

## Great Recession, Financialization and Marxian Political Economy

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### Büyük Durgunluk, Finansallaşma ve Marksist Politik İktisat

#### Abstract

Mainstream economic approaches, such as Keynesian and Neoclassical, agree one another in that the crises of capitalism should be handled within the capitalism. While Keynesians defend preemptive state intervention to avoid crises, neoclassical economics believe that the market will solve all problems without the need to resort to state action. After the Great Depression in 1930, Keynesian economics gained popularity, while neoclassical economics took over in the 1970s. Today, Keynesian economics became popular again in the aftermath of 2008 financial crisis. According to them, there is no alternative to the market system. Marxian explanation of 2008 financial crisis presents an alternative to the both. In this light, the aim of this study is to discuss the Marxian take on the 2008 global crisis, focusing on the phenomenon of financialization in this context.

**Keywords** : Crises, Great Recession, Economic Schools of Thought, Mainstream Economics, Marxian Political Economy.

**JEL Classification Codes** : A10, B22, G01.

#### Öz

Keynesyen ve Neoklasik iktisat gibi ana akım yaklaşımlar, kapitalizmin krizinin yine kapitalizm içinde kalınarak çözülebileceği üzerinde anlaşmaktadırlar. Keynesyenler krizi önleme konusunda devlet müdahalesini savunurken, Neoklasik iktisat devlet müdahalesine gerek kalmadan piyasanın bütün problemleri çözeceğine inanmaktadır. Keynesyenler, 1930'larda yaşanan Büyük Buhran sonrasında popüler olmuş fakat 1970'li yıllarda Neoklasik iktisat onların yerini almıştır. Günümüzde, Keynesyen iktisadın popülaritesi tekrar yükselmiştir. Her iki yaklaşım da, piyasa sisteminin bir alternatifi olmadığını ifade eder. Yaşanan kriz sürecine alternatif bir açıklama ise, Marksist teoriden gelmiştir. Bu çalışmanın amacı, küresel kriz sürecine yönelik ortaya konan bu alternatif açıklamayı finansallaşma bağlamında tartışmaktır.

**Anahtar Sözcükler** : Krizler, Büyük Buhran, İktisadi Düşünce Okulları, Ana Akım İktisat, Marksist Politik İktisat.

## **1. Introduction**

After the Great Depression of the 1930s, Keynesian school had dominated in economic policy discussions. The school argued that state intervention is necessary to control the instability that exists inherently in capitalism. Therefore, they offered state intervention as a method by which to overcome the depression. Popularity of the Keynesian interventionist policy gradually increased until 1970s, when stagflation hit the global economic scene. It was then that neoclassical economics took over Keynesian economics. Neoclassical economics is against state intervention because it is believed that the capitalist market economy provides maximum wealth for the society. Thus, ideology of deregulated markets became more popular than the interventionist view.

Stock market crash, real estate collapse, liquidity crisis and deep recession were all witnessed in the 2000s. After that, Keynesians came to the fore again and today's wisdom is that the state must rescue capitalism. When crisis hit the capitalism in 2008, two sides argued again whether state intervention is necessary or not. In fact, both Keynesian and Neoclassical economics accept that the market system is the best possible way of organizing the economy. Therefore, crises of capitalism should be solved within capitalism. According to them, there is no other alternative.

However, Marxian theory proposes another explanation to the crisis. This explanation emphasizes neither the importance of state intervention nor the superiority of markets. Instead, Marxian theory stresses the connection between crisis of capitalism and the principle of diminishing profit rates. In the Marxist approach capitalism has a tendency towards crises. Crises have been observed both in regulated and deregulated forms of capitalism. According to this view, after facing stagnation, the system began to seek new areas to sustain profitability. To avoid the effects of stagnation, investments began to tend towards the financial sector and financialization emerged as a new sphere of production. However, with the financial crisis of 2008, subprime mortgage securities market collapsed at first hand, and large number of individuals have been affected negatively. The aim of this study is to focus on an alternative (Marxist) explanation to the crisis rather than mainstream theories and the relation of financialization with the crisis. The outline of this paper is as follows: The second section discusses the general outlines of the Keynesian and the neoclassical schools towards the issues such as economic instability and the role of the state in containing it. The third section elaborates on the explanation of the Marxist school concerning the main instability mechanisms of capitalism. The phenomenon of financialisation is addressed in the fourth section. The final section concludes.

## **2. From Mainstream Theories to Marxian Theory**

Mainstream theories approach crises differently, hence they propose proposed different solutions to them. Keynesian economics claims that the operating mechanism of unregulated markets induce price movements that lead the economy into inflations, recessions or even depressions. Without the intervention of the state the economy may remain in a depression or recession for a long period of time. Thus, capitalism must be

rescued by the intervention of the state. Otherwise, the market economy of capitalism may collapse. According to the Keynesian school, the market mechanism could produce cyclical crises; therefore, state intervention is necessary to control the instability inherent in capitalism. Therefore, the Keynesian motto is "regulate, regulate" (Resnick & Wolff, 2010: 170-171). It is also interesting that Keynes (1937: 17) mentioned the forces that could "destroy" the capitalist system if left unchecked. Those forces are inequality, high interest rates and the consequent underemployment. However, Keynes is also optimistic that the society would eliminate these threats and the "more signal faults" of the system would suffer "euthanasia" in time. Likewise elsewhere, Keynes (2008 [1936]: 318) mentions the "euthanasia of the rentier". It is ironic that today, in the shadow of the recent crisis, the rising power of finance is one of the main issues of discussion on instability.

The other mainstream theory is the neoclassical approach. Its origins go back to Adam Smith's views. Neoclassical economics claims that the market economy provides maximum wealth for the society because free markets and private property, ensure conditions for optimum economic outcomes. When occasionally a non-optimal outcome appears, private markets and private enterprises restore this imperfection on their own. Therefore, neoclassical economics opposes state intervention claiming that state intervention would cause different kinds of imperfections. According to Neoclassical economics, the best solution is to let markets recover themselves via internal mechanisms, instead of state intervention and market regulation. Hence, the Neoclassical motto is "deregulate, deregulate" (Resnick & Wolff, 2010: 170-171). However, regulation brings about discussions over the capacity of the authorities to collect and process, adequate amounts of data; for instance, according to Hayek (2006 [1944]: 58) "...The economist is the last to claim that he has the knowledge which the co-ordinator would need. His plea is for a method which effects such co-ordination without the need for an omniscient dictator." (2006 [1944]: 52) and ".....division of knowledge between individuals whose separate efforts are co-ordinated by the impersonal mechanism for transmitting the relevant information known by us as the price system" (Hayek, 2006 [1944]: 52).

Various types of states emerged in Europe after the Second World War. All of these various types accepted that the state should direct attention to full employment, economic growth and well being of its citizens. Therefore, states should intervene in the economy via monetary and fiscal policies. This type of intervention is called the Keynesian economic policy implementation. After 1950s, the influence of Keynesian economics expanded and these policies were implemented to contain business cycles and provide full employment. In addition to this, these policies contributed to the emergence of a class compromise between capital and labor through guarantee of the state. Because the state actively intervened in industrial policy and implemented variety of welfare systems such as health care, education, etc. (Harvey, 2005: 10-11).

It was argued that Neoliberalism, on the other hand, was related to liberal political economy. After the end of the nineteenth century, liberal political economy lost its power as it was realized that the power of the markets did not solve all the problems (Clarke, 2005: 57-58). After the Great Depression, Keynesians dominated in debates over economic policy

issues. They advocated state intervention to overcome the depression. According to Keynesians, the cause of the Great Depression was the weakness of aggregate demand and from this point, Keynes had attacked the foundations of economic orthodoxy after the great depression of the 1930s. The main claim of Keynesianism is that the level of economic activity is determined by the level of aggregate demand. From this perspective, weakness in aggregate demand causes unemployment. Besides, this weakness could lead to economic depressions. Keynesian economics was effective to solve those problems through state intervention; therefore, popularity of the Keynesian state intervention increased until the 1970s (Lapavistas, 2005: 31; Palley, 2005: 20; Resnick & Wolff, 2010: 172). Nevertheless, towards the end of the 1960s, economies faced inflation and unemployment at the same time. Those developments caused the rise of arguments such that Keynesian policies had not worked well and they needed to be abandoned. Neoliberal policies gained momentum in this (Harvey, 2005: 9-12).

Neoliberal policies were implemented firstly in Chile; therefore, this country is defined as the 'Neoliberal laboratory'. A group of economists, called the Chicago Boys implemented their policies under the Pinochet regime. Later, United Kingdom and United States practiced Neoliberal policies, then this policy was exported to the periphery. Main characteristics of Neoliberalism relate to a new discipline of labor, the limited intervention of the state and the dramatic growth of financial institutions (Duménil & Lévy, 2005: 9-10; Venugopal, 2015: 172; Crouch, 2014: 29-30).

Although Republican President Richard Nixon stated "I am now a Keynesian in economics", he decided to delink dollar and gold in 1971 and then adopted the floating exchange rate regime. It was important because this decision meant the end of the Keynesian period and rise of the Monetarist view (Patomäki, 2009: 431). After the stagflation of 1973, neoclassical economics took the left by Keynesian economics. In this period, unemployment and inflation increased hand in hand in most countries therefore, Keynesian policies were no longer effective. As a result Neoliberal policies began to be implemented as a response to the crisis of the Keynesian policy. At this stage, free market ideology became popular again with the rise of Neoliberalism, it can be said that Neoliberalism represents a reassertion of the liberal political economy. On the other hand, as years passed, income inequality and bubbles in stock markets began to soar as economic problems. For instance, the millennium started with a stock market crash and then the real estate collapse, liquidity crisis and deep recession were witnessed across countries. Keynesians came forward again with this crisis and today's wisdom is that the state must rescue capitalism as it did before (Harvey, 2005: 12; Clarke, 2005: 58; Resnick & Wolff, 2010: 172).

Milton Friedman, treated inflation as a monetary phenomenon. Accordingly, if governments desired to avoid inflation, they had to constrain the growth of the money supply. Originally, this reasoning could be observed in the Quantity Theory. After Friedman's Monetarism started to lose its influence, mainstream macroeconomics began to be dominated by the New Classical economics. The New Classical economics, emphasizes the market clearing properties of a capitalist economy and the effect of economic intervention causing more harm than use. And it can be said that Lucas has regenerated Say's

Law (Lapavistas, 2005: 34). Meanwhile casino capitalism, the term used by Keynes to depict the speculative side of the financial market, was replaced by the Efficient Market Theory (Krugman, 2009). In this context, Robert Lucas (2003:1) noted that the ".....central problem of depression-prevention has been solved..." As Lucas emphasizes monetary shocks as causes of business cycles; real business cycle theorists Kydland and Prescott argue that business cycles were products of random changes in technology (Snowdon & Vane, 2005: 294-295). In 1979, Robert J. Shiller showed that the Efficient Market model was far away from explaining the volatility in stock market indexes: "measures of stock price volatility over the past century appear to be far too high –five to thirteen times too high- to be attributed to new information about future real dividends" (Shiller, 1979).

*On the other hand, New Keynesians "...believe in an active role for government." However they also believe in "...investors and consumers are rational and that markets generally get it right." (Krugman, 2009). They also cast a role to monetary policy in overcoming economic disruptions. For instance Ben Bernanke "formerly a more or less New Keynesian Professor at Princeton" said: "You're right. We did it. We're very sorry. But thanks to you, it won't happen again." (Krugman, 2009).*

Likewise, Allan Greenspan, who was the former chairman of the US Federal Reserve admitted "Partially... I made a mistake in presuming that the self-interest of organizations, specifically banks, is such that they were best capable of protecting shareholders and equity in the firms... I discovered a flaw in the model that I perceived is the critical functioning structure that defines how the world works. I had been going for 40 years with considerable evidence that it was working exceptionally well." (The Guardian, 2008).

Both Keynesian and Neoclassical economics regard the market system as the best mechanism for allocating resources efficiently. Their difference lies in the issue of the role of the state in the economy. While according to Keynesians, state intervention is necessary to protect citizens from risks of inflation and recession; neoclassical economics maintains that markets would find their way without any intervention. After the crisis hit capitalism again in 2007, two sides have argued whether state intervention is necessary or not. An alternative explanation to crisis originates from the Marxist theory. This explanation emphasizes neither importance of state intervention nor sanctity of markets because these crises could be observed both in regulated and deregulated forms of capitalism. Therefore, the outcome reached by the Marxian theory is different from those of Neoclassical and Keynesian economics (Resnick & Wolff 2010, 172-173).

Another issue is the use of mathematics in economics. Although Hodgson (2009) says that, "The market is no longer seen as the solution to every problem", he doubts the idea that the recent crisis, would lead to a radical change in the mathematics orientedness of the profession, just as the 1997 crisis did not cause it to be less mathematical. The toy model of economic analysis which treats individuals like "wind-up toy dolls" is criticised by authors such as Tony Lawson (2009). As an alternative way of thinking over economic issues, Palma (2009: 832) offers a perspective including, Neo-Schumpeterian, Marxist and Faucaldian analyses alongside Keynesian-Minskian-Kindlebergian arguments. According to

him, this approach has significance because it takes into account the distributional issues of macroeconomics, as the state of the new macro economy could not be understood effectively without recourse to distributional issues (Palma, 2009: 851).

Tonak states that the mainstream approaches are still struggling to patch the torn parts of the overinflated balloon of global capitalism. Hence, the small tears (Greece) are being followed by bigger ones (Spain, Italy, and France) (Tonak, 2014: 12, 13). Brenner (2011) points out to the fact that the Marxian theory is often referred to in the context of the explanations towards the recent global crisis. Marx, arguing that problems arise from the inner nature of the capitalist system, regained popularity today. (Brenner, 2011: 11). In this context, this study aims to evaluate whether Marx's theory, rather than mainstream arguments could be used to explain the causes, effects and consequences of the 2007-2008 Financial Crisis.

### 3. Capitalism, Crisis and Marxism

Capitalism is prone to crises in the Marxist theory. The diminishing profit rate is in the center of this tendency. Marx gives detailed explanations concerning the operating laws of the capitalistic economy, its inherent contradictions and its proneness to crises in the 13th and 15th chapters of the Capital III (Marx, 2009 [1894]). Nevertheless of the most frequently asked questions is that if 'Marx ever had any crisis theory?'. At this point Akman explains that Marx did not have a crisis theory but he did have very important clues and main arguments towards a crisis theory. In fact, in its current situation, Marx's writings about crises have become among the studies that are taken most seriously not only by his contemporaries, but also by students of crises even today (Akman, 2010: 18-19). Clarke's question of whether there were three separate crisis theories instead of one in the Marxian literature is significant and useful in this context (Clarke, 2009: 159). Those three types of crises can be classified as: crisis caused by declining profit rates, crises caused by disproportionalities and crises caused by underconsumption (Akman, 2010: 19-20). Crises caused by disproportionalities is the theory that is in the vogue in the 20<sup>th</sup> century. This theory, suggested firstly by Tugan Baranowski, was further developed by Hilferding. In the second half of the 20<sup>th</sup> century, declining profit rates as the cause of crises gained attention and this was seen as Marx's original explanation to crises<sup>1</sup>. The third theory, which concerns underconsumption was developed by Rosa Luxemburg at the beginning of the century and scholars such as Sweezy and Baran who were also influenced by Keynesianism in the second half of the same century (Akman, 2010: 20).

Adam Smith, David Ricardo, and other political economists also emphasized the fall in the rate of profits in the long run. They reached this conclusion from evidence of the decline in the interest rates. Although Karl Marx acknowledged their results, he rejected

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<sup>1</sup> It is argued that Marx saw the law of declining rate of profit as "the most important historical fact" (Brenner, 2011: 31).

their theories which were put forward to explain the decline in the rate of profit (Kliman, 2015: 241). According to Marx, vast amounts of commodities are produced and exchanged in the capitalist world. Those commodities have two values; one of them is the use value; the other is the exchange value. Exchange value is at the center of capitalistic production. According to Marx, exchange value is originally derived from labor time. Therefore, this is called the labor theory of value. On the other hand, tensions and contradictions between the use and exchange values of commodities production generate the root causes of the crisis. In this line of thought, during the production process, capitalists invest their money to produce commodities, because they can make more money by selling the product. The reason they do so is to capture the surplus at the end of the production process. Marx calls this surplus as the surplus value. This surplus value depends on the exploitation of workers. Marx emphasizes two facets of surplus value. One of them is related to workers' physical routine and increasing working hours. This is identified as the absolute surplus value by Marx. The other is the relative surplus value. Increase in the technical composition of capital, which is called the organic composition of capital, improves labor productivity and this productivity further generates the surplus. Therefore, capitalists can increase their profit by substituting labor with capital. However, increases in the technical composition of capital reduces the value composition of capital in the long run. As a consequence, capitalist's profits start to decline (Dunn, 2011; Lucarelli, 2004: 14-19). Marx, expressed this process as follows: "...as long as the rate of surplus value or the intensity of exploitation of labor by capital is steady, the gradual growth of fixed capital relative to variable capital, compulsorily leads to a *gradual decline in the rate of profit*. As we can see, with the advent of capitalist production, a decline in the variable capital relative to fixed capital, thus a decline in its share in total capital that is induced is one of the laws of capitalist production." (Marx, 2009[1984]: 189). Again in Grundrisse, Marx depicts these developments as: "... the growth of parts of capital that does not bring surplus value, causes the rate of profit (the productivity of labor) to decline, even if surplus value (real productivity) increases. This in turn, is another expression of capital being a drawback to production." (Marx, 2014[1979]: 577).

Discussions over the factors that cause rate of profit to decline still continues<sup>2</sup>. For instance, Brenner indicates that one of the most important reasons for the decline in the profit rates is international competition (Brenner, 2002: 43). Luxemburg mentions that underconsumption leads to decreases in capitalist profits<sup>3</sup> (Luxemburg, 2004 [1913]). On the other hand, Bell and Cleaver insist that decreases in profits should be evaluated from the perspective of the working-class (Bell & Cleaver, 2002: 2). Sweezy and Baran, state in their 'Monopoly Capital' that today the typical form of economic unit is not the small firm, but the large scale enterprise which produces a significant portion of the total output, adjusts and

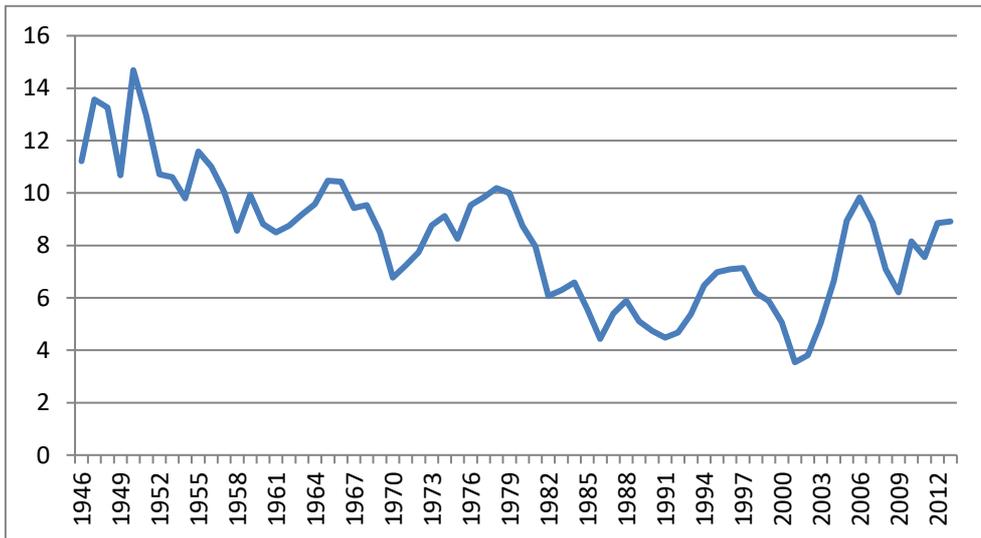
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<sup>2</sup> On the other hand, Mohun (2010) mentioned that the rate of profit increased after early 1980s.

<sup>3</sup> It is possible to observe Marx's critique of the underconsumptionist view from his following arguments (Tonak, 2014: 10-11): "It is nothing but an empty recurrence to say that depressions are caused by the insufficiency of actual consumption or number of consumers..." (Tonak, 2014: 11 quoting Marx). Tonak points out that variations in explanations towards the reasons of decline in the profits still persist today.

controls prices or the volume of production (Sweezy & Baran, 2007: 23). Baran and Sweezy describe this form of capitalism which can be observed in the U.S. economy as an economic and social order that is run by corporations. The central feature of this system was to increase surplus value continuously. This was possible through producing monopolistic industries by hindering competition and continuously increasing production. The main difficulty that is encountered under these circumstances was the absorption of the surplus value (Foster, 2011: 12-13).

**Figure: 1**  
**Nonfinancial Profits/National Income**



Source: FED, *Financial Accounts of the U.S.*

The main motivation of a capitalist firm is to make profit. In the Marxian literature, surplus value is the source of profits. However, there are times when a capitalist firm could make profit without exploiting any surplus value. Paradoxical it may seem, this is the foremost of the issues to be resolved when one tries to account for the recent crisis. From the perspective of the labor-value theory, when it is the productive sector in which the surplus value is generated, it is the non-productive sector which continues its presence with the share it takes from this surplus value. The financial sector is one of the largest of these non-productive sectors. This financial sector, made up of commercial banks, insurance companies and investment banks can make profits without generating any surplus value. This picture can be observed through Figure 2 below. Profitability in the financial sector drives capital towards financial activities; thus, causing the productive sector to shrink. Hence, it is possible to interpret the fall in non-financial sector profit rates in this perspective (Tonak, 2009; 36-37). Similarly, Brenner points out that a speculative fever which would

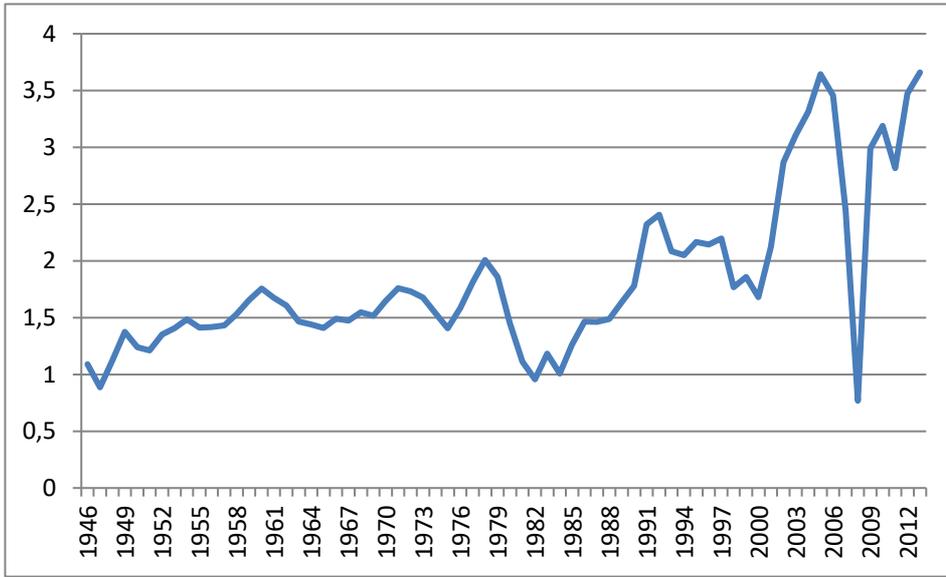
eventually lead to a crisis would occur even if a resurgence in the productive industries was present previously (Brenner, 2011: 17).

It will be useful to take an account of capital-labor relations after the Second World War. The developments and the rise of Neoliberalism in 1980s is especially important in this context. Post World War II governments tried to intervene in the market mechanism through monetary and fiscal policies. During this period which spans until 1980, the Fordist accumulation regime prevailed and there was compromise between labor and capital. The 1980s, on the other hand, were the years in which the influence of free markets expanded and the rise of neoliberalism was witnessed. The expanding effect of free markets, led firms to go global to overcome the scale limitations of domestic markets. Thus, firms needed to be more competitive in the global markets. Labor was the most effected factor from intensifying global competition. At this point it could also be argued that various regulations were lifted over a waxing financial sector (Boyer, 2010: 349). In this neoliberal stage of capitalism, financialization was a key element in capital relations. It is noteworthy that in this period, financial firms in the U.S. made huge profits (Saad-Filho, 2010: 249-250). With financialization, the traditional role of finance supporting the real sector has changed; and finance began to be more and more influential on the real sector (Foster, 2008: 7). It is safe to say that in part, speculative investments began to replace real investments (Lucarelli, 2012: 3).

For this reason, while real sector profits decreased, asset prices and earnings in financial sector steadily increased with deregulation and financial innovations. And this led to a change in the distribution of income in favor of the financial sector. Moreover, this self-ordained behaviour of the financial sector increased fragility in the economy (Altwater, 2009).

Marx also mentions some contradictions concerning the financial aspect of the capitalistic economy: "...Credit augments the severe bursting of this contradiction – depressions- and thus carries with itself the elements that will dissolve and disperse the previous form of production" (Marx 2009 [1894], 390) and also "...Credit system, gives this class of parasites ....at the same time the power to interrupt in the actual production in a most dangerous way." (Marx 2009 [1894], 483). According to Tabb, here Marx gives the outline of an endogenous business-cycle theory with finance at the center (Tabb, 2010: 313).

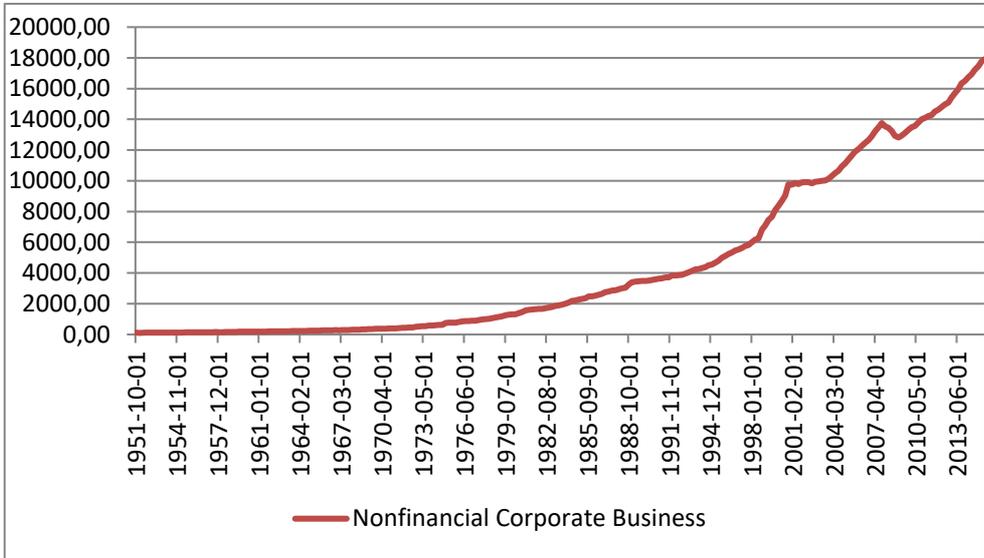
**Figure: 2**  
**Financial Profits/National Income**



Source: FED, *Financial Accounts of the U.S.*

Orhangazi (2008) drew attention to the negative relationship between financialization and real investment. He proposed two channels to explain this relationship. Firstly, he mentions that increased financial profit opportunities crowded out real investment. Secondly, available funds were invested in the financial sector instead of the real sector, therefore financialization hampered real investment. Both of these reasons were related with increased financial profits. Similarly, Duménil and Lévy (2004) emphasized that financial relations between the financial sector and nonfinancial corporations were altered in the Neoliberal decades. According to him, the main reason of this change was the profit rate. While profit rates of nonfinancial corporations decreased, profit rates in financial sector increased after 1980. In response, capital was redirected to financial assets instead of real assets. Duménil and Lévy drew attention to the fact that financialization affected real investment negatively because sizeable amounts of money were invested in financial markets instead of the real sector. Crotty (2003: 275) came to the conclusion that destructive competition in product markets constrained nonfinancial corporations' profits, therefore they tended towards the financial sector. Similarly, Stockhammer (2004) argued that the financial investment of nonfinancial corporations increased accordingly, and the accumulation of capital goods declined. Figure 3 shows that total financial assets of nonfinancial corporate business went up especially after the 1970s. This rise is related to growth in financial incomes as stated previously. This translated into the consequence that nonfinancial corporation funds are now flowing to the financial sector, and the Figure below indicates very clearly the degree of financialization in the non-financial sector.

**Figure: 3**  
**Nonfinancial Corporate Business Total Financial Assets, (Level, Millions of Dollars, Not Seasonally Adjusted)**



Source: Federal Reserve Bank of ST. Louis.

According to Brenner (2009), underlying the Great Recession are the loss of power of advanced economies with the declining profit rates since the 1970s and the overproduction phenomenon. With the globalization of trade, new industrial powers such as China and South Korea have emerged. This, however, led both to decreased profit rates and overproduction in the industrial sector. Brenner puts forward that financial bubbles that emerged in the U.S. should also be held in this context, since these bubbles are the result of the efforts (such as expansionary policies, financial deregulations etc.) by advanced countries to prevent slowdowns in the capitalist system. Similar problems had also emerged in Japan, which had faced a recession following a bubble burst. With regards to the relationship between financialization and stagnation, Palley observes that "...the business cycle generated by financialization may be unstable and end in prolonged stagnation." (Palley, 2007: 21).<sup>4</sup>

<sup>4</sup> Some radical economists (Palley, 2007; Orhangazi, 2007) mention that financialization caused stagnation instead rather than stagnation generating financialization. These economists emphasize that deep stagnation came up after the end of a financial bubble (Foster, 2008: 10-11).

#### 4. Great Recession and Financialization

The bubble in the U.S. mortgage market lies at the center of the 2007-2009 global crisis. And the crisis took a global turn with the securitization of sub-prime assets (Lapavistas et. al., 2010: 324). Later on, the crisis arising from bankruptcy of U.S. financial institutions expanded into the crisis arising from insolvent European economies (Akçay & Güngen, 2014: 102). Capitalism has not faced a crisis of this magnitude since 1929 (Piketty, 2014: 508).

Central banks played a key role in the efforts to recover from the crisis. They bought mortgage-based securities to mitigate the credit risk, introduced expansionary open market operations, and extended discount credits and loans for investment banks. In addition, gradual decline in interest rates further lowered the cost of those credits. In the aftermath of the crisis, financial institutions were bailed out with capital injections as part of government plans to attenuate the effects of the crisis (Lapavistas, 2009: 122; 2010: 321).

Prior to the crisis, a booming housing sector fueled with increasing mortgage credits, caused consumption and construction investments based on borrowing to explode in the U.S. From the mids of 2006, housing prices began to decline in the U.S. signaling the beginning of the Subprime Crisis. The problems then spread to interbank markets in August 2007. The loss of confidence triggered an increase in interest rates by a rise in the risk premium. At this stage, central banks fed the market with liquidity. However, in 2008, talks over problems in some of the investment banks such as Bear Sterns and Lehman Brothers intensified and the period marked the official beginning of the financial crisis. In the fall of 2008, sharp declines were reported in the GDPs of advanced economies. Those declines were the sharpest that have been witnessed since the 1930s, indicating that countries fell into an economic recession. The crisis then spread to developing economies. Production declined, unemployment increased and people lost their homes and jobs. Government actions towards crisis caused budget deficits to increase. At the end, in 2009, crises evolved into a new form which was now a fiscal crisis (Stockhammer, 2012: 42-44).

One of the most important developments prior to this process of recession is the phenomenon known as financialization. Increasing weight of finance in the past thirty years is a salient feature of the developed economies (Lapavistas, 2009: 124; Lapavistas et al., 2010:321). The natural outcome of this process is that real estate and prices of various assets in the financial sector now lead the economy. However, in this finance-led accumulation regime, financial fragility also increases (Stockhammer, 2012: 40). Now, the growth strategy based on investment is replaced by the finance-led growth regime. Contribution of the financial sector to the GDP surpasses that of industry and services in this new regime. The relation between debtor and creditor has also changed under this new system. Creditor financial institutions can generate new credit by issuing derivatives that would spread risks of default. Profitability is derived not from the payment of debts but from the fees acquired through this process of securitization. On the other hand, alongside non-financial firms, households also participate in the financial markets in growing numbers; thus, contributing to the growth of the financial sector and to financialization (Krippner, 2005: 174; Bayram,

2013: 150). Capital is transferred to complex financial instruments, real estate speculation and credits in order to ensure the continuation of the system. Those developments cause an increase in various forms of fictitious capital that has little connection to real values of commodities. Marx names these the counter tendencies that impede the fall in profit rates. But he also insists that these counter tendencies could not delay the effects of falling profit rates forever. Thus, when credits and complex financial instruments became over-valued, crisis follows. Finally, the over-accumulation of capital turns into a speculative fever that will result in a crisis. With devaluations in national currencies, credit squeezes, falls in both profit rates and aggregate profits, and soaring unemployment, the crisis turns into a depression (Brenner, 2011: 16-17). Foster states that the recent crisis is a result of a long term financial disturbance and increasing instability along with a decline in the rate of economic growth. To him, another bubble would have caused the same problems if the real estate bubble had not burst. Foster notes that the main problem is related to capitalistic development dynamics, not to economic policies that were implemented (Foster, 2011: 8-9).

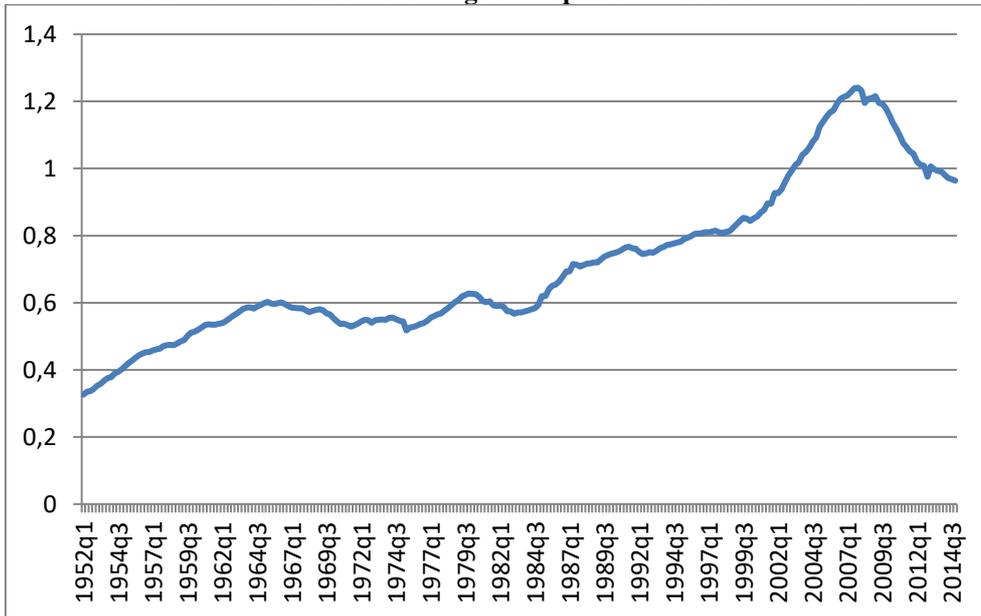
There are various definitions concerning the concept of financialization. For instance, according to Duménil & Lévy (2004: 82), financialization is "the growth of financial enterprises, the rising involvement of nonfinancial enterprises in financial operations, the holding of large portfolios of shares and other securities by households, and so on". Stockhammer (2004: 721) define financialization as "the engagement of non-financial business in financial markets". Krippner (2005: 174) defines "financialization as a pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production." Orhangazi (2008: 5-6) defines financialization in a narrower and a general level. At the general level, "financialization refers to an increase in the size and significance of financial markets, transactions and institutions." At a narrower level, he uses the concept of "financialization to designate changes in the relationship between nonfinancial corporate sector and financial markets."

Marxian political economy reveals that financialization is a transformation in mature capitalist economies. This transformation is related to three features. Firstly, the relation between non-financial corporations and banks has been changed. In this context, non-financial corporations do not depend solely on banks for finance any longer. They could prefer using equity directly from financial markets. Second, banks have changed their profit resources. They focus on earning fees by mediating between transactions in the open market. In addition to this, they turn towards individuals in terms of lending practices and marketing of financial assets. Third, households connect to the financial system via borrowing and holding financial assets (Lapavistas, 2011: 623).

After the financial sector had become much more profitable than the real sector, capital which took the larger share of output began to be invested in the financial sector. For instance, especially after the 1970s, mortgages soared. These mortgages were sold to securities holders who sold them to other investors. After the financial crisis, subprime mortgage securities market collapsed and then crisis expanded to the rest of the mortgage backed securities market and other areas of the credit market because these were connected

to each other (Resnick & Wolff, 2010: 182). In this period, the housing price bubble fed increasing demand in an unsustainable way. For instance, homeowners borrowed money from financial markets with the increased value of their homes. Rising asset prices led to debt-financed spending by making people wealthier and thus, they sustained their consumption levels (Kliman, 2015: 247). Figure 4 shows that household debt rose rapidly with the second half of the 1980s.

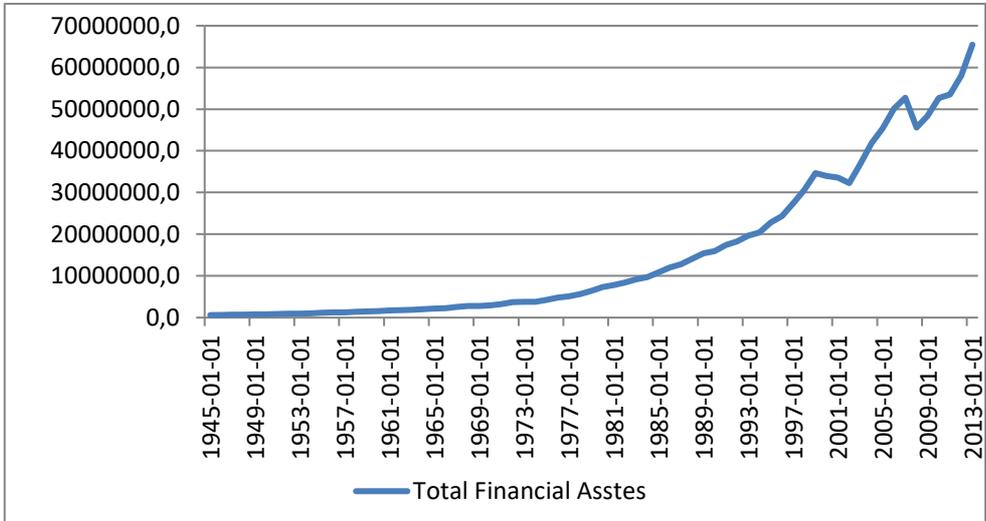
**Figure: 4**  
**Household Debt as a Percentage of Disposable Household Income**



Source: FED, *Financial Accounts of the U.S.*

Beginning in the 1970s, banks restructured themselves in the above mentioned order. With this, the main source of profits for the banks became households and individuals. Another change was the banks aiming toward investment banking thus, making profits through operations in the financial markets. In the 2000s, bank assets reached huge amounts and the sources of this increase were the credits given to individuals and other banks, rather than corporations (Saad-Filho, 2010: 249-250; Lapavistas, 2011: 620; Lucarelli, 2012: 3). Figure 5 shows the amount of financial assets owned by households and non-profit organizations. The trend indicates growing participation of households and non-profit organization in the financial markets.

**Figure: 5**  
**Households and non-profit organizations; total financial assets, (Level, Millions of Dollars, Not Seasonally Adjusted)**



Source: Federal Reserve Bank of ST. Louis.

This transformation of banks and other financial institutions contributed to the globalization of the crisis. Commercial banks moving away from financing industry and commerce, tending towards investment-banking and individual incomes as sources of profit, contributed to the formation of the bubble between 2001 and 2007 in the U.S. (Lapavistas, 2009: 115). When the speculative sub-prime bubble burst, financial *laissez-faire* approach failed and state action came forward again (Boyer, 2010: 308). Kotz thinks that the main reason of the crisis is the unsustainability of the Neoliberal accumulation structure. According to him, as Neoliberal economic order progressed, income inequality increased and as a result, upper income groups have accumulated vast funds available for financial markets. At the same time, this income inequality brought about the insufficient aggregate demand problem and this problem was delayed through borrowing (Kotz, 2009: 4). On the other hand, Kliman (2015), questioning the thesis that the phenomenon of financialization is behind the Great Recession, points to declining rates of profit and the inherent instability of capitalism as sources of the crisis. Taking a pessimistic stance against bank bailouts from the point that they would aggravate the moral hazard problem, he argues that the fundamental motivations of the system should change, mentioning "Marx's theory" that crises of capitalism could not be resolved while staying in the confines of the capitalist system.

## 5. Conclusion

Almost since the establishment of economics as an independent field, crises have been extensively studied by economists. The debate over the proper way to contain the fluctuations experienced in the capitalist history constitutes an important part of economic thought. While Keynesian and Neoclassical schools have come up with differing arguments on the role of state intervention in containing and overcoming crises, they both agree that remedies to crises should be restricted to the confines of the capitalistic economic system. On the other hand, Marxist thought takes a more radical view and could even go as far as to suggest a complete elimination of the capitalist system as a final solution to financial crisis. This paper concludes that the phenomenon known as 'financialization' constitutes the focus of the efforts taken to explain recent financial crises, and to take measures to prevent repeat thereof in the future. The Marxist view does not contradict with the assumptions of this conceptualization, as it stresses gradual, inevitable decline in profit rates in the real sector and consequent concentration on the financial sector at the expense of the real sector. While it can be argued that falling profit rates were offset by the financial sector, financialization brought about intractable economic disruption in recent crises and capitalism is in trouble again. Wolff (2010) stresses that, while the 1848 crisis was influential on Marx's ideas, the crisis we have been going through at the moment led to increased attention to Marxism and its way of explaining the failings of the capitalism. The crisis was instrumental in proving that Marx was right in arguing that capitalism is prone to crises (Wolff, 2010).

To avoid financial crises, some measures have been suggested (Dunn, 2011). This includes the measures to eliminate financial speculation or increase wages so as to help alleviate the ever-broadening gap in the income strata. Higher taxation for higher income groups and less frequent bailouts for failing financial institutions may be other measures to serve this end. Nevertheless, if such measures were introduced in capitalist economies, the ruling classes would be expected to raise their objections. The author, therefore, proposes a systemic transformation, rather than mere measures within the system, to fight against crises; and needless to say, such a transformation would inherently include *overthrow of capitalism*.

The data presented in this paper shows that profits from non-financial sector as a share of national income declined during the period 1980-2000. But the trend reversed at the turn of the second millenia (Figure 1). But financial profits as a percentage of national income shows a rising trend after 1980, and this rise has been consistent except for the crises period of the Great Recession (Figure 2). The data also shows a significant upward trend for financial assets of non-financial corporations, beginning well ahead of the 1970s (Figure 3). Thus, as the theories of exploitation still await confirmation -both profits and labor share has fallen- a marked trend towards financialization is evident. Figures 4 and 5 document the data picturing the financialization at the level of household and non-financial firms. Economic theories, whether Keynesian, Marxist or other, should factor in this phenomenon in their attempt to explain and analyze the economic structure and issues of systemic fragility.

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