Mapping the Faultlines: A Historical Perspective on the 2008-2009 World Economic Crisis

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Selected Delegates to the Bretton Woods Conference, 1944

At the conclusion of his widely popular 1987 study of the global political economy, titled *The Rise and Fall of the Great Powers,* English born and Oxford trained Yale historian Paul Kennedy observed, "The task facing American statesmen over the next decades . . . is to recognize that broad trends are under way, and that there is a need to 'manage' affairs so that the *relative* erosion of the United States' position takes place slowly and smoothly" (Kennedy, 1989: 534). In chronicling the decline of the U.S. as a global power, Kennedy compared measures of U.S. economic health, such as its levels of industrialization and growth of real gross national product (GDP), against those of Europe, Russia, and Japan. What he found was a shift in the global political economy over the last fifty years generated by underlying structural changes in the organization of its financial and trading systems.

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Kennedy's arguments about a structural decline in U.S. power are shared by other critical historical thinkers who similarly see global political economy through a historical lens. Andre Gunder Frank (*ReOrient*, 1998), Emmanuel Todd (*The Breakdown of the American Order,* 2002), Giovanni Arrighi (*Adam Smith in Beijing: Lineages of the Twenty-First Century*, 2007), Niall Ferguson (*The Ascent of Money,* 2008), and Fareed Zakaria (*The Post-American World*, 2008) all use history to argue that U.S. power is declining in parallel to a rise of regional powers, and particularly China. In their view, this decline is not the consequence of "bad behaviour," even if bad behaviour has occurred, but is the function of structural changes that have occurred as the global economy attempts to adapt to changing historical circumstances. Our analysis of the roots of the present crisis similarly finds that historical change has attacked the structures of the present system in ways that its original design did not anticipate, and argues along with Kennedy, Frank, Todd, Arrighi, Ferguson, and Zakaria that these changes are long-term trends that cannot be mitigated by regulatory reform but that accommodated through structural adaptations that recognize emerging political, economic, and environmental realities that cannot be contained by Euro-American global capitalism.

Immediate Cause of the Present Crisis

As of this writing, economic opinion has converged around a consensus that the immediate cause of the present global crisis was sub-prime mortgage lending in the United States that spread through an interconnected global financial system.[1] We argue that this sub-prime lending, which began in the U.S. in the early 2000s and spread to parts of Europe thereafter, was generated not for the purposes of either providing housing to those previously excluded from home ownership, as many mainstream economists and politicians have argued, but in response to a massive accumulation of capital in the

[1] Sub-prime mortgages carry a higher risk to the lender (and therefore tend to be at higher interest rates) because they are offered to people who have had financial problems or who have low or unpredictable incomes.

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international financial system that required profit-oriented investment.[2] While sub-prime lending was accompanied by the development of new speculative financial instruments, in operation it functioned as part of a money merry-go-round that was created within global capitalist financial structures to enable the expansion of global capitalism. This expansion involved privatizing important elements within the system, such as currency management and banking, in ways that removed them from public scrutiny and regulation.

By closely examining how sub-prime mortgage lending served the global money merry-go-round, we hope to offer insights into the more pernicious features of the global capitalist political economy that have plagued it with reoccurring economic crises since its creation at Bretton Woods in 1944. Of particular importance has been the role of the U.S. in acting as the economic policeman for this system, and the way that it has encouraged, rather than discouraged, a proliferation of complex investment tools that masked the true nature of underlying capitalist economic activity. In so doing, the U.S. oversaw a structural transformation of international banking that interconnected global financial institutions and exposed them to speculative losses they little understood. This framed the present crisis as the first truly global economic contraction in more than seventy years, making it a direct challenge to continuing U.S. economic and political leadership. As capitalist governments scramble to regain control, they are confronted not only with the failure of U.S. leadership, but also the inadequacies of the Bretton Woods system to accommodate the global shifts and systemic fault-lines that now infect global economic and political relationships.

Sub-prime Mortgages and the Money Merry-go-round

As the term suggests, "sub-prime" mortgage lending was highly speculative

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[2] In "Global Imbalances and the Financial Crisis" (*Council on Foreign Relations*, Special Report No. 44, March 2009), Steven Dunaway characterized this development as "imbalances between savings and investment in major countries," which he attributes to flaws in the international financial system that allowed governments, as well as private investors, to evade the consequences of their economic choices.

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because it targeted potential buyers that otherwise could not qualify for standard home loans. The "sub-prime" element in these loans was the below market rate of interest charged during the initial loan period, which would last 3-5 years, depending on the loan terms. However, once the initial period past, the rate was destined to rise, raising the underlying mortgage payment. Additionally, many, if not most, of these loans were made with little or no down payment. Instead of the 5% or 10% usually required in standard home mortgages, down payments were effectively folded back into the original loan, which when closing costs and fees were added made the amount of the loan exceed the stated price of the house. The underlying premise of sub-prime lending was that borrowers would be able to accommodate higher payments in the future, either because their incomes would increase, or because the value of the house itself would continue to rise, creating equity for the borrower where none had earlier existed.

The amount of global capital devoted to U.S. sub-prime lending was staggering, amounting at one point to some $12 trillion in the U.S. alone.[3] Yet, even as sub-prime mortgages carried risks related to their character, these risks were not equally distributed among the borrowers, lenders, and ultimate holders of these mortgages. For example, loan originators, who earned large fees for making but not managing these loans, were exposed only to the risk that the market would collapse, leaving them with few customers. On the other hand, borrowers bore the risk that their income would not keep up with the increase in their mortgage costs, or that the value of their property would decline, leaving them "upside down" on their mortgage, a condition where the value of their mortgage exceeded the value of their house. However, the greatest risk was born by the ultimate holders of the mortgage because they had no direct knowledge of the actual value of the property, the circumstances of the borrower, or the prospective long-term value of the home. While the low risk, high-profit motive of the loan originators is apparent, and the deferred risk motives of the borrower can be understood, it is still

[3] John Gittelsohn, "Ex-subprime exec works flip side of the market," *The Orange County Register*, March 16, 2009, <http://www.ocregister.com/articles/span-style-font-2334783-weight-bold> [accessed in April 2009].

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difficult to understand why sub-prime mortgages became such a major part of the U.S. home loan industry, or why the ultimate holders of these loans would agree to buy them.

On closer inspection, sub-prime mortgages were driven by lending practices that created an illusion of opportunities for risk free profit. With huge amounts of capital pouring into the U.S. through the purchase of U.S. treasury notes and corporate stocks and bonds, U.S. interest rates, including mortgage interest rates, fell steadily through much of the 2000s. Yet, at the same time opportunities for traditional investments in the U.S. were shrinking as the U.S. increasingly bought more and more of its goods and services from low-wage countries. This created the "problem" of the excess capital requiring new outlets for profitable investment, which was solved by channelling it into real estate at all levels. Sub-prime loans thus became a popular investment because they offered a quick profit to the lending industry, and the appearance of long-term profits to the ultimate managers of the loans, based on the seemingly unstoppable rise in real estate values.

The loan originators in the U.S. were led by Country Wide, which as its name suggests was a major national mortgage lender, and Freddie Mac and Freddie Mae, two quasi public lending agencies that originated home loans on behalf of the U.S. government. These and other, smaller lenders, were encouraged to enter the sub-prime market by public officials, who wanted to both appear to generously extend home ownership to the working class and poor and a profitable outlet for money invested in Treasury notes. Seeing the potential for speculative profits, major banks joined the sub-prime parade by buying up and repackaging sub-prime loans into investment bundles that mixed them with traditional loans and resold them at a considerable profit to other investors in the U.S. and throughout the world. Along the way, various security ratings services got into the act by offering assurances, for a price, that these bundled loans were AAA rated as low risk investments. As the money merry-go-round spun faster and faster, generating quick and seemingly risk-free profits to lenders, banks, and the U.S. Treasury, no one seriously questioned how this was possible.

The illusion of risk-free profit was promoted by the way that the global financial system had become enmeshed in a web of privatized, quick-profit schemes generated by capitalist speculators. In the decade between the mid-1990s, when the global economic

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system was transformed and largely privatized, and the first tremors of crisis in 2007, an alphabet soup of new speculative financial tools emerged. At the time, and under the influence of a powerful capitalist narrative of profit generated by neo-liberalism, few asked and even fewer understood how these tools worked, but several have now been demystified and exposed as reckless, if not criminal, covers for looting the system. One of the most popular tools was a financial "derivative," such as the bundling and reselling of sub-prime loans, which simply referred to several ways of disguising the nature of an investment and its risks from potential investors. Citibank, Morgan Stanley, and Lehman Brothers were major sources of these derivatives, which earned them huge profits during the 2000s. A second and particularly onerous tool was the "credit default swap," CDS, which acted as form of insurance to cover the risk that an investment might go sour. American International Group (AIG), which was a relatively small insurance company in the 1990s, gorged itself on CDSs during the 2000s to become among the largest insurers in the global market. But unlike a prudent insurer, AIG paid out the fees it earned for issuing a CDS to its own corporate officers and shareholders, keeping only a minimum of capital in reserve. As investigators subsequently discovered, driven by insane profits none of these capitalist corporations did much to determine the actual risks involved in derivative or CDS investments, leaving the entire structure of global finance exposed.

