YANIS VAROUFAKIS

THE GLOBAL MINOTAUR

America, The True Origins of the Financial Crisis and the Future of the World Economy

ECONOMIC CONTROVERSIES

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Yanis Varoufakis is Professor of Economic Theory at the University of Athens, Greece, where he now lives after more than two decades of studying and teaching in Britain and Australia (where he held academic posts, in reverse order, at the Universities of Sydney, Glasgow, Cambridge and East Anglia). This is his first book aimed at the general reader. His more stuffy books include *Rational Conflict* (1991), *Foundations of Economics* (1998) and (with Shaun Hargreaves Heap) *Game Theory: A critical text* (2004).

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Abbreviations

AC	alternating current
ACE	aeronautic–computer–electronics complex
AIG	American Insurance Group
ATM	automated telling machine
CDO	collateralized debt obligation
CDS	credit default swap
CEO	chief executive officer
DC	direct current
ECB	European Central Bank
ECSC	European Coal and Steel Community
EFSF	European Financial Stability Facility
EIB	European Investment Bank
EMH	Efficient Market Hypothesis
ERAB	Economic Recovery Advisory Board
EU	European Union
FDIC	Federal Deposit Insurance Corporation
GDP	gross domestic product
GM	General Motors
GSRM	global surplus recycling mechanism

IBRD	International Bank for Reconstruction and Development
ICU	International Currency Union
IMF	International Monetary Fund
LTCM	Long-Term Capital Management (name of a hedge fund)
MIE	military-industrial establishment
NAFTA	North American Free Trade Agreement
NATO	North Atlantic Treaty Organization
OECD	Organisation for Economic Co-operation and Development
OEEC	Organisation for European Economic Co-operation
OPEC	Organization of the Petroleum Exporting Countries
RBCT	Real Business Cycle Theory
RBS	Royal Bank of Scotland
REH	Rational Expectations Hypothesis
RMB	renminbi – Chinese currency
SME	small and medium-sized enterprise
SPV	Special Purpose Vehicle
TARP	Troubled Asset Relief Program

Acknowledgements

The Global Minotaur is a metaphor that crept up on me during endless conversations with Joseph Halevi on what made the world tick after the economic crises of the 1970s. Our conversations were long, repetitive and animated. They took place over two decades in Australia, in Europe, face to face, by email, in an assortment of media and moods. Nevertheless, gradually they led us to a coherent view of the global economic system in which America's deficits played a defining and, paradoxically, hegemonic role.

That viewpoint first saw the light of day in 2003, in an article published by *Monthly Review*, under the same title: 'The Global Minotaur'. In it, Joseph and I put forward the working hypothesis that the defining characteristic of the global political economy was the reversal of the flow of trade and capital surpluses between the United States and the rest of the world. The hegemon, for the first time in world history, strengthened its hegemony by wilfully enlarging its deficits, once it had lost its surplus global position. The trick was to understand *how* America did this and the tragic manner in which its success gave rise to the financialization that both reinforced US dominance and, simultaneously, implanted the seeds of its potential downfall.

It was an attractive story that seemed to resonate powerfully with many different people's thinking about our brave globalizing world. And when the Crash of 2008 struck, our story began to make even more sense – at least to us. In response to the ensuing crisis, Joseph and I enlisted Nicholas Theocarakis, our good friend and colleague, to tell a larger story: a tale of how the events of 2008 marked a break with the past both for global capitalism and for the way in which, as economists, we can make sense of it.

The result was a recent academic book, entitled *Modern Political Economics*, in which the Global Minotaur made its presence felt on almost every page. As it was a book aimed at our academic colleagues and students, its basic narrative was intertwined with elaborate discussions and inane mental excursions that would drive sensible non-academic readers crazy. Thus, the idea occurred to me of distilling the crux of the Global Minotaur story in the book you are now holding.

Besides thanking Joseph and Nicholas for the shared thoughts that have trickled into the following pages, I must also thank: George Krimpas for spiritual encouragement, intellectual guidance and much-needed corrections, Nicholas Theocarakis (again) for meticulous proof-reading of an earlier draft, Alejandro Nadal for some excellent comments and Clive Liddiard for inspired copy-editing. Lastly, I owe a debt of gratitude to Rob Langham, of Routledge, who suggested that I approach Zed Books with the idea for this project, and, naturally, Ken Barlow of Zed Books for embracing my idea warmly and efficiently.

For Danaë Stratou,
my global partner

CHAPTER 1

Introduction

The 2008 moment

Nothing humanizes us like *aporia* – that state of intense puzzlement in which we find ourselves when our certainties fall to pieces; when suddenly we get caught in an impasse, at a loss to explain what our eyes can see, our fingers can touch, our ears can hear. At those rare moments, as our reason valiantly struggles to fathom what the senses are reporting, our *aporia* humbles us and readies the prepared mind for previously unbearable truths. And when the *aporia* casts its net far and wide to ensnare the whole of humanity, we know we are at a very special moment in history. September 2008 was just such a moment.

The world had just astonished itself in a manner not seen since 1929. The certainties that decades of conditioning had led us to acknowledge were, all of a sudden, gone, along with around $40 trillion of equity globally, $14 trillion of household wealth in the US alone, 700,000 US jobs every month, countless repossessed homes everywhere… The list is almost as long as the numbers on it are unfathomable.

