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# Financialisation in Crisis

Edited by Costas Lapavitsas

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Costas Lapavistas



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GARY DYMSKI is founder and Executive Director of the University of California Center Sacramento (UCCS), and professor of economics at the University of California, Riverside. Gary received his Ph.D. in economics from the University of Massachusetts, Amherst in 1987. He has been a visiting scholar at the Bangladesh Institute for Development Studies, Tokyo University, the University of Sao Paulo, the Federal University of Rio de Janeiro, the Federal University of Minas Gerais, Newcastle University, and the University of Athens. Gary's most recent books are *Capture and Exclude: Developing Nations and the Poor in Global Finance* (Tulika Books, New Delhi, 2007), co-edited with Amiya Bagchi, and *Reimagining Growth: Toward a Renewal of the Idea of Development*, co-edited with Silvana DePaula (Zed, London, 2005).

NURAY ERGÜNEŞ teaches economics at the Maltepe University, Turkey. She has written extensively on political economy of banking and finance, corruption and gender. Recent publications are *Banks, Accumulation, Corruption: the Banking Sector of Turkey after 1980s*, SAV Publications, 2008; 'Marxism and Women', in *Actuality of Marxism at the 160th year of Manifesto*, edited by Yüksel Akkaya and Irfan Kaygısız, EPOS Publications, 2008; 'Understanding of Intra-class Conflicts on Banking Capital', *Praksis* 19, 2009.

MAKOTO ITOH Emeritus Professor at the University of Tokyo; and a member of the Japan Academy. He has taught widely at many Universities including New School for Social Research, London University, Greenwich University, Thammasat University, and the University of Sydney. His books in English are; *Value and Crisis, The Basic Theory of Capitalism, The World Economic Crisis and Japanese Capitalism, Political Economy for Socialism, Political Economy of Money and Finance*, and *The Japanese Economy Reconsidered*.

COSTAS LAPAVITSAS teaches economics at the School of Oriental and African Studies, University of London. He has done research in the political economy of money and finance, the Japanese economy, history of economic thought, economic history, and the contemporary world-economy. He has published widely, and his books include *Political Economy of Money and Finance* (with M. Itoh), MacMillan, 1999, *Development Policy in the Twenty-first Century* (with B. Fine and J. Pincus), Routledge, 2001, *Social Foundations of Markets, Money and Credit*, Routledge, 2003, and *Beyond Market-Driven Development* (with M. Noguchi), Routledge, 2005.

CARLOS MORERA is Professor at the Economic Research Institute of the National Autonomous University of Mexico (UNAM). He has also taught in several Mexican universities and was a guest researcher at Oxford University and the Federal University of Bahía. He is the author and co-author of several books and chapters of books, among them *El capital financiero en México y la globalización*, Era Mexico City 1997; *Globalización inserción de México y alternativas incluyentes para el siglo XXI*, Porrúa-UNAM-IIIEc; Mexico City, 2001; 'Mexico: Work Process, Oil Revenue and Financial Restructuring in World Economy', published in the proceedings of the international symposium held in Beijing, China. Morera has been a speaker at seventy national and international seminars.

JUAN PABLO PAINCEIRA is currently carrying out research in the political economy of money and finance at SOAS, University of London, focusing on the role of central banks in middle-income countries. He has published work on financial instability, the South-Korean financial system, Brazilian external vulnerability and economic method in Brazilian annals and journals. He has worked as financial analyst for several years in the Brazilian financial sector, at the Banco Central do Brasil. He is also interested in the philosophy of science and macroeconomics.

DEMOPHANES PAPADATOS works in the banking sector in Greece. He is also currently undertaking research in the political economy of money and finance at SOAS, University of London. His research interests include finance, economic development and macroeconomics.



JOSÉ ANTONIO ROJAS is Professor at the Academy of Political Economy and (until 1990) professor in postgraduate studies in the Energy Economics Programme in the UNAM Economics Department. He has also worked as a technical specialist at Mexico's Federal Electricity-Commission (CFE) since 1991. He has conducted research on energy economics since 1980, and received UNAM's 'Jesus Silva Herzog' Economy Award in 1986. He has also been a regular contributor to the national dailies *Uno más Uno* and, more recently, *La Jornada*.

PAULO L. DOS SANTOS lectures in capital-markets, finance and microeconomic theory at the School of Oriental and African Studies. His research focuses on the political economy of capital-markets, financial intermediation, and the internationalisation of banking.

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## Chapter Six

# The Globalisation of Financial Capital, 1997–2008<sup>1</sup>

Carlos Morera Camacho

José Antonio Rojas Nieto

### **I. The transformation of the world-economy**

The world-economy has experienced thirty years of dramatic changes, deriving from the profound economic turmoil that followed the oil-crises of 1973–4 and 1980–1, the collapse of ‘actually existing socialism’, and the transformation of China. Global and generalised restructuring took place as a result of these developments. Gradually, new characteristics emerged in a world-economy including, first, predominance of financial capital subject to dollar-hegemony; second, strong dynamism and new characteristics of the world-financial sector; and third, intensified articulation between national-financial markets and monetary systems. To a large extent, these characteristics flowed from the deregulation- and

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1. This chapter is part of a bigger study currently under way on the ‘The World Financial and Oil Markets, 1997–2007’. It has benefited from critical observations by Costas Lapavistas, particularly with regard to credit. The development of the database and the diagrams received support from Lidia Salinas Islas, Isaac Torres and Iván Mendieta.



liberalisation-measures implemented initially by the United States and the United Kingdom between 1979 and 1982. But the majority of industrialised and developing countries have followed suit.

What has emerged is the consolidation of an international-financial space through which practically all national-financial processes are obliged to pass in an articulated manner. This imperative also applies to national productive and commercial activities. Without a doubt, major technological changes have sustained these transformations. Modern microelectronics and the internet have enormous capacity to maximise volume and minimise costs of transmitting information. Technical changes have made structural transformations possible and gave them momentum.

The transformation of world-capitalism has further been sustained by numerous and substantial changes in the processes of work, which have typically meant generalised attacks on workers' conditions. Without a doubt, some of the most important changes experienced by capital in the last three decades correspond to both waged and unwaged labour.<sup>2</sup> These have included, first, substantial changes in production-technologies, particularly control and automation of processes; second, the extension of so-called temporary layoffs; and third, proliferation of flexible forms of hiring. Workers' conditions have been adversely affected through prices rising faster than wages, falls in money-wages, worsening conditions of social security, layoffs, old-age provision and retirement, and finally, business-insolvencies and bankruptcies.<sup>3</sup>

Nevertheless – as demonstrated by the extremely critical conditions of 2008–9 – global capital has not succeeded in re-establishing the rhythms of growth and profitability that characterised the early post-World-War II era. On the contrary, the effects of continuous restructuring during the last thirty years have been asymmetrical on production and circulation. This asymmetry has intensified since 1998 – in favour of circulation. The current crisis comes at end of a boom in the US-economy that lasted for nearly ten years, and which – as is now apparent – was prolonged far beyond what was justified by its true foundations. The (relatively artificial) boom actually rested on an unprecedented expansion of credit to government, to businesses and to US-

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2. Munck 2002, pp. 19–27. Anderson 2006, p. 28.

3. Moseley 2007, pp. 2–3. Gill 2002, pp. 643–4.

households. To establish this point, consider the following aspects of the US economy.

## 2. The restoration of profitability and the performance of the US-economy

Marxist theory identifies profit as the engine of capitalism, and asserts that the rate of profit tends to fall as a result of intensified capital-accumulation relative to the generation and appropriation of surplus-value. However, the process is complex since, on the one hand, there is a tendency for the rate of profit to fall but, on the other, there are substantial increases in the mass of profit. These two different movements make disputes among all the factions of capital more controversial and violent.<sup>4</sup>

The performance of the US-economy can be analysed in line with the evolution of the rate of profit. The crisis and stagnation phase of the US-economy in the 1970s were based on a fall in the rate of profit by approximately 50% from 1950 to 1970.<sup>5</sup> There was further fall of 30% in the following decade (see Figure 2 below).

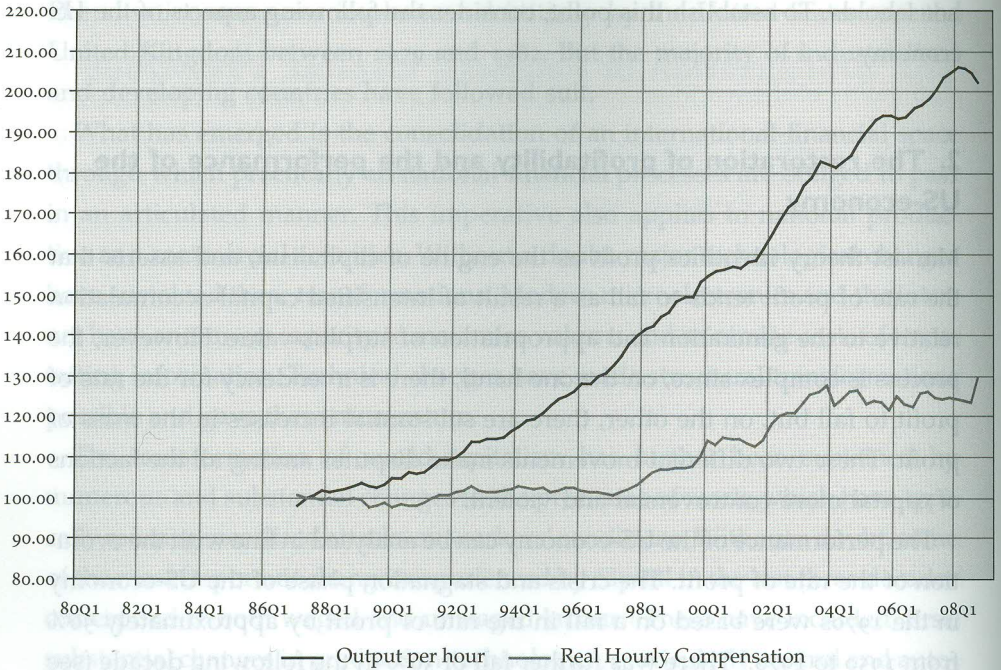
The recovery of the rate of profit began in 1981, based on intensified exploitation of labour. Nevertheless, the circumstances of exploitation have also changed. The changes in the labour-process were expressed in what is known as *detritorialisation* – the relocation of the production-process to other areas of the world-economy where wages, raw materials, fuels and energy are lower – which was promoted in the 1990s. However, the major strategy for restoring the rate of profit in the United States was *financialisation*, based on an increase in international debt and over-expansion of credit. Three moments stand out in the evolution of international debt: first, the United States becoming a net debtor, beginning in 1986; second, the arrival of crisis in Southeast Asia; and third, the impact of financial crisis of 2001 and 2008–9 on the markets.

In the second half of the 1990s, the prices of raw materials, fuel, energy and labour costs were relatively low. Interest-rates were at their lowest since World-War II. Substantial increases in productivity took place in the USA

4. Marx 1976 [1894], 57–82.

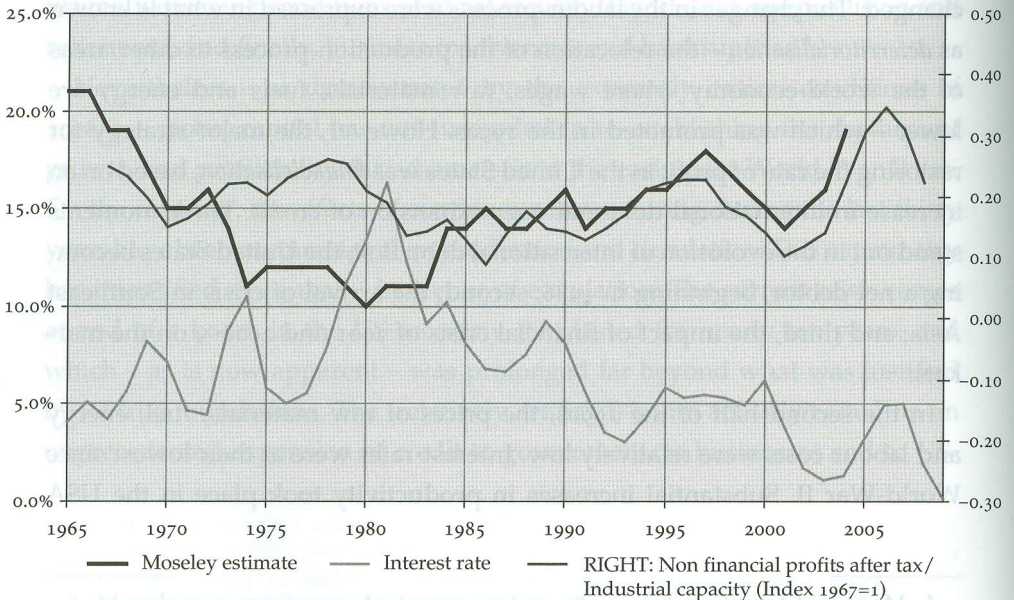
5. Moseley 2007, p. 6.





Source: Developed by authors, with data from the Federal Reserve Bank of St. Louis.

**Figure 1 USA: Productivity and Real Wages in Manufacturing 1980-2009**  
1987=100



Source: Developed by authors, with data from the Federal Reserve Bank of St. Louis.

**Figure 2 USA: Rate of Profit and Interest-Rate 1965-2009 Annual**  
Percentage-Level

(see Figure 1 above). Consequently, there was an impressive recovery of the profit rate in the United States, thus expressing improvements in the overall profitability of the world-economy. However, dramatic and violent increases in the prices of the raw materials, fuels and energy followed soon after. On the other hand, and in contrast to past experience, interest-rates not only remained low but tended to fall.

As a result, many mainstream-economists concluded that the boom at the end of the 1990s was a landmark. Apparently, the US-economy had left behind the long stagnation that began in the 1970s, and opened a new period of high economic growth, increased employment, inflation-reduction and moderate increases in wages. Yet, the crisis of 2001 showed that things were different, and recession established itself once again. Recovery, beginning in 2002, was slow, and growth in jobs lagged behind output. The dynamic of job-losses and insufficient employment-opportunities to absorb new labour-supplies has been extraordinarily severe. Profound transformations have ensued across the spheres of the world-economy (real sector), as well as in the financial and commercial system (virtual sector) and in technological development.<sup>6</sup>

The international credit-crisis that began in August 2007 has revealed the magnitude of the transformations that have taken place not only in banking but in all forms of capital and the state. The crisis itself was the result of an enormous expansion of mortgage-loans and consumer-credit, some of which were granted to the poorest and most oppressed sections of the working class.<sup>7</sup> Borrowers were heavily black and Latino, giving to the crisis a racial dimension.<sup>8</sup> US- and European banks were heavily affected by the collapse in the value of the mortgage-backed securities that they had created, and which turned out to be a significant portion of their assets. The resulting insolvency provoked a credit-crisis, and the initial reaction of financial institutions was to hoard funds, thereby intensifying the crisis.

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6. Lapavitsas 2009.

7. Lapavitsas 2009.

8. Dymski 2009.



### 3. The Mexican and Asian financial crises of the 1990s, and the subsequent evolution of finance

The roots of the actual crisis and of the evolution of finance in the 2000s are to be found in the Mexican crisis of 1995 and the Southeast Asian (Thailand, Indonesia, Malaysia, and Philippines) crisis of 1997–8. Both crises evolved in similar fashion. They began with a devaluation of the local currency as a result of high trade-deficits, which had reached serious levels because of the link of the currencies to the dollar in the first place. This was followed by short-term capital-flight and collapse of weak financial markets.

As a result, there was strong contraction of credit and a severe drop in production, to say nothing of the brutal increase in the cost of public foreign debt. There was also a sharp rise in private-sector debt (banks and enterprises), which, in the case of Mexico, was transferred to captive taxpayers and to fiscal revenue from oil-profits. Simultaneously, there was withdrawal of short-term foreign and domestic investments and insolvency of local banking systems, which, in some cases, led to the collapse of both banks and national companies.

The Mexican crisis and the so-called 'tequila-effect' were contained. This can be attributed to several factors including, first, support from the United States, which was at the time experiencing considerable economic strength; second, the US-origin of the bulk of private capital-flows to Mexico, which prompted immediate support by the Clinton administration;<sup>9</sup> third, the trade-links of Mexico with the United States, in contrast to the intense trade-interdependence among the affected Asian economies; and fourth, the deepening of the privatisation-process in telecommunications and transportation, and even in areas forbidden by the country's constitution, specifically oil and electricity.

In the case of Southeast Asia, the private and fragmentary character of the economies tremendously hindered negotiations on how to deal with the crisis. In addition, the mechanisms of contagion in the Asian region were heavily located in the productive and commercial spheres, given that the development strategy of these economies since the 1960s was to orient themselves toward foreign markets. For Thailand, Indonesia, Malaysia, and the Philippines, as well as China in 1997, approximately 50% of their trade was regional, and a

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9. Morera 1998, pp. 218–20, 2002, pp. 430–32.

similar proportion of this regional trade was with Japan. South Korea was also strongly affected and entered a recession.<sup>10</sup> In addition, Russia's external bankruptcy occurred in mid-1998, and subsequently Brazil.<sup>11</sup>

Following the Asian crisis, the international banking system became more closely articulated with both the private and public sectors of these countries. The new relationships included easy terms of refinancing agreed with the national banking systems in these countries. Debts did not disappear but rather increased as the crisis was expressed as a drop in production, trade, and employment. Asia accounts for a third of world-trade and, during the 1990s, it represented the only region that experienced sustained industrial growth, together with the United States. It is precisely in this region where most US-industrial exports are sold. In 1998, contraction in production and trade affected the US-economy and spilled over to countries that export raw materials, including oil.

However, in 1999 oil-prices began to rise, partly due to the tremendous dynamism of China and India, and partly due to the low margin of production capacity in relation to the levels of world-demand for crude. Consequently, capital-flows deriving from oil-profits and rent as well as from savings in emerging economies began to flow toward developed countries and particularly the United States. This allowed the US-economic cycle to go beyond what the internal savings rate would have permitted. And it also provided finance for the enormous US-deficit.<sup>12</sup>

Against this background, global-financial liberalisation and the ongoing technological revolution fostered an unprecedented financial boom after 1998. At the same time, it became impossible for monetary authorities to carry out monitoring and evaluation of financial conditions.<sup>13</sup> This boom reflects the powerful development of banking and non-banking financial institutions across the world. The close articulation of these institutions with the world-financial centre (the United States) is the reason why the 'momentary' crash of key debtors in the late 1990s actually translated into further increases in international banking assets. There was further global-financial expansion after 1998, and conditions were created for an even greater crisis.

10. Chesnais 1999, pp. 9–10.

11. UNCTAD 1999, pp. 59, 71–2.

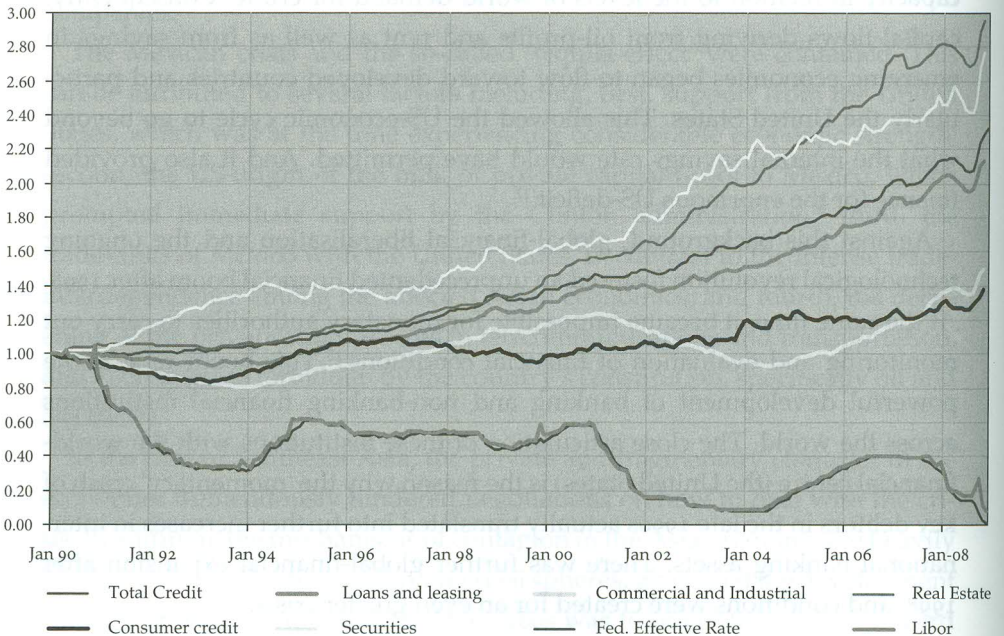
12. BIS 2003, pp. 9–12, 50–3 and 2005, pp. 41–9.

13. *New York Times* 2002.



Underlying the phenomenal expansion of finance during the last ten years has been the relentless liberalisation of interest-rates, financial activities and international capital-flows. But note that the share of commercial banks (and savings institutions) in the total volume of loans has been declining. During this period, as was mentioned above, technological innovation became more intense in the areas of telecommunications and information, as well as in the new systems, processes and instruments used by financial institutions. The financial sector in the USA made the most intensive use of technological information, as measured by relative spending on computer-equipment and software.

Consequently, the activities of major US- (and British) banks during the last two decades have shifted away from meeting traditional demand for loans on the part of industrial and commercial corporations. Banks have developed profitable lines of lending to individuals as well as drawing income from a wide variety of fees charged (see Figure No. 3).



Source: Developed by authors, with data from the Federal Reserve Bank of St. Louis.

**Figure 3 US Banking-Credit Index 1990-2008 (1990=1)**

These developments have had a strong impact on credit-distribution and the socialisation of credit-risk, thereby introducing new elements of fragility in financial markets, which emerged sharply in 2008.<sup>14</sup>

#### 4. The role of stock-markets

Stock-markets played a decisive role in the crises of 1997–8 as well as in the subsequent recovery of finance, and now, in the severe financial crisis, and it is important to examine them more closely. The stock-market is at the heart of fictitious capital, which takes the form of financial assets, both stocks and bonds.<sup>15</sup> In this market, the speed of transmission is almost instantaneous, making it even more difficult to foresee crises. As a rule, falls occur after phases of calm and recovery, and they can be local or regional, as in Asia in 1997–8, or worldwide, as in the USA after 2008. The collapse of Wall Street in 1997 was avoided by massive share-buybacks by large conglomerates.

But the crisis of 1997–8 also revealed the consequences, limits, and contradictions of financial liberalisation, dominated by large investment-funds (pension-funds and mutual funds), major transnational corporations, international banks and state-debt. A key pillar of this international economy of capital-money valorisation is the secondary capital-market, which generates increasing volatility and instability.<sup>16</sup> The origin and formation of fictitious capital is to be found in this market, through the issuing of securities, the formation of large companies via equity, and the immense accumulation of financial assets.

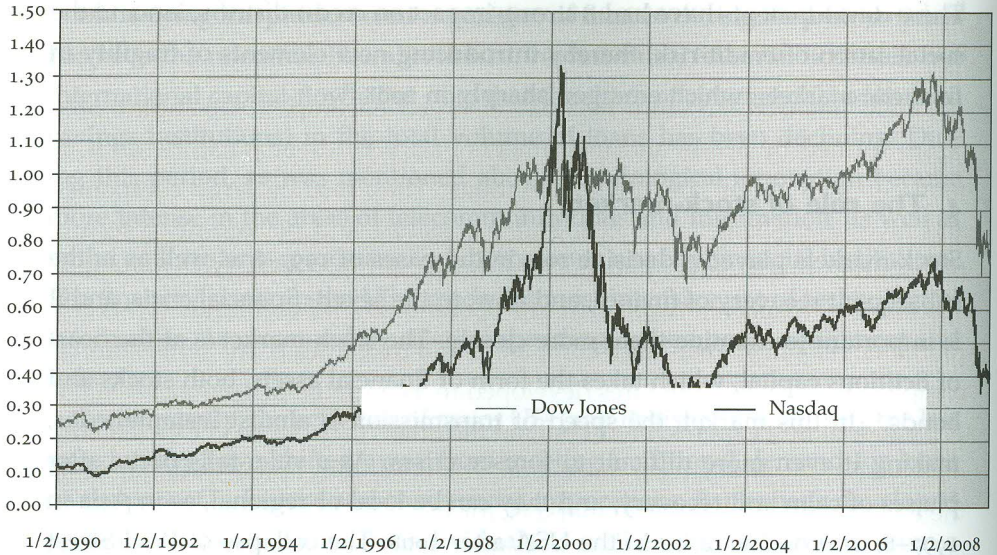
During the 1990s, the US-economy exhibited considerable dynamism and was able to promote innovative companies, particularly in the 'new' fields that encompass information-technologies and biotechnologies. This was also expressed in the stock-market sector, taking the NASDAQ-index from 400 points at the beginning of the decade, to a peak of 5000 points. The speculative bubble was particularly acute in 1999–2000. When it burst, the NASDAQ was brought down to slightly more than 1,000 points. To date, the index has not recovered the levels reached in 2000. (See Figure 4)

14. Lapavistas 2009.

15. Marx 1976 [1894], pp. 511–31.

16. Bannock and Manser 2003, p. 238.





Note: Last data at February fifth

**Figure 4 Evolution of US Stock-Market (Dow Jones and NASDAQ, 1990–2009) Index (2000=1)**

Speculation, as a phenomenon characteristic of contemporary capitalism, tends to be interpreted as an aspect of the 'casino-economy'. But the crises discussed above are not only the result of the inherent instability of financial markets. Rather, they can be attributed to slow growth and endemic over-production throughout the 1990s, which spilled over into the crisis of the US-economy in 2001 (see Figure 5).

Moreover, fictitious capital is a property-title and, in the course of the development of capitalism, property-rights are continually reallocated. Mergers and acquisitions were pronounced in the 1980s, up to the crash of 1987. They recovered in the 1990s and evolved to their historic peak in 2000. Following the collapse of Wall Street and NASDAQ in 2000, mergers and acquisitions again recovered their dynamism, particularly after 2004. It appears that the process of capital-concentration (mergers and acquisitions) is cyclical, and historically occurs in periods of calm, following crisis and the recovery of the economy. As concentration takes place, it brings changes in the control of capital and rearranges financial powers, thus affecting world-economic conditions on all levels.

## 5. Foreign-direct investment, mergers and acquisitions, and the rising power of transnational companies

The new financial structure that has emerged encompasses complex processes formed by actors and instruments of a very diverse nature, both in terms of their origin and their operations. They include large companies and investment-banks specialising in the issuing and placement of securities; mutual funds (small and medium-investors); hedge-funds (companies specialising in speculative short-term operations); pension-funds (workers' retirement-savings); insurance-companies and treasuries of the transnational companies. The new structures developed in a contradictory manner. On the one hand, they cheapened credit but, on the other, they created new elements of instability, such as greater dispersion, volatility, and capital-speculation. In the emerging Latin-American markets, for instance, they initially cheapened credit, but later made it more expensive. But there is no doubt that the so-called globalisation of financial markets has led to an extraordinary transnationalisation of the holdings of debt-securities.

The result of this process was that foreign investment emerged as the predominant form of capital-transactions on an international scale. The relationship between foreign-direct investment and portfolio-investment has varied in the past 25 years. In 1981, fully 19% of the annual flows of private investment were portfolio-investment. However, the 1990s were characterised by growth of capital-flows toward developing economies mostly through institutional investors engaging in speculative investment and intensifying the volatility of these economies. Simultaneously, foreign-direct investment by transnational companies grew. In the second half of the decade, foreign-direct investment became the predominant form of capital-transactions, undertaken by transnational companies and international financial groups in the form of mergers, strategic alliances and privatisations.

From 1993 to 1998, developing economies received 35.3% of total foreign-direct investment, the highest percentage in the past two decades. This figure is even more significant if we consider that the total flow of foreign-direct investment throughout 1990–5 remained at an annual average level of slightly more than \$225bn. However, in 1996, the figure rose to \$386bn and in 1997 to \$478bn. During 1995–8, developed countries channeled an annual average of 50% of these flows toward mergers and acquisitions, while the corresponding



figure for the developing countries was 31%. During this period, the figure became double what it had been during the first half of the decade.<sup>17</sup>

Latin America was the most important recipient of foreign-direct investment aimed at mergers and acquisitions throughout the entire decade. Its annual average during the entire period was approximately 57.5%. A total of more than \$196bn was earmarked for mergers and acquisitions, and most of these resources (\$125bn) were invested during 1996–8 in Brazil, Argentina, and Mexico. During this period, South Asia (India) and East Asia (China, Hong Kong, Taiwan), as well as Southeast Asia (Indonesia, Republic of Korea, Philippines, Singapore, Thailand, and Malaysia) also witnessed significant mergers and acquisitions (\$44bn). The largest volume of such resources was directed toward China, Hong Kong, and South Korea. Nevertheless, the greatest volume of mergers and acquisitions was registered in 1999–2001, when investment almost doubled (\$82bn).<sup>18</sup>

The coming together of productive, financial, technological and organisational factors altered the profile of transnational corporations and gave them the greatest power they have ever had in the world-economy. Their percentage share of the world-GDP rose from 17% in the mid-1960s, to 24% in 1982, and to more than 30% in 1995. In that year, there were 39,000 transnational companies (including more than 4,000 in developing countries) that already dictated the course of the world-economy, with 270,000 subsidiaries abroad (of which 119,000 operated in developing countries). At present, there are 60,000 transnational companies with 800,000 subsidiaries. But the degree of concentration and centralisation of capital is even greater if we consider that the 100 largest transnational companies (not including banks and financial companies) controlled a third of foreign-direct investment. During 1988–95, 72% of these flows went to mergers and acquisitions of all types which, together with strategic alliances, were the international transactions that grew the most rapidly.

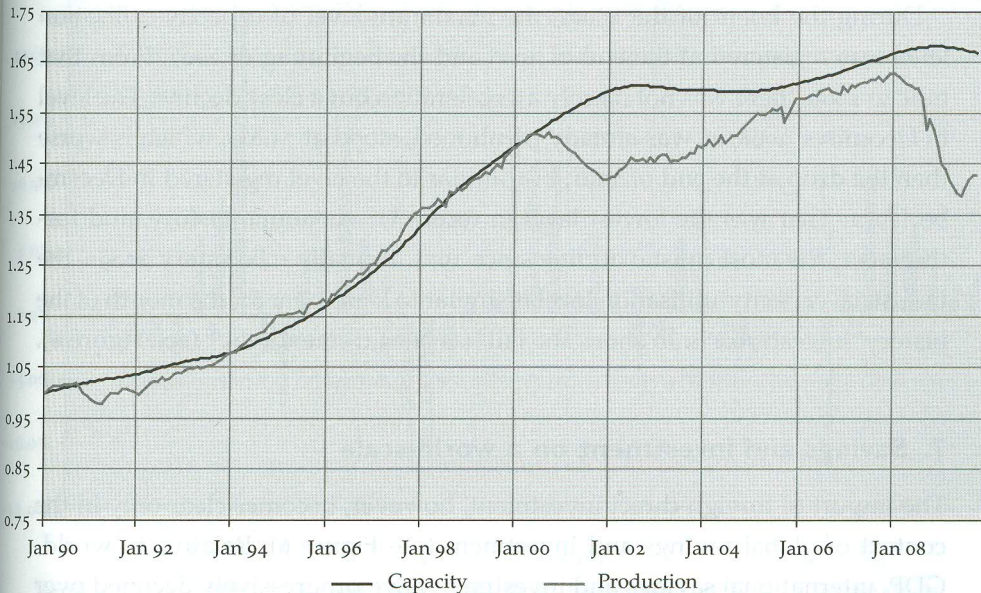
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17. UNCTAD 2002, pp. 7, 33, 303, 306, 337.

18. Figures were calculated based on statistical information from UNCTAD, 2002.

## 6. Extreme weakness of US-industry in the late 2000s

During the past two decades, the behaviour of US-industry (representing almost a third of the world-total) has been very uneven. From 1991 to mid-2000, industrial production rose continuously at an annual average real rate of approximately 4.6%. Nonetheless, beginning in 1998, industrial production grew at increasingly lower rates, and, during the first few months of 2001, at negative rates. Only in mid-2002 (almost 18 months later) did rates of change become positive again. And it was not until the beginning of 2004 that the level of industrial production reached again the levels of the half of 2000. In all, US-industrial growth stagnated for three and a half years. The retreat and stagnation of industry during a period of almost forty months was reflected in two indicators: first, in the stagnation of industrial capacity for almost thirty months (see Figure 5); and second, in the severe fall of capacity-utilisation.<sup>19</sup>



Source: Developed by authors, with data from the Bureau of Economic Analysis, Department of Commerce.

**Figure 5 US-Industrial Production and Capacity 1990–2009.**  
January (1990=1)

19. Morera and Rojas 2008, pp. 112–13.



In December 2008, the level of industrial production in the USA was equivalent to that in the summer of 2004. Compared to December 2007, the drop was nearly 8%. This was the biggest fall in US-industrial production since the spring of 1975. US-industry currently stands at the level of five years ago and presents the dynamism of thirty-five years ago – a difficult predicament. Meanwhile, capacity-utilisation dropped to 73.6%. At its highest, between 1968 and 1973, years of unrestrained growth, capacity-utilisation in the USA stood at nearly 90%. In the 1980s, the average level of utilisation was above 80%, and at times it was almost 5% higher.

In the autumn of 1982, US-industry experienced one of the worst falls in its history but still managed to recover. Nevertheless, capacity-utilisation dropped to a mere 72% at the end of that decade, while in the 1990s – in the winters of 1995 and 1997 – it achieved maximum-levels of 85% during certain months. From 1998 to the present, US-industry was never able to return to those utilisation-levels, even with the dramatic expansion of credit in the 2000s, which stretched production beyond its real potential.

During the boom of the 2000s, the maximum-level of capacity-utilisation level was registered at the end of 2006 and the beginning of 2007. From that time to 2009, there was not merely a deceleration but a clear decline. The level in December 2008, as was already mentioned, stood at 73.6%, which is worse than the drop at the end of 2001, but similar to the level registered in December 1982. That was the lowest level in recent US-economic history, and furthermore, the most drastic decline since 1975. Actually – February 2009 – the industrial capacity-utilisation level is similar to December 82, the month of the history' lowest: 70.8%. In short, the fall has been tremendous.<sup>20</sup> (see Figure 6).

## **7. Savings and investment on a world-scale**

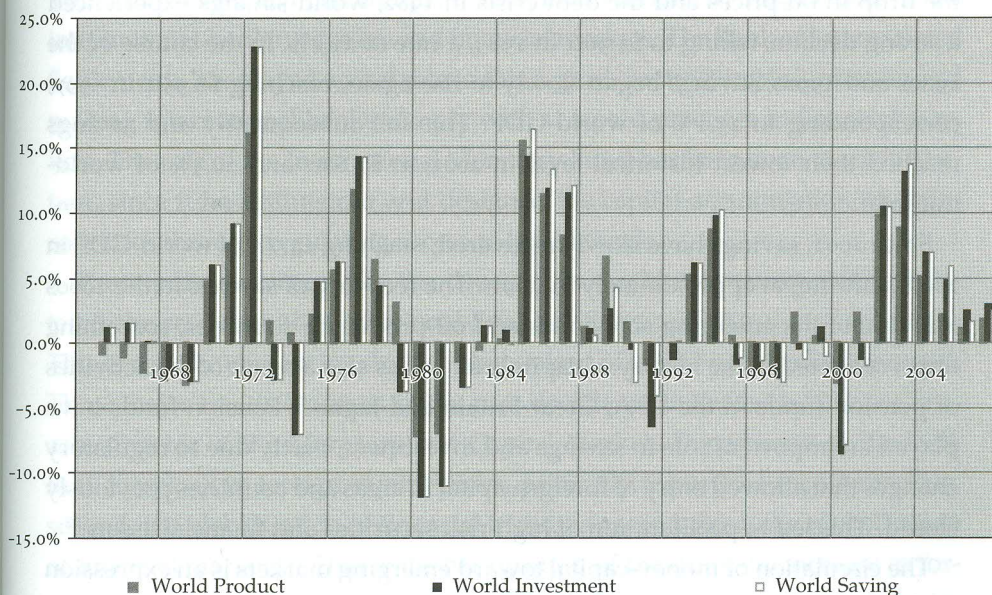
The import of foreign-direct investment, however, becomes clear only in the context of global savings and investment (see Figure 6). Relative to world-GDP, international savings and investment have progressively declined over the past thirty years. The share of industrialised countries in both savings and investment has remained dominant, but their share relative to world value-added has declined steadily, falling from 26% in the 1970s to 20% in

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20. Morera and Rojas 2008, p. 114.

the new millennium. At the same time, the emerging economies and oil-producing countries have boosted their share from negative or very small numbers to nearly 7%.<sup>21</sup>

Historically, money-capital has flown toward developing countries as a result of savings in industrialised countries. This trend was reinforced by the activities of pension-funds in industrialised countries coupled with international-monetary flows. But this international circulation of money-capital has been recently transformed by the rapid industrialisation of some developing countries as well as the growth of oil-revenue in petroleum-producing countries. Indeed, emerging economies and oil-producing countries have played a strong role in generating world-savings during three periods in recent years. First, at the time of the second oil-shock, 1978–82; second, at the time of the industrial boom in Southeast Asia, 1994–8; and third, after the recovery of oil prices in 2000–7, and the industrial boom in China and India.



Source: Developed by authors, with data from the Bureau of Economic Analysis, Department of Commerce.

**Figure 6 World-Product, Saving and Investment 1965–2008.**  
Annual Growth in %

21. Morera and Rojas 2008, pp. 101–2.



Nonetheless, savings and investment relative to world-output remained on a downward trend since the beginning of the 1970s. They reached their lowest historical growth-rates in 2002, and, since then, they have gradually recovered (see Figure 6). At the same time, in emerging markets and oil-producing countries a tendency toward increasing savings and investment began two decades ago, except for the years of the Asian crisis. After 2000, the participation of emerging economies and oil-producing countries in world-savings took an ever greater importance, in view of booming oil-prices and industrial development of China and India.<sup>22</sup>

Total savings and investment have doubled in the past twenty years. Specifically, during the past five years, savings rose by 50% and the savings rate reached 22.9% of world-output. In broader historical perspective, world savings in 1965 amounted to nearly \$4.43tr (in constant 2007 US-dollars, as for the rest of the figures in this section). They then fell but rose again during the oil-boom of the 1970s, reaching almost \$7.35tr in 1979, a rate of 24.7%. With the drop in oil-prices and the debt-crisis in 1982, world-savings experienced a strong decline, falling to \$5.36tr in 1983, a rate of 21.4%. In the course of the 1980s and 1990s, savings began slowly to rise again, reaching \$8.95tr in 1997, corresponding to 23.1% of world-GDP. This fell subsequently and savings reached their lowest historical level in 2002, at \$7.68tr and 20.5% of world-output.<sup>23</sup>

Since 2002, savings have slowly recovered, reaching 22.9% of world-GDP in 2007, standing at approximately \$11.09tr. The recovery of savings in the 2000s was due to the emerging economies and oil-producing countries, something unprecedented in the history of capitalism. It was also a result of the activities of pension-funds in the USA, Great Britain and Japan.<sup>24</sup> Pension-funds have played an important role in savings and investment, partly due to regulatory changes that allowed entry of foreign capital in areas and countries previously closed. This led to proliferation of high-risk securities and financial assets.<sup>25</sup>

The circulation of money-capital toward emerging markets is an expression of the international dynamics of savings, but also reflects the conditions of valorisation in emerging markets, namely dynamic industrialisation and oil-

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22. Morera and Rojas 2008, p. 125. IMF-GFSR 2007, pp. 20–4. UNCTAD 2006, pp. 2–3.

23. Morera and Rojas 2008, pp. 101–3.

24. IFSL 2007, p. 1

25. Morera and Rojas 2008, p. 107.

production. How did the world-economy arrive at this position? It is possible that this outcome has a connection with the phenomenon of overproduction. However, for most economists, the catalyst of this development is the qualitative transformation of Asia, where savings have increased but investment has fallen abruptly since the end of the 1990s. This, in turn, has served to finance the enormous deficit in the US current account. Other economists also stress monetary and fiscal policies deployed by Asian countries. However, this does not explain why investment-flows have been directed to the United States even though other emerging markets offer higher interest-rates.

The important point is that the world-financial system is structured under the hegemonic power of the dollar.<sup>26</sup> This was established in the 1980s, when the United States reached agreements with representatives of other capitalist states, including the Plaza Accord and the Louvre Accord. It was strengthened in the 1990s when complex economic and political mechanisms were applied for the purpose of facilitating the handling of world money-capital. This includes regulations and prudential interventions in the practices of the international-banking system and financial markets. The Bank of International Settlements has played a vital role in this regard, centralising information and making international banks comply with accepted practices in financial markets. The role of the International Monetary Fund has been even more important, since it has influenced and designed the capital-accumulation of entire countries through regulating access to liquid-funds.

These policies account for the decrease in world interest-rates that facilitated the recovery of international-financial flows and the end of the crisis. This is also the context in which the behaviour of world-savings has changed. Three major trends emerged in the past decade, as indicated by Jaime Caruana, director of the Monetary and Capital Markets Department of the IMF: first, increases in foreign capital-flows, primarily toward emerging markets, second, the globalisation of financial institutions, and third, the globalisation of financial markets.<sup>27</sup> That is the background of the dramatic increase in foreign capital-flows (accumulation of financial assets with international investment-banks, public and private debt-portfolios, stocks and debt-portfolios,

26. Morera and Rojas 2007, p. 5.

27. Caruana 2007.



loan-portfolios, deposits and foreign-direct investment). By April 2007, these flows had risen to \$9tr, almost a fifth of world-output.<sup>28</sup>

## 8. The accumulation of US foreign debt and its impact on developing countries

The USA remained an international creditor until 1985, a position it had maintained since World-War I. However, its strength as world-creditor had been deteriorating for some time. From 1986, US foreign debt increased, and its liabilities continued to rise throughout the 1990s, as is shown in Figure 7. At the end of 1996, US net debt had reached \$456bn (including market-securities). A year later, the debt had risen to \$776.5bn, equivalent to 13% of its GDP, and before the end of 2000 it had become \$1.3tr, equivalent to 18% of its GDP.

After 1998 the volume of capital-flows to and from the USA increased significantly. In 2004, debt stood at \$2.2tr, though, as a result of the dollar's devaluation in 2004, the net value of US-liabilities decreased from 20.5% to 20.1% of GDP.<sup>29</sup> Nevertheless, the dollar-value of assets held by foreigners rose as proportion of US-GDP. At the end of 2003, foreigners held assets worth 97% of US-GDP, while, in 2005, the proportion had gone up to 107.4%. The net inflow of foreign investment in 2004 and 2005 was much greater than the necessary sum to finance the deficit in the US current accounts, and the excess flowed back to the world-economy.

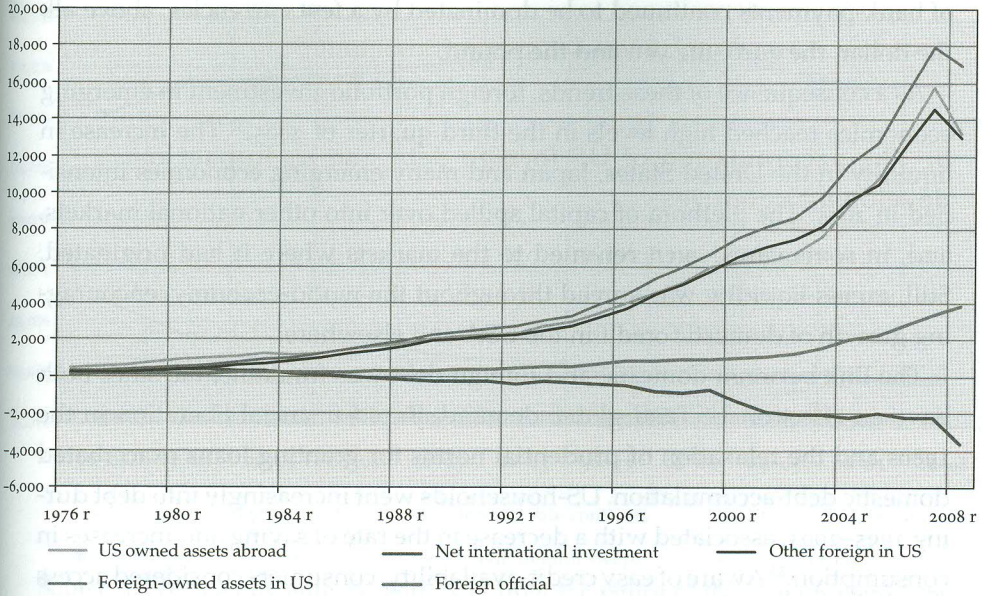
There are significant asymmetries in the composition of foreign property in the hands of US-residents compared to US-property in the hands of foreigners. In 2005, for instance, 27% of US total assets abroad was direct investment (facilities and equipment), in contrast to only 19% of US-liabilities in the hands of foreigners. Foreign investors in the USA tended to purchase negotiable financial assets (stocks, bonds, public securities and banking liabilities) that could be liquidated more easily than direct investments.<sup>30</sup> A further major difference is that the Federal Reserve and other entities in the US-government invested insignificant amounts in other countries. In contrast, foreign public

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28. Caruana 2007.

29. Morera and Rojas 2008, p. 116.

30. D'Arista 2007, pp. 14–15.



Source: Developed by authors, with data from the Office of the Comptroller of the Currency and Bank for International Settlements

**Figure 7 US-International Investment-Position 1986–2007, Derivatives Not Included. Billions dollars**

sectors had invested approximately \$2.3tr in the USA in 2005, around 16% of total foreign investment. By the middle of the decade, foreign-public institutions had become important sources of capital-flows to the United States.

Large flows of private-foreign investment and rapid expansion in world-liquidity were the result of monetary policies in industrialised countries in response to the recession of 2001.<sup>31</sup> Abundant liquidity and low interest-rates propelled a global search for greater returns. With a view to protecting profitability, the Federal Reserve increased interest-rates after 2004 and reduced the rate on sovereign-bonds, a process that lasted until September 2007. At the same time, securities-markets in emerging economies were stimulated. Moreover, the Federal Reserve encouraged commercial loans in dollars in place of loans in yen, thereby renewing speculative interest in US-financial securities. All these developments took place while the international system

31. BIS 2004, pp. 3–9.



of bank-payments continued to be dominated by a few currencies, above all, the dollar, the euro, the yen and the pound.

As a consequence of these trends, foreign portfolio-investment in emerging economies reached high levels in the third quarter of 2005.<sup>32</sup> The increase in liquidity in the United States, Japan and many emerging economies intensified in 2005. The plethora of capital spilled over into other national markets, and, in some cases, even returned to the markets where it had originated. Still, excess-liquidity was spread throughout the world-economy, encouraging growth of domestic credit in the USA and elsewhere.

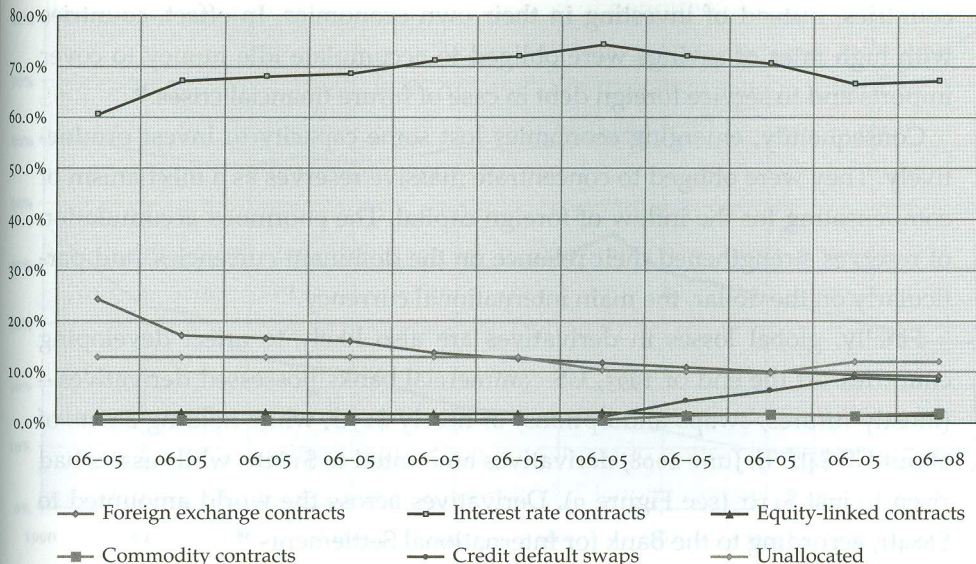
The link between domestic and foreign debt was fundamental, since both have an effect on US- and global demand. Rapid financial liberation in the 1980s and the relaxation of prudential norms for granting loans exacerbated domestic debt-accumulation. US-households went increasingly into debt during 1995–2005, associated with a decrease in the rate of saving and increases in consumption.<sup>33</sup> Aware of easy credit-availability, consumers considered access to credit as a substitute for savings, especially after 2002, when debt was used both to acquire appreciating residential property and to extract liquidity for consumption. Enterprise also took advantage of low rates in bonds-markets to apply for loans in order to repurchase bonds or stocks in the secondary market, thus strengthening their profitability.

In short, private capital was the driving force behind international capital-flows and an important source of the expansion of credit in the USA. At the same time, excessive volumes of foreign private capital appeared, exacerbating investment-flows out of the USA, and increasing liquidity both in the USA and the world-market. Moreover, massive amounts of foreign-government investments took place in the USA. For emerging economies, these trends had considerable repercussions, driving monetary authorities in those countries to intensify the level of intervention. The aim was to stop appreciation of domestic currency and contain domestic growth of money and credit. Consequently, the accumulation of reserves played a fundamental role in the process of expansion and contraction, creating further scope for generation of international liquidity (see Figure 7).

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32. BIS 2005c, pp. 1–3.

33. Family-debt increased from 65.7% of the GDP in 1995 to 92.1% at the end of 2005. Federal-government debt, on the other hand, diminished during that same period from 49.2% to 37.2% of the GDP. Federal Reserve Bank, Flow of Funds, various.



Source: Developed by authors, with data from the Office of the Comptroller of the Currency and Bank for International Settlements

**Figure 8 Non-Stock-Market Credit by Instrument, June 1998–June 2008, Total Contracts**

To put it differently, the strategies used by the large private-financial institutions dominating the international payments-system to increase their profits also intensified the vulnerability of emerging economies. As more developed and developing countries freed their capital-accounts in the 1990s, the value of their currencies came increasingly to depend on the operations conducted by financial among various financial instruments and markets, rather than depending on trade.<sup>34</sup> Changes in the differentials among interest rates denominated in different currencies became the driving force behind capital- and foreign-currency flows. Thus, the problems in monetary control world-wide were exacerbated (see Figure 8).

The extraordinary increase in the reserves of emerging economies during the last decade points to the pressure to use surpluses from trade to create a buffer to diminish vulnerability to external forces.<sup>35</sup> In order to undertake this policy, emerging countries were obliged to lend their savings to developed

34. Conford 2005, pp. 3–6.

35. Paineira 2009. BIS 2007, pp. 44–52.



countries, instead of investing in their own economies. In effect, countries with high rates of savings were obliged to accumulate idle money to cover imports and to service foreign debt in case of future financial crises.<sup>36</sup>

Consequently, emerging economies lost some capacity to invest productively. They were obliged to concentrate massive reserves as a mechanism of compensating for the inflow of foreign capital. The enormous accumulation of reserves strengthened their reliance on the dominant currencies, and particularly on the dollar, the main international currency.<sup>37</sup>

Finally, global losses in derivatives are also likely to affect developing countries. At the end of 1995, US-commercial banks possessed derivatives – (mostly futures, swaps and options) of nearly \$15tr, while holding assets of about US \$4tr. In June 2008, derivatives amounted to \$182tr, while assets had risen to just \$11tr (see Figure 9). Derivatives across the world amounted to \$684tr, according to the Bank for International Settlements.<sup>38</sup>

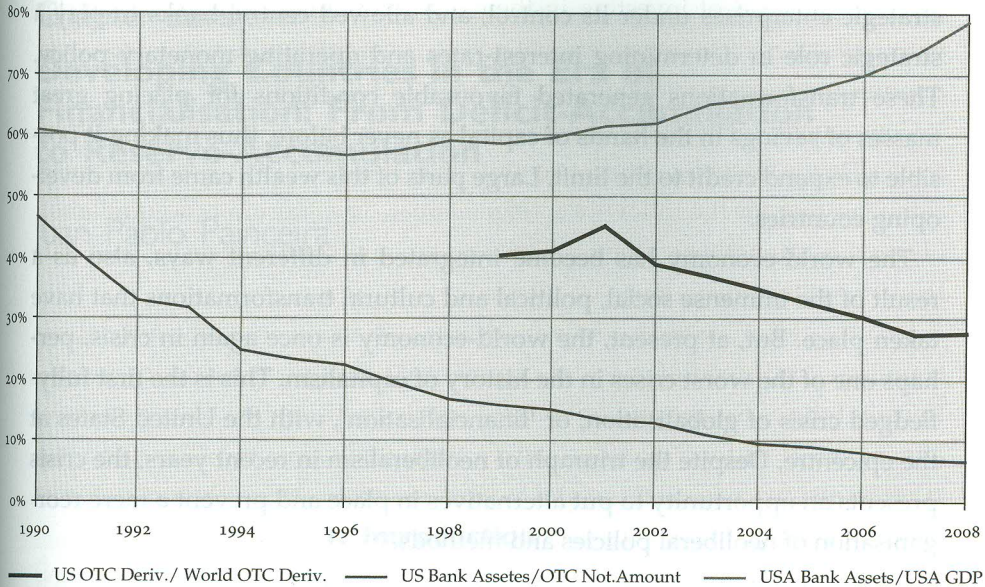
These derivatives have a gross market-value of no more than \$20tr, and are controlled by investment-funds, pension-funds, commercial banks, and other financial institutions. By September 2008, the value of derivatives held by US-commercial banks had dropped to \$176tr, while assets stood at \$12tr. About \$6tr was lost, equivalent to nearly seven times Mexico's GDP. After the sustained fall of the Dow Jones from June to December, the notional amount of derivative-value lost was at least 35%, or more than \$60tr. This is a terrible loss, from any point of view. Similar losses took place across the world. On this basis, the question naturally arises: who lost more than \$60tr in the USA, and possibly \$235tr across the world – equivalent to five times the value of the world-output? And who will recover this value?

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36. 'Although foreign-exchange reserves held on the books of central banks provide support for expansions of money and credit in the domestic economy, monetary authorities in these countries must sterilize some or all of the buildup in reserves by selling holdings of domestic assets or issuing central bank liabilities to prevent over-expansion. Both of these sterilization techniques inhibit the growth and stability of domestic capital markets by constraining the central banks' ability to support those markets.' (D'Arista 2007, p. 32).

37. Lapavitsas 2009.

38. BIS 2008.



Source: Developed by authors, with data from the Office of the Comptroller of the Currency and Bank for International Settlements

**Figure 9 Non-Stock-Market Credit in US, 1990–2008 (OTC-Derivatives) (%)**

## 9. Conclusion

Restoring the rate of profit has been the focus of efforts by both state and by capital, since the crisis of the 1970s. Profound changes have taken place in the social relations of production between capital and labour for more than three decades. The scope of capitalist operations has been considerably broadened by the collapse of the so-called socialist régimes and the profound transformation of China. But a most striking development is that, under the predominance of banking capital and the hegemony of the US-dollar, the strategy of 'financialisation' was imposed on all forms of capital.

Vital to 'financialisation' were changes in the labour-force as well as a transformation of the state. The nature of work has altered and many of the social advances achieved in earlier periods were reversed, particularly in education, health-services, and pension-systems. New financial institutions, operating under the logic of private profitability, transformed the wage-income of both productive and unproductive labour into financial assets. Workers were thus subjected to even greater exploitation. In addition, the state privatised



strategic enterprises under its control, and allowed central banks to play a strategic role in determining interest-rates and operating monetary policy. These transformations generated favourable conditions for placing great masses of savings in the hands of capital as never before, thus making it possible to expand credit to the limit. Large parts of this wealth came from developing countries.

The world-economy has become integrated in different ways, also as a result of the immense social, political and cultural transformations that have taken place. But, at present, the world-economy is once again in crisis, perhaps one of the worst crises in the history of capitalism. This is the first fully-fledged crisis of globalisation, or 'financialisation', with the United States at the epicentre. Despite the triumph of neoliberalism in recent years, the crisis presents an opportunity to put alternatives in place and prevent a mere reorganisation of neoliberal policies and methods.