For their part, sub-prime borrowers, who were generally members of the working class that had long been excluded from home ownership, either accepted sub-prime mortgages because they were their own choice, or were pushed into it by the lenders who saw them only as profit opportunities. Few of them, however, had any real knowledge of how sub-prime mortgage lending worked, or about the longer term risks that they accepted along with their sub-prime loans. Rather, lenders commonly enticed their applications by assuring them that the risks were small and that they would be able to manage the loan in the future because housing prices would continue to rise, allowing them to either sell for a profit or take out a second mortgage to cover the difference. Once the loan approved, these lenders disappeared, leaving the borrowers to grapple with the consequences as the lenders escaped with their fees as the loans themselves were sold and then resold to other investors.

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How Banks Failed

The money merry-go-round of sub-prime lending could not have developed without the changes in the global financial system that that allowed for the accumulation of the vast amounts of capital that it required. These changes, generally understood as neo-liberal reforms, included both the promotion of new privatized financial investment tools, and the deregulation of banking, which spread through the U.S. controlled Bretton Woods economic system through its interlinking of global financial institutions. This allowed high-risk sub-prime mortgages to insinuate themselves into the fabric of ongoing financial activities without a test of their underlying value. As a consequence, second, third, fourth, and fifth tier investors, many of them international banks, were never required to account for the value of the sub-prime mortgages that they held, until the system began to unravel in 2007.

Looking at the present crisis as interlinked problems with the valuation of bank assets, it is easier to see how the collapse of sub-prime lending acted to constrict the free flow of money necessary to keep the global capitalist system working. The first chapter in this story came when world stock markets peaked and began a sympathetic decline in October 2007, signalling that a global rather than national economic crisis was unfolding. The role of banking in the crisis then became apparent when news of a sharp drop in the profits of Citigroup led to a sharp fall on the New York Stock Exchange in January 2008, which then spread to global markets on January 21 as other U.S. and European banks disclosed they also had suffered massive losses in 2007. Thereafter, several key financial dominos in the global system began to fall, beginning with the venerable Wall Street investment bank Bear Sterns, which was rescued by the U.S. Federal Reserve in a controversial move in March 2008 that merged it with the Bank of America as it was nearing bankruptcy.[4] The crisis was held in relative suspension for the next several

[4] The U.S. Federal Reserve is a quasi-public central banking system managed by a board whose members are appointed by the U.S. President and confirmed by the U.S. Congress, but who act independently of both political institutions in setting U.S. monetary policy. This independence in the past has led to conflicts

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months as capitalist speculators debated how U.S. government actions might rescue the global economy through various stimulus schemes that would inject hundreds of billions of dollars into the U.S. national economy, and through various schemes that would rescue the U.S. banking system. The debate ended, however, in September 2008 when Lehman Brothers, a 158-year old international investment bank and one of the largest financial institutions in the U.S., was forced into bankruptcy.

The failure of Lehman Brothers was immediately caused by the reluctance of the U.S. government to step in with yet another bank rescue, which was attributed to a split within capitalist policymakers between those that favoured purely "free-market" economics that would allow any institution to fail in a competitive marketplace, and liberal capitalists who argued that Lehman Brothers was "too large to fail" because its failure would trigger a "credit crunch," or inability of banks to provide loans except to their very best customers, as banks withdrew from lending in the face of uncertainty about loan risks. The decision to let Lehman Brothers fail first demonstrated that the risks of a credit crunch were very real, but also revealed how governments played a key role in managing capital markets. The relationship between banks and the government economic management had been first raised by commentators with the rescue of Bear Sterns, who observed that its rescue was required "to prevent key financial players from going under,"[5] but without noting just who qualified as a "key" financial player. Because the capitalist markets reacted favourably at the time, the rescue of Bear Sterns became a further argument in favour of rescuing Merrill Lynch, Goldman Sachs, and Morgan Stanley, three other giant investment groups, after Lehman Brothers failed. Thus, gripped by fear of a total financial meltdown the U.S. government began to pour hundreds of millions of dollars directly into major U.S. banks, predicated on the ability of this rescue, deemed the "Toxic Asset Relief Program" (TARP), to relieve the speculative pressures that were enveloping the U.S. banking system. However, this too failed to stem

between the political interests of the U.S. government and the economic interests of private U.S. banks when the Fed acts to protect financial capitalist at the expense of the interests of industrial capitalist.

[5] Neil Irwin and David Cho, Washington Post, March 17, 2008 <http://www.washingtonpost.com/wp-dyn/content/article/2008/03/16/AR2008031601672_pf.html> [accessed in September 2008].

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the crisis and other and even larger and more visible interventions by the U.S. and other capitalist governments followed during the Fall of 2008 and Winter of 2009 – which together were the largest synchronized government interventions in markets since the 1930s.

Even as the U.S. and European governments coordinated action in November 2008, the crisis intensified in the U.S. and Europe and spread to other national banks and economies, with a particularly vicious impact on those, such as Iceland, that had been most active in the global financial system. This radically changed forecasts about the global economy, with the International Monetary Fund (IMF) first revising its projections for real global 2008-2009 GDP growth downward in November 2008 to 3.7% in 2008 and 2.2% in 2009, against its earlier projections of 3.9% in 2008 and 3.0% in 2009.[6] It also saw that the distribution of growth would be uneven, with advanced economies actually contracting by .25% in 2009, which would be its first annual contraction for those countries since World War Two, and 2009 GDP growth in emerging economies receding to 5.1%, instead of the 6.1% earlier forecast. Most notably, the IMF predicted that the U.S. economy would shrink in 2009 by 0.7% and the U.K. would suffer the greatest decline among Western European countries by contracting 1.3%. Taken as a whole, these projections meant that emerging economies would provide all real global GDP growth in 2009 and bear the burden of rescuing global economic performance after 2010.[7]

The revisions made by the IMF in November quickly proved inadequate, and it was forced to update them again on January 28, 2009, projecting even slower growth, with the world economy assuming its slowest pace since World War Two. In this case, overall growth was expected to be only 0.5% in 2009, with economic activity contracting in the U.S. by 1.5%, in the Eurozone by 2%, and in Japan by an even greater 2.5%. This

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[6] Gross domestic product is a measure of economic activity in a country that aggregates all the services and goods produced in a year. There are three main ways of calculating GDP-by measuring national output, income and expenditure.
[7] World Economic Outlook Update. Rapidly Weakening Prospects Call for New Policy Stimulus, IMF, November 6, 2008, <http://www.imf.org/external/pubs/ft/weo/2008/update/03/index.htm> [accessed in January 2009].

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revision also projected that growth in the developing economies of China and India would decrease to 5.75% and 5% respectively, thus limiting their ability to act as major engines for the world economy.[8] This led IMF Chief Economist Oliver Blanchard to admit that, "We now expect the global economy to come to a virtual halt." Then, in March 2009 the IMF further warned that the world economy would likely to contract this year in a "Great Recession" that would be "the worst performance in most of our lifetimes."[9]

The IMF was not alone in its gloomy assessment as the World Bank reported in December 2008 in *Global Economic Prospects 2009* that world trade would contract in 2009 for the first time since 1982, with the decline driven primarily by a sharp drop in demand as the global financial crisis imposed a rare simultaneous recession in high-income countries and a slowdown across the emerging economies.[10] At the national level, the U.S. Federal Open Market Committee (FOMC) similarly revised its earlier economic projections on February 18, 2009, predicting that 2009 economic growth would slow further, while inflation and unemployment would increase.[11] These revisions were understandably hostage to the crisis itself and further revisions were likely to follow that would drive down expectations even further.[12]

As dark as these dark forecasts were, they represented a conservative view by mainstream capitalist economists who tried to put the best face on events. Thus, these

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[8] World Economic Outlook, IMF, January 28, 2009, <http://www.imf.org/external/pubs/ft/survey/so/2009/RES012809A.htm> [accessed in February 2009].

[9] "Global economy to contract in 'great recession,' IMF warns," *the International Herald Tribune*, 10 March 2009, <http://www.iht.com/articles/reuters/2009/03/10/business/OUKBS-UK-IMF-AFRICA-STRAUSSKAHN.php> [accessed in March 2009].

[10] Global Economic Prospects 2009, Prospects for the Global Economy, World Bank, 9 December 2008, <http://web.worldbank.org/WEBSITE/EXTERNAL/EXTDEC/EXTDECPROSPECTS/EXTGBLPROSPECTS/0,,contentMDK:20665751~menuPK:3023135~pagePK:2904583~piPK:2904598~theSitePK:612501,00.html> [accessed in January 2009].