The collective *aporia* was intensified by the response of governments that had hitherto clung tenaciously to fiscal conservatism as perhaps the twentieth century's last surviving mass ideology: they began to pour trillions of dollars, euros, yen, etc. into a financial system that had, until a few months before, been on a huge roll, accumulating fabulous profits and provocatively professing to have found the pot of gold at the end of some globalized rainbow. And when that response proved too feeble, our presidents and prime ministers, men and women with impeccable anti-statist, neoliberal credentials, embarked upon a spree of nationalizing banks, insurance companies and car manufacturers that put even Lenin's post-1917 exploits to shame.

Unlike previous crises, such as the dotcom crash of 2001, the 1991 recession, Black Monday,[1] the 1980s Latin American debacle, the slide of the Third World into a vicious debt trap, or even the devastating early 1980s depression in Britain and parts of the US, this crisis was not limited to a specific geography, a certain social class or particular sectors. All the pre-2008 crises were, in a sense, localized. Their long-term victims were hardly ever of importance to the powers-that-be, and when (as in the case of Black Monday, the Long-Term Capital Management (LTCM) hedge fund fiasco of 1998 or the dotcom bubble of two years later) it was the powerful who felt the shock, the authorities had managed to come to the rescue quickly and efficiently.

In contrast, the Crash of 2008 had devastating effects both globally and across the neoliberal heartland. Moreover, its effects will be with us for a long, long time. In Britain, it was probably the first crisis in living memory really to have hit the richer regions of the south. In the United States, although the sub-prime crisis began in less-than-prosperous corners of that great land, it spread to every nook and cranny of the privileged middle classes, its gated communities, its leafy suburbs, the Ivy League universities where the well-off congregate, queuing up for the better socio-economic roles. In Europe, the whole continent reverberates with a crisis that refuses to go away and which threatens European illusions that had managed to remain unscathed for six decades. Migration flows were reversed, as Polish and Irish workers abandoned Dublin and London alike for Warsaw and Melbourne. Even China, which famously escaped the recession with a healthy growth rate at a time of global shrinkage, is in a bind over its falling consumption share of total income and its heavy reliance on state investment projects that are feeding into a worrying bubble – two portents that do not bode well at a time when the rest of the world's long-term capacity to absorb the country's trade surpluses is questionable.

Adding to the general *aporia*, the high and mighty let it be known that they, too, were at a loss to grasp reality's new twists. In October 2008, Alan Greenspan, the former chairman of the Federal Reserve (the Fed) and a man viewed as a latter-day Merlin, confessed to 'a flaw in the model that I perceived is the critical functioning structure that defines how the world works'.[2] Two months later, Larry Summers, formerly President Clinton's treasury secretary and at the time President-Elect Obama's chief economic adviser (head of the National Economic Council), said that '[i]n this crisis, doing too little poses a greater threat than doing too much…' When the Grand Wizard confesses to having based all his magic on a flawed model of the world's ways, and the doyen of presidential economic advisers proposes that caution be thrown to the wind, the public 'gets' it: our ship is sailing in treacherous, uncharted waters, its crew clueless, its skipper terrified.

Thus we entered a state of tangible, shared *aporia*. Anxious disbelief replaced intellectual indolence. The figures in authority seemed bereft of authority. Policy was, evidently, being made on the hoof. Almost immediately, a puzzled public trained its antennae in every possible direction, desperately seeking explanations for the causes and nature of what had just hit it. As if to prove that supply needs no prompting when demand is plentiful, the presses started rolling. One after another, the books, the articles, the long essays – even the movies – churned through the pipeline, creating a flood of possible explanations for what had gone wrong. But while a world in shock is always pregnant with theories about its predicament, the overproduction of explanations does not guarantee the *aporia*'s dissolution.

Six explanations for why it happened

1. 'Principally a failure of the collective imagination of many bright people...to understand the risks to the system as a whole'

That was the gist of a letter sent to the Queen by the British Academy on 22 July 2009, in response to a question she had put to a gathering of red-faced professors at the London School of Economics: 'Why had you not seen it coming?' In their letter, thirty-five of Britain's top economists answered in effect: 'Whoops! We mistook a Great Big Bubble for a Brave New World.' The gist of their response was that, while they had their finger on the pulse and their eye on the data, they had made two related diagnostic mistakes: the error of extrapolation and the (rather more sinister) error of falling prey to their own rhetoric.

Everyone could see that the numbers were running riot. In the United States, the financial sector's debt had shot up from an already sizeable 22 per cent of national income (Gross Domestic Product or GDP) in 1981 to 117 per cent in the summer of 2008. In the meantime, American households saw their debt share of national income rise from 66 per cent in 1997 to 100 per cent ten years later. Put together, aggregate US debt in 2008 exceeded 350 per cent of GDP, when in 1980 it had stood at an already inflated 160 per cent. As for Britain, the City of London (the financial sector in which British society had put most of its eggs, following the rapid deindustrialization of the early 1980s) sported a collective debt almost two and a half times Britain's GDP, while, in addition, British families owed a sum greater than one annual GDP.

So, if an accumulation of inordinate debt infused more risk than the world could bear, how come no one saw the crash coming? That was, after all, the Queen's reasonable question. The British Academy's answer grudgingly confessed to the combined sins of smug rhetoric and linear extrapolation. Together, these sins fed into the self-congratulatory conviction that a paradigm shift had occurred, enabling the world of finance to create unlimited, benign, riskless debt.

