# World Economic Crisis:
# The Failure of Unfettered Capitalism

> For to what purpose is all the toil and bustle of this world? What is the end of avarice and ambition of the pursuit of wealth, of power, and pre-eminence?[1]

The current global breakdown of the capitalist system must compel all thinking men and women to examine the soundness of our economic model. For the state of the world economy is in a great flux of instability amidst trillions of Euros been lost in various stock exchanges while thousands of working people are thrown daily to the unemployment ranks.

The unforeseen consequences of the present capitalist meltdown[2] should provide the reason for us to examine in detail the field of economics which unfortunately is rife with many contradictions. For the science, if we could call it thus, is divided into two schools of thought, the Capitalist and the Marxist, and these schools are contradictory.

Nevertheless, the present chaotic conditions of the world economy oblige us to put aside the ideological differences that arise from the two diametrically opposed economic doctrines, and attempt to discover the causes and remedies of our mounting ills. For all around us we see that the fictitious new knowledge of the infamous now "financial revolution" is being used to possibly destroy our civilization and us with it.

Moreover, the question of the destruction or development of human civilization is not for our generation an academic issue. It involves our destruction or our advancement. It means life or death to us personally; peace

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[1] Adam Smith, *The Theory of Moral Sentiments*, London, 1759, p.63 of the 1817 publication by Wells and Lilly, Boston, USA.

[2] "People must be free to act in their self interest unencumbered by external economic shocks or economic policy ... Even in crisis economies seem inevitably to write themselves ... Why do we wish to inhibit the pollinating bees of Wall Street?" Alan Greenspan, *The Age of Turbulence*, p.368, 372, Penguin Books, 2007. As soon as those phrases were written, the heavens opened and the financial cataclysm began. Two years later and there is no sign of relief in sight. One wonders how a man with such an experience could be so wrong. Probably, he was so blinded by his mentor Ayan Rand and her Social Darwinism doctrine.

or war; security or destitution. These issues involve the very lives of any one of us.

But what should we do? In order to answer this question a resort to financial economics and political economy is inevitable. For, political economy professes to explain determinate relationships of our economic actions, whether collective or individual, and their social consequences. Hence, our behavior and activities are bound to be profoundly affected by our economic opinions. This is the main reason that compelled me to write this essay on the principal explanations of the occurrence of this economic crisis and its consequences.

During the last decade, the world economy dominated by finance capital had been going through the boom and bust cycle in amplified phases. We were living in a debt-world of leverage with the banks and hedge funds pulling the reins of the deceptive chariot of growth. It was a period in which when fortunes and losses were extraordinary, it was characterized by catch phrases such as “Tulip Mania”, South Sea Bubble” or “Dot-com Bubble”. It was a financial world of bubbles everywhere as debt was piling up dangerously in the balance sheets of consumers, corporations and governments. And finally when all the debt bubbles of the main sectors of the economy got united, they created a huge bubble of gigantic proportions which was impossible to be sustained by real assets. The result of its bursting was the creation of tidal waves that took underneath them all, innocent and culprits.

Hence, we are presently experiencing the most severe economic crisis which the capitalist system has encountered. The capital losses, business failures and mortgage defaults are surpassing even those of the Great Depression. As a matter of fact, it could be characterized as the “mother of crises” since the inception of the capitalist system in the 18$^{th}$ century. It is worth noting that before the financial meltdown which began in the summer of 2007, following the bankruptcy of two Bear Sterns (now defunct) hedge funds specializing in mortgage backed securities, an elusive “smoke and mirrors” economic growth was taking place. This started in the spring of 2003, simultaneously with the invasion of the United States in Iraq.

This economic growth, better, a statistical illusion, was entirely financed through borrowing due to cheap credit that the financial system not only easily provided, but even encouraged. These were the times where leverage was the "mother's milk" to almost everyone. Interest rates had dropped to 1% and 2% in the United States and Europe, respectively. These were the lowest rates in 50 years, while the net spread of lending and borrowing rates of banks increased dramatically. Hence, the profitability of the banks was enhanced whereas the financial burden of borrowers became unbearable as credit card charges reached the usurious level of 22%.

Meanwhile, the governments of nations across continents were celebrating the economic miracle of globalization and deregulation.[3] Posted annual growth rates of GDP were in excess of 4% in the Western world and in some countries of the East, such as China and India above 10%. It was an era of win-win phenomena where everybody believed that stock prices and those of houses in particular, never go down, only interest rates do. It was an era of reckless speculation where excessive leverage was used to bet on financial assets including the toxic mortgage backed securities. It was an era of private vices producing even greater vices in a fool's paradise of grand deception. But the governments, by following the adage "illusions are more comfortable than reality" concurred to this borrowing spree and the public loved it. And it kept spending leisurely on conspicuous consumption and buying overrated investments through credit, swelling their debt balances up to the hilt.

In that advanced stage of the evolution of the capitalist system in which finance capital predominates, the so called stage of "unfettered capitalism" or "vulture capitalism" all values conjoin in one, that of *wealth enhancement*. Individualism is extreme and human and moral values matter less than accumulation of material wealth which becomes the real fetish and symbol of success. In this Machiavellian environment where "the end justifies the

[3] Below is cited a characteristic quote from the champion of deregulation the "maestro" as he was called then, Alan Greenspan: "Avid defender though I was of letting markets function unencumbered, I knew that as chairman I would also be responsible for the Fed's vast regulatory apparatus. Could I reconcile that duty with my beliefs? ... Since, I was an outlier in my opposition to most regulation I planned to be passive in such matters..." ibid, p.373.
Now, just imagine the chairman of the Federal Reserve, the most powerful banker, to be passive on important regulatory matters such as the regulation of the secretive operations of the hedge funds or the non- reported multi-trillion derivative operations of the banks. As history has proven beyond any reasonable doubt, this was his most unforgivable policy mistake. Only after the Etna volcano had erupted and millions of people were thrown like dogs to the unemployment ranks of the "industrial reserve army" he began screaming "nationalize the banks!" But it was too late. An unprecedented economic carnage was underway.

means" and the Schumpeterian "creative destruction" is transformed to destructive creation, the economic landscape resembled a huge park of drunken savages.

Within this morbid economic climate, firms borrowed not to increase productive capacity, but to devour other firms, and banks lent on teaser interest rates to hopeless people, sub-prime borrowers with bad credit and a checkered past.[4] And after, like Procrustes, the highwayman of ancient Attica, placed their victims on an Iron bed for measurement. If they were too short they stretched them and if they were too long they chopped off their feet. The result was millions of home foreclosures and broken families.

In that advanced stage of "savage society", the debt-equity ratios, the banality of leverage, exceeded the ratio of 30:1. Paradoxically, this hyperbolic leverage factor was considered a prudent ratio by Henry Paulson when in February of 2000, as the CEO of Goldman Sachs then, he petitioned the Securities Exchange Commission (SEC) to allow his firm and other Wall Street investment banks to raise their levels of leverage in order to expand their financial business internationally.[5] Accordingly, Paulson knew better than anybody else that if the initial rescue plan of $700 billion did not pass by Congress, the banks will have failed. Thus he said agonizing, in a chilly evening of October 2008, the unforgettable "if the plan does not pass heavens help us all."

It was, therefore, not a surprise but a judicious expectation that the economic system amidst this financial insanity will eventually collapse. Few of the most responsible capitalist economists had already ringed the alarm of danger. They knew that the world financial institutions were balancing in suspense at the edge of a steep cliff. They knew that the biggest threat was not what it was shown in the banks balance sheets, but what it was off-balance

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[4] "If you hang around the sub-prime lending business long enough, you will meet your share of interesting borrowers: strippers, cons, pimps, thugs, and various other upstanding citizens of the community". *Confessions of a Sub-Prime Lender: An Insider's Tale of Greed, Fraud, and Ignorance* by Richard Bitner, John Wiley, 2008, p.17

[5] *Time Magazine*, "Living in a world with less credit", October 23, 2008. It is ironic that Henry Paulson, a fund raiser of the Bush family, and Secretary of the Treasury from June 2006, till January 2009, turned out to be the protagonist of the 2008 financial meltdown drama. By his irresponsible intervention in essence he helped create a larger grave for the financial system which 8 years later he so strenuously tried in vain to save. According to *Time*, Paulson considered this change as "the single most important factor" in driving significant parts of their business off shore.

sheets, hidden from the public view. And they also knew that out there in the woods smartly camouflaged was lurking in the shadows a huge monster anxious to devour the capitalist system and with it the rest of us together with the avaricious and corrupt bankers. The latter, after cunningly receiving in advance bonuses to the tune of tens of millions of euros, they let their shareholders' equity vanish down to Hades.

In this environment of pernicious greed and rampant corruption, the lurking Hydra, the serpent with the nine heads which bears the name "derivatives market" was ready to attack with vehemence. This mythological monster grew so fast to such a size that its nominal value reached €400 trillion by the end of 2008, about 10 times of the value of the world gross product combined. And when the attack occurred, seismic waves demolished not only stock markets but also mortgage markets and their related mortgage backed securities (MBS) and collateralized debt obligations (CDO). These exotic financial instruments, whose innovative process was named "securitization"[6] or "financial engineering", were so aesthetically attractive that when the Hydra attacked screaming voices of despair were heard not only from Europe but as far as China and Japan.

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[6] Securitization or the Tool of Financial Transformation* is defined as a process by which an economic entity pools together its future cash flows with the intention of selling them. Thus the purpose of securitization is to achieve financing by sale of future cash flows, i.e. loan payments, which are assets on the balance sheet of the entity. The financing however, is not obtained via borrowing at interest, but by selling its future cash flows, i.e. credit card installment payments. This entity besides a bank or a private corporation, could be a government, national or municipal.

There is however, a big difference in the quality of the underlying asset of the future cash flows. The underlying asset is not an asset in the first place; it is a loan, credit or debt. And here is the slight of hand of transforming a loan to an asset. This is pure alchemy. The process is alchemical because the original source is not an asset but debt. The future cash flows originating from debt are placed on the left hand side of the balance sheet because they are receivables based on debt. This debt was incurred by another entity, such as consumers, homeowners, or governments. If any of those goes bankrupt, the whole process of securitization goes bankrupt also. Accordingly, with securitization a dangerous inverted pyramid standing on its apex – a very curious creature- is constructed having as foundation only one point which is debt and not an asset. How on earth these rocket scientists coming fresh from universities visualized the financial world to stand, on its feet, or on its head, is another matter. The practical issue is that this precarious pyramid collapsed as it was supposed to from its own genesis. Because the slightest impairment in the value of collateral enforces liquidation which initially creates a panic as part of the pyramid structure crumbles. This in turn leads to a further liquidation due to fallen prices generating a vicious downward spiral towards hell.

*Frank Fabozzi and Vinod Kothar, *Securitization: The Tool of Financial Transformation*, July 2007, Yale University.

While the imminent attack of the Hydra was anticipated by few economists who were contemptuously considered by the majority as "cranks" the speed of the cataclysmic collapse of almost all markets was unanticipated. The extent of the damage done worldwide on wealth and actual jobs lost as well as potential layoffs are issues that perplex everybody, experts and novices alike. In hindsight, the cause is attributed to Hydra's non-transparency of activities and the unrestrained freedom of financial institutions to act without even a superficial regulatory oversight. In particular, her most powerful and deadly tentacle that listens to the name Credit Default Swaps (CDS)[7] is so lethal that causes instant death such as those experienced by Bear Stearns, Lehman Brothers, and AIG.[8]

Despite the unprecedented money infusion of trillion of euros to the virtually bankrupt financial sector by governments, it is highly doubtful that these efforts will meet with success. The primary reason is that the Hydra of the derivatives market is enormous[9] and helplessly self-catastrophic, that any

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[7] Credit Default Swaps (CDS) are credit derivatives, insurance "like" futures contracts that are sold and bought as protection against possible default of loans, in particular bonds. However, CDS are not ordinary insurance contracts because they are not government regulated, do not have statutory limits of reserves and no examiners are routinely checking their books. They are completely unregulated, since Alan Greenspan's dictum "the regulators should keep hands-off the markets". Although an agreement was reached in November 2008 to establish a Clearing House and the SEC to regulate the market, so far nothing has been accomplished. In the CDS market which is around $50 trillion in notional value, future contracts are actively traded on the basis of the prospect of default of an entity, which may not only be firms and financial institutions, but also governments. Thus, CDS are dual bets by any participant on the probability of default on the credit of any company or country. In this gambling casino that can turn easily into hell, as the Bear Sterns, Fannie Mae, Freddie Mac, Lehman, and AIG, tragic episodes have shown, speculators are hectically betting in a scenery reminiscent of de la Vega's Amsterdam's exchange during the Tulip Mania in the 1630s: "Gamblers and speculators ... Oh, what an order of life has been created by these schemers! The labyrinth of Crete was no more complicated than the labyrinth of their plans" (*Confusion de Confusiones*, by Joseph de la Vega, 1688, p.151, Wiley Investment Classics, 1996). One reason the CDS market took off in the last decade since 2000, is that the U.S. congress with the support of Alan Greenspan and Lawrence Summers (then Secretary of Treasury, now Obama's Chief economic Adviser) past a Bill prohibiting all federal and most state regulation of CDS. The whole process of CDS trading which consists of bets on other people's debt is haphazard. Most contracts are bought and sold over the phone or by instant message and settle manually. This market which is in essence a gambling house with the habitué betting on whether or not their next neighbor or countries will die financially, it was called by the "oracle", Alan Greenspan, a major invention of "counterparty surveillance" (ibid. p.371).

[8] AIG is not legally bankrupt because the U.S. government decided to rescue it by assuming an 80% equity participation in the company. Because it was one of the largest derivatives players and as an insurer its contribution to systemic risk was large. So far it has cost the U.S. taxpayer some $170 billion. The company reported 4th quarter results of 2008, registering losses of $61 billion, the largest quarterly loss in financial history.

[9] In a recent report (March 2009) of the Comptroller of the Currency Administrator of National Banks in the U.S. the derivatives held by U.S. Commercial banks amounted to $200.4 in notional value by the end of 2008. Derivatives activity in the U.S. banking sector is

bailout money to save their toxic assets will be money thrown in the winds. For, they offer no benefit to society whatsoever, since they are dual games, where one wins and the other necessarily loses within the time limits specified on the particular contracts.[10] This battle of the wits in the derivatives game and its anti-social character is elegantly expressed in the following statement:

> The actual, private object of the most skilled investment today, is "to beat the gun", as the Americans so well express it, to outwit the crowd, and to pass the bad or depreciating half-crown to the other fellow.

Keynes, who himself was a great speculator, in the above passage from *The General Theory*[11] speaks of investment and not derivatives. Because derivatives in the form of weapons of mass destruction such as CMOs, CDOs, and CDSs were not in existence in the 1930s. These financial instruments that are in fact speculative whirlpools are "innovations" of Greenspan's "irrational exuberance" period. They are pure gambling bets, a financial scheme invented by the "too-big-to-fail" banking institutions, the insiders, to trick or deceive the outsiders to part with their money. This mischievous socially predatory behavior prompted Merkel, the chancellor of Germany, to call the financial markets "evil" in the G-20 summit.[12] Echoing U.S. president Jackson's views on the bankers "you are a den of vipers and thieves".[13]

It is worth noting, as the G-20 economic summit closed its proceedings and a communiqué was issued of "common agreement", including the intention to regulate the hedge funds secretive operations, no reference was made to the colossal problem of derivatives. The pledge that was made to

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dominated by a small group of large financial institutions. Four large commercial banks represent the 94% of the total industry notional amount. According to the report, JP Morgan holds the lions share with $87.4 trillion (43.6%), Bank of America $38.3 trillion (19%), Citibank $31.9 trillion (15.9%) and Goldman Sachs $30.2 trillion (15.1%). Thus only those four "too-big-too-fail" institutions hold an astronomical total of $188 trillion in derivatives or about 15 times the value of GDP of the U.S. The above sum does not include AIG because it is an insurance company, and of course the European huge derivatives players, Deutsche Bank, UBS, Barclays and others.

[10] This is why in March 2009, a public outrage erupted in the U.S. when it was revealed that AIG used more than $100 billion of borrowed funds from the U.S. government to settle offsetting derivative contracts to Goldman Sachs, Merrill Lynch, JP Morgan and the rest of the cabals in this rotten business.

[11] Keynes, *The General Theory of Employment, Interest and Money*, Harcour Brace, 1964 p.155.

[12] In a remark at the G-20 economic summit in London in the first week of April 2009.

[13] In a speech made by Jackson in 1832 when he became president of the U.S. winning the elections by a wide margin. Ellen Brown, *The Web of Debt*, p.80.

provide €1.1 trillion to the International Monetary Fund (IMF) to tackle the global downturn and to assist the lower income countries, it appears to be a joke in the face of the mythical in size derivatives exposure. This indicated an obvious reluctance to deal with the real issue, an action of escapism in the light of evidence that the value of derivatives held by the U.S. banks increased by $24 trillion to $200.4 trillion by the year end of 2008.[14]

As the G-20 summit failed to address the "over-trading" and reckless speculation of the banks which as referred to earlier, offers no social benefits but only promotes the satisfaction of their avaricious motives, we are heading for more onerous problems later. Because, the governments' current commitment - in particular in the euro zone – in bailing out bankrupt financial institutions via taxpayers' money is an ineffective economic policy. Since, it does not only reward incompetence, but also the villains who caused the present economic disaster.[15] Moreover, an economic policy for the social benefit requires the commitment of funds to public investments and jobs creation, and not to save unscrupulous speculators.

In addition, experience teaches us that behind speculative manias and dubious lending practices always lies the phenomenon of Moral Hazard[16]: the risk arising from the possible dishonesty of a borrower and/or speculator when his business undertaking fails, to voluntarily default in order to escape his debt obligation. Or, in general, the human tendency to assume irresponsible risks when you know in advance that someone else will bear the costs in case that things turn to disaster .Where, a splendid example is the funding of trillion of Euros rescue operations to save the "too big to fail" bankrupt banks and footing the bill to taxpayers.

Hence, the derivatives Hydra was left loose again to devour more funds

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[14] Quarterly Report on Bank Trading and Derivatives Activities, 4th Quarter 2008, Controller of the Currency Administrator of National Banks, Washington D.C.

[15] As of this writing, the unemployment numbers of the U.S. economy were released showing that 663,000 jobs were lost in March 2009. This brings the total number of unemployed people in the U.S. to above 2 million from the beginning of the year, i.e. the worst unemployment figures in 26 years, since 1983.

.[16] "Moral Hazard" has its origins in the insurance industry. Very early in the game providers of fire insurance noticed that the property owners who were fully insured against loss had an intrusting tendency to set destructive fires – particularly when changing conditions have reduced the probable market value of their building to less than the insurance coverage ... Borrowed money is inherently likely to produce moral hazard" (Paul Krugman, *The Return of Depression Economics*, p.63, Penguin Books, 2008).

at the expense of dangerously swelling public deficits. But, how this monster is extinguished in the light of governments' irresponsible policies? Unfortunately, Hydra's extrication, in this morbid economic environment, will require the help of more than one semi-God of the status of Hercules to do the job. We need also the help of Theseus, the popular king of ancient Athens, to kill first Procrustes and throw his iron bed in the Aegean Archipelago. Because, this unique iron bed in modern banking is adjustable in order to accommodate the body measurement of the unfortunate debtors according to interest rate changes. This renders improbable the escape of the victims captured and constitutes the banks even worst creatures than Procrustes.

Regarding Hercules, as known, he was a mythological deity in human flesh bestowed not only with enormous physical power and bravery, but also with virtue, that uncommon nowadays human charisma. Now, the question arises in a financial landscape swarm with deception, fraud and vice, how Hercules will fit in? Is it logical to expect Hercules to appear with his club and start knocking off the nine heads of Hydra? Probably not, but if he listens to our voices of despair and he does appear, he will most likely use his club to knock down, to demolish the whole edifice of banking institutions and bury underneath the debris Hydra too. Yet, after achieving his deed, Hercules has an additional onerous task to perform: to clean up the stables from the Augean coprous which have not been cleaned for 300 years, a task that may take years to accomplish, unless a river like Alpheus is adjacent.

There is no need to emphasize that the phenomena of economic crises are not any new experience to capitalism, even though these crises have differed enormously in their intensity, character and longevity throughout the world. As noted earlier, the centerpiece of the current severe crisis is the meltdown and bankruptcies of financial institutions and homeowners which was exasperated by the exotic products of financial derivatives. This in turn led to the creation of a grand scale international casino which suddenly – like the "Butterfly effect" in chaotic systems- collapsed due to paranoid leverage of its chief players.

Whether the origin is identified to be the breakdown of the sub-prime market which in turn triggered the crumbling of its securitized products is not the important issue as the public via the media was made to believe. The crucial issue is that financial assets outweighed real productive assets by a wide margin due to excessive leverage on speculative derivative activities which are by their nature non- productive to the real economy:

> If the increase in lending does not increase productivity then this fact alone is responsible for the spelling disaster [as] speculation never fails to add to the structure of debt...The credit machine is so designed as to serve the improvement of the productive apparatus and to punish any other use.[17]

Thus said the erudite Schumpeter and added, “In the atmosphere of prosperity phase there will also develop reckless fraudulent practices”[18]. But neither Schumpeter nor any knowledgeable non-dogmatic economist would ever perceive the astronomical leverage ratios utilized by the banks to conduct their speculative operations. This financial insanity rendered inevitable the collapse of the inverted debt- pyramid the Wall Street wizards created. To paraphrase Keynes, the enterprise of the banks became the bubble of the whirlpool of speculation and the capital development of the world economies became the by-product of the activities of an international casino.

Financial markets are dynamic systems that are governed by laws of chaos or complexity theory, where stasis and equilibrium are illusions while “out of equilibrium” and “extreme events” are the rule.[19] The collapse occurred because financial markets being “systemically unstable” had entered an unstable phase where any small disturbance following Lorenz’s axiom of “sensitive dependence on initial conditions”, could have triggered the instability. The true cause of the collapse is the financial markets’ “systemic instability” which will be found in its genesis, in the preceding years, and in my opinion in the repeal of the Glass-Steagall Act[20], in December 1999.

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[17] Joseph Schumpeter, *Business Cycles*, McGraw Hill, 1964, p.123.
[18] Ibid., p.124
[19] Didier Sornette, *Why Stock Markets Crash, Critical Events in Complex Financial Systems*, Princeton University Press, p. xv, p.4
[20] The Glass-Steagall Act was enacted in 1932, during the Great Depression at the year in which the U.S. stock market hit bottom, with the Dow Jones losing 90% of its value from its peak in 1929. In this frightening environment, the Roosevelt administration decided to separate the financial institutions into two kinds, (a) commercial banks and (b) investment banks. The main purpose of the Act was to limit speculation and inside information, but most importantly to prevent the banks from gambling with the money they themselves create out of thin air, and with the money entrusted to them by their clients. Commercial banks were allowed to take in deposits and issue commercial loans, but were prohibited to underwrite

Therefore, the actual event that triggered the instability whether that is the sub-prime market breakdown or the Lehman Brothers bankruptcy is of secondary importance. Anything could have caused a complete breakdown of the globalized financial system due to the extensive leakages of today's markets as the system was ripe.[21]

Accordingly, the dual game that was set on an unstable system[22] by Wall Street financial engineers was a devious zero-sum game based on the ruthless principles of Mercantilism. This is the fundamental reason why they wanted so desperately to expand "off-shore" to "beat the gun" to pass the "old maid" to their neighbors, to their allies, before the game was over. To secure a chair in a game of "musical chairs" when the music stops.[23] Because they knew that it was a *ponzi finance scheme* built on debt which necessarily it had to be financed by new debt in order to repay creditors at the top.

They thought that could have won it only by their sheer size, JP Morgan with $87 trillion in derivatives, Bank of America with $38 trillion and Citibank with $32 trillion, but the scheme failed with the known catastrophic

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stock issues and to trade on their own accounts. Investment banks, on the other hand, were allowed to raise capital in the stock and bond markets for their clients and trade in the securities of these markets, but were not allowed to accept deposits or make commercial loans. Hence, real Chinese Walls were placed between the financial functions of the two corporate entities. This system has served well for almost 70 years not only the U.S. economy, but also the rest of the world that followed in her steps as the leading nation after WWII.

It should be emphasized, in the roaring 1920s, trusts and monopolies reminiscent of the Gilded Age had emerged. The U.S. banking business was dominated by two enormous in size banking cartels, one by the Morgan Family (Morgan House, today J.P. Morgan) and the other by the Rockefeller Family (National City, today Citigroup). Prior to 1932, all banking business, commercial, investment, underwriting and brokerage were conducted, effectively, by these gigantic financial institutions and their affiliates. The result, inside information, rampant stock manipulation, and other fraudulent practices were prevalent. In this environment, the two conglomerate banking cartels contributed greatly to the 1929 stock market crash and its aftermath: the Great Depression, the Securities Exchange Act (1934), which instituted the Securities Exchange Commission (SEC) to control speculative abuses and fraud, and Social Security, since by 1934, average incomes had fallen by 50% and the unemployment rate had reached the astonishing level of 25%, where executives were selling in the streets apples 5 cents each.

As history repeats in a very strange and unpredictable way, the Glass-Steagall Act, this magnificent piece of legislation that kept the integrity of the financial system intact for so many decades, was abolished by Congress, in December 1999, just before Christmas, underneath an 11,000 pages Appropriation Bill. The repeal was made after hundreds of millions of dollars in contributions to the governing party (AIG was also a big contributor) and the assurances of the Treasury Secretary, Lawrence Summers, (now President Obama's Chief Economic Adviser) that the two main functions of commercial and investment banking will be separated by Chinese Walls which proved to be dismally thin and on paper only.

[21] Ibid., p.75

[22] "Greed and Scarcity of Money: the Flaw of our Monetary System" by Spiros Lavdiotis, unpublished paper, November 2008, Athens.

[23] John Maynard Keynes, *The General Theory*, ibid., p.156

consequences. All the big players of the international financial casino knew that the "old maid" was circulating and they rushed panic-stricken to unload it, like madmen in a lunatic asylum where in front of danger most try to escape through the same exit simultaneously and some jump to the void space.

In the ever-recurrent and ever-growing crises of capitalism, it is undeniable the monstrous paradox of co-existence of enforced scarcity and enforced unemployment. The state of equilibrium, as the theory of dynamic systems such as complexity theory has shown, is an elusive nirvana: a boom never flattens itself into a period of stable prosperity, but always ends in crisis. Savings which is necessary for investment is postponing present consumption which is of paramount importance to economic growth. Profit maximization which thrives on lower wages and increasing productivity in order to be realized, a high effective demand is required which implies a high purchasing power and wage income.

The system is self-contradictory as it contains parameters which are conflicting, counter-balancing each other, with the end result being one to be caught between wind and water. And to avoid being swept by strong winds or being drowned by stormy waters, the neo-conservative economists of Wall Street invented alchemical processes of money creation. However, this provides only a short term artificial solution with a possibility of a financial disaster later. Debt is always debt and it must be repaid together with interest. You can escape over the short term your predicament, but over the longer term you are faced with strangulation if your income does not keep up with the interest payments. You can deceive the public temporarily by exploiting the deficiencies of economic aggregates such as GDP by posting illusively high growth rates, but you cannot deceive them forever.

Eventually, even the public will learn that in the national accounts of governments, the debt of both governments and households is excluded from the calculation of GDP because it is considered a transfer payment: the principle and interest payments are transferred to other sectors of the economy such as banking institutions and high net worth individuals and hence there is no effect to the economy as a whole. Thus the issue of income inequality is statistically buried while the true economic growth and well being of a nation is overstated.

In fact, the capitalist world has never been able to discover why its economic life is periodically thrown into confusion, disarray and privation. For if they knew they could have prevented the occurrence of this economic tsunami that brought about such a catastrophe of wealth and human suffering. What on earth sane person or politician gains from this human and capital carnage under democracy? Who desires, except misanthropes, to see hundreds of thousands of people thrown overnight to the unemployment ranks and a general economic bloodshed to ensue with robberies and human insecurity? Is this an achievement of our economic system that we should be proud of?

It follows, therefore, that capitalist economists, the advocates of laissez-faire and in particular "unfettered capitalism", the schema of capitalism espoused by neo-conservatives Milton Friedman and its practitioners Alan Greenspan and Jean Trichet were completely impotent to comprehend and hence prevent the current debacle:

> Not only have individual financial institutions become less vulnerable to shocks from underlying risk factors, but also the financial system as a whole has become more resilient[24].

Laissez-faire economists have habitually spoken about crises as events that convey an aura of uncontrollable nature. This is derived from the very terms that they use to characterize these events as "earthquakes", "blizzards", or "cataclysms of nature". Thus despite our technological achievements and highly developed industrial knowledge, economic crises to us, modern civilized people, are what the hurricanes and earthquakes were to savage people. How could it be to claim that we live in a highly developed civilization,

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[24] Alan Greenspan quoted in Paul Krugman, *The Return of Depression Economics,* p.164. In addition, in the New York Times article, "Taking a Hard New Look at a Greenspan Legacy", Oct. 9, 2008. This quote taken from a speech of Alan Greenspan in 2004, is clearly indicating the degree of impotence in comprehending the system which he ideologically supported and served for so many years, that only after the "sinking of the Titanic" he realized that there was a flaw in his thinking: "I made a mistake in presuming that the self-interest of organizations, specifically banks and others was such that they were best capable of protecting their own shareholders" and he added "I am in a shocked disbelief at the present economic turmoil" (Greenspan's testimony in Congress, Oct.24, 2008).

when our attitude towards the forces of economic crises does not differ from the attitude of the savage man to the blind forces of nature? What type of economic advancement and prosperity are we talking about when the destroyer is not understood and in his passage he destroys our homes, takes away our livelihoods, wrecks our hopes and starves us by the thousands, just as the forces of nature kill, starve, and destroy the savage?

But the savage had his experts, his medicine men, his magicians, who by chants or howls, by sacrifices or incantations attempted to cajole the destroying forces. Likewise the modern capitalist world has also its experts, its economists, who however consider the phenomena of crises as infrequent, *rare events* which lie outside the scope of the science of economics. This fact, which is not widely realized, is admitted by economists who have no difficulty in accepting that their science offers no explanation of crises:

> [Equilibrium theory] does not provide any explanation of the phenomena of booms and slumps ... It explains fluctuations which are in the nature of orderly adaptations. But it does not explain the existence within the economic system of tendencies conducive to disproportionate development ... Yet unquestionably such discrepancies exist, and any attempt to interpret reality solely in terms of such a theory must leave a residue of phenomena not capable of being subsumed under its generalizations.[25]

Thus economic theory offers no explanation of crises since the science leaves an “unexplained residue” in its interpretation of reality. Now, if that unexplained residue turns out to be so catastrophic as to make the whole world convulse through the enormous capital losses sustained and the foundations of the system to be shaken up through numerous bankruptcies and massive layoffs, then this is undoubtedly a failure of the capitalist model built on such a theory.

“No great crisis has ever come about that was not fully explainable by the objective facts of the situation”[26]. These objective facts which in the current economic crisis are hyperbolic debt on all economic sectors and the

[25] Lionel Robbins, *The Nature and Significance of Economic Science,* London, 1932.
[26] Joseph Schumpeter, *Business Cycles,* p. 125

Hydra of derivatives market coupled with fraud and corruption in the apex of the capitalist pyramid, caused the unprecedented Abnormal Liquidation in economic values. Abnormal Liquidation, which we experienced four times[27] in a span of 16 months, it created, as noted earlier, capital losses of tens of trillion euro's, millions of home foreclosures and thousands of bankruptcies. This compelled the governments to lend trillions of euros in order to rescue from definite bankruptcy financial institutions thus aggravating further their already heavily indebted balance sheets.

Consequently, in the current crisis the cyclical process under heavy debt pressure literally collapsed and this is the main reason why we experienced this extended Abnormal Liquidation. But this condition leads the economic system to a new disequilibrium which has the name of Depression[28]. In other words, while in a Recession a mechanism is at work to draw the system back to equilibrium, in a Depression this recovery mechanism is destroyed due to colossal losses, enormous bankruptcies and nightmarish employment situation. Depression has a way of feeding upon itself and of setting into motion a mechanism which according to Schumpeter could in fact run on indefinitely under its own steam. Thus, under Depression which is a very difficult situation, the return of the economic system from the depressive phase takes considerable time and it may take several years:

> No theoretical expectation can be formed about the occurrence and severity of depressions. We may try to appraise the extent of existing maladjustments of the presence of fraudulent schemes, "unsound credit"; and so on; but beyond such indications it is impossible to go.[29]

Spiros Lavdiotis

14 April 2009

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[27](1) March 2008, due to Bear Stearns' failure, (2) July 2008, the failure and nationalization of Fannie Mae and Freddie Mac, the largest mortgage financial institutions of the world, (3) September 2008, Lehman Brothers bankruptcy and AIG's failure and subsequent nationalization by the U.S. government and (4) March 2009, a further collapse of global stock indices which began since Obama's inauguration as President of the U.S., January 21st 2009.

[28] Joseph Schumpeter, ibid., p. 125

[29] Ibid., p.126