[11] "US FED: Fed Worsens Projections For 2009 GDP, Inflation, Unemployment," *Forbes.com*, 18 February 2009, <http://www.forbes.com/feeds/afx/2009/02/18/afx6067181.html> [accessed in February 2009].

[12] It should be understood that official projections rely on economic data generated by governments, and that in the U.S. the process of producing this data has become highly politicized with the process of data collection and reporting increasingly tilted toward underreporting politically sensitive data. See, e.g. John Williams, *Shadow Government Statistics*, <http://www.shadowstats.com/> [accessed in December 2009].

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reports minimized or ignored how this and earlier crises imposed long-term structural damage on the global economy, choosing rather to blandly predict an economic "recovery" in 2010, based on past experience rather than on the crisis' peculiar global and financial characteristics. For example, in its 2009 forecast the IMF forecast a 2010 recovery with the caveat that the economic contraction would be more prolonged in certain countries, including the U.S. and the U.K.[13] Yet, with past experience as a guide these official forecasts look increasingly weak as new measurements of economic activity reveal a much deeper annual decline in the U.S. fourth quarter GDP, far beyond the 3.8% earlier estimated, with private U.S. investment falling in that quarter at a 21% annual rate and the Japanese economy contracting at a 12% annual rate.[14] Thus, prudence argues that official estimates be seen more as self-interested "guesstimates" than as fact, with a parade of downward revisions into the future.

All of these separate facets of the present crisis came together in the banking system because each of them lowered the underlying value of bank assets, which limited the ability of banks to provide credit. With an integrated global economy functioning through an interconnected financial system, whatever happens within the system, whether at the centre or periphery, becomes a factor in determining the value of assets held by banks. This creates a circular process, where a crisis in any part of the global economic system translates into financial factors that feed into global finance creating a crisis in proportion to the weight of the initial crisis that initiated the cycle. Thus, because the U.S. dominates the global economy and leads its financial sector, its sub-prime mortgage lending and crisis of confidence in bank assets has become the defining factor in generating a global financial and now economic crisis. As political economists understand, this is what makes economics political and not just a collection of calculations.

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[13] Shobhana Chandra and Alex Tanzi, "U.S. Economy May Shrink 1.5% in 2009 as Recession Stymies Fed," *Bloomberg*.com, 13 January 2009, <http://www.bloomberg.com/apps/news?pid=20601068&sid=aTv0Xmo40wr8&refer=home>.

[14] Connor Dougherty and Kelly Evans, "Economy in Worst Fall Since '82," *Wall Street Journal*.com, 28 February 2009, <http://online.wsj.com/article/SB123574078772194361.html> [accessed in March 2009].

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It also is the case that the effects of the global crisis will not be evenly shared among developed or developing economies, and what happens within the countries of the E.U. will differ, and in some significantly, from what happens in the U.S. or Japan. This is born out by the way that new Central European members of the E.U. and the poorer economies in the global system are experiencing the crisis with far more limited resources, tools and prospects,[15] and is chronicled in the plight of developing economies that have already been forced to seek emergency funding from the IMF and World Bank, or face the dark near-term prospect of not meeting their basic needs.[16]

A Neo-Liberal System

As earlier observed, structural changes in the global economy associated with *neo-liberalism* created the conditions for the current crisis. These structural changes, however, involved not only changes in formal relationships and the distribution of power over the global economy, but were ideological in that they justified those changes and encouraged people to buy into a neo-liberal set of values. As Peter Gowan observed,

> The housing bubble had a double effect: it not only made American consumers feel confident that the value of their house was rising, enabling them to spend more; it was reinforced by a strong campaign from the banks, . . . urging them to take out second mortgages and use the new money for consumption spending.[17]

How and when neo-liberalism appeared in the global political economy becomes an important question in uncovering the roots of the present crisis, which requires revisiting

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[15] See, e.g., "How to Prevent a Financial Crisis in Hungary and Avoid a Domino Effect," January 2009, <http://www.xpatloop.com/news/how_to_prevent_a_financial_crisis_in_hungary_and_avoid_a_domino_effect> [accessed in February 2009].

[16] "Global short-term growth revised downwards as economic prospects deteriorate," Euromonitor International, 27 Nov 2008, <http://www.euromonitor.com/Global_short_term_growth_revised_downwards_as_economic_prospects deteriorate> [accessed in January 2009].

[17] Peter Gowan, "Crisis in the Heartland, Consequences of the New Wall Street System," Editorial, *New Left Review*, January-February 2009, p.25.

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the historical road taken by liberal political economics at Bretton Woods and the series of crises that plagued it thereafter. This reveals how neo-liberalism became a favoured alternative to the classic liberal capitalist economics of Bretton Woods, and how after 1971 it was the principal means used by the U.S. to deflect political accountability for those crises away from the political and economic structures of capitalism at the national and global levels. This part of the story begins in the U.S. and Britain during the 1970s, but takes on an added power as the collapse of the Soviet Union and its parallel COMECON system of international trade collapsed in the early 1990s. Then, arriving at the end of this middle history, neo-liberal practices and ideology were injected into an expanded Bretton Woods system to give it a global impact that sponsored speculative capitalism and deregulation throughout the world.

It also should be understood that because the present crisis is ideological as well as structural, it cannot be explained merely as a case of "bad" behaviour by the few.[18] Rather, the bad behaviour that has broadly infected the global financial system itself can be traced back to neo-liberal ideology. Thus, explanations of the crisis, such as that offered by British anti-debt campaigner Ann Pettifor, who characterized it in *openDemocracy* as "the stupidity, poor economic analysis and sheer ignorance of those central bankers, politicians, auditors . . . ,"[19] does little to illuminate how ideas shaped these actions. While this crisis admittedly has had its share of blatant deceit and corruption and spectacular incidents of massive fraud and tragic loss, these all can be explained by the neo-liberal ideological preference for unregulated capitalism and its greedy pursuit of power and money for its own sake. Rather, a more useful comment can be found in the words of Martin Wolf, the chief economic commentator of the London *Financial Times*, who opined, "I now fear that the combination of the fragility of the financial system with the huge rewards it generates for insiders will destroy something

[18] Former U.S. Federal Reserve Chair, Alan Greenspan, has famously sought to deflect criticism of his management policies by blaming "irrational exuberance" by speculators, rather than his own loose money policies, for the housing and stock market bubbles that emerged during the mid-2000s.
[19] Ann Pettifor, "America's financial meltdown: lessons and prospects," *openDemocracy*, 16 September 2008, <http://www.opendemocracy.net/article/america-s-financial-meltdown-lessons-and-prospects> [accessed in January 2009].

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even more important – the political legitimacy of the market economy itself – across the globe."[20] Or, in the thoughts of Angel Gurria, Secretary-General of the OECD, who lamented that "the market system is in crisis,"[21] and James Boughton, IMF historian and Assistant Director for its Policy Development and Review Department, who observed, "What we are seeing right now looks like a very slow train wreck."[22]

The many commentators who would want to confine the lessons of the present crisis to merely improving the regulation of the international financial system, including many government officials that attended the London G-20 meeting in April 2009, can take little comfort in the remarks of Zhou Xiaochuan, Chairman, Monetary Policy Committee of the People's Bank of China, who called not for regulatory reform, but for structural reform of the international monetary system. His call, which has been favourably received by Russia, India, and Brazil, was based on a historical view that that there are "inherent weaknesses of the current international monetary system" that require a restructuring of reserve currencies to accommodate the role of China, India, and Brazil as emerging economies.[23] We share this view, and have titled our essay "Global Shifts and Faultlines" as a metaphor for the historical processes that have acted over time like tectonic plates, which move not smoothly but suddenly as crises that cause shifts within the structure of the global economy. Thus, our analysis has focused on how these historical forces have developed through long periods, becoming apparent only at those moments when the institutions of governance in the global economy break down.

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[20] *Financial Times*, 15-Jan-2008, <http://us.ft.com/ftgateway/superpage.ft?news_id=fto011620080031470347> [accessed in October 2008].
[21] Angel Gurria, Secretary-General of the OECD, October 2008, *OECD Observer*, <http://www.oecdobserver.org/news/fullstory.php/aid/2753/> [accessed in January 2009].
[22] Bernd Debusmann, "Karl Marx and the world financial crisis," *Reuters*, 15 October 2008, <http://www.reuters.com/article/reutersComService4/idUSTRE49E99F20081015> [accessed in January 2009].
[23] Zhou Xiaochuan, "Reform the International Monetary System," <http://www.pbc.gov.cn/english//detail.asp?col=6500&ID=178> [accessed April 20, 2009].