The first sin, which took the form of a mathematized rhetoric, lulled authorities and academics into a false belief that financial innovation had engineered risk out of the system; that the new instruments allowed a new form of debt with the properties of quicksilver. Once loans were originated, they were then sliced up into tiny pieces, blended together in packages that contained different degrees of risk,[3] and sold all over the globe. By thus spreading financial risk, so the rhetoric went, no single agent faced any significant danger that they would be hurt if some debtors went bust. It was a New Age faith in the financial sector's powers to create 'riskless risk', which culminated in the belief that the planet could now sustain debts (and bets made on the back of these debts) that were many multiples of actual, global income.

Vulgar empiricism shored up such mystical beliefs: back in 2001, when the so-called 'new economy' collapsed, destroying much of the paper wealth made from the dotcom bubble and the Enron-like scams, the system held together. The 2001 new economy bubble was, in fact, worse than the sub-prime mortgage equivalent that burst six years later. And yet the ill effects were contained efficiently by the authorities (even though employment did not recover until 2004–05). If such a large shock could be absorbed so readily, surely the system could sustain smaller shocks, like the $500 billion sub-prime losses of 2007–08.

According to the British Academy's explanation (which, it must be said, is widely shared), the Crash of 2008 happened because by then – and unbeknownst to the armies of hyper-smart men and women whose job was to have known better – the risks that had been assumed to be riskless had become anything but. Banks like the Royal Bank of Scotland, which employed 4,000 'risk managers', ended up consumed by a black hole of 'risk gone sour'. The world, in this reading, paid the price for believing its own rhetoric and for assuming that the future would be no different from the very recent past. Thinking that it had successfully diffused risk, our financialized world created so much that it was consumed by it.

2. *Regulatory capture*

Markets determine the price of lemons. And they do so with minimal institutional input, since buyers know a good lemon when they are sold one. The same cannot be said of bonds or, even worse, of synthetic financial instruments. Buyers cannot taste the 'produce', squeeze it to test for ripeness, or smell its aroma. They rely on external, institutional information and on well-defined rules that are designed and policed by dispassionate, incorruptible authorities. This was the role, supposedly, of the credit rating agencies and of the state's regulatory bodies. Undoubtedly, both types of institution were found not just wanting but culpable.

When, for instance, a *collateralized debt obligation* (CDO) – a paper asset combining a multitude of slices of many different types of debt[4] – carried a triple-A rating and offered a return

1 per cent above that of US Treasury Bills,[5] the significance was twofold: the buyer could feel confident that the purchase was not a dud and, if the buyer was a bank, it could treat that piece of paper as indistinguishable from (and not an iota riskier than) the real money with which it had been bought. This pretence helped banks to attain breathtaking profits for two reasons.

1 If they held on to their newly acquired CDO – and remember, the authorities accepted that a triple-A rated CDO was as good as dollar bills of the same face value – the banks did not even have to include it in their capitalization computations.[6] This meant that they could use with impunity their own clients' deposits to buy the triple-A rated CDOs without compromising their ability to make new loans to other clients and other banks. So long as they could charge higher interest rates than they paid, buying triple-A rated CDOs enhanced the banks' profitability without limiting their loan-making capacity. The CDOs were, in effect, instruments for bending the very rules designed to save the banking system from itself.
2 An alternative to keeping the CDOs in the bank vaults was to pawn them off to a central bank (e.g. the Fed) as collateral for loans, which the banks could then use as they wished: to lend to clients, to other banks, or to buy even more CDOs for themselves. The crucial detail here is that the loans secured from the central bank by pawning the triple-A rated CDO bore the pitiful interest rates charged by the central bank. Then, when the CDO matured, at an interest rate of 1 per cent above what the central bank was charging, the banks kept the difference.

The combination of these two factors meant that the issuers of CDOs had good cause:

(a) to issue as many of them as they physically could;
(b) to borrow as much money as possible to buy other issuers' CDOs; and
(c) to keep vast quantities of such paper assets on their books.[7]

Alas, this was an open invitation to print one's own money! No wonder Warren Buffet took one look at the fabled CDOs and described them as WMDs (weapons of mass destruction).The incentives were incendiary: the more the financial institutions borrowed in order to buy the triple-A rated CDOs, the more money they made. The dream of an ATM in one's living room had come true, at least for the private financial institutions and the people running them.

With these facts before us, it is not hard to come to the conclusion that the Crash of 2008 was the inevitable result of granting to poachers the role of gamekeeper. Their power was blatant and their image as the postmodern wizards conjuring up new wealth and new paradigms was unchallenged. The bankers paid the credit rating agencies to extend triple-A status to the CDOs that they issued; the regulating authorities (including the central bank) accepted these ratings as kosher; and the up-and-coming young men and women who had secured a badly paid job with one of the regulating authorities soon began to plan a career move to Lehman Brothers or Moody's. Overseeing all of them was a host of treasury secretaries and finance ministers who had either already served for years at Goldman Sachs, Bear Stearns, etc. or were hoping to join that magic circle after leaving politics.

