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IS IT GREEK OR DÉJÀ VU ALL OVER AGAIN?: NEOLIBERALISM, AND WINNERS AND LOSERS OF INTERNATIONAL DEBT CRISES

Tayyab Mahmud

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Tayyab Mahmud[*]

Abstract:

The global financial meltdown and the Great Recession of 2007-09 have brought into sharp relief the uneven distribution of gain and pain in economic crises. The 2009-10 debt crisis of Greece has resulted in a windfall for financial institutions at the expense of tax-payers, a rollback of welfare systems, and impoverishment of the working classes. This result is in tune with a pattern evidenced by the ubiquitous international debt crises of the last three decades, including the Latin American crisis of the 1980s, and the Asian crisis of 1990s. The recurrent international debt crises of the last three decades and the resulting transfers of wealth from the poor to the rich are the products of the neoliberal restructuring of economies that aims to rollback the gains made by the working classes under the Keynesian welfare compromise, and to establish the hegemony of finance capital. These objectives have been facilitated by an extensive refashioning of the U.S. and international regulatory regimes resulting in financialization of the global economy and unbridled international mobility of finance capital. Global financial institutions channeled access global liquidity in ways that created unsustainable international debts, followed by recurrent international debt crises. These crises are managed to displace welfare systems with neoliberal restructuring. The end result is transfer of wealth from the poor to the rich, further impoverishment of working classes, and enhanced power of finance capital. A collective moratorium on debt servicing by the Global South is a viable path towards a new global financial order that is sustainable and gives human beings priority over capital.

[*] Professor of Law and Director, Center for Global Justice, Seattle University School of Law. Earlier versions of this paper were presented Cleveland-Marshall College of Law, Loyola University of Chicago School of Law, University of Oregon School of Law, and Seattle University. I want to thank Jaswinder S. Brara, Larry Meacham, and Meena Rishi for their thoughtful comments on earlier drafts. My research assistant, Setareh Mahmoodi, and research librarians at Seattle University School of Law provided invaluable assistance with this project.

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Rule one: Never allow a crisis to go waste. They are opportunities to do big things.[1]

In a depression, assets return to their rightful owners.[2]

Bankers have a bad habit of making economic cycles worse. They are notorious for lending people umbrellas when the sun is shining and asking for them back when rain starts to fall.[3]

I used to think if there was reincarnation, I wanted to come back as the president or the pope or a .400 baseball hitter. But now I want to come back as the bond market. You can intimidate everybody.[4]

We live again in a two-super-power world. There is the U.S. and there is Moody's. The U.S. can destroy a country by leveling it with bombs; Moody's can destroy a country by downgrading its bonds.[5]

I. Introduction

The world is awash with money,[6] but two fifth of humanity remains without access to even a bank account much less credit.[7] While captains of finance capital bemoan an Asian "savings glut"[8] and a resulting "liquidity glut,"[9] nearly three billion people struggle to survive on less than

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[1] Rahm Emanuel, White House Chief of Staff, *quoted in* Jeff Zeleny, *Obama Weighs Quick Undoing of Bush Policy*, NEW YORK TIMES, November 9, 2009, at A11.

[2] Andrew Mellon, banker and U.S. Secretary of the Treasury 1921-32, *quoted in* DAVID HARVEY, THE ENIGMA OF CAPITAL AND THE CRISES OF CAPITALISM 11 (2010).

[3] *Joseph and the Amazing Technicalities*, ECONOMIST, April 26, 2008, at 20.

[4] James Carville, political strategist and White House advisor, *quoted in* WALL STREET JOURNAL, February 25, 1993, at A1

[5] Thomas A. Friedman, *Don't Mess with Moody's*, NEW YORK TIMES, February 22, 1995, at A15.

[6] The total daily global financial transactions increased from $2.3 billion in 1983 to $130 billion in 2001. This $40 trillion annual turnover compares with $800 billion needed to support international trade and productive investment flows. *See* PETER DICKENS, GLOBAL SHIFT: RESHAPING THE GLOBAL ECONOMIC MAP IN THE 21ST CENTURY, ch. 13 (2003). In 2006, on the eve of the global financial meltdown and the Great Recession of 2007-2009 , while the entire world output was USD 48.6 trillion, market capitalization was USD 48.6 trillion, total international banking assets were USD 29 trillion, domestic and international bonds were USD 67.9 trillion, and USD 3.1 trillion changed hand every day on foreign exchange markets. In December 2007, the face value of all over-the-counter derivatives was over USD 596 trillion, with a market value of USD 14.5. NIALL FERGUSON, THE ASCENT OF MONEY: A FINANCIAL HISTORY OF THE WORLD 5-6, 63, 229 (2009). Nearly 90 percent of international financial flows represent speculative and hedging behavior . L. Randall Wray, Monetary *Theory and Policy for the Twenty-first Century*, in POLITICAL ECONOMY FOR THE 21ST CENTURY: CONTEMPORARY VIEWS ON THE TRENDS OF ECONOMICS 139 (Charles J. Whalen ed., 1996).

[7] FERGUSON, ASCENT, *supra* note _ at 282.

[8] Ben Bernanke, *The Global Savings Glut and the U.S. Current Account Deficit*, Homer Jones Lecture, St. Louis, Missouri, April 15, 2005. *Accessed* July 29, 2010, at http://www.federalreserve.gov/boarddocs/speeches/2005/20050414/default.htm.

[9] Alan Greenspan, *The Fed Didn't Cause the Housing Bubble*, WALL STREET J., March 11, 2009, at A15.

two dollars a day.[10] The global financial crisis we are living through may well be "a transformative moment in global economic history, whose ultimate resolution will likely reshape politics and economics for at least a generation."[11] The magnitude of the crisis and the largest shrinking of world output since the Great Depression, lends new urgency to Karl Polanyi's admonition: "Only a madman would have doubted that the international economic system was the axis of the material existence of the human race."[12] The ILO estimates that the downturn has cost over 50 million lost jobs worldwide.[13] In the developing countries, the share of the "working poor" in the labor force increased to 64 percent, and another 84 million will remain poor or fall into extreme poverty due to the crisis.[14] The global losses in the financial sector alone exceed USD 3.6 trillion,[15] and the bill for worldwide public rescue of financial institutions is USD 20 trillion.[16] The long-term total potential cost of just the U.S. tax-payers' rescue of finance capital is USD 23.7 trillion - over 150 percent of GDP.[17] Much more pain may be on its way. The average GDP contraction following a severe banking crisis is a stunning 9.3 percent,[18] and, on average, banking crises lead to an 86 percent increase in government debt over three years

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[10] *Fast Facts: Three Faces of Poverty*, UN Millennium Project (Nov. 22, 2009). *Accessed*, June, 5, 2010, at http://www.unmillenniumproject.org/resources/fastfacts_e.htm.

[11] CARMEN M. REINHART AND KENNETH S. ROGOFF, THIS TIME IS DIFFERENT: EIGHT CENTURIES OF FINANCIAL FOLLY 208 (2009).

[12] KARL POLANYI, THE GREAT TRANSFORMATION: THE POLITICAL AND ECONOMIC ORIGINS OF OUR TIME 18 (2001 [1946]).

[13] Nelson D. Schwartz, *Unemployment Surges around the World, Threatening Stability*, NEW YORK TIMES, February 14, 2009, at B1. Reporting ILO estimates.

[1414] UNITED NATIONS, WORLD ECONOMIC SITUATION AND PROSPECTS 2010, v-vi (2010).

[15] IMF, GLOBAL FINANCIAL STABILITY REPORT: NAVIGATING THE CHALLENGES AHEAD, October 2009. *Accessed* July 7, 2010, at http://www.imf.org/external/pubs/ft/gfsr/2009/02/pdf/text.pdf.

[16] UNITED NATIONS, WORLD ECONOMIC SITUATION AND PROSPECTS 2010, xii-xiii (2010).

[17] Estimate by the special inspector general for TARP, *quoted in* SIMON JOHNSON AND JAMES KWAK, 13 BANKERS, THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN 174 (2010). As of June 2009, the total Fed asserts were over USD 2 trillion, an increase of 2.3 times over USD 852 billion in 2006. While Treasury securities were over 90 percent of Fed assets in 2006, they were only 29 percent in June 2009, reflecting the unprecedented funding of the financial system. Besides a lack of transparency of these transactions, the adequacy of the collateralization of these positions is suspect and the "potential risk to the Fed from these positions is substantial." HAL S. SCOTT, THE GLOBAL FINANCIAL CRISIS 31 (2009).

[18] REINHART AND ROGOFF, THIS TIME IS DIFFERENT, *supra* note _ at 229, 230 Fig. 14.4. *See also*, MARTIN WOLF, FIXING GLOBAL FINANCE 33 Fig 3.1 (2010).

following a crisis.[19] We are also living through a unique period. In "the ultimate role reversal in financial history,"[20] developing economies are bailing out global finance and the revival of global economic growth increasingly rests upon capital injections by developing counties.[21] In the midst of all this, we have seen "*one of the largest redistributions of wealth in such a short period of time in history*."[22] We are told that "Wall Street only became stronger as a result of the financial crisis."[23] Hiring on Wall Street has picked up "underscoring the remarkable recovery of the biggest banks and brokerage firms since Washington rescued them in the fall of 2008, and follows the huge rebound in profits."[24] How does a moment of general economic distress and wrenching hardship for the many becomes an opportunity of enhanced resources and power for the few? How do non-market forces and the market work together to produce and mange international debt crises? The search for an answer should be mindful that "in the world of economics, things are never as they seem."[25]

Over 200 years ago, Thomas Jefferson cautioned that "banking institutions are more dangerous than standing armies.[26] Today, in "the age of leverage"[27] and derivatives,[28] finance

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[19] REINHART AND ROGOFF, THIS TIME IS DIFFERENT, *supra* note _ at 231-32.
While the Global South has been the primary arena of this phenomenon, advanced capitalist economies have not been immune to financial crises. The Savings and Loan collapse in the 1980s, the exchange-rate crisis in Europe in early 1990s, Japan's prolonged deflation since the 1990s, the dot.com crisis of 2000, and the 2008-2010 financial meltdown and the resulting "great recession" are instances of this turn.
[20] FERGUSON, ASCENT, *supra* note _ at 338.
[21] In 2009, the net financial transfers (net capital flows minus investment income payments) from developing countries to the developed ones was USD 568 billion, compared with USD 891 billion in 2008. UNITED NATIONS, WORLD ECONOMIC SITUATION AND PROSPECTS 2010, ix-x (2010). *See also* Robert Wade, *The First-World Debt Crisis of 2007-2010 in Global Perspective*, 51:4 CHALLENGE 23, 24 (July/August 2008).
[22] JOSEPH E. STIGLITZ, FREEFALL: AMERICA, FREE MARKETS, AND THE SINKING OF THE WORLD ECONOMY 200 (2010).
[23] JOHNSON AND KWAK, 13 BANKERS, *supra* note _ at 156.
[24] Nelsen D. Schwartz, *Wall St. Is Hiring in Anticipation of Recovery,* NEW YORK TIMES, July 11, 2010, at A1.
[25] STIGLITZ, FREEFALL *supra* note _ at 71.
[26] Thomas Jefferson, *quoted in* JOHNSON AND KWAK, 13 BANKERS, *supra* note_ at 14.
[27] Niall Ferguson, *Fiscal Crises and Imperial Collapses: Historical Perspectives on Current Predicaments*, Ninth Annual Niarchos Lecture, Peterson Institute for Int'l Econ., May 13, 2010, at 4. *Accessed* July 21, 2010, at http://www.iie.com/publications/papers/niarchos-ferguson-2010.pdf.
[28] For detailed studies of derivatives, *see* DICK BRYAN AND MICHAEL RAFFERTY, CAPITALISM WITH DERIVATIVES: A POLITICAL ECONOMY OF FINANCIAL DERIVATIVES, CAPITAL AND CLASS (2006); Raghuram G. Rajan, *Has Financial*

capital equipped with "financial weapons of mass destruction"[29] can and does inflict more destruction than an eighteenth century standing army ever could. Economic crises that are endemic to capitalism appear to be particular occasions for such damage.[30] One study identifies 148 crises since 1870 in which the GDP of a country fell 10 percent or more, and 87 crises when consumption fell by a comparable magnitude.[31] Similarly, the history of finance capital is one of bubbles, busts, shocks and crashes.[32] International financial crises are rooted in the dissonance between territorial logic of states and the globalizing imperative of capital.[33] A new global economic order has accelerated this volatility and there have been 124 banking crisis just in the

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Development Made the World Riskier? August 27, 2005. *Accessed* July 21, 2010, at http://www.kansascityfed.org/publicat/sympos/2005/pdf/rajan2005.pdf.

[29] Warren Buffett, *Chairman's Letter*, BERKSHIRE HATHAWAY 2002 ANNUAL REPORT, February 21, 2003. *Accessed* July 21, 2010, at http://www.berkshirehathaway.com/letters/2002pdf.pdf).

[30] For capitalism's boom and bust cycles and the tendency towards crisis, *see* DAVID HARVEY, LIMITS OF CAPITAL (2006); ROBERT HEILBRONER, THE NATURE AND LOGIC OF CAPITALISM (1985)

[31] Robert J. Barro and Jose F. Ursua, *Macroeconomic Crisis since 1870*, BROOKINGS PAPERS ON ECONOMIC ACTIVITY 255 (2008). *Accessed* July 29, 2010, at http://muse.jhu.edu/journals/brookings_papers_on_economic_activity/summary/v2008/2008.1.barro.html.

[32] *See* Larry Neal, *A Shocking View of Economic History*, 60:2 J. OF ECON. HIST. 317 (2000). Financial crises are born of the tendency of financial markets to over or under-estimate risk that results in misallocation of capital and economic bubbles. According to Hyman Minski, financial markets tend to go through a cycle from conservative hedge financing, to risky speculative financing, to unsustainable Ponzi financing, and then back to hedge financing. Without public intervention, this financial instability cycle transforms moderate prosperity into a boom, which can unravel quickly to produce a deep recession. Hyman P. Minski, *The Financial Instability Hypothesis*, The Jerome Levy Economics Institute Working Paper No. 74. (1992). Accessed, June 2, 2010, at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=161024. Financial speculative boom typically ends with the "Minski moment"- the moment it becomes clear that borrowers are overextended and need to sell assets to meet debt obligations. Justin Lahart, *In time of Tumult, Obscure Economist Gains Currency*, WALL STREET JOURNAL, August 8, 2007, at A1.

[33] In the international arena the dissonance between the tendency of capital to expand globally and territorial sovereign states creates a basic dilemma for capital. Capital is denominated in the currency of the state whose space it occupies, and must change its currency denomination as it moves from one state to another. Multiple of national currencies circulate internationally at changing rates of exchange and domestically determined and fluctuating interest rates. Relative changes across monetary areas and over time within monetary spaces are continually transmuted through derivatives. Besides mediating between savers and investors, finance capital has to manage the risk born of spatial and temporal uncertainties. Financialization of the last three decades can be seen, then, as devices of struggle between indiv*id*ual capitals to profit from global economy's need to hedge itself against the contingencies that disrupt global circulation and accumulation of capital. Trading in financial markets has risen exponentially as the risk born of uncertainty is continually passed along to whoever wishes to bear it. Competition to profit between individual capitals to profit from global economy's risk management needs leads to misallocation of risks. At a tipping point, the misallocation of risk and capital turns into a financial crisis.