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Historical Roots of the Crisis

The roots of the crisis now gripping the global economy can be found in the history of the Bretton Woods system and the way that it has adapted over time in an effort to accommodate its own contradictions. While we recognize the textured and layered character of economic behaviour, we argue that only a structural analysis of the global economy can produce useful insights into the underlying dynamics that drives it in particular directions. Thus, we begin our own analysis with Eric Helleiner's argument in *States and the Reemergence of Global Finance* (1996) that only states have the power to govern a modern global financial system, whether or not private interests have any significant influence, because only states can authorize structures to accommodate private interests. It also follows a similar observation by Susan Strange that global political economic analyses need to appreciate how international structures are governed according to the national politics of the states that shape them.[24] Thus, we offer a hybrid structural-national political approach to the analysing the present crisis that attempts to shine a stronger light on how the structural elements of the present Bretton Woods system interacted with U.S. politics to produce an unstable global economic governance that was unresponsive to changing historical circumstances.

The Bretton Woods System of Global Economic Governance

The current global system of political economy that was created at Bretton Woods during the Fall of 1944 reflected the historical circumstances of its time. The period immediately preceding it had been deeply influenced by the Great Depression and World War Two, which demonstrated that unbridled capitalism within national economies and a state of competition between nations could not sustain the development of modern global economics. At the same time, it was apparent that the post-war world would be

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[24] Susan Strange. (1998) "What Theory? The theory in Mad Money," University of Warwick - Centre for the Study of Globalisation and Regionalisation, Working Paper No. 18/98.

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dominated, at least in the short-term, by the U.S., which was the only advanced economy to survive the war in better shape, in absolute terms, than any of its allies or adversaries. It was also apparent that the U.S. would dominate the capitalist world and act as the flagship of liberal capitalism, in managing global economic governance.[25] This meant that the institutions that were constructed at Bretton Woods would follow the institutional character of Keynesian thinking, which would require that global economic institutions would be capitalist but also regulated by a central authority, and U.S. management. Thus, when the conference was convened, these basic assumptions and structures were already in place before deliberations or negotiations began.

The primary institutions that emerged from Bretton Woods included the International Monetary Fund (IMF), which was to manage currency relations among the Bretton Woods subscribers, and the International Bank for Reconstruction and Development (IBRD, now the World Bank), which was to act as the primary conduit that channelled capital into development projects approved by the Bank's board of directors. While these institutions appeared as broadly collaborative entities, in practice they were controlled by the advanced capitalist governments, and particularly the U.S., who held the primary posts within them and dominated the voting blocs that governed them. In spite of periodic tinkering, the fundamental character of these Bretton Woods institutions and arrangements of power have not changed for more than sixty years, and they continue to play key roles in the present crisis.

The post-Bretton Woods history of global political economy can be divided into three distinct periods: a first period that runs roughly from 1945 through the 1960s, which we characterize as the "golden age of capitalism"; a second period that runs roughly from 1970 to 1993, which we interpret as an ongoing period of crises that never fully managed to stabilize the Bretton Woods system; and a last period that began with the collapse of the Soviet Union and COMECON (the Council for Mutual Economic Assistance), which

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[25] It is useful to remember that Lord Keynes was one of the two principal organizers of the Bretton Woods conference, along with U.S. Secretary of the Treasury, Hans Morganthau. Arman van Dormael (1978) *The Bretton Woods Conference: Birth of a Monetary System*. New York: Palgrave-MacMillan.

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allowed for the rapid expansion of global capitalism that transformed it into a truly global economic system. The first period, however, can also be characterized as an extension of the Cold War that emerged between the U.S. and the Soviet Union, with the Soviet Union participating in Bretton Woods deliberations but never joining it as it developed its own parallel international trading institution, COMECON, in 1949. It should also be noted that while Bretton Woods attracted delegates from more than forty countries, the Conference itself was dominated by the U.S., and to a lesser extent by Britain, which revealed some of the fault-lines that later emerged and eroded cohesion among its members.[26]

The liberal capitalist assumptions that grounded Bretton Woods required that the IMF and IBRD be constructed according to the then existing distribution of economic and political power. This meant that currency stabilization through the IMF would employ the U.S. dollar as the system's primary reserve currency, and that the IBRD would function as a public-private for-profit institution that acquired capital from private investors, on terms set by a capitalist financial market, or from capitalist governments and that it be used to make for-profit loans that advanced corporate capitalist interests.[27] These assumptions and practices, in turn, followed similar structures adopted by the U.S. in its unilateral post-war development programs, such as its Marshall Plan to rebuild Western Europe, which similarly focused on rebuilding industrial and transportation infrastructure that primarily benefited U.S. and European corporate interests, rather than supporting social reconstruction that would benefit Europeans as a whole.[28] Thus, U.S. liberal capitalism, which offered itself as a role model, built Bretton Woods around a

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[26] Debates at the conference erupted at times into confrontations between the U.S. and the Soviets, and between the U.S. and the "free" French delegates over allocation of powers and the purposes of the Conference, forewarning of the competition that would later emerge for control of global economics.

[27] In its earliest years, IBRD loans went primarily to rebuild transportation and industrial production with little or no investment in social infrastructure, such as education and health system. This has changed to a degree in recent years, but even these shifts have promoted international for-profit activities by pharmaceutical and technology corporations.

[28] This U.S. dominated financial system, in turn, relied on the huge amounts of gold that the U.S. had acquired primarily from Britain and the Soviet Union through its *Lend-Lease* program that required payment in gold for war-time material assistance.

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macro-economics and institutions that first benefited U.S. banks and corporations.[29] The U.S. bias of this arrangement had little to offer the socialist bloc, leaving the Soviet Union, its Socialist allies, and eventually the Peoples Republic of China as the only major states outside of the Bretton Woods system after 1949.[30]

The 1960s: the Beginning of the End of Bretton Woods

Cracks began to appear in the Bretton Woods system as early as the 1950s when the reconstruction of Western Europe and Japan transformed them from investment and market opportunities for U.S. companies to international competitors. The first crack appeared with the inability of the U.S. to maintain the value of the dollar as the measure against which other currencies could be valued. The dollar's role as a reserve currency had been predicated on linking the dollar to a fixed rate of exchange for gold, with governments allowed to exchange dollars for gold held by the U.S. treasury based on the U.S. post-War holding of more than 80% of the world's gold reserves.[31] In turn, this reserve role meant that other governments would need to accumulate dollars to protect the value of their domestic currencies, which were required for trade with other Bretton Woods members. This allowed the U.S. a competitive trading advantage over other Bretton Woods members, but only so long as the U.S. also held a competitive advantage in industrial production, based on the U.S. providing 40% of the world's industrial production after the war. Similarly, the dollar's role as a reserve currency provided yet

[29] With the exception of the Soviet Union, Conference delegations from other war-time U.S. allies similarly reflected a strong pro-capitalist bias. See, Armand van Dormael (1978) *The Bretton woods Conference: Birth of a Monetary System (Part I)*. New York: Palgrave-MacMillan.

[30] Although it never formally joined COMECON, the Chinese government maintained a loose trading relationship with it from 1949 through the 1990s. At the same time, China's government slowly opened up to Bretton Woods members through a series of bilateral agreements that led it to eventually become a member of both the IMF and the World Bank in the 1980s when it assumed the membership of the Nationalist government of Taiwan. Harold Jacobson and Michael Oksenberg. (1991) *China's Participation in the IMF, the World Bank, and GATT*. Ann Arbor: University of Michigan Press.

[31] The U.S. acquired this horde by requiring payments in gold for the wartime materials that it supplied to its allies, and particularly Britain and the Soviet Union, under the Lend-*Lease* program. "Money Matters: An IMF Exhibit – The Importance of Global Cooperation," International Monetary Fund, <http://www.imf.org/external/np/exr/center/mm/eng/mm_dr_01.htm> [accessed in March 2006].

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another subsidy for U.S. trade and fiscal policy, but only so long as the U.S. could maintain sufficient gold reserves to cover its outstanding international debt. The support offered by the Bretton Woods system to international finance and trade and the advantages it allowed to the U.S. were thus predicated on a static rather than dynamic history. And when the U.S. lost its competitive industrial advantage as Europe and Japan rebuilt their industry with newer and more efficient systems of industrial production, the stability of the system was thrown into doubt, and the U.S. dollar became subject to a more traditional competitive capitalist market.