In an environment that reverberated with the popping of champagne corks and the revving of gleaming Porsches and Ferraris; in a landscape where torrents of bank bonuses flooded into already wealthy areas (further boosting the real estate boom and creating new bubbles from Long Island and London's East End to the suburbs of Sydney and the high-rise blocks of

Shanghai); in that ecology of seemingly self-propagating paper wealth, it would take a heroic – a reckless – disposition to sound the alarm bells, to ask the awkward questions, to cast doubt on the pretence that triple-A rated CDOs carried zero risk. Even if some incurably romantic regulator, trader or senior banker were to raise the alarm, she would be well and truly trumped, ending up a tragic, crushed figure in history's gutter.

The Brothers Grimm had a story involving a magic pot that embodied industrialization's early dreams – of automated cornucopias fulfilling all our desires, unstoppably. It was also a bleak and cautionary tale that demonstrated how those industrial dreams might turn into a nightmare. For, towards the end of the story, the wondrous pot runs amok and ends up flooding the village with porridge. Technology turned nasty, in much the same way as Mary Shelley's ingenious Dr Frankenstein had his own creation turn viciously against him. In similar fashion, the virtual automated telling machines (ATMs) conjured up by Wall Street, the credit rating agencies and the regulators who connived with them flooded the financial system with a modern-day porridge, which ended up choking the whole planet. And when, in autumn of 2008, the ATMs stopped working, a world addicted to synthesized porridge juddered to a grinding halt.

3. Irrepressible greed

'It's the nature of the beast', goes the third explanation. Humans are greedy creatures who only feign civility. Given the slightest chance, they will steal, plunder and bully. This dim view of our human lot leaves no room even for a modicum of hope that intelligent bullies will consent to rules banning bullying. For even if they do, who will enforce them? To keep the bullies in awe, some Leviathan with extraordinary power will be necessary. But then again, who will keep tabs on the Leviathan?

Such are the workings of the neoliberal mind, yielding the conclusion that crises may be necessary evils; that no human design can avert economic meltdowns. For a few decades, beginning with President Roosevelt's post-1932 attempts to regulate the banks, the Leviathan solution became widely accepted: the state could and should play its Hobbesian role in regulating greed and bringing it into some balance with propriety. The Glass–Steagall Act of 1933 is possibly the most often quoted example of that regulatory effort.[8]

However, the 1970s saw a steady retreat away from this regulatory framework and toward the re-establishment of the fatalistic view that human nature will always find ways of defeating its own best intentions. This 'retreat to fatalism' coincided with the period when neoliberalism and financialization were rearing their unsightly heads. This meant a new take on the old fatalism: the Leviathan's overwhelming power, while necessary to keep the bullies in their place, was choking growth, constraining innovation, putting the brakes on imaginative finance, and thus keeping the world stuck in a low gear just when technological innovations offered the potential to whisk us onto higher planes of development and prosperity.

In 1987, President Reagan decided to replace Paul Volcker (a Carter administration appointment) as chairman of the Fed. His choice was Alan Greenspan. Some months later, the money markets experienced their worst single day ever, the infamous 'Black Monday' episode. Greenspan's deft handling of the consequences earned him a reputation for cleaning up efficiently after a money market collapse.[9] He was to perform the same 'miracle' again and again until his retirement in 2006.[10]

Greenspan had been chosen by Reagan's staunch neoliberals not *in spite of* but *because of* his deeply held belief that the merits and capacities of regulation were overrated. Greenspan truly doubted that any state institution, including the Fed, could rein in human nature and effectively restrain greed without, at the same time, killing off creativity, innovation and, ultimately, growth. His belief led him to adopt a simple recipe, which shaped the world for a good nineteen years: since nothing disciplines human greed like the unyielding masters of supply and demand, let the markets function as they will, but with the state remaining ready and willing to step in to clean up the mess when the inevitable disaster strikes. Like a liberal parent who lets his children get into all sorts of mischief, he expected trouble but thought it better to remain on the sidelines, always ready to step in, clean up after a boisterous party, or tend to the wounds and the broken limbs.

Greenspan stuck to his recipe, and this underlying model of the world, in each and every downturn that occurred on his watch. During the upturns, he would sit by, doing almost nothing, save for giving the occasional sibyllic pep talk. Then, when some bubble burst, he would rush in aggressively, lower interest rates precipitously, flood the markets with cash and generally do anything it took to refloat the sinking ship. The recipe seemed to work nicely – at least until 2008, a year and a half into his golden retirement. Then it stopped working.

To his credit, Greenspan confessed to having misunderstood capitalism. If only for this *mea culpa*, history ought to treat him kindly, for there are precious few examples of powerful men willing and able to come clean – especially when the people who used to be their minions remain in denial. Indeed, Greenspan's model of the world, which he himself renounced, is still alive, well and making a comeback. Aided and abetted by a resurgent Wall Street bent on derailing any serious post-2008 attempt to regulate its behaviour, the view that human nature cannot be restrained without simultaneously jeopardizing our liberty and our long-term prosperity is back. Like a criminally negligent doctor whose patient survived by luck, the pre-2008 establishment is insisting on being absolved on the grounds that capitalism, after all, survived. And if some of us continue to insist on apportioning blame for the Crash of 2008, why not censure human nature? Surely honest introspection would reveal to each and every one of us a culpable dark side. The only sin to which Wall Street confessed is that it projected that dark side onto a larger canvas.