Global South between 1970 and 2007.[34] The unmistakable lessons of the history of debt and financial crises are that unfettered international mobility of capital is harmful for the wellbeing of societies,[35] and that financial liberalization is a leading indicator of future crisis.[36]

Liberalization and financialization of the global economy have ushered in an era of recurrent financial and public debt crises. These crises, which become frequent enough to be considered endemic, have "always caused transfers of ownership and power to those who keep their own assets intact and who are in a position to create credit."[37] As a result, "public debt crises are always and everywhere a political phenomenon."[38] Response to a debt crisis "is at its heart a question of politics, not of economics or of regulatory technicalities."[39] Such crises always force "difficult political decisions about what is going to be sacrificed in order to pay the debt."[40] Non-market forces play a crucial role in managing the turmoil caused by these crises to deepen finance capital's hold on economies.[41] In what has become a pattern over the last three decades, financial crises are managed in modes that "the damage caused by the turmoil is directed away

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[34] Luc Laeven and Fabian Valencis, *Systemic Banking Crises: A New Database*, IMF WORKING PAPER, WP/08/224 (2008). *Accessed* July 20, 2010, at http://papers.ssrn.com/sol3/papers.cfm?abstract_*id*=1278435.

[35] *See* Ross p. Buckley, *International Capital flows, Developing Countries and Economic Sovereignty*, in YEARBOOK OF INTERNATIONAL ECONOMIC AND FINANCIAL LAW 1999 (2001).

[36] *See* Graciela Kaminsky and Carmen Reinhart, *The Twin Crises: The Causes of Banking and Balance of Payment Problems*, 89 AM. ECON. REV. 473 (1999). Ferguson points out that "[b]ubbles are more likely to occur when capital flows freely from country to country. … and …without easy credit creation a true bubble cannot occur." FERGUSON, ASCENT, *supra* note _ at 123.

[37] Robert Wade and Frank Veneroso, *The Asian Crisis: The High Debt Model versus the Wall Street-Treasury-IMF Complex*, 228 NEW LEFT REV. 3, 20 (1998).

[38] Ferguson, *Fiscal Crises and Imperial Collapses*, *supra* note_ at 9.

[39] JOHNSON AND KWAK, 13 BANKERS, *supra* note _ at 221.

[40] Ferguson, *Fiscal Crises and Imperial Collapses*, *supra* note _ at 9.

[41] The genesis, consolidation, and global expansion capitalism cannot be separated from the role played by the states. The rise and consolidation of capitalism was dependent upon the critical role states played in establishing legal regimes of property, contracts, currency, and wage-labor in conjunction with colonial expansion and siphoning of value. It is critical to appreciate the role states play in making "free markets" possible. *See* FERNAND BRAUDEL, II CIVILIZATION AND CAPITALISM, 15TH-18TH CENTURY 232 (Sian Renolds trans., 1992); IMMANUEL WALLERSTEIN, THE CAPITALIST WORK ECONOMY (1979); SAMIR AMIN, ACCUMULATION ON A WORLD SCALE: A CRITIQUE OF THE THEORY OF UNDERDEVELOPMENT (1974); ELLEN MEIKSINS WOOD, EMPIRE OF CAPITAL (2003). Note that it is the state that creates "the most important of all financial markets – that in government debt." WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 17.

from the dominant classes and the center towards the subordinated classes and the periphery."[42] Imperial forces choreograph responses to ubiquitous debt crises that allocate burdens of these crises to subordinated classes through unemployment and impoverishment, and losses to finance capital are covered by bailouts financed by public revenues, at the cost of public expenditures on social welfare. All this adds up to transfers of wealth from the poor to the rich. Furthermore, the "U.S Treasury-Wall Street-IMF Complex"[43] consistently takes advantage of international debt crises to further push financial liberalization.[44] In this sense "financial instability is functional. It disciplines world capitalism."[45] In this process, developing societies are relabeled overnight as "emerging markets,"[46] neoliberal missionary institutions push free market ideology on reluctant societies,[47] and "capital now flows upstream, from the world's poor to the richest country of all."[48] The end result is that neoliberalism facilitates finance capital to turn whole populations to "*debt peonage*."[49] In this deadly game, the iron fist of the state and the hidden hand of the market come together to make machinations of finance capital "the real cutting edge of accumulation by dispossession on the global stage."[50]

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[42] Christopher Rude, *The Role of Financial Discipline in Imperial Strategy*, in EMPIRE RELOADED 82, 83 (Leo Panitch and Colin Leys eds., 2005).
[43] I adopt the construct from Wade and Veneroso, Th*e Asian Crisis*, *supra* note _ . Earlier, Jagdish Bhagwati had used the construct 'Wall Street-Treasury complex." *See* Jagdish Bhagwati, *The Capital Myth: The Difference Between Trade in Widgets and Dollars*, FOREIGN AFFAIRS, May-June 1998 at 7-12.
[44] *See* PAUL BLUSTEIN, THE CHASTENING: INSIDE THE CRISIS THAT ROCKED THE GLOBAL FINANCIAL SYSTEM AND HUMBLED THE IMF ch. 7 (2001); RAWI E. ABDELAL, CAPITAL RULES: THE CONSTRUCTION OF GLOBAL FINANCE (2006); Bhagwati, *The Capital Myth, supra* note _ at 7-12; JOHNSON AND KWAK, 13 BANKERS, *supra* note _ at 24.
[45] Rude, *supra* note _ at 82.
[46] The term, initially coined by World Bank economist Antoine van Agtmael, was popularized by the International Finance Corporation (IFC). When investors remained unenthusiastic about an IFC investment fund styled Third World Investment Trust, the Emerging Market Growth Fund, floated in 1984, proved marketable. The new name gained broad appeal by the early 1990s. *See* Alain. Soulard, *The Role of Multilateral Financial Institutions in Bringing Developing Companies to US Markets*, 17 FORDHAM INT'L L. J. 145, 147 (1994).
[47] JOSEPH E. STIGLITZ, GLOBALIZATION AND ITS DISCONTENTS 13 (2002).
[48] WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 59.
[49] HARVEY, NEOLIBERALISM, *supra* note_ at 36. (2007). Emphasis added.
[50] *Id* at 37. (2007). The key point of the accumulation by dispossession thesis is that the market always relies on non-market forces and processes to facilitate accumulation of capital. This is in tune with Polanyi's classic observation that "the market has been the outcome of a conscious and often violent intervention on part of government which

This article aims to explore the causes and mechanics of such distributions of gain and pain by locating the current Greek debt crisis in the chain of ubiquitous international debt crises of the last thirty years. It argues that the intensity and the result of the Greek debt crisis, and the other international debt crises that preceded it, are rooted in the neoliberal reordering of global capitalism since the 1970s. Consequently, a thorough examination of the genesis and operations of neoliberal reordering is essential to understand the causes and results of international debt crises. The neoliberal reordering was prompted by falling rates of accumulation, threats to U.S. economic hegemony, and the need to recycle global surpluses to fund fiscal and current account deficits of the U.S. The reordering entailed ascendency of finance capital and Americanization of global finance directed by the U.S. Treasury-Wall Street-IMF complex. The resulting unbridled international capital flows, while enhancing the returns for finance capital, have accelerated and accentuated boom and bust cycles of the world economy that were tempered by the Keynesian welfare compromise and the Bretton Woods system. International debt crisis are then managed to advance the agenda of neoliberal restructuring national economies and result in transfer of wealth and assets from the poor to the rich.

Part II recounts the unfolding of the 2009-10 Greek debt crisis. The sequence of events shows that the bond-market pushed the Greek government to squelch economic rights won by the working classes for over a generation, and the European Union (EU) was browbeaten to commit USD 1 trillion to subsidize financial institutions. Part III describes the post-World War II Bretton Woods system of capital controls which injected a measure of stability to global finance

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imposed the market organization on society for non-economic ends." POLANYI, *supra* note_ at 258. For a detailed discussion of accumulation by dispassion, *see* Tayyab Mahmud, *"Surplus Humanity" and the Margins of Legality: Slums, Slumdogs, and Accumulation by Dispossession*, _ Chapman L. Rev. _ (forthcoming).; David Harvey, *The "New" Imperialism: Accumulation by Dispossession*, in THE NEW IMPERIAL CHALLENGE 63 (Leo Panitch and Colin Lays, eds., 2003).

for over a generation. It then describes how growing U.S. balance of payment deficits brought this system to an end. Part IV analyses the neoliberal counterrevolution to show that it was designed to secure U.S. economic hegemony through ascendency of finance capital, and to rollback gains made by the working classes under the Keynesian welfare compromise. It is argued that neoliberalism was not a self-generating phenomenon of free markets or the result of deregulation. Rather, it was an elaborate reordering of U.S. and global regulatory regimes coupled with imperial domination that established the legal and institutional frameworks to facilitate financialization of the global economy and ascendency of finance capital. Part V examines three major international debt crises of the neoliberal era that preceded the Greek crisis and shows that all these crises were caused by opportunistic channeling of access liquidity towards developing economies by financial institutions, and resulted in impoverishment of the working and marginalized sections of societies and enhancement of the power of global finance capital. These crises also served as a means to force neoliberal restructuring on targeted economies. Part VI draws conclusions of the study and recommends a collective moratorium on debt servicing by developing economies to force a reordering of the global financial system towards one that would give human beings priority over finance capital.

II. **Appeasing the Bond Gods[51]: A Modern Greek Tragedy**

Deployment of extra-economic power to secure payment of international debts is an age-old phenomenon. The means and methods of doing so, of course, have changed over time. During

[51] I adopt the expression from Paul Krugman, *Appeasing the Bond Gods*, NEW YORK TIMES, August 20, 2010, at A19.

the colonial era, colonial powers periodically intervened militarily to enforce debt contracts.[52] Default of foreign debts often led to imposition of foreign control over finances, gun-boat diplomacy, wars, and even complete loss of sovereignty.[53] Being shut out of the credit market is an ever-present consequence of default. For example, Greece's 1826 default shut it out of international capital markets for fifty-three years.[54] The current debt crisis of Greece brings into sharp relief the political economy of global finance, specially the role of the bond market, home governments of lending institutions, and the IMF in constraining the choices available to debtor countries. The crisis underscores the operating principle of global finance that in the event of a conflict between financial institutions and bondholders on the one hand and the well-being of the citizens on the other, the former are given preference.

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[52] *See* MICHAEL TOMZ, REPUTATION AND INTERNATIONAL COOPERATION: SOVEREIGN DEBT ACROSS THREE CENTURIES (2007); Niall Ferguson, *The Empire Effect: The Determinants of Country Risk in the First Age of Globalization, 1880-1913* 66:2 J. OF ECON. HIST. 283 (2006); Kris James Mitchener and Marc Weidenmier, *Empire, Public Goods, and the Roosevelt Corollary*, 65 J. OF ECON. HIST. 658 (2005); FERGUSON, ASCENT, *supra* note _ at 99-100. Such military actions include Britain in Turkey (1876) and Egypt (1882), and the US in Venezuela (1905) and Haiti (1915). REINHART AND ROGOFF, THIS TIME IS DIFFERENT, *supra* note _ at 54. The imposition of British rule over Egypt in 1882, "practically amounted to a 'no default' guarantee" for the bond markets. FERGUSON, ASCENT, *supra* note _ at 296.

[53] It was following debt defaults that Newfoundland became a Canadian province and Egypt became a British protectorate. The recent treatment of Iceland shows that overt coercive measures to settle international financial disputes are by no means a matter for the history books. The case of Iceland during the 2007-10 global financial crisis is instructive. Iceland, a country with a per capita income of USD 40,000 and a population of 300,000 bought into the neoliberal dogma and let three banks take on deposits and assets of USD 176 billion, eleven times the country's GDP. When its banking system collapsed in the fall of 2008, Iceland became the first developed country in over thirty years to turn to the IMF for help. Among others, depositors from UK and Netherlands lost their deposits in accounts that had promised high returns. The UK went so far as to seize Icelandic assets using anti-terrorism laws. STIGLITZ, FREEFALL, *supra* note_ at 23; Willem H. Buiter and Anne Sibert, *The Icelandic Banking Crisis and What to Do about it*, CEPR POLICY INSIGHT, October 2008. *Accessed* July 20, 2010, at http://www.cepr.org/pubs/policyinsights/CEPR_Policy_Insight_026.asp. Iceland's parliament passed legislation in August 2009 to repay UK and Netherlands about USD 6 billion as compensation to depositors from the two countries. Matthew Saltmarsh, *Iceland to Repay Nations for Failed Banks' Deposits*, NEW YORK TIMES, August 29, 2010, at B2. The president refused to sign the legislation, and in a subsequent referendum 93 percent of Iceland voters rejected the repayment plan. Sarah Lyall, *Voters in Iceland Reject Repayment Plan*, NEW YORK TIMES, March 7, 2010, at A11. Disbursement of an IMF loan was put off until the resolution of this dispute, and UK threatened to bloc Iceland's entry into the EU until the dispute is resolved. *UK May Try to Stop Iceland Joining EU Over Bank Collapse Refund*, THE GUARDIAN (London), June 17, 2010, *Accessed* July 20, 2010, at http://www.guardian.co.uk/business/2010/jun/17/uk-threat-block-iceland-eu/print.

[54] REINHART AND ROGOFF, THIS TIME IS DIFFERENT, *supra* note _ at 12-13.

All actors in ancient Greek tragedy donned masks. In the 2009-10 Greek financial tragedy many operative forces also remained opaque. None was more opaque and powerful than the global bond market, whose "real power lies in its ability to punish a government with higher borrowing costs," and in a crisis it can "dictate[] government policy."[55] In October 2009, the newly elected Socialist government of George A. Papandreou, discovered an unprecedented budget deficit of 12.7 percent of GDP for 2009, more than twice asserted by the departing government, and 4 times the initial estimates. This triggered a battle between Greece and the global bond market about the means to service the USD 430 billion Greek debt held by foreign banks.[56]

Rating agencies reacted to the disclosure, and, led by Moody's, cut their rating of Greek debt, citing the government's "crumbling finances."[57] In response, the Greek parliament quickly passed an "austerity budget" promising to cut public spending by 10 percent.[58] The bond market, however, was unimpressed and Greece was "punished by the rough treatment of bond investors no longer willing to countenance soft promises of reform."[59] The European Central Bank (ECB) told Greece not to "expect from us any special treatment," and Moody's warned that "the government knows what to do."[60] Greece now announced a three year plan to reduce its budget

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[55] FERGUSON, ASCENT, *supra* note _ at 69. Keynes considered "euthanasia of the rentier" through inflation preferable to mass unemployment through deflation. ROBERT SKIDELSKY, KEYNES: THE RETURN OF THE MASTER 146 (2009). *See also*, FERGUSON, ASCENT, *supra* note _ at 107.

[56] Rachel Donadio and Niki Kitsantonis, *Greece Struggles to Tame Debt as Its People Grow More Restive*, NEW YORK TIMES, December 12, 2009, at A4. France, Greece's biggest creditor, holds USD 67 billion of the Greek debt; German financial institutions hold USD 37 billion, Italy USD 27 billion, followed closely by Belgium, the Netherlands, and Luxemburg. American banks hold USD 16.6 billion. Jack Ewing, *Already Holding Junk, Germany Hesitates*, NEW YORK TIMES, April 29, 2010, at B1.

[57] David Jolly, *Moody's Joint Others in Cutting Debt Rating on Greece*, NEW YORK TIMES, December 23, 2009, at B2.

[58] Rachel Donadio, *Greece: Austerity Budget Passed*, NEW YORK TIMES, December 25, 2009, at A10.

[59] Landon Thomas, Jr., *With Greece Teetering, the Worst May Not Be Over for Europe*, NEW YORK TIMES, December 31, 2009, at B1.