Seen through a historical lens, the processes that destabilized the reserve currency role of the dollar appeared as follows. From the late 1940s through the mid-1950s, the dollar was relatively stabile because the U.S. competitive advantage in industrial production and its control over the terms of trade meant that the dollar didn't have to compete with other currencies. This obviated any need for the U.S. to protect its value by adjusting its interest rates as other governments were required to do for their currencies, which acted as a further incentive to hold dollars as the most stable source of value. Consequently, capital flew to the dollar and to the U.S. banks that managed the global economy. Thus, as more and more dollars circulated outside the U.S., or were invested by foreign owners in the U.S., during the late 1940s and early 1950s, the rest of the world has had to provide the U.S. with goods and services in exchange for these dollars. Then, because trade debt also was denominated and payable in dollars, it would be paid down on terms favourable to U.S. creditors and banks, which could also recover huge profits from originating and managing credit and debt accounts. And finally, because the dollar was at the centre of both international trade and finance, governments, banks, and individuals were encouraged to think and act in dollars, reinforcing the logic and practice of a dollar-based global trade and financial system. All of this worked to insulate the U.S. from accountability for its internal financial management in ways that were denied to other countries, leaving other countries to carefully measure and manage internal spending to insure the stability of their currencies while the U.S. was allowed to self-manage its internal and external debt through monetary and fiscal policies that were accountable only to domestic politics and not to the international marketplace. This encouraged a false assumption within the U.S. that debt and policies surrounding debt

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were exclusively matters of domestic concern and without consequence in the global political economy, leading to profligate policies that eventually undermined confidence that the U.S. could act responsibly in its role as manager of the Bretton Woods system.

The march away from U.S. monetary control over Bretton Woods began during the mid-1960s as the inequitable distribution of power and wealth within the system led the U.S. to overreach the advantages offered by the dollar's reserve currency role. Concerns about U.S. national debt and its international trade and financial deficits grew after the mid-1950s as more and more dollars accumulated in the central banks of other countries. For a time, these central banks foreswore their right to demand gold in exchange for dollar debt, based on their reliance on the promise that the U.S. would act to protect their interests as fellow members of the Bretton Woods system.[32] But as more dollars accumulated, central bankers began to see that U.S. policies and financial practices, and particularly its increasing military interventions in former U.S. and European colonies, were exposing a continuing decline in relative U.S. political and economic power and its commitment to a cooperative Bretton Woods system. These suspicions were finally confirmed when in 1965 U.S. President Lyndon Johnson declared that the U.S. could both maintain its increasingly expensive intervention in Vietnam and its "Great Society" economic expansion at home through a "guns and butter" economic strategy. The folly of this declaration became apparent as the U.S. quickly expanded both its national debt and the amount of dollars accumulating abroad.[33]

The precipitating condition that announced the end of the dollar-gold link came as U.S. gold reserves fell from $30 billion in 1960, which were adequate to its obligations, to alarmingly low levels in 1965 that barely covered U.S. liabilities to foreign central banks. This fall in 1965 led French President Charles de Gaulle to break with the practice of deferring gold for dollar demands by asking that the U.S. exchange its $300

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[32] "Money Matters: An IMF Exhibit – The Importance of Global Cooperation, System in Crisis (1959-71)," Part 2, <http://www.imf.org/external/np/exr/center/mm/eng/mm_sc_01.htm> [accessed in February 2006].
[33] The U.S. eventually spent more than $500 billion on the Vietnam War alone, which was an enormous sum for that time, equivalent to more than $2 trillion today.

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million debt to France for gold from the U.S. Treasury.[34] While the U.S. met this demand, it became apparent that the U.S. would not be able to meet all demands for gold as its gold reserves fell in 1970 to only 55% of its liabilities and in 1971 to a mere 22%.[35] This rapid decline created a stampede by foreign central banks to convert the U.S. debt to gold, forcing then U.S. President Richard Nixon to publicly declare an end to the Bretton Woods fixed, dollar-gold link on 15 August 1971. This declaration effectively represented a default by the U.S. on both its international payments and on its guarantee to represent the interests of all in managing the role of the dollar as a reserve currency. But as dramatic as it was, this declaration was adopted as much to "save" the overall system by preventing an outright collapse of all other Bretton Woods institutions, as it was to save the dollar and help the U.S. to control over the IMF and the IBRD as the primary Bretton Woods financial institutions.[36] But in exchange, the U.S. lost some of its power over global trade and finance, which weakened the dollar and opened the door for other central banks to diversify and develop alternative currencies as a hedge against any precipitous decline in the dollar's value. Thus, after 15 August 1971, the U.S. was exposed to imported inflation and left the task of convincing the rest of the world to continue to accept devalued dollars in exchange for economic goods and services.

1971 to 1993: An Unstable "Petro-dollar" system

After 15 August 1971 and the collapse of the dollar's powerful role in international finance, the U.S. entered into a long period of economic instability, which began with a recession in 1971, an even deeper and longer recession from 1973 to1975, a

[34] "De Gaulle v. the Dollar," *Time*, 12 February 1965, <http://www.time.com/time/archive/printout/0,23657,840572,00.html> [accessed in September 2008].

[35] F. William Engdahl, "The Dollar System and US economic reality post-Iraq War," <http://www.engdahl.oilgeopolitics.net/1973_Oil_Shock/Dollar_System/dollar_system.html>. See also John Whiteclay Chambers II (ed.), *The Oxford Companion to American Military History,* New York: Oxford UP, 1999.

[36] "Money Matters: An IMF Exhibit – The Importance of Global Cooperation, System in Crisis (1959-71)," Part 5, http://www.imf.org/external/np/exr/center/mm/eng/mm_sc_01.htm.

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period of hyper inflation from 1979 to 1980 followed by a severe recession in 1981-1982, a real estate bubble and stock market panic in 1987, and another deep recession in 1992-1993. Altogether, nine of the twenty-two years from 1971 to 1993 could be characterized as "economically troubled," with the years in between reflecting uneasy transitions from one crisis to another. The one constant that marks this period was an unsteady attempt by the U.S. to recover the role of the U.S. dollar and its own economic power by linking the dollar to yet another commodity – petroleum. The contradictions produced by this "petro-dollar" system were economic, in that the Bretton Woods system never found a way to successfully recycle the huge profits and wide-spread speculation that it generated, and political, in that the petro-dollar system shifted the focus of global politics to the Middle East and other areas of petroleum production.[37] Understanding how that system developed with those contradictions offers insights into the present crisis and the contradictions that still plague what is now a truly global political economy.

The U.S. effort to recreate the dollar's dominant role in global finance began almost immediately after 15 August 1971, as it coalesced around the emerging role that oil was already playing in the early 1970s as a strategic commodity for industrial production. This made oil a logical choice because, unlike gold, it had a central role in modern economies that could act to further underpin its value. This advantage was put on dramatic display during the oil embargo that followed the 1973 Arab-Isreali war, when a denial of significant amounts of oil drove the advanced economies of the Bretton Woods system into a panic. Linking the dollar to oil, however, was a work of diplomatic art conducted between the U.S. and Saudi Arabia, which was then the leader of the oil embargo and the principal source of oil for Bretton Woods countries. The term "petro-dollar system" derives from the way this diplomacy linked the sale of oil to the dollar through a series of agreements between the U.S. and Saudi Arabia concluded during 1972-1974, which were later formalized as the U.S.-Saudi Arabian Joint Economic Commission (JEC). These agreements, many of which were never publicized or

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[37] Bulent Gökay, "The Beginning of the End of the Petrodollar: What Connects Iraq to Iran," *Alternatives: Turkish Journal of International Relations,* Vol.4, No.4, Winter 2005, pp. 40-56.

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understood by the public, had both political and economic components. Politically, they placed the power of the Saudi ruling family under the U.S. security umbrella by guaranteeing that the U.S. would supply the Kingdom with technical and military support, which secured the House of Saud at the centre of power in the Arab Middle East but also required that U.S. foreign policy thereafter would be hostage, at least to some degree, to providing its security in a dangerous neighborhood. Economically, the agreements required that oil sales conducted by the Organization of Petroleum Exporting Countries (OPEC) would be made exclusively in U.S. dollars,[38] which ensured that OPEC oil markets would be dominated by the U.S. through the demand they created for U.S. dollars.[39] Since the agreements, Saudi Arabia, which was and remains one of the world's largest oil producers, has become one of the most reliable of U.S. allies, enjoying a privileged status within OPEC that exempts it from allotted production quotas as the proxy representative of the U.S.[40] After the mid-1970s it used this status to "manage" oil prices as OPEC's "swing producer," increasing or decreasing oil production and bringing about oil scarcity or glut in the world market according to U.S. interests.

As structured, the U.S.-Saudi agreements implicitly created a global petrodollar economic system that not only put a floor under the value of the U.S. dollar, but also allowed the U.S. to once again manage international trade on terms that disadvantaged its European and Japanese competitors. This worked by making petro-dollars a *de-facto* replacement for the pre-15 August 1971 gold-dollar standard by guaranteeing a demand for dollars, whose value was then linked to oil through the OPEC trading standards and practices. In this scheme, all industrially advanced nations in the Bretton Woods system

[38] "Petrodollar Problem," <http://www.imf.org/external/np/exr/center/mm/eng/mm_rs_03.htm>. See also David E. Spiro, *The Hidden Hand of American Hegemony: Petrodollar Recycling and International Markets*, Ithaca: Cornell UP, 1999.

[39] Department of Treasury, "Jeddah, Saudi Arabia, Joint Statement: US-Saudi Arabian Economic Dialogue," press release, 6 March 2002, <http://www.ustreas.gov/press/releases/po1074.htm> [accessed in October 2008].

