other hand, excessive and cheap liquidity resulted in high level of consumption with the encouragement of states. Furthermore, this high level of consumption increased demand for goods and services. Additionally, individuals of some developed countries consumed much more than their real incomes.

> *[...] the wealth effect of higher prices for housing or stocks led households in the United States and in the United Kingdom to borrow and consume far beyond the real incomes that they could realistically expect, given the productivity growth of the real economy and the dismal trends in personal income distribution* UNCTAD (2009a, p.4).

According to organization, there is a correlation between consumption of U.S. and employment rates and living standards of emerging-market economies. In this manner, consumption of U.S. means more employment and high living standards for emerging-market economies. Actually, in an economy when consumption is high due to demand and supply mechanism, economy grows; however, if it is not supported by domestic industry and production, the result is economic boom. In addition, these levels were fuelled through speculative bubbles that are inflated by housing and stock markets.

The households do not have any income except for their salaries in general, considering that there have not been enough investments to industry. Moreover, because of no increase in wages, household saving rates became almost zero and households could only sustained their level of consumption by much more borrowing. Some developed countries with zero saving rates are given in Figure 4.11.

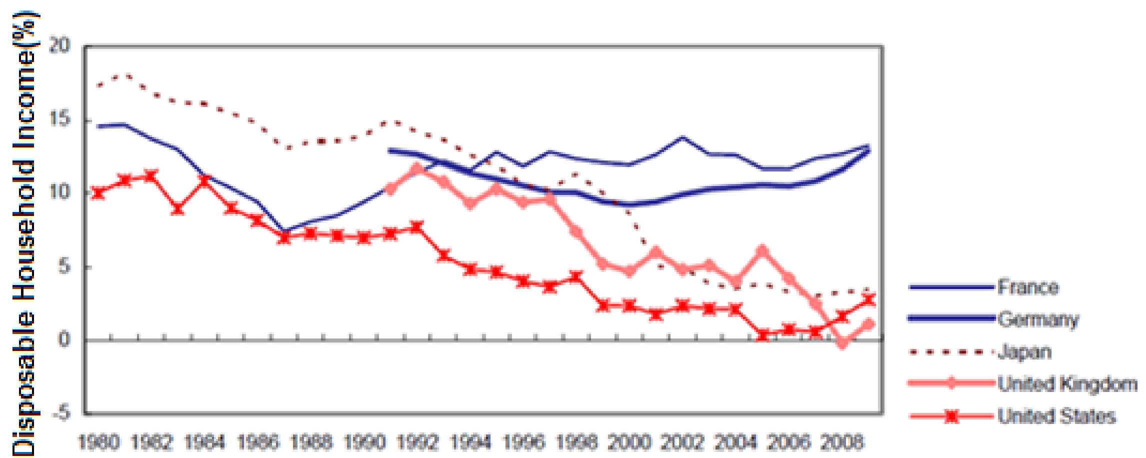

Figure 4.11: Household Savings, 1980–2009[21].

Source: OECD, Economic Outlook database.

This consumption boom with unsupported form, in a global prospect *considering open market and international competition in the markets for manufactures, the spending trend boosted through borrowing on international markets and led to large current account deficits at last* (UNCTAD, 2009a, p.5).

[21]Data refer to net savings with the exception of United Kingdom where data refer to gross savings

Contrary to countries with current account deficits, some countries such as Germany and some Asian Countries were having huge current account surpluses through engaging belt-tightening policies ended with slow growing rate, low wages and low consumption level. Through the world-wide increased cost competitiveness, some countries advanced the excessive export growth and current account surpluses, thereby accumulating huge net asset positions as opposed to the overspending nations. As mentioned before, interest rate differentials through the speculative capital flows led to exchange rate depreciation. Later on, international competitiveness additionally adjusted by temporary exchange rate depreciations.