[60] Jack Ewing, *Bank Chief Says Greece Gets No Special Treatment*, NEW YORK TIMES, January 15, 2010, at B4.

deficit to 3 percent of GDP from 12.9 percent in 2009.[61] Corporate media recommended that "powerful countries of the European Union – like Germany – must come to the rescue."[62] The crisis started putting downward pressure on the euro, and there was speculation about possible Greek exit from the single currency zone.[63] ECB reiterated its no-special treatment posture and reminded Greece that "it has to catch up on its homework."[64] While investors "worr[ied] that the crisis in Greece could touch off a domino effect across Southern Europe," European leaders remained divided on whether to involve the IMF in a possible bailout. [65] Greece had to pay 6.22 percent to borrow money, a rate the government called "punitive."[66] Greece felt constrained to express "contrition for [past] mistakes … and promised to do better," and affirmed its commitment to the euro.[67] Greece needed to raise USD 50 billion before June 30, 2010 or default, while the bond market remained "skeptical that Greece can achieve the magnitude of required savings in the face of recession and rising social and labor unrest."[68] Pressure on the euro mounted and rising bond rates put pressure on Germany and France to decide whether they would bailout the EU economies in trouble or let them default with "major repercussions for Europe and financial markets worldwide."[69] Meanwhile, "markets [were] having fun testing the euro," and there was an increasing recognition that euro's problem "has at its heart elements of a political problem" – national or EU control over economic and fiscal policies.[70]

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[61] *Id*.
[62] *After Dubai*, NEW YORK TIMES, January 18, 2010, at A20.
[63] *Europe Markets Rise Amid Rumors on Deals*, NEW YORK TIMES on the Web, January 19, 2010.
[64] Javier C. Hernandez, *Disappointing Earnings Send Markets lower a Day After 15-Month Highs*, NEW YORK TIMES, January 21, 2010, at B15.
[65] Stephen Castle and Mattew Salmarsh, *Rumblings of a Bailout*, NEW YORK TIMES, January 29, 2010, at B1.
[66] *Id*.
[67] Jack Ewing, *Spain, Greece and Latvia Affirm Their Commitment to the Euro*, NEW YORK TIMES, January 29, 2010, at B5.
[68] *The Not-So-Safe Euro Zone*, NEW YORK TIMES, February 2, 2010, at A26.
[69] Floyd Norris, *Fraying at the Edges*, NEW YORK TIMES, February 5, 2010, at B1.
[70] Steven Erlanger, *Euro Debt Crisis Is Political Test*, NEW YORK TIMES, February, 6, 2010, at A1.

As the bond rates in Europe kept climbing, investors wanted to know whether governments "will have the stomach to push through tough reforms," and bond investors were "spending as much time analyzing the power of ... Greek unions as they do the spreads on credit default swaps."[71] "[B]ond vigilantes" started challenging "weak governments to raise taxes and impose harsh spending cuts on a restive population to bring down their deficits."[72] Nobel Prize laureate Joseph Stigliz found "the investor demands as lacking in merit," and reminded the markets that "[t]hese are democracies – not dictatorships."[73] It was noted that Greeks view "welfare policies as acquired rights," and the head of the civil servants union argued that "[i]t is not the workers that should be blamed for [the crisis]; it is bankers and large capital."[74]

Because European leaders did not want to turn to the IMF to bailout Greece, and ECB is prevented from buying government bonds or offering direct support to troubled banks, their options are to guarantee Greek bonds, advance aid funds, or issue bonds on behalf of Greece.[75] Rumors that a rescue of Greece by the wealthy nations of Europe may be in the offing touched off a broad rally in European stocks, bonds, and the euro.[76] The President of EU used the growing alarm over debt levels to call for a new form of "*economic government*" in Europe, and argued that "whether it is called coordination of policies or economic government, only European Council is capable of delivering and sustaining a common European strategy for more

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[71] Landon Thomas, Jr., *Under Siege in Europe*, NEW YORK TIMES, February 6, 2010, at B1.
[72] *Id*.
[73] *Id*. Historically, dictatorships have proved more amenable to give foreign creditors priority over citizens. For example, during the global debt crises of 1980s, Romanian dictator Nikolai Ceausescu "single-mindedly insisted on repaying … the debt of $9 billion owed by his poor nation to foreign banks." REINHART AND ROGOFF, THIS TIME IS DIFFERENT, *supra* note _ at 52.
[74] Landon Thomas, Jr., *Is Debt Trashing the Euro?,* NEW YORK TIMES, February 7, 2010, at B1.
[75] Jack Ewing, *The Uneven World of Debt*, NEW YORK TIMES, February, 8, 2010, at B1.
[7676] Javier C. Hernandez and Jack Ewing, *Talk of Assistance for Greece Propels Markets*, NEW YORK TIMES, February 10, 2010, at B1.

growth and more jobs."[77] Concerns about moral hazard and investor expectation of similar response to other weak economies expressed by EU heads of government meeting in Brussels, led an economist to warn: "If you encouraged the markets to believe that support is forthcoming and then it is not, we will see a backlash."[78] While Germany found itself "forced to help Greece remain solvent, or risk watching markets attack one week member [of the EU] after the next," coalition partners in the Merkel government insisted that there be "no direct financial help for Greece. … It would send the absolutely wrong signal to other euro counties that no country has to strain to save any more."[79] Greek government announced new plans for USD 2.75 billion in spending cuts including a salary freeze, increased retirement age, and a higher gasoline tax, and striking civil servants pledged that they "won't pay for the crisis! Not one euro to be sacrificed to the bankers!"[80] Faced with further pressure on the euro, EU leaders promised to safeguard the euro by aiding Greece, but offered no immediate assistance and remained silent about how they would respond if investors remain jittery about Greece.[81] Merkel government felt domestic pressure as 7 in 10 Germans opposed financial support to Greece.[82] Market analysts warned that "anything that encourages the sovereign[s] … to prevaricate over tough fiscal measures … would be a mistake."[83]

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[77] Stephan Castle, *European Debt Issues Top Agenda For Meeting*, NEW YORK TIMES, February 10, 2010, at B9. Emphasis added.
[78] Stephen Castle, *Europe Agrees to Help Greece, but Is Unsure of How*, NEW YORK TIMES, February 11, 2010, at B1.
[79] Nicholas Kulish, *Germany, Forced to Buoy Greece, Rues Euro Shift*, NEW YORK TIMES, February 11, 2010, at A1.
[80] Dan Bilefsky and Niki Kitsantonis, *Greek Civil Servants Strike Over Austerity*, NEW YORK TIMES, February 11, 2010, at A3.
[81] Stephen Castle, *European Leaders Vow to Aid Greece, but Skirt Details* NEW YORK TIMES, February 12, 2010, at A6.
[82] *Id*.
[83] Rob Cox and Rolfe Winkler, *A U.S. Analogy For a Greek Fix*, NEW YORK TIMES, February 12, 2010, at B2.

It was discovered that Goldman Sachs had helped Greece hide billions in debt from EU budget overseers.[84] Starting in 2001, Goldman Sachs, for USD 300 million in fees, had designed instruments that disguised loans as currency trades, thus hiding the size of the Greek debt.[85] The scheme amounted to "a garage sale on a national level, Greek officials essentially mortgaged the country's airports and highways."[86] While this scheme was underway, in 2002 EU finance ministers had decided not to prohibit uses of derivatives for creative accounting.[87] While a bomb exploded at JPMorgan Chase's offices in Athens, EU officials asked Greece that "it must immediately explain how the government used complex financial tactics engineered by Wall Street to mask its rising debt."[88] Bets against Greece by some of the same banks that had helped Greece shroud its mounting debt "alarm[ed]" bond investors and escalated the financial crisis.[89] The iTraxx SovX Western Europe index, launched in September 2009, "let traders gamble on Greece shortly before the crisis. … [D]erivatives have assumed an outsize role in Europe's dept crisis"[90] A financial expert opined that "The iTraxx SovX did not create the situation, but it has exacerbated it. … Credit-default swaps give illusion of safety but actually increase systemic risk."[91] Another expert termed credit derivatives "the most dangerous instruments yet," and added that "[i]nnovation has now cost us $7 trillion. That's a pretty high price to pay for

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[84] Louise Story, Landon Thomas, Jr., and Nelson D. Schwartz, *Wall St. Helped To Mask Debt Debts Shaking Europe*, NEW YORK TIMES, February 14, 2010, at A1.
[85] *Id*.
[86] *Id*. In 2009, Goldman Sachs and Morgan Stanley also drew up a plan to overhaul the Greek railway system. The plan involved laying off half of the system's 7000 workers and have the government take over half of the company's 8 billion euros in debt. Landon Thomas, Jr., and Niki Kitsantonis, *Rail System in Greece Adds to Debt*, NEW YORK TIMES, July 21, 2010, at B1.
[87] Louise Story, Landon Thomas, Jr., and Nelson D. Schwartz, *Wall St. Helped To Mask Debt Debts Shaking Europe,* NEW YORK TIMES, February 14, 2010, at A1.
[88] Stephen Castle, *Pressure Rises on Greece To Explain and Fix Crisis*, NEW YORK TIMES, February 17, 2010, at B3.
[89] Nelson D. Schwartz and Eric Dash, *Banks Bet Greece Defaults on Debt They Helped Hide*, NEW YORK TIMES, February 25, 2010, at A1.
[90] *Id*.
[91] *Id*.

innovation."[92] Given how such instruments had been used, Federal Reserve Chairman Ben Bernanke's "view that it's 'counterproductive' to use credit default swaps to crash an institution or a nation exhibits a certain naiveté about how the titans of finance operate now."[93] The U.S. Federal Reserve disclosed that it was investigating Goldman Sachs and other banks that had helped Greece mask its debt. [94] Calls for crackdown on derivatives increased as an August 2009 confidential Goldman Sachs report surfaced that had advised its clients to "buy CDS of developed countries," months before the Greek debt became a big story in financial markets.[95] Greece called on the US and EU to "crack down on speculative trading, arguing that exotic bets had driven up Greece's borrowing costs and threatened its efforts to ease its debt crisis."[96] A hedge fund investor called inquiries into hedge fund activities "witch hunts."[97]

Faced with growing opposition in Germany towards a bailout of Greece, EU again refused to specify measures to help Greece and the euro.[98] European Commission proposed new powers for Eurostat, the European statistical agency, to audit books of national governments, a regime that would constitute "a significant erosion of sovereignty."[99] Crowds in a 24-hour general strike that paralyzed Greece chanted "hands off our pension funds," and wondered "what else are they going to cut, the air that we breathe?"[100] Moody's and Standard & Poor warned that they might

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[92] Gretchan Morgenson, *It's Time for Swaps to Lose Their Swagger*, NEW YORK TIMES, February 28, 2010, at B1.
[93] *Id*.
[94] Nelson D. Schwartz and Sewell Chan, *As Greek Crisis Appears to Deepen, Fed Studies Wall St.'s Activities*, NEW YORK TIMES, February 26, 2010, at B1.
[95] Lynnley Browning and Matthew Saltmarsh, *Calls Increase For Crackdown On Derivatives*, NEW YORK TIMES, March 10, 2010, at B1.
[96] Sewell Chan and Jack Ewing, *Greece Fumes at Speculators, and Backs a New Monetary Fund*, NEW YORK TIMES, March 9, 2010, at B3.
[97] Nelson D. Schwartz and Graham Bowley, *Traders Turn Attention to the Next Greece*, NEW YORK TIMES, March 4, 2010, at B1.
[98] Nicholas Kulish, *Germans Upset Over Helping Greece*, NEW YORK TIMES, February 16, 2010, at A4.
[99] Stephen Castle and Matthew Saltmarsh, *Greece Struggles to Win Europe's trust in Its deficit-Cutting Plan*, NEW YORK TIMES, February 16, 2010, at B3.
[100] Niki Kitsantonis, *Greeks Strike For 2nd Time Against Steps to Cut Deficits*, NEW YORK TIMES, February 25, 2010, at A13. In its 2009 annual report on Greece, the IMF warned that "excessive pension and health care payments to the elderly" would result in a debt level of 800 percent of GDP by 2050. Landon Thomas, Jr., *Retiring at 50? Greek*

again downgrade Greek government bonds.[101] EU's commissioner for monetary affairs said that Greek austerity measures, though not adequate, were steps "in the right direction." [102] The head of the main Greek labor union characterized these measures "a cause for war."[103] Calling them "painful decisions, Greece announced that it is studying a new series of austerity measures."[104] Investors welcomed the news that Greece would raise taxes and cut spending by USD 6.5 billion this year, and derivative traders turned their attention to other vulnerable economies in Europe.[105] Greece raised USD 6.8 billion in the bond market at 6.37 percent, twice the rate on comparable German bonds; this suggested that "once-reluctant governments [were] now heeding market warnings and taking the political risks necessary to carry out tough fiscal measures."[106]

In a "game of brinkmanship [that] may well bring the IMF to its doorsteps," Greece "threatened to turn to the IMF for a bailout" if Markel and other European politicians resist pledging aid to help Greece "cope with its newfound frugality."[107] As protesters clashed with police in Athens, the Merkel government, feeling vulnerable in the upcoming election in Germany's largest state North Rhine-Westphalia due to widespread opposition to helping Greece, made no public offer of support after her meeting with the Greek prime minister.[108] German politicians suggested that the Greeks consider "plugging the large hole in their budget

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Trend Is a Cautionary Tale, NEW YORK TIMES March 12, 2010, at A1. A similar calculation for the US estimates the true measure of federal debt, incorporating Medicare, Medicaid, Social security and other obligations, at USD 79 trillion, or about 500 percent of GDP. *Id*.

[101] Nelson D. Schwartz and Sewell Chan, *As Greek Crisis Appears to Deepen, Fed Studies Wall St.'s Activities*, NEW YORK TIMES, February 26, 2010, at B1.

[102] Niki Kitsantonis, *Greece Is Urged to Make more Budget Cuts*, NEW YORK TIMES, March 2, 2010, at B3.

[103] *Id*.

[104] Niki Kitsantonis, *Greece Plans New Austerity Measures to Cut Debt*, NEW YORK TIMES, March 3, 2010, at B3.

[105] Nelson D. Schwartz and Graham Bowley, *Traders Turn Attention to the Next Greece*, NEW YORK TIMES, March 4, 2010, at B1.

[106] Landon Thomas, Jr., and David Jolly, *Big Bond Sale Eases Pressure on Greece*, NEW YORK TIMES, March 5, 2010, at B1.

[107] Swell Chan and Liz Alderman, *IMF Help for Greece Is a Risky Prospect*, NEW YORK TIMES, March 5, 2010, at B1.