[40] In 1982, OPEC adopted the "quota system" to limit its oil supplies to keep oil prices at certain levels. According to this system, each OPEC country is allocated a specific quota for oil production to limit total OPEC oil supply and thereby influence oil prices in the world market. This system, however, did not help OPEC to avoid the 1986 oil price collapse because most OPEC countries did not respect their quotas.

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had to purchase oil, either from OPEC or one of the smaller oil producers, but they could conduct these purchases only by pricing and buying the oil in dollars, thus recreating the old hegemonic role for the U.S. dollar as a required reserve currency. This kept demand for dollars artificially high, and as the price of oil increased, as it did following the 1973 Arab-Israeli war, the demand for dollars increased, raising the value of the dollar on international markets and once again subsidizing U.S. domestic and military spending. However, this also allowed the U.S. to once again to run up huge current-account deficits, eventually once again destabilizing the Bretton Woods system.[41]

The creation of the petrodollar system also once again provided a double loan to the U.S., first by allowing it to set the terms for the international oil trade, and second by subsidizing the value of the dollar and exempting it from the burden of internal U.S. monetary and economic policies. This allowed the U.S. to print dollars to pay for its oil imports without giving up goods and services in exchange, with the value of those dollars supported by the demand created for them by the petrodollar system.[42] The yin and yang of this petro-dollar economy, however, also meant that U.S. benefits were offset by costs imposed on other capitalist economies, and particularly those emerging from post-colonialism, by allowing the U.S. to export its economic problems. Thus, when the 1973-1975 recession began, the U.S. could export its effects to its capitalist partners, which then bore the greater burden as oil prices rose after 1974. Similarly, the hyper inflation of the late 1970s and the sharp global recession of 1981-1982, which were also were linked to the petro-dollar economy and caused dollars to once again pile up in an international banking system, became global crises as the Bretton Woods system struggled to recycle them into for-profit investments. This led depositor banks in the advanced capitalist economies to look to developing countries for profits, because oil exporting economies were unable to absorb the huge oil revenues that were generated in

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[41] "Petrodollar Problem," <http://www.imf.org/external/np/exr/center/mm/eng/mm_rs_03.htm> [accessed in September 2008]. See also David E. Spiro, *The Hidden Hand of American Hegemony: Petrodollar Recycling and International Markets*, Ithaca: Cornell UP, 1999.

[42] David E. Spiro, *The Hidden Hand of American Hegemony: Petrodollar Recycling and International Markets*, Ithaca: Cornell UP, 1999, p. 121.

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U.S. dollars. However, because these investments had to be for-profit in the capitalist Bretton Woods system, rather than for social needs such as schools, health, and housing, they were made as above-market rate loans that could never be fully repaid. The wave of defaults on these loans that followed was easily predictable as the industrial capacity of developing counties was already limited by their post-colonial condition and their prospects for competing with advanced capitalist economies similarly limited by their lack of power within the Bretton Woods trading system.

The tragic results of the crises of the 1970s and early 1980s were, once again, exacerbated by a failure of the U.S. to exercise leadership within the system's Bretton Woods' hegemonic power. Rather than promoting sensible social investments in its own and the developing world's economies, in the mid-1970s the U.S. chose to use the petrodollar overhang as an opportunity to promote the purchase of U.S. treasury bonds, because their purchase would act as yet another subsidy for the U.S. economy by keeping domestic interest rates low. The short-term benefits this solution provided, however, were more than offset by its long-term costs as the U.S. increasingly came to rely on foreign investors as the primary source of finance for U.S. investments.[43] This had the effect of artificially increasing prices through speculation, rather than domestic demand, leading to an inflationary outburst that undermined the perceived value of the dollar, causing a decline in demand for dollars and a corresponding upward spike in U.S. interest rates. This forced depositor banks to scramble to find new ways to invest the growing horde of petro-dollars, leading to further attempts to dump excess petro-dollars in developing economies, which merely fed the inflationary spiral by adding a rapid increase in the price of basic commodities to the mix. But in this case, as the present one, the vast amount of capital that flowed into the banking system was accompanied by a disregard for the underlying financial problems that it masked: the banks, who were making huge profits on loans, had little incentive for blowing the whistle, and the

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[43] Robert G. Kaiser and David Ottaway, "Oil for Security Fueled Close Ties. But Major Differences Led to Tensions," *Washington Post*, 11 February 2002, <http://www.library.cornell.edu/colldev/mideast/saudusxx.htm> [accessed in September 2008].

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government, which was using the situation to create an illusion of prosperity at home and in the developing world, had little incentive to self-critically examine a system for which it was ultimately responsible. But, by early 1980 the game was up, and as the U.S. Federal Reserve stepped in to radically raise interest rates to cool inflation and protect the dollar, a growing number of the economies of developing countries sank into a deep depression.

These petro-dollar crises might have collapsed the entire Bretton Woods system, except for massive new spending by the U.S. as part of a new Cold War initiative. Generally identified as "Star Wars," this initiative by then U.S. President Ronald Reagan poured money into defense spending in an effort to drive the Soviet Union into bankruptcy. This helped to temporarily dry up the petro-dollar overhang by channeling it into military development, but it also touched off another burst of speculation within the U.S. that centered on commercial and residential real estate. While much smaller than the present speculative bubble, the collapse of this real estate speculation was at the time the most serious financial crisis to hit the U.S. since the Great Depression, sparking the largest single day decline in U.S. stock prices and shaking confidence in the U.S. economy that continued up to and through the 1992-1993 U.S. economic recession.[44] But in spite of the reoccurring crises of the 1970s and 1980s, the Bretton Woods system continued to operate as if the structure of the international economy had little changed. Rather, the periodic reforms that occurred merely attempted to fix immediate circumstances with little regard to the underlying systemic problems in Bretton Woods, including the shifting balance of global economic power away from the U.S. The collapse of the Soviet Union and COMECON in 1993, however, allowed the system to side-step and fundamental change by globalizing itself and privatizing many of its essential functions.

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[44] For a detailed discussion of this "S&L crisis," see, William K. Black. (2005) *How to Rob a Bank: How Corporate Executives and Politicians Looted the S&L Industry*. Austin: University of Texas Press.

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1993 to present: Globalizing Neo-liberal Capitalism

The globalizing and privatizing of the Bretton Woods system after 1993 occurred in the context of the collapse of the Soviet Union and the emergence of neo-liberalism as the form of capitalism preferred in the U.S. and Britain. With no alternative socialist system available, the former members of COMECON and states emerging from the Soviet collapse had few alternatives to joining and thus expanding Bretton Woods into a truly global political economy. These new opportunities for profit also arrived conterminously with the descent of the U.S. and Britain into a neo-liberal form of capitalist economics. Neo-liberalism, which formed around the writings of Milton Friedman and other conservative U.S. economic theorists, had been incubating in the U.S. and Britain during the 1970s and 1980s, largely based on its claims that capitalism was failing to thrive under liberal economic practices.[45] These arguments particularly targeted the Bretton Woods assumptions about liberal institutionalism and government regulation, which it argued should be replaced with an open free-market system left to the management of private enterprise. Neo-liberalism, however, also came with a political price in undermining the basic liberal political concept of a social contract between citizens and their government that the provision of essential social services and concentrating economic power in the hands of private capitalists. The limit to its extension from the U.S. and Britain into the larger Bretton Woods system before 1993 was the post-war reconstruction of political authority in Western Europe and Japan around social democratic principles that required major roles for their governments in economic affairs.[46]

While the collapse of socialist systems of economics in the early 1990s opened

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[45] See, e.g., Milton Friedman (1962) *Capitalism and Freedom*: University of Chicago Press; Noam Chomsky and Robert W. McChesney (2003) *Profit Over People: Neoliberalism and Global Order*: Seven Stories Press; and David Henry (2007) *A Brief History of Neoliberalism*: Oxford University Press.

[46] Of all of the advanced industrial countries in World War Two, only the U.S. and Britain maintained a continuity in their governments, which generally protected their pre-war constructions of political power from the need for renegotiation.

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the door to an extension of Bretton Woods and its reconstruction around neo-liberalism, it also removed an important safety valve that had acted to protect Bretton Woods during its many crises. From the time of its organization in 1949 to its collapse in 1993, the state-socialist economies had offered a relatively stable, long-term market for the excess production among Bretton Woods member states that periodically led to capitalist crises. At the same time, this socialist alternative market also provided a counter weight to capitalist politics that was used by the U.S. and its Bretton Woods allies as a rationale for Cold War policies that restricted the free exchange of ideas and justified militarism and intervention in the post-colonial world. Once this safety net and counter weight disappeared, the comfortable balance of a bipolar world disappeared with it. Its absence after 1993 increasingly exposed Bretton Woods to capitalist system's own contradictions, such as its tendencies toward speculation and over-production, its reliance on U.S. benign leadership, and its disregard for the connection between the political consequences of its bad economics. All of those contradictions came to full realization at different points as the U.S. drove the Bretton Woods system deeper into a neo-liberal quagmire.