Financial losses in the deficit countries or their inability to repay borrowed funds then directly feed back to the surplus countries and endanger their financial system. Since, there is not clearly described governance in financial relations between countries trading with one another, the channel of infectivity becomes danger. The credit-debtor relations between countries (Figure 4.12) are not only because of the high levels of spending spree but also because of the currency system called "Bretton Woods II" (Dooley, Folkerts-Landau and Garber, 2004) This currency system is an explanation for how developing economies overcame the crises of 1990s. Since U.S. dollar is accepted as the most reliable reserve money, these economies unilaterally stabilized their exchange rates at an undervalued level or later on fixed it to the dollar. This was a solution in order to cope with trade and financial shocks of 1990s, later they performed significant successes in growth and trade. According to organization, unilateralism around the world in dealing with the implications of global imbalances at the national level has aggravating effects on the severity of the current crisis

Figure 4.12: Global Current-Account Balance (Percent of GDP), 1990–2008.

Source: UCTAD secretariat calculations, based on data from Thomson DataStream, referring to 122 countries.

UNCTAD (2009a, p.7) states that *"movements of relative prices in traded goods as a result of speculation in currency and financial markets ("carry trade"), which leads to considerable misalignments of exchange rates"* is another important reason of imbalances. In detail, as mentioned before, there are capital flows searching for high yields through the interest rate differentials. If there is huge capital flows into a country, the currency of capital-receiving country would be appreciated in nominal and in real terms, affecting to the level of overall competitiveness of country vis-à-vis other countries. Finally, organization asserts that, these types of movements in the real exchange rates are clearly associated with the growing global imbalances.

4.3.2.3. What should have been predicted?

The global financial crisis emerges in the middle of the disregard of international governance. According to organization, international community could not give credible global rules to global economy. The unexpected unwinding of those speculative positions in financial markets was triggered by the burst of the house price bubble in the U.S. Similar with the previous cases; housing price bubble itself was the result of the world wide deregulation of financial markets. The contagion of risk and the severing of risk and the information about it were promoted by the use of

"securitization" through the various structured instruments like residential mortgage-backed securities (RMBS) that seemed to satisfy investors' lust for double-digit profits. Most of investors began to invest in hedge funds and restructured financial instruments. A key impulse of this kind of "financial innovation" was the naive belief in efficiency of the market theories that assume well informed economic agents (buyers and sellers) and hence promised minimal risk (Davidson, 2008). But in the end, the opposite occurred: financial "innovation" resulted in a concentration of risk, since most of the "vehicles" were "securitized" by using assets that contains identical default risks (Kuttner, 2007, pp.21-22).

Finally, in the event of relatively slow real economic growth with respect financial growth, high rate of return expectations are misguided by experts, credit rating agencies, regulators and policy advisors who must know that such an economy cannot deal with incomes earned through exaggerated real estate and commodity prices or misaligned exchange rates in long term. UNCTAD (2009a) states that *through the experience of the crisis, that the relevance of real economic growth and its necessary link to the possible return on capital is slowly coming to be understood by many actors and policymakers.*

4.3.3. Bank of International Settlements (BIS)

The Bank for International Settlements (BIS) is referred as proverbial 'IT staff' (Information Technologies) of the global economy. BIS remains mostly out of the public eye while other international financial institutions are highly visible (Seabrooke, Leonard, 2006). BIS set rules, norms and decision-making procedures that establish governance structures for all banks. Furthermore, bank is like a centre of information sharing among central banks and private financial institutions, known as the Bank of Central Banks. Seabrooke (2006, p.1) states the importance situation of BIS as; "*these institutions would face severe information asymmetries, their assessments of creditworthiness would be harder to establish, and the effective management of currency crises would be more difficult to achieve*."

BIS has been established in Basel in 1930 to govern Germany's war reparations as a special bank license with consortium of central banks of England,

Japan, France, Italy and JP Morgan, City Bank and National Bank of Chicago. Most important objective of BIS is to set the regulation standards of internationally active banks. To advance objectives about the standards on supervision international banking Basel Committee I accords were made. Then decisions of Basel I became unsatisfactory because of the complexity of system and accords continued with in Basel II in 1999 and Basel III in 2010.

In general, the causes of the crisis can be divided into two main parts under the perspective of BIS: microeconomic and macroeconomic. Microeconomic causes fall into three areas: incentives, risk measurement and regulation. Macroeconomic causes fall into two groups: problems associated with the build-up of imbalances in international claims and difficulties created by the long period of low real interest rates. BIS states that it should not be thought that these two main groups are disconnected from each other rather they are surely interrelated (BIS, Jun., 2009).

4.3.3.1. Microeconomic Causes of the Crisis

Under this perspective, microeconomic causes of current crisis fall into three areas: flawed incentives; failures of risk measurement and management; and weaknesses in regulation and supervision. For BIS (2009), these shortcomings together allowed financial industry to account financial gain according to financial reports too early and without proper risk adjustment.

Flawed Incentives

The financial crisis made clear for consumers and investors that incentives were not true as mentioned. Indeed, incentives were distorted not only for consumers and investors but also financial sector employees, and credit rating agencies. Especially, due to the encouragement of increasing house prices, consumers and investors failed to watch out for themselves, borrowing heavily and investing in overly complex and opaque products (BIS, 2009). Also short term expected returns and business volumes due to so-called accounts of compensation schemes of financial firms encouraged managers to increase leverage and accumulate huge amounts of risks.

As mentioned before, it has been claimed that credit rating agencies has misled all of the economic actors. BIS also claims that credit rating agencies failed to correctly evaluate the probability that borrowers would repay. Since there were huge amounts of complex structured products (packaged and repackaged products), credit rating agencies took on profits from their business. It is a crucial case in finance to make right measure and pricing, so it is required to use modern statistical tools largely based on historical experience (BIS, 2010). Data series that shows evolution of slow but permanent does not mean that it is all right, since it can be just a trend reducing the distant past. Therefore, BIS report asserts that the long but more recent period of relative stability created the perception that risk had permanently fallen. The result of such wrong perception was a willingness to buy and sell risk thoughtlessly and very cheaply. Considering the great social costs of current crisis, it is seen that those omnipresent statistical methods are specifically bad at assessing large-scale, uncommon events. *"They perform worst when we need them most"* (BIS, 2010).

Failures of Risk Measurement

There were governance problems in risk management practices and this inadequate governance created more risks. There were both structural and behavioral reasons that led senior managers and board members were neither to ask the right questions nor to listen to the right people (BIS 2009). The structural problem was that risk officers did not have sufficient contact with top decision-makers. In addition, it was also the behavioral problem that there was not enough support from top management so it did not matter what the chief officer said.

It is really hard to say that risk managers have foreseen the risks and if they did say or they did not. But for BIS, risk managers have the very unpopular job of telling actors to stop making money. Also a lack of support from top management sidelined the risk managers.

Weakness in Regulation

The fact that cannot be ignored about regulations is that financial institutions found it relatively easy to move activities outside the regulatory perimeter in addition to incentives and risk measurement according to BIS. In other words, this means that regulatory system was too tolerant for some activities and avoid from some altogether.

Indeed, banks are required to hold a certain amount of capital in order to engage in risky activities. Through this rule, bank's capital requirement limited the build-up of leverage on bank balance sheets. According to BIS, since lower leverage meant lower profitability, bank managers found ways to increase risk without increasing the capital that they were required to hold. This process is named as a story of the structured investment vehicle by BIS. After all, it is clear that the *"enlarged financial sector – comprising both traditional banks and an increasingly important parallel financial system composed of non-bank intermediaries and off-balance sheet entities – had become much riskier than in the past"*(Rajan, 2005).

As a result according to BIS (2010), *"by fighting the wrong battles or not fighting at all, weak regulators and supervisors allowed the build-up of enormous risk"*.

4.3.3.2. Macroeconomic Causes of the Crisis

The macroeconomic causes of crisis are divided into two broad categories by BIS: problems associated with the build-up of imbalances in international claims and difficulties created by the long period of low real interest rates.

Global Imbalances

Prior to the current crisis, it clearly observed that there were outstanding current account surpluses and deficits. These are called imbalances that generated net capital flows from capital-poor emerging market countries to capital-rich industrial economies. Origins of these flows are a controversial issue between economists. BIS asserts that there were excessive domestic demand in some major advanced economies

because of high consumption rates and current account deficits. In addition, there were huge current account deficits in U.S.;

> *[...] between 1999 to mid-2007 to the beginning of the current crisis – the cumulative U.S. current account deficit was $4.6 trillion. The U.S. Treasury estimates that, by the end of 2007, U.S. gross external debt was roughly $13.4 trillion, nearly four times what it had been just nine years earlier* (BIS, 2009, p.5).

As mentioned before, there are some hypothesis about these flows, in its 79th Annual Report BIS eliminates those hypotheses to four. The first one is Global savings glut. The second one is the dearth of investment opportunities worldwide. The third candidate is fast-growing emerging market countries' desire for both international diversification and low-risk liquid assets. And the last hypothesis is that emerging market economies were accumulating foreign exchange reserves to fight the appreciation of their currencies. Also the last one has an additional meaning that is "*emerging market countries saw these reserve stockpiles as welcome war chests to help them defend against sudden capital flow reversals of the sort that had occurred during the Asian crisis*" (BIS, 2009). BIS explains the relationship between these surplus and deficit countries as a symbiotic relationship due to the export-led growth in one set of countries and leverage-led growth in another. Moreover, those flows contributed to the incorrect pricing of assets and to the global spread of the crisis.

Low Real Interest Rates

Beginning with the early 2000s, there has been a long period of low interest rates that caused a number of important effects. Especially, boom in credit to households fuelled some unsustainable run-ups in housing prices. Additionally, high profit search drove the institutional investors to take on a significant additional risk.

Finally, for a more stable financial system the causes of the current crisis must guide everyone to help in designing series of reforms. Thus, it is crucial to draw correct conclusions from the causes. Certain activities can deduced, like securitization or over-the-counter trading, and certain financial instruments, like collateralized debt obligations or credit default swaps, should be banned in order to prevent another

meltdown. Moreover, banning is not a reasonable solution to avoid the next crisis. Instead of banning, a flexible and forward-looking approach that addresses the externalities that allowed the specific activities to inflict systemic damage can be more sufficient. BIS accepts that it is impossible to eliminate crises, rather find it more acceptable to seek for solutions reducing both their likelihood and their severity.

To summarize, BIS asserts that, it is required to build a more resilient financial system after addressing the risks coming from two types of externalities in the system: one is joint failures stemming from common exposures (institutions are all exposed to the same risk) and inter-linkages (institutions are inextricably tied together), and the other is pro-cyclicality.

5. CONCLUSION

Explanations on current financial crisis differ greatly from each other. As considered in the study, ideas about the causes have been forming a large literature since the emergence of crisis in 2007-2008. Generally, most of these explanations are based on financial sector, banking sector, supervisory institutions, lax monetary policy leading low interest rates, low credit conditions, house price inflation, increasing global imbalances and among others. On the other hand, some explanations are based on to the structural problems of economic system and the logic of capitalist mode of production.

In addition, particularly mainstream economics and (also institutions acting in the way of mainstream economics) and Marxist political economy are constituted the core of the study with their explanations. International financial institutions such as; IMF, WB, WTO and BIS have been very dominant on world's economy and maintaining under the neo-liberal policies. So to say, these financial institutions have been implicitly smoothing the way of international capital movements. On the other hand, UNCTAD has been different from other financial institutions because of putting out and advising human-centered and develop mentalist economic policies for poorer countries. Moreover, followers of Marxist political economy have addressed the causes of the crisis to structural problems and particularly claim that capitalist economic system is crisis-prone due to its nature.

According to Akyüz (2010) IMF has been unable to achieve to have success on its main purpose of "the global public good of financial stability" which requires a stable system of exchange rates, sustainable current account balances and orderly currency and balance-of-payments adjustments. Since global crisis followed by the years of low interest rates that produced excessive optimism and risk taking that created an extensive range of failures; in market discipline, financial regulation, macroeconomic policies, and global oversight. According to IMF, the global financial system expanded massively, spreading out new instruments that seemed to offering higher profits at lower risk.

Furthermore, Fund points its analysis to a failure in the surveillance, and regulatory framework such as: excessive leverage and risk taking, driven by a long period of low real interest rates and high growth; shortcomings in the approach to domestic and international financial regulation; fragmented regulatory structures; inadequate disclosure of risks; and weaknesses in crisis management and bank resolution frameworks. IMF moves away from structural problems putting the blame on economic actors and policy makers. Furthermore, according to Fund financial regulators were inadequate to see the risks and flawed incentives behind the finance. Otherwise, there were some additional factor on building up systemic risks such as; macroeconomic imbalances and lack of effective policy cooperation at the international level, which compounded the risks inherent in the inability to spot growing vulnerabilities and cross-border links. In addition, central banks focused mainly on inflation, not on risks associated with high asset prices and increased leverage. And financial supervisors did not care about the risks in the shadow financial system.