[108] Nicholas Kulish, *Germany Offers No Financial Help to Ailing Greece*, NEW YORK TIMES, March 6, 2010, at A6.

by selling off some of their lovely islands."[109] Greece said it "would not rule out turning to the IMF for assistance.[110] The European Commission, "wary of IMF involvement" in the Greek crisis, endorsed a German proposal for a "European monetary fund" to head off future debt crises.[111]

EU announced a mechanism to help Greece that will not include loan guarantees, but will involve "coordinated European action, which will make bilateral aid available."[112] S & P affirmed Greece's long-term credit rating of BBB+, an investment grade, but warned of a negative outlook.[113] Markel demanded that the "turnaround must come from Greece," and warned about the possibility of exclusion of a country from the euro zone for non-fulfillment of fiscal obligations.[114] Greek benchmark 10-year bond climbed to 6.265 percent as Germany signaled that help for Greece should come from the IMF rather than Europe.[115] With Germany reluctant to be part of any package that may appear to be a bailout of Greece, the IMF appeared more likely to lead any rescue efforts.[116] Given the important U.S. role in the IMF, the fund's involvement remained "neuralgic" for the Europeans, and they believed that "if they can't come up with a European solution, it will undermine the credibility of the euro zone as a whole."[117] EU agreed on a financial safety net for Greece that would take effect if the Greek government were unable to borrow in the commercial markets, and called for the European Council to become a form of "*economic government*" for the bloc - after objection from many countries about the loss

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[109] Nicholas Kulish, *A Chorus of Strum, Drang and Pathos*, NEW YORK TIMES, March 7, 2010, at WK4.
[110] Sewell Chan and Jack Ewing, *Greece Fumes at Speculators, and Backs a New Monetary Fund*, NEW YORK TIMES, March 9, 2010, at B3.
[111] *Id*.
[112] Stephen Castle, *Europe Creates an Apparatus to Provide Loans to Greece*, NEW YORK TIMES, March 16, 2010, at B2.
[113] Stephen Castle, *Greece Eager For Details On Loans From Europe*, NEW YORK TIMES, March 17, 2010, at B3.
[114] Jack Ewing, *Merkel Urges Tougher Rules for Euro Zone*, NEW YORK TIMES, March 18, 2010, at A12.
[115] Matthew Saltmarsh and Nelson D. Schwartz, *Germany, in a Reversal, Says Greece Should Turn to IMF*, NEW YORK TIMES, March 19, 2010, at B1.
[116] Stephen Castle, *IMF Is More Likely to Lead Efforts for Aid to Greece*, NEW YORK TIMES, March 23, 2010, at B2.
[117] Steven Erlanger, *With Greece Struggling, Europe Looks Uneasily at the IMF*, NEW YORK TIMES, March 25, 2010, at A6.

of sovereignty, the wording was changed to "*economic governance*" in the final English version.[118]

Greece was able to raise USD 6.7 billion in the bond market at 6 percent.[119] Greek government announced that due to austerity measures, the Greek economy will contract 3 percent in 2010.[120] The yield of the Greek bonds pushed over 7 percent for the first time in two months.[121] As Greek bond-yields continued to climb, it became apparent that "the end game is an IMF program, and the end game is getting closer."[122] Investors remained suspicious of the European assistance package, suspecting that "it was designed to fob off the market and buy everyone time."[123] Greek bond-yields continued to rise even as the head of ECB said that Greece will not be allowed to default.[124] With Greek bond-yields reaching as high as 7.5 percent, it appeared that "the market is testing Europe's resolve," and that this is "no longer about liquidity; it's a solvency issue."[125] As Greece approached "the point of no return," the only way appeared to be "*savage spending cuts and tax increases … [because] the bond markets are losing confidence, and pushing the situation to the brink*."[126] Europe offered USD 40 billion in aid to Greece at 5 percent and IMF offered another USD 20 billion at an even lower rate.[127] As

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[118] Stephan Castle and Matthew Saltmarsh, *Europeans Reach Deal On Rescue For Greece*, NEW YORK TIMES, March 26, 2010, at B1. Emphasis added.
[119] David Jolly, *In Crucial Test, Greece Raises $6.7 Billion With Sale of Bonds*, NEW YORK TIMES, March 30, 2010, at B3.
[120] David Jolly, *Optimism And Doubt Feed a dual Over Greece*, NEW YORK TIMES, April 1, 2010, at B3.
[121] Javier C. Hernandez, *Optimism on Low Interest Rates Offsets Worry Over Greece*, NEW YORK TIMES, April 7, 2010, at B8.
[122] Nelson D. Schwartz, *Greek Bond Yields Soar In Sell-Off*, NEW YORK TIMES, April 7, 2010, at B1.
[123] Matthew Saltmarsh and Niki Kitsantonis, *Pressure Builds as Europe Delays Details on Crisis Help*, NEW YORK TIMES, April 8, 2010, at B11.
[124] Matthew Saltmarsh, *Head Of European central bank Says Greece Will Not Be allowed to Default*, NEW YORK TIMES, April 9, 2010, at B8.
[125] Landon Thomas, Jr., *Running Out of Time in Greece*, NEW YORK TIMES, April 9, 2010, at B1.
[126] Paul Krugman, *Learning From Greece*, NEW YORK TIMES, April 9, 2010, at A27. Emphasis added.
[127] Stephan Castle and Jack Ewing, *Europe Unites to Assist Greece With Line of Aid*, NEW YORK TIMES, April 12, 2010, at A1.

frustration over Germany's harsh handling of Greek debt crisis grew, a German scholar claimed: "we sublimated hegemony. But we're dropping sublimation now."[128]

With its "monster [rescue] package," the IMF "is back at the peak of its power and relevance.[129] Investors "largely shrugged off " the package, claiming that "many of the details had already been priced into markets."[130] Investors "enthusiastically snapped up" USD 2.12 billion Greek short-term securities at rates more than double those Greece paid in January on similar maturities.[131] While Greek bond yield hovers around 7.3 percent, speculators began to "zero in" on Portugal's debt.[132] Greek bond-yields closed at 7.6 percent, and "the market wants it clearly pinned down that the money is there and ready to go."[133] Greek bond-yield climbed to 7.83 percent and the yield-gap over comparable German bonds rose to a record of 4.76 percent.[134] Eurostat raised its estimate of Greek budget deficit for 2009 to 13.6 percent of GDP; the Greek debt to GDP ratio now stood at 115.1 percent.[135] With the yield on Greek bonds nearly 9 percent, the Greek prime minister described his country's economy as "a sinking ship," and formally requested an international bailout.[136] A German lawmaker insisted that Greece first has to negotiate "a credible savings program," and the program "*has to hurt*."[137] Merkel insisted that

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[128] Steven Erlanger, *Germany Asserts Its Interests as Greek Debt Crisis Unfolds*, NEW YORK TIMES, April 13, 2010, at A4.
[129] Christopher Swann and Nicholas Paisner, *History Is Hardly on Greece's Side*, NEW YORK TIMES. April 13, 2010, at B2.
[130] Javier C. Hernandez, *Move to Aid Greece Helps Dow Close Above 11,000*, NEW YORK TIMES, April 13, 2010, at B1.
[131] Jack Ewing and David Jolly, *Some Respite for Greece in Successful Debt Sale*, NEW YORK TIMES April 14, 2010, at B5.
[132] Landon Thomas, Jr., *Debt Worries Shift to Portugal, Spurred by Rising Bond Rates*, NEW YORK TIMES, April 16, 2010, at B1.
[133] Matthew Saltmarsh, *Greece's Uncertain Future Weighs on Bond market*, NEW YORK TIMES April 20, 2010, at B3.
[134] David Jolly, *Greece Sells Bills, but Prospects Are Dim*, NEW YORK TIMES, April 21, 2010, at B2.
[135] Matthew Saltmarsh, *A Setback for Greece as Europe Says Deficit Is Larger Than Thought*, NEW YORK TIMES, April 23, 2010, at B1.
[136] Niki Kitsantonis and Matthew Saltmarsh, *Greece, Out of Ideas, Requests Global Aid*, NEW YORK TIMES, April 24, 2010, at B1.
[137] *Greece and Who's Next?,* NEW YORK TIMES April 24, 2010, at A18. Emphasis added.

Greece has to accept "hard measures" for three years as specified in the IMF program.[138] A restructuring of the Greek debt became likely.[139] The EU and IMF package does "little to calm the markets," Standards & Poor cut Greece's debt to junk level, and warned that bondholders could face losses of up to 50 percent in a restructuring.[140] IMF increased its package to USD 160 billion.[141] Merkel, her "hand forced by mistrustful credit market and the rating agency that downgraded Spain, Portugal, and Greece in a matter of just two days," now said that negotiations with Greece "had to be accelerated and that Germany would do its part to safeguard the euro."[142]

Merkel's "foot-dragging" gave markets "both reason and room to run up the price of Greek debt to unsustainable levels." [143] Observers found it "astonishing" that a German regional election "can play such a disproportionate role in messing up efforts to contain what was a much smaller crisis several months ago."[144] An economist claimed that "*the IMF is the last man standing* and is structuring the program."[145] In return for USD 160 billion over three years, the IMF demanded that Greece cut public sector spending by 8 billion euro in 14 months, raise value-added tax to 25 percent, freeze civil servants' wages, eliminate public sector bonuses, adopt measures making it easier to lay off public sector workers, and privatize health care,

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[138] Judy Dempsey and Matthew Saltmarsh, *Confidence About Greek Debt Falters in Germany*, NEW YORK TIMES, April 27, 2010, at B1.
[139] Jack Ewing, *Best Hope For Greece: Minimize The Losses*, NEW YORK TIMES, April 26, 2010, at B1.
[140] Landon Thomas, Jr., *Financial fears Grow in Europe Over Greek Debt*, NEW YORK TIMES, April 28, 2010, at A1.
[141] Landon Thomas, Jr., and Nicholas Kulish, *IMF Promises More Aid for Greece as European Crisis Grows*, NEW YORK TIMES, April 29, 2010, at A1.
[142] Nicholas Kulish, *Ripples From Greek Crisis Speed Up Merkel's Pace*, NEW YORK TIMES, April 29, 2010, at A12.
[143] Steven Erlanger, *In Debt Crisis, Europe's Latest Drama, Leaders are Offstage*, NEW YORK TIMES, April 30, 2010, at A1.
[144] *Id*. There was an alarm that 'the Greek debt crisis is spreading. Europe needs a bolder solution – and quickly." *Acropolis Now,* ECONOMIST, May 1, 2010. At 11.
[145] Steven Erlanger, *In Debt Crisis, Europe's Latest Drama, Leaders are Offstage*, NEW YORK TIMES, April 30, 2010, at A1. Emphasis added.

transportation, and energy.[146] Tens of thousands of Greeks took to the streets to protest the austerity measures.[147] Some economists expressed fear that "*such harsh measures risk killing the patient*."[148] It was pointed out that "*unfortunately for economists, there is democracy*. If you impose too strict a program, the population will refuse."[149] German approved its share of the Greek bailout, and ECB said that it will accept Greek bonds as collateral regardless of any future downgrades.[150] Despite the "supersize" bailout, the yield on two-year Greek bonds rose to 14 percent, under the "logic" that "Greece still has to go through wrenching cuts and may still end up restructuring its debt which could force current bondholders to take a haircut."[151] Speaking about the impact of the Greek bailout on the prospects of the euro, an economist opined that "It is not really about money. *It is about how much pain the people in periphery can stand in order to keep this thing going*."[152] Three people were killed as continuing protests in Athens turn violent.[153] The bond market expressed disappointment that ECB did not decide to buy the Greek bonds itself as part of the rescue package, and bond yields rose across Europe.[154] Greece's problems were deemed "deeper than Europe's leaders are willing to acknowledge," and Greece leaving the euro zone remained a possibility.[155] Investors were now focused on the risk to European banks if severe budget-cuts in crisis-ridden countries freeze credit markets and cause a

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[146] Dan Bilefsky and Landon Thomas, Jr., *The Bitter Pills In The Plan To Rescue Greece*, NEW YORK TIMES, May 1, 2010, at B1.
[147] Dan Bilefsky, *Greeks Take to Streets to Protest Cutbacks*, NEW YORK TIMES, May 2, 2010, at A20,
[148] Steven Erlanger, *In Bitter Pill, No Sure Cure*, NEW YORK TIMES, May 3, 2010, at A1. Emphasis added.
[149] *Id*.
[150] Judy Dempsey and Jack Ewing, *Germany Approves Assistance For Greece*, NEW YORK TIMES, May 4, 2010, at B4.
[151] Anthony Currie, Nicholas Paisner and Agnes T. Crane, *Trading Desks Keep Churning*, NEW YORK TIMES, May 5, 2010, at B2.
[152] Landon Thomas, Jr., *Bold Stroke may Be Beyond Europe's Means*, NEW YORK TIMES, May 6, 2010, at B1. Emphasis added.
[153] Dan Bilefsky, *3 Reported Killed as Violent Groups Overtake Athens Protest*, NEW YORK TIMES, May 6, 2010, at A6.
[154] Jack Ewing, *European Bank's Assurances Fail to Placate Investors*, NEW YORK TIMES, May 7, 2010, at B1.
[155] Paul Krugman, *A Money Too Far*, NEW YORK TIMES, May 7, 2010, at A27.

double-dip recession – "the risk is that the periphery pulls down the rest of Europe,"[156] Ripple effects of the Greek debt crisis started "affecting the broader global economy," including ability of Asian firms to raise money and US banks that have USD 3.6 trillion exposure to European banks.[157]

Finally, EU leaders reached "extraordinary agreement" to provide a rescue package of USD 1 trillion – "*a financial bazooka*"- to stop the spreading debt crisis.[158] IMF and EU hope that the sum, which may rise to "more than a quarter of the bloc's GDP [will] prevent troubled institutions from falling."[159] The new plan came after "some not so subtle prodding" from President Obama, worried about the threat of the debt crisis to "the still-fragile" recoveries in the US and Asia.[160] The Greek bailout is likely to follow the model of the World Bank and IMF bailout of Russia after the 1998 default – "tax payers paying for the bailout while investors in Greek debt are largely made whole."[161] The IMF, in crafting the rescue package "acceded to Europe's wish and agreed not to even discuss the option of restructuring the country's punishing debt load. That would have been a way to blunt some of the pain Greeks are feeling and shift some of the burden to bankers who made irresponsible loans in the first place."[162] ECB bought 16.5 billion euro in bonds taking the unprecedented step of intervening in markets to halt a sell-off of Greek and other European debt.[163] Historians "will likely look back to May 9 as a turning

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[156] Jack Ewing, *Risk to European Banks Seen in Austerity Programs*, NEW YORK TIMES, May 8, 2010, at B6,
[157] Nelson D. Schwartz and Eric Dash, *Greek Debt Woes Ripple Outward, From Asia to US*, NEW YORK TIMES, May 9, 2010, at A1.
[158] Christine Hauser, *Stocks Soar After Europe Announces Rescue Plan*, NEW YORK TIMES, May 11, 2010, at B1. Emphasis added.
[159] Jack Ewing and Matthew Saltmarsh, *Doubts Persist as Most European Banks Pass Stress Test*, NEW YORK TIMES, July 24, 2010, at B4.
[160] Steven Erlanger, Katrin Bennhold and David E. Sanger, *After Half Steps, major Rescue Took a Nudge From Washington*, NEW YORK TIMES, May 11, 210, at A1.
[161] Andrew E. Kramer, *The Euro in 2010 Feels Like the Rubble in 1998*, NEW YORK TIMES, May 12, 2010, at B4.
[162] Landon Thomas, Jr., *IMF Plays Deal maker in Europe*, NEW YORK TIMES, May 12, 2020, at B1.
[163] Jack Ewing, *Central Bank Buys Billions in European Debt,* NEW YORK TIMES on the Web, May 18, 2010. The Maastrich Treaty expressly prohibits such bailouts, and this prohibition has been reaffirmed by the German

point," when European leaders announced the USD 1 trillion in guarantees to deal with the debt crisis in Europe.[164] Greek pledge to slash its budget deficit by more than 10 percent of GDP by 2014, was characterized "a recipe for economic disaster … debt restructuring is inevitable."[165] Greece announced plans for "a big sale of state-owned assets," including 49 percent of the state railroad, 39 percent of the post office, and minority stakes in water utilities, to list ports and airports on the stock market, and privatize casinos.[166] Moody's cuts Greece's credit rating to junk.[167] The fifth general strike grinds Greece to a halt.[168] The Greek parliament, by a vote of 157-134, "forc[ed] through a pension bill that would sharply pare down the country's welfare state by increasing the retirement age and reducing benefits."[169] The drafters called this bill, which also made it easier for companies to fire workers, "our passport out of hell."[170]

As the long hot summer of 2010 comes to a close, the Greek debt still stands at 114 percent of its GDP.[171] By 2040 Greece would have to spend 20 percent of its GDP to simply service this debt.[172] The rescue package has "not paid down one penny. [It's] just moving around a big pile of debt."[173] Even with interest rates around the world "stuck to the floor," Greece has to pay 11 percent on its 5-year bonds, while Germany pays 1.4 percent.[174] A team from the IMF and the

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Constitutional Court. *See* George Soros, *The Euro and the Crisis*, NEW YORK REV. BOOKS, August 19, 2010, at 28, 29.