4. Cultural origins

In September 2008, Europeans looked smugly over the pond, shaking their heads with a self-serving conviction that the Anglo-Celts, at long last, were getting their comeuppance. After years and years of being lectured on the superiority of the Anglo-Celtic model, on the advantages of flexible labour markets, on how inane it was to think that Europe could retain a generous social welfare net in the era of globalization, on the wonders of an aggressively atomistic entrepreneurial culture, on the wizardry of Wall Street and on the brilliance of the post-Big Bang City of London, the news of the Crash, its sights and sounds as they were beamed all over the world, filled the European heart with an ambiguous mix of *Schadenfreude* and fear.

Of course, it was not too long before the crisis migrated to Europe, metamorphosing in the process into something far worse and more threatening than Europeans had ever anticipated. Nevertheless, most Europeans remain convinced of the Crash's Anglo-Celtic cultural roots. They blame the fascination that English-speaking people have with the notion of home ownership at all costs. They find it hard to wrap their minds around an economic model which generates silly house prices by stigmatizing rent-paying non-homeowners (for being in thrall to landlords) while celebrating pretend homeowners (who are even more deeply indebted to bankers).

Europeans and Asians alike saw the obscene relative size of the Anglo-Celtic financial sector, which had been growing for decades at the expense of industry, and became convinced that global capitalism had been taken over by lunatics. So when the meltdown began in precisely those locations (the US, Britain, Ireland, the housing market and Wall Street), they could not help but feel vindicated. While the Europeans' sense of vindication was dealt a savage blow by the ensuing euro crisis, Asians can afford a large dose of smugness. Indeed, in much of Asia the Crash of 2008 and its aftermath are referred to as the 'North Atlantic Crisis'.

5. Toxic theory

In 1997, the Nobel Prize for Economics went to Robert Merton and Myron Scholes for developing 'a pioneering formula for the valuation of stock options'. 'Their methodology', trumpeted the awarding committee's press release, 'has paved the way for economic valuations in many areas. It has also generated new types of financial instruments and facilitated more efficient risk management in society.' If only the hapless Nobel committee had known that, in a few short months, the much-lauded 'pioneering formula' would cause a spectacular multi-billion-dollar debacle, the collapse of a major hedge fund (the infamous LTCM, in which Merton and Scholes had invested all their kudos) and, naturally, a bail-out by the reliably obliging US taxpayers.

The true cause of the LTCM failure, which was a mere test run for the larger Crash of 2008, was simple enough: huge investments that relied on the untestable assumption that one can estimate the probability of events that one's *own* model assumes away not just as improbable but, in fact, as untheorizable. To adopt a logically incoherent assumption in one's theories is bad enough. But to gamble the fortunes of world capitalism on such an assumption is bordering on the criminal. So how did the economists get away with it? How did they convince the world, and the Nobel committee, that they could estimate the probability of events (such as a string of defaults by debtors) which their own models assumed to be inestimable?

The answer lies more in the realm of mass psychology than in economics itself: economists relabelled *ignorance* and marketed it successfully as *a form of provisional knowledge*. The financiers then built new forms of debt on that relabelled ignorance and erected pyramids on the assumption that risk had been removed. The more investors were convinced, the more money everyone involved made and the better placed the economists became to silence anyone who dared to doubt their underlying assumptions. In this manner, *toxic finance* and *toxic economic theorizing* became mutually reinforcing processes.

As the Mertons of the financial world were sweeping up Nobel Prizes and accumulating fabulous profits in the same breath, their counterparts who remained in the great economics departments were changing the economic theory 'paradigm'. Whereas, once upon a time, leading economists were in the business of explanation, the new trend was toward relabelling. Copying the financiers' strategy of disguising ignorance as provisional knowledge and uncertainty as riskless risk, the economists relabelled unexplained joblessness (e.g. an observed rate of 5 per cent that refused to budge) as the *natural rate of unemployment*. The beauty of the new label was that, suddenly, unemployment seemed natural, and therefore no longer in need of explanation.

It is worth, at this point, delving a little deeper into the economists' elaborate scam: whenever they were unable to explain the observed deviations of human behaviour from their predictions, they (a) labelled such behaviour 'out of equilibrium', and then (b) assumed that it was random and best modelled as such. So long as the 'deviations' were subdued, the models worked and the financiers profited. But when panic set in, and the run on the financial system began, the 'deviations' proved anything but random. Naturally, the models collapsed, along with the markets that they had helped create.

Any fair-minded investigator of these episodes must, many believe, conclude that the economic theories that dominated the thinking of influential people (in the banking sector, the hedge funds, the Fed, the European Central Bank (ECB) – everywhere) were no more than thinly veiled forms of intellectual fraud, which provided the 'scientific' fig leaves behind which Wall Street tried to conceal the truth about its 'financial innovations'. They came with impressive names, like the Efficient Market Hypothesis (EMH), the Rational Expectations Hypothesis (REH) and Real Business Cycle Theory (RBCT). In truth, these were no more than impressively marketed theories whose mathematical complexity succeeded for too long in hiding their feebleness.

Three toxic theories underpinning pre-2008 establishment thinking

EMH: No one can systematically make money by second-guessing the market. Why? Because financial markets contrive to ensure that current prices reveal all the privately known information that there is. Some market players overreact to new information, others underreact. Thus, even when everyone errs, the market gets it 'right'. A pure Panglossian theory!