UNCTAD's explanations on break down of the financial system are more complex than the prevailing explanations based on alleged government failure suggest such as "too much liquidity" as the result of "expansionary monetary policy in the United States" and "global savings glut". To address the systemic failures, organization develops three multilateral-dimensioned issues; first one is the failure of the ideology of financial deregulation. Second one is the growing role of large-scale financial investors on commodities futures markets which has affected commodity price volatility and fed speculative bubbles. Third one is the role of widespread currency speculation in exacerbating global imbalances and fuelling the current crisis in the absence of a cooperative international system to manage exchange rate fluctuations.

Consequently, for a realistic solution in a globalized economy, interventions in financial markets necessitate cooperation of national institutions and multilateral mandate specialized institutions to stabilize speculative activities. Furthermore, UNCTAD asserts that it is required to stabilize exchange rates by direct and coordinated government intervention, supported by multilateral oversight. Moreover, the capital flows must be tackled in an integrated fashion since they cause speculations and

volatility through searching for a quick gain. Finally, as UNCTAD states that the lasting solution can just be provided by closing down the "big casino".

Unlike the other institutions, because of its expertise on financial system and financial regulation BIS develops a different categorization to address the causes of current crisis; microeconomic and macroeconomic. Shortcomings on flawed incentives, failures of risk measurement and management, and weaknesses in regulation and supervision can be classified through microeconomic causes those together allowed financial industry to account financial gain according to financial reports too early and without proper risk adjustment. On the other hand, BIS claims that, as a result of imbalances, net capital flows from capital-poor emerging countries contributed the incorrect pricing of assets and global spread of crisis. In addition, long period of low real interest rates caused a number of important effects such as; boom in credit to households fuelled increases in housing prices, further high profit search of the investors which lead them to take on a significant additional risk.

Consequently, BIS calls for a series of reforms to design a more stable financial system. Financial activities and their derivatives like CDOs or CDSs should not be banned in order to prevent another meltdown. Rather than banning, it will be more helpful to conceive a flexible and prudential approach which can deal with specific activities that can cause a systemic damage. Consequently, BIS prefers seeking a solution to reduce the possibility and severity of crises rather getting rid of it which is accepted as an impossible task.

Contrary to the mainstream economic literature Marxist political economy analyses the crises through Marxist crisis tendencies such as FRP and the theory of underconsumption. In response to current crisis there have been two main distinctions between Marxist accounts. Since the crisis spread out from financial markets; most of the Marxist writers have focused on the common sense of "financialisation" and others explains the underlying problems of "real" economy that lead the finance to expanse.

To sum up, some of the Marxist writers emphasize the internal logic of "financialisation" and tend to see the financial crisis as impinging upon the "real"

economy from the outside; others, while recognizing the importance of the financial dimension, emphasize the underlying problems in the "real" economy that drove the expansion of finance and paved the way for the crisis." (Choonara, 2009b) On the other hand some accounts concentrates on falling rates of profits, some on limited consumption of individuals and finally, some of them define the current crisis as a Minsky crisis.

Consequently, Marxist writers assert that the current crisis is not just a crisis of neoliberal ideology but also a crisis of capitalist mode of production. Furthermore, since the current crisis and its results are sourced from the logic of capital, writers claim that it would be replaced with different social logic, based on democratic and collective control of the economy, in which workers and consumers participate in directing production to meet their requirements. (IS, 2008)

In conclusion, it is crucial to make acceptable inferences from the causes of the crisis. Since, the crisis dragged a lot of national and international companies into the bankruptcy that result in millions of people to be out of work following by the process of unrest and rebellion in many countries due to the poverty and increase in food prices, the causes of current crisis must guide in conceiving series of reforms to avoid from next ones. Furthermore, it is required a more stable, equitable, humane-centered and develop-(mentalist) global economic structure better than that of the mainstream economics of the past.

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