[164] Gabot Steingart, *It Takes A Crisis To make a Continent*, NEW YORK TIMES, May 22, 2010, at A17.

[165] *Europe's Endangered Banks*, NEW YORK TIMES, May 30, 2010, at WK7.

[166] David Jolly, *Greece to Sell Assets to Help Pay Down Deficit*, NEW YORK TIMES on the Web, June 3, 2010.

[167] Christine Hauser, *Greece's Rating Is Cut, And the Markets Ebb*, NEW YORK TIMES, June 15, 2010, at B7.

[168] Niki Kitsantonis and Matthew Saltmarsh, *World Briefing Greece: Workers' Strike Halts Public Services and Transportation,* NEW YORK TIMES, June 30, 2010, at A8.

[169] Landon Thomas, *Greece Approves Pension Overhaul Despite Protests*, NEW YORK TIMES, July 8, 2010, at B1.

[170] *Id*.

[171] Christopher Swann and Nicholas Paisner, *History is hardly on Greece's Side*, NEW YORK TIMES, April 13, 2010, at B2.

[172] Ferguson, *Fiscal Crises and Imperial Collapses*, *supra* note _ at 8.

[173] Christopher Swann and Nicholas Paisner, *History is hardly on Greece's Side*, NEW YORK TIMES, April 13, 2010, at B2.

[174] Floyd Norris, *Interest Rates Stuck to Floor*, NEW YORK TIMES, August 16, 2010, at A1, A3.

European Union is in Athens "to examine the government's progress."[175] An "extremely imperfect" tress test of European banks conducted by European regulators did not test banks' ability to survive a default by Greece.[176] The bond market remains skeptical about the ability of Greece and other debt-ridden economies in Europe to "manage their debts long term."[177] Many Europeans officials, including the French president, now believe that Europe's banking problems and sovereign debt crisis are "largely the creation of speculators out to make a profit."[178] The EU USD 1 trillion "financial bazooka" increasingly looks like the U.S. financial institution rescue plan, a "win-win-lose proposal: the banks win, investors win – and taxpayers lose."[179]

At the end of this phase of the Greek tragedy enacted on a global stage, global finance capital, led by the bond market, has secured USD 1 trillion of EU's tax-payers' money. Greeks are left to contend with higher unemployment, a higher retirement age, lower pensions, higher prices of essential goods, and drastic cuts in social services. The Greek foreign debt stands where it did when the curtains opened in October 2009. This Greek tragedy underscores that borrowing from the bond market to make up budgetary shortfalls rather than relying on taxation has a profound impact on public policies and accountability as the state becomes beholden to capital owning classes, particularly the bond market.[180] The developments surrounding the Greek debt crisis also substantiates that in the face of unbridled global mobility of finance capital, governments increasingly are "hostages to financial-market sentiments, [and] compelled to take

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[175] Landon Thomas, *Greece Approves Pension Overhaul Despite Protests*, NEW YORK TIMES, July 8, 2010, at B1.
[176] Jack Ewing, *Europe's Markets Will Judge Success of Bank Stress Tests*, NEW YORK TIMES July 26, 2010, at B3.
[177] Matthew Saltmarsh, *Default Fears Return to European Debt*, NEW YORK TIMES, August 26, 2010, at B3.
[178] *Id*.
[179] Joseph E. Stiglitz, *Obama's Ersatz Capitalism*, NEW YORK TIMES, April 1, 2009, at A31. Stiglitz views these plans as "the kind of Rube Goldberg device that Wall Street loves – clever, complex and nontransparent, allowing huge transfers of wealth to the financial markets." *Id.*
[180] According to the head of PIMCO, the largest bond fund in the world, "bond markets have power because they're the fundamental base for all markets. The cost of credit, the interest rate [on a benchmark bond], ultimately determines the value of stocks, homes, all asset classes." Bill Gross, *quoted in* FERGUSON, ASCENT, *supra* note _ at 69. Historically, bond-holders are the capital-owning classes and constitute a very small minority of the population. *See id*. at 73, 100

account of investor concerns at every turn."[181] The thesis that unchecked international capital flows result in "dramatically more regressive income distribution and an effective veto over public policy," has come true.[182] All this raises profound questions about the architecture and architects of the global financial system, the patterns of distribution of gain and pain that issue from international capital flows, and the role of international debt crises in this schema. It also puts in question the asymmetrical sovereignty of states, and the representative nature and accountability of political orders. Finally, it brings into relief accumulation by dispossession, an enduring feature of capitalism whereby markets always rely on non-market legal and extra-legal forces to augment capital accumulation by impoverishing subordinated classes.[183] In order to address these questions an examination of the genesis of the current global financial order is warranted. The first step in that task is to examine the Bretton Woods system that governed the field for three decades after the World War II, and the demise of which furnished the grounds for the current scheme of things.

III. Bretton Woods System and Its Collapse

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[181] Banjamin J. Cohen, *Phoenix Risen: The Resurrection of Global Finance*, 48 WORLD POLITICS 268, 286 (1996).
[182] *Id.* Historically, increase in the mobility of taxable property had always forced political authorities to "bargain with those who possess property rights over the moveable tax base and to share with them formal control over the conduct of public affairs." Robert H. bates and Da-Hsiang Donald Lien, *A Note on Taxation, Development, and Representative Government*, 14 POLITICS & SOCIETY 53, 57 (1985). A study of four European welfare states demonstrated that "as business and finance became more mobile, their power resources increased, and those of labor decreased," and governments "lost the ability to carve out national economic strategies and to sustain social accords."PAULETTE KURZER, BUSINESS AND BANKING: POLITICAL CHANGE AND ECONOMIC INTEGRATION viii (1993). The result is "the abandonment of policies traditionally associated with social democracy – including numerous entitlement programs; redistributive income policies; and consensual tripartite exchanges among business, labor, and government." *Phoenix Risen, supra* note _ at 286. *See also*, *Jonathan W. Mosses, Abdication from National Policy Autonomy: What's Left to Leave?* 22 POLITICS AND SOCIETY 125 (1994).
[183] *See* MICHAEL PERELMAN, THE INVENTION OF CAPITALISM: CLASSICAL POLITICAL ECONOMY AND THE SECRET HISTORY OF PRIMITIVE ACCUMULATION (2000); Jim Glassman, *Primitive Accumulation, Accumulation by Disposession, Accumulation by 'Extra-Economic' Means*, 30:5 PROGRESS IN HUMAN GEOGRAPHY 608 (2006); DAVIS HARVEY, THE NEW IMPERIALISM 137-182 (2003); Michael Perelman, *Primitive Accumulation from Feudalism to Neoliberalism*, 18 (2) CAPITALISM NATURE SOCIALISM 44, 54 (2007).

By the end of the World War II, the center of gravity of global capitalism and military power had decisively shifted to the U.S. At this point, as Dean Acheson put it, "only the U.S. had the power to grab hold of history and make it conform."[184] A new imperial economic order had to be designed overcoming earlier fragmentation of global capitalism into rival empires, and to facilitate U.S. economic penetration and close institutional linkages with other advanced capitalist states. The U.S. proceeded to "conjugate its *particular* power with the *genera*l task of coordination."[185] A critical step in this direction was to choose an enabling global financial architecture. The preference of U.S. finance capital had been articulated in the 1942 joint statement of the editors of *Fortune*, *Time* and *Life* magazines. It called for a "new American imperialism" whose goal would be "to promote and foster private enterprise, by removing barriers to its natural expansion," by creating "an expansionist context in which tariffs, subsidies, monopolies, restrictive labor rules … and all other barriers to further expansion can be removed," with "universal free trade" as "the ultimate goal of a rational world."[186] Managers of U.S. state, however, remained mindful of the instability and conflicts that unregulated global capital markets had engendered in the pre World War I era, and the havoc global financial mismanagement had unleashed in the inter-war period. [187]

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[184] *Quoted in* WILLIAM APPLEMAN WILLIAMS, EMPIRE AS A WAY OF LIFE 185 (1980). This understanding of omnipotence appears to be an enduring feature of U.S. foreign policy establishment. Madeleine Albright claimed that the U.S. is "the author of history." *Quoted in* PETER GOWAN, A CALCULUS OF POWER: GRAND STRATEGY IN THE TWENTY-FIRST CENTURY 137 (2010) In her first major foreign policy address, Hillary Clinton cited with approval Tom Paine's statement that "We have within our power to begin the world over gain," and went on to declare, "Today … we are called upon to use that power." Foreign Policy Address at the Council on Foreign Relations, July 15, 2009. *Accessed* on June 25, 2010 at http://www.state.gov/secretary/rm/2009a/july/126071.htm.

[185] Perry Anderson, *Force and Consent*, 17 NEW LEFT REV. 24 (2002). *See also*, MICHAEL HUDSON, SUPER IMPERIALISM: THE ECONOMIC STRATEGY OF AMERICAN EMPIRE (1971).

[186] *An American Proposal*, FORTUNE MAGAZINE, May 1942, at 59-63.

[187] The negative posture towards finance capital is captured by Louis Brandeis in 1914: "The dominant element in our financial oligarchy is the investment banker." LOUIS BRANDEIS, OTHER PEOPLE'S MONEY, AND HOW THE BANKERS USE IT 4 (1914). *See also*, Jefferey Rosen, *Why Brandeis Matters: The Constitution and the Crash*, THE NEW REPUBLIC, July 22, 2010, at 19. For the inter-war havoc in global finance, *see* JOHN MAYNARD KEYNES, THE ECONOMIC CONSEQUENCES OF THE PEACE (2010 [1919]); BARRY EICHENGREEN, GLOBALIZING CAPITAL:A HISTORY OF THE INTERNATIONAL MONETARY FUND 43-90 (2nd ed. 2008).

Faced with the tasks of reconstruction of Europe and Japan, containment of the socialist bloc, and management of decolonization in the Global South, the emerging Keynesian consensus of the post-depression era appeared the right road to take. A cautious posture towards finance capital, and the comprehensive war-time controls over currency and capital flows furnished the backdrop of the new global financial architecture institutionalized at Bretton Woods.[188] The U.S. Treasury Secretary, Henry Morgenthau, articulated the agenda as seeking a "New Deal in international economics," and "driving the usurious money lenders out of the temple of international finance."[189] Economist Arthur Bloomfield, writing in 1946, captured the posture well:

> It is now highly respectable doctrine, in academic and banking circles alike, that a substantial measure of direct control over private capital movements, especially of the so-called hot money varieties, will be desirable for most countries not only in the years immediately ahead but also in the long run as well … This doctrinal volte-face represents a widespread disillusionment resulting from the destructive behavior of the movements in the interwar years.[190]

Keynes, the guiding light at Bretton Woods, was deeply suspicious of speculative capital flows and considered capital controls essential for exchange rate stability.[191] A global financial architecture was envisaged that would complement the Keynesian compromise so that national fiscal and monetary policies could be calibrated aiming at full employment, and a welfare state.[192] The Bretton Woods system was created to lend stability to global finance.[193] The

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[188] The Commission responsible for establishing the IMF was chaired and tightly controlled by Harry White, American Deputy Secretary of the Treasury, who ensured that "legal language which made everything difficult to understand" would "make easier the imposition of a *fait accompli.*" ROBERT SKIDELSKY, JOHN MAYNARD KEYNES: FIGHTING FOR FREEDOM, 1937-1946 350-51 (2001).
[189] *Quoted in* Leo Panitch and Sam Gindin, *Finance and American Empire*, in EMPIRE RELOADED 46, 49-50 (Leo Panitch and Colin Leys eds., 2005).
[190] *Quoted in* RAWI ABDELAL, CAPITAL RULES: THE CONSTRUCTION OF GLOBAL FINANCE 45 (2007).
[191] *Id*. at 19.
[192] A good definition of a welfare state is offered by Asa Briggs:

adopted approach aimed at charting a course between the rigidity of the gold standard and volatility of unbridled mobility of capital.[194] The new order envisaged that control of capital movements would be "a permanent feature of the post-war system."[195] The USD, convertible into gold at USD 35 per ounce, was to be the new anchor of the global financial architecture. The IMF was created to police this system of fixed exchange rates. The IMF Articles of Agreement required each member state to maintain a fixed par value for its currency, expressed in USD, and to intervene in foreign exchange markets to maintain the value with a 1% range; if a central bank ran out of gold or dollars to maintain the fixed rate, IMF would provide bridge loans.[196] Cross-border capital movement was to be controlled and the classic "trilemma,"[197] or the "unholy trinity,"[198] was resolved in favor of a fixed exchange rate and independent monetary policy. While calling it "financial repression" may be an exaggeration, the restrictive Bretton Woods order did relatively marginalize finance relative to production and trade.[199] A prolonged era of

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> A 'welfare state' is a state in which organized power is deliberately used (through politics and administration) in an effort to modify the play of market forces in at least three directions – first, by guaranteeing individuals and families a minimum income irrespective of the market value of their work or their property; second by narrowing the extent of 'social contingencies' 9for example, sickness, old age or unemployment) which lead otherwise to individual and family crises; and third by ensuring that all citizens without distinction of status or class are offered the best standards available in relation to an agreed range of social services.

Asa Brigggs, *The Welfare State in Historical Perspective*, in THE WELFARE STATE READER 16 (Christopher Pearson and Francis Castle eds., 2nd ed. 2006).

[193] For details of Bretton Woods, *see* ARMAND VAN DORMAEL, BRETTON WOODS: BIRTH OF A MONETARY SYSTEM (1978); ANTHONY ENDRES. GREAT ARCHITECTS OF INTERNATIONAL FINANCE: THE BRETTON WOODS ERA (2005);

[194] For the era of the gold standard, *see* EICHENGREEN, GLOBALIZING CAPITAL, *supra* note _ at 6- 42.

[195] ABDELAL, CAPITAL RULES, *supra* note _ at 46. *Quoting* John M. Kaynes.

[196] For details, *see* EICHENGREEN, GLOBALIZING CAPITAL, *supra* note _ at 91- 100.

[197] Trilemma refers to the fact that a state can choose only two of three financial policy options: unbridled cross-border capital movements; a fixed exchange rate; and, an autonomous monetary policy. FERGUSON, ASCENT, *supra* note _ at 307.

[198] This is Benjamin Cohen's term to signify the intrinsic incompatibility of exchange rate stability, capital mobility, and national monetary policy autonomy. Benjamin J. Cohen, *The Triad and the Unholy Trinity: Lessons for the Pacific Region*, in PACIFIC ECONOMIC RELATIONS IN THE 1990S: COOPERATION OR CONFLICT? 133 (Richard Higgott, et. al., eds., 1993).