REH: No one should expect any theory of human action to make accurate predictions in the long run if the theory presupposes that humans systematically misunderstand or totally ignore it. For example, suppose a brilliant mathematician were to develop a theory of bluffing at poker and schooled you in its use. The only way it would work for you is if your opponents either had no access to the theory or misunderstood it. For if your opponents also knew the theory, each could use it to work out when you were bluffing, thus defeating the bluff's purpose. In the end, you would abandon it and so would they. REH assumes that such theories cannot predict behaviour well because people will see through them and will eventually violate their edicts and predictions. No doubt this sounds radically anti-patronizing. It assumes that not much light can be shed on society by theorists who believe they understand its ways better than Joe Bloggs. But note the sting in the tail: for REH to hold, it must be true that people's errors (when they predict some economic variable, such as inflation, wheat prices, the price of some derivative or share) must *always* be random – i.e. unpatterned, uncorrelated, untheorizable. It only takes a moment's reflection to see that the espousal of REH, especially when taken together with EMH, is tantamount to never expecting recessions, let alone crises. Why? Because recessions are, by definition, systematic, patterned events. However surprising when they hit, they unfold in a patterned manner, each phase highly correlated with what preceded it. So how does a believer in EMH–REH respond when her eyes and ears scream to her brain: 'recession, crash, meltdown!'? The answer is by turning to RBCT for a comforting explanation.

RBCT: Taking EMH and REH as its starting point, this theory portrays capitalism as a well-functioning *Gaia*. Left alone, it will remain harmonious and never go into a spasm (like that of 2008). However, it may well be 'attacked' by some 'exogenous' shock (coming from a meddling government, a wayward Fed, heinous trades unions, Arab oil producers, aliens, etc.), to which it must respond and adapt. Like a benevolent *Gaia* reacting to a large meteor crashing into it, capitalism responds efficiently to exogenous shocks. It may take a while for the shockwaves to be absorbed, and there may be many victims in the process, but, nonetheless, the best way of handling the crisis is to let capitalism get on with it, without being subjected to new shocks administered by self-interested government officials and their fellow travellers (who pretend to be standing up for the common good in order to further their own agendas).

To sum up, *toxic derivatives* were underpinned by *toxic economics*, which, in turn, were no more than motivated delusions in search of theoretical justification; fundamentalist tracts that acknowledged facts only when they could be accommodated to the demands of the lucrative faith. Despite their highly impressive labels and technical appearance, economic models were merely mathematized versions of the touching superstition that markets know best, both at times of tranquillity and in periods of tumult.

6. Systemic failure

What if neither human nature nor economic theory was to blame for the Crash? What if it did not come about because bankers were greedy (even if most are), or because they made use of toxic theories (even though they undoubtedly did), but because capitalism was caught in a trap of its own making? What if capitalism is not a 'natural' system but, rather, a particular system with a propensity to systemic failure?

The Left, with Marx its original prophet, has always warned that, as a system, capitalism strives to turn us into automata and our market society into a *Matrix*-like dystopia. But the closer it comes to achieving its aim, the nearer it gets to its moment of ruin, very much like the mythical Icarus. Then, after the Crash (and unlike Icarus) it picks itself up, dusts itself down, and embarks upon the same path all over again.

In this final explanation on my list, it is as if our capitalist societies were designed to generate periodic crises, which get worse and worse the more they displace human labour from the production process and critical thinking from public debate. To those who blame human avarice, greed and selfishness, Marx replied that they are following a good instinct but are looking in the wrong place; that capitalism's secret is its penchant for contradiction – its capacity to produce at once massive wealth and unbearable poverty, magnificent new freedoms and the worst forms of slavery, gleaming mechanical slaves and depraved human labour.

Human will, in this reading, may be dark and mysterious; but, in the Age of Capital, it has become more of a derivative than a prime mover. For it is *capital* that usurped the role of the primary force shaping our world, including our will. Capital's self-referential momentum makes a mockery of the human will, of entrepreneur and labourer alike. Though inanimate and mindless, *capital* – shorthand for machines, money, securitized derivatives and all forms of crystallized wealth – quickly evolves as if it were in business for itself, using human actors (bankers, bosses and workers in equal measure) as pawns in its own game. Not unlike our subconscious, capital also instils illusions in our minds – above all, the illusion that, in serving it, we become worthy, exceptional, potent. We take pride in our relationship with it (either as financiers who 'create' millions in a single day, or as employers on whom a multitude of working families depend, or as labourers who enjoy privileged access to gleaming machinery or to puny services denied to illegal migrants), turning a blind eye to the tragic fact that it is *capital* which, in effect, owns us all, and that it is *we* who serve *it*.

The German philosopher Schopenhauer castigated us modern humans for deceiving ourselves into thinking that our beliefs and actions are subject to our consciousness. Nietzsche concurred, suggesting that all the things we believe in, at any given time, reflect not truth but someone else's power over us. Marx dragged economics into this picture, reprimanding us all for ignoring the reality that our thoughts have become hijacked by capital and its drive to accumulate. Naturally, although it follows its own steely logic, capital evolves mindlessly. No one designed capitalism and no one can civilize it now that it is going at full tilt.