With the Bretton Woods system evolving into a fully integrated financial system by the late 1990s, the U.S. role in its neo-liberal reconstruction became more visible. The institutional power that the U.S. enjoyed in governing the IMF and World Bank before 1993 was thereafter joined by an even greater power of persuasion that drew public as well as private institutions to neo-liberalism around the world.[47] Thus, when the U.S. dismantled its own Depression-era restraints on speculative investments by banks, known as the Glass-Steagall Act, and replaced it with the Gramm-Leach Bliley Act, labeled the Financial Services Modernization Act of 1999, it effectively introduced *casino capitalism* into the global economy everywhere.[48] Once introduced, casino capitalism rippled through the global economy promoting massive concentrations and exchanges of capital

[47] See, e.g., Louis W. Pauly. (1994) "Promoting a Global Economy: The Normative Role of the International Monetary Fund," in Richard Stubbs and Geoffrey R.D. Underhill, eds. *Political Economy and the Changing Global Order*. London: The MacMillan Press, Ltd.

[48] "Casino capitalism" was a term developed by Susan Strange in the mid-1980s to describe the unbridled speculation that was developing in the wake of neo-liberal economics. *Casino Capitalism*, (Blackwells 1986).

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among global speculators, and the transfer of their funds to international banks and other financial institutions, who were encouraged to develop an array of new speculative investment tools that could generate quick and easy profits. The possibilities for corrupting this system grew exponentially as new technologies, such as computers and the world-wide-web, allowed for funds to speed around the globe with little or no scrutiny.

It should come as no surprise that the neo-liberal transformation of the global economy would come to a bad end. Warning signs of its destructive capacity had been in evidence even before the late 1990s, as witness the U.S. Savings & Loan fiasco of 1987. With the addition of the internet and its global communications revolution, by 1997 neo-liberalism allowed unregulated currency trading to ricochet like a shot inside the global banking system, creating the Asian financial crisis that brought down a long list of governments in Asia and Eastern Europe and led the U.S. government to make a frantic multi-billion dollar midnight rescue of the Long-Term Capital Management. The U.S. “dot.com bubble” that collapse in late 1999 then added further evidence that the unregulated speculation of neo-liberalism had the power to put even the world’s most powerful economy at serious risk. What is curious, and largely unexplained, is why in the face of this evidence neo-liberalism was not only tolerated, but also encouraged and exported internationally.

The cumulative economic effects of neo-liberalism over the past fifteen years have been breath taking. For example, the pyramiding of speculative investments on speculative debt ballooned overall global paper capital from a relatively modest sum of $70 trillion in the late 1990s to more than $700 trillion by 2007. But because it was speculative rather than actual value, these trillions did little more than encourage further speculation that crowded out more reasoned long-term investments. This speculation was then duplicated as investors sought ways to protect themselves against loss, which most commonly was by buying credit default swaps, a form of insurance, which as a “new” investment tool grew from zero to $450 trillion in less than a decade. As investment advisor Jim Jubak observed in January 2008, before the crisis became public,

> The more investors who bought in, the more of these new products Wall Street

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> could sell and the more money it was willing to lend to home builders, home mortgage lenders and credit card companies; to the savings and loans and banks that created the raw materials (mortgages, credit card debt, auto loans) that Wall Street needed to manufacture its products; and to the hedge funds and structured investment vehicles that bought what Wall Street produced. . . . It worked out just fine until reality stuck a pin in the bubble.[49]

Eventually, mortgage prices began to fall in the middle of 2006, and as the decline continued, investors who had bought mortgages directly, or through mortgage-backed securities that were marketed around the world, found that the value of what they owned was also dropping.[50] Then, when U.S. housing prices continued to fall during 2007, mortgage delinquencies began to rise and U.S. mortgage lenders discovered that they could no longer recover their investments simply by repossessing and reselling the foreclosed homes because the real estate market was glutted with foreclosures. By mid-2008, the U.S. foreclosure crisis was in full bloom, with some one million repossessed homes clogging the market.[51] As risks and losses mounted, investment banks, which earlier had been aggressive in providing funds to mortgage lenders, found that they were facing tens of billions of dollars in losses that would never be recovered, and because they listed these mortgages as "assets" on their balance sheets they were forced to revalue their assets. This, in turn, forced a contraction in the banks' liquidity, because by law they had to maintain a strict balance between assets and available funds. By early 2009, losses from failing mortgages amounted to somewhere between $1 trillion and $10 trillion, with no end in sight.[52]

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[49] Jim Jubak 18 January 2008, "The next banking crisis on the way" MSN Money, <http://articles.moneycentral.msn.com/Investing/JubaksJournal/TheNextBankingCrisisOnTheWay.aspx?page=all> [accessed in October 2008].

[50] Ronald R. Cooke, "BANKS: Bleeding Value And Hiding Desperation," *Financial Sense,* 24 March 2008, <http://www.financialsense.com/editorials/cooke/2008/0324.html> [accessed in October 2008].

[51] "Homes in foreclosure top 1 million," *CNNMoney.com*, 5 June 2008, <http://money.cnn.com/2008/06/05/news/economy/foreclosure/index.htm> [accessed in September 2008].

[52] "Toxic" debts are the debts that are very unlikely to be recovered from borrowers. The estimated US 1,000-billion dollar-worth of assets lost in the current crisis seems largely underestimated. It is probably

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The crisis in U.S. mortgage lending was exacerbated by the neo-liberal linking of banks in the U.S. to banks and financial institutions everywhere. As the crisis unfolded in 2008, no one knew precisely which national and international banks had become infected because the "financial instruments" they used were incomprehensibly complicated. At the same time, investors were reluctant to disclose the extent to which they were interconnected and at risk because they were unsure as to whether and to what extent they were exposed and other investors were exposed. This uncertainty translated into the financial panic of September 2008, which then became a "credit crunch," or institutional fear that the whole of global finance had been built on the sands of speculation.[53] Consequently, money began to disappear from the general economy and reappear in "safe" investments, such as U.S. Treasury bonds, with a concomitant contraction in the willingness of creditors to lend. When lending later resumed, it was limited to only the most "credit worthy" of borrowers and at premium rates, all of which led to a fundamental reassessment of the value of virtually every asset in the world.

Capitalism and Human Needs: the Contradictions of For-Profit Capitalism

Perhaps the most intractable challenge faced by a global capitalist economy is its need for ever-growing profits. While it is given lip service, the central for-profit motives that operate within this economy infect everything, eventually transforming what are offered as development and social service programs into new business opportunities for corporations and capitalist banks. Notwithstanding its claims to be addressing human and environmental needs, this system by definition can only reduce them, as Marx

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closer to 10,000-billion of USD that are about to be lost over the coming two years. ("Global systemic crisis: Four big trends over the 2008-2013 period," *GEAB N°24* (April 16, 2008, <http://www.leap2020.eu/GEAB-N-24-is-available!-Global-systemic-crisis-Four-big-trends-over-the-2008-2013-period_a1561.html> [accessed in February 2009]).

[53] There are today approximately 10,000 billion of fictitious US dollars circulating on the planet which global banks are now trying to get rid at any cost in order to limit their own losses. "The credit crunch explained," *timesonline*, 14 August 2008, <http://www.timesonline.co.uk/tol/money/reader_guides/article4530072.ece> [accessed in January 2009].

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observed in the mid-nineteenth century, to reified elements that are deprived of their true character. This has been particularly true during the neo-liberal era because its efforts to privatize global economic governance have undermined the limited liberal attempts to achieve improvements in the human condition and environmental sustainability through international institutions. The evidence for this can be found everywhere, from the fight to get AIDS medication into the developing world, to the rapid expansion of so-called public-private partnerships that conceal corporate environmental abuses. Yet, even without neo-liberalism, profit-centred capitalism would be hard pressed to achieve its promise of environmental and social sustainability where it must subordinate those goals to for-profit economic growth.

The tension within capitalism between the concern of its liberal politics for the quality of the environment and its essential purpose to generate growth revolves around its need to generate economic growth as a means to generate profit and concentrate capital. Thus, zero or limited growth is anathema to capitalism because it fails to achieve the "rising tide" of wealth, however mal-distributed, that justifies capitalist policies. This can be seen in the fear that grips capitalist governments at the very mention of the word "recession," which merely identifies periods when capitalist markets contract, even to a limited extent. Liberal capitalists have tried to solve this contradiction by redefining sustainability as economic rather than ecological, generating a vast literature on "sustainable development" which at its core is nothing more than using concerns about the environment to further extend the influence of advanced capitalist countries into the inner workings of industrially less developed societies. This strategy has done little for either environmental sustainability or development, but, like the petro-dollar economy, has created vast new opportunities for the investment of accumulated capital and excess technological production in less-developing economies. The problem with a capitalist strategy for environmental sustainability is thus two-fold: it defines a "healthy" economy as one that generates growth, which by its own definition implies a further exploitation of natural resources; and the profits that it generates perverts sustainability strategies by tying them to for-profit schemes that exacerbates inequalities in economic and political power.

That said, capitalism also generates its own environmental *unsustainability* by

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failing to fully account for the effects that its systems of production have on the environment. Broadly identifiable as various forms of pollution, capitalism in the past has regarded them as "externalities," or costs that do not have to be incorporated directly into its system of production, but which are exported to society in general. Thereafter, the costs are borne by those directly affected – most often the workers and their families that are involved in the productive process, and by other middle- and working-class members who either pay taxes to clean up the pollution, or who share in the affects of that pollution as it spreads throughout their communities. The limited efforts of liberal capitalism during the 1950s and 1960s to regulate pollution inevitably ran into strong resistance from the corporations they sought to regulate, and their failed efforts to stem the effects of pollution worked primarily to discredit liberal capitalism itself. The neo-liberal public-private partnerships that filled the gap from the mid-1970s onward were even less successful, but because the processes through which they worked were privatized and hidden these failures achieved little public notice.

Looking more closely at how liberalism and neo-liberalism have responded to environmental quality issues is a cautionary tale about how they parallel the structures and ideology that guided the Bretton Woods system and led to the global economic meltdown we are now experiencing. Perhaps the best example of this is the present liberal/neo-liberal effort to contain global warming, which is being led by the governments of advanced capitalist countries and conducted through liberal environmental institutions closely associated with the World Bank. Climate science has been concerned with global warming at least since the early nineteenth century, but it was only widely heard after it became of interest to the U.S. government in the late 1940s, when its potential for promoting technological development and national security politics became better understood. Thereafter, climate science became an ever larger, government-sponsored, institutional science program that incorporated universities, corporations, and government agencies into its web. This, the alliance between climate science and capitalist governments, however, was cemented only after it achieved a place within a larger "sustainable development" project, which itself was devoted to extending control over the post-colonial world by means other than traditional international politics, that thereafter inseparably linked institutional climate science to capitalist development

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and security strategies by becoming part of the World Bank's economic and political agendas. The clearest evidence of this can be seen in the way that the Intergovernmental Panel on Climate Change (IPCC), which provides the scientific authority for government-based international climate policy making, has become part of this the capitalist agenda by arguing in its Fourth Assessment Report that market-based strategies are the best way to address climate change.

The cautionary tale in this story of global climate change policymaking is, as Marx argued, that capitalism acts to reshape all parts of society, including science, to promote its interests and goals. In this case, capitalism chose to institutionalize and promote climate science because it was useful in generating profits for technology companies, and particularly for rocketry and computing, and in generating discourses and storylines that were useful to promote concentrations of power within capitalist states. But its value increased as it became global climate science because it could then act as an organizing point to draw scientists from developing countries into the system and employ them as both human resources for science and as entry points to gain access to the inner workings of the scientific and political communities of their home countries. Then, once organized this community of climate scientists could be used as a powerful voice in favour of modern "Western" science and in support of the thick web of international institutions, such as the United Nations Environment Programme (UNEP), the World Bank, and regional capitalist economic policy groups, that would use climate change as a wedge to introduce sustainable [capitalist] development programs.

Capitalism using climate science in this way does not argue that the climate knowledge that it has produced is without merit, as conservative capitalists and conspiracy theorists like to argue. Rather, it demonstrates how science as an institution within modern capitalism has been managed to produce knowledge useful to capitalism, as Marx argued more than a century ago. Some scientists working inside this system have acknowledged that problem by citing how institutions fail to address many, if not most, of the important issues that are not susceptible to capitalist exploitation, such as the

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need to adapt to a changing climate by improving the equitable distribution of power in society,[54] and the glaring absence of acknowledgements in climate policymaking of the limits to technological solutions.[55] Of course, both of these issues are directly related to capitalism's necessary preoccupation with promoting profit, which blinds it to much of the human cost of its environmental pollution, and to its role in deflecting the problems with technological development where they undermine the potential for economic growth. But, if climate scientists are to be believed, and their evidence is compelling, a changing climate offers serious threats to continuing a "business as usual" approach to organizing human society.

There are many more examples of the perverse effect that capitalism is having on government responses to the global crisis of environmental change. In Britain, it first appeared with Margaret Thatcher's profession of concern about reducing greenhouse gas emission through a switch from coal to fuel oil and natural gas, which in practice was used as a rationale for attacking the coal miner unions. Tony Blair and Gordon Brown added their own contradiction by advocating the expanded use of "green" bio-fuels as a means for Britain to achieve its promised reductions in greenhouse gases. But in effect, this swapped British tailpipe emissions for pieces of the Amazon, even as Blair-Brown continued to promote the expansion of intra-country air transport, which comes with heavy greenhouse gas emissions. For its part, the U.S. has followed a similar path and for similar reasons, adopting a rapid expansion of bio-fuel production, which has produced windfall profits for agri-business but also dramatically increased the world price of grain and accelerated the pollution of the Gulf of Mexico through increased runoff of petroleum-based pesticides, herbicides, and fertilizers. Similar profiles apply to other critical natural resources, including: global ocean fish stocks, which have been

[54] See, e.g., Conca, Ken. (1993) "Environmental change and the deep structure of world politics," in Ronnie Lipschutz and Ken Conca, eds. *The State and Social Power in Global Environmental Politics*. New York: Columbia University Press: 306-326.

[55] Carol Gramling. (2008) "Swapping one greenhouse gas for another," *Earth Magazine*, August 28, 2008. In recounting the work of Dr. Michael Prather, an atmospheric chemist at the University of California at Irvine who identified nitrogen trifluoride as a new, powerful greenhouse gas, Dr. Prather was quoted as complaining that policymakers promoted these substitutions without regard for potential negative effects.

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depleted through massive harvests conducted by huge factory ships (now being replaced by "ocean farming," which is a serious threat to biodiversity and natural ocean systems); forests, with a rapid deforestation occurring in the developing world in response to their national debt and a considerable loss of biodiversity in the developed countries through the overuse of "managed" tree farms; water, which is no longer regarded as a common resource but a commodity that can be commercially exploited by trans-national corporations; and wildlife, which has been depleted to satisfy global capitalist economics to the extent that Stuart Pimm and Edward Wilson, two prominent ecologists, describe the current state of the planet in catastrophic terms.[56]

Conclusion

At this point in the global economic crisis, the question to be answered is whether regulatory reform will be sufficient to restore the global economy to health, as many mainstream capitalist economists and government leaders argue, or whether this economy is broken and in need of a fundamental restructuring away from capitalism. We argue that reforms can only be cosmetic because they will leave intact the very structures of capitalist economics that lie at the diseased heart of the system. As the U.S. and other capitalist governments pour trillions of dollars into the capitalist top of their national economies there is no evidence that they will "trickle down" in any meaningful way to the middle and working classes who actually make economies work. What is apparent as of this writing is that national economies continue to shrink, even as capitalists celebrate the largess of the governments that serve them.

Seen in the broader historical terms, this crisis is only one of a string of crises that have all had the same effect of further concentrating economic and political power in the hands of capitalists, who invariably have used past crises as an opportunity to generate adaptations of basic capitalist institutions that can be used to generate new ways to profit.

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[56] See, Stuart Pimm. (2001) *The World According to Pimm*. New York: McGraw-Hill; and Edward Wilson (2002) *The Future of Life*. New York: Alfred K. Knopf.

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If the U.S. continues to be a guide, these adaptations will include promoting new, "green technologies" which may have some limited value environmentally but which will be developed primarily for their capacity to generate new and profitable economic activity. In addition, an expansion of the existing emissions trading infrastructure within the U.S. and between the U.S. and its trading partners will generate new speculative financial instruments based on "hot air," adding costs to production that will then be used to increase profits from sales. Reforms – and there will be "reforms," which will be introduced as a return to old style liberal capitalism – will mask the slow movement of capitalist governments toward a capitalist class that is powerfully organized around finance rather than production.

The future, as ever, is open to other choices. But these choices must be articulated as more than a critical assessment of the capitalist system as it is: they must articulate a vision of an alternative future that is at once more efficient, more humane, and more ecologically sustainable. Socialism, as a relatively new way of organizing societies, must account for its past failures by addressing the problems of management and concentrations of power that plagued and eventually undermined COMECON and the Soviet Union. Its most powerful weapon is that it begins by assuming that society is an inclusive social compact that builds structures around the human needs of the many, rather than the profits and privileges of the few. It also has the capacity to meaningfully address the global environmental crisis because it neither relies on the growth imperative, nor the externalization of the costs of pollution that are practiced by capitalism. But, as we argue here, that task must begin by carefully examining the present structures of the global economy and how they have been and continue to be reshaped by historical change.

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