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ASSESSING THE TRANSFORMATION OF GLOBAL FINANCE

Schwerpunktredaktion: Hans-Jürgen Bieling
Karen Imhof
Johannes Jäger

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Hans-Jürgen Bieling, Karen Imhof, Johannes Jäger

Assessing the transformation of global finance[1]

1. Introduction

In spring 2007, when the decision was made to edit a special issue of this journal on the transformation of global finance, we never thought that the turbulences in global finance would be that dramatic. Basically, the idea was to assess the transformation of global finance ten years after Peter Gowan (1999) coined the famous term "Dollar Wall Street Regime" (DWSR) to characterize the main features of the global financial architecture of the post-Bretton Woods era. To shed some light on the ongoing 'hype' around the financial crisis, a sound reassessment of the concept of the DWRS would appear to be useful and illuminating in order to deepen a structural understanding of ongoing financial transformations.

The main idea of this issue is then, in the light of such considerations, to take stock of financial and monetary changes in different areas and parts of the world and to highlight transformations of global financial power relations. Global financial power relations determine not only the prospects for socio-economic, but also for cultural, environmental and democratic development in the core as well as in the periphery of the world economy. Hence, an in-depth analysis and theoretical reflection is required, as certain processes tend to undermine the established modes of financial and monetary reproduction. An example of these are: the rise of the so-called BRIC countries, i.e. Brazil, Russia, India and China; the accumulation of US dollars as foreign currency reserves in these and other Emerging Economies; certain initiatives of regional (monetary) integration in the EU and Asia; the rather unclear role of the International Monetary Fund (IMF); the persistent and very high US current account deficit and the associated huge global financial imbalances; and last, but not least, the unfolding of the current financial crisis.

Indeed, although all of these developments have an impact on the DWSR, the latter event seems to shake the very basic foundations of the global financial architecture of the post-Bretton Woods era. Hence, one of the main questions of this issue is, how much the processes mentioned above might condense into a paradigm shift in global monetary and financial governance. This introductory paper tentatively approaches this question in the following ways: it starts with a short outline of the emergence and the main features of the DWSR. Then, we try to show how global financial and monetary power relations have incrementally changed from the late 1990s onwards due to the sequence of specific financial crises occurring at this time. In this context, we also reflect on whether the more recent crisis might lead to a paradigm shift or not. We conclude with a brief overview of the main findings and perspectives discussed in the other contributions to this issue.

2. The re-emergence of global finance and the Dollar Wall Street Regime (DWSR)

During the decades after the Second World War international monetary and financial issues were politically controlled according to the rules of the Bretton Woods system. Given fixed exchange rates and the widespread use of capital controls, international currency competition was almost nonexistent and incentives to attract foreign capital by deregulating national financial centres were weak at best. This changed, however, after the US decided to let the Bretton Woods system break down in 1971/1973. From there onwards, the political control or 'embedding' of finance was relaxed bit by bit. Under conditions of fluctuating exchange rates in the OECD world more and more governments – in close cooperation with stock markets and the financial services industry – turned towards a strategy of competitive deregulation in order to improve the attractiveness of national financial markets to foreign investors (Helleiner 1994: 123ff; McNamara 1998: 112ff; Lütz 2002: 141ff). At the same time, governments in the global periphery also applied strategies to fix the exchange rate against a mayor currency (in many cases the USD) to bring soaring inflation under control. Often this took the form of abrupt policy-switches between free floating and fixed exchange rates, which frequently ended in crisis. The overall liberalization process was facilitated by the notion that, in principle, unilateral liberalization of financial markets seemed to be beneficial for individual states. However, apart from this general rule, financial market liberalization accelerated on only two occasions: when, in the course of the 1980s, the UK and the US applied a strategy of systematically exploiting the benefits of financial liberalization and deregulation, and when the IMF came in, enforcing financial liberalization via structural adjustment programs in many countries.

A result of these strategies was the emergence of the DWSR. This term refers to the global monetary and financial structures after the break down of the Bretton Woods system of fixed exchange rates and politically controlled capital markets. Compared to the old regime, which provided national governments with a certain degree of economic, financial and monetary autonomy, the DWSR was considerably less generous. Its main features were open capital markets, floating exchange rates, and the worldwide supremacy of the US dollar. The most influential forces determining the rules of this regime were the US treasury department, the Federal Reserve, and private financial firms located on Wall Street. The relation between both was characterized by personal exchange, close working relations and similar goals. Moreover, the centre of the DWSR, the "Wall Street Treasury Complex" (Bhagwati 1998: 10f), was closely linked-up with international organizations such as the IMF, the World Bank, the World Trade Organization (WTO), the Bank of International Settlements (BIS) and the Basel Committee or the International Organization of Securities Commissions (IOSCO). It was in this context that Robert Wade and Frank Veneroso (1998) spoke of the "Wall Street Treasury IMF Complex" as a network of powerful forces and institutions in favour of a world of free capital mobility. This network was also the most important proponent of the '(Post-)Washington Consensus', i.e. the view that free trade, open financial markets, currency convertibility, domestic structural adjustment and neoliberal reforms provide the only successful route to economic development.

In some respects, the DWSR also contained institutional and legal dimensions. Its functioning was facilitated by a range of mutually approved regulations. More important, however, was the material basis of the regime, which compelled other governments to follow its rules. This was mainly due to the preeminent economic power of the US and the fairly undisputed role of the US dollar as the world's leading currency, which placed Wall Street and the treasury at the centre of global financial networks. Most international credit was and still is denominated in US dollars, US banks were the most important international creditors, and, as the Basel Accord reveals, the standards of international regulation and supervision were strongly influenced by the US authorities (Bieling/Jäger 2008). Moreover, the dominant role of the dollar and the control over the IMF and World Bank minimized the risk for US-based financial operators while enabling the US government to pursue its 'America first' approach and exploit all seignorage of the global key currency (Gowan 1999: 25ff).

The structural power of the US in international monetary and financial affairs is underlined by the fact that foreign creditors – commercial banks, investment funds or central banks – continued to provide additional loans in order to stabilize the US dollar and to avoid financial losses. At the same time, this implied that there was an option "to create capital through credit and not simply or primarily through the accumulation of resources" for the US (Cafruny/Ryner 2007: 24). Furthermore, the attractiveness of the US market for foreign corporations and investors was used by the US as an effective lever to open foreign economies and financial markets for American capital. Hence, according to Peter Gowan (1999: 27), the DWSR connected three basic aims: "first, to remove barriers to the free flow of funds in both directions between Wall Street and private operators within the target state; second, to give full rights to Wall Street operators to do business within the financial system and economies of the target states; and thirdly, to redesign the financial systems of target states to fit in with the business strategies of Wall Street operators and of their American clients (transnational corporations, money market mutual funds, etc.)."

In general, other economies are incorporated into the DWSR in two ways. One way is that of achieving the position of a privileged junior partner. This seems to apply to the European Union. Since the EU has some bargaining power in international forums and organizations such as the G7, the Basel Committee, IOSCO, and the WTO, it is not simply a 'regime taker', but to a certain degree also a 'regime shaper'. In principle, however, the European approach to the regulation of global capital markets is broadly in line with US objectives (Bieling 2006). So far, globally oriented European corporations benefited from the liberalization in the financial sector as well as from the opening up of other economies to European goods, services and investment. This is clearly shown by the growth of profits of (especially large) European non-financial and financial corporations and the increase of the profit share at the expense of the wage share (see AMECO 2008). The privileged incorporation of the EU into the DWSR is also illustrated by the emulation of US-American business practices as well as by existing transatlantic lobbying and cooperation networks: for example, the role of US business inside the EU (e.g. via the EU Committee) or the close links of American financial firms to the City of London.

The other form of incorporation, which is characteristic for indebted 'Third World' countries, is that of disciplinary subordination, i.e. the exposure to global financial operators and thereby to the vagaries of global external financing and dependency. As a consequence, these countries often only had a limited possibility to resist various pressures – from private creditors, the governments of the US and EU member states or the IMF and World Bank – to remove national barriers to the free flow of funds, to give full rights of operation to foreign financial investors, and to redesign national financial systems according to external requirements (Kellermann 2006). This liberalization was frequently accompanied and accelerated by financial and monetary crises (Becker 2007; Küblböck/Staritz 2008); hence, from a global point of view, the DWSR has saved the interests of the countries in the core, in particular the USA, by causing substantial net capital outflows from the developing world to the developed (Imhof/Jäger 2008).

Although even the IMF had to admit that there is no evidence for positive effects of the liberalization process on economic growth in developing countries (Prasad et al. 2003), financial liberalization proved to be one of the decisive tendencies of past decades. An important reason for this was that financial liberalization was also promoted by national capitalists in the (semi-)periphery. While governments hoped to benefit from the free movement of capital, i.e. the expected inflow of foreign capital, certain capital fractions, e.g. the new oligarchs in Russia, seized it as an opportunity to channel their money legally outside the country. Eventually, this provided them with additional leverage vis-à-vis other social groups within the national context. Notwithstanding these similarities, considerable differences between peripheral countries and their specific subordinated way of insertion into the global financial regime can be observed. These differences mainly depend on the particular national economic structures as well as on the relations of forces between domestic social classes (Imhof/Jäger 2008).

3. From the 'Asian' crisis to 'the' financial crisis: A shifting paradigm?

Although the DWSR represents an impressive financial and monetary power structure, its precise mode of operation and reproduction has remained contested. In 1997, the Asian crisis triggered a first round of discussion oriented towards a "New International Financial Architecture" (Soederberg 2004: 62ff). Out of the G20 the "Financial Stability Forum" was created, thereby admitting that not only the G7/G8 should play a role in organizing the global financial structure, but also important 'emerging countries' such as China, India, Brazil or Argentina. Furthermore, the Basel Committee started a new round of negotiations in 1999 to reform the international standards of banking regulation (Bieling/Jäger 2008). In addition, a new agenda on 'Financing for Development' was agreed upon by the UN at the Monterrey Conference in 2001. Despite these efforts, the basic principles of the DWSR have remained unchanged and were also not seriously questioned at the follow up conference in Doha in 2008. Although on the surface these measures seem to be in sharp contrast with former laisser-faire rhetoric, a closer analysis shows that they can by no means be considered as marking a substantial rupture with the DWSR. Rather, they represent minor and, in part, necessary adaptations within the broadly unchanged global monetary 'non-system' consisting of switching national exchange rate policies.

Considering these and other developments the prospects for the DWSR are difficult to assess. On the one hand, there are indicators that a slow but steady structural shift of material dominance in global capitalism and in the global financial system away from the USA is taking place. By analyzing the materiality of global finance we find a considerable decline of the US share in global finance which has continued since the 1990s (Imhof/Jäger 2008). On the other hand, however, most of the recent financial crises – in Asia, Latin America or Russia – proved to be beneficial for the DWSR, since Wall Street and dollar-denominated assets were seen as the only 'safe haven' under conditions of financial turbulence. Therefore, capital still fled to the US and caused the dollar to appreciate.

At first sight, this pattern of interaction still seems to be working at the onset of the so-called 'subprime' or 'credit crunch' crisis. This may mean that the DWSR continues to reproduce itself by exporting financial and economic problems to the rest of the world, making the global periphery less stable in relative terms and eventually deepening the global financial asymmetry while strengthening the financial power of the US. However, quite a few observers and analysts do not share this view, as this ongoing financial crisis is quite different from former crisis of the past decades. A few aspects may illustrate this:

- First, unlike the financial crisis of the 1980s and 1990s – but similar to the bursting of the dot-com bubble in 2000/01 – the ongoing financial crisis originates in the very power centre of global financial relations, mainly in the US; and it is accompanied by a number of serious economic and political problems – the war against Iraq and the extensive twin deficit in the US, i.e. of the public as well as of the current account, which together trigger debates on the decline of the US in global power relations.

- Compared to the crisis of the so-called 'new economy' the current crisis does not remain restricted to specific financial market segments but simultaneously also affects a range of markets: above all, real estate, securities and particularly stock markets, yet also credit insurance and certain others. As a consequence the whole pattern of 'financialization' – a term that describes the growing importance of investment banking, shareholder value management, the capitalization of old age insurance etc. which has been a main characteristic of the drive towards the new Anglo-Saxon type of finance-led capitalism, is now put into question.

- And finally, there are at least some indicators that governments are again more willing to regulate and control global securities and credit markets. After the crisis had necessitated a new type of emergency state intervention, which included the nationalization of banks and insurance companies in the US and the UK, the emergence of a new public discourse on more and stronger international political regulation is partly visible.

Of course, it is still too early to assess and to presumptuous to predict the impact of the outlined crisis processes on the DWSR. Yet the indications that the US is getting into considerable trouble and may lose its position as 'the' dynamic centre of the world economy cannot be ignored. While there are to a certain extent signs that the financial crisis will change global financial power relations, there is no clear answer to the question of how they will change. While the Eurozone constitutes the only possible replacement of the US within the global financial order when measured by size, it is not yet considered as a 'real' alternative since the European macroeconomic regime itself suffers from "self-limitation" (Cafruny/Ryner 2007): a fragmented process of internal political decision making resulting from national boundaries and rising internal imbalances caused by different national regimes of accumulation. Ongoing quibbles and missing economic policy instruments are not only severe obstacles to Europe replacing the US as the dominant economic power, but also impediments to countering the current crisis. Hence, the EU or the Eurozone does not seem to constitute a new and reliable force sufficient to form a substantially different global financial regime. The same restrictions apply to the BRIC countries. In financial terms they are still too small to effectively promote a new financial order on a global level (McKinsey 2008). Alternatively, some countries in the periphery may take advantage from the current turbulence and the fact that the US is mainly concerned with its internal problems. On a national or in a co-ordinated way they may cease to service international debts, start to control and/or nationalize foreign capital, restrict capital flows and promote national financial structures and institutions such as national or regional development banks as the basis for more internal-oriented development strategies.

4. Contributions of the authors

Given these difficulties in achieving a deep and comprehensive understanding of the ongoing crisis, the contributions to this issue place current financial market dynamics in the broader context of the mid and long term development of global finance. While all authors are generally interested in the causes and consequences of the financial crisis, their individual articles highlight particular monetary and financial aspects in the core or the periphery of the world economy.

The first paper by Peter Gowan starts off by describing the particular structures and modes of financial reproduction, which represent the 'domestic' dimension of the DWSR and are, in his opinion, responsible for the subprime crisis in the US. While he argues that this crisis is an expression of the financial system that has emerged within the US since the 1980s, he holds responsible the financial sector itself and not the real economy (i.e. the real estate sector) for causing it by actively promoting the processes which consequently led to the housing bubble and the subprime crisis. He shows how this 'New Wall Street System' is basically built on the rise of the lender-trader model, on speculative arbitrage and on asset-price bubble building and bubble blowing. In particular, he relates the hype of credit derivatives to the sharp rise of a shadow-banking system, in which the City of London played an important role due to its very low regulatory standards. Building on this analysis of the structural roots of the current crisis, he presents a broader and deeper investigation into the organizational forms of financial systems in capitalist economies. For him the organization of a financial system is not simply a choice between free market or regulation but between three different organizational options: a public utility model, a capitalist credit system geared to accumulation in the productive sector, and a rentier capitalism based on the dominance of the financial sector. Building on this argument he explains the reasons for the rise of rentier capitalism in the US as a national strategy. Although ideological effects of the crisis may be significant, he concludes that financial regimes are the product of power relations rather than intellectual paradigms. In the current situation it cannot be said whether the US dollar will definitely lose its dominance in the global monetary regime and whether the DWSR will soon become history.

In their contribution Leo Panitch and Sam Gindin insist on the fact that the crisis and the following interventionist responses show that reading neo-liberalism mainly as an ideology is highly misleading. They also argue that the relationship between states and financial markets cannot be explained by the extent of financial regulation but must be seen in terms of the guarantee the state provides to property, especially the promise not to default on its bonds. In this sense the central foundation of a financial market is always the state. Building on an overview of the history of financial development in the US, Panitch and Gindin show that for the financial sector state intervention has always been essential, particularly in times of financial crisis. Against this background, they try to assess the questions of whether the current crisis will be overcome soon, whether it will lead to the demise of neoliberalism and whether it will eventually contribute to the end of US hegemony. While they argue that the crisis is likely to be as severe as the one at the beginning of the 1990s, they are more sceptical about the end of neoliberalism and even more about the end of US hegemony. Nevertheless, Panitch and Gindin conclude that the scale of the crisis and popular outrage today provide a historic opening for radical politics well beyond the transformation and democratization of the financial sector. However, it is not yet clear whether social forces will be sufficiently strong and organized to achieve that in the present conjuncture.

Although John Grahl shows that the present financial crisis is not just another crisis but a crisis of finance itself, he argues that neither financial globalization nor the increasing importance of financial markets is likely to be reversed by the crisis. From his point of view, the financial sector is expected to be subject to closer regulation. However, the global character of financial systems seems to be reinforced by the crisis. One aspect of this is the efforts by different national governments and central banks to co-ordinate the responses. In addition, the intervention of sovereign wealth funds is supposed to foreshadow larger shifts in the ownership and the control of the global financial system. Moreover, Grahl argues that the general trend from classical bank intermediation to security markets is likely to continue as regulation leading to standardization may foster markets for derivatives. Regarding the future he distinguishes two possible, but contradictory scenarios: firstly, the crisis may lead to a period of cheap capital in the form of a general decline of demanded interest rates and yield. This could change the balance of power in favour of labour. Secondly, the rescue of finance at public expense may lead to reforms that might go as far as challenging the ends and priorities of the financial system.

Susanne Soederberg provides an explicit analysis of the global South and its role in the DWSR. She establishes a framework for the analysis of the current crisis by critically assessing the so-called 'New International Financial Architecture' which was originally set up at the end of the Asian crisis in 1999. She insists on the fact that the credit system has the potential to resolve contradictions within capitalism but at the same time also heightens the contradictions of capitalism. The 'New International Financial Architecture', which is based on market-led regulations, has not delivered on its promises because of its underlying neoliberal assumptions and paradoxes. The capital account liberalization has led to growing social and political insecurity in the global South. The DWSR locks many countries into adherence to market discipline, which results in growing volatility and reversibility of global capital flows to emerging markets and a marginalization of many poorer developing countries. Soederberg concludes that the current discussion about the re-regulation of global finance may just lead to a mere reinvention of the 'New International Financial Architecture'; alternatively, the legitimacy of US imposed leadership may be called into question. The outcome will be determined by the configuration of political forces and struggles but also by the paradoxes of global capitalism.

Miguel Otero investigates the future of the dollar hegemony by focussing on the role of the US dollar in the periphery. Taking Brazil, one of the large BRIC countries, as an example, he shows that the euro is, partially seen as an alternative to the US dollar. The euro is steadily replacing the US dollar in various fields. If this process continues, this will certainly have a significant impact on the stability and the prospects of the DWSR. Instead of the US dollar being the only international reserve currency the euro could potentially challenge its position and lead to a multi-polar currency standard. However, as Otero concludes, this prospect is not yet clear. Although financial elites in Brazil welcome the euro as an alternative world currency, they are at the same time very much in favour of a liberal global financial regime.

5. Prospects

An assessment of the transformation of finance shows that developments in the periphery are closely linked to the developments in the core of the world economy, but it is the latter which shape the rules of global finance and therefore to an important extent restrict the possibilities for alternative development strategies in the global South. The current neoliberal financial regime has proven to be not only devastating for peripheral countries but has also led to a severe financial crisis in the core of world capitalism. It is difficult to assess whether the current crisis is going to undermine the DWSR substantially or if it can, on the contrary, even reinforce it. Nevertheless, there is a long-standing tendency toward a declining weight of the US in the global economy and in global finance. Some countries in the periphery, such as the BRIC countries, are becoming more important on an international level. Against the background of the ongoing financial crisis, social forces in favour of a more state-controlled and socially regulated – not necessarily democratically organised – financial sector seem to be to be on the rise.

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Abstracts

The paper provides a framework for the assessment of the transformation of global finance that goes well beyond the discussion of the current financial crisis, as it discusses the latter against the background of the structural changes in the existing global monetary regime. The main question is whether the Dollar Wall Street Regime (DWSR), having emerged as the successor of the Bretton Woods order in the end of the 1970s, is undergoing a substantial transformation or not. This is important insofar as the DWSR has had severe consequences for the formation of independent development strategies in the global periphery. The paper concludes that the development of the current system is still ambiguous. Although important long-term changes slowly undermine the stability of the DWSR it remains to be seen whether the current financial crisis will speed up this process or if it even reverses it temporarily.

Der Beitrag beschreibt den Kontext, in dem sich die Transformation der globalen Finanzbeziehungen vollzieht. Die Überlegungen weisen insofern über die derzeitige Finanzkrise hinaus, als diese vor dem Hintergrund der strukturellen Veränderungen des bestehenden globalen Finanzsystems diskutiert wird. Die zentrale Frage lautet dabei, ob das Dollar Wall Street Regime (DWSR), das sich im Anschluss an das Bretton Woods-System seit Ende der 1970er Jahre herausgebildet hat, sich substantiell verändert oder nicht. Diese Frage ist für die globale Peripherie von Bedeutung, weil das DWSR maßgeblich die Handlungsspielräume für eigenständige Entwicklungsstrategien bestimmt. In dem Beitrag wird die Entwicklung des derzeitigen Systems ambivalent eingeschätzt: Obwohl wichtige langfristige Änderungen die Stabilität des DWSR allmählich untergraben, ist ungewiss, ob die derzeitige Finanzkrise diesen Prozess beschleunigen wird oder sogar kurzfristig umkehren kann.

Johannes Jäger, Karen Imhof
University of Applied Sciences BFI Vienna
Wohlmutstraße 22
A-1020 Vienna
johannes.jaeger@fh-vie.ac.at, karen.imhof@univie.ac.at

Hans-Jürgen Bieling
University of Hamburg
Faculty for Economics and Social Sciences
Von-Melle-Park 9
20146 Hamburg
hans-juergen.bieling@wiso.uni-hamburg.de

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Peter Gowan

Causing the credit crunch: the rise and consequences of the New Wall Street System

1. Introduction

The long credit crunch that began in the Atlantic world in August 2007 is strange in its extraordinary scope and intensity. Mainstream discourse, referring to a 'subprime' crisis, implies that the credit crunch has been caused rather than triggered by a bubble in the real economy. This is at best naïve: after all, the bursting of an equally large bubble in the Spanish housing market led to no such blowout in the Spanish banking system (Crawford/Tett 2008: 39). To approach an understanding of the credit crunch we must transcend the common sense idea that changes in the 'real economy' cause changes in the 'mere' financial system. We will argue on the contrary, that over two and a half decades a new financial system structure emerged within the US and that it has been this which played the decisive role in causing not only the credit crunch but the housing bubble before it.

Making the 'epistemological' break from assuming that the so-called real economy drives the supposed financial superstructure is not easy. We assume, for example, that the huge oil price bubble from autumn 2007 to June 2008 was caused by supply and demand factors in the 'real economy', instead of grasping that financial operators reeling from the start of the financial crisis blew the oil price from $70 a barrel to over $140 in less than a year before letting that bubble burst. We assume the same for commodity prices, ignoring the fact that institutional investors like pension funds and money market funds, lending to the Wall Street banks, poured hundreds of billions of dollars into commodities indices (Blas 2008: 38), much like hedge funds with their backs against the wall blowing a bubble in coffee and cocoa, etc., etc (Flood 2008: 38). And, of course, the fact that that these financial operators could build and burst such bubbles has derived from the fact that the markets for oil and commodities are organised in London and New York and Chicago with rules made to match the interests of American and British capital. Indeed, breaking from the idea that actors in the 'real' economy rather than in the financial sector caused crisis effects also carries a political price: you can no longer blame mortgage borrowers for the credit crunch, the Chinese for the commodity price bubble and the restrictive Arab producers for the oil price bubble.

We will explore the structural transformation of Wall Street since the mid-1980s and we will argue that the resulting financial structure-cum-agents have been the driving force behind the current credit crunch, producing new actors, new practices and new dynamics. Before generating the present blowout, this New Wall Street System was spectacularly successful for the richest social group in the USA. By far the most profitable sector of the US and UK economies and by far the most important 'export' earners of those economies, they channelled astonishingly large transfers of value; thus in 2006, no less than 40% of American corporate profits accrued to the financial sector (Summers 2008: 13). The figure of 40% actually understates the share of profits accruing to the financial sector, because the latter conceals such profits by transforming them into huge employee bonuses in order to reduce headline profits data – a fact which is often overlooked.

We will firstly try to sketch the main elements of this New Wall Street Financial System and briefly show how its crisis took such spectacular forms. But we will then argue that to understand the deeper roots of this New Wall Street System we need to probe deeper into the overall socio-economic and socio-political characteristics of American capitalism as it has evolved since the 1970s.

2. The New Wall Street System

The structure and dynamics of Wall Street banking changed rather dramatically in the quarter of a century after the mid-1980s. We can bring out the main features of this changed system as follows:

1) The rise of the lender-trader model.

2) The rise of speculative arbitrage and asset-price bubble blowing.

3) The drive to maximise balance-sheet expansion and leverage.
4) The rise of the shadow-banking system and the changing role of London.
5) The rise to centrality of the money markets and their transformation into founders of speculative trading in asset bubbles.
6) The rise to centrality of credit derivatives.

These changes mutually reinforced each other, forming an integrated and complex whole which then disintegrated in 2007–2008. We will examine each of these trends in turn very briefly.

2.1 The rise of the lender-trader model

Before the mid-1980s, the Wall Street investment banks had engaged in very little securities trading on their own account (as opposed to trading on behalf of clients) and the big depository commercial banks had shunned such activity. As of 2007 the dominant investment banks were: Goldman Sachs, Morgan Stanley and Merrill Lynch, with Bear Sterns and Lehman Bros., along with Credit Swiss (a Swiss bank), somewhat smaller but roughly in the same league. However, from the mid-1980s onwards, proprietary trading in financial and other assets became an ever more central activity of the investment banks and also became increasingly central in the case of many of the commercial banks. By this last decade such proprietary trading was an absolutely central source of profits for the investment banks. Until a change in the law in 1975 banned fixed fees, the bread-and-butter of Wall Street investment bank income had been fixed (cartelised) fees for trading securities on behalf of clients. Indeed, at the start of the 1980s, this fee income had still been greater for the investment banks than profits from trading on their own account. However, from the mid-1980s, pioneered by Salomon Bros., these banks plunged seriously into proprietary trading. By the end of the 1990s, trading income was a third bigger than income from commissions for trading on behalf of others. Some of the biggest banks earned over half their profits from such trading (Gapper 2008b: 15).

As well as trading on their own account, the Wall Street banks were increasingly involved in lending funds to others for their trading activities: to hedge funds, so-called private equity groups (trading in companies), to special investment vehicles (SIVs) and conduits, created by the investment banks themselves. After the Enron scandal, SIVs and conduits were initially not allowed to engage in active trading on their own account, but this restriction was soon lifted. Such lending to others for their trading, known in the jargon as 'prime brokerage', was also an extremely profitable activity for the Wall Street banks; for many, this was their single most profitable activity (Mackintosh 2008: 47).

This turn to the lender-trader model did not mean that the investment banks ceased their other traditional activities in investment banking, broking, fund management etc. But these activities acquired a new significance in that they provided the banks with vast amounts of real-time market information of great value for their trading activity. Philip Augar gives a vivid account of how central such informational centralisation from all the main markets was in giving the investment banks a decisive competitive 'edge' over their smaller or non-investment banking rivals (Augar 2006).

The turn to trading activity on the part of the Wall Street banks was evidently connected to the new volatility in foreign exchange markets after the dismantling of Bretton Woods, and to the opportunities created by domestic financial liberalisation, the scrapping of capital controls and the opening of other national financial systems to American financial operators. These changes offered great new opportunities for a massive expansion of Wall Street trading activity.

2.2 Speculative arbitrage and asset-price bubble blowing

By trading activity we do not mean long term investment, Warren Buffett style, in this or that security: we mean buying and selling financial and real assets to exploit – not least by *generating* – price differences and price shifts. This can better be called speculative arbitrage, a kind of activity which became a central focus of the Wall Street banks, not only the investment banks, but the commercial banks too (Saber 1999).

So too did the related effort to generate asset price bubbles. Time and time again, Wall Street could enter a particular market, generate a price bubble within it, make big speculative profits, and then withdraw, bursting the bubble. Such activity was extremely easy in so-called emerging market economies with small stock or bond markets. The Wall Street banks gained a wealth of experience in blowing such bubbles, say in the Polish or Czech or Russian stock markets in the 1990s and then bursting them to great profit. The dot.com bubble in the US then showed how the same blowing-bursting operation could be carried through in the US without any significant loss whatever to the Wall Street banks (as opposed to some European operators, notably insurance companies, eager to profit from the bubble only to be hit by the burst.)

Both the Washington regulators and Wall Street evidently believed that they could together manage bubble bursts Greenspan 2008: 11). This meant there was no need to prevent such bubbles from occurring; on the contrary, it is patently obvious to any dispassionate observer that both regulators and operators actively generated such bubbles. And they no doubt believed that one of the ways of managing bursts was precisely to blow another dynamic bubble in another sector: after the dot.com bubble, the housing bubble, after the latter an energy price bubble or an emerging market bubble etc., etc. This may seem to involve a formidably centralised financial power at the centre of such markets. Yet just such huge centralisation did indeed exist: the New Wall Street System was dominated by five investment banks holding over $4 trillion of assets and able to call upon or move literally trillions of dollars from such institutions, moving behind them in the form of the commercial banks, the money market funds, the pension funds etc. This new system was a million miles away from a decentralised market with thousands of players, all slavish price takers, of the kind beloved in neoclassical free market fairy-tales.

Thus, the operational belief systems of what might be called the Greenspan-Rubin-Paulson milieu seem to have been post-Minskian. They understood Minsky's theory of bubbles and blowouts and believed that they could collectively use it strategically for blowing bubbles, bursting them, managing the fall-out and/by blowing some more.

2.3 Maximising balance sheet expansion and leverage

Arbitrage and bubble blowing requires more of financial operators than merely centralising maximum amounts of information about conditions across all markets; it also demands the capacity to mobilise huge funds to throw into any particular arbitrage play in order to shift market dynamics in the speculator's favour.

A striking feature of the new Wall Street business model was its relentless drive to expand balance sheets, maximising the asset and liabilities sides. Tobias Adrian and Hyun Song Shin bring out well this side of Wall Street activity (Adrian/Hyun: 2008). The term 'leverage' refers to the relationship between a bank's 'equity' or 'capital' and its assets – the sum that it has lent out. It is usually expressed as a ratio, so that if we say that Lehman Bros' leverage at the time of its collapse was 25, this means that for every dollar of capital the bank has 25 dollars of assets. But this figure of 25 also means that for every dollar of capital, Lehman's had 24 dollars worth of borrowings – i.e. liabilities.

Tobias Adrian and Hyun Song Shin show that the investment banks used their leverage ratio as the target to be achieved at all times rather than as an outer limit of risk to be reduced, ,where possible by holding surplus capital. They also show how this approach was powerfully pro-cyclical in an asset market boom (or bubble), driving the banks to expand their borrowing as asset prices rose. We will illustrate the mechanism with the example given by Adrian and Song Shin as follows.

We will assume the bank manages its balance sheet actively to maintain a constant leverage ratio of ten. Suppose the initial balance sheet is as follows. The bank holds 100 worth of securities, and has funded this holding with debt worth 90.

Assets	**Liabilities**
Securities 100	Equity 10
	Debt 90

Assume that the price of debt is approximately constant for small changes in total assets. Suppose the price of securities increases by 1% to 101.

Assets	**Liabilities**
Securities 101	Equity 11
	Debt 90

So leverage is now down to 111/11 = 9.18. If the bank targets leverage of 10, then it must take on additional debt of D to purchase D worth of securities on the asset side so that assets/equity = 101 + D/11 = 10.

The solution is D = 9. The bank takes on additional debt worth 9, and with this money purchases security worth 9. Thus, an increase in the price of the security of 1 leads to an increased holding worth 9. The demand curve is upward-sloping. After the purchase, leverage is now back up to 10.

Assets	**Liabilities**
Securities 110	Equity 11
	Debt 99

The mechanism works in reverse, too. Suppose there is shock to the securities price so that the value of security holdings falls to 109. On the liabilities side, it is equity that bears the burden of adjustment, since the value of debt stays approximately constant.

Assets	**Liabilities**
Securities 109	Equity 10
	Debt 99

Leverage is now too high (109/10 = 10.9). The bank can adjust down its leverage by selling securities worth 9, and paying down 9 worth of debt. Thus, a fall in the price of securities leads to sales of securities. The supply curve is downward-sloping. The new balance sheet then looks as follows.

Assets	**Liabilities**
Securities 100	Equity 10
	Debt 90

The balance sheet is now back to where it started before the price changes. Leverage is back down to the target level of 10.

The main way in which the investment banks responded to asset price rises was through repo funding. 'Repo' stands for 'repurchase agreement'. Typically, the investment bank wishes to buy a security but needs to borrow funds to buy it. On the settlement day the bank receives its security but has to pay for it. So it uses the security it is buying as collateral for the loan needed to buy it. And, at the same time, it promises the lender that it will repurchase the security at a given future date. In that way it will repay the loan and receive the security. Typically however, the funds for repurchasing the security from the lender are acquired by selling the security to someone else. Thus, on the settlement day, the original lender to the investment bank is paid off and hands over the security and immediately the security is passed on to the new buyer in exchange for cash.

This kind of repo funding operation presupposes an asset price boom, and it accounts for 43% of leverage growth amongst Wall Street banks, according to researchers at the New York Fed. Repos were also the largest form of debt on investment banks' balance sheets in 2007–2008 (Adrian/Hyun 2008).

The question arises as to why the Wall Street banks (followed by others) pushed their borrowing to the leverage limit in such a systematic way. One explanation is that they were doing this in line with the wishes of their shareholders (once they had turned themselves into limited liability companies). 'Shareholder value' capitalism allegedly requires the ratio of assets to capital to be maximised. Surplus capital reduces the return on shareholder equity and acts as a drag on earnings per share. Moreover, the rewards of senior bank executives were often linked to changing earnings per share (Kay 2008: 15). But there is also another possible explanation for borrowing to the leverage limit: the struggle for market share and for maximum pricing power in trading activities. If you are a speculative arbitrageur of an asset bubble blower, financial operational scale is everything in moving markets by shifting prices in the direction you want to go in. In assessing which of these pressures – shareholder power or pricing power – drove the process, we should note how ready the Treasury, Fed and Wall Street executives have been to crush shareholder interests during the credit crunch, yet how resolutely they have sought to protect the levels of leverage of the bulge-bracket banks.

2.4 The rise of the shadow banking system and the role of London

Both the drive for scale and the drive to *expand* the amount of leverage available to them leads on to another basic feature of the New Wall Street System: the drive to create and expand a shadow banking system.

The most obvious features of the shadow banking system were the new, entirely unregulated banks, the most important of which were the hedge funds: these have had no specific functional role – they have simply been trader-banks free of any regulatory control or transparency in their speculative arbitrage. Private equity groups have also been in essence, shadow trading banks, specialising in the buying and selling of companies. Special Investment Vehicles (SIVs) and Conduits are similarly part of this system. Created by the Wall Street banks themselves as satellites to be treated as entirely independent for accounting purposes, they were supposed, following the Enron scandal, to be purely passive institutions, but this restriction was later lifted. In the words of Spain's director of regulation at its central bank, these SIVs and conduits "were like banks but without capital or supervision". Yet, in the words of the Financial Times: "In the past two decades, most regulators have encouraged banks to shift assets off their balance-sheets into SIVs and conduits […]" (Crawford/Tett 2008: 39).

This shadow banking system was not in competition with the regulated system: it was an outgrowth of it. The commercial and investment banks within the regulated system acted as the prime brokers of the shadow banking operators, thereby gaining very large profits from their operations. And because of the way in which this prime brokerage was organised, this increasingly central feature of official bank activity was, in reality, a way of massively expanding their balance sheets and leverage. To tap the Wall Street banks for funding, the hedge funds had to hand over collateral. However, through a practice known as rehypothecation, a proportion of these collateral assets could then be used by the prime broker as *its own* collateral for raising its *own funds*. The result was the self-financing of massively expanding and hugely profitable prime brokerage activities by the Wall Street banks without any extra commitment of their own capital whatever (Mackintosh 2008: 47) – an ingenious way of greatly enlarging their leverage ratios.

There has been a great deal of academic debate about whether deregulation or reregulation in the financial sector has been occurring since the 1980s. This seems to miss the point that there has been a combination of a regulated and an unregulated/shadow system working together, dynamically.

Shadow banking does not, however, refer only to institutional agents like hedge funds; it also refers to practices and products, and these also allowed the investment banks to expand their leverage. Since the late 1990s an increasingly important part of this side of shadow banking was the over-the-counter (OTC) credit derivatives market, notably collateralised debt obligations (CDOs) and credit default swaps (CDSs). The most obvious attractions of both of these lay in the regulatory arbitrage they offered, enabling banks to expand leverage (Bannier/Hänsel 2008). Traditionally banks had to insure their credit operations and such insurance entailed supplying collateral. The beauty of CDSs lay in the fact that, as shadow OTC products, they required no collateral and thus facilitated more leverage. CDS expansion began on a major scale after derivatives specialists from JP Morgan Chase persuaded the American International Group (AIG), the world's largest international insurance group, to start writing them on CDOs (collateralised debt obligations) in 1998 (Morgenson 2008: 1, 11).

CDOs were also a clever solution to leverage problems. By acquiring large quantities of securitised loans and thus greatly expanding their balance sheets, banks should have expanded their equity base. But CDOs bundled together dozens or hundreds of such loans of very varied quality and then gave the bundle Triple A status, thus minimising equity commitment and expanding the bank's leverage. The CDOs were typically written by the rating agencies for a fee and then rated by the same agency at Triple A for a second fee!

However, leverage restrictions were also removed through public policy. Hank Paulson achieved a notable success in this area in 2004 when, as head of Goldman Sachs, he led Wall Street in obtaining a major amendment from the Securities and Exchange Commission (SEC). It agreed to relax the so-called 'net capital rule' restricting leverage for large investment banks, and effectively allowed firms to decide their own leverage on the basis of their risk models. The result was that the leverage ratios of the big banks rose rapidly. This is a rather classic manoeuvre, which was dressed up as a turn by the SEC towards *more* regulation of the investment banks. From a formal, legal point of view this was correct: the SEC acquired regulatory jurisdiction over them. Nevertheless, it simultaneously removed basic capital base restrictions. Furthermore, from 2004 onwards the SEC had seven staff to supervise the five big investment banks, which, by 2007, had combined assets of over

$4 trillion – hopelessly inadequate resources (Labaton 2008: 15-16). And, very importantly, it enabled them to transfer their capital base to new activities such as collateralised debt obligations, which subsequently became such a huge element in the trading activities of the investment banks.

All these shifts are grouped under the heading of 'financial innovation' – changes in institutional arrangements, products, regulatory structures enabling Wall Street Banks to expand their activities and profits. There are dozens of shifts of this sort that could be documented. Yet the most fundamental such shift was the construction of a very large, new shadow banking system, alongside the regulated 'official' system.

Once the Wall Street investment banks had wiped out their London counterparts by the early 1990s, thereby dominating the City of London's asset markets, the City of London's 'Wimbledonised' role in the Wall Street system became significant. Gordon Brown institutionalised the new system in 1997 by creating the unified Financial Services Authority, claiming to operate according to 'principles' rather than binding rules. One such central principle was that the Wall Street banks could regulate themselves. London thus became in the financial field for New York something similar to what Guantanamo Bay would become for Washington in the torture field: – the place where you could do what you couldn't do back home – a place of regulatory arbitrage. And the term 'Wall Street' should be understood as including London as a satellite location for these American operators. At the same time, there are some very large British commercial banks, but these should be distinguished from the City of London, because while some of these have participated heavily in the Wall Street system, others, such as the Hong Kong and Shanghai Banking Corporation (HSBC) – by some measure the largest bank in the world and the Standard Chartered Bank, both deriving from the British Empire, have been heavily focused on banking activities in East Asia.

Together, London and New York dominate the issuing of new shares and bonds; they are the centre of the foreign exchange markets and, most significantly, they dominate the sales of over-the-counter derivatives, which make up the overwhelming bulk of derivatives sales. For derivatives based on interest rates and currencies the UK has a global share of 42.5% in 2007 with the US handling 24%. The US handled 40% of credit derivatives trading in 2006 while London handled 37% (down from 51% in 2002).

2.5 The rise to centrality of the money markets and their transformation into funders of speculative trading in asset bubbles

The enormous expansion of the activities of the Wall Street banks and shadow banks required ever-larger amounts of funding. Historically, such funding has been classically supplied by the recycling of retail savings sitting in deposit accounts in depository banks and, even more importantly, by the commercial banks creating large supplies of credit money. However, in post-1980s America such retail savings were minuscule – a point to which we will return – and credit money from the commercial banks, though important, was soon hopelessly inadequate. In these circumstances the trader banks turned to the wholesale money markets. At the heart of such markets were the inter-bank markets, with interest rates at, or just a few basis points above, the Fed's policy rates. Historically, these markets were used to ensure that the banks were able to clear smoothly on a daily basis, rather than as a source of new, large scale, far less speculative funding. Then there was also the commercial paper market, typically used by the big corporations for short-term funding, again principally to smooth their funding operations.

However, in the new Wall Street these money markets were transformed. They remained centres of short-term funding, but they were increasingly funding speculative trading activity. On the supply side, the funds available for lending to Wall Street were expanding rapidly, especially through the expansion of pension funds during the 1980s and 1990s. In rather typical American style, a small change in the tax code through amendment 401K in 1980 opened the door to this development. This amendment gave a tax break to employees and employers if they put money into pension plans. This legal change was then used to enable regular salaries to avoid tax in this way and the result was a massive flow of employee income into pension plans. This flow totalled nearly $400 billion by the end of the 1980s and climbed to almost $2 trillion by the end of the 1990s (Lowenstein 2004: 24-25).

2.6 The rise to centrality of credit derivatives

At the same time as becoming the key sources of the liabilities of the Wall Street banks through short-term lending to them, the mutual funds, pension funds etc also became increasingly important targets for Wall Street banks' efforts to sell asset-backed securities (ABSs) and in particular collateralised debt obligations (CDOs). These securitised loans, mainly from the housing market but also from credit card debt and car loans, offered investors a higher rate of return than they could get in the money markets; at the same time they were triple A rated by the rating agencies and thus given the status of having maximum security.

The crucial point about these so-called 'structured securities' was not that they were securitised loans. These could in principle be perfectly safe: after all, a bond is, in reality, itself nothing but a securitised loan. Such bonds have a clearly identifiable source in an economic operator whose credit-worthiness (and cash flow capacities) could be assessed. And they have clear prices in the secondary bond markets. But these products in the form of CDOs came from hundreds of thousands of unidentifiable sources whose creditworthiness and cash-flow capacity were not known; they were over-the-counter (OTC) and without any secondary market whatever to determine prices, far less an organised market to minimise counterparty risk. In short, they were at best extremely risky because more or less totally opaque to those who bought them; at worst they proved to be a scam, so that within a few months of late 2007 the supposedly super-safe super-senior debt tranches within such CDOs were being downgraded to junk status.

Thus, the money market and pension fund managers were drawn into speculative bubble activity on the part of Wall Street, both on the funding (liability) side and on the asset side, enabling ever-larger balance-sheet expansion.

3. Exploring the causes of the crisis

It might, in principle, have been the case that the cluster of mutually re-enforcing innovations which we have called the New Wall Street System were *responses* to the emergence of a housing market bubble in the US in and after 2001. If that had been the case we would have had a classic Minskian crisis linked to housing. But it was not the case. All the key innovations were set in place before the onset of the so-called housing bubble. Indeed, there is ample evidence that Wall Street quite deliberately *planned* a house price bubble. Thus, the Wall Street banks spent billions of dollars on advertising campaigns to persuade Americans to increase their mortgage-related debt;

Citigroup alone spent $1 billion on a campaign with the theme 'Live Richly' in the 1990s, designed to get home owners to take out second mortgages to spend on whatever they liked. Other Wall Street banks acted in a similar fashion, with a great deal of success: debt in second mortgages climbed over $1 trillion dollars in a decade.

But the bubble that generated the credit crunch of 2007 lay not only or even mainly in the housing market: it lay in the financial system itself. The crisis was triggered not only by the scale of the debt bubble, but by its forms. In a normal over-lending crisis of the banking system when banks have ended up with non-performing loans (as in Japan in the 1990s), both the scale and location of the crisis can be identified without great difficulty. In 2007 however, the debt bubble within the financial system was concentrated in OTC derivatives in the form of individual collateralised debt obligations (CDOs) which had no market price or pricing mechanism whatsoever and which were distributed in their tens of thousands across most of the main institutions at the summit of the financial system (and/or within their satellite institutions such as SIVs). The proof that these assets were worth anything was nothing more than the rating given to them by the rating agencies. Thus, as soon as this set of debt accumulation arrangements protected by credit ratings was shown to be junk in the two cases in August 2007, the suppliers of credit funding, such as money market funds and pension funds, grasped that they had no way of knowing how much of the rest of the CDO mountain was also junk, so they fled the system and produced the credit crunch. Because the financial system was extraordinarily centralised, abandoning it meant refusing to keep supplying credit to a handful of opaque investment banks and other institutions at the summit

These institutions at the summit initially spread the word round that the effect of their securitisation of debt had been to disburse risk widely across a multitude of institutions. But this seems to have been false: the top Wall Street institutions had themselves been holding on to the so-called super-senior debt tranches in tens of thousands of collateralised debt obligations (CDOs) (Tett 2008). They had been borrowing billions in the money markets to buy these super-senior tranches, gaining an interest rate on them some 10 basis points above their costs of money market borrowing. And to continue to turn that profit they had to keep going back to the money markets to roll over their debts. Yet now the money markets were shutting down.

When investors in the money market fled the recycling of short-term borrowing in the summer of 2007, the entire pyramid centred on the CDOs began to crumble; when the Wall Street banks tried to off-load their CDOs they found that there was no market for them. And the insurance companies which had insured the CDOs with CDSs similarly found the market in these collapsing.

Much remains obscure about the precise mechanisms through which the credit crunch acquired its scope and depth in 2007-8, mainly because the main Wall Street operators themselves sought to obfuscate both the nature of their plight and their manoeuvres by which they attempted to survive. However, by the end of October 2008 the crisis had passed through a number of phases: first, the attempt by the Fed and Treasury to defend the continuation of the Wall Street investment bank model as the top of the system by acting as its lender of last resort; second, the collapse of this effort with the collapse of Lehman Brothers and the disappearance of the investment bank model, producing a drive to consolidate a universal bank model in which the trading activities of the investment banks would occur within and protected by the depository universal bank; in this phase, the Fed essentially substituted itself for the creditor institutions of the credit system, supplying loans, 'money-market' funding and 'commercial paper' market funding for the banks. This massive central bank funding operation between April and October 2008 has involved about $5 trillion of credit from the Fed, the European Central Bank (ECB) and the Bank of England (equivalent to about 14% of global GDP). Assuming that this state funding can continue without raising serious sovereign credit-worthiness problems, the most difficult and dangerous phase of the response to the crisis – the deleveraging of the biggest banks, in the current context of negative feedback loops from deepening recessions – can get under way in a serious fashion. How and when that is achieved will give us a sense of the overall contours of the credit crunch.

3.1 An accidents theory of the crisis?

Most of the mainstream debate on the causes of the crisis takes the form of an 'accidents' theory; in other words, it explains the crisis by reference to contingent actions by say, Greenspan's Fed or the banks or the rating agencies etc. We have argued against this in Part 1 above, saying that the rather coherent, well-integrated object which we have called the New Wall Street System should be understood as generating the crisis. But in addition to our argument in Part 1we should note another and very striking feature of the last twenty years: the extraordinary harmony between Wall Street operators and Washington regulators. Typically in American history there have been phases of great tensions not only between Wall Street and Congress but also between Wall Street and the Washington executive. This was true, for example, in much of the 1970s and early 1980s. Yet there has been extraordinary harmony in the last quarter of a century, a clear sign of a rather well-integrated project.

3.2 An ideological theory of the crisis?

An alternative explanation much favoured in social democratic circles is one that argues that both Wall Street and Washington were gripped by a false ideology which led them astray, an ideology of 'free markets' or perhaps 'neoliberalism', which was treated as a synonym for 'free markets'. An ingenious right-wing twist on this line of explanation is to say that the ideology was 'laissez-faire' – i.e. no regulation – while what is needed is 'free market' thinking, which implies some regulation. The consequence of this kind of explanation is often a rather rudderless discussion of 'how much' and 'what kind' of regulation (Baker et al. 2005).

The problem with this explanation is that while the New Wall Street System was legitimated by free market, laissez faire or neoliberal ideology, the practitioners, both in Wall Street and in Washington, do not seem to have had such an operative ideology at all. Philip Augar's serious and detailed study of the Wall Street investment banks argues that they have actually operated in large part as a conscious cartel – the opposite of free markets (Augar 2006). And it is also evident that neither they nor Greenspan believed in the serious version of free market ideology: neoclassical financial economics. Greenspan has not argued that financial markets are efficient, always clear, etc. He has fully accepted that they can tend towards bubbles and blowouts. He and his colleagues have also been well aware that there can be horrendous financial crises in which the American state may have to throw huge amounts of tax-payers' money into saving the system. Greenspan has also always grasped that all the various risk models used by the Wall Street banks were flawed, and were bound to be so, because they presupposed a general context of financial market stability within which one bank in one market sector might face sudden threats; their solutions were thus in essence about diversification or risk across markets. They therefore assumed away the systemic threat problem that Greenspan and others were well aware of: namely, a sudden negative turn across all markets (Beattie/Politi 2008: 6; Greenspan 2008: 11). Greenspan's two main claims were rather different. First, that between blowouts, sweeping away restrictions on what private actors get up to is the best way for the financial sector to make very large amounts of money. A heavily restricted financial sector will make far less money. This claim is surely true. His second claim has been that when bubbles burst and blowouts occur, the banks, aided strongly by the actions of the state authorities, can cope with the consequences. The current crisis may have made many doubt this but it seems certain that many bankers would privately argue that the jury is still out on this one.

3.3 Options for the organisation of financial systems

The serious intellectual debate about the organisation of financial systems in capitalist economies is not, in fact, one between free markets and regulation at all. It is, rather, a debate between three options:

1) A public utility credit and banking system.
2) A capitalist credit and banking system geared to capital accumulation in the productive sector.
3) A capitalist credit and banking system subordinating all other economic activities to its own profit drives.

We can briefly look at each of these in turn.

The public utility model

All modern economic systems, capitalist or not, need credit institutions to smooth all the main kinds of exchanges, they need banks to produce credit money and they need clearance systems to smooth the payments of debts. These are vital public services, like a health service. They are also inherently unstable: the whole point of banking, after all, is that banks do not hold enough funds to cover all the claims of their depositors at any one time. Ensuring the safety of the system requires that competition between banks should be suppressed. Furthermore, policy questions as to where credit should be channelled for future development are issues of great public economic, social and political import. Thus, public ownership of the credit and banking system is necessary, along with democratic control.

This model can, in principle, operate within capitalism. Even now the bulk of the German banking system remains in public hands through savings banks and land banks. The Chinese financial system is overwhelmingly centred on a handful of huge, publicly owned banks and the Chinese government does indeed steer the credit strategies of these banks.

A capitalist credit system geared to capital accumulation in the productive sector

A private capitalist credit system centred on banks would operate under the logic of money capital: in Marx's formula M-M' – advancing money to others to make more money. There may be competition between banks but there would also be rather strong capital requirements, supervised by the state; they may also be more or less strong steering of the credit operations of the banking system towards certain goals rather than others.

This was broadly the approach of the French and Japanese banking systems in the post-war decades and it is by no means clear that credit steering by the state authorities has been entirely abandoned in these cases. However, such steering capacity has been weakened by internal liberalisation and above all by the dismantling of capital controls and the rights of other external operators to move into (and out of) the national financial system. But there are still ways of counteracting the pure money capital drives of the financial system with longer term capital accumulation goals.

Financial system dominance and rentier capitalism

This has been the model adopted in the US (and the UK) since the 1980s: making money capital king and entirely subordinating the public functions of the credit system to the self-expansion of money capital. More than that, the entire spectrum of capitalist activity is drawn under the sway of money capital in that the latter absorbs an expanding share of the profits generated across these other sectors. This has been the model that has risen to dominance in what we have called the New Wall Street System. It has been a generator of extraordinary financial wealth within the financial system and has actually transformed the entire process of class formation in the US and the UK. And it is this model that is now in deep crisis.

The interesting question is why *this latter model* achieved intellectual ascendancy in the Anglo-Saxon world. To find an answer to this question does not, however, take us further into ideological exploration. It takes us, finally, back out of the financial sphere into the wider and deeper field of socio-economic and socio-political relations in these countries since the 1970s.

3.4 Financial system dominance as a national capitalist strategy

When we set the New Wall Street System in this broader context we can begin to see how its rise to dominance within the US could have been seen as a strategic idea for tackling the problems of the American economy from the 1980s onwards.

From the 1970s through the early 1980s, the American state waged a vigorous battle to revive the industrial economy, partly through a mercantilist term in external trade policy but above all through a domestic confrontation with labour to reduce its share in national income. This, it was assumed, would return American industry to world dominance. This was the vision of such leaders as Paul Volcker. Yet the hoped-for broad-based industrial revival did not take place. By the mid-1980s, non-financial corporate America was falling under the sway of short-term financial engineering tactics geared towards the governing goal of enhancing immediate 'shareholder value' and has since then been linked to wave after wave of 'mergers and acquisitions' and buy-outs by financial operators encouraged by Wall Street investment banks which have profited handsomely from such operations. Though legitimated as enhancing industrial efficiency, this seems very doubtful indeed in most cases. A better case could be made for arguing that these trends have been fed by the new centrality of the financial sector within the structure of American capitalism. This is not to say that American industrial production disappeared; it remained substantial notably in the defence-budget related sector as well as in cars, aerospace, information and communication technologies and pharmaceuticals.

A full explanation of this trend is, I think, not yet available. However, it is clear that the trend produced some characteristic, structural features of American capitalism which have been present ever since. A protected military industrial sector funded out of federal and state budgets along with some high tech sectors, especially in ICT, which were also strongly supported in the 1980s and 1990s by state subsidies, and involving real new industrial investment in the late 1990s but without a transformative role in the overall economy – the main impacts of ICT have been in the financial sector and retail. But the bulk of the American economy, on which growth has depended, has been marked by stagnant or even declining incomes amongst the mass of the population and the absence of a growth motor from new investment. In these conditions GDP growth in the US has not been driven by new investment whether in the private sector or in the form of state infrastructure investment. It has instead come to depend upon the stimulus of consumer demand. Yet such household consumption was itself inhibited by stagnant mass incomes.

This circle was squared in two main ways. Firstly and most importantly, the problem of stimulating consumer demand could be tackled through the massive, sustained supply of credit from the financial system. And secondly, cheap consumer imports could be bought on an endless basis from abroad – especially from China – because dollar dominance enabled the US to run up huge current account deficits since other countries allowed their exports to the US to be paid for in dollars.

The supply of credit from the financial system to the mass of consumers through the usual mechanisms of credit card, car debt and other loans and mortgages was, however, supplemented by the distinctive mechanism of asset price bubbles which generated so-called wealth effects among the mass of consumers. The stock market bubble of the 1990s raised the paper value of the private pensions of the mass of Americans, thus giving them the sense that they were becoming richer and could spend more. And the housing bubble had a double effect of this sort: it not only made American consumers feel that the value of their house was rising, enabling them to spend more, but was combined with a strong campaign by the banks urging them to take out second mortgages and use the new money for consumption spending.

Thus, the New Wall Street System, which we have described above, directly and centrally fuelled the consumer-led boom in the US, a boom which continued from 1995 to 2008. This boom ensured that the US continued to be a central driver of the world economy and it also formed the basis for a massive global propaganda campaign which claimed in effect that the US boom was the result, not of debt-fed growth aided by pathological trends in the US financial system, but of the American free market institutions.

Here, then, was the basis in the broader social relations of American capitalism for the rise to dominance of the New Wall Street System: it played the central role in ensuring debt-fed growth. This Anglo-Saxon model was based upon the accumulation of consumer debt: it was growth today, paid for by hoped-for growth tomorrow, and it was not based upon the strengthening of the bases of value-generation in the economies concerned. In short, it was a bluff and one buttressed by some creative national accounting practices which exaggerated the extent of the American boom and of productivity gains in the American economy.

And we should add that the role of China and other Asian exporting economies in this growth model extended beyond their large export surpluses of consumer goods to the USA. These export surpluses were recycled back into the American financial system via the purchasing of US financial assets, thus cheapening the costs of debt – i.e. massively expanding 'liquidity' within the financial system.

The results of these trends can be summarised in the following figures. Aggregate US debt as a percentage of GDP rose from 163% in 1980 to 346% in 2007. The two sectors which account for this great rise were household debt and debt within the financial sector. Household debt rose from 50% of GDP in 1980 to 100% of GDP in 2007. But the really dramatic rise in indebtedness occurred within the financial sector itself. This rose from 21% of GDP in 1980 to 83% in 2000 and 116% in 2007 (Wolf 2008: 15).

4. Conclusions: what implications?

The ideological effects of the crisis will be significant, though of course far less significant than imagined by those who believe financial regimes are the product of intellectual paradigms rather than power relations. The cant dished out by the US Treasury and IMF to other countries in the past is over. American-style financial system models are now viewed as dangerous, and no less dangerous is the EU banking and financial system framework, which the crisis has shown to be a house of cards, even if one which at the time of writing is still standing. The central EU idea is that banking systems are secured by good rules rather than by authoritative states with tax raising powers. This has been shown to be a dangerous joke. The whole European Economic and Monetary Union (EMU) project has encouraged banks to grow too big for their national states to save them while offering no alternative whatever at an EU or even Eurozone level. Worse, the single market and competition rules in the financial sector ludicrously insist upon no state aid for banks! More, they insist on free competition between banks at all costs. And the stability criteria also mean that a full-blown credit crisis *must be* transformed into a 1930s-style depression in order to respect the EU limits on public sector deficits. Obviously all these house-of-cards rules are for the birds, yet they are simultaneously the central planks of the EU political economy.

This crisis of the US and EU models will no doubt have two intellectual effects: to raise the credibility of the Chinese model and to begin a debate that has been silenced since 1991. The Chinese model of a state-owned bank-centred financial system is the serious alternative model to those of the Atlantic world, but essential to the security of this model is the maintenance of capital controls and a non-convertible currency. All of this China has. It is also the traditional socialist model for financial system organisation, and discussion of this model, silenced since 1991, is sure now to return to public political life, albeit on the fringes to start with.

Some predict much more sweeping short-term changes, such as the replacement of the dollar as the global currency or the collapse of Western leadership institutions within the world economy. The US government's complete debauching of the dollar in the near future could, perhaps lead towards a stampede to dump it globally, along with a retreat into regional or narrow imperial trading blocks. Yet no less likely could be a temporary strengthening of the use of the dollar over the next decade: a long stagnation in the US is likely and it will likely be combined with very low interest rates and a low dollar. This could produce a new dollar carry trade replacing the yen carry trade of the last decade in which everybody borrows in dollars to take them across exchanges into higher value assets (Gowan 1999). This would produce a strong trend towards a decoupling of other exchange rates with the dollar, but it would not necessarily undermine the central element in dollar dominance: the readiness of other states to accept payments for their goods and credits in dollars.

We are also likely to see the intensification of the two basic structural trends in long-term credit-debt relations in the world economy: that between the Atlantic world and its traditional South in Latin America, Africa and elsewhere, traditionally policed by the IMF – this has weakened over the last decade but is likely to be re-enforced in the present crisis; and that contrary long-term credit-debt relation between the East Asian New Growth Centre economies and the United States. This is also likely to deepen and tighten, particularly between China and the US. This is a power relationship in which China (and other creditors) can exercise real political leverage over the US. We have seen this leverage operating in both the timing and the form of the renationalisation of Fannie and Freddie. The Financial Times reported that US Treasury Secretary Paulson confronted the fact that "the Bank of China had cut its exposure to agency debt over the summer" and he thus "found himself with a fait accompli. The federal government had to give reassurance to foreign investors in agency debt if it wanted to avoid chaos in financial markets and a run on the dollar." It smacks of previous debt crises in Latin American countries, where the ultimate pressure for a bailout came from foreign investors (Gapper 2008a: 39), and we will see it again as the US Treasury seeks buyers of its large new tranches of debt in 2009. Moreover, the East Asian economies, above all China, will likely become ever more central to global macro-economic trends while the US's centrality will weaken during its long stagnation. Additionally, this strengthened financial clout of China and other East Asian states could impinge upon the old imperial credit-debt relationships between the Atlantic world and the South by offering alternative sources of financial support to countries in the South which were traditionally controlled by the IMF/WB. This threat is already prompting warnings in the Atlantic world for Washington to restrain the traditional brutality with which it has imposed its predatory regime on Africa, Latin America and elsewhere (Rothkopf 2008: 15).

Yet, whether this will mean that East Asia will start to build new market centres and new market institutional arrangements for the world economy with which to challenge those of the Atlantic, and especially the Anglo-American world, remains unclear because of the internal divisions within East Asia and because of the strategic priorities of China at the present time.

Thus, East Asia has an overwhelmingly a clearly obvious rational collective interest in building its own centralised commodity and oil markets and in promoting them to world leadership, ending the dominance of London and Chicago. Such new market frameworks have sprung up, and there are three of them: one in Hong Kong (China) one in Japan and one in Singapore. Finally, China is currently overwhelmingly concentrated on maintaining domestic growth and carrying through the leap from the coast to dynamic capital accumulation in the interior. It is thus showing not the slightest interest in challenging the US or the Atlantic world for leadership of the shaping of the institutions of the world economy. Thus, the US has some breathing space. Yet, such is the social and political strength of Wall Street and the weakness of the social forces for an industrial revival of the US that it would seem most likely that the US capitalist class will squander that breathing space.

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Abstracts

This article approaches an understanding of the current credit crunch by exploring the structural transformation of Wall Street since the mid-1980s to show that the resulting financial structures and financial agents have been the driving force behind the current credit crunch. After sketching the main elements of this New Wall Street financial system to show how the crisis took such spectacular forms, the article probes deeper into the socio-economic and socio-political characteristics of American capitalism as it has evolved since the 1970s to gain a better understanding of the deeper roots of the current crisis. It concludes by showing possible implications of the crisis for the financial system as well as structural trends in long-term credit-debt relations in the world economy.

Der Artikel erklärt die derzeitige Kreditkrise mit der strukturellen Transformation des Wall Street-Systems seit Mitte der 1980er Jahre. Nach Einschätzung des Autors haben die aus den Veränderungen hervorgegangene Finanzstruktur und ihre AkteurInnen die Krise entscheidend vorangetrieben. Die Hauptelemente des neuen Wall Street-Regimes haben dazu beigetragen, dass die Krise so spektakuläre Ausmaße annehmen konnte. Der Artikel beschreibt überdies die sozioökonomischen und die soziopolitischen Charakteristika des US-amerikanischen Kapitalismus seit den 1970er Jahren und schafft auf diese Weise ein besseres Verständnis für die Wurzeln der aktuellen Krise. Schließlich werden mögliche Folgen der Krise für das globale Finanzsystem und die weltweiten Schuldner- und Gläubigerverhältnisse diskutiert.

Peter Gowan
ISET Institute for the Study of European Transformations
London Metropolitan University
Tower Building
166-220 Holloway Road
London N7 8DB
p.gowan@londonmet.ac.uk

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Leo Panitch, Sam Gindin

The current crisis: a critical perspective

1. Introduction

"They say they won't intervene. But they will." This is how Robert Rubin, Bill Clinton's Treasury Secretary, responded to Paul O'Neill, the first Treasury Secretary under George W. Bush, who openly criticized his predecessor's interventions in the face of what Rubin called "the messy reality of global financial crises"(Rubin 2003: 297). The current dramatic conjuncture of financial crisis and state intervention has proven Rubin more correct than he could have imagined. But it also demonstrates why those, whether from the right or the left, who have only understood the era of neoliberalism ideologically – i.e. in terms of a hegemonic ideological determination to free markets from states – have had such a weak handle on discerning what really has been going on over the past quarter century. Clinging to this type of understanding will also get in the way of the thinking necessary to advance a socialist strategy in the wake of this crisis (Panitch/Konings 2008, 2008 forthcoming).

The fundamental relationship between capitalist states and financial markets cannot be understood in terms of how much or little regulation the former puts upon the latter. It needs to be understood in terms of the guarantee the state provides to property, above all in the form of the promise not to default on its bonds – which are themselves the foundation of financial markets' role in capital accumulation. But not all states are equally able, or trusted as willing (especially since the Russian Revolution), to honour this guarantee. The American state emerged in the 20th century as an entirely new kind of imperial state precisely because it took utmost responsibility for honouring this guarantee itself, while promoting a world order of independent nation states which the new empire would expect to behave as capitalist states. Since World War Two the American state has been not just the dominant state in the capitalist world but the state responsible for overseeing the expansion of capitalism to its current global dimensions and for organizing the management of its economic contradictions. It has done this not through the displacement but through the penetration and integration of other states. This included their internationalization, in the sense of their cooperation in taking responsibility for global accumulation within their borders, and their cooperation in setting the international rules for trade and investment.

It was the credibility of the American state's guarantee of property which ensured that, even amidst the Great Depression and business hostility to the New Deal's union and welfare reforms, private funds were readily available as loans to all the new public agencies created in that era. This was also why whatever liquid foreign funds that could escape the capital controls of other states in that decade made their way to New York, and so much of the world's gold filled the vaults of Fort Knox. And it is this which helps explain why it fell to the American state to take responsibility for making international capitalism viable again after 1945, with the fixed exchange rate for its dollar, as established at Bretton Woods, providing the sole global currency intermediary for gold. When it was established by the 1960s that those who held US dollars would have to suffer a devaluation of their funds through inflation, the fiction of a continuing gold standard was abandoned. The world's financial system was now explicitly based on the dollar as American-made 'fiat money', backed by an iron clad guarantee against the default of US Treasury bonds, which were now treated as being as 'good as gold'. Today's global financial order has been founded on this; and this is why US Treasury bonds are the fundamental basis from which calculations of value of all forms of financial instruments begin.

To be sure, the end of fixed exchange rates and of a dollar nominally tied to gold now meant that it had to be accepted internationally that the returns to those who held US assets would reflect the fluctuating value of US dollars in currency markets. But the commitment by the Federal Reserve and Treasury to an anti-inflation priority via the founding act of neoliberalism – the 'Volcker shock' of 1979 – assuaged that problem. (This 'defining-moment' of US-state intervention, like the current one, came in the run-up to a presidential election – i.e. before Reagan's election, and with bipartisan support and the support of industrial as well as financial capital in the US and abroad.) As the American state took the lead, by its example and its pressure on other states around the world, in giving priority to low inflation in a much stronger and ongoing commitment than before, this bolstered finance capital's confidence in the substantive value of lending; and after the initial astronomical interest rates produced by the Volcker shock, this soon made an era of low interest rates possible. Throughout the neoliberal era, the enormous demand for US bonds and the low interest paid on them has rested on this foundation. This was reinforced by the defeat of American trade unionism; by the intense competition in financial markets domestically and internationally; by financial capital's pressures on firms to lower costs through restructuring if they are to justify more capital investment; by the reallocation of capital across sectors and especially the provision of venture capital to support new technologies in new leading sectors of capital accumulation; and by the 'Americanization of finance' in other states and the consequent access to global savings this provided the American state.

Deregulation was more a consequence than the main cause of the intense competition in financial markets and its attendant effects, By 1990, this competition had already led to banks scheming to escape the reserve requirements of the Basel bank regulations by creating 'Structured Investment Vehicles' to hold these and other risky derivative assets. It also led to the increased blurring of the lines between commercial and investment banking, insurance and real estate in the finance and real estate sector sector of the US economy. Competition in the financial sector fostered all kinds of innovations in financial instruments, which allowed for high leveraging of the funds that could be accessed via low interest rates. This meant that there was an explosion in the effective money supply (this was highly ironic in terms of the monetarist theories that are usually thought to have founded neoliberalism). The competition to purchase assets with these funds replaced price inflation with the asset inflation that characterized the whole era. This was reinforced by the American state's readiness to throw further liquidity into the financial system whenever a specific asset bubble burst (while imposing austerity on economies in the South, much as the condition for the liquidity the IMF and World Bank provided to their financial markets at moments of crisis). All of this was central to the uneven and often chaotic making of global capitalism over the past quarter century, to the crises that have punctuated it, and to the active role of the US state in containing them.

Meanwhile, the world beat a path to US financial markets, not only because of the demand for Treasury bills, and not only because of Wall Street's linkages to US capital more generally, but also because of the depth and breadth of its financial markets – which had much to do with US financial capital's relation to the popular classes. The American Dream has always materially entailed promoting their integration into the circuits of financial capital, whether as independent commodity farmers, as workers whose paychecks were deposited with banks and whose pension savings were invested in the stock market, as consumers reliant on credit, and not least as heavily mortgaged home owners. It is the form that this incorporation of the mass of the American population took in the neoliberal context of competition, inequality and capital mobility, much more than the degree of supposed 'deregulation' of financial markets, that helps to explain the dynamism and longevity of the finance-led neoliberal era.

But it also helped trigger the current crisis – and the massive state intervention in response to it. The scale of the current crisis, which significantly has its roots in housing finance, cannot be understood without considering how the defeat of American trade unionism had played out by the first years of the 21st century. Constrained in what they could get from their labour for two decades, workers were drawn into the logic of asset inflation in the age of neoliberal finance, not only via the institutional investment of their pensions, but also via the one major asset they held in their own hands (or could aspire to hold) – their family home. It is significant that this went as far as the attempted integration, via financial markets, of poor African-American communities, so long the Achilles heel of working class integration into the American Dream. The roots of the subprime mortgage crisis, triggering the collapse of the mountain of repackaged and resold securitized derivative assets to hedge the risk involved in lending to poor people, lay in the way the anti-inflation commitment had since the 1970s ruled out the massive public expenditures that would have been required to even begin to address the crisis of inadequate housing in US cities.

As the 'Great Society' public expenditure programs of the 1960s ran up against the need to redeem the imperial state's anti-inflationary commitments, the financial market became the mechanism for doing this. In 1977, the government-sponsored mortgage companies, Freddie Mac and Fannie Mae (the New Deal public housing corporation privatized by Lyndon Johnson in 1968 before the word neoliberalism was invented), were required by the Community Reinvestment Act to sustain home loans provided by banks in poor communities. This effectively initiated that portion of the open market in mortgage-backed securities that was directed towards securing private financing for housing for low-income families. From modest beginnings, this only really took off with the inflation of residential real estate values after the recession of the early 1990s and the Clinton Administration's embrace of neoliberalism, leading to its reinforcement of a reliance on financial markets rather than public expenditure as the primary means of integrating working class, Black, and Hispanic communities. The Bush Republicans' determination to open up competition to sell and trade mortgages and mortgage-backed securities to all comers was in turn reinforced by the Greenspan Fed's dramatic lowering of real interest to almost zero in response to the bursting of the dot.com bubble and to 9/11. However, this was a policy that was only sustainable via the flow of global savings to the US, not least to the apparent Treasury-plated safety of Fannie Mae and Freddie Mac securities as government sponsored enterprises.

It was this long chain of events that led to the massive funding of mortgages, the hedging and default derivatives based on this, the rating agencies' AAA rating of them, and their spread onto the books of many foreign institutions. This included the world's biggest insurance company, AIG, and the great New York investment banks, whose own traditional business of corporate and government finance around the globe was now itself heavily mortgaged to the mortgages that had been sold in poor communities in the US and then resold many times over. The global attraction and strength of American finance was seen to be rooted in its depth and breadth at home, and this meant that when the crisis hit in the sub-prime security market of the heart of the empire, it immediately had implications for the banking systems of many other countries. The scale of the American government's intervention has certainly been a function of the consequent unraveling of the crisis throughout its integrated domestic financial system, yet it is also important to understand this in terms of its imperial responsibilities as the state of global capital.

This is why it fell to the Fed to repeatedly pump billions of dollars via foreign central banks into inter-bank markets abroad, where banks balance their books through the overnight borrowing of dollars from other banks. And an important factor in the nationalizations of Fannie Mae and Freddie Mac was the need to redeem the expectations of foreign investors (including the Japanese and Chinese central banks) that the US government would never default on its debt obligations. It is for this reason that even those foreign leaders such as the German finance Minister Peer Steinbrück, who have opportunistically pronounced the end of American 'financial superpower status', have credited the US Treasury for "acting not just in the US interests but also in the interests of other nations" (Benoit 2008). The US was not being altruistic in doing this, since not to do it would have risked a run on the dollar. Yet this is precisely the point. The American state cannot act in the interests of American capitalism without also reflecting the logic of American capitalism's integration with global capitalism both economically and politically. This is why it is always misleading to portray the American state as merely representing its 'national interest' while ignoring the structural role it plays in the making and reproduction of global capitalism.

2. A century of crises

It might be thought that the exposure of the state's role in today's financial crisis would once and for all rid people of the illusion that capitalists don't want their states involved in their markets, or that capitalist states could ever be neutral and benign regulators in the public interest of markets. Unfortunately, the widespread call today for the American state to 'go back' to playing the role of such a regulator reveals that this illusion remains deeply engrained, and obscures an understanding of both the past and present history of the relationship between the state and finance in the US.

In October 1907, near the beginning of the 'American Century', and exactly a hundred years before the onset of the current financial crisis, the US experienced a financial crisis that, for anyone living through it, would have seemed as great as today's. Indeed, there were far more suicides in that crisis than in the current one, as 'Wall Street spent a cliff-hanging year' which spanned a stock market crash, an 11 per cent decline in GDP, and accelerating runs on the banks (Chernow 1990: 121; Friedman/Schwarz 1971: 159; Studenski/Krooss 1965: 252). At the core of the crisis was the practice of trust companies to draw money from banks at exorbitant interest rates and, without the protection of sufficient cash reserves, lend out so much of it against stock and bond speculation that almost half of the bank loans in New York had questionable securities as their only collateral. When the trust companies were forced to call in some of their loans to stock market speculators, even interest rates which zoomed to well over 100 per cent on margin loans could not attract funds. European investors started withdrawing funds from the US.

Whereas European central banking had its roots in 'haute finance' far removed from the popular classes, US small farmers' dependence on credit had made them hostile to a central bank that they recognized would serve (a) bankers' interests. In the absence of a central bank, both the US Treasury and Wall Street relied on JP Morgan to organize the bailout of 1907. As Henry Paulson did with Lehman's a century later, Morgan let the giant Knickerbocker Trust go under in spite of its holding $50 million of deposits for 17,000 depositors ("I've got to stop somewhere", Morgan said). This only fuelled the panic and triggered runs on other financial firms, including the Trust Company of America (leading Morgan to pronounce that "this is the place to stop the trouble"). Using $25 million put at his disposal by the Treasury, and calling together Wall Street's bank presidents to demand they put up another $25 million "within ten or twelve minutes" (which they did), Morgan dispensed the liquidity that began to calm the markets (Chernow 1990: 123-125).

When the Federal Reserve was finally established in 1913, this was seen as Wilson's great Progressive victory over the unaccountable big financiers. As Chernow's monumental biography of Morgan put it, "from the ashes of 1907 arose the Federal Reserve System: everyone saw that thrilling rescues by corpulent old tycoons were a tenuous prop for the banking system" (Chernow 1990: 128). Yet the main elements of the Federal Reserve Bill had already been drafted by the Morgan and Rockefeller interests during the previous Taft administration; and although the Fed's corporatist and decentralized structure of regional federal reserve boards reflected the compromise the final Act made with populist pressures, its immediate effect was actually to cement the 'fusion of financial and government power' (Rothbard 1999; see also Livingston 1986). This was so both in the sense of the Fed's remit as the 'banker's bank' (that is, a largely passive regulator of bank credit and a lender of last resort) and also by virtue of the close ties between the Federal Reserve Bank of New York and the House of Morgan. William McAdoo, Wilson's Treasury Secretary, saw the Federal Reserve Act's provisions allowing US banks to establish foreign branches in terms of laying the basis for the US "to become the dominant financial power of the world and to extend our trade to every part of the world" (Broesamle/Gibbs McAdoo 1973: 129).

In fact, in its early decades, the Fed actually was "a loose and inexperienced body with minimal effectiveness even in its domestic functions" (Arrighi 1994: 272). This was an important factor in the crash of 1929 and in the Fed's perverse role in contributing to the Great Depression. It was class pressures from below that produced Franklin D. Roosevelt's union and welfare reforms, but the New Deal is misunderstood if it is simply seen in terms of a dichotomy of purpose and function between state and capitalist actors. The strongest evidence of this was in the area of financial regulation, which established a corporatist "network of public and semi-public bodies, individual firms and professional groups" that existed in a symbiotic relationship with one another distanced from democratic pressures (Moran 1991: 29). While the Morgan empire was brought low by an alliance of new financial competitors and the state, the New Deal's financial reforms, which were introduced before the union and welfare ones, protected the banks as a whole from hostile popular sentiments. They restrained competition and excesses of speculation, not so much by curbing the power of finance, but rather through the fortification of key financial institutions, especially the New York investment banks that were to grow ever more powerful through the remainder of the century. Despite the hostility of capitalists to FDR's union and welfare reforms, by the time World War Two began the New Dealers had struck what they themselves called their 'grand truce' with business (Brinkley 1995: 89-90). And even though the Treasury's Keynesian economists took the lead in rewriting the rules of international finance during World War Two (producing no little tension with Wall Street), a resilient US financial capital was not external to the constitution of the Bretton Woods order; it was embedded within it and determined its particular character.

In the postwar period, the New Deal regulatory structure acted as an incubator for financial capital's growth and development. The strong position of Wall Street was institutionally crystallized via the 1951 Accord reached between the Federal Reserve and the Treasury. Whereas during the War the Fed "had run the market for government securities with an iron fist" in terms of controlling bond prices that were set by the Treasury, the Fed now took up the position long advocated by University of Chicago economists and set to work successfully organizing Wall Street's bond dealers into a self-governing association that would ensure they had "sufficient depth and breadth" to make "a free market in government securities", and thus allow market forces to determine bond prices (Herzel/Leach 2001: 57-63). The Fed's Open Market Committee would then only intervene by 'leaning against the wind' to correct 'a disorderly situation' through its buying and selling of Treasury bills. Lingering concerns that Keynesian commitments to the priority of full employment and fiscal deficits might prevail in the Treasury were thus allayed: the Accord was designed to ensure that 'forces seen as more radical' within any administration would find it difficult, at least without creating a crisis, to implement inflationary monetary policies (Epstein/Shor 1995: 27; see also Dickens 1995, 1998).

Profits in the financial sector were already growing faster than in industry in the 1950s. By the early 1960s, the securitization of commercial banking (selling saving certificates rather than relying on deposits) and the enormous expansion of investment banking (including Morgan Stanley's creation of the first viable computer model for analyzing financial risk) were already in train. With the development of the unregulated Euromarket in dollars and the international expansion of US multi-national companies, the playing field for American finance was far larger than New Deal regulations could contain. Both domestically and internationally, the baby had outgrown the incubator, which was in any case being buffeted by inflationary pressures stemming from union militancy and public expenditures on the Great Society programs and the Vietnam War. The bank crisis of 1966, the complaints by pension funds that fixed brokerage fees discriminated against workers' savings, the series of scandals that beset Wall Street – all foretold the end of the corporatist structure of brokers, investment banks and corporate managers that had dominated domestic capital markets since the New Deal, culminating in Wall Street's 'Big Bang' of 1975. Meanwhile, the collapse of the Bretton Woods fixed exchange rate system, due to inflationary pressures on the dollar as well as the massive growth in international trade and investment, laid the foundation for the derivatives revolution by leading to a massive demand for hedging risk by trading futures and options in exchange and interest rates. The newly created Commodity Futures Trading Commission was quickly created less to regulate this new market than to facilitate its development (Bryan/Rafferty 2006; see also Melamed 1992: 43, 77-78). It was not so much neoliberal ideology that broke the old system of financial regulations as it was the contradictions that had emerged within that system.

If there was going to be any serious alternative to giving financial capital its head by the 1970s, this would have required going well beyond the old regulations and capital controls, and introducing qualitatively new policies to undermine the social power of finance. This was recognized by those pushing for the more radical aspects of the 1977 Community Reinvestment Act, who could have never foretold where the compromises struck with the banks to secure their loans would lead. Where the socialist politics were stronger, the nationalization of the financial system was, by the mid 1970s, being forcefully advanced as a demand. The left of the British Labour Party were able to secure the passage of a conference resolution to nationalize the big banks and insurance companies in the City of London, albeit with no effect on a Labour Government that embraced one of the IMF's first structural adjustment programs. In France, the Programme Commun of the late 1970s led to the Mitterand Government's bank nationalizations, but this was carried through in such a way that ensured that the structure and function of the banks were not changed in the process. In Canada, the directly elected local planning boards were proposed, which would draw on the surplus from a nationalized financial system to create jobs, were seen as the first step in a new strategy to get labour movements to think in ways that were not so cramped and defensive (Panitch/Gindin 1986). Such alternatives – strongly opposed by social democratic politicians who soon accommodated themselves to the dynamics of finance-led neoliberalism and the ideology of efficient free markets – were soon forgotten amidst the general defeat of labour movements and socialist politics that characterized the new era.

Financial capitalists took the lead as a social force in demanding the defeat of those domestic social forces they blamed for creating the inflationary pressures which undermined the value of their assets. The further growth of financial markets, increasingly characterized by competition, innovation and flexibility, was central to the resolution of the crisis of the 1970s. Perhaps the most important aspect of the new age of finance was the central role it played in disciplining and integrating labor. The industrial and political pressures from below that characterized the crisis of the 1970s could not have been countered and defeated without the discipline that a financial order built upon the mobility of capital placed upon firms. 'Shareholder value' was in many respects a euphemism for how the discipline imposed by the competition for global investment funds was transferred to the high wage proletariat of the advanced capitalist countries. New York and London's access to global savings simultaneously came to depend on the surplus extracted through the high rates of exploitation of the new working classes in 'emerging markets'. At the same time, the very constraints that the mobility of capital had on working class incomes in the rich countries had the effect of further integrating these workers into the realm of finance. This was most obvious in terms of their increasing debt loads amidst the universalization of the credit card. But it also pertained to how workers grew more attuned to financial markets, as they followed the stock exchanges and mutual funds that their pension funds were invested in, often cheered by rising stocks as firms were restructured without much thought to the layoffs involved in this.

Both the explosion of finance and the disciplining of labour were a necessary condition for the dramatic productive transformations that took place in the 'real economy' in this era. The leading role that finance has come to play over the past quarter century, including the financialization of industrial corporations and the greatest growth in profits taking place in the financial sector, has often been viewed as undermining production and representing little else other than speculation and a source of unsustainable bubbles. Yet this fails to account for why this era – a period longer than the 'golden age' – has lasted so long. It also ignores the fact that this has been a period of remarkable capitalist dynamism, involving the deepening and expansion of capital, capitalist social relations and capitalist culture in general, including significant technological revolutions. This has been the case especially for the US itself, where financial competition, innovation, flexibility and volatility have accompanied the reconstitution of the American material base at home and its expansion abroad. Overall, the era of finance-led neoliberalism has experienced a rate of growth of global GDP that compares favourably with most earlier periods over the last two centuries (Maddison 2001: 265).

It is, in any case, impossible to imagine the globalization of production without the type of financial intermediation in the circuits of capital that provides the means for hedging the kinds of risks associated with flexible exchange rates, interest rates variations across borders, uncertain transportation and commodity costs, etc. Moreover, as competition to access more mobile finance intensified, this imposed discipline on firms (and states), which forced restructuring within firms and reallocated capital across sectors, including via the provision of venture capital to the new information and bio-medical sectors which have become leading arenas of accumulation. At the same time, the very investment banks which have now have come undone in the current crisis have spread their tentacles abroad for three decades through their global role in M&A and IPO activity, during the course of which relationships between finance and production, including their legal and accounting frameworks, were have been radically changed around the world in ways that have increasingly resembled American patterns. This was reinforced by the bilateral and multilateral international trade and investment treaties, which were increasingly concerned with opening other societies up to New York's and London's financial, legal and accounting services.

3. The American state in crisis

The era of neoliberalism has been one long history of financial volatility, with the American state leading the world's states in intervening in a series of financial crises. Almost as soon as he was appointed to succeed Volcker as head of the Fed, Greenspan immediately dropped buckets of liquidity on Wall Street in response to the 1987 stock market crash. In the wake of the Savings and Loan crisis, the public Resolution Trust Corporation was established to buy up bad real estate debt (this is the model being used for today's bail-out). In Clinton's first term, Wall Street was saved from the consequences of bond defaults during the Mexican financial crisis in

1995 by Rubin's use of the Stabilization Exchange Fund (this Treasury kitty, established during the New Deal, has once again been called into service in today's crisis). During the Asian crisis two years later, Rubin and his Under-Secretary Summers flew to Seoul to dictate the terms of the IMF loan. And in 1998 (not long after the Japanese government nationalized one of the world's biggest banks), the head of the New York Federal Reserve summoned the CEO's of Wall Street's leading financial firms and told them they would not be allowed to leave the room (reminiscent of Morgan in 1907) until they agreed to take over the insolvent hedge fund, Long-Term Capital Management. These quick interventions by the Fed and Treasury, most of them without waiting upon Congressional pressures or approval, showed they were aware of the disastrous consequences which the failure to act quickly to contain each crisis could have on both the domestic and global financial system.

When the current financial crisis broke out in the summer of 2007, the newly appointed Chairman of the Fed, Ben Bernanke, could draw on his academic work as an economist at Princeton University on how the 1929 crash could have been prevented (Bernanke 2000), and Treasury Secretary Henry Paulson could draw on his own illustrious career (like Rubin's) as a senior executive at Goldman Sachs. Both the Treasury and Federal Reserve staff worked closely with the Securities Exchange Commission and Commodity Futures Trading Commission under the rubric of the President's Working Group on Financial Markets which had been set up in 1988, and known on Wall Street as the 'Plunge Protection Team'. Through the fall of 2007 and into 2008, the US Treasury would organize, first, a consortium of international banks and investment funds, and then an overlapping consortium of mortgage companies, financial securitizers and investment funds, to try to get them to take concrete measures to calm the markets. The Federal Reserve acted as the world's central bank by repeatedly supplying other central banks with dollars to provide liquidity to their banking systems, while doing the same for Wall Street. In March 2008 the Treasury – after guaranteeing to the tune of $30 billion JP Morgan Chase's takeover of Bear Stearns – issued its Blueprint for a Modernized Financial Regulatory Structure, especially designed to extend the Fed's oversight powers over investment banks.

Most serious analysts thought the worst was over, but by the summer of 2008, Fannie Mae and Freddie Mac, whose reserve requirements had been lowered in the previous years to a quarter of that of the banks, were also being undone by the crisis; by September so were the great New York investment banks. The problem they all faced was that there was no market for a great proportion of the mortgage-backed assets on their books. As the subprime mortgage phenomenon was reaching its peak in 2005, Greenspan was claiming that "where once more-marginal applicants would simply have been denied credit, lenders are now able to quite efficiently judge the risk posed by individual applicants and to price that risk appropriately" (Greenspan 2005). However, financial capital's risk evaluation equations unraveled in the crisis of 2007–2008. And, as they did, so did financial markets' ability to judge the worth of financial institutions balance sheets. Banks became very reluctant to give each other even the shortest-term credits. Without such inter-bank credit, any financial system will collapse. The unprecedented scale of interventions in September 2008 can only be understood in this context. They involved pumping additional hundreds of billions of dollars into the world's inter-bank markets; the nationalizations of Fannie Mae, Freddie Mac and AIG; the seizure and fire sale of Washington Mutual (to prevent the largest bank failure in US history); a blanket guarantee on the $3.4 trillion in mutual funds deposits; a ban on short-selling of financial stocks; and Paulson's $700 billion TARP ('troubled asset relief program') bailout to take on toxic mortgage assets.

Amidst the transformation, in the course of a week, of New York's investment banks through a dramatic series of bankruptcies and takeovers, the Treasury undertook to buy virtually all the illiquid assets on the balance sheets of financial institutions in the US, including those of foreign owned firms. We now know that Barnanke had warned Paulson a year before that this might be necessary, and Paulson had agreed: "I knew he was right theoretically," he said. "But I also had, and we both did, some hope that, with all the liquidity out there from investors, that after a certain decline that we would reach a bottom" (Baker 2008b). Nevertheless, the private market has no secure bottom without the state. The Fed and Treasury needed to act not only as lender of last resort, but also, by taking responsibility for buying and trying to sell all those securities that couldn't find a value or market in the current crisis, as market maker of last resort (Buiter 2008).

Is it over? This is the question on most people's minds today. Yet what does this question mean? The way this question is posed, especially on the left, usually conflates three distinct questions. First, is the Paulson program going to end the crisis? Second, does this crisis, and both the state and the popular reaction to it, spell the end of neoliberalism? Third, are we witnessing the end of US hegemony?

There is no way of knowing how far this financial crisis, the most severe since the Great Depression, might still have to go. On the one hand, despite the grave condition of the (former) 'Big Three' in the US auto sector, the overall health of US non-financial corporations going into the crisis – as seen in their relatively strong profits, cash flow and low debt – has been an important stabilizing factor, not least in limiting the fall in the stock market. The growth of US exports at close to double-digit levels annually over the past five years reflects not only the decline in the dollar but the capacity of American corporations to take advantage of this. That said, the seizing up of inter-bank and commercial paper markets even after Paulson's program was announced leaves big questions about whether it will work. And even if it does, unwinding such a deep financial and housing crisis is going to take a long time. As of now, foreclosures are still rising, housing starts and house prices are still falling, and the financial markets have not yet calmed. Moreover, it has been clear for over a year that the US economy will fall into – or already is in – a recession.

The immediate problem in this respect is where consumer demand will come from. Credit is obviously going to be harder to obtain, especially for low income groups, and with the end of housing price inflation closing off the possibility of secondary mortgages, and especially reinforcing concerns about retirement alongside the devaluation of pension assets and even company cutbacks of benefits, most workers will not only be less able to spend, but also inclined to try to save rather than spend. To the extent that a great deal of US consumption in the neoliberal era was also spurred on by the enormous appetites of the rich, this is obviously also going to now be restrained. Fiscal stimulus programs are unlikely to be enough to compensate for this, especially given the nervousness over the impact of the bailouts on the fiscal deficit, the size of the US public debt and the value of dollar, and hence over whether low interest rates can be maintained. To the extent that global growth through the neoliberal era was dependent on credit-based mass consumption in the US, the impact of this being cut back will have global implications, including on US exports. This is why the current recession is likely to be deeper and longer than the last significant one in the early 1990s, and maybe even than the severe recession with which neoliberalism was launched in the early 1980s.

Yet, when it comes to the question of whether this crisis spells the end of neoliberalism, it is more important than ever to distinguish between the understanding of neoliberalism as an ideologically-driven strategy for free markets from states on the one hand, and on the other a materially-driven form of social rule which has involved the liberalization of markets through state intervention and management. While it will be now hard for politicians and even economists to uncritically defend free markets and further deregulation, it is not obvious – as exemplified by the concentration by both candidates on tax and spending cuts in the first presidential debate of 2008 – that the essence of neoliberal ideology has been decisively undermined, as it was not by the Savings and Loan crisis at the end of the 1980s, the Asian and LTCM crises at the end of the 1990s, or the post-dot.com Enron and other scandals at the beginning of the century. On the more substantive definition of neoliberalism as a form of social rule, there clearly is going to be more regulation. However, it is by no means clear yet how different it will be from the Sarbanes-Oxley type of corporate regulation passed at the beginning of the century to deal with 'Enronitis' (Soederberg 2008). Nevertheless, it is possible that a new form of social rule within capitalism may emerge to succeed neoliberalism. But, given how far subordinate social forces need to go to reorganize effectively, it is most likely that the proximate alternatives to neoliberalism will either be a form of authoritarian capitalism or a new form of reformist social rule that would reflect only weak class realignment.

Nevertheless, whatever the answers to the questions concerning the extent of the crisis or the future of neoliberalism, this does not resolve the question of 'is it over?' as it pertains to the end of US hegemony. Just how deeply integrated global capitalism has become by the 21st century has been obvious from the way the crisis in the heartland of empire has affected the rest of the globe, quickly putting facile notions of decoupling to rest. The financial ministries, central banks and regulatory bodies of the advanced capitalist states at the centre of the system have cooperated very closely in the current crisis. That said, the tensions that earlier existed in this decade over Iraq have obviously been brought back to mind by this crisis. European criticisms of the Bush administration's inadequate supervision of finance, including the accusation that US leaders ignored their pleas for more regulation during the last G8 meetings, may seem hypocritical in light of how far they opened their economies to the Americanization of their financial systems, but it is nevertheless significant in terms of their expectation that the US play its imperial role in a less irresponsible or incompetent manner.

This is reminiscent of the criticisms that were raised during the 1970s, which were an important factor in producing the policy turn in Washington that led to the Volcker shock as the founding moment of neoliberalism. US hegemony was not really challenged then; the US was being asked to act responsibly to defeat inflation and validate the dollar as the global currency and thus live up to its role as global leader. With the economic integration and expansion of the EU and the emergence of the euro, many would like to think that Europe has the capacity to replace the US in this respect. But this is not realistic.

If and when the Chinese state will develop such capacities to assume the mantle of hegemonic leadership of the capitalist world, remains to be seen. Yet, for the interim, a sober article in China's business newspaper, the Oriental Morning Post, reflects a better understanding of the real world than some of those among the Western left who look to China as an alternative hegemon: "Bad news keeps coming from Wall Street. Again, the decline of U.S. hegemony became a hot topic of debate. Complaining or even cursing a world of hegemony brings excitement to us. However, faced with a decline of U.S. hegemony, the power vacuum could also be painful. We do not like hegemony, but have we ever thought about this problem when we mocked its decline […] at present the world's financial system does not exist in isolation. It is the result of long-term historical evolution, closely associated with a country's strength, its openness, the development of globalization, and the existing global economic, political patterns. The relationship can be described as 'the whole body moving when pulling one hair' […]. The subprime crisis has affected many foreign enterprises, banks, and individuals, which in itself is again a true portrayal of the power of the United States […] Therefore, the world's problems are not merely whether or not the United States are declining, but whether any other country, including those seemingly solid allies of the United States, will help bear the load the U.S. would lighten" (Ding 2008).

For the time being, what is clear is that no other state in the world – not only today, but perhaps ever – could have experienced such a profound financial crisis, and such a enormous increase in the public debt without an immediate outflow of capital, a run on its currency and the collapse of its stock market. That this has not happened reflects the widespread appreciation among capitalists that they sink or swim with Wall Street and Washington. D.C. But it also reflects the continuing material underpinnings of the empire. Those who dwell on the fact that the American share of global GDP has been halved since World War Two not only underplay the continuing global weight of the American economy in the world economy, but fail to understand, as American policy makers certainly did at the time, that the diffusion of capitalism was an essential condition for the health of the American economy itself. Had the US tried to hold on to its postwar share of global GNP, this would have stopped capitalism's globalizing tendencies in its tracks. This remains the case today. Not only is the US economy still the largest by far, but it also hosts the most important new high-tech arenas of capital accumulation, and leads the world by far in research and development, while American MNCs directly and indirectly account for so large a proportion of world-wide employment, production and trade.

Moreover, in spite of the fact that the New York investment banks have come undone in this crisis, the functions of American investment banking are going to continue. Philip Augar (the author of the perceptive insider account of the investment banking industry, *The Greed Merchants*), while affirming that "the eight days between Sunday September 14 and Sunday September 21, 2008 […] [were] part of the most catastrophic shift among investment banks since the event that created them, the Glass Steagall Act of 1933", goes on to argue that "[…] it is likely that investment banks will exist as recognizable entities within their new organizations and investment banking as an industry will emerge with enhanced validity […] While they are licking their wounds, the investment banks may well eschew some of the more esoteric structured finance products that have caused them such problems and refocus on what they used to regard as their core business. While we may have seen the death of the investment bank I would be very surprised if we have seen the death of investment banking as an industry" (Augar 2008; see also Augar 2006).

Indeed, the financial restructuring and reregulation that is already going on as a result of the crisis is in good part a matter of establishing the institutional conditions for this, above all through the further concentration of financial capital by completing the integration of commercial and investment banking. The repeal of Glass-Steagall at the end of the last century was more a recognition of how far this had already gone than an initiation of it; and the Treasury's Blueprint for a Modernized Financial Regulatory Structure, announced in March 2008 but two years in preparation, was designed to create the regulatory framework for seeing that integration through. There is no little irony in the fact that, whereas the crisis of the 1930s led to the distancing of investment banking from access to common bank deposits, the long-term solutions being advanced to address the insolvencies of investment bankers today is to give them exactly this access.

4. It ain't over until it's made over

The massive outrage against bailing out Wall Street today is rooted in a tradition of populist resentment against New York bankers which has persisted alongside the ever increasing integration of the 'common man' into capitalist financial relationships. American political and economic elites have had to accommodate to – and at the same time overcome – this populist political culture. This could be seen at work this September when Henry Paulson declared before the House Financial Services Committee, as he tried to get his TARP plan through Congress, that "the American people are angry about executive compensation and rightfully so" (Stout 2008). This was rather rich given that he had been Wall Street's highest paid CEO, receiving $38.3m in salary, stock and options in the year before joining the Treasury, plus a mid-year $18.7 bonus on his departure as well as an estimated $200 million tax break against the sale of his almost $500 million share holding in Goldman Sachs (as was required to avoid conflict of interest in his new job) (The Guardian 26.9.2008). The accommodation to the culture of populism is also seen at work in both McCain's and Obama's campaign rhetoric against greed and speculation, despite the fact that Wall Street investment banks are among their largest campaign contributors and supply some of their key advisers.

This should not be reduced to hypocrisy. In the absence of a traditional bureaucracy in the American state, leading corporate lawyers and financiers have moved between Wall Street and Washington ever since the age of the 'robber barons' in the late 19th century. Taking time off from the private firm to engage in public service has been called the 'institutional schizophrenia' that links these Wall Street figures as 'double agents' to the state. While acting in one sphere to squeeze through every regulatory loophole, they act in the other to introduce new regulations as "a tool for the efficient management of the social order in the public interest" (Gordon 1984: 53, 58, 65-66). It is partly for this reason that the long history of popular protest and discontent triggered by financial scandals and crises in the US, far from undermining the institutional and regulatory basis of financial expansion, have repeatedly been pacified through the processes of further "codification, institutionalization and juridification" (Moran 1991: 13). And, far from buckling under the pressure of popular disapproval, financial elites have proved very adept at not only responding to these pressures but also using them to create new regulatory frameworks that have laid the foundations for the further growth of financial capital as a class faction and as a lucrative business.

This is not a matter of simple manipulation of the masses. Most people have a (however contradictory) interest in the daily functioning and reproduction of financial capitalism because of their current dependence on it: from access to their wages and salaries via their bank accounts, to buying goods and services on credit, to paying their bills, to realizing their savings – and even to keeping the roofs over their heads. This is why, in acknowledging before the Congressional hearings on his TARP plan to save the financial system that Wall Street's exorbitant compensation schemes are 'a serious problem', Paulson is also appealing to people's sense of their own immediate interests when he adds that "we must find a way to address this in legislation without undermining the effectiveness of the program" (Stout 2008). Significantly, both the criticisms and the reform proposals now coming from outside the Wall Street-Washington elite reflect this contradiction. The attacks on the Fed's irresponsibility in allowing subprime mortgages to flourish, poses the question of what should have been said to those who wanted access to the home-ownership dream, given that the possibility of adequate public housing was (and remains) nowhere on the political agenda. No less problematic, especially in terms of the kind of funding that would be required for this, is the opposition to Paulson's TARP program in terms of protecting the taxpayer, presented in a pervasive populist language with neoliberal overtones. It was this definition of the problem in the wake of Enron that led to the shaming and convictions of the usual suspects, while Bush and Republican congressmen were elected and reelected.

At the same time, many of the criticisms and proposed reforms today often display an astonishing naiveté about the systemic nature of the relationship between state and capital. This was seen when an otherwise excellent and informative article in the New Labour Forum founded its case for reform on the claim that "Government is necessary to make business act responsibly. Without it, capitalism becomes anarchy. In the case of the financial industry, government failed to do its job, for two reasons – ideology and influence-peddling" (Atlas et al. 2008). It is this perspective that also perhaps explains why most of the reform proposals being advanced are so modest, in spite of the extent of the crisis and the popular outrage. This is exemplified by those proposals advanced by one of the US left's leading analysts of financial markets: "The first target for reform should be the outrageous salaries drawn by the top executives at financial firms [...] While we don't want a chain reaction of banking collapses on Wall Street, the public should get something in exchange for Bernanke's generosity. Specifically, he can demand a cap on executive compensation (all compensation) of $2 million a year, in exchange for getting bailed out [...] The financial sector performs an incredibly important function in allocating savings to those who want to invest in businesses, buy homes or borrow money for other purposes [...] The best way to bring the sector into line is with a modest financial transactions tax [...] [on] options, futures, credit default swaps, etc." (Baker 2008a).

This is a perfect example of thinking inside the box: explicitly endorsing two million dollar salaries and the practices of deriving state revenues from the very things that are identified as the problem. Indeed, even proposals for stringent regulations to prohibit financial imprudence mostly fail to identify the problem as systemic within capitalism. At best, the problem is reduced to the system of neoliberal thought, as though it was nothing but Hayek or Friedman, rather than a long history of contradictory, uneven and contested capitalist development that led the world to 21st century Wall Street.

The scale of the crisis and the popular outrage today provide a historic opening for the renewal of the kind of radical politics that advances a systemic alternative to capitalism. It would be a tragedy if a far more ambitious goal than making financial capital more prudent did not now come back on the agenda. In terms of immediate reforms and the mobilizations needed to win them – and given that we are in a situation when public debt is the only safe debt – this should start with demands for vast programs to provide for collective services and infrastructures that not only compensate for those that have atrophied but meet new definitions of basic human needs and come to terms with today's ecological challenges.

Such reforms would soon come up against the limits posed by the reproduction of capitalism. This is why it is so important to raise not merely the regulation of finance but the transformation and democratization of the whole financial system. This would have to involve not only capital controls in relation to international finance but also controls over domestic investment, since the point of taking control over finance is to transform the uses to which it is now put. And it would also require much more than this in terms of the democratization of both the broader economy and the state. It is highly significant that the last time the nationalization of the financial system was seriously raised, at least in the advanced capitalist countries, was in response to the 1970s crisis by those elements on the left who recognized that the only way to overcome the contradictions of the Keynesian welfare state in a positive manner was to take the financial system into public control (Minns 1982). Their proposals were derided as Neanderthal not only by neoliberals but also by social democrats and post-modernists.

We are still paying for their defeat. It is now necessary to build on their proposals and make them relevant in the current conjuncture. Of course, without rebuilding popular class forces through new movements and parties this will fall on empty ground. But crucial to this rebuilding is to get people to think ambitiously again. However deep the crisis and however widespread the outrage, this will require hard and committed work by a great many activists. The type of facile analysis that focuses on 'it's all over' – whether in terms of the end of neoliberalism, the decline of the American empire, or even the next great crisis of capitalism – is not much use here insofar as it is offered without any clear socialist strategic implications. It ain't over till it's made over.

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Abstracts

In this article the authors stress the general centrality of the state for the functioning of the financial sector. This centrality is essential in times of crisis as well as in 'normal' times, but it becomes more visible in the moment of a crisis. Building on this premise the authors analyse under which conditions and in which form the current crisis can be overcome. They come to the conclusion that the crisis – although severe – does not necessarily mean the end of neoliberalism and even less so the end of US hegemony. However, against the background of the current crisis-prone development there is the possibility that social inconsistencies could come to a head. This could be the basis of policies which might entail a radical transformation of the financial sector as well as the beginning of structural economic changes.

In diesem Artikel betonen die Autoren zunächst die generelle Zentralität des Staates für die Funktionsfähigkeit des Finanzsektors. Diese zentrale Rolle des Staates ist nicht nur in Krisenzeiten, sondern auch in ‚normalen' Zeiten gegeben, obgleich sie in der Krise sichtbarer wird. Darauf aufbauend wird analysiert, unter welchen Bedingungen und in welcher Form die gegenwärtige Krise überwunden werden kann. Sie kommen zu dem Schluss, dass die Krise – auch wenn sie sehr tief ist – nicht das Ende des Neoliberalismus bedeuten muss. Für noch unwahrscheinlicher halten sie, dass die gegenwärtige Wirtschaftskrise zu einem Ende der US-Hegemonie führen wird. Dennoch wird es für möglich erachtet, dass sich vor dem Hintergrund der krisenhaften Entwicklungen gesellschaftliche Widersprüche zuspitzen. Diese könnten die Basis für Politiken bilden, die eine radikale Transformation des Finanzsektors beinhalten und darüber hinaus strukturelle ökonomische Veränderungen einleiten könnten.

Leo Panitch
Department of Political Science, York University
S672 Ross Building, 4700 Keele Street
Toronto,TO ONT M3J1P3 Canada
lpanitch@yorku.ca

Sam Gindin
Packer Visitor in Social Justice
Department of Political Science , York University
S672 Ross Building, 4700 Keele Street
Toronto, TO ONT M3J1P3 Canada
gindins@caw.ca

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John Grahl

Global finance after the credit crisis

1. Introduction

The vast financial disturbances which broke out in 2007, leading to unprecedented state intervention to rescue financial systems in 2008, surely necessitate a reconsideration of the role and prospects of the global financial system which has developed over the last decades. That system is widely recognised to be both a central component of the global economy as a whole and a key driving force in its emergence and transformation. For example, only the enormous financial recycling operation linked to China's export surplus has permitted the exceptional growth of the Chinese economy.

The continuing crisis of major banks, as well as other large financial corporations and capital markets, clearly impairs core functions of the financial system. Both political reactions to the crisis and the reactions of market participants themselves are bound to enforce major changes in the system. These are difficult to foresee – the present essay only sketches some possible lines of development.

The next section looks at certain features of the crisis and suggests that it represents not simply another financial crisis but a crisis of finance itself. The following section argues that neither financial globalisation nor the increasing importance of financial markets is likely to be interrupted by the crisis; rather, both market actors and regulators will have to grapple with the introduction of specific public goods, without which both the stability and the efficiency of the global financial system will be put permanently at risk. The concluding section speculates on the possible long-term consequences of the crisis.

2. A crisis of finance

The liberalisation of finance, from the 1970s onwards, in most advanced economies, together with the removal or attenuation of many regulatory restrictions and controls, led to a chronic destabilisation of finance from the beginning of the 1980s onwards. From the start, the main victims of crises were in the developing world. Indeed, the most serious such episode, in 1982, was the outbreak of a crisis of third world indebtedness which, aggravated by harsh and misguided policies at the IMF, had grave and long-lasting effects across much of Africa and Latin America.

It is not yet clear whether the financial turbulence which broke out in 2007 will have such devastating social consequences. However, to a much greater extent than previous crises, it calls into question the global financial system as such. There are several reasons for this.

2.1 Scale

Firstly, whereas several of the previous crises were centred on peripheral or emerging markets, or on the high-technology sector of developed economies, the latest crisis is clearly centred on the financial sectors of the United States and Western Europe. Moreover, most of the problematic financial claims relate to the financing of US real estate – this is by far the biggest financial market in the world. Outstanding household mortgage debt, on its own, is much larger than either government or corporate debt (and the latter also includes large amounts of mortgage debt: at the end of 2007, household mortgage debt in the US stood at $10.5 trillion; corporate debt was $6.3 trillion; government (Federal, State and local) $7.3 trillion; claims on foreign debtors $1.9 trillion (Federal Reserve 2008: 8). The understandable interest of many researchers in corporate finance and in international financial transactions should not obscure the sheer scale of North American real estate finance.

Of course, to begin with, only a small fraction of these real estate claims were called into question – the subprime mortgages which, repackaged and resold, became the collateralised debt obligations at the centre of the subsequent turmoil. But more and more mortgages were affected, partly by the contagion of doubt among similar assets, partly by the fall in real estate prices, which undermined previously adequate collateral.

Leverage undoubtedly contributed to the enormous profits of major banks during the bubble. The 'big five' British banks, for example, declared profits of £37 billion in 2006 – the year before the crisis broke out. This sum represented nearly 13% of all corporate profits in the UK and nearly 4% of total UK GDP.

The sheer scale of the crisis was then multiplied by the same leverage mechanisms which had expanded and intensified the subprime bubble. Losses relative to the banks' own capital and hedge funds were multiplied because so much borrowed money had been used to obtain increased subprime exposure.

This effect in turn was aggravated by the failure of tactics widely used by the banks to avoid capital adequacy regulations. Most of the dubious mortgage-backed assets had been moved off the balance sheets of the banks themselves into various 'conduits' or 'Special Investment Vehicles' (SIVs). This meant that the banks themselves did not have to raise capital to match the risks involved. Most of the SIVs, however, were funded by short-term borrowing, which became difficult or impossible to roll over as the quality of their assets was called into question and alarm spread through the credit markets. Thus, banks had to take the mortgage-based assets back onto their balance sheets and ensure that enough risk-adjusted capital was in place to meet regulatory requirements. These risks, of course, were growing at the same time. The ratings agencies, which had initially given astonishingly high credit-worthiness ratings to subprime-based and similar assets, now rapidly downgraded them, increasing the capital needed.

The move to highly leveraged positions had been very general and had affected other sectors besides residential mortgages. Thus, the rapid expansion of both hedge funds and private equity investment in Europe towards the end of the bubble period was part of the same general attempt to increase the yield on financial assets by assuming more debt. Hedge funds and private equity are two very types of investment vehicle – but they do have in common the use of very high gearing and this accounts for the simultaneous expansion in the years up to 2006 (PSE 2007).

In the subsequent crisis, many of these positions also had to be unwound because the assets were losing value and the credit by which they were funded was drying up. For all these reasons, the credit crisis involved losses on an unprecedented scale. The main factor involved, however, seems to have been the very general move to highly leveraged positions. This in turn reflected a general reluctance to accept what would otherwise have been much lower rates of return on financial assets than had been the case over the previous 25 years. It should be noted that, contrary to the declarations of the European Commission (D.-G. Internal Market press release, 27th February 2008) and some political leaders in Europe, the drive for high leverage was even more marked in Europe than in the US itself. Daniel Gros and Stefano Micosi report that, "the dozen largest European banks have now on average an overall leverage ratio (shareholder equity to total assets) of 35, compared to less than 20 for the largest US banks". These economists recognise that the leverage numbers reported to regulators are much lower, but they explain this by the "massive in-house investment banking operations of European banks" which "are not subject to any regulatory capital requirement". They give the following figures for the leverage ratios of European banks as of 30th June 2008: UBS, 46.9; ING, 48.8; Barclays, 61.3; Crédit Agricole, 40.4, Deutsche Bank, 52.5 (Gros/Micosi 2008).

When an individual bank takes a more leveraged position, it increases its own exposure to systemic risk, but that risk as such does not necessarily increase. However, when the sector as a whole does so, the risk of system-wide disturbance is bound to grow. Central banks and other regulatory authorities around the world seem to have been aware that this was happening but were reluctant to respond by higher interest rates or tightened regulatory constraints because of the wish to extend the macroeconomic upturn. The consequence was a system breakdown on such a scale as to constitute a very serious threat to production and employment.

The deregulatory *Zeitgeist* was also a factor: the banks and other financial corporations have been powerful forces behind the continuing drive to dismantle many forms of social control over economic life. One consequence of such lobbying was the promulgation of new, and much less restrictive, capital adequacy standards for international banks (Basel II) at just the time when the bubble burst. Regulators had been repeatedly warned that Basel II would aggravate the cycle by requiring banks to raise additional capital in economic downturns, that it gave far too much scope to banks to disguise the risks of their positions and that it did not impose sufficient transparency on bank accounting practices. The neglect of these prescient criticisms means that Basel II will almost certainly be rapidly superseded by new, more rigorous, regulatory arrangements.

2.2 Impairment of the banks

Secondly, the crisis struck at the central actors of the global financial system – the banks. It has been a central feature of financial globalisation that classical bank intermediation has to some extent been displaced by the growth of security markets. This never meant, however, that the banks were less important as financial actors – on the contrary they have played a leading role in the security markets – as market-makers, market analysts and fund managers as well as in their more established functions of underwriting security issues and financing security trading (Plihon et al. 2006).

A necessary condition for the banks to play this key role has been the globalisation of interbank relations. In fact the money markets of the advanced economies, largely dominated by inter-bank credit flows, are the most completely globalised component of international finance, and the major international banks, which are active lenders and borrowers across currency zones, can be regarded as the core of the global system. Globalised money markets require huge amounts of collateralised foreign currency trading: the key instrument involved, the foreign exchange swap (FX swap), accounted for the first time for more than half of all foreign exchange trading (FX trading) in 2007, some $1.7 trillion per day (out of a total of $3.2 trillion). Dollar trades against the euro, the yen, sterling Swiss francs, Australian and Canadian dollars and Swedish krona made up two thirds of all FX trading, again relating it to the activities of Western financial centres (BIS 2007). The banks concerned, which it is plausible to take as those linked to the CHIPS payment system, have undergone a ferocious concentration process, bringing their number down from 142 in 1985 to 46 today. This concentration was until recently dominated by mergers between banks in the same currency zone and this may have disguised the increasingly global nature of the system as a whole. The recently announced merger of Commerzbank and Dresdner Bank continues this pattern, but the crisis has also seen a number of large international mergers and takeovers such as Mitsubishi's stake in Morgan Stanley. The crisis has accelerated this process because even among these giants there are banks which have been badly affected by the credit crunch and the associated write-downs of assets and which are looking for safety in a merger.

These giants have the closest interconnections, supported by the deployment of extremely powerful information and communication technologies. Together, they form a coherent system at the core of global finance. The fact that they use different currencies has disguised these close interdependencies from some commentators, but in fact the huge amounts of currency traded on foreign exchange markets represent, much more than 'casino' speculation, a vast international interbank credit market. The frequent misinterpretation of FX trading as essentially currency speculation is discussed in Grahl and Lysandrou (2003). The growth of security trading around the world is completely dependent on the functioning of these interbank markets because this is how the banks are able to finance security trading.

The impairment of this system through the crisis was never the 'paralysis' sometimes evoked in the press, because that would have meant a catastrophic breakdown of the entire economy. At the start, problems were confined to unsecured term interbank credit and what happened was a rise in the risk and liquidity spreads in the interest rates concerned, rather than a cessation of lending. Most interbank lending is against collateral and these markets continued to function more or less normally.

However, as bank balance sheets continued to deteriorate, problems of illiquidity were combined with a growing threat of insolvency (see the commentaries by Willem Buiter on the Financial Times website: http://blogs.ft.com/maverecon/). The failure of the investment bank, Lehman Brothers, seems to have concentrated minds, and tensions spread to interbank relations as a whole while the banks perceived as being most vulnerable suffered runs on their credit which they could no longer roll over at any interest rate.

In general, financial crises tend to be more or less severe according to whether or not risks are concentrated in the banking system (Boyer et al. 2004). Such a concentration was certainly the case here, with an IMF estimate that, out of some $1.4 trillion of losses and write-downs through the crisis to October 2008, the banks had incurred at least some $725 billion and possibly as much as $820 billion (IMF 2008b: 9). In principle, a fraction of the losses incurred by banks and other agents was insured either through 'monoline bond insurance companies' or the use of credit default swaps, but the authorities, by buying many of the most dubious assets, tried hard to avoid too much stress being placed on these insurance systems for fear of another wave of failures and asset price falls.

Interbank credit represents an enormous economy of monetary resources, with a relatively restricted aggregate deposit base supporting a vast and rapidly growing amount of financial transactions. By the same token, its collapse would be the equivalent of an immense monetary deflation. By the autumn of 2008, however, only unprecedented and coordinated interventions by governments prevented such a collapse. Many of the giant banking corporations at the centre of global finance were now subjected to political tutelage.

2.3 Loss of control

A third novel feature of the crisis was the loss of control by central banks. Macroeconomic textbooks usually assert that monetary policy is implemented through the central bank's control over short-term interest rates. By the summer of 2007 this truism was being re-examined as it became clear that the interest rates charged to households and businesses had become detached from the official rates set by central banks. As the latter were eased in response to financial distress and weakening economic activity, the former remained stubbornly high.

It is here that interest rates on unsecured term interbank lending become highly significant because these rates, such as LIBOR or EURIBOR (London or Euro interbank offered rate, respectively), are the benchmarks used to set interest rates on a very large amount of private lending. The banks were not prepared to reduce the rates at which they lent to their customers in step with reductions in central bank target rates.

In fact, central banks are relatively small players in credit markets. (For example, the Bank of England in 2007 had assets totalling £39 billion, although this grew in the crisis to £73 billion in 2008; compare Barclays – one of the 'big five' British commercial banks, with assets of £1.3 trillion in 2007.) They typically directly target only one very short-run interest rate, that in unsecured overnight interbank lending, and rely on substitution among the different credit markets to influence the general level of short-run rates in the economy as a whole. Implicitly, this depended on the strength and stability of the big commercial banks as well as their confidence in one another. Given those conditions, the commercial banking sector as a whole came close to being part of the state in that it could borrow on approximately the same terms as could central government.

The impairment of the big banks put an end to this situation. A huge spread opened up between one month and three month interbank interest rates and those in the overnight markets which were still, more or less, under central bank control. It is interesting that this happened at virtually the same time and to approximately the same extent in dollar, euro and sterling money markets, testifying to the close global integration of the financial sectors concerned. That the Japanese banking sector escaped the credit crisis with relatively limited damage seems to be due to the severity and persistence of the Japanese banking crisis from the late eighties onwards. These spreads correspond to the liquidity and risk premia exacted by the banks' creditors (for a detailed analysis IMF 2008a, chapter 2).

At the same time, the interest rates on lending to the government went very low indeed as wealth-holders sought a safe haven (late in October 2008, the annual yield on three month US Treasury Bills was below 1% while the corresponding rate in Germany was 1.75%).

These gaps persisted, and even widened, in spite of big moves by the central banks to re-establish control. They started lending much greater sums to the banks, for longer periods and accepting a much wider range of assets as collateral. Thus, a central tool of macroeconomic policy has itself been impaired by the crisis. In a deteriorating macroeconomic climate, where interest rate reductions for household and business borrowers would normally be a key policy response, this situation eventually provoked quite radical proposals. Suggestions include channelling all interbank lending through the central bank or expanding the scope and scale of central bank lending in other ways. In any case it seems likely that central bank balance sheets will grow substantially relative to those of commercial banks and other financial corporations, leading perhaps to a permanent shift in the balance between public and private power in the financial sector.

Such a development would, at least to some extent, reverse the monetarist reassignment of macroeconomic functions which began in the 1980s. The sole goal of monetary policy was to be price stability, rather than either financial stability or support for general macroeconomic policies. The minimalist central bank – with a very limited balance sheet – is to some extent a consequence of the approach to monetary policy adopted at that time. To that extent, central banks may be recovering some of their previous functions, although in a very different context.

3. Reform, not fragmentation

The argument so far has merely been to characterise the credit crisis as being, in at least three important respects, different from and more severe than previous crises: the combination of the scale of the disturbances, the impairment of the large banks at the centre of global finance, and the weakened control of central banks suggests that this is not simply a financial crisis, but a crisis of finance, calling into question both the structure and functioning of the financial system.

It is much more difficult to go beyond these descriptions to assess the possible nature and direction of future changes to this system. Any such assessment has also to consider the new political situation. The financial debacle is the biggest blow ever suffered by neoliberal ideology and the biggest ever setback for the neoliberal project. The neoliberal project is understood here as a political strategy which uses the intensification of certain market processes to roll back many of the gains achieved by the workers' movement and other social movements in the first 70 years of the twentieth century. It is important to add that this definition excludes the use of the term 'neoliberalism', to cover all important developments in contemporary capitalism. In particular, the emergence of a global financial system is not seen as a consequence of neoliberalism, but rather as a necessary and functional aspect of globalisation in general, which is itself perceived as a new stage in the socialisation of production. Due to this setback for the neoliberal project, a much wider range of economic strategies are now becoming politically possible than was the case in the recent past where neoliberalism has dominated; this makes future developments even more uncertain.

However, some implications of the crisis already seem relatively clear. Firstly, the financial sector, especially major banks, is likely to be subjected to much closer, more intrusive and more comprehensive regulation. Some obvious examples can be given (it has to be acknowledged that some regulatory issues raise technical difficulties beyond the expertise of this writer. For a recent account, responding to the first phases of the crisis, see Davies/ Green 2008). Reforms to bank accounting will be used to control off-balance sheet assets and liabilities and to reassert capital requirements over the entirety of a banks' positions. The conflicts of interest which have clearly distorted the work of the ratings agencies will be addressed. There will be a push for more complete and up-to-date reporting of the positions taken by banks and hedge funds. Some reforms also seem likely to reduce the immense incomes enjoyed by those at the head of financial corporations. Many of the parameters of regulation are likely to become cyclically variable in order to avoid the exacerbation of cyclical upswings and downswings allowed by existing regulatory structures.

Secondly, it seems already clear that the crisis has not called into question but rather reinforced the global character of the financial system. One aspect of this is the serious attempts that were made, in spite of some initial disarray, to coordinate the official responses to the crisis. Central banks, firstly, organised a series of simultaneous monetary policy changes and other coordinated interventions; central bank literature shows that, although little action was taken during the subprime bubble, there was a growing concern with stability issues and intense communication and debate among central banks about them (for an account of arrangements in Europe see ECB 2006).

Serious government intervention began in the autumn of 2008 with the rescue package proposed by US Treasury Secretary Henry Paulson and eventually adopted by the Congress, and a rescue package, including the provision of new capital for the banks from the government, in Britain. Coordination of such policy interventions seems to have begun almost at once, both within the EU and among the G7 group of the largest economies. There were clearly dangers of spillover effects from some types of intervention, such as the Irish government's guarantee of bank liabilities, and some clashes, notably between Britain and Iceland, but in general the international nature of the crisis and the need for an international response seem to have been recognised early (Iceland's appeal for credit from the Russian Federation is an interesting illustration of the geo-political shifts which may be accelerated by the crisis). Reference to global forces might also, of course, be an attempt to evade responsibility by national political leaders, but on the whole the political language used seems to have been justified by economic and financial events.

The responses to crisis in the private sector also seem to have reinforced the global character of the system. Protectionist tactics were hardly to be expected from the big banking corporations, which surely place a very high value on their freedom of action, but there were some indications that the banks were mobilising international resources to meet the crisis. The intervention of sovereign wealth funds to supply new capital to Western banks went very badly for the former, which came in too early, bought bank equity too dear and suffered huge losses in consequence (Demarolle/Johanet 2008). Nevertheless, these actions may foreshadow larger shifts in the ownership and control of the global financial system in the future.

It was mentioned above that the globalisation of finance has been marked by a substantial change in the structure of finance, away from classical bank intermediation and towards a much bigger role for organised security markets – for both company shares and, especially, bonds. Does the 'securitisation' fiasco mean the end of this trend? The view taken here is that such an outcome is extremely unlikely. A security is a marketable claim. It is necessary to distinguish between the legal and economic interpretations of this definition. The whole range of 'toxic' assets arising from the subprime bubble had the legal form of marketability but they often lacked its economic content – the markets for such paper were thin and inadequate even towards the end of the bubble when the absurd AA and AAA ratings had not yet been exposed. (For just this reason these assets had yields well in excess of what could normally be expected from high-grade paper.) It was pointed out above that much of the risks involved stayed with the banks – this in itself indicates that formal securitisation did not really correspond to the creation of a functioning market.

To function in an effective way, asset markets require a certain standardisation. The possibility or otherwise of such standardisation determines whether the widespread recognition of the asset which is needed for tradability exists. The key advantages of traditional 'relationship' banking over the public issue of securities arises where credits or investments are too specific to permit a wide market to develop. As Michel Aglietta (2008) points out, when such standardisation is not possible, securitisation destroys information. The thin, fragile markets for subprime-based collateralised debt obligations destroyed it on an enormous scale, with potential buyers knowing less and less about the nature of the claims being offered.

Similar considerations apply to the huge growth of financial derivatives. Those which have given rise to most difficulties are over-the-counter (OTC) instruments rather than the much smaller number of standardised, exchange-traded derivatives where big defaults are unlikely because changing prices are rapidly reflected in payments by counterparties with deficit positions. In the case of both asset-based obligations and OTC derivatives, the danger was a confusion between the two types of claim. Those which are highly specific or which depend on detailed knowledge of a particular agent should stay with or close to the original creditor because information will be destroyed by secondary trading; those which are effectively standardised can be safely traded on secondary markets. What is to be avoided is a confusion whereby claims are moved off banks' balance sheets without being effectively distributed across liquid secondary markets. Regulation should perhaps encourage a certain standardisation of claims; this is often said to discourage innovation but, in both retail and wholesale financial markets, it is now clear that many supposed innovations are either exercises in spurious product-differentiation or, quite simply, scams. A somewhat slower pace of financial innovation is perhaps desirable.

The broad trend from classical bank intermediation to security markets is not yet fully understood. On one view, the main reason for it is regulatory – the imposition of risk-adjusted capital requirements on the banks. However, it is also possible to interpret the shift in terms of economic development – as supporting financial relations among a very large number of agents and on a very great scale. Thus, the clear lead of the US in the development of security markets could reflect the fact that, even before the era of global finance, this was a vast economic system spread over a huge area (Grahl 2001; Lysandrou 2005).

Therefore, although one can be certain that much tighter controls will be put on bank activities, both the global character of financial systems and the increased role of security markets seem likely to survive the crisis, and indeed may even be advanced by it.

4. Two conjectures

The predictions made in the previous section are already somewhat tentative. At the time of writing, the end of the crisis is not yet in sight and there is no possibility of any definitive assessment of its course and consequences. Instead of attempting to reach clear conclusions, two possible lines of development will be sketched in this last section – both of them speculations but with a certain rationale.

Firstly, there now seems to be a real possibility that the world economy is entering a period of cheap capital and low rates of return. Since the Volcker shock of 1979 (the drastic change in US monetary policy with very high interest rates), the potential abundance of investible funds has been prevented from driving down target rates of return in industry and commerce. During the 1980s, very tight monetary policies and a general search for liquidity by potential investors kept interest rates at very high levels. Real (that is, inflation adjusted) rates were driven higher by the fact that disinflation ran ahead of monetary policy relaxation. In the 1990s, rates on government debt came down markedly, but the very high rates of return sought by investors in the equity markets prevented this from lowering the cost of risk-bearing capital. These unsustainable conventions as to rates of return were shaken by the dot.com crash when it turned out that in many cases high reported shareholder returns were illusory. Then, in the subprime bubble, banks used massive leverage in an ultimately futile attempt to raise the return on their capital.

One lesson of these episodes is that a sustainable convention, among investors, of a general rate of return has something of the character of a public good. The authorities might in the future use their analytical and research resources to diffuse realistic expectations as to yields; they will certainly try to police the use of leverage by major financial corporations. One result could be a general decline in yields and interest rates, not simply on government debt, but also on industrial investments and consumer credit. If this happened the social consequences, particularly in labour markets, could be dramatic. The persistent deterioration in the relative bargaining position of employees has been caused to a considerable extent by the high rates of return which were routinely pursued on industrial assets. It is impossible to predict how such a change in the balance of power in the labour market would be expressed – a revival of traditional trade unionism seems rather unlikely. But a reassertion of employee interests in some form would most certainly be encouraged by cheap capital. One of the main forces pressing down on the confidence and the ambitions of the popular classes would be weakened.

The second conjecture is even more speculative. At present the global financial system is being rescued by governments and at public expense. This is bound to lead to reforms – the way the system works will change. It is at least conceivable, however, that change will go further than this – that there will be a challenge to the finalities of the system, to its goals and the priorities among them. To envisage such a development is certainly to take a sanguine view of the global economy and global financial relations. But, whether or not such a transformation is feasible, it is most certainly necessary. The key priorities of development in the poorest countries and of environmental protection cannot plausibly be asserted in economic life unless they shape the financial constraints on households and businesses. Only if the global financial system becomes the bearer of these objectives do they have the slightest possibility of realisation. This is a long way from the frenzy of speculation and excess which has disfigured Western financial centres in recent years. But it is to be hoped that the end of that world may make another possible.

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Abstract

Although the author regards the current financial crisis as a crisis of finance itself, he sees neither financial globalisation nor the increasing importance of financial markets as being interrupted by the crisis. Instead, the direction of changes to the financial system is determined by new possibilities in the political spectrum due to the recent setback for the neoliberal project. Regarding future developments, he distinguishes two possible but contradictory scenarios. Firstly, because of falling interest rates and profits, the crisis could lead to a period of cheap money. In this case the power structures would change in favor of the working class, which could among other things be evidenced in a higher relative wage share. Secondly, the rescue of the financial sector via public money could lead to radical reforms in the financial sector. This could go hand in hand with a substantial realignment of the social and economic objectives of the financial system.

Obwohl der Autor die aktuelle Finanzkrise als eine Krise des Finanzsektors als solchen einstuft, sieht er weder die finanzielle Globalisierung noch die wachsende Bedeutung von Finanzmärkten durch die Krise bedroht.

In welche Richtung künftige Änderungen im Finanzsystem gehen, hängt nämlich davon ab, inwieweit politische Gestaltungsmöglichkeiten genutzt werden, die sich aufgrund des Rückschlags des neoliberalen Projektes auftun. Was zukünftige Entwicklungen anbelangt, unterscheidet der Autor zwischen zwei möglichen, wenngleich widersprüchlichen Szenarien. Erstens könnte die Krise aufgrund des Verfalls der Zinsraten und Gewinne zu einer Periode billigen Geldes führen. Damit würden sich die Machtverhältnisse zugunsten der Arbeiterschaft verschieben, was sich u.a. in höheren Lohnquoten ausdrücken würde. Zweitens könnte die Rettung des Finanzsektors mittels öffentlicher Gelder zu substanziellen Reformen des Finanzsektors führen. Dies könnte mit einer grundlegenden Neuausrichtung der gesellschaftlichen und ökonomischen Zielsetzungen für das Finanzsystem einhergehen.

John Grahl
Human Resources Management
Middlesex University
The Burroughs, Hendon
London NW4 4BT
j.grahl@mdx.ac.uk

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Susanne Soederberg

Old promises and new perils: an assessment of the new international financial architecture

1. Introduction

Global policymakers have been scrambling to respond swiftly to the 'First World debt crisis' of autumn 2008 (Wade 2008). The so-called ripple effects of the worst financial crisis since the 1930s have not only hit the advanced industrialized countries hard, but also have threatened to pummel developing countries, as the latter brace themselves for a major recessionary downturn. The IMF and some world leaders, such as French President and current EU President, Nicolas Sarkozy, have called for nothing less than "re-founding the capitalist system" (Rachman 2008). Little agreement exists, however, on how to move forward with the reforms. For instance, while Europe and Asia have insisted on 'even more' financial regulation to ensure financial safety, President G.W. Bush, conversely, has been championing the importance of free markets as the surest path to creating prosperity and hope (Freedman/Stearns 2008). The highly anticipated reforms that were tabled at the global financial summit in November 2008 were disappointingly ill-defined. Despite this shortcoming, it is possible to identify several dominant themes that have been occurring in the official discussions since the outset onset of the credit crisis. Firstly, the term 'regulation' has been vaguely defined in the debates thus far; indeed, it is difficult to ascertain whether the term 'more regulation,' used by policymakers, refers to state-led or market-led forms of regulation. It is important to note that recent experiences have revealed that the term 'regulation', even the rule-based, state-backed version, can often be deceiving. As I have argued elsewhere, the Sarbanes-Oxley Act, which was an attempt by the G.W. Bush administration to impose the "most far-sweeping regulatory reforms since the New Deal" in the wake of

Enron-style debacles in the US, has had the effect of naturalizing market-led governance in both the corporate and financial sectors (Soederberg 2009). Secondly, there appears to be a unanimous consensus among global policy-makers that the International Monetary Fund (IMF or Fund) – a stalwart of market-led reform – should play a central role in the re-founding of the capitalist system. The decision by the global leaders at the 2008 financial summit to pour more, albeit insufficient, amounts of money into the Fund is a case in point. Thirdly, and related, the debates about the 2008 financial crisis have taken place without mentioning the former, market-led solution to the spate of crises that swept across emerging market economies during the 1990s. Leaders of the world's most powerful countries, along with the global lending institutions – the IMF and World Bank – forged the 'New International Financial Architecture' (NIFA) in 1999. The NIFA aimed to ensure that governments and market participants of the global South adhere to 'prudent' (neoliberal) policies, so that they may reap the rewards of maintaining open market access to global financial flows.

There are two interlocking aims and overarching pillars of this article. Firstly, I strive to assess and make sense of the general changes and ongoing contradictions in global finance. Secondly, I contextualize the 2008 credit crisis. Both these objectives are examined against the backdrop of the NIFA. My central argument is that the NIFA, which has sought to ensure greater stability and prosperity in global finance via market-led regulations, has not delivered on its promises. Despite the claims by international policy-makers that financial globalization leads to economic growth and, in turn, general economic improvement, the majority of the world's population has seen greater levels of economic insecurity since the creation of the NIFA in 1999. My argument is developed in the following four sections. The second section explores the official premises underpinning the NIFA, and more generally, official versions of global development over the past decade. The third section exposes the neoliberal assumptions and paradoxes of the NIFA by exploring three key features that not only reveal its capitalist nature, but also, and relatedly, demonstrate how the NIFA has been a temporary response to the crisis-prone, contradictory and uneven nature of global capitalism. The final section concludes by drawing out some implications of the argument.

2. Basic premises and promises of the NIFA

According to official accounts, the main cause of the financial crises during the 1990s was due to imprudent policy choices of Third World governments, which extended to the lack of transparency and accountability of market actors in the developing world. Interestingly, key global players such as the IMF did not call into question either the short-term and highly speculative nature of global financial markets or the absence of regulatory mechanisms at the global level as potential sources of the crisis (Soederberg 2004). To correct these weaknesses in the global South, international policy-makers, led by the general directive of the United States, created the Group of 20 (or, G-20) and the Financial Stability Forum (FSF) to help strengthen, as opposed to radically alter, international financial markets. The G-20 was celebrated as an inclusive project that comprised the powerful Group of 7 industrialized countries, the IMF, and the World Bank, and which, for the first time, brought on board several 'systematically important' emerging market economies such as Brazil, India, and China. It should be noted that the countries and global institutions linked to the G-20 were involved in the 2008 global financial summit. Another key feature of the NIFA is that the FSF was seen as an important venue through which central banks and finance ministries of core countries could exchange information as well as engage in international co-operation in financial supervision and surveillance. The FSF was instrumental in establishing the Reports on the Observance of Standards and Codes (ROSCs). These voluntary international codes and standards, which are monitored by several key international organizations such as the IMF and the World Bank, are based on good governance practices ranging from accounting to corporate governance practices. It should be underlined that, although these standards and codes are said to reflect international norms and practices, they tend to replicate the Anglo-American version of neoliberalism (Cerny 2008), which accords a high value to minimal state intervention and high exposure to market forces (Soederberg 2004). Taken together, these components that comprise the NIFA were lauded by its supporters as an important policy corrective to the economistic focus on global development finance (Eichengreen 1999). It is useful to elaborate briefly on the underlying promises and premises of the NIFA, so that we may not only evaluate its performance over the past ten years, but also understand the neoliberal logic upon which it was constructed.

According to standard economic theory, private capital flows such as foreign direct investments (FDI) and, constituting the main focus of this article, foreign portfolio investments (FPI), e.g., stocks and bonds, have overshadowed official financial flows in the forms of bilateral and multilateral loans and aid over the past ten years (World Bank 2007). It is important to underline that the Fund views these changes in capital flows as a natural phenomenon of the market, as opposed to a situation that was actively encouraged by powerful capitalist interests and states, and, by extension, the NIFA. For the IMF, when left to their own devices (read: free capital mobility and low levels of regulation), private capital flows can make a major contribution to the extent that they flow from capital-abundant, usually developed countries, to capital-scarce developing countries (Ocampo et al. 2007). The basic assumption here is that capital flows will bring about efficiency gains and lead to growth, which in turn will, through rational, market mechanisms, trickle down to the rest of the population. To attract foreign capital flows, the onus is on governments and firms in developing countries to ensure that they adhere to the 'correct' (market-led) policy and institutional frameworks to attract and retain the capital flows. 'Correct' policies reflect, among other things, minimal state intervention in the market. The reason for this position is that the state is seen as representing not only a direct source of inefficiency (i.e., rent-seeking behavior), but also as encouraging "wasteful use of resources to gain essentially corrupt advantage" (Fine 2006: 5).

In the 1990s, and in direct response to growing legitimacy problems faced by the IMF and World Bank, and, more specifically, their policies, which, as many observers viewed, were too economistic and top-down in nature (Fine 2006), some, albeit minimal, features of state intervention were deemed to be positive in harnessing efficiency gains. Mirroring the field of institutional economics, which formed the backbone of the reformulated Washington consensus, or, what was inventively referred to as the 'the Post-Washington Consensus', the NIFA sought to strengthen, as opposed to question the standard economic assumption that free capital mobility leads to growth, mainly by suggesting that while the state should refrain from playing a major role in the market, governments should complement and protect the infrastructure in which markets operate by implementing good governance policies. Specifically, the latter should primarily be aimed at encouraging perfect exchange of information between contracting parties in the marketplace (Fine 2006: 5). Reflecting the underlying tenets of the Post-Washington Consensus, the architects of the NIFA sought to facilitate market transparency without imposing state-led regulations by opting instead for voluntary principles and market-based rules as opposed to legal reforms restricting capital flows.

Almost a decade after the construction of the NIFA, the Managing Director of the IMF, Dominique Strauss-Kahn, stated that the global financial architecture has failed to adapt to the needs of 21st century globalized markets (IMF 2008a). Given the central role accorded to the IMF to manage the effects of the first world debt crisis, it is useful to examine briefly its two-part diagnosis, as they mirror the neoliberal premises of the NIFA. Firstly, and in contrast to its position regarding the financial crises of the previous decade, the IMF has identified the underlying cause of crisis in the global financial system. Thus, official blame has neither been located in the so-called 'mature' financial systems of the developed world, or more specifically, the low level of regulation characterizing these systems, nor in the speculative and short-term nature of financial markets, nor in the institutions, codes and standards that comprise the NIFA. Secondly, and related, the principal reason for the crisis was the failure of existing governance structures to ensure that markets function in a highly transparent manner, that is in a fashion in which all actors have sufficient information on which to base their decisions to buy or sell. In the wake of the 2008 crisis, the Fund has been championing the tweaking of the FSF by including new disclosure guidelines and frequent asset valuations in order to reduce uncertainty (IMF 2008c). Another area in need of reform, according to the IMF, is the strengthening of risk management of the corporate sector by better aligning compensation packages of corporate executives to reward returns on a risk-adjusted basis using more robust risk management strategies, with greater weight placed on the long-term aspect of executive compensation – all of which is to take place within the market-based regulatory scheme of corporate governance (IMF 2008c: xiv; Soederberg 2009).

3. Changes and paradoxes of global capitalism

The NIFA is more than a policy and institutional response to imperfect information in markets, however. To understand how and why this policy and institutional response to the previous round of crises has failed to deliver on its promises, as well as the reasons for its possible repeat in the solution to the 2008 credit crisis, it is useful to grasp the underlying paradoxes and relations of power of the NIFA – all of which are rooted in global capitalism. Drawing on my earlier work, I identify in this section three interrelated components that characterize the paradoxes and social power of the NIFA (Soederberg 2004). The first feature of the NIFA is the neoliberal nature of global capitalism, which has taken the form of financialization. The second tension underpinning the NIFA is the complex and interdependent relationship between the US and free capital mobility. The third tension underpinning the NIFA is the growing political and social insecurity caused by free capital mobility in the global South (Soederberg 2004). In what follows, I elaborate briefly on each of the three characteristics underpinning the NIFA, as well as providing a short update on some aspects that have led to increased levels of economic insecurity since its inception in 1999.

3.1 Financialization and the ongoing contradictions of the credit system

According to Gerald Epstein, the global financial system has been marked by 'financialization', a term that refers to the growing influence of financial markets and institutions on economic growth and development since the late 1970s (Epstein 2005). However, this situation is not, as neoliberal ideologues would have us believe, created by autonomous and irresistible forces beyond political control. Instead, financialization has been socially constructed and reproduced through relations of power within the wider constraints posed by the crisis-prone, uneven and highly exploitative nature of global capitalism (Marx 1991). One chief contradiction of global capitalism is the underlying tendency of capitalism to overaccumulation. Put simply, the latter is a "condition where surpluses of capital lie idle with no profitable outlets in sight" (Harvey 2003: 149). When crises emerge, however, capitalists and states respond swiftly by increasing levels of economic exploitation over labour and the environment and by establishing new forms of political domination to legitimate, discipline, and naturalize their power. One of the key features of capitalism's resiliency, most notably its ability to continue to expand, even in times of crisis, is the credit system. The latter, which lies at the heart of financialization, has played a central role in facilitating the expanded reproduction of capitalism not only in everyday life, but also, and especially, in times of crises where it has historically been marked by strategies of speculation, fraud and predation (Luxemburg 2003). The debt-led forms of capital accumulation spanning government, consumers and the private sector, which have been the hallmark of many countries across the globe, including, and especially, the world's most powerful country, the United States, is a case in point (Soederberg 2009).

Unlike the discourse and policy surrounding the NIFA, the credit system is not merely a sum of economic transactions; instead, as Susan Strange notes, it is marked by relations of power, i.e., the "power to create credit implies the power to allow or to deny other people the possibility of spending today and paying back tomorrow" (Strange 1994: 90; Soederberg 2006). It is necessary to go beyond Strange's insight, however, to stress that the credit system and the power relations therein are integral features of capital accumulation. As such, the credit system has the potential to resolve all of the imbalances for which capitalism is prone, such as overaccumulation of capital. The problem is, as Marx noted, that the credit system also internalizes these contradictions and often acts to heighten rather than diminish the paradoxes of capitalism (Harvey 1999). Moreover, it should be underlined that this power in the credit system is not a natural feature of the market but is both constructed and guaranteed by the capitalist state and by international organizations such as the NIFA (Bourdieu 2005). For example, the $4 trillion government-sponsored bailout to support banks and restart money markets, primarily in the US and Europe, was not only simply an attempt to avert a global recession, but, more generally, to guarantee the conditions for expanded reproduction of capital. As I have argued elsewhere, the power relations within the credit system are, like capitalism itself, highly uneven (who gets credit and on what conditions) and disciplinary in nature (capital flight or strikes, high risks premiums for poor credit ratings, and so forth) (Soederberg 2004, 2009).

Against the backdrop of the highly precarious debt-led accumulation of neoliberal globalization, there have been many features of the predatory and speculative nature of the global credit system that have served to widen and deepen the levels of economic insecurity across the global North and global South over the past decade. Two features are worth noting here. Firstly, pension and mutual funds have played a central role in driving and expanding financialization. These funds are valued at some $24.6 trillion, with a ratio of OECD pension fund assets to OECD gross domestic product of nearly 73 percent in 2006, and above 100 percent in a few countries (OECD 2008). Due to the ongoing privatization strategies, we have seen a shift from more secure, defined-benefit pension plans to market-based, defined-contribution pension schemes, which has meant that an increasing number of people, in both rich and poor countries, have become dependent on the economic performance of financial markets for their old age security. This phenomenon reflects what Richard Minns refers to as 'social security capital'. The latter describes all deferred wages or salaries that enter the credit system in the form of company stocks and bonds (Minns 2001). Social security capital has become an important source of capital for corporations in both the core and periphery (World Bank 2007).

Seen from the above perspective, there exists a growing interdependency between social security capital and the global financial system, including publicly-traded corporations. This dependency is both asymmetrical and disciplinary in nature. That is to say, international financial markets and actors wield far more power over decision-making processes and gain more from deregulated markets than the middle and working classes, yet they also wield enormous discipline over societies, as workers (skilled and unskilled) are socialized into relying on the market to deliver economic security in their old age (Soederberg 2009). With each crisis and subsequent downturn, however, social security capital across the globe has taken a considerable hit, leading to widespread insecurity. For the United Nations, insecurity describes a situation where individuals and communities are not only exposed to adverse events, but are also unable to cope with and recover from the downside losses that emerge from these developments (United Nations 2008). According to the UN publication, *World Economic and Social Survey 2007: Development in an Ageing World* (United Nations 2007), "[e]ighty per cent of the world's population do not have sufficient protection in old age to enable them to face health, disability and income risks [...] In developing countries alone, about 342 million older persons currently lack adequate income security" (Blackburn 2007: 71). The asymmetrical interdependency between Wall Street and social security capital (Main Street) expresses itself in many ways, from the exorbitantly high fees charged by money managers, the $700 billion bailout of investment banks and insurance companies, who engaged in predatory and speculative activities with pension savings, and, at a more fundamental level, the ability of the powerful to define and select risk, whilst others do the risking (Zizek 2008).

The asymmetrical dependence between social security capital and financial markets is aggravated by a second characteristic of financialization, namely increasing leveraging and speculation, that has emerged through state design, i.e., the decision to adhere to the principle of minimal state intervention in capital markets, over the past decade. While the credit system normally operates with a certain level of fictitious capital – that is, a flow of money capital not backed by any commodity transaction, such as highly leveraged credit derivatives and strategies such as short-selling, which have little to do with the realities of the market (productive economy) and have played an increasingly large role in both the Enron-style debacles at the beginning of the new millennium and the sub-prime mortgage scandal of 2007 – the reliance on this form of capital has risen to high levels (Harvey 1999: 265ff; Soederberg 2009). One example of this is the market for credit-default swaps, which are described as "insurance contracts on bonds and other assets that are meant to pay off if those assets default" (Cox 2008). These swaps, which do not require public disclosure or any legal requirement to report to the Securities Exchange Commission (SEC), and which lie at the centre of the 2008 credit crisis, have mushroomed over the past several years. According to the Chair of the SEC, as of 2008, there is about $55 trillion in credit-default swaps outstanding, which amounts to more than the gross domestic product of all countries combined (ibid.) and more than twelve times the total amount of official reserves in the developing world (United Nations 2008). Interestingly, the SEC has not suggested doing away with these swaps or subjecting them to state-led regulation; instead, and mirroring the above neoliberal premises of the NIFA, it has recommended measures that promote greater transparency.

3.2 The ongoing perils of the modern Prometheus

The second feature of the NIFA relates to the privileged status of the United States in the global financial system due to the uncontested role of the dollar as the world's trading, and, more significantly, reserve currency (see Gowan's contribution in this volume). This position has allowed the American state, as well as global capitalist interests linked to it, to maintain structural power through what I have referred to as 'imposed leadership', not only over other countries, especially the global South and the institutions and policies of the NIFA, but also international lending institutions such as the IMF, where the US wields veto power over other countries by influencing international monetary and credit arrangements (Soederberg 2004, 2006; see Panitch and Gindin's contribution in this volume). Structural power allows the US to "exercise purchasing power and thus influence markets for production, and also the power to manage or mismanage the currency in which credit is denominated" (Strange 1994: 90). Since the demise of the Bretton Woods System in 1971, and the shift to freely floating exchange rates and the eradication of capital controls and low level of financial regulation, this structural power is underpinned by a deep-seated paradox, or what I have referred to as the Frankenstein Factor, as it captures the similar symbiotic yet mutually destructive relationship between Dr Frankenstein and his monster (Soederberg 2004).

On the one hand, the relationship between the structural power of the United States and free capital mobility is mutually beneficial, because as the international financial markets grow in size and power, so does the US economy, which has absorbed the majority of these flows to feed its debt-driven accumulation strategy since the 1980s. The structural power of the US and its ability to suck in massive amounts of global capital flows largely in the form of US Treasury bills and bonds and corporate securities, from the rest of the world, especially from Asian surplus countries, most notably China, has, as Robert Wade argues, allowed "US policy makers to run the economy for the past decade spending 5 to 7 percent more than it produces, importing twice as much as it exports. The US has reaped large benefits, including fast growth, low unemployment, and easy financing for US military activities in Iraq and elsewhere, even with tax cuts. The same mechanism has helped to generate fast growth in much of the rest of the world" (Wade 2008: 1). The developing world has also been contributing to debt-fuelled growth in the US in another way. According to the United Nations, net transfers of financial resources from developing to developed countries from 1997 to 2005 reached over half a trillion dollars. While these transfers were initially the result of primarily debt-related, capital outflows from the global South, they have come to reflect increasingly large foreign-exchange reserve accumulation taking place in many developing countries, particularly Asia. Reserves, for example, have increased "from 2-3 percent of gross domestic product in the 1980s to about 5 per cent in the 1990s and about 12 per cent in the current decade" (United Nations 2008: 12).

There is also a dark side to the Frankenstein factor, or growing reliance of the US economy on the constant inflow of global capital: the viability of US structural power, and by extension its debt-led accumulation regime, is heavily reliant not only on, as Peter Gowan suggests, the US dollar as the chosen reserve currency, but also, relatedly and more fundamentally, on the health and stability of global financial markets, including its own. With each crisis, more and more people are dispossessed of their old age savings, homes, livelihoods, and so forth, which make it increasingly difficult for free market ideologues to justify the benefits of free capital mobility. In the wake of the 2008 global credit crisis, for instance, we may see a reversal in the use of US dollar as the preferred reserve currency in the developing world, and a subsequent change direction of net capital transfers. According to some observers, "reserve accumulation in several countries in Asia now appears to exceed the requirement for self-insurance, raising questions about the balance of costs and benefits of additional accumulation, especially if such reserves are invested in low-yielding assets and in the US dollar, which has been, and is expected to continue to depreciate" (United Nations 2008: 25). Mexico and Brazil, Latin America's biggest economies, have sought to stop the depreciation of their currencies by selling reserves, most of which were denominated in US dollars. The Mexican central bank, for instance, moved 'to auction off $2.5 billion of its reserves after the peso fell to a record low of 14 against the dollar' in October 2008 (BBC 2008). Another development closely related to the foreign reserve build-up has been the explosion of internal public debt levels, mainly in middle-income countries. According to one observer, "servicing of the internal public debt in 2007 amounted to $600 billion – in other words triple the cost of servicing the external debt. Total servicing of external and internal public debt exceeds the astronomical sum of $800 billion – the amount repaid each year by public authorities in developing countries" (Toussaint 2008: n.pag.). To put this figure into perspective, it would cost "only $80 billion a year over a period of 10 years – a total of $800 billion – for the entire population of these countries to have access to essential services, such as basic health care, drinking water and primary school education" (ibid.).

3.3 Growing political and social insecurity in global finance

The third and final component of the NIFA, which has been tempered by the previous two characteristics, and more fundamentally, by the underlying nature of global capitalism, is the growing political and social insecurity caused by capital account liberalization in the global South. While the effects of allowing financial flows to move freely in and out of countries has been highly uneven across the developing world, there have been two general tendencies – neither of which have brought about the promised efficiency gains and faster growth. Firstly, as governments of emerging markets embrace foreign portfolio investment as an important source of financing, their exposure to risk increases. As the 2008 global crisis has made abundantly clear, the global South continues to pay the higher price for risks associated with US-led strategies of expanded reproduction of capital, which primarily involve the credit system. Secondly and related, to attract international creditors, which include institutional investors, governments of emerging markets must continually signal creditworthiness, such as low levels of labor standards, balanced budgets, low taxation, environmental and financial regulation and trade deregulation – all of which have had harmful effects on the social fabric and environmental sustainability of the developing world. At a more fundamental level, this locks many countries into adherence to market discipline instead of forging policies that would benefit their productive and social structures. In what follows, we look more closely at these two points.

As I mentioned earlier, some emerging markets have used windfalls from high commodity, oil and gas prices to build up currency reserves to help buffer their economies from the devastating effects of capital flight. This strategy has come at relatively high opportunity costs, however (United Nations 2008: 76ff). Reserve accumulation is associated with a high carry cost of reserves, which, according to the United Nations, amounts to about

$100 billion, representing a net transfer to reserve-currency countries well above what they provide in terms of official development assistance (ODA). Reserve accumulation also results in foregone domestic consumption, social services, or investment in the productive sector (United Nations 2008: 12). In the an era of free capital mobility, many countries in Latin America and Sub-Saharan Africa, for example, with weak growth and balance of payments, are compelled to absorb net capital inflows into low-yielding reserve assets instead of using them for investment (United Nations 2008: 28). The fact that developing countries are seeking to amass huge foreign currency reserves – as opposed to strong current accounts, healthy and productive workers, and a sustainable environment – to shield them from global instability, should in itself give us pause to question the benefits derived from the unshackling of finance and its promises for a safer and more stable world economy – even without taking the 2008 credit crisis into account.

Despite the existence of the $4.5 trillion in official reserves in the developing world, financial capital flows have remained highly volatile and reversible in recent decades, generating high costs for developing countries, as well as developed countries, especially pension savers (Ocampo et al. 2007; United Nations 2008). This precariousness of the global financial system was made abundantly clear with the 2008 credit crisis, which forced several countries – most of which, such as Brazil, Turkey, and South Africa, were believed to possess strong economies in the developing world – to go cap in hand to the IMF (Tran 2008: n.pag.). The point here is that global capital flows have not led to growth in the productive sectors and thus the generation of secure jobs with living wages, but increased forms of economic insecurity, increased levels of socio-economic inequality, especially in terms of income levels, and growing (asymmetrical) dependency on unregulated financial flows (United Nations 2008). The asymmetrical dependence is also contingent on the factors beyond the control of recipient countries, including shifts in monetary and fiscal policies in the core countries, e.g. high interest rate policies pursued by the US, which is viewed as the international benchmark (United Nations 2008). For instance, as the three major waves of international financial flows to (some) developing countries – (1) the petro-dollar driven debts of the 1970s, (2) the portfolio and direct investment of the 1990s up to the Asian Crisis, and then again in (3) 2003–2005

– reveal, private capital inflows were dependent on 'favorable investment conditions', including the ability of foreign investors to engage in arbitrage, or taking advantage of a price differential in between two national markets (Ocampo et al. 2007: 2).

In sum, in the past decade, the steady expansion of capital flows linked to the predatory and speculative global credit system has not delivered on the promises made by the architects of the NIFA. Financial globalization has not only led to the growing volatility and reversibility of capital flows to emerging market economies, due to their increased integration and thus exposure to its swift and debilitating effects, but also to the continual marginalization of many of the poorer and smaller developing economies (Ocampo et al. 2007; United Nations 2008). The latter have been particularly affected by the growing role of private capital flows to the developing world, which has been compounded by the steady drop in Overseas Development Assistance (ODA) by wealthy countries over the past decades, which, aside from several Scandinavian countries, have refused to provide 0.7 of their gross national income in the form of aid flows to the poorest countries (World Bank 2008). The only assistance for these countries will more than likely come from the IMF, predicated on austerity and structural adjustment policies, which is standing by to lend to the 33 countries that have been given the status of 'Heavily Indebted Poor Countries' (HIPC) (IMF 2008b).

4. Conclusion

This article has sought to take stock of the global financial system over the past decade, whilst contextualizing the 2008 first world debt crisis against the backdrop of the neoliberal solution to the financial crises of the 1990s: the NIFA. In doing so, I have argued that the neoliberal promises made almost a decade ago as they relate to free capital flows have not been kept. It follows that there is a danger in reconstructing another building that rests on the same foundations as the NIFA. The reforms tabled at the 2008 international financial have signaled a basic tension in global capitalism. On the one hand, the Asian and European governments, which are arguing for regulations regarding finance, represent societies and capitalist interests that have benefited from debt-led forms of capital accumulation and an ever-expanding credit system. In other words, while international policy-makers agree that regulatory schemes need updating, especially with regard to a greater role for oversight, these new forms of regulation should take place through voluntary initiatives by market actors, as opposed to mandatory, rule-based economic regimes. If it dominates, this position will inevitably lead to the reinvention of the NIFA. On the other hand, given the enormous productive and social costs of each financial crisis on the global South, it will be interesting to see how and to what extent this free-market ideology of neoliberalism can be legitimated and reproduced. According to the "UN general-secretary, Ban Ki-moon, the crisis could strike a 'final blow' to some poor countries" (Tran 2008: n.pag.). The legitimacy of US imposed leadership, and the role of the IMF, as well as the central role accorded to the predatory and fraudulent credit system under its control, may be called into question as an increasing number of people across the globe become further disenfranchised. The outcome will be, as with all things, determined by the configuration of political forces and struggles as well as by the above-mentioned paradoxes of global capitalism.

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Abstracts

The article has two interlocking goals: (1) to assess the past 10 years of neoliberal-led forms of financial globalization, and (2) to provide a contextualization of the 2008 global credit crisis. Both objectives are discussed against the backdrop of the reforms implemented at the end of the Asian Crisis in 1999, that is, the so-called New International Financial Architecture (NIFA). I argue that the NIFA, which rested on the basic assumption of free capital mobility and low levels of state regulation, did not deliver on its promises that 'prudent' (market-based) policies would lead to prosperity, growth and stability. To the contrary, the post-NIFA world has been marked by increasing levels of economic insecurity.

Dieser Artikel verfolgt zwei miteinander verbundene Zielsetzungen. Erstens werden die vergangenen zehn Jahre neoliberal geprägter Formen finanzieller Globalisierung analysiert, zweitens wird eine Kontextualisierung der globalen Kreditkrise 2008 vorgenommen. Beide Analyseschritte werden vor dem Hintergrund der so genannten Neuen Internationalen Finanzarchitektur (NIFA) diskutiert, also jener Reformen, die nach dem Ende der Asienkrise 1999 umgesetzt wurden. Die Autorin ist der Meinung, dass NIFA, die auf uneingeschränkter Kapitalmobilität und geringer staatlicher Regulierung beruhte, nicht ihr Versprechen einlösen konnte, nämlich dass

„zurückhaltende“ (marktkonforme) Politiken zu Wohlstand, Wachstum und Stabilität führen. Im Gegenteil, die auf NIFA folgende Ära ist durch eine steigende wirtschaftliche Instabilität geprägt.

Susanne Soederberg
Department of Global Development Studies
Queen's University
Mackintosh-Corry Hall, E-323
Kingston, ON K7L 3N6, Canada
soederberg@queensu.ca

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Miguel Otero-Iglesias

EU-Brazil transformismo in the reconfiguration of the global financial order

1. Introduction

The dollar has been, for more than five decades, the international currency *par excellence*, epitomising US hegemony in international finance. This exorbitant privilege, based on the attraction of credit to Wall Street from all over the world, and especially from the Global South, has allowed the US to live well beyond its means, with huge chronic current account deficits to the present day (Helleiner 1994; Seabrooke 2001). The immense structural power of this 'Dollar Wall Street Regime' (DWSR) was last seen in the South East Asian financial crisis of 1998 (Gowan 1999). However, two major changes have occurred in the world financial system since then: the introduction of the euro and the vast accumulation of foreign reserves in the emerging markets. Both moves have to be understood as defensive actions undertaken in order to acquire more autonomy from the DWSR (Cohen 2008). Both Europe and the emerging markets are trying to protect themselves against the inherent volatility of the financial system which was set up progressively by the DWSR since the closure of the 'Gold Window' and the Bretton Woods system of fixed exchange rates by Richard Nixon in 1971–1973. As Helleiner (1994) argues, the 'neoliberal' economic school considerably increased its influence in US policy making in the Nixon administration. Inspired by Friedrich Hayek and Milton Friedman, these new advisers rejected the post-war concern that speculative financial flows would disrupt stable exchange rate arrangements by arguing strongly in favour of a floating exchange rate system. They did not agree with the commitment of Keynes and White to national Keynesianism and the autonomy of the welfare state. Instead, they applauded the way international financial markets would discipline government policy and force states to adopt more conservative, 'sound' fiscal and monetary programmes. Ironically the DWSR has imposed this fiscal austerity on other states but not on US policymakers who have run huge public deficits over the last 30 years, especially with Republican Governments.

The DWSR has always profited from the financial crises in the periphery due to the fact that Wall Street has always been the market-haven of last resort. This time, however, the financial deregulatory boomerang has hit back and today's credit crunch crisis has seriously damaged the core foundations of the DWSR. The whole framework is now in jeopardy. The big high-risk investment banks of Wall Street have disappeared altogether; the whole banking system of the US has been partly nationalised with an extraordinary $700 billion rescue package put forward by the US Treasury. Equity prices are collapsing all over the world, turmoil in currency markets is widespread and house prices are plunging everywhere. Simply put, this is the greatest financial crisis since the Great Depression. This gives considerable credibility to those who predicted this type of crisis long ago, setting it in the context of a more general US hegemonic decline (Arrighi/Silver 1999). Arrighi and Silver document, historically a hegemonic crisis is always characterised by a diversion of capital from production and trade to finance and speculative activities. This shift is often assumed to cause a massive polarisation of wealth, such as is the case today. This "expansion can be expected to be a temporary phenomenon that will end more or less catastrophically, depending on how the crisis is handled by the declining hegemon" (1999: 272), in this case, the United States. For many analysts, including free-market gurus like Martin Wolf, this is the end of neoliberal capitalism as we have known it in the last three decades. Considering that US hegemony in financial activity has predominantly been based on this neoliberal framework (Alvater 2007; Cafruny/Ryner 2007) of laissez-faire capitalism that is now "melting away before our eyes" (Wolf 2008), the question that arises is whether the DWSR will last for long.

The academic debate on the future of the dollar as the main international currency has intensified over the past 5 years, even before the outbreak of the current financial turmoil. The main cause was the consolidation of the euro as a potential rival to the greenback for the role of international money and anchor of the financial system (Kindleberger 1981). So far the analyses have been contradictory. They range from economists who believe that the European currency will inevitably match the influence of the dollar, establishing a bipolar monetary system (Bergsten 1997, 2005; Mundell 1998, 2000), to those who are less optimistic about the trajectory of the euro and predict the continuation of dollar hegemony for several decades to come (Cooper 2000, Kenen 2002). In the more interdisciplinary field of International Political Economy (IPE), the positions are also opposed. While some see too many weaknesses in the European project to allow it to rival the US (Cohen 2003, 2007; Posen 2008), others argue that the European Union will acquire a predominant role as a civil and normative power in the 21st century (Leonard 2005; McCormick 2007; Telò 2006).

In any case, this debate has been so far too centred on the West, leaving the emerging markets of the BRIC (Brasil, Russia, India and China) states at the margins. This article strives to overcome this lacuna by focusing on how the financial elites of the emerging markets see the introduction of the euro and the evolution of the international financial system in the midst of the current financial crisis. Drawing on a methodological triangulation of secondary literature, archival documents and surveys as well as elite interviews[1] in the key study region of Brazil, it will be argued that the financial elites of the emerging markets consider US hegemony to be in decline and see the EU in many ways as an important partner in the creation of a multi-polar financial system characterised by progressive sharing of power in global governance institutions. In this sense, the BRIC elites have much in common with the European elites and hence they have the potential to create a counter-hegemonic bloc opposed to the DWSR.

2. Theoretical considerations

The question of whether the dollar will continue to be the main international currency cannot be answered solely by economic determinants. If only economic variables were to be considered (Lim 2006), the euro should by now be much closer to the dollar than it is. The euro-zone GDP is very close to that of the US, the euro-zone has a larger population, it has a greater world trade share than the US and the integration pace of the European financial markets has been outstanding (McKay 2007). But economic clout is not all that matters and thus the debate has to be politicised, as recently done by Eric Helleiner (2008), demonstrating who demonstrates that the field of IPE is best suited to deal with questions of world dominance. For his theoretical framework, Helleiner draws largely on the work of Susan Strange, one of the founders of modern IPE. Strange established as early as in 1971 (in the midst of another crisis) an IPE taxonomy of international currencies (Strange, 1971). For her there are four types of international money: (1) top currency; (2) master currency; (3) neutral currency; and (4) negotiated currency.

The master currency concept is easy to understand because Strange refers to a *de facto* territorial domination or protection of one state by the issuer state of the master currency. A top currency, on the contrary, acquires this privileged status mainly because of economic factors. It may be defined as "the currency that has world economic leadership, the currency of the predominant state in the international economy" (Strange 1971: 221). The dollar has certainly deserved this status during many decades. It is to be seen whether it can maintain this privileged position in the future. Today's economic shape of the US indicates that it is instead becoming a Negotiated currency. In this case, the issuer of the master currency loses political and economic might (as has been the case with the US in the last decade) and it has to bribe the other states with financial aid, military protection or trade advantages in order to convince them to continue to use its currency. Following Strange's reckoning, "the master currency depends heavily on the stick. But if the stick is weakened or if the issuing state for any reason becomes too embarrassed to use it, then it may be replaced by carrots" (Strange 1971: 220). In today's world the US carrots are: an open market for Chinese goods; military protection for the Gulf States; and recently, the willingness to hold an international conference in Washington to *negotiate* the reconfiguration of the financial system after the diplomatic pressure exercised by the French presidency of the European Union in alliance with the BRIC states, led by Brazil, which have been pushing for the widening of the discussion forum to the current G20 format for years (Cody 2008).

In this framework the BRIC states and naturally other key countries like South Africa and Saudi Arabia play a crucial role because, in the last instance, by using it, they are the ones that will decide to a great extent which currency will be the international money of the future. By advocating a more ethnographic approach for the financial elites of the emerging markets, this research differentiates itself from both the rational choice theory embraced by neoclassical economic modelling (Chinn/Frankel 2008; Portes/Rey 1998) and the structural-hegemony-theses put forward by world-system scholars (Arrighi 2005a, 2005b; Wallerstein 2003). Both of these approaches are highly deductive, while this work follows a more inductive line of research, leaving more room for agential autonomy and intersubjectivity, without at any time discarding the structural constraints. The concept of hegemony is understood here in a neo-gramscian sense whereby "world hegemony can be described as a social structure, an economic structure, and a political structure; and it cannot be simply one of these things but must be all three. World hegemony, furthermore, is expressed in universal norms, institutions, and mechanisms which lay down general rules of behaviour for states and for those forces of civil society that act across national boundaries" (Cox 1996: 137). Given that the hegemonic norms, institutions and mechanisms beneficial to the DWSR are now seriously in doubt, the neoliberal system as we have known it seems to have exhausted its full potential and the EU is seen as a soft power that promotes multilateralism and a 'fairer' globalisation, it seems justified to explore whether the financial elites of the BRIC states envision a tipping point in the configuration of the financial system and, thus, whether there is in fact the potential for a EU-BRIC counter-hegemonic coalition that can rival US hegemony actively as a *historic bloc* or just passively through a *transformismo* attitude (Cox 1996).

3. Brazil, the voice of the BRIC

In general, the academic literature on this topic has widely overlooked the BRIC states. The debate is Western-centred and focuses primarily on the balance of power between the US and the EU. The BRICs, however, are becoming increasingly influential in IPE. When their foreign ministers met for the first time in May 2008 in the Ural Mountains city of Yekaterinburg, one observer summarised very graphically their extraordinary weight. This summit brought together "the ministers from the second-largest food producer (Brazil), the biggest energy exporter (Russia), the largest democracy (India), and the most populous country (China)" in the world. “Together the BRIC nations represent 40 percent of world population and more than 10 percent of global GDP” (Wolfe 2008). On monetary affairs some works have recently focused their attention on Russia due to its aggressive de-dollarisation process (Johnson 2008), which backs the thesis that the BRIC states are distancing themselves from the DWSR; and also on China because of its huge foreign reserves and its central role in covering the US current account deficit (Bowles/Wang 2008), which supports the notion that the dollar is right now a negotiated currency. Surprisingly, there is a lack of insightful coverage of Brazil, with the recent exception of Stefan Schmalz (2008), who delivers an extensive analysis on how Brazil has acquired in recent years a crucial role in balancing power relations in the Americas and the world at large.

Indeed, Brazil is a very important player for several reasons. It is the tenth largest economy in the world and the second largest emerging market in GDP after China. Brazil today has over $150 billion dollars in foreign reserves (Meirelles 2008), which makes it the sixth largest holder of US Treasury bills (UST 2008). Brazil is also a good case study because it is the largest economy in Latin America, a region that has always been under the umbrella of the dollar. Thus, if there is a move out of the greenback, then it might be argued that the DWSR is losing its appeal. Today, however, the importance of Brazil goes beyond the regional scale. Under the central-left administration of Lula, Brazilian diplomacy was instrumental in setting up the G20 group within the WTO negotiations (Schmalz 2008) and since then Brazil has been the most active country in building a range of “counter-hegemonic coalitions” (Patricio 2008) with emerging (BRIC and G3-IBSA) and also with developed countries (UN-G4 and G20).

4. Brazil-EU partnership

Since the beginning of the new century Brazil has gradually moved away from the US and closer to the EU. As Klom (2003: 356) argues, “although Brazilian foreign policy was geared towards the US for most of the twentieth century, and only occasionally towards Europe, the Mercosur project has in effect pushed Brazil in the opposite direction”. This has been proven by Brazil’s reluctance to sign the Free Trade Agreement of the Americas (FTAA) advocated by the US, while it has been very keen in developing a free trade framework between Mercosur and the EU (Schmalz 2008). The reason for this was explained by President Lula when he stated that the EU is "the only Mercosur trade interlocutor that, putting on the table offers in all relevant areas, signals a positive disposition towards negotiations" (Poletti 2007: 278). Under this more amicable free-trade framework, it is not surprising to see how in the last decade the trade and investment volumes between the US and Brazil have decreased, while the ones between Brazil and the EU have increased. The EU represents 22.2 percent of Brazilian imports against 15.7 percent of those of the US. This difference is even larger when it comes to Brazilian exports,with the EU receiving 25.2 percent of the total volume and the US importing only 15.8 percent (MDIC 2007) of Brazilian goods and services. The EU is also the largest foreign direct investment (FDI) partner of Brazil in both directions (BCB 2008a, 2008b). Just to give one example: between 1990 and 2001 the percentage of Spanish FDI in Brazil ballooned from 0.3 percent to 13.5 percent, while the US percentage shrank from 29.9 percent to 22 percent in the same period of time (Schmalz 2008: 157-158).

This outstanding economic integration in the last decade between the EU and Brazil has certainly not always been smooth, which is somehow understandable when two trade powers of this magnitude interact in an uneven neoliberal framework. The Brazilian elites consider the EU as a protectionist power with double standards when it comes to free trade agreements. They criticise strongly, for instance, the subsidies to European farmers established by the Common Agricultural Policy (CAP) of the EU, which undermines the huge potential of the very strong Brazilian agro-business industry (Poletti 2007). These frictions, however, do not stop the Brazilian elites from seeing the EU as a positive force in world affairs. According to the *Latinobarometro* survey undertaken between 2000 and 2004, among educated Brazilians the EU receives better marks than the US in the fields of democracy, development, peace and free trade (Fioramonti/Poletti 2008). This has been widely ratified by the in-depth interviews with the financial elites. The EU is generally seen as an important partner in promoting a more multilateral and multi-polar trade and financial world system, which is ultimately the main goal of the foreign policy of Brazil (Schmalz 2008). Here again the words of President Lula are very illustrative: "We want integration with political, economic and cultural autonomy; in this sense the FTAA cannot be considered a project for integration. The process developed with the European Union, on the contrary, should be considered as an example" (Poletti 2007: 278). These comments back the thesis that the EU is seen as a normative power with great appeal among BRIC elites, leaving open the possibility for the formation of a counter-hegemonic bloc with aspirations to reshape the world governance structures. They also confirm, however, that these elites want only to have a more regulated and balanced neoliberal order. They do not call for the creation of a new world order opposed to the existent one, at least for now.

5. Implications for the financial system

The closer economic and political ties between Brazil and the EU should reinforce the use of the euro in Brazil, a country that has always used the dollar as foreign currency. So far, however, the change has not occurred and it seems that it will not happen soon. Inertia and path dependency play an important role here. Once an international currency is established and the whole economic system operates with it, it is very difficult to replace it in a matter of a few years (Cooper 2000; Kenen 2002). The Brazilian financial elites interviewed throughout this research reject the idea of the dollar being substituted by the euro, yet they recognise that the European currency has been a success and that some Brazilian exporters to the EU are already issuing their contracts in euros. The introduction of the euro is seen by some banking elites as a "counter-hegemonic move" (Interview with Luis Manuel Rebelo[2]) that should be emulated by Mercosur. The first step in this direction was accomplished on 3rd October 2008 with the introduction of a regional payment system (SML) out of the dollar for the Mercosur countries so that their exporters and importers can trade with each other in their own local currencies (Berardinelli 2008). This move shows that the dollar is slowly losing its Top Currency status in a region that has always relied on this currency for trade transactions.

The consolidation of the euro as an alternative to the dollar has certainly brought a greater diversification tendency out of the dollar in Brazilian investments; this has been confirmed by private banking managers in Brazil's biggest banks. A high official of the Central Bank of Brazil (CBB), who has asked to stay anonymous, has also declared that the arrival of the euro has been seen positively by the CBB and by private investors in general because it leaves more room for diversification out of the dollar. Without disclosing the percentage of total share, this same official recognises that the CBB has partly diversified its foreign reserves into euros. In a recent public speech Maria Celina Berardinelli, deputy governor of the CBB, indicated that "the commercial and financial relations between Brazil and the EU are very strong and that there is still room for improvement for the use of the euro to match the economic importance of the euro-zone" (Berardinelli 2008). In general it can be said that the Brazilian financial elites see the European single currency as an integration model to emulate in South America in order to acquire more independence from the DWSR.

The implication of all this is that we are gradually entering a multi-polar monetary world where the dollar will lose steadily its supremacy and where other regional currencies like the euro will gain in importance. Against the backdrop of today's recession and the dim growth forecasts for the US, the father of the BRIC term, Jim O'Neill from Goldman Sachs, reckons that "we are emerging into this very hazy and slightly worrying state of affairs where there is not going to be any single country leading the world in the way the US has done and with it no single currency either" (Woods 2008). This multi-polar system is to be recognised in the G20 negotiations that will take place in the next months with the aim of restructuring (and not *remaking*) the world financial system. The first meeting in Washington has not produced any substantial changes due to the absence of Barack Obama, the incoming president of the US, and the measured ambitions of the EU-BRIC bloc in creating a completely new financial order. However, the summit demonstrated that there is a clear shift in economic power in the world and that the EU and the BRIC states together favour a multilateral system with more regulation in financial activity, away from the laissez-faire approach that has been so beneficial for the DWSR in the last decades.

6. Conclusion

The financial and political elites of Brazil analysed throughout this research believe that the current credit crunch crisis will diminish the dominance of the US in the realms of international finance and economics, and by extension, in world affairs in general. In this sense they concur with the remarks made by the finance minister of Germany, Peer Steinbrück, when he stated that "the US will lose its status as the superpower of the world financial system. This world will become multi-polar" (Benoit 2008). In this regard there is the potential for the formation of a counter-hegemonic bloc with the sufficient clout and influence to undermine the power structures that have so far benefited the DWSR. The Brazilian elites, lobbied by their strong agro-business industry, see in the EU a competitor in world trade share but also a close ally with whom to create a more global, balanced and multilateral trade and financial system that recognises the importance of the BRIC states. In the last decade the economic and political ties between Brazil and the EU have increased quantitatively and qualitatively, while those with the US have suffered several setbacks. The last matter of contention is the reactivation, after more than 60 years, of the 4th Fleet by the US Navy with the mission to patrol South American waters (US Navy 2008), an event seen with worry and mistrust by the Brazilian elites. This stands in clear contrast with the Brazilian willingness to include Spain, another European country, in the G20 negotiating framework. Spain has close economic and cultural links with Brazil and thus both countries see each other as potential allies sitting at the negotiating table.

As has been argued throughout this article, the reputation of the European Economic and Monetary Union (EMU) has increased considerably among the financial elites of Brazil and in many cases it is seen as an integration model to be emulated by Mercosur. The introduction of a regional payment system in local currencies out of the dollar is just the first step in this direction. Because of structural path-dependency the dollar is still the main international currency in Brazil and it will remain so for a while, but "this is not a matter of inertia but more a symptom of hysteresis" (Interview with Luiz Gonzaga Belluzzo[3]). Market agents need some time to adapt themselves to the new environment, but once they see the advantages of the new framework, they will gradually embrace the alternative. The euro offers an opportunity for diversification, which can be of great benefit for Brazilian investors, importers and exporters, and more so considering that the EU is the largest trading partner of Brazil. The officials of the CBB agree on this point and see the euro as a new top currency. Up to now, Brazil has not used more euros, because most of its trade is done with Latin American countries, which traditionally have always used the greenback. With the introduction of the euro, however, these countries have seen that an alternative is feasible and this has encouraged them to move slowly away from their DWSR dependency.

The Brazilian elites are convinced that the era of US hegemony is gradually being eroded and they advocate a new multi-polar financial and economic system where Brazil should have the influence in world governance that it deserves. For this they see the EU more as a partner rather than as a rival in the current G20 negotiations. In the view of these elites, countries like Brazil have benefited considerably from the liberal framework established by the US. They want it to continue, but on more multilateral terms, as was seen in recent WTO negotiations. Following a critical theoretical framework, this article indicates that so far neither the EU nor Brazil are ready to change the neoliberal order because of their vested interests in keeping their export industries intact. They rather prefer to make it more equalitarian in order to have more influence in the decision-making process. Instead of forming a new *historic bloc* to create a radical new world order, both powers seem to be content with what could be called global *transformismo*. As one of the banking managers interviewed said: "Right now, if you ask the workers in the US and Europe, they want more protectionism, they want to close the doors. We on the other hand, want more openness, more liberalism. We have learned how to use the liberal framework, how to negotiate" (Interview with Anonymous[4]). Right now the future of the financial system, and with it the Dollar as the main international currency, are under negotiation. The outcome of such negotiations is uncertain until the new administration of Barack Obama shows how it will manage the current crisis. Will it use sticks or carrots to preserve the DWSR? It is too soon to tell.

1) Considering that there is not much literature available on the impact of the euro and the European Union at large on Brazil, the use of in-depth interviews followed by qualitative discourse analysis with key financial elites (Dexter 2006) is widely considered to be of great value in providing a better understanding of how the Brazilian elites assess the arrival of the euro, the current crisis and the reconfiguration of the financial architecture. The sample of interviewees includes professors in Economics and International Political Economy, senior managers of the biggest private banks,

prestigious economic journalists, senior managers and economic consultants of the public development banks and high officials from the Central Bank of Brazil (CBB).

2) Semi-structured elite interview with Luis Manuel Rebelo, President of the Brazilian funding institute for studies and research, Financiadora Nacional de Estudos e Projetos (FINEP). Rio de Janeiro, 25.7.2008.

3) Semi-structured elite interview with Luiz Gonzaga Belluzzo, Editor of the economic magazine Carta Capital. São Paulo, 17.07.2008.

4) Interview with the Senior manager of one of Brazil's biggest banks who asked to stay anonymous. Brasilia, 24.07.2008.

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Abstracts

The dollar as the international currency *par excellence* and Wall Street as the main financial centre of the neoliberal system have been the two pillars of US hegemony in the last decades in what is known as the Dollar Wall Street Regime (DWSR). However, the current financial crisis has put this hegemonic set-up in jeopardy. Drawing on primary research in Brazil (a key BRIC country), I argue that the financial elites of the emerging markets consider US hegemony to be in decline and see the EU in many ways as an important partner in the creation of a multi-polar financial system. In this sense, the BRIC elites have much in common with the European elites and hence together they have the potential to create a counter-hegemonic bloc opposed to the DWSR.

Der Dollar als internationale Währung par excellence und die Wall Street als das Finanzzentrum des neoliberalen Systems bildeten in den letzten zwei Jahrzehnten die beiden Säulen der US-Hegemonie, die unter dem Schlagwort Dollar Wall Street Regime (DWSR) bekannt geworden sind. Diese Hegemonie wird durch die aktuelle Finanzkrise gefährdet. Basierend auf Erhebungen in Brasilien wird in diesem Artikel argumentiert, dass die Finanzeliten der aufstrebenden Schwellenländer die Hegemonie der USA als geschwächt beurteilen und in vielen Aspekten die Europäische Union als wichtigen Partner bei der Schaffung eines multipolaren Finanzsystems sehen. Dieses gemeinsame Anliegen der Eliten der „BRIC“-Staaten und jener der europäischen Staaten birgt nach Ansicht des Autors das Potential, einen gegenhegemonialen Block in Opposition zum DWSR zu begründen.

Miguel Otero
Department of International Relations, Politics and Sociology
Oxford Brookes University
Office: G1.07, Gipsy Lane
Headington, Oxford, OX3 OBP
United Kingdom
m.otero@brookes.ac.uk

Glossary

AIG: American International Group, Inc. (AIG) is the world's largest international insurance organisation, specialising in insurance and financial services. In March 2009 AIG revealed the extent of its financial plight with a $61.7 billion loss – the largest in US corporate history – which required a radical breakup of the company: it has ceded control of its two biggest divisions to the US government in exchange for a $30 billion plus lifeline. This has been the most recent government intervention and the third time in three months that AIG has been bailed out by the US government.

BRIC states: The acronym 'BRIC states' refers to the states Brasil, Russia, India and China. The term was first coined by Jim O'Neill, Goldman Sachs' chief global economist, in his 2001 report Building Better Global Economic BRICs. This report and subsequent reports by the same bank predict that the BRIC states will have an extraordinary share of world GDP by 2050.

CHIPS: The clearing house interbank payments system, a wire transfer payments system that operates in real time, processing over 95% of the US dollar cross-border payments and an increasing volume of US domestic payments.

FX swap: The foreign exchange swap, a transaction which involves the actual exchange of two currencies (principal amount only) on a specific date at a rate agreed at the time of the conclusion of the contract (short leg), and at a date further in the future at a rate agreed at the time of the contract (the long leg).

G3-IBSA: Formally established on June 6, 2003, through the Brasilia Declaration, the India-Brazil-South Africa Dialogue Forum (IBSA) represents a major initiative of policy coordination aiming at strengthening multilateralism, reinvigorating south-south cooperation and fostering democratisation of decision-making in major international instances.

IPO: Initial public offering, a corporation's first offer to sell stock to the public.

LTCM: Long-Term Capital Management (LTCM) was a very large hedge fund ($126 billion in assets) that nearly collapsed in late 1998. Like many hedge funds, its investment strategies were based on a fairly regular range of volatility in foreign currencies and bonds. When Russia declared it was devaluing its currency and basically defaulting on its bonds, it moved beyond the regular range that the LTCM had anticipated. In response, the US stock market dropped 20 %, while European markets fell 35 %. Investors sought refuge in Treasury bonds, causing interest rates to drop by over a full point. As a result, LTCM's highly leveraged investments started to crumble.

M&A: Mergers and acquisitions, a general term used to refer to the consolidation of companies.

Sarbanes-Oxley: The Sarbanes-Oxley Act, also known as the Public Company Accounting Reform and Investor Protection Act of 2002 and commonly called Sarbanes-Oxley, Sarbox or SOX, is a United States federal law enacted on July 30, 2002. The legislation introduced major changes to the regulation of financial practice and corporate governance. Named after Senator Paul Sarbanes and Representative Michael Oxley, who were its main architects, it also set a number of deadlines for compliance.

TARP: The Troubled Asset Relief Program (TARP) was established under the Emergency Economic Stablization Act of the United States government. It is a programme which provides authority for the Federal Government to purchase and insure certain types of troubled assets for the purposes of providing stability to and preventing disruption in the spheres of economy and finance.

UN-G4: An alliance among Brazil, Germany, India, and Japan for the purpose of supporting each other's bid for permanent seats on the United Nations Security Council. Unlike the G8, where the common denominator is the economy and long term political motives, the G4's primary aim is the acquisition of permanent member seats on the UN Security Council.

Karin Küblböck, Cornelia Staritz (Hg.): Asienkrise: Lektionen gelernt? Finanzmärkte und Entwicklung. *Hamburg: VSA 2008, 238 Seiten, 14.80 Euro.*

Die gegenwärtige Finanz- und Wirtschaftskrise war in ihren Dimensionen zum Erscheinungszeitpunkt des Buches im Mai 2008 noch unabsehbar. Die Grundthese des Bandes ist dennoch aktueller denn je: Die modernen, liberalisierten und globalisierten Finanzmärkte sind inhärent krisenanfällig.

Ausgehend vom zehnjährigen „Jubiläum" der Finanzkrisen in Südostasien, Russland, der Türkei und Lateinamerika gehen die Beiträge des Buches der Frage nach, welche Spuren diese Krisen hinterlassen haben und welche Konsequenzen daraus gezogen wurden. Der erste Teil des Buches widmet sich dabei den Finanzmärkten im Allgemeinen und versucht, deren Entwicklung mit Fokus auf die letzten zehn Jahre nachzuzeichnen.

Der zweite Teil des Buches, auf den hier aus Platzgründen nicht näher eingegangen wird, analysiert in sechs spannenden Beiträgen die erwähnten Finanzkrisen in ihren nationalen und regionalen Kontexten mit dem Ziel, Ursachen, Eigenheiten und langfristige ökonomische wie soziale Folgen festzumachen. Außerdem wird auf die Rolle der Finanzmärkte in Indien, China und Subsahara-Afrika eingegangen.

In den letzten 30 Jahren haben sich, wie Jörg Huffschmid in seinem Beitrag argumentiert, die ökonomischen, sozialen und politischen Kräfteverhältnisse deutlich zugunsten der Kapitalinteressen verschoben. Dabei wurde ein neuer institutioneller Rahmen geschaffen, der einerseits die Renditemöglichkeiten, gleichzeitig aber auch die Krisenanfälligkeit erhöht hat.

Huffschmid führt dies vor allem auf drei Faktoren zurück: Auf die zunehmende Konzentration von Vermögen und Einkommen durch Umverteilung von unten nach oben, auf die Zunahme institutioneller Anleger infolge der Privatisierung der Pensionsvorsorge sowie auf die Liberalisierung und Deregulierung des Kapitalverkehrs. Die ersten zwei Faktoren haben zu einem Überangebot an freiem, Rendite suchendem Kapital geführt und die Relation zu den Anlagemöglichkeiten in den letzten drei Jahrzehnten umgekehrt: War früher Kapital notorisch knapp, so sind es heute lukrative Anlagemöglichkeiten. Der dritte Faktor ermöglichte aber erst die unkontrollierte Explosion der Finanztransaktionen und die Entwicklung immer komplexerer Derivate, deren Hebelwirkungen schon bei schwachen Anzeichen einer Krise katastrophale Auswirkungen entfalten können.

Die enorme Bündelung von Kapital bei privaten institutionellen Anlegern wie Pensions-, Investment- oder Hedgefonds hat deren Einfluss massiv anwachsen lassen. Mittlerweile übernehmen diese Akteure auch eine immer aktivere Rolle in der Gestaltung der Rahmenbedingungen für Finanztransaktionen, die traditionellerweise eine Domäne der Politik war – beispielsweise über das Setzen von Standards. Susanne Soederberg führt in ihrem Beitrag drei derartige Standards an, die von einem Pensionsfonds, der US-Regierung unter Bush und den G7-Staaten entwickelt wurden, um das Investitionsrisiko in „Schwellen- und Entwicklungsländern" zu bewerten.

Diese Standards stellen sich, ganz in neoliberaler Tradition, nach außen hin als objektiv, neutral und jedenfalls notwendig für die weitere wirtschaftliche Entwicklung dar – und verschleiern die Interessen, die dahinter stecken. Durch die Marktmacht dieser Institutionen und die Legitimität, die ihnen zugeschrieben wird, kommt ihnen allerdings eine überproportionale Bedeutung zu: Kein Land, das auf Kapitalimporte angewiesen ist, kann sich ein Zuwiderhandeln leisten – ein unmittelbarer Kapitalabzug mit nicht abzusehenden realwirtschaftlichen und sozialen Folgen schwebt wie ein Damoklesschwert über jeder Regierungsentscheidung.

Das Befolgen der diesen Standards impliziten und von Institutionen wie Weltbank oder Internationalem Währungsfonds (IWF) explizit ausgesprochenen Empfehlungen zur Liberalisierung der Finanzmärkte hatte in den meisten Ländern der Peripherie ähnliche Effekte, wie Gabriel Palma in seinem Beitrag ausführt: Nach der Deregulierung setzte, wie erwünscht, recht rasch der Zustrom an ausländischem Kapital ein – allerdings in einem derartigem Umfang, dass das makroökonomische Gefüge der betroffenen Staaten ziemlich erschüttert wurde. Obwohl sich in der Reaktion der untersuchten Staaten drei unterschiedliche strategische Muster erkennen lassen, kam es unabhängig davon nach einer anfänglichen, durch das billige Kapital erzeugten Boomphase in jedem Fall zu ökonomischen Schwierigkeiten. Diese wiederum führten – da ja keine Kapitalverkehrskontrollen mehr vorhanden waren – sofort zu Kapitalflucht, durch die aus den Schwierigkeiten rasch eine ausgemachte Krise wurde.

José Antonio Ocampo und Stephany Griffith-Jones argumentieren in ihrem Beitrag, dass dies nicht zuletzt auf die prozyklischen, eskalativen Effekte von immer stärker vernetzten Finanzmärkten zurückzuführen ist, die antizyklische Geld- und Fiskalpolitik zunehmend wirkungsloser machen – wenn diese im Rahmen von Strukturanpassungsprogrammen des IWF, als Bedingung für die Gewährung von Krediten im Krisenfall, nicht ohnehin verboten wird. Darüber hinaus liefern die Autoren interessante Vorschläge für Änderungen im Regelwerk der Entwicklungsfinanzierung, die diese antizyklischer und damit krisenfester machen könnten.

Diese Krisen in der Peripherie führen jedoch, wie Lydia Krüger in ihrem Beitrag ausführt, auch immer zur Umverteilung von unten nach oben: Während in den betroffenen Ländern die Arbeitslosigkeit steigt, die Reallöhne dramatisch fallen und nationale Unternehmen bankrott gehen, werden ausländische Kredite trotzdem bedient und ausländische Unternehmen gerettet. Das Ergebnis, wie Krüger anhand der Beispiele Korea und Argentinien beschreibt, ist ein signifikanter Anstieg der Marktkonzentration und des Anteils ausländischer Investoren.

Letztendlich tragen die internationalen Kapitalflüsse dazu bei, wie auch Kunibert Raffer in seinem Beitrag feststellt, dass die ohnehin ungleiche Verteilung des Kapitals zwischen Zentrum und Peripherie weiter vertieft wird. Statt zur „Entwicklung“ der Peripherie hat die Liberalisierung und Deregulierung der Finanzmärkte zu dem absurden Effekt geführt, dass sich der Netto-Kapitalfluss seit dem Ende der Bretton-Wood-Ära umgekehrt hat und „von Süd nach Nord“ fließt und die Peripherie damit unter anderem den Konsum der USA finanzieren.

Dass die Länder des kapitalistischen Zentrums von der Funktionsweise der Finanzmärkte und ihren Krisen insgesamt profitiert haben, ist wahrscheinlich auch der Grund, warum allfällige Diskussionen über eine Re-Regulierung der Finanzmärkte in den letzten Jahren immer in den Kinderschuhen stecken geblieben sind. Dies ist wohl auch der größte Unterschied zwischen den bisherigen Finanzkrisen und der aktuellen: Die USA und Europa sind nicht nur am Rande, sondern voll betroffen. Und siehe da, plötzlich wird die Diskussion über ein neues, weltweites Regulierungsregime für die Finanzmärkte zu einer erstmals realistischen Option...

Fazit: ein spannendes, großteils sehr flüssig geschriebenes Buch, das sowohl für ÖkonomInnen interessante Details beinhaltet als auch ausreichend verständlich geschrieben ist, um mit wenig Vorwissen gut verstanden zu werden. Der vom Titel suggerierte Fokus auf Asien ist im Buch zwar kaum erkennbar; dies muss aber im Hinblick auf die Relevanz des Buches für die aktuelle Wirtschaftskrise kein Nachteil sein.

Michael Druckenthaner,
Sebastian Howorka

SchwerpunktredakteurInnen und AutorInnen

Hans-Jürgen Bieling is Junior Professor for European Integration and Globalisation at the Department of Political Science, Philipps-University Marburg. Currently, he works as a stand-in Professor for Political Economy at the Department of Socioeconomics, University of Hamburg. His main fields of interest are European integration, international political economy as well as theories of the state, politics and society.

Sam Gindin is Packer Visiting Professor in Social Justice at York University and former research director for the Canadian Auto Workers union (CAW). He has published numerous articles on free trade, socialism, working class capabilities and political economy.

Peter Gowan is Professor of International Relations at London Metropolitan University and course director of the MA in International Relations. He is a member of the editorial board of the New Left Review and of the America Discussion Group at the Royal Institute of International Affairs.

John Grahl is Professor of European Integration at the Human Resources Management Department at Middlesex University. He is also a member of European Economists for an Alternative Economic Policy in Europe. His research interests include EU financial integration, EU labour politics and financial change, and European employment relations

Karen Imhof teaches at the Project International Development at the University of Vienna and currently works for the research project Global Financial Governance, funded by the Jubil umsfonds of the Austrian Central Bank (OeNB). Her research interests include global political economy, global governance, and financial markets.

Johannes Jäger is Head of the Economics Department at the University of Applied Sciences, BFI Vienna and teaches Development Studies at the University of Vienna. His main research interests are the political economy of the financial sector and regional economic developments.

Miguel Otero-Iglesias is a PhD Candidate and Teaching and Research Assistant at the Department of International Relations, Politics and Sociology, Oxford Brookes University. Among his current research focuses are the triangulation of power relations in monetary affairs between the US, the EU and the emerging markets, with particular focus on Brazil, China and the Gulf Cooperation Council (GCC).

Leo Panitch is distinguished Research Professor for Political Science at York University in Ontario, Canada. He has been rewarded the Canada Research Chair for his study of the role of the United States in leading and managing globalisation. His research interests include comparative political economy, state theory, theories of globalisation and imperialism, the US empire, socialism and democracy, and working class politics.

Susanne Soederberg is a Canada Research Chair and Associate Professor in Global Development Studies at Queen's University, Canada. Among her research interests are global political economy, global governance, financial markets, transnational debt and the global aid industry, and north-south relations.

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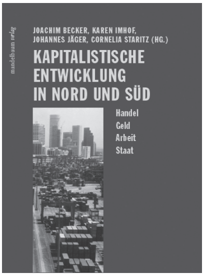

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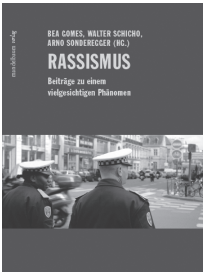

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