Having simply evolved, without anyone's consent, it quickly liberated us from more primitive forms of social and economic organization. It bred machines and instruments (material and financial) that allowed us to take over the planet. It empowered us to imagine a future without poverty, where our lives are no longer at the mercy of a hostile *nature*. Yet, at the same time, just as nature spawned Mozart and HIV using the same indiscriminate mechanism, so too did capital produce catastrophic forces with a tendency to bring about discord, inequality, industrial-scale warfare, environmental degradation and, of course, financial freefalls. In one fell swoop, it generated – with neither rhyme nor reason – wealth and crises, development and deprivation, progress and backwardness.

Could the Crash of 2008, then, be nothing more than our periodic chance to realize how far we have allowed our *will* to be subjugated to *capital*? Was it a jolt that ought to awaken us to the reality that capital has become a 'force we must submit to', a power that developed 'a cosmopolitan, universal energy which breaks through every limit and every bond and posits itself as the only policy, the only universality, the only limit and the only bond'?[11]

The parallax challenge

A stick half submerged in a river looks bent. As one moves around it, the angle changes and every different location yields a different perspective. If, in addition, the river's flow gently moves the stick around, both the 'reality' of the 'bent' stick and our understanding of it are in constant flux. Physicists refer to the phenomenon as the *parallax*. I enlist it here to make the simple point that many different observations about the Crash of 2008 may be both accurate *and* misleading.

This is not to deny the objective reality either of the stick (i.e. that it is not bent at all) or of the Crash and its aftermath, the *Crisis*. It is simply to note that different viewpoints can all generate 'true' observations, yet fail to unveil the basic *truth* about the phenomenon under study. What we need is something beyond a variety of potential explanations and perspectives from which to grasp the stick's reality. We need a theoretical leap, like the one the physicist makes, which will allow us to rise above the incommensurable observations before landing in a conceptual place from which the whole thing makes perfect sense. I call this 'leap' the *parallax challenge*.

Coming to terms with the Crash of 2008 is like coming face to face with the parallax challenge at its most demanding. Who could credibly deny that economists and risk managers miscalculated systemic risk big time? Is there any doubt that Wall Street, and the financial sector at large, *did* grow fat on insidious voracity, on quasi-criminal practices, and on financial products that any decent society ought to have banned? Were the credit rating agencies not textbook cases of conflict of interest in action? Was greed not hailed as the new good? Did the regulators not fail spectacularly to resist the temptation to stay on the 'right' side of the bankers? Were Anglo-Celtic societies not more prone than others to neoliberalism's cultural trickery, acting as a beachhead from which to spread the word to the rest of the globe that 'scruples' meant nothing and self-interest was the only way, the only motive? Is it not true that the Crash of 2008 affected the developed world more acutely than it did the so-called emerging economies? Can anyone refute the simple proposition that capitalism, as a system, has an uncanny capacity to trip itself up?

Just as in a simple optical parallax, where all perspectives are equally plausible depending on one's standpoint, here, too, each of the explanations listed above illuminates important aspects of what happened in 2008. And yet they leave us dissatisfied, with a nagging feeling that we are missing something important; that, while we have glimpsed many crucial manifestations of the Crash, its quintessence still escapes us. Why did it happen, *really*? And how could legions of keenly motivated, technically hyper-skilled market observers miss it? If it was not greed and profligacy, loose morals and even looser regulation that caused the Crash and the ensuing Crisis, what was it? If the Marxists' expectation that capitalism's internal contradictions will always strike back is too simple an explanation for the events leading to 2008, what is the missing link there?

My figurative answer is: the Crash of 2008 was what happened when a beast I call the *Global Minotaur* was critically wounded. While it ruled the planet, its iron fist was pitiless, its reign callous. Nevertheless, so long as it remained in rude health, it kept the global economy in a state of *balanced disequilibrium*. It offered a degree of stability. But when it fell prey to the inevitable, collapsing into a comatose state in 2008, it plunged the world into a simmering crisis. Until we find ways to live without the beast, radical uncertainty, protracted stagnation and a revival of heightened insecurity will be the order of the day.

The Global Minotaur: a first glimpse

The collapse of communism in 1991 saw the conclusion of a tragedy with classical overtones, a fatal inversion (a *peripeteia*, as Aristotle would have called it) which began when the noble intentions of revolutionary socialists were first usurped by power-hungry zealots, before giving way to an unsustainable industrial feudalism containing only victims and villains. By contrast, the Crash of 2008 exuded the air of a pre-classical, more mythological and thus cruder sequence of events. It is for this reason that this book adopts a title alluding to a period before tragedy was invented.

I might have called this book *The Global Vacuum Cleaner*, a term that captures quite well the main feature of the second post-war phase that began in 1971 with an audacious strategic decision by the US authorities: instead of reducing the twin deficits that had been building up in the late 1960s (the budget deficit of the US government and the trade deficit of the American economy), America's top policy makers decided to increase both deficits liberally and intentionally. And who would pay for the red ink? Simple: the rest of the world! How? By means of a permanent tsunami of capital that rushed ceaselessly across the two great oceans to finance America's twin deficits.

The twin deficits of the US economy thus operated for decades like a giant vacuum cleaner, absorbing other people's surplus goods and capital. While that 'arrangement' was the embodiment of the grossest imbalance imaginable on a planetary scale, and required what Paul Volcker described vividly as 'controlled disintegration in the world economy', nonetheless it did give rise to something resembling *global balance*: an international system of rapidly accelerating asymmetrical financial and trade flows capable of creating a semblance of stability and steady growth.

Powered by America's twin deficits, the world's leading surplus economies (e.g. Germany, Japan and, later, China) kept churning out goods that Americans gobbled up. Almost 70 per cent of the profits made globally by these countries were then transferred back to the United States, in the form of capital flows to Wall Street. And what did Wall Street do with them? It instantly turned these capital inflows into direct investments, shares, new financial instruments, new and old forms of loans and, last but not least, a 'nice little earner' for the bankers themselves. Through this prism, everything seems to make more sense: the rise of financialization, the triumph of greed, the retreat of regulators, the domination of the Anglo-Celtic growth model. All these phenomena that typified the era suddenly appear as mere by-products of the massive capital flows necessary to feed the twin deficits of the United States.

Clearly, 'the global vacuum cleaner' would have been an accurate description of this book's theme. Its humble origins in the world of domestic appliances might prove a marketing demerit but should not disqualify it *per se*. However, at a more symbolic level, it would have failed to connect with the dramatic, almost mythological, aspects of the international design under which we all laboured prior to the ill-fated 2008 – a design too unstable to survive in perpetuity but, at the same time, one that helped maintain global tranquillity for decades, based upon a constant flow of tribute from the periphery to the imperial centre – tribute that sustained the mutual reinforcement between the US twin deficits and overall demand for the surplus nations' goods and services.

Such were the features of a global beast that roared from the 1970s until so very recently. They lend themselves, I believe, more readily to the Minotaur metaphor than to one involving domestic chores.

Box 1.1
The Cretan Minotaur

The Minotaur is a tragic mythological figure. Its story is packed with greed, divine retribution, revenge and much suffering. It is also a symbol of a particular form of political and economic equilibrium straddling vastly different, faraway lands; a precarious geopolitical balance that collapsed with the beast's slaughter, thus giving rise to a new era.

According to the myth's main variant, King Minos of Crete, the most powerful ruler of his time, asked Poseidon for a fine bull as a sign of divine endorsement, pledging to sacrifice it in the god's honour. After Poseidon obliged him, Minos recklessly decided to spare the animal, captivated as he was by its beauty and poise. The gods, never allowing a good excuse for horrible retribution to go begging, chose an interesting punishment for Minos: using Aphrodite's special skills, they had Minos's wife, Queen Pasiphaë, fall in lust with the bull. Using various props constructed by Daedalus, the legendary engineer, she managed to impregnate herself, the result of that brief encounter being the Minotaur: a creature half-human, half-bull (Minotaur translates as 'Minos's Bull', from the Greek *taurus*, 'bull').

When the Minotaur grew larger and increasingly unruly, King Minos instructed Daedalus to build a labyrinth, an immense underground maze where the Minotaur was kept. Unable to nourish itself with normal human food, the beast had to feast on human flesh. This proved an excellent opportunity for Minos to take revenge on the Athenians, whose King Aegeus, a lousy loser, had had Minos's son killed after the young man had won all races and contests in the Pan-Athenian Games. After a brief war with Athens, Aegeus was forced to send seven young boys and seven unwed girls to be devoured by the Minotaur every year (or every nine years, according to another version). Thus, so the myth has it, a *Pax Cretana* was established across the known lands and seas on the basis of regular foreign tribute that kept the Minotaur well nourished.

Beyond myth, historians suggest that Minoan Crete was the economic and political hegemon of the Aegean region. Weaker city-states, like Athens, had to pay tribute to Crete regularly as a sign of subjugation. This may well have included the shipment of teenagers to be sacrificed by priests wearing bull masks.

Returning to the realm of myth, the eventual slaughter of the Minotaur by Theseus, son of King Aegeus of Athens, marked the emancipation of Athens from Cretan hegemony and the dawn of a new era.

Aegeus only grudgingly allowed his son to set off for Crete on that dangerous mission. He asked Theseus to make sure that, before sailing back to Piraeus, he replaced the original mournful black sails of his vessel with white ones, as a signal to his waiting father that the mission had been successful and that Theseus was returning from Crete victorious. Alas, consumed by joy at having slaughtered the Minotaur, Theseus forgot to raise the white sails. On spotting the ship's black sails from afar, and thinking that his son had died in the clutches of the Minotaur, Aegeus plunged to his death in the sea below, thus giving his name to the Aegean Sea.

A quick perusal of the ancient myth (see Box 1.1) confirms its suitability as a tale of unbalanced might stabilized and sustained by one-sided tribute; of a hegemonic power projecting its authority across the seas, and acting as custodian of far-reaching peace and international trade, in return for regular tribute that keep nourishing the beast within.

In the misty world of Cretan myth, the beast was a sad, unloved, vicious creature, and the tribute was young people, whose sacrifice preserved a hard-won peace. To end its reign, a brave prince, Theseus, had to perform the ugly deed – to slay the Minotaur and usher in a new post-Cretan era. No such heroics were necessary in our more complicated world. The role of the beast was played by America's twin deficits, and the tribute took the form of incoming goods and capital. As for our Global Minotaur's end, it came suddenly, with no physical agent intentionally striking out. The potentially fatal wound was inflicted by the cowardly, spontaneous collapse of the banking system. While the hit was just as dramatic, ending global capitalism's second post-war phase in no uncertain terms, the new era is stubbornly refusing to show its face. Until it does, we shall all remain in the state of *aporia* brought on by 2008.

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