[199] Carlos Diaz-Alejandro, *Good-Bye Financial Repression, Hello Financial Crash,* 19: 1-2 J. DEV. ECON. 1 (1985); ERIC HELLEINER, STATES AND THE REEMERGENCE OF INTERNATIONAL FINANCE: FROM BRETTON WOODS TO THE 1990s 3 (1994).

growth, often termed "the golden age" of capitalism (1947-1973), was the result.[200] U.S. finance capital did quite well during this phase, and was able to get rid of the negative image that had attached to it in the post-Great Depression phase.[201] While operating under New Deal regulations, financial institutions took advantage of the post-war boom and rising mass consumption, and profits of financial firms grew faster than non-financial profits through the 1950s and 1960s.[202]

Within a few decades, however, negative balance of payments of the U.S. started putting strains on this system. A steady flow of USD and gold out of the U.S., and emergence of the unregulated Eurodollar and Eurobond markets was the result.[203] By the late 1960s, American hegemony of global capitalism was in crisis. The growing offshore pool of convertability seeking USD in the Eurodollar market was augmented by growing intra-firm transfers of rapidly expanding transnational corporations and direct foreign investments.[204] Rapidly expanding U.S. balance of payment deficits, particularly with Europe and Japan, and the resulting outflows of

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[200] Hyman Minsky observed that "the most significant economic event of the era since World War II is something that has not happened: there has not been a deep and long-lasting depression." Hyman Minsky, *Introduction: Can "It" Happen Again? A Reprise*, in INFLATION, RECESSION AND ECONOMIC POLICY xi (Hyman P. Minsky, ed.., 1982)

[201] Failure of an1947 anti-trust suit instituted by the Justice Department against investment houses was a "watershed in the history of Wall Street" that "finally freed the Street of its image as the home of monopoly capitalists." RON CHERNOW, THE HOUSE OF MORGAN: AN AMERICAN BANKING DYNASTY AND THE RISE OF MODERN FINANCE 402 (1990)

[202] Between 1945 and 1962 the average annual growth in profits in finance was 18 percent compared to 11 percent in the non-financial sector; from 1953 to 1969 the figures were 7.5 per cent versus 4.5 percent. Panitch and Gindin, *Finance and American Empire*, *supra* note_ at 46, 53. Bank failures, an endemic feature of capitalism, also were at their lowest in history during this period. *See* JOHNSON AND KWAK, 13 BANKERS, *supra* note_ at 36 Fig 1-1.

[203] In 1948 the U.S. held more than two-thirds of global monetary reserves; within a decade its share had fallen to one-half. EICHENGREEN, GLOBALIZING CAPITAL, *supra* note _ at 112. For the emergence of the Euromarket, *see* ERIC HELLEINER, STATES AND THE REEMERGENCE OF GLOBAL FIANANCE: FROM BRETTON WOODS TO THE 1990S 82-91 (1994). Some protectionist actions by the U.S. also had the unintended consequence of enhancing the Eurodollar market. For example, the Interest Equalization Tax instituted in 1963 to stem foreign-bond sales in the U.S., gave further impetus to the rise of the Eurobond market. Cohen, *Phoenix Risen, sputa* note _ at 279; John B. Goodman and Louis W. Pauly, *The Obsolescence of Capital Controls? Economic Management in an Age of Global Markets*, 46 WORLD POLITICS 50, 79 (1993).

[204] Between 1950 and 1970, Europe's share of American direct foreign investment more than doubled to match Canada's share of over 30 percent, while Latin America's share fell from 40 to under 20 percent. MICHAEL BARRATT BROWN, THE ECONOMICS OF IMPERIALISM 39, 57 (1974).

USD also created the so called Triffin dilemma[205]- the Bretton Woods system had created an incentive for reserve banks around the world to accumulate dollars as their convertability was guaranteed; however, the greater such accumulation relative to US gold reserves, the greater to risk to the guarantee. In order to stem its growing balance of payments deficits, the U.S. incrementally instituted controls over export of capital in the early 1960s.[206] The immediate effect was that U.S. banks expanded their overseas operation to participate directly in the unregulated Euromarket and secure funding for domestic operations.[207] An added incentive was that Glass-Steagall's separation of commercial and investment banking did not extend to overseas operations of U.S. banks.[208] These overseas operations helped American banks "to internalize aspects of [the unregulated Euromarket] within the US domestic financial system."[209] As U.S. deficits grew sizable, Europe started complaining that US was collecting "*seigniorage*" from foreign creditors by printing USDs.[210] As the real value of gold started to exceed the fixed USD price of gold, demands for gold conversion from foreign holders of USD increased.[211]

For capital owning classes in the U.S., a crisis was building rapidly. Rates of profit were falling, the share of income of capital owning classes was shrinking, and the oil price hike of early 1970s exacerbated the crisis and triggered "stagflation" – an unprecedented combination of

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[205] *See* EICHENGREEN, GLOBALIZING CAPITAL, *supra* note _ at 114-115; Walker Todd, *Triffin Dilemma, Reserve Currencies, and Gold*, AIER, Dec. 31, 2008. *Accessed* June 9, 2010, at http://www.aier.org/research/briefs/975-triffins-dilemma-reserve-currencies-and-gold. For a detailed exposition, *see* ROBERT TRIFFIN, GOLD AND THE DOLLAR CRISIS: THE FUTURE OF COVERTABILITY (1961).

[206] EICHENGREEN, GLOBALIZING CAPITAL, *supra* note _ at 127.

[207] Thomas E. Huertas, *US Multinational Banking: History and Prospects*, in BANKS AS MULTINATIONALS 254 (G. Jones, ed., 1990).

[208] Regulation K of the Federal Reserve, section 211. International Banking Operations 12 CFR Part 211.

[209] LEONARD SEABROOKE, U.S. POWER IN INTERNATIONAL FINANCE: THE VICTORY OF DIVIDENDS 111 (2001).

[210] FERGUSON, ASCENT, *supra* note _ at 308. Emphasis added. Holders of overseas USD were well aware that US, suspension of gold convertability to print money in response to liquidity crisis went back to the Aldrich-Vreeland Act of 1908. *See* WILLIAM L. SILBER, WHEN WASHINGTON SHUT DOWN WALL STREET: THE GREAT FINANCIAL CRISIS OF 1914 AND THE ORIGINS OF AMERICA'S MONETARY SUPREMACY (2007).

[211] Starting in 1960, U.S. external USD liabilities exceeded its gold reserves, and the price of gold in international markets started rising significantly above the pegged value of USD. EICHENGREEN, GLOBALIZING CAPITAL, *supra* note _ at 117, 126.

inflation and stagnation.[212] The share of national income by the top 1 percent of earners in the U.S. fell from pre- World War II high of 16 percent to less than 8 percent by 1978. While the inflationary climate made for "the worst bond bear market not just in memory but in history,"[213] others started to foresee "the death of equities."[214] In the face of accelerating demands from below for expanded economic and social rights the Keyensian welfare capitalism and the compact between capital and labor in the Global North supervised by an interventionist state appeared exhausted. The costs of a welfare state within and imperial wars outside kept increasing the pressure on the USD, and the Bretton Woods system did not offer any satisfactory options.[215] As a buildup towards the end of covertability, the Nixon administration rescinded the temporary capital controls of the 1960s and positioned the U.S. as unequivocally opposed to the use of such controls.[216] The formal end of USD-gold convertability by the U.S. in 1971, a refusal to honor a commitment to pay gold for USD at a fixed rate, was in effect a default on foreign obligations,

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[212] *See* ROBERT BRENNER, THE BUBBLE AND THE BOOM: THE US IN THE WORLD ECONOMY 19 Fig 1.1; 20 Fig 1.2, 21 Table 1.2, 22 Table 1.3 (2002). *See also*, Robert Brenner, *Uneven Development and the Long Downturn: The Advanced Capitalist Economies from Boob to Bust 1950-1988*, 229 NEW LEFT REV. 1 (1998); Robert Brenner, *The Economics of Economic Turbulence* 229 NEW LEFT REV 48 (1998); GIOVANNI ARRIGHI, THE LONG TWENTIETH CENTURY: MONEY, POWER, AND THE ORIGINS OF OUR TIME (1994).

[213] PIMCO CEO, Bill Gross, *quoted in* FERGUSON, ASCENT, *supra* note _ at 109.

[214] *The Death of Equities: How Inflation is Destroying the Stock market*, BUSINESS WEEK, August 13, 1979, at cover.

[215] A state faced with negative balance of payments has a variety of options: devalue the currency, impose capital controls, restrict capital accounts, seek reduction of trade barriers of trading partners, or adopt tight fiscal and monetary policies. Only some the options were open under the Bretton Woods system. Adjustment of currency value was restricted. The Keynesian welfare compromise between capital and labor precluded raising interest rates or curbs on spending. Capital controls were permitted but became increasingly difficult to enforce because of growing capital mobility that came with the growth of intra-company transfers of proliferating multination corporations

[216] ERIC HELLEINER, STATES AND THE REEMERGENCE OF GLOBAL FINANCE: FROM BRETTON WOODS TO THE 1990S 101-21 (1994).

and sounded the death knell for Bretton Woods.[217] With this delinking, the fixed rate international regime, and the "golden age" of capitalism (1949-1973) came an end.[218]

The termination of USD-gold convertability in 1971 was done more as an act of expedience than as a foundational break with Bretton Woods system.[219] This was not quite "the dawning of a new international regime for money and international relations."[220] Inflation, stagnation, and balance of payment problems improved only marginally. Declining USD and large outflows of capital threatened the very grounds of U.S. global domination, and democratic pressures on the welfare state kept growing.[221] Low rates of interest, stagnant profits, and inflation were putting increasing pressure on American finance capital.[222] Due to inflation, bond returns in the US remained negative for nearly four decades.[223] The measure of discontent on Wall Street was one "not seen since the last days of the Hoover presidency."[224] In 1979, even the

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[217] *See* Michael Bordo, *The Bretton Woods International Monetary System: A Historical Overview*, in A RETROSPECTIVE ON THE BRETTON WOODS SYSTEM: LESSONS FOR INTERNATIONAL MONETARY REFORM 3-98 (Michael Bordo and Barry Eichengreen eds., 1993).
[218] *See* PHILLIP ARMSTRONG, ANDRE GLYNN, AND JOHN HARRISON, CAPITALISM SINCE WORLD WAR II: THE MAKING AND BREAKING OF THE LONG BOOM (1991).
[219] JOANNE GOWA, CLOSING THE GOLD WINDOW: DOMESTIC POLITICS AND THE END OF BRETTON WOODS, 147, 166 (1983).
[220] PETER GOWAN, THE GLOBAL GAMBLE: WASHINGTON'S FAUSTIAN BID FOR GLOBAL DOMINANCE 320 (1999).
[221] *See* BARRY EICHENGREEN, GLOBALIZING CAPITAL: A HISTORY OF THE INTERNATIONAL MONETARY SYSTEM ch. 2-3 (1996); G. John Ikenberry, *Rethinking the Origins of American Hegemony*, 104:3 POL SCI Q. 375 (1989); EMMANUEL TODD, AFTER THE EMPIRE: THE BREAKDOWN OF THE AMERICAN ORDER (C. John Delogu trans., 2006); IMMANUEL WALLERSTEIN, THE DECLINE OF AMERICAN POWER: THE U.S. IN A CHAOTIC WORLD (2003). For critiques of the decline thesis, *see* Bruce Russett, *The Mysterious Case of Vanishing Hegemony. Or is Mark Twain Really Dead?*, 39:2 INT'L ORG. 207 (1985); Stephen Gill, *American Hegemony: Its Limits and Prospects in the Reagan Era*, 15:3 MILLENIUM: J. OF INT'L STUD. 311 (1986); Susan Strange, *The Persistent Myth of Lost Hegemony*, 41:4 INT'L ORG. 551 (1987).
[222] *See* ROBERT BRENNER, THE BUBBLE AND THE BOOM: THE US IN THE WORLD ECONOMY (2002); ROBERT BRENNER, THE ECONOMICS OF GLOBAL TURBULENCE (2006); MAKOTO ITOH, THE WORLD ECONOMIC CRISIS AND JAPANESE CAPITALISM (1990); DAVID MCNALLY, ANOTHER WORLD IS POSSIBLE: GLOBALIZATION AND ANTI-CAPITALISM (2006). David McNally, *From Financial Crisis to World-Slump: Accumulation, Fiancialization, and the Global Slowdown*, 17 HISTORICAL MATERIALISM 35, 43, f,n, 23 (2009).
[223] Ferguson, *Fiscal Crises and Imperial Collapses*, *supra* note_ at 12.
[224] CHARLES R. GEISST, WALL STREET: A HISTORY 320 (1997).

usually circumspect Bank for International Settlements (BIS) raised the alarm of "*a genuine Dollar crisis.*"[225]

The search for qualitative transformations was increasingly running up against the New Deal banking regulations. The gap between the potential and highly profitable markets for private credit and New Deal restrictive regimes was bridged by an incipient "financial services revolution" that can be dated as beginning in the mid-1970s with the abolition of fixed rates on brokerage commissions on Wall Street.[226] However, what American finance capital needed was a fundamental break with New Deal regimes and a reversal of the Keynesian capital-labor compromise about a welfare state and full employment. Breaking the power of the unions and workers in general was an essential step towards that. Finance capital needed a new disciplinary mechanism to adjust national economies to the new demands of global accumulation. This is when the neoliberal counterrevolution was launched. Coming in response to economic and political gains secured by working classes, the colonized, and other subordinated groups, falling rates of profit, and decline in the share of wealth of capital owning classes, since the late 1970s this neoliberal counter-revolution has "swept across the world like a vast tidal wave of institutional reform and discursive adjustment."[227]

III. Neoliberal Counterrevolution

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[225] BANK OF INTERNATIONAL SETTLEMENTS (BIS), ANNUAL REPORTS, 3 (1979). Emphasis added. *See also*, EICHENGREEN, GLOBALIZING CAPITAL, *supra* note _ at 126-132.

[226] *See* MICHAEL MORGAN, THE POLITICS OF THE FINANCIAL SERVICES REVOLUTION (1991). Building on certificates of deposit that had initiated the "securitization" of commercial banking money market mutual funds mushroomed, accounting for $25 billion in 1979 and further quadrupling by 1981. During the 1970s, assets of American banks overseas increased almost seven folds, matching the growth the Eurodollar market. And by the end of 1970s foreign earnings accounted for more than half of total earnings of the five largest American banks. Panitch and Gindin, *Finance and American Empire*, *supra* note _ at 57-58.

[227] David Harvey, *Neoliberalism as Creative Destruction,* 610 (1) ANNALS OF AM. ACAD. OF POL. & SOC. SCI. 22, 23 (2007)

a. The Idea, the Road-tests, and the Launch

The neoliberal project aims to unfold a new social order across the globe to reverse the setbacks that the economic power and political hegemony of the wealth-owning classes had suffered on account of Keynesian welfare in the West, socialism in Eastern Europe, and nationalism in the global South.[228] Neoliberalism makes increasing recourse to the law to displace Keynesian welfare states through liberalization, deregulation, and privatization, and uses the discipline of expanded markets to remove barriers to accumulation that earlier democratic gains had achieved. [229] To secure unfettered rights to private property and profits, it expands and deepens the logic of the market, undermines state sovereignty and national autonomy, and links local and global political economies to facilitate transnational accumulation of capital.[230] Neoliberalism entails the abandonment of the post- Great Depression Keynesian compromise about state intervention in the market that aimed to maintain steady aggregate demand through full employment.[231] It deems flexible labor markets and rollback of welfare safety nets as necessary for stabilization of capitalist economies. As an opening salvo, radical deployment of tight monetary policy is used as a shock treatment to break the power of labor and inflationary expectations of welfare societies. A sustained tight fiscal policy follows grounded in

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[228] *See* DANIEL YERGIN AND JOSEPH STANISLAW, THE COMMANDING HEIGHTS: THE BATTLE BETWEEN GOVERNMENT AND MARKETPLACE THAT IS REMAKING THE MODERN WORLD (1998); Harvey, *Neoliberalism*, *supra* note _;

[229] For articulation of the case for neoliberal global political economy and related accounts of the law, s*ee,* R. KEOHANE, AFTER HEGEMONY (1984); K. Abbot, et. al., *The Concept of Legalization*, 54 (3) INTERNATIONAL ORGANIZATION 401 (2000).

[230] *See* B. de Sousa Santos, *Law: A Map of Misreading. Towards a Postmodern Conception of Law*, 14 J. LAW & SOC'Y 297 (1987); A. CLAIRE CUTLER, PRIVATE POWER AND GLOBAL AUTHORITY: TRANSNATIONAL MERCHANT LAW IN THE GLOBAL POLITICAL ECONOMY (2003); W. ROBINSON, A THEORY OF GLOBAL CAPITALISM: PRODUCTION, CLASS, AND STATE IN A TRANSNATIONAL WORLD (2004); HISTORICAL MATERIALISM AND GLOBALIZATION (M. Rupert and H. Smith eds., 2002)

[231] *See* Thomas I. Palley, *From Keyensianism to Neoliberalism: Shifting Paradigms*, in NEOLIBERALISM: A CRITICAL READER 142 (Alfredo Saad-Filho and Deborah Johnson, eds., 2005); Susanne MacGregor, *The Welfare State and Neoliberalism*, in *id*. at 142;

the belief that supply finds its own demand and that a free market always tends towards equilibrium. In the international realm, free trade of goods, services and capital is its "sacred tenet."[232] The political agenda of liberalism was summed up by Margaret Thatcher: "There is no such thing as society. There are individual men and women, and there are families."[233] Such an agenda necessitates breaking the back of organized labor and fragmenting coalitions of working classes.[234] For neoliberalism "society achieves its coherence not through design but through the market and its processes of exchange."[235] Consequently, neoliberalism aims at "disempowerment of government: it disables the state from interfering with the established order of society."[236] Neoliberalism does not displace the state as much as it reformulates it and restructures its options.[237] The neoliberal project is to turn the "nation-state" into a "market-state,"[238] one with the primary agenda of facilitating global capital accumulation unburdened from any legal regulations aimed at assuring welfare of citizens. In summary, neoliberalism seeks unbridled accumulation of capital through a rollback of the state to minimal security and maintenance of law, fiscal and monetary discipline, flexible labor markets, and liberalization of trade and capital flows.

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[232] Paul Krugman, *Is Free Trade Passé?* 1:2 J. ECON. PERS. 131 (1987).
[233] Interview with WOMAN'S OWN, Sept. 23, 1987. *Accessed* March 11, 2010, at http://www.margaretthatcher.org/document/106689.
[234] Calling the neoliberal blueprint a "process of 'dedemocratization,'" Philippe Schmitter argues that neoliberal economic and political changes have two common features: "1) they diminish popular expectations from public choices, and 2) they make it harder to assemble majorities to overcome the resistance of minorities, especially well-entrenched and privileged ones. " Philippe Schmitter, *Democracy's Future: More Liberal, Preliberal, or Postliberal?* 6:1 J. OF DEMOCRACY 15, 20 (1995).
Privatization of public enterprises; removal of state regulations;
[235] BARRY SMART, ECONOMY, CULTURE, SOCIETY 95 (2002).
[236] ROBERTO M. UNGER, DEMOCRACY REALIZED: THE PROGRESSIVE ALTERNATIVE 58 (1999).
[237] Many perceptive observers reject the "state shrinking and declining" argument as political posturing of neo-liberals. In particular, they point to the expansion of the coercive apparatuses of the state and the shift of the state from a managerial mode befitting the Fordist era towards a neoliberal entrepreneurial mode. *See, e.g.*, David Harvey, *From Managerialism to Entrepreneurialism: Transformation in Urban Governance in Late Capitalism*, 71 (B) GEOGRAFISKA ANNALER 3 (1989).
[238] Anthony Carty, *Marxism and International Law: Perspectives for the American (twenty-first) century*?, in INTERNATIONAL LAW ON THE LEFT: REEXAMINING MARXIST LEGACIES 169, 170 (Susan Marks ed.,2008).

The neoliberal counterrevolution arrived in stages. First came an ideological assault on the Keynesian consensus and the welfare state.[239] Then neoliberalism was road tested on a country-wide scale in Chile following the *coup d'etat* of September 11, 1973, under the supervision of "the Chicago Boys" - so-called for their subscription to Milton Friedman's economic theories.[240] Government spending was cut by 27 percent; natural resources, manufacturing, and public pension systems were privatized; trade, profit repatriation and capital flows were liberalized; and suppression of unions and labor by an authoritarian political order lubricated the transition to neoliberalism.[241] While preparing the ground for unbridled capitalism, by 1982-83, the neoliberal "shock treatment" ended up with 13 percent contraction of the economy with one in five workers unemployed.[242] Foreign investment and lending poured in attracted by high rates of profit.

The Chile experiment was followed by "a *coup d'etat* by financial institutions against the democratically elected government of New York City."[243] Financial institutions refused to roll over New York's debt forcing the city to the edge of bankruptcy. A group of bankers forced New

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[239] The 1971 memo by Lewis Powell, just before his elevation to the Supreme Court, that urged the American Chamber of Commerce to mount a campaign to publicize that what was good for business was good for America, was perhaps the opening ideological salvo. *See* HARVEY, NEOLIBERALISM , *supra* note_ at 31. (2007). Formation of the Business Roundtable, proliferation of corporate political action committees legalized by campaign finance laws of 1974, and with their activities given free speech protection by the Supreme Court in 1976, the California Proposition 13 tax revolt of home owners in 1976, the emergence of the Christian right as the moral majority, and the turn of the American South to the Republican party as part of the politics of backlash against post world-War II civil rights gains were all serial markers along this road. The ideological assault also targeted the media, and educational and research institutions. Existing news medium were taken over and new ones established which along with think tanks financed by wealthy individual and corporate donors publicized the supposedly commonsense character of neoliberalism and its promise of liberty, entrepreneurship, and consumerism.

[240] *See* JUAN GABRIEL VALDEZ, PINOCHET'S ECONOMISTS: THE CHICAGO SCHOOL IN CHILE (1995); Patricio Silva, *Technocrats and Politics in Chile: From the Chicago Boys to the CEIPLAN Monks*, 23:2 J. of LATIN AM. STUD. 385 (1991); Rossana Castiglioni, *The Politics of Retrenchment: The Quandaries of Social Protection under Military Rule in Chile*, 1973-1990, 43:4 LATIN AM. POL. AND SOC. 39 (2001). MILTON FRIEDMAN AND ROSE D. FRIEDMAN, TWO LUCKY PEOPLE: MEMOIRS 399-400 (1998).

[241] *See* FERGUSON, ASCENT, *supra* note _ at 213-220.

[242] STIGLITZ, GLOBALIZATION, *supra* note _ at 114; FERGUSON, ASCENT, *supra* note _ at 218.

[243] HARVEY, NEOLIBERALISM, *supra* note_ at 29. (2007)

York to accept "fiscal discipline" as the cost of a bailout - curbing municipal unions, layoffs in public employment, wage freezes, cuts in social provisions, and imposition of user fees.[244] Management of New York's fiscal crisis "established a principle that, in the event of a conflict between the integrity of financial institutions and bondholders on the one hand and the well-being of the citizens on the other, the former would be given preference."[245] This principle has ever since served as the controlling grammar of international debt crises. Finally, the rollback of the welfare state in the Global North was tried out. The IMF was used in 1975-76 to secure abandonment of Keynesianism by the U.K. during its fiscal and balance of payment crisis.[246]

With trial-runs in Chile, New York, and the U.K. secured, finance capital launched the decisive "financial coup"[247] October 6, 1979 by way of the "Volcker Shock," characterized by Volcker himself as a "triumph of central banking."[248] To be able to institute a new global capitalist discipline, the U.S. had to, in Volcker's words, "discipline ourselves."[249] This involved radically limiting the money supply and allowing interest rates to rise to whatever level and with whatever short-term economic cost in order to break the back of inflation, the enemy of finance capital.[250] The Federal base rate increased from 8 percent in 1978 to over 19 percent at the beginning of 1981, and did not return to single digits until 1984; inflation rate went down from 11.3 percent in 1979 to 3.6 percent in 1987. An unwavering anti-inflation agenda was to now guide Federal Reserve's direct manipulation of interest rates, gaving the Federal Reserve, in

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[244] *See* WILLIAM K. TABB, THE LONG DEFAULT: NEW YORK CITY AND THE URBAN FISCAL CRISIS (1982); ROGER E. ALCALY AND DAVID MERMELSTEIN, THE FISCAL CRISIS OF AMERICAN CITIES (1977).
[245] HARVEY, NEOLIBERALISM , *supra* note_ at 31. (2007).
[246] MARK D. HARMON, THE BRITISH LABOR GOVERNMENT AND THE IMF CRISIS (1997); LEO PANITCH AND COLIN LEYS, THE END OF PARLIAMENTARY SOCIALISM chs. 5, 6 (2001).
[247] GERARD DUMENIL AND DOMINIQUE LEVY, CAPITAL RESURGENT: ROOTS OF NEOLIBERAL REVOLUTION 69, 165 (2004).
[248] Paul Volcker, *The Triumph of Central Banking?* Jacobson Lecture, Per Jacobson Foundation, Washington, D.C., September 23, 1990, at 5. *Accessed* July 12, 2010 at http://www.perjacobsson.org/lectures/1990.pdf.
[249] PAUL VOLCKER AND TOYOO GYOHTEN, CHANGING FORTUNES: THE WORLD'S MONEY AND THE THREAT TO AMERICAN LEADERSHIP 167 (1992).
[250] JACK CASHILL, POPES AND BANKERS: A CULTURAL HISTORY OF CREDIT AND DEBT, FROM ARISTOTLE TO AIG 200 (2010).

Volcker's words, a central "role in stabilizing expectations [that] was once a function of the gold standard, the doctrine of the annual balanced budget, and fixed exchange rates."[251] The Keynesian compromise and commitment to full employment stood abandoned, and displaced by neoliberalism - the new uber-rule of global accumulation that aims to expand markets and use their discipline to remove barriers to accumulation that earlier democratic gains had achieved. The radical use of monetary policy was Federal Reserve's bid to become the anchor of a new phase of the USD-based global economy.

The "induced recession"[252] triggered by the Volcker Shock was intended to break the inflationary spiral, and the resulting unemployment would also break the strength of organized labor, as a means to reverse the gains working classes had secured since the New Deal. It is critical to note that "monetary policy involves a tradeoff between inflation and unemployment. Bond-holders worry about inflation; workers, about jobs."[253] Along with unemployment induced by high interest rates, the power of organized labor was broken by direct and decisive state action.[254] Besides winning the confidence of the financial markets, the U.S. state could now tell others how to manage their economies and address their respective balances of class forces. It opened the door for liberalization of U.S. financial markets, expanding their depth, increasing their liquidity, and propelling their unprecedented globalization. High interest rates induced an inflow of capital, U.S. government securities became an investment of choice, and the USD again became secure as the global currency of choice. The attraction of highly liquid US

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[251] *Quoted in* PETER A. JOHNSON, THE GOVERNMENT OF MONEY: MONETARISM IN GERMANY AND THE UNITED STATES 178 (1998).
[252] Panitch and Gindin, *Finance and American Empire*, *supra* note _ at 63.
[253] STIGLITZ, FREEFALL, *supra* note _ at 142.
[254] In 1980, the government intervened in the Chrysler bankruptcy proceedings and conditioned loans on securing UZW's concessions about wage cuts and outsourcing. Next year the Air Traffic Controllers' strike was smashed. Volcker acknowledged that "the most important single action of the administration in helping the anti-inflation fight was defeating the air traffic controllers' strike."*Quoted in* John B. Taylor, *Changes in American Economic Policy in the 1980s: Watershed or Pendulum Swing?*, 33 J. ECO. LIT. 777, 778 (1995).

Treasury bills induced a massive secondary market in bonds, and allowed the U.S. to rely on global financial reserves to run up deficits while expanding its global economic reach. Volcker Shock thus "represented a convergence of imperial and domestic responsibilities."[255]

The Volcker Shock and the first round of liberalizations, however, did not quite do the job of restoring vitality to the U.S. economy. High interest rates resulted in the rise of interest payments as a percentage of pre-tax profits from 26 percent between 1982 and 1990, compared to 13 percent between 1973 and 1979.[256] The high-interest rates also kept the USD overvalued with a negative impact on exports, and leading corporations undertook powerful lobbying campaigns demanding relief.[257] Finally, in order to restore the viability of the US manufacturing sector, on September 22, 1985, the G-5 countries, "under US pressure," signed the Plaza Accord, agreeing to take joint action to reduce the exchange rate of USD "to rescue a US manufacturing sector on its way to desolation."[258] The USD "duly plunged."[259] These steps were complemented by "aggressive unilateralism."[260] The so-called "voluntary export restraints" of early 1980s imposed by the US on Japanese automakers into the US market, were followed by the use of the threat of closing off US markets "as a bludgeon" both to limit imports and to force open Japanese and Asian markets to US exports and direct investments.[261] The Omnibus Trade and Competition Act of 1988 (Super 301)[262] extended the reach of the Trade Act of 1974.[263] As a

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[255] Panitch and Gindin, *Finance and American Empire*, *supra* note _ at 65.
[256] BRENNER, THE BUBBLE, *supra* note _ at 58.
[257] C. RANDALL HENNING, CURRENCIES AND POLITICS IN THE UNITED STATES, GERMANY, AND JAPAN 276-84 (1994).
[258] BRENNER, THE BUBBLE, *supra* note _ at 60.
[259] FERGUSON, ASCENT, *supra* note _ at 318. *See also*, GEORGE SOROS, THE NEW PARADIGM FOR FINANCIAL MARKETS: THE CREDIT CRASH OF 2008 AND WHAT IT MEANS 105 (2008).
[260] *See* AGGRESSIVE UNILATERALISM: AMERICA'S 301 TRADE POLICY AND THE WORLD TRADING SYSTEM (Jagdish Bhagwati and Huge T. Patrick eds, 1991).
[261] BRENNER, THE BUBBLE, *supra* note _ at 60 (2002). *See* also, R. GILPIN, THE CHALLENGE OF GLOBAL CAPITALISM: THE WORLD ECONOMY IN THE 21ST CENTURY 81-82, 232-236 (2000).
[262] The Omnibus Trade and Competition Act of 1988 (Super 301). Pub. L. No. 100-418. 102 Stat. 1107. (codified as amended in scattered sections of 19 U.S.C.).

result, "actions brought against 'unfair' trading practices increased dramatically."[264] The Structural Impediments Initiative of 1989,[265] sought a further opening of the Japanese market.[266] Brenner dates the origins of the U.S. bubble-economy from the Plaza Accord of 1995, which he rightly characterizes "a major watershed for the world economy as whole."[267] It was this Accord and unilateral acts by the U.S., not the free-market, that set off a decade-long devaluation of the USD with respect to yen and the mark. The result was relative stabilization of US manufacturing, a secular crisis for Japanese industry, and an unprecedented explosion of export-based expansion of Asian economies.[268] This is the context of "quasi-pegging" of Asian currencies with USD, termed by some "Bretton Woods II." [269] However, U.S. balance of payment and fiscal deficits kept expanding. Bringing back balance of payment surpluses in foreign hands to helps sustain U.S. fiscal and current account deficits was now became a prime agenda. This is where neoliberal financialization of the U.S. economy came in to furnish the grounds for the "dramatic … resurrection of global finance."[270]

b. Financialization and the Myth of Deregulation.

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[263] The Trade Act of 1974. Pub. L. No. 93-618. 88 Stat. 1978. (codified as amended in scattered sections of 19 U.S.C.)

[264] MILES KAHLER, REGIONAL FUTURES AND TRANSNATIONAL ECONOMIC RELATIONS 46 (1995). It was noted that after passage of the new legislation, "no other economic regulatory program took on such an increased in case-loads." PIETRO NIVOLA, REGULATING UNFAIR TRADE 21 (1993),

[265] *U.S., Japan launch structural impediments initiative - joint statement by George Bush and Sosuke Uno - transcript*, Dep't St. Bull. (1989). Accessed July 3, 2010, at http://findarticles.com/p/articles/mi_m1079/is_n2150_v89/ai_8057493/.

[266] For details of the considerable pressure by the U.S. upon Japan to liberalize its financial markets, *see* FRANCES M. ROSENBLUTH, FINANCIAL POLITICS IN CONTEMPORARY JAPAN, ch. 3 (1989).

[267] BRENNER, THE BUBBLE, *supra* note _ at 134.

[268] See WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 61-63.

[269] Michael Dooley, David Folkerts-Landua and Peter Garber, *An Essay on the Revived Bretton Woods System*, 9:4 INT'L J. FINANCE & ECON. 307 (2004); WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 81-97.

[270] Banjamin J. Cohen, *Phoenix Risen: The Resurrection of Global Finance*, 48 WORLD POLITICS 268 (1996).

Financialization refers to a marked increase in the size and significance of financial markets and institutions in the economy.[271] It entails a "set of transformations through which relations between capitals and between capital and wage-labor have been increasingly financialized – that is, increasingly embedded in interest paying financial transactions."[272] The "Volcker Shock" and its aftermath had restored the confidence of the financial markets. Finance capital was now poised for accelerated accumulation on a global scale. But first it needed to be unshackled of the post New Deal regulatory order. What happened over the next two decades was not de-regulation but a redesign of regulations – a re-regulation. To appreciate this critical point one needs to jettison the formal dichotomy between regulation and deregulation and between the state and the market.[273] New forms of state intervention were indispensible for finance capital to have an expanded and deepened field of operations.[274] The question was not de-regulation but the shape regulations would take. The market was not left to its own devices.[275]

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[271] *See generally*, FINANCIALIZATION AND THE WORLD ECONOMY (Gerald A. Epstein ed., 2002); GARARD DEMENIL AND DOMINQUE LEVY, CAPITAL RESURGENT: ROOTS OF THE NEOLIBERAL REVOLUTION (Derek Jeffers trans., 2004); H. Feng, et. al., *A New Business Model?: The Capital Market and the New Economy*, 30:4 ECON. & SOC. 467 (2001).

[272] McNally, *From Financial Crisis*, *supra* note _ at 56.

[273] In this context, it is also critical to note that the state and the economy are not unified entities. A state does not necessarily represent the interests of all who inhabit its territorial bounds. All societies are stratified, with different groups having different measures of representation and influence over state-policy, and the impact of state-policy falls differentially on different groups. Similarly, different groups within a society participate in the economy from different positions. For example, capital and labor, or producers and consumers, or borrowers and lenders, participate in the same economy but from different positions and with different interests.

[274] In debates about financial globalization, neoclassical economists typically assert that "technological non-policy factors were so powerful … that they would have caused a progressive internationalization of financial activity even without changes in government separation fences." RALPH C. BRYANT, INTERNATIONAL FINANCIAL INTERMEDIATION 69 (1987). While capital mobility was certainly facilitated by advances in communication and information technologies and innovations in financial instruments, "contemporary open global financial order could never have emerged without the support and blessing of states." HELLEINER, STATES AND THE REEMERGENCE OF GLOBAL FINANCE, *supra* note _ at vii. *See also*, ANDREW C. SOBEL, DOMESTIC CHOICES, INTERNATIONAL MARKETS: DISMANTLING NATIONAL BARRIERS AND LIBERALIZING SECURITIES MARKETS (1994). The decisions that the states made in this regard were "solidly rooted in domestic policy dilemmas and distributional debates." *Id.* at 19. Indeed, financial globalization was "politically engineered … a reassertion by the state of an underlying disposition towards financial interests." Ron Martin, Stateless Monies, *Global Financial Institutions and National economic Autonomy: The End of Geography?* In MONEY, POWER AND SPACE 271 (Stuart Corbridge, et. al., eds., 1994).

[275] In 2005, it was rightly observed that "to conceive of the changes in the global financial markets since the early 1970s as 'deregulation', the withdrawal of the state … cannot survive study of the regulation of financial markets.

Instead, elaborate new regulations were redesigned to pave the way for the ascendency of finance capital, and "through innovation and invention of financial and regulatory technologies, U.S. actors established the agenda and boundaries of change in other markets."[276] Note that after a generation of so-called deregulation, the U.S. has a regulatory regime with over 100 authorities responsible to oversee different and overlapping segments of the financial market.[277] In 2000 it was noted that "the financial system is among the most heavily regulated sectors of the American economy."[278]

The neoliberal counterrevolution entailed an extensive redesigning of the regulatory regimes related to finance.[279] Regulatory regimes born of the New Deal and the Keynesian consensus were set aside or drastically modified. In addition, a host of new regulations were fashioned and entrenched to achieve hegemony of finance capital in particular. The only unifying coherence to this regulatory regime was furnished by the overarching neo-classical ideology of "efficient market" theory that saw all markets as efficient and self-adjusting, which left to their own would produce efficiency, innovation, demand and supply equilibrium, and stability.[280] This theory, which assumes that market prices are always right and unemployment is voluntary

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The modern American financial markets are almost certainly the most highly regulated markets in history, if regulation is measured by volume (number of pages) of rules, probably also if measured by extent of surveillance, and possibly even by vigor of enforcement." Donald Mackenzie, *Opening the Black Boxes of Global Finance,* 12:4 REV. OF INT'L POL. ECON . 555, 569 (2005). Note that Friedrick Hayek, the godfather of neoliberalism, recognized the indispensability of the state for "free" markets. He took the view that "nothing has done so much harm [to the market advocates cause as the] wooden insistence … on certain rules of thumb, above all of the principle of *laissez-farie* capitalism." FRIEDRICH HAYEK, CONSTITUTION OF LIBERTY 502-03 (1960).

[276] HELLEINER, STATES AND THE REEMERGENCE OF GLOBAL FINANCE, *supra* note _ at 151.

[277] Joanna Chung, *Multi-Layered Patchwork Will Be Tough to Unpick*, FINANCIAL TIMES, April 24, 2008, at 13.

[278] F. S. MISHKIN, THE ECONOMICS OF MONEY, BANKING AND FINANCIAL MARKETS 41 (2000).

[279] *See* Greta R. Krippner, *The Financialization of the American Economy*, 3 SOCIO-ECONOMIC REV. 173 (2005).

[280] Wade, *The First-World Debt*, *supra* note_ at 34. One scholar notes that "an ideological backlash against state economic interventionism" played a key part in this reordering of the markets. Philip G. Cerny, *The Deregulation and Re-regulation of Financial Markets in a More Open World*, in FINANCE AND WORLD POLITICS 51 (Philip G. Cerny ed., 1993). Another notes the critical role of "widely shared ideological commitments" and "mindsets." David M. Andrews, *Capital Mobility and State Autonomy: Towards a Structural Theory of International Monetary Relations*, 38 INT'L STUD. Q. 193, 200-201 (1994). One should emphasize the global dimension of this phenomenon because of "international patters of elite interaction … [which] are explicitly concerned to foster … a shared outlook among the international establishments of the major capitalist countries." Stephen R. Gill and David Law, *Global Hegemony and the Structural Power of Capital*, 33 INT'L STUD. Q. 475, 483 (1989).

leisure, "became the intellectual justification for financial deregulation."[281] The elaborate legislative interventions of the last generation changed the very nature of financial institutions beyond acquiring savings and providing credit. Far beyond its classic role of credit provision, finance was now positioned "directly at the heart of the accumulation process, essentially introducing a new sector that straddled credit and production."[282]

The critical legislations that enabled neoliberal financialization were the Depository Institutions Deregulation and Monetary Control Act of 1980, which eliminated interest rate caps;[283] the addition of the 401K provision to the tax code in 1980, which channeled incomes into private pension plans;[284] the Garn-St. Germain Depository Institutions Act of 1982, that lifted restrictions on the savings and loan industry to enter commercial lending and corporate bonds, and allowed inter-state mergers between banks and S&Ls;[285] the Secondary Mortgage Market Enhancement Act of 1984, that permitted investment banks to buy, pool, and resell mortgages in slices with varying levels of risk;[286] the Tax Reform Act of 1986, that created the Real Estate Mortgage Investment Conduit, making mortgage-backed securities more

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[281] JOHNSON AND KWAK, 13 BANKERS, *supra* note _ at 68-69. For an insightful analysis of the efficient market hypothesis, and the underlying neo-classical economic theory, *see* ROBERT SKIDELSKY, KEYNES: THE RETURN OF THE MASTER 29-51 (2009). The foundational flaw of neo-classical economic theory is that that "leaving history and its uncertain movement out of the analysis imparts false sense of determinacy and predictability to the economic process." Wallace C. Peterson, *Institutionalism, Keynes and the Real World*, 11:2 J. ECON. ISSUES 201, 213-14 (1977). Because neo-classical theory assumes that time and institutions do not matter, it remains an inappropriate toll for analyzing and prescribing real-world policies. *See* Douglas North, *Economic Performance Through Time*, 84:3 AM. ECON. REV. 359 (1994). In light of the 2007-09 financial meltdown, it has been suggested that "September 15, 2008, the date that Lehman Brothers collapsed, may be to market fundamentalism … what the fall of the Berlin wall was to communism." STIGLITZ, FREEFALL, *supra* note _ at 219.

[282] Panitch and Gindin, *Finance and American Empire*, *supra* note _ at 68.

[283] Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132. (codified as amended in scattered sections of 12 U.S.C.)

[284] *See* ROGER LOWENSTEIN, ORIGINS OF THE CRASH: THE GREAT BUBBLE AND ITS UNDOING 24-5 (2004).

[285] Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469. (codified as amended in scattered sections of 12 U.S.C)

[286] Secondary Mortgage Market Enhancement Act of 1984, Pub. L. No. 98-440. 98 Stat. 1689. (codified as amended in scattered sections of 15 U.S.C.)

attractive;[287] the Financial Institutions Reform, Recovery, and Enhancement Act of 1989,[288] which rearranged the government-sponsored entity landscape; the Interstate Banking and Branching Act of 1994, that allowed banks to operate across state lines;[289] the Community Reinvestment Act, that directed financial institutions to expand their market base;[290] the Gramm-Leach-Bliley Act (Financial Services Modernization Act) of 1999, [291] that repealed the Glass-Steagall Act of 1933; [292] the Commodities Futures Modernization Act of 2000, that left derivatives out of regulatory oversight ;[293] and the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, that made it difficult for consumers to seek protections of bankruptcy.[294] The courts and regulatory agencies played their supportive role. In 1986, the courts upheld the Federal Reserve's ruling that commercial banks' placing commercial paper issued by corporations with investor did not violate Glass-Steagall.[295] A November 2001 rule jointly adopted by OCC, OTS, FDIC, and the Federal Reserve tied bank capital requirement in

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[287] Tax Reform Act of 1986 Pub. L. No. 99-514, 100 Stat. 2085. (codified as amended in scattered sections of 26 U.S.C.)

[288] Financial Institutions Reform, Recovery, and Enhancement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (codified as amended in scattered sections of 12 U.S.C.)

[289] Interstate Banking and Branching Act of 1994. *Pub. L. No. 103--328; 108 Stat. 2338* (codified as amended in scattered sections of 12 U.S.C)

[290] Community Re-Investment Act. (12 U.S.C. 2901) and implemented by Regulations 12 CFR parts 25, 228, 345, and 563e. While this legislation is often cited by free-market enthusiasts as the primary cause of the mortgage meltdown, default rates on CRA lending are comparable to other areas of lending. *See also*, STIGLITZ, FREEFALL, *supra* note _ at 10.

[291] Gramm-Leach-Bliley Act (Financial Services Modernization Act) of 1999 . 15 USC Sec. 6801-6809.

[292] 48 Stat. 162.

[293] Commodities Futures Modernization Act of 2000. Pub. L. No. 106-554. 114 Stat. 2763.

[294] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. Pub. L. No. 109-8. 119 Stat. 23. (codified as amended in scattered sections of 11 U.S.C.)

[295] *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 807 F.2d 1052 (D.C. Cir. 1986).

securitization to the ability of banks get rating agencies to approve the investment.[296] On April 28, 2004, SEC agreed to allow large investment banks use their own "risk management practices "for regulatory purposes."[297] This decision facilitated investment banks to increase their leverage to 40 to 1.[298] The basic principle behind oligarchies, that economic power yields political power, translated well in the course of neoliberal regulatory design for finance capital; a design which substantiated that "as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit."[299]

One area that was significantly left out of the purview of regulatory oversight was derivatives, which were to play havoc down the road.[300] This considered abdication issued from a desire to both accelerate the hegemony of finance capital and the imperial role of the U.S. In

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[296] Rule published in the Federal Register, November 29, 2001. JOHNSON AND KWAK, 13 BANKERS, *supra* note _ at 138-39.

[297] Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities Release, Exchange Act Release No. 34-49830; File No. S7-21-03 (August 20, 2004). *See also*, JOHNSON AND KWAK, 13 BANKERS, *supra* note _ at 140; Stephen Labaton, *Agency's '04 Rule Let Banks Pile Up New Debt*, NEW YORK TIMES, October 3, 2008, at A1.

[298] STIGLITZ, FREEFALL, *supra* note_ at 163.

[299] George Stigler, *The Theory of Economic Regulation*, 2 THE BELL J. OF ECON. AND MANGT. SCI. 3 (1971). *Accessed* July 21, 2010, at http://faculty.msb.edu/murphydd/CRIC/Readings/Stigler--Th%20of%20Econ%20Regulation%201971.pdf. A century ago, Louis Brandeis argued that the "dominant element in our financial oligarchy is the investment banker." LOUIS BRANDEIS, OTHER PEOPLE'S MONEY, AND HOW THE BANKERS USE It 4 (1914). Today, Barney Frank, Chairman of the House Banking Committee, takes the position that financial institutions and instruments have taken "a large chunk of the economy hostage. And we have to pay ransom, like it or not." Barney Frank, *quoted* in ANDREW ROSS SORKIN, TOO BIG TO FAIL: THE INSIDE STORY OF HOW WALL STREET AND WASHINGTON FOUGHT TO SAVE THE FINANCIAL SYSTEM FROM CRISIS – AND THEMSELVES 38 (2009).

[300] With the end of USD's convertability, and the move from fixed to floating rates, the measure-of-value property of money was rendered highly unstable. With this increased uncertainty, risk-assessment and risk-hedging became critical for capital that moves through multiple fluctuating currencies. The market for derivatives, instruments designed to hedge risk, exploded in this context. Because one did not have to have a stake in the underlying security to buy a derivative, they quickly became instruments of speculation rather that risk-management. Besides Credit Default Swaps, derivatives mushroomed as speculative bets on the movements of currencies, interest rates, bonds, and stocks. The modern "derivatives revolution," began with the 1981 invention of interest rate swap by Solomon Brothers, by 2008 had grown to USD 350 trillion in face value and USD 8 trillion in gross market value. JOHNSON AND KWAK, 13 BANKERS, *supra* note _ at 79. As a preview of bigger things to come on the global stage, the game of "frantically rