



The crisis: a return to political economy?

Loong Wong

*School of Business and Government, University of Canberra,
Canberra, Australia*

Abstract

Purpose – This paper aims to examine the current financial crisis, suggesting that most analyses have attributed the crisis to a lack of business ethics, the rise of greed and lax regulation. Prescriptions offered to address this crisis draw accordingly on the need for greater regulation of market behaviour, business practices and boardroom pay. Whilst these reforms are necessary, they fail to recognise that such business practices have their roots in an extreme political and economic ideology – neoliberal market fundamentalism. This paper seeks to suggest that a greater appreciation of the nexus between politics, philosophy and economics is critical in order to develop a different practice. As such, the author provides a socio-historical and political context for understanding the present crisis before offering a critique and reform of the business educational agenda. The author argues that such a context would engender greater understanding of business practices and systems for both students and practitioners and would go some way in enabling them to fashion a more critical reflexive and engaged practice.

Design/methodology/approach – The paper draws on a critical-historical review of the literature on the crisis. In so doing, the paper opens up the analysis to philosophical and political approaches to understanding financial crises.

Findings – The paper finds that explanations for the crisis can be found through a critical appreciation of philosophical and political texts. This finding also suggests that current business and management education and practices can benefit from an incorporation of these historical strands of thought.

Research limitations/implications – In drawing on various strands in philosophy, politics, economics and sociology, the paper finds that a singular account for the crisis is flawed. The paper also finds that a richer and deeper appreciation of the crisis can be found through a critical-historical positioning of the crisis. This necessitates an understanding of politics and philosophy in business practices and education.

Practical implications – In explaining the crisis, the paper suggests that many of the current financial “innovations” are problematic and a more critical approach is needed to engage with these “new” innovations.

Originality/value – The paper seeks to open up new vistas for business education and practices. Through a critical-historical interrogation of the crisis, the paper opens up new spaces for understanding international economics and business practices. This reflexivity is often missing in international business studies and most management practices.

Keywords Political economy, Recession, Politics, Capitalist systems, Education, United States of America

Paper type Viewpoint



Introduction

“Modern history’s greatest regulatory failure”; “The end of American capitalism as we know it” – these are just two of the headlines thrown up by the credit crunch, both appearing in the *Financial Times (FT)*. In the course of a single week, we have seen the collapse of three of America’s biggest financial institutions: on Sunday, 13 September

2008, Bank of America announced it was buying out Merrill Lynch, one of the world's most famous investment banks; on the following Monday, Lehman Brothers, the fourth largest securities firm in the USA, filed for bankruptcy; and, on Tuesday, the US Federal Reserve invested \$85 billion in a takeover of AIG, America's largest insurance company. More recently, on Thursday, 25 September, the huge US bank Washington Mutual, in a state of collapse, was taken over by JPMorgan Chase, in a move described as "the biggest bank failure in American history" (Scholtes *et al.*, 2008).

This panic on the world's stock markets is a reflection of the underlying crisis of world capitalism, as it plunges into the deepest slump since the 1930s. Five European banks have collapsed in as many days. Despite the \$US700bn bailout, the crisis continues unabated. The German government was forced to intervene to bail out the real estate giant, Hypo, amid growing panic in the financial sector. BNP Paribas was forced under Belgian government pressure to take over Fortis's operations in Belgium and Luxemburg. This followed the decision of The Netherlands government to nationalise Fortis in The Netherlands. Turmoil has also hit France, where Caisse d'Epargne is likely to merge with Banque Populaire, and Italy, with Unicredit going under. In Iceland, the economic crisis has forced the government to nationalise one of its biggest banks, Glitnir, while a large investment house collapsed; the authorities also drew up sweeping powers to nationalise banks and sack executives as the country faced bankruptcy. The krona fell as much as 45 per cent against the euro, as the country faced a balance of payments crisis. The crisis is producing panic everywhere. According to the *FT*:

Yesterday's fresh outburst of panic on global markets was final proof that as financial crises go, we are now in the big league. Comparisons with the dotcom bubble or even the Asian crisis of 1997 are inadequate. We must think of 1987 or 1929.

The article continues:

With hindsight, 1987 was more contained than today. The brief, savage fall in world equities seemed the prelude to a downturn in the real economy. But the real world sailed on, and other asset classes were largely unscathed.

Compared to 1929, there are two main differences today. First, world policy makers have grasped the scale of the threat more quickly and are prepared for much more drastic action. Against that, the financial system is more complex. And thanks to modern communications, the pace has accelerated. So any policy action is uncertain in its effect and generally out of date by the time it arrives (*Financial Times*, 7 October 2008).

In the last few months, companies that were thought to be too big to fail have all either filed for bankruptcy, been "bailed out" by the government, or been nationalised. Most economists do not know the depth and extent of the loss. As Dominique Strauss-Kahn writes in the *FT*:

But with much of the losses yet to be realized, and with the financial crisis now acute, it has become clear that nothing short of a systemic solution – comprehensive in tackling the immediate fallout and comprehensive in addressing the root causes – will permit the broader economy, in the US and globally, to function with any semblance of normality (*Financial Times*, 22 September 2008).

Indeed, the US economy no longer functions with any "semblance of normality". As David Wessel (2008) noted in the *Wall Street Journal*, "The past 10 days will be

remembered as the time the U.S. government discarded a half-century of rules to save American financial capitalism from collapse". For years the USA economy appeared to be defying the laws of economic gravity, going up and up. However, its present fall is more spectacular and is far from over. The crisis has clearly spread from the financial sector to the rest of the economy. The difference with 1929 is that the world is far more interdependent and the scale of the crisis is potentially far bigger. All the factors that developed the boom over the past 20 years are now turning into their opposites. The profits bonanza has crashed. The market is contracting rapidly. Consumer spending is falling. The *FT* opined: "We are now, unquestionably, in the worst financial crisis since 1929. We do not know how many more banks and institutions will fail – Washington Mutual, the US counterpart of HBOS, is under severe pressure – but Bear Stearns, Fannie Mae and Freddie Mac, Lehman and AIG are plenty" (*Financial Times*, 19 September 2008).

Financial turbulence originating in the USA has slowly expanded and worsened. There is now "the messy reality of global financial crisis" (Rubin, 2003, p. 297). Banks and financial institutions are weighed down by huge losses caused by "non-performing loans". Lending channels are choked up, as lenders are being called to pay back their loans, to clean up their balance sheets, and fearful that they are "throwing good money after bad" and will not be paid back. There is real danger of a breakdown of the financial system. The new president of the International Monetary Fund has stated that the current turmoil poses the greatest financial crisis since the 1930s (Weisman, 2008).

Fortune magazine, in its April 14 issue, analyses the stakes this way:

The fear – a justifiable one – is that if one big financial firm fails, it will lead to cascading failures throughout the world. Big firms are so interlinked with one another and with other market players that the failure of one large counterparty, as they're called, can drag down counterparties all over the globe. And if the counterparties fail, it could down the counterparties' counterparties, and so on (Sloan, 2008).

In this paper, I seek to position current academic reflexive comments on the present global crisis. Some have commented on the inadequacy of management and business education, particularly its neglect of social and political questions (Corbyn, 2008). Others, including the popular press, have drawn our attention to the "continuing" relevance of Marx and even Alan Greenspan in Washington recently saw the crisis as a battle between capitalism and socialism. I therefore turn to a recent piece in the *Financial Times* which seeks to contextualise and position Marx within our understanding of the present crisis. I next examine critically the work of Marx and show how it enables us to frame the present crisis before examining the current phase of neoliberal capitalism and the rise of finance capital. Free market economist Martin Wolf sees the crisis as one arising from the mutation of capitalism from "mid-20th century managerial capitalism into global financial capitalism" (Wolf, 2007). Contemporary Marxist John Bellamy Foster also recognised this qualitative shift, but saw it as "a new hybrid phase of the monopoly stage of capitalism that might be termed 'monopoly-finance capital'" (Foster, 2007, p. 1). The paper next discusses the responses to the crisis and argues that unless fundamental reforms are introduced, including an injection of politics within business education and our practices, the crisis will recur again in the future.

The MBA, the crisis and Marx

Not many MBA courses include the reading of Marx's *Capital*. Not many CEOs could quote from *The Communist Manifesto*. But there are times when it pays even the most passionate believers in capitalism (and I count myself among them) to heed the bearded Cassandra. Times like these: the worst bear market since the Great Depression – although Marx himself would have preferred to call it a “crisis of capitalism”.

So wrote Niall Ferguson, Professor of Political and Financial History at Oxford and Visiting Professor at the Stern School of Business, New York University. In his article, “Full Marx” (Ferguson, 2008), Ferguson noted that “Marx’s insights into capitalism can still illuminate [...] Marx got one thing right. Behind the bubbles and busts of the capitalist system there is a class struggle; and that class struggle is the key to modern politics”. He went on: “This may read like heresy, especially in the pages of the *Financial Times*”, said Ferguson, somewhat on the defensive. “But a little reflection on the current crisis of capitalism will show otherwise. Not that today’s class struggle bears much relation to that of Marx’s day”. In fact, says Ferguson, there is “a conflict within the bourgeoisie” where “the history of capitalism is the history of expropriation and the concentration of wealth – the means of production – in the hands of an ever-decreasing minority [...] widening inequality and globalisation”, making capitalism crisis-prone.

Ferguson also pointed out “the real point is that many of the defects [Marx] identified in nineteenth century capitalism are again evident today. In the last 20 years, there has been a significant increase in inequality in the pre-eminent capitalist economy, the United States. In 1981, the top 1 percent of households owned a quarter of American wealth; by the late 1990s, that single percentage owned more than 38 percent, higher than at any time since the 1920s”. Commenting on the present crisis, he noted that “The global implications of a slowdown in the vast American economy are alarming. The other key element of the late-90s bubble was the willingness of foreign investors to pour money into the US, funding an enormous balance of payments deficit. These foreign investors are now staring at income statements spattered with red ink. And they have more to worry about than American investors, because a slide in the dollar exchange rate threatens to make those losses even bigger. If the experience of the 1980s is anything to go by, the dollar could fall steeply as foreign investors sell off. The resulting reduction of American imports would further hurt the rest of the world”. He went on to advise us that we should not “prepare for the death-knell of capitalism just yet” and that there was good news: the US stock market has simply retraced its steps back to mid-1997, the USA is free from the spectre of inflation, the American financial sector is in far better health than its Japanese counterpart, and above all, the Fed is not the Bank of Japan. For him, we should relax: “the recession was last year, and you barely felt it. This is the kind of crisis of capitalism Argentines can only dream about”. For him, there are lessons to be learnt and “It is the social structure of American capitalism that is in real need of attention”. In Ferguson’s analysis, the primary culprit is the rise of the new class of CEOs and the lack of supervision of their activities[1].

Clearly there is an element of truth in his claims but so are other explanations, for example the lack of regulation and the lack of transparency was glaring as risks were undetermined (Walker, 2008). Others have castigated the US economy for its “monstrous bubble of cheap credit [...] with one bubble begetting another” – in the words of Stephen Roach, chairman of Morgan Stanley Asia. Elsewhere Roach has

A return to
political
economy?

observed that “America’s bubbles have gotten bigger, as have the segments of the real economy they have infected”. Household debt has risen to 133 percent of disposable personal income, while the debt of financial corporations has hit the stratosphere, and government and non-financial corporate debt have been steadily increasing (Roach, 2007). This huge explosion in debt – consumer, corporate, and government – relative to the underlying economy (equal to well over 300 percent of GDP by the housing bubble’s peak in 2005) has lifted the economy, created an appreciation of assets and wealth, and leads to growing instability. This was brought about as investors began to realise that a large proportion of the debt securities that they were trading were based on sub-prime mortgages that were never going to be paid back. The banks had supposedly discovered how to limit their own exposure, while raking in the charges, by repackaging poor debts as CDOs (collateralised debt obligations) and selling them on to their clients, in ways that supposedly spread and insured the risk. More fundamentally, a second, huge financial system based on banks borrowing from other banks to buy equities (the general term for assets traded on financial markets) on the basis that the value of these equities would continue to rise indefinitely, developed outside the normal banking network (Shiller, 2008). It was unregulated, not transparent and way too leveraged. If these equities begin to fall in price, the huge debts of these banks become exposed, and the contradictions in the system become apparent[2].

The spectre of Marx

In their article “Production and finance”, Magdoff and Sweezy (1983) argued that that the normal path of the mature capitalist economies, such as those of the USA, the major Western European countries, and Japan, is one of stagnation rather than rapid growth. In this perspective, today’s periodic crises, rather than merely constituting temporary interruptions in a process of accelerated advance, point to serious and growing long-term constraints on capital accumulation. They saw financial explosion as a response to the stagnation of the underlying economy, helping to “offset the surplus productive capacity of modern industry”. A capitalist economy in order to continue to grow must constantly find new sources of demand for the growing surplus that it generates. That’s why, for example, money jumps into Thai real estate markets one day, and pulls out and goes into ethanol production in Brazil the next . . . and then back to mortgage securities. And there is something else: the inflows and outflows of short-term and speculative capital also act as a perverse means of imposing discipline on and restructuring capitals – a major manufacturing firm can be starved of credit or threatened with a leveraged buyout. And this kind of “financial discipline” has been imposed on whole countries in the Third World (Rude, 2004). All this is part of the reason that financial instability is a constant feature of capitalism in its more globalised and financialised forms of existence. There comes a time, however, in the historical evolution of the economy when much of the investment-seeking surplus generated by the enormous and growing productivity of the system is unable to find sufficient new profitable investment outlets[3].

In recent months, the spectre of Marx has been revived. Marxists claimed that these contradictions were anticipated by Marx. Whilst Marx was never able to complete a theory of crisis in his lifetime (volumes II and III of *Capital* remained unfinished when he died), Marxists traditionally link capitalist crisis to the tendency of the rate of profit

(surplus value extracted per unit capital invested) to fall over time. In order to deduce this tendency, Marx divides this “unit capital invested” into two parts:

- (1) constant capital, which invested in the production process (e.g. the plant, raw materials etc.); and
- (2) variable capital, which is invested in staff wages.

Surplus value can only be extracted from workers, not machines. Surplus value is the value of the labour given by a worker above and beyond that which is paid to him or her as wages; hence it is the source of profit for the capitalist. Therefore, increasing the constant capital, for example, by investing in new machinery, whilst doubtless improving the production process, will mean that for the same surplus value extracted, a greater total capital (constant and variable) will have been invested; hence, the rate of profit will fall. This manifests itself as a fall in prices of commodities (think about how the price of electronic goods falls over time).

Of course, this tendency is not a law – there are other interacting factors which can cause the rate of profit to rise. Marx identified more intense exploitation of labour, reduction of wages below their value, cheapening of the elements of constant capital, and the increase in share capital, amongst other factors. Clearly, the tendency for the rate of profit to fall represents a huge contradiction in the capitalist system: competition forces capitalists to increase constant capital (by investing in new technology, for instance), which leads to an ever-diminishing rate of return on that investment.

However, this current crisis originated in the financial sector, which in this current epoch dominates world capitalism. According to Marx, capital agglomerates and seeks greater returns and a higher rate of profit. This growing concentration for Marx leads in turn, at a certain point, to a new fall in the rate of profit. Accordingly, smaller, fragmented pools of capitals are thereby forced onto new “adventurous paths” – speculation, credit swindles, share swindles, crises (Marx, 1909, Volume III, pp. 469ff). Marx is clearly identifying how concentration (i.e. the grouping of more and more capital under the control of fewer and fewer capitalists, tending to monopoly) is a driving force behind falling rate of profit, and how this falling rate of profit drives capitalists to seek profit through speculation, in effect making “free money” through trading bits of paper. This increase in share capital, claims Marxists, can counteract the tendency of falling rate of profit. In the age of huge monopoly capitalism, where 500 companies control 45 percent of the world’s economy, it is hardly surprising that it is increasingly hard to turn a large profit without engaging in “risky” financial activities (i.e. without gambling other people’s money) – credit, shares, derivatives and other assets. In this carnival of money-making, the banks lent vast sums of money and vastly over extended their loans, especially in the property market[4]. But boom turned inevitably to bust, threatening to bring down all in its wake.

The present crisis is not one arising from a lack of money; on the contrary, it is the crisis that causes a lack of money. When the economy enters into crisis, credit dries up and people demand hard cash instead. This is the effect of the crisis, but in turn it becomes cause, pushing down demand and creating a downward spiral. Bankers and governments insist that the cause of the crisis is the fact that the financial system has too little capital. Clearly if we look at the last two decades, banks have been and are continuing to make huge profits. For example, in Australia both the St George Bank

A return to
political
economy?

and Westpac bank reported annual record profits in late October 2008. It would surely be incredulous for banks to claim they do not have enough capital. Actually, there was a huge amount of loan capital in circulation during the boom, and this superabundance of capital itself found itself flowing into speculation, especially in the housing sector. This was the basis upon which the subprime mortgage scandal arose and flourished, generating unimaginable amounts of fictitious capital. But as long as vast profits were being made and investors were happy, nobody cared. Let us take just one example: the credit default swap industry. This market allows two parties to bet on the likelihood of a company defaulting on its debt. It has grown to about *\$90 trillion* in notional amounts insured – *that is to say, probably more than double the total outstanding credit in the world*. But contracts are registered nowhere but in the books of the partners. Nobody knows the real volume of trading, which therefore exposes the world economy to a huge risk. That explains the panic on Wall Street and in the White House[5]. They fear – correctly – that any severe shock can bring the whole unstable edifice of international finance crashing down, with unforeseen consequences. Unless and until all the bad assets are removed, many institutions will still lack sufficient capital to extend fresh credit to the economy. Marx described this stage in the economic cycle long ago:

That means of payment are scarce during the period of crisis goes without saying. The convertibility of bills of exchange has substituted itself for the metamorphosis of commodities themselves, and so much more so at such times, as a portion of the firms operates on pure credit. *An ignorant and mistaken bank legislation, such as that of 1844-45, can intensify this money crisis. But no manner of bank legislation can abolish a crisis* [. . .] In a system of production, in which the entire connection of the reproduction process rests upon credit, a crisis must obviously occur through a tremendous rush for means of payment, when credit suddenly ceases and nothing but cash payment goes. At first glance, therefore, the whole crisis seems to be merely a credit and money crisis. And in fact it is but a question of the convertibility of bills of exchange into money. But the majority of these bills represent actual sales and purchases, and it is the extension of these far beyond the needs of society which is at the bottom of the whole crisis. At the same time, an enormous quantity of these bills of exchange represents mere swindles, and this becomes apparent now, when they burst. There are furthermore unlucky speculations made with the money of other people. Finally, they are commodity-capitals, which have become depreciated or unsalable or returns that can never more be realized. This entire artificial system of forced expansion of the reproduction process cannot, of course, be remedied by having some bank, like the Bank of England, give to the swindlers the needed capital in the shape of paper notes and buy up all the depreciated commodities at their old nominal values. Moreover, everything here appears turned upside down here, since no real prices and their real basis appear in this paper world, but only bullion, metal coin, notes, bills of exchange, securities' (Marx, 1909, Volume III, Chapter 30, pp. 575-6, my emphasis).

Marx further explained that capitalist production depends, among other things, on credit, and that “the solvency of one link in the chain depends upon the solvency of another”. The chain can be broken at numerous points. And that sooner or later, credit must be paid off in cash. This fact, for Marxists, is all too frequently forgotten by those who become indebted during the process of capitalist upswing. In the first phase of capitalist expansion, credit typically acts as a spur to production: “the development of the productive process extends the credit, and credit leads to an extension of industrial and commercial operations” (Marx, 1909, vol. 3, pp. 563-5). This has a tendency to push

the market beyond its normal limits, almost limitless[6] but as soon as a crisis appears, the illusion is shattered and financial returns and prices all become problematic to enforce.

Marx's views are not so different from the recent work of Thomas Palley (2007). In his paper, "Financialization: what it is and why it matters", Palley notes that "the era of financialization has been associated with generally tepid economic growth. [...] In all countries except the U.K., average annual growth fell during the era of financialization that set in after 1979. Additionally, growth also appears to show a slowing trend so that growth in the 1980s was higher than in the 1990s, which in turn was higher than in the 2000s". He goes on to observe that "the business cycle generated by financialization may be unstable and end in prolonged stagnation". Nevertheless, the main thrust of Palley's argument is that this "prolonged stagnation" is an outgrowth of financialization rather than the other way around. Thus he contends that such factors as the "wage stagnation and increased income inequality" are "significantly due to changes wrought by financial sector interests". The "new business cycle" dominated by "the cult of debt finance" is said to lead to more volatility arising from financial bubbles. Thus "financialization may render the economy prone to debt-deflation and prolonged recession". Palley calls this argument the "financialization thesis"[7].

Neoliberalism and financialisation

For the past quarter of a century, neoliberalism, sometimes called market fundamentalism, the policy of non-intervention in the economy, has been the ideology, and the set of policies that go with it. Now the economic crisis is forcing the authorities to intervene, regulate, and even nationalise firms. Is neoliberalism dead?

Martin Wolf, economic guru of the *Financial Times*, suggests the neoliberal rulebook needs to be torn up. He dates the change from the collapse of Bear Stearns last March. "Remember Friday March 14th: it was the day the dream of global free-market capitalism died. For three decades we have moved towards market-driven financial systems. By its decision to rescue Bear Stearns the Federal Reserve, the institution responsible for monetary policy in the US, chief protagonist of free market capitalism, declared this era over. It showed in deeds its agreement with the remark by Joseph Ackerman, chief executive of Deutsche Bank that, 'I no longer believe in the market's self-healing power.' Deregulation has reached its limits".

As the crisis bit into the popular consciousness, the popular press recorded the same thought. The *Daily Express* (*DE*) headline screamed, "Don't let the spivs destroy Britain" (*Daily Express*, 17 September 2008). The article began, "Millions of British families are facing the destruction of their livelihoods as the nation's economy teeters on the brink of catastrophe, brought low by the greed and stupidity of spivs in high finance". Here, greed and Gordon Gekko is the cause but clearly not compelling or persuasive enough. Many of these policies have their roots in the 1970s and the emergence of a new neoliberal ideology. In 1973-1974 we saw the first generalised crisis of world capitalism. The preceding period from 1948 to 1973 was seen to be a golden age for world capitalism. Production went up year after year, as did living standards. In this situation of full employment, everyone was seen to be benefiting and the perception was that capitalism had changed fundamentally. Booms and slumps, it was generally believed, had been banished to the history books. Clearly the 1973-1974

recession came as an enormous political shock. The working class internationally mobilised to defend the gains of the post-war period. The ruling class, for their part, was determined to drive down living standards and restore the rate of profit. As a result of this clash, a revolutionary wave swept across the capitalist world. All the earlier certainties were thrown up in the air and called into question. In addition to rapidly rising unemployment the world economy experienced spiralling prices. The immediate trigger for inflation was the oil price crises of 1973 and 1979. Never before had we experienced inflation together with recession. This was called stagflation and in its wake neoliberalism was spawned.

Associated with neoliberalism was “globalisation”. Tariff barriers were coming down all over the globe. Capital was expanding everywhere and everything was “deregulated”[8]. Its proponents argued that “globalisation” meant that resistance was futile. Because capital was endlessly mobile, nation states were becoming powerless. They had to reduce taxes on profits and obey the multinationals’ every wish or they would simply move their money elsewhere. Workers would be “blackmailed” into accepting lower and lower wages or they would lose their jobs altogether. It was a race to the bottom[9]. Neoliberal triumphalism received a further fillip as the Soviet Union collapsed and capitalism, it was claimed, had won the Cold War! So it seemed there was no alternative to capitalism (or “the market”, as apologists came to call it) and its proponents proclaimed “the end of history” (Fukuyama).

Movement of money used to be analysed in terms of trade. For example, in buying a kilogram of potatoes, goods go one way and money the other. Now that’s all old hat. The movements of foreign exchange are now no longer the handmaiden of trade. By 1990, banks were creating “structured investment vehicles” and other derivative assets to bypass the reserve requirements of the Basel Bank regulations. The assumption was that geographical and sector dispersion of the loan portfolio and the “slicing and dicing” of risk would convert all but the very lowest of the tranches of these investment vehicles into safe bets. It also led to the blurring of the lines between commercial and investment banking, insurance and real estate in the FIRE (finance, insurance and real estate) sector. This led to financial innovative packages enabling high leveraging of funds accessible through low interest loans[10]. As a *Financial Times* report put it at the close of 2007:

While investors are scrutinizing some of the industry’s best-known names, a spectre will be silently haunting events: the state of the little known, so-called “shadow” banking system. A plethora of opaque institutions and vehicles have sprung up in American and European markets this decade, and they have come to play an important role in providing credit across the system (Tett and Davies, 2007).

This “hidden” system had expanded rapidly in the 1990s and 2000s as a consequence of deregulation, which allowed many financial institutions to take on banking functions and loosened the rules that govern borrowing and lending. Effectively, there was an explosion in money supply and there was a greater competition to purchase these assets. For every dollar that crosses the exchanges for trade, sixty go for pure speculation. Speculative capital movements, swaps, forwards and options now overwhelm trade in their importance for the balance of payments (Augar, 2006)[11]. As a percentage of total US corporate profits, financial sector profits rose from 14 percent in 1981 to 39 percent in 2001 (Brenner, 2002, p. 76; see also Glyn, 2006). Financial globalisation has simply become detached from the real world of surplus value

production. For globalisers, the explosion of global financial flows shows capitalism has at last created one world.

More importantly, it increased their powers and spheres of operations: from their traditional underwriting and brokerage, from mergers and acquisitions (M&As) and initial public offerings (IPOs), from proprietary trading and risk arbitrage; and from positioning themselves and their clients in relationship to the wider impact of a merger or some other major event, enabling them to gain from changes in relative prices whether or not a deal goes ahead. In lifting themselves from space (territory), corporate activities now also seek to supersede the temporal dimensions; for example, vast funds can now be shifted in nano-seconds and central banks have little control over their exchange rate, which is mainly driven by the market.

Globalisers argue that “market forces” are now sweeping all before them. Now, the globalisers say, the state has to give in, privatise, deregulate and comply with the “demands” of the market. These globalisers, however, fail to understand that the state is itself an economic actor, a power affecting economic behaviour. As Bukharin points out, “The fact is that the very foundation of modern states as definite political entities was caused by economic needs and requirements. The state grew on the economic foundation; it was an expression of economic connections; state ties appeared only as an expression of economic ties” (Bukharin, 1929, p. 63). He goes on: “The stronger state secures for its industries the most advantageous trade treaties, and establishes high tariffs that are disadvantageous for the competitors. It helps its finance capital to monopolise the sales markets, the markets for raw materials and particularly the spheres for capital investment” (Bukharin, 1929, p. 137). This state of play – the interaction between economic power and state power – is still a central feature of modern economic rivalry, but in the light of the crisis, all has changed. Governments now intervene to stop the markets from collapsing and indeed, bailouts have been the order of the day. As Sutherland observes: “In the US, hundreds of billions of dollars of banking risk will be transferred to the federal government, adding to America’s huge burden of debt and increasing its reliance on foreign investors [. . .] Policymakers now face formidable challenges: fighting the fire, then repairing the financial system while keeping a lid on inflation, then putting in place effective new regulation”. For her, the worst is yet to come. She goes on, “This crisis should prompt us to reappraise our relationship with money and debt, and to think hard about how we can create a fairer and more inclusive version of capitalism. There should be no return to the market’s false gods”.

Indeed, there are deeper questions that lie beyond the wrangling over the bail-out. The events that have been unfolding over the last six months have made it abundantly clear that voluntary regulation does not work. This has been echoed by European leaders, including President Sarkozy Agreeing with this sea change in consciousness. “[The] idea of an all powerful market without any rules and any political intervention is mad”. So the unchallenged economic orthodoxy of yesterday is now mad! He goes on, “Self regulation is finished. Laissez faire is finished. The all-powerful market which is always right is finished’. Vladimir Putin, Russia’s Prime Minister, sees this as an American problem exported out. He proclaimed:

Everything happening now in the economic and financial sphere began in the United States. This is not the irresponsibility of specific individuals but the irresponsibility of the system that claims leadership.

Others similarly agreed: “The origin and centre of gravity of the problem is clearly in the USA”, German finance minister Peer Steinbrück pronounced. And Gordon Brown, prime minister of UK, said his nation’s economic problems were imported from America, a view shared by opposition leader David Cameron (Stelzer, 2008).

This is all trenchant criticism – unprecedented for a generation. Their outrage is directed at financial “geniuses” they now realise were simple charlatans, who have been helping themselves to the good things in life at our expense and landing us all in the mire in the process. Their call is for regulation. Capitalism, we are told, would be a good system if only it were adequately regulated. In ‘A shattering moment in America’s fall from power’, John Gray (2008) argues that “It is America’s political class that, by embracing the dangerously simplistic ideology of deregulation, has responsibility for the present mess”. In the same issue of *The Observer*, Richard Wachman writes under the headline, “This transforms the financial system. Forever”. He sums up his argument: “US power is ebbing away and free market fundamentalism is an outdated ideology”.

Forever is a long time in politics. It is true that the USA is running a huge deficit with the countries it trades with. This is surely a sign of economic weakness. The country is up to its ears in debt to the rest of the world. The dollar is derided. US hegemony is weakening. Is it still the one, unassailable economic superpower? The real questions remain:

- (1) What is the real relation between capitalism and regulation?
- (2) What other country can lead the capitalist world and impose the norms and principles without which it cannot function?

Capitalism will always go through cycles of boom and slump. But the 1929 Wall Street Crash led directly to the Great Depression, the worst capitalist slump so far. Economist Charles Kindleberger sought to answer the question why the Great Depression was so deep and so widespread in his book *The World in Depression 1929-39*. His explanation was that the slump was so severe and long-lasting because there was no international lender of last resort. We do not believe this offers a complete explanation for the disastrous decade, but it is an important aspect of the truth. Before the First World War Britain was regarded as the hegemon and acted as the lender of last resort. The gold standard was really the sterling standard. The war showed that British hegemony was under decisive challenge.

After the Second World War the USA asserted its supremacy under the Bretton Woods Agreement, which determined the terms of world trade. It imposed the dollar as *de facto* world currency. And it had the power to act as international lender of last resort. Between the wars the USA was the most powerful capitalist nation, but it did not impose its power upon the world economy, remaining isolationist. This international anarchy led to “beggar-my-neighbour” devaluations and the virtual drying up of world trade. This impacted in turn on the economies of every nation on the globe. Now US hegemony is under challenge, but no clear alternative is in sight. If Kindleberger’s analysis of the 1930s is right, and we are entering a similar era today, then we are in for stormy times.

Reforms and the big picture

It has been argued that the present crisis is the result of regulatory failure to guard against excessive risk-taking in the financial system, especially in the USA (Gray, 2008; Walker, 2008). It is further argued that “we must ensure it does not happen again”. At its core are a number of fundamental questions: the issue of business practices (which includes the practices of management, greed, business ethics and management education) and that of regulation, particularly the role of the state in effecting such regulations. The latter is particularly telling and ironic given that most economists and commentators have argued precisely the opposite: that all regulations were bad for business and should be abolished (this was particularly advocated for the financial sector). The market, its proponents claim, would deliver the right and most efficient outcome and wealth was unbounded. Similarly, present calls to ban (temporarily) the practice of “selling short” are unrealistic. In order that the markets can function, it is necessary for people to buy and sell shares, and they must do so on the basis of estimating whether the share price is going to rise or fall. The idea that it is permissible to buy shares only when they are rising is clearly an absurdity.

Clearly, the present crisis presents an abertura for change. As such, some have seen in the wake of the present crisis attempts to redress the capital-society-labour relationship. Regulating the share market, curbing excessive bonuses and regulating boardroom pay, minimising risks for speculative activities and ensuring security for these transactions have all been touted as necessary reforms to make capitalism work, but such “regulation” is still driven by profits and does not necessarily make the economy more stable or provide greater equality, but rather provides conditions for greater speculation as speculators can now depend on government bailouts or their decisions. Whilst laws and regulations can be enacted, reining in greed and regulating boardroom pay is patently not feasible; how and by what mechanisms are these practices to be performed? Similarly, the (re)regulation of the finance sector and governmental interventions in the sector do not constitute a radical change[12]. In the past, states’ entities were highly involved in financial transactions and they was highly regulated. What has transpired is the reemergence of the state in managing fiscal crises engendered by finance-state actions which precipitated the crisis in the first instance, the “deregulation” of the economy and the “retreat of the state”. In effect, the state has been brought back in to enforce fiscal discipline. This requires the state to protect the interest of vested interests by giving them vast subsidies, paid for out from state revenues[13]. Speculators and bankers are rewarded for their nefarious activities by the state, which buys up all their losses, then spends further vast amounts of the taxpayers’ money to make them profitable, and when discipline has been restored, to sell them back to the bankers, who will then reap the rewards from such stabilisation (Augar, 2008).

The recent events are a graphic reminder of the anarchic nature of capitalism. The idea that this can be controlled by governments and central bankers is nonsense. On the contrary, the uncontrollable nature of capitalism has never been more apparent than at the present time. Moreover, the unprecedented intensification of the concentration of capital, where vast amounts of capital (much of it fictitious) are moved about the world at the caprice of a small number of people, lends the whole process an even more convulsive and unpredictable character. The present nervousness on world stock markets is thus the first of what will be a series of tremors which, for anyone with

eyes to read, announce the beginning of the end of the present cycle. What we are witnessing now is that a particular dynamic of growth, marked by intensified financialisation, is generating new contradictions and new barriers to sustained accumulation.

Here we come to a basic point of this analysis: a financial crisis has broken out because of the severe imbalances built up between the financial system – and its expectations of future profits – and the accumulation of capital; that is, the structures and actual production of profit based on exploitation of wage-labour. The state is intervening to head off further damage and to discipline and restructure the financial system. But the very complexity of the “financial packages” created during the speculative boom – with their bundled-up loans and long strings of finance – are producing new challenges for policy-makers. As one Yale economist put it, perhaps unintentionally echoing a phrase from Marx: “like the sorcerer’s apprentice, we have created things we do not understand and cannot easily control” (Dapice, 2008).

This explosive uncertainty is developing against a larger international canvas. Major shifts are taking place in the world capitalist economy. The European market recently eclipsed the US market in size. China’s growing demand for raw materials to fuel its export economy is making it a new player in the scramble for resources and control over them. And China’s increasing importance as a supplier of capital to the USA is giving it new leverage. Russia is reemerging as a world imperialist player, owing in part to its vast energy reserves and rising oil and gas prices. At the same time, and at this very moment of financial crisis, the USA’s freedom of manoeuvre is severely hobbled – and this includes its ability to stimulate the economy through fiscal and monetary policy. The USA has never run such large current account deficits and no single country’s deficit has ever bulked as large relative to the global economy. The present crisis clearly foreshadows changes in geo-economic and geopolitical realities and may signal the passing of a great power and the emergence of a “new” power. It will also, in the short term, usher in a new regime of global governance and (re)regulation of financial markets. Maybe, business schools and international business practitioners can also revisit basic principles of economics and explore the relationships between economics, philosophy and politics again.

Lessons learned

As I have indicated, the present crisis provides us with an opportunity to reflect critically on business practices, including management education. As academics, some of us have been guilty of presenting simple, linear solutions to our students. We privilege quantifiable measures and success is determined by these measurable performance indicators. This is abundantly clear in courses in finance, strategic management and finance, particularly in MBA and executive education. Most MBA programs rely on American textbooks and case study materials, and they continue to constitute the international benchmark which typically reproduces this “American” standard and ethos (Liang and Wang, 2004). Of late, the quality of MBA programs has been and remains a subject of continual debate (Bennis and O’Toole, 2005; Cudd *et al.*, 1995; Hettenhouse, 1998; Mitroff and Churchman, 1992; Porter and McKibbin, 1988; Roome, 2005). Henry Mintzberg (2004), for example, has been fairly critical and has condemned MBA programs as promoting formulaic, generic, “cookie-cutter” responses to business management issues and practices, rather than training people involved to

manage (Pfeffer and Fong, 2002, 2004). For Mintzberg and his colleagues, education makes the issue of management worse if it merely involves a reproduction of the insubstantial knowledge and skills offered (Gosling and Mintzberg, 2006; Mintzberg and Gosling, 2002). Ghoshal (2005) similarly opines:

Business schools do not need to do a great deal more to help prevent future Enrons [...] They do not need to create new courses [...] Our theories and ideas have done much to strengthen the management practices that we are all now so loudly condemning (Ghoshal, 2005, p. 75; see also Pfeffer and Fong, 2002, 2004). In focusing on being scientific, developing models and techniques rather than the development of diagnostic capabilities, the MBA has become too instrumental and renders analysis simplistic. In the process, the MBA produces “critters with lopsided brains, icy hearts and shrunken souls” (Pfeffer and Fong, 2002, p. 80).

This concentration on models, financial indicators and performance and the lack of reflexivity within the MBA means that many managers simply do not develop or have the necessary skills to manage and/or be creative in their work and thinking (Weick, 2003). Some academics (e.g. Daniel Pink, 2004) have argued that the MFA (the Master of Fine Arts) may in fact be of more value than the MBA, because they promote creative, innovative, “out-of-the-box” thinking and conceptualisation of problems. Business leaders have similarly echoed such sentiments, noting the dearth of critical and creative thinking (Andrews and Tyson, 2004; Doria *et al.*, 2003). Despite these criticisms, “MBA fever” has shown little signs of abating.

Indeed, executive education, MBA and business education in general have all been criticized for its simplicity, positivity and linearity. Financial measures have all been overly privileged and short-term performances are lauded and celebrated through record *financial* profits. Business strategies and plans typically rely on a planning or design scenario but as the crisis shows, such approaches are inadequate; they do not provide us with real-time information nor are they complete. They also certainly do not take into account the dynamism inherent in market practices, and cannot factor in for example some behavioural practices, the run on credit, confidence quantum and herd behaviour. Equally problematic is the reliance on market solutions to “regulate” the economy. Indeed, many aspects of our “efficient” capitalism combined to produce the credit meltdown that now threatens ever more aspects of the global economy.

First and foremost was the private rating companies’ failure to accurately assess and honestly reveal the risks of securities based on a “bundle” of loans (securities that provide their owners with a portion of that bundle’s principal and/or interest). This was especially true for securities based on mortgage loans issued in the years of the housing boom. Investors around the world bought those securities based on those companies’ ratings. Their purchases financed the US housing bubble. We know now that those ratings were badly mistaken. Owners of those securities around the globe are taking staggering losses and reducing their lending to all borrowers. Anxiety about the risks of all sorts of borrowing has risen alongside deepening distrust of all risk assessments. Understanding why the rating companies contributed to this disaster opens a crucial window into today’s global credit crisis. It also teaches basic lessons about today’s globalised capitalism.

Since the crisis, it has become abundantly clear that global financial structures and systems are arcane and inadequate. Its structures are unsophisticated and management incompetent. The presumed sophistication of bank risk-assessment models were no better than fig leaves; financial analysts use the tools of financial

engineering for valuing options and constructing derivatives. To begin with, these techniques were used mainly to reduce uncertainty and hedge currency risk, to shape a trade limiting their exposure to the level in which the trader has confidence. Derivatives, such as swaps, options and other financial instruments, are used as tools limiting such exposure (Buenza and Stark, 2004; Tett, 2007). Again, this practice points to the effects of one-dimensional reliance on economic and financial modelling techniques, that is, as useful as they are, they are limited and cannot possibly account for the range of human responses and dynamism within complex business social environments. In part, this is because the prospects of a given stock cannot be distilled in a single figure since the balance sheet of an enterprise will always comprise a complex of receipts and liabilities in which the past, present and future uneasily coexist. This is highly complex, interactive and reiterative; the deregulation of financial markets also further increased this “complexity” (Ingham, 2004). Moreover, with financial data, there is often a problem of a sample size that is not large enough to capture their variance over a significant time period. In a long-term perspective the information available to someone basing themselves on today’s financial data is very limited; by excluding the future, it is impossible to estimate and determine the future[14].

Second, we need to grasp the structure of the financial industry and the concomitant industry that sells assessments of the risks attached to securities (including those based on loans). Even the most powerful corporations need the financial world to assess their own progress, to plan for the future and to generate growth. Financialisation, as such, encourages corporations to privilege financial functions, see themselves as accidental repositories of assets which, as circumstances change, must be continually broken up and reconfigured. Their credit-worthiness is determined by banks and ratings agencies, especially if they wish to reassure investors and ensure cheap access to capital (Sinclair, 2005).

Of the 150 rating enterprises around the world, three dominate – Moody’s, Standard and Poor’s and Fitch. *Barron’s Magazine* (Laing, 2007) reported on a Morgan Stanley research report which studied the 6,431 subprime residential mortgage-backed securities issued in 2006. Of these, 2,087 issues were rated AAA (the highest rating, the lowest risk); 1,266 were rated AA; and the rest were rated A or lower. Within one year of being issued, most of these securities were re-examined by the rating companies and over 50 per cent were downgraded, i.e. given a new, lower rating[15]. Clearly there was a problem with the ratings and the methodologies employed and whilst they could not be held solely for the crisis, they “were key enablers, by countenancing and legitimizing lethal capital structures”. As Brian Clarkson, the president of Moody’s, notes ruefully to *Barron’s*: “We misjudged the magnitude of the problem, the fact that what we expected to be a tropical disturbance ended up being a Category 5 hurricane”. As risk evaluation equations unravelled, so did financial markets’ ability to judge the worth of financial institutions’ balance sheets.

Clearly, therein lies in the problem of reliance solely on indicators which were provided by firms themselves and which were, in themselves, dense, incomplete and inadequate. The complexity of the deals and the relationships between the different logics of financial instruments were not well understood and certainly had grave unintended consequences. It is apparent that “independent risk assessments” are inadequate and ineffective. Years ago, when huge losses flowed from securities whose

issuers had misrepresented their risks, the reformist demand arose that someone should “independently” assess their risk so investors would be honestly informed. It turns out now that providers of such independent assessments can misrepresent them as disastrously as their issuers did and do. More fundamentally, it reveals a blinkered ideology – market fundamentalism – at work. For example, Alan Greenspan in addressing the Futures Industry Association in March 1999 insisted that any new regulations on derivative products “would be a major mistake”: “Regulatory risk-measurement schemes”, he added, “are simpler and much less accurate than banks’ [own] risk-measurement models” (Schwartz and Creswell, 2008). Appearing recently before the US Congress, Greenspan admitted to having made mistakes, being an ideologue with a misplaced faith in the ability of markets to self-regulate. Similarly, the clauses of Basel II that allow banks to use their own valuation models need to be struck down.

Financialisation, as I have indicated, privatises information that should be public, just as it commercializes everyday life. In addition, the techniques of financialisation could convert one type of income stream into another, or an asset into income or the other way round – reducing or avoiding tax. There are already calls for proper regulation and registration of these instruments. Would governments and regulation do any better? I think not. It is worth recalling that financialisation was born in a quite heavily regulated world, with some of its techniques designed to frustrate and defeat the regulators, just as others aimed at releasing “value” (Tett, 2007). As such, as a first step, the clauses of Basel II that allow banks to use their own valuation models need to be struck down before we address other pressing issues.

Most prescriptions for more regulation call for a new regulatory order where the state is a more active agent. This involves a network of mechanisms designed to constrain collective outbreaks of financial imprudence before they become global. For example, it has been suggested that there needs to be a new system of globally coordinated financial regulation (Eatwell and Taylor, 2000). How and what this new regulatory framework should do, however, remains unknown for the fundamental problem remains: full and complete information, transparency and greater democratic accountability, to which the corporate sector will not readily agree[16]. Governments similarly would not be able to provide such access as privacy and commercial information enables corporations to “protect” such information. We need therefore to be more sceptical of merely pushing for regulation, financial performance indicators and seek to deconstruct them. Similarly, calls for moral restraints and greater morality in business may lead to various institutional designs and strategies to build self-restraint in organisations and whilst certainly an important aspect of “regulating” corporate capitalism, such “moralism” fails to appreciate that “conduct” cannot be divorced from the wider context of social and economic power.

The actual and potential costs of the credit crunch are already huge, but they must be seen as part and parcel of the rhythm of financialised capitalism. The solution to the huge problems outlined above is not to abandon money or finance but to embed them in a properly regulated system. When properly embedded in structures of social control, finance can help to allocate capital, facilitate investment and smooth demand. But if it is unaccountable and unregulated it becomes sovereign in the reallocation process, and can grab the lion’s share of the gains it makes possible, including anticipated gains before they have been realised. The problem is aggravated as

financial intermediaries proliferate and take advantage of asymmetries in access to information and power imbalances. Such distortions multiply as “financialisation” takes hold. It is boosted as the logic of finance becomes ubiquitous, feeding on a commodification of every aspect of life and the life-course – student loans, baby bonds, mortgages, home equity release, credit-card debt, health insurance, individualised pension funds (Martin, 2002).

The issues canvassed here are clearly political issues and a return to the political is necessary if reforms are to be effective. Debates about corporations, the market, the state and their attendant effects need to be revisited. This would result in more regulation like the neoliberal governance response to Enron; its efficacy cannot be assumed and needs to be questioned and challenged (Soederberg, 2008). On a more mundane level, this requires greater elements of cooperation, collaboration and contestation of ideas within and across locales and countries. The financial crisis has brought forth a coalition of the unwilling with strange bedfellows and the task for critical scholars and practitioners is to ensure the process continues to influence the “new” centres of power that now claim to represent the interests of the people. This necessitates control, transformation, democratisation and a makeover of finance capital and the restoration and creation of “new” collective public services and infrastructures.

Notes

1. Despite knowing of the credit crunch in 2007 and dropping profits and share prices, senior executives were still awarded handsome pay-offs by their boards of directors. The CEOs of two Wall Street banks left their jobs in 2007 clutching lavish rewards for failure: \$160 million for Stanley O’Neal at Merrill and \$90 million for Charles Prince at Citigroup. At Bear Stearns the rescue left shareholders with \$10 a share compared with \$170 a year earlier. One-third of the bank’s shares were held by its employees, many of whom will also lose their jobs. Board members lost heavily on their holdings, but will remain very rich men since during the great CDO bonanza – in which their bank was a lead player – they had earned fees and bonuses of tens, or even hundreds, of millions. Morgan Stanley also announced a \$9.4 billion loss in the last quarter of 2007 but still increased the size of its bonus pool by 18 per cent, arguing that the losses had been concentrated in structured finance and should not blight the rewards of those who continued to be profitable. Employee compensation generally runs at 50 per cent of an investment bank’s revenue. In 2007 this rose sharply and in some cases came close to 100 per cent (Rajan, 2008).
2. Thousands of mortgages would be consolidated into one instrument and the resulting pool of debt subdivided into ten tranches, each representing a claim on the income accruing to the underlying mortgages; the lowest tranche represented the first to default, the second the next poorest-paying assets and so on up to the senior levels which were least likely to default. The different tranches’ vulnerability to default was hedged by taking out insurance, at rates varying according to the perceived level of default risk. Note that a feature of the securitising and tranching process is that the holders of a tranche would not know which specific mortgages they held until the default rate within a specified period became clear.
3. The reasons for this are complex having to do with the maturation of economies, in which the basic industrial structure no longer needs to be built up from scratch but simply reproduced (and thus can be normally funded out of depreciation allowances); the absence for long periods of any new technology that generates epoch-making stimulation and transformation of the economy such as with the introduction of the automobile (even the widespread use of computers and the internet has not had the stimulating effect on the economy of earlier transformative technologies); growing inequality of income and wealth,

which limits consumption demand at the bottom of the economy, and tends to reduce investment as unused productive capacity builds up and as the wealthy speculate more with their funds instead of investing in the “real” economy – the goods and services producing sectors; and a process of monopolisation (oligopolisation), leading to an attenuation of price competition – usually considered to be the main force accounting for the flexibility and dynamism of the system.

4. Although this behaviour of the banks goes far beyond all such activities, it is not unique. In a book published in 1974, called *The Bankers*, the author Martin Mayer criticised the banks for over-extending themselves.
5. In April 2008, the International Monetary Fund (2008, p. 12) was estimating that total losses were likely to come to \$945 billion: “Global banks are likely to shoulder roughly half of aggregate potential losses, totalling from \$440 billion to \$510 billion, with insurance companies, pension funds, money-market funds, hedge funds and other institutional investors accounting for the balance”.
6. This is most evident in financial trading particularly through trading in foreign exchange markets and in derivatives. A *New York Times* (NYT) report noted that in 2006, the financial sector’s share of total corporate profits in the USA rose from 8 percent in 1950 to 31 percent in 2006 (*New York Times*, 11 December 2007)
7. There are a number of studies linking financialisation, neoliberalism and dollar hegemony. See for example, Harvey (2005), Glyn (2006) and Phillips (2006, 2008).
8. David Harvey (2005) sees this process as a process of accumulation by dispossession through which working people are divested of their rights and assets, for example, the privatization of water, health care and education, goods that had been or should be entitlements. The sale of these “goods” in private markets dispossessed those who could not afford what should have been theirs by right. At the global level, this has resulted in loss of government benefits, dispossessing people through debt repayment and the liberalisation of the local economy to benefit foreign investors and domestic elites.
9. Ironically, as Martin Wolf (2006) has shown, the economy grew twice as fast in the golden age (circa 1945-1873) as in the succeeding era of globalisation. See also the more scholarly work of Maddison (2001).
10. Beginning in January 2001, the Federal Reserve Board lowered interest rates in 12 successive rate cuts, reducing the key federal funds rate from 6 percent down to a post-Second World War low of 1 percent by June 2003. Low interest rates tempted many homeowners to go deeper into hock by re-mortgaging. As Robert Brenner (2006) showed, the asset bubbles – first technology shares and then houses – helped to maintain the mirage of a buoyant economy and consumption growth, but only at the cost of growing personal and corporate indebtedness. This expanded the number of mortgage borrowers despite the increasing prices of houses. Many of these mortgage loans amounted to 100 percent of the appraised value of the house and could only be sustainable as long as house prices continued to rise and rates remained low. Heavy borrowing is, as such, used to buy up financial assets, not based on the income streams they will generate but merely on the assumption of increasing prices for these assets.
11. In a recent book, Fleckenstein and Sheehan (2008) have critically appraised Alan Greenspan’s tenure at the Federal Reserve. In their view, many bad decisions were enacted, contrary to popular belief: for example, the stock market crash of 1987; the Savings And Loan crisis; the collapse of Long Term Capital Management; the tech bubble of 2000 and the credit bubble and real estate crisis of 2007.
12. Michael Moran, for example, has pointed out that there is a long history of popular protest and discontent triggered by financial scandals and crises in the USA and that far from

undermining the institutional and regulatory basis of financial expansion, have repeatedly been “pacified” through the process of further “codification, institutionalisation and juridification” (Moran, 1991, p. 13). Furthermore, financial elites have been adept at responding to these pressures and able to use them to create regulatory frameworks beneficial to them.

13. In October 1907, a hundred years before the onset of the current subprime crisis, the USA experienced an 11 percent decline in GDP and accelerating runs on its banks (Studenski and Krooss, 1965; Chernow, 1990). In the absence of a central bank, the US treasury and Wall Street relied on J.P. Morgan to organise the bailout. As Henry Paulson had done, Morgan let the giant Knickerbocker Trust go under in spite of its holding \$50million of deposits for 17,000 depositors, fuelling further runs and panic. Finally, using \$25 million provided by Treasury and a similar amount provided by Wall Street, Morgan then dispensed the liquidity to calm the markets (Chernow, 1990, pp. 123-5). This chain of events is not dissimilar to what is currently happening in the USA.
14. Quantitative economists, however, continue to naively believe in a simple numerical discount rate which can be used to calculate the net present value of a future stream of income or payments. This flattening process – also brought on by “mark to market” and “fair value” accounting – robs the future of its most unsettling characteristics: it is at once unpredictable and carries the past within it.
15. Morgan Stanley compared the rate of downgrades in 2006-2007 to the historical norm for 1998- 2006. The results are stunning. Among AAA-rated subprime residential mortgage-backed securities, 4 per cent were downgraded (whereas the historical norm was 0.12 per cent). Among AA rated securities, 12.2 per cent were downgraded (versus an historical norm of 0.64 per cent). Of securities rated A and below, some 97 per cent experienced downgrades (versus the historical norm of 1.24 per cent).
16. George Soros (2008) calls for “a clearing house or exchange with a sound capital structure and strict margin requirements to which all existing and future contracts would have to be submitted”.

References

- Augar, P. (2006), *The Greed Merchants: How the Investment Banks Played the Free Market Game*, Penguin, London.
- Augar, P. (2008), “Do not exaggerate investment banking’s death”, *Financial Times*, 22 September.
- Bennis, W. and O’Toole, J. (2005), “How business schools lost their way”, *Harvard Business Review*, Vol. 85 No. 5, pp. 96-104.
- Brenner, R. (2002), *The Boom and the Bubble*, Verso, London.
- Brenner, R. (2006), *The Economics of Global Turbulence: The Advanced Capitalist Economies from Long Boom to Long Downturn, 1945-2005*, Verso, London.
- Buenza, D. and Stark, D. (2004), “Tools of the trade: the socio-technology of arbitrage in a Wall Street trading room”, *Industrial and Corporate Change*, Vol. 13 No. 2, pp. 369-400.
- Bukharin, N. (1929), *Imperialism and World Economy*, Merlin Press, London.
- Chernow, R. (1990), *The House of Morgan*, Simon & Schuster, New York, NY.
- Cudd, M., King, J.O. and O’Hara, B. (Eds) (1995), “Assessment of the nature and status of the MBA restructuring trend”, *Journal of Education for Business*, Vol. 71 No. 4, pp. 44-8.
- Dapice, D. (2008), “Bad spell on Wall Street”, 24 January, available at: www.Policyinnovations.org

- Doria, J., Rozanski, H. and Cohen, E. (2003), "What business needs from business schools", *Strategy and Business*, Vol. 32, pp. 39-45.
- Eatwell, J. and Taylor, L. (2000), *Global Finance at Risk: The Case for International Regulation*, Polity Press, Cambridge.
- Ferguson, N. (2008), "Full Marx", *Financial Times*, 17-18 August.
- Fleckenstein, W. and Sheehan, F. (2008), *Greenspan's Bubbles: The Age of Ignorance at the Federal Reserve*, Wiley, New York, NY.
- Foster, J.B. (2007), "The financialisation of capitalism", *Monthly Review*, Vol. 58 No. 11, pp. 8-10.
- Ghoshal, S. (2005), "Bad management theories are destroying good management practices", *Academy of Management Learning & Education*, Vol. 4 No. 1, pp. 75-91.
- Glyn, A. (2006), *Capitalism Unleashed*, Oxford University Press, Oxford.
- Gosling, J. and Mintzberg, H. (2006), "Management education as if both matter", *Management Learning*, Vol. 37 No. 4, pp. 419-28.
- Gray, J. (2008), "A shattering moment in America's fall from power", *Sunday Observer*, 29 September.
- Harvey, D. (2005), *A Brief History of Neoliberalism*, Oxford University Press, Oxford.
- Hettenhouse, G.W. (1998), "The new MBA: a journey just begun", *Business Horizons*, Vol. 41 No. 4, pp. 45-8.
- Ingham, G. (2004), *The Nature of Money*, Oxford University Press, Oxford.
- International Monetary Fund (2008), *Global Financial Stability Report: Containing Systemic Risks and Restoring Financial Soundness*, International Monetary Fund, Washington, DC, available at: www.asiaimf.com/global-financial-stability-report-2008.html (accessed 30 July 2008).
- Liang, J. (2007), "Failing grade", *Barron's Magazine*, 24 December.
- Liang, N. and Wang, J.Q. (2004), "Implicit mental models in teaching cases: an empirical study of popular MBA cases in the United States and China", *Academy of Management Learning & Education*, Vol. 34, pp. 397-413.
- Maddison, A. (2001), *The World Economy: A Millennial Perspective*, OECD, Paris.
- Magdoff, H. and Sweezy, P.M. (1983), "Production and finance", *Monthly Review*, Vol. 35 No. 1, pp. 11-12.
- Martin, R. (2002), *The Financialization of Daily Life*, Temple University Press, Philadelphia, PA.
- Marx, K. (1909), *Capital*, Vols 1-3, Charles H. Kerr, Chicago, IL.
- Mintzberg, H. (2004), *Managers not MBAs: A Hard Look at the Soft Practices of Managing and Management Development*, Berrett-Koehler, San Francisco, CA.
- Mintzberg, H. and Gosling, J. (2002), "Reality programming for MBAs", *Strategy and Business*, Vol. 26 No. 1, pp. 28-31.
- Mitroff, I.I. and Churchman, C.W. (1992), "Debate – MBA: is the traditional model doomed?", *Harvard Business Review*, Vol. 70 No. 6, pp. 128-40.
- Moran, M. (1991), *The Politics of the Financial Services Revolution*, Macmillan, New York, NY.
- Palley, T.I. (2007), "Financialization: what it is and why it matters", Working Paper Series, No. 153, November, Political Economy Research Institute, available at: www.peri.umass.edu/Publication.236 + M505d3f0bd&c.0.html
- Pfeffer, J. and Fong, C.T. (2002), "The end of business schools? Less success than meets the eye", *Academy of Management Learning and Education*, Vol. 1 No. 1, pp. 78-96.

-
- Pfeffer, J. and Fong, C. (2004), "The business school 'business': some lessons from the US experience", *Journal of Management Studies*, Vol. 41 No. 8, pp. 1503-20.
- Phillips, K. (2006), *American Theocracy*, Viking, New York, NY.
- Phillips, K. (2008), *Bad Money*, Viking, New York, NY.
- Pink, D. (2004), "The MFA is the new MBA", *Harvard Business Review*, February, pp. 21-2.
- Porter, L.W. and McKibbin, L.E. (1988), *Management Education and Development: Drift or Thrust into the 21st Century?*, McGraw-Hill, New York, NY.
- Rajan, R. (2008), "Bankers' pay is deeply flawed", *Financial Times*, 9 January.
- Roach, S. (2007), "America's inflated asset prices must fall", *New York Times*, 16 December.
- Roome, N. (2005), "Teaching sustainability in a global MBA", *Business Strategy and the Environment*, Vol. 14, pp. 160-71.
- Rubin, R. (2003), *In an Uncertain World: Tough Choices from Washington to Wall Street*, Random House, New York, NY.
- Rude, C. (2004), "The role of financial discipline in imperial strategy", in Panitch, L. and Leys, C. (Eds), *Socialist Register 2005: The Empire Reloaded*, Merlin Press, London.
- Scholtes, S., Chung, C. and Brewster, D. (2008), "JPMorgan swoops in again", *Financial Times*, 26 September.
- Schwartz, N.D. and Creswell, J. (2008), "What created this monster?", *New York Times*, 23 March.
- Shiller, R. (2008), *The Subprime Solution: How Today's Global Financial Crisis Happened, and What to Do about It*, Princeton University Press, Princeton, NJ.
- Sinclair, T. (2005), *The New Masters of Capital*, Cornell University Press, Ithaca, NY.
- Sloan, A. (2008), "On the brink of disaster", *Fortune*, 14 April, p. 82.
- Soederberg, S. (2008), "A critique of the diagnosis and cure for 'Enronitis': the Sarbanes-Oxley Act and neoliberal governance of corporate America", *Critical Sociology*, Vol. 34 No. 5, pp. 657-80.
- Soros, G. (2008), "The false belief at the heart of the financial turmoil", *Financial Times*, 3 April.
- Stelzer, I. (2008), "Old 'friends' are happy to blame US for the chaos", *Sunday Times*, 5 October.
- Studenski, P. and Krooss, H. (1965), *Financial History of the United States*, McGraw-Hill, New York, NY.
- Tett, G. (2007), "Volatility wrecks financial world's value at risk models", *Financial Times*, 12 October.
- Tett, G. and Davies, P. (2007), "Out of the shadows: how banking's secret system broke down", *Financial Times*, 17 December.
- Walker, D. (2008), "Washington must heed fiscal alarm bell", *Financial Times*, 22 September.
- Weick, K. (2003), "Positive organising and organisational tragedy", in Cameron, K.S., Dutton, J.E. and Quinn, R.E. (Eds), *Positive Organisational Leadership*, Berrett-Koehler, San Francisco, CA, pp. 66-80.
- Weisman, S.R. (2008), "Financial regulators suggest tighter controls", *New York Times*, April 12.
- Wessel, D. (2008), "Ten days that changed capitalism: officials improvised to rescue markets; will it be enough?", *Wall Street Journal*, 27 March.
- Wolf, M. (2006), *Why Globalization Works*, Yale University Press, New Haven, CT.
- Wolf, M. (2007), "Unfettered finance is fast reshaping the global economy", *Financial Times*, Vol. 18, June.

Further reading

- Allen, F. and Gorton, G. (1993), "Churning bubbles", *Review of Economic Studies*, Vol. 60 No. 4, pp. 813-36.
- Blackburn, R. (2008), "The subprime crisis", *New Left Review*, March/April, available at: www.newleftreview.org/?view=2715 (accessed 30 September 2008).
- Bruner, R. and Carr, S.D. (2007), *Panic of 1907: Lessons Learned from the Market's Perfect Storm*, Wiley, New York, NY.
- Bryan, D. and Rafferty, M. (2006), *Capitalism with Derivatives: A Political Economy of Financial Derivatives, Capital and Class*, Palgrave, London.
- Hirst, P. and Thompson, G. (1996), *Globalisation in Question*, Polity Press, Cambridge.
- Holzer, B. and Millo, Y. (2005), "From risks to second-order dangers in financial markets: unintended consequences of risk-management systems", *New Political Economy*, Vol. 10 No. 2, pp. 223-45.
- Jackson, T. (2007), "Crazy crisis may herald the end of new derivative folly", *Financial Times*, 24 December.
- Kindleberger, C. and Aliber, R. (2005), *Manias, Panics, and Crashes*, Wiley, Hoboken, NJ.
- Labaton, S. (2008), "SEC concedes oversight flaws fueled collapse", *New York Times*, 26 September.
- Maddison, A. (1991), *Dynamic Forces in Capitalist Development: A Long-run Comparative View*, Oxford University Press, Oxford.
- Magdoff, H. and Sweezy, P.M. (1988), *The Irreversible Crisis*, Monthly Review Press, New York, NY.
- Orhangazi, O. (2007), "Financialization and capital accumulation in the non-financial corporate sector", Working Paper Series, No. 149, October, Political Economy Research Institute, available at: www.peri.umass.edu/Publication.236+M547c453b405.0.html
- Shiller, R. (2006), *Irrational Exuberance*, Doubleday, New York, NY.
- Sunderland, R. (2008), "Now is our chance to change capitalism for good. Let's take it", *Sunday Observer*, 28 September.

About the author

Loong Wong works at the University of Canberra, Australia. He has taught and researched at universities in Australia, Denmark, New Zealand and Malaysia. His research has focused on international business practices and he has published in the *Journal of Contemporary Asia*, *Asian Business and Management*, *Chinese Management Studies*, *Prometheus*, and *Information Society* amongst others. He is also active in a range of public interest and social movements. Loong Wong can be contacted at: loong.wong@canberra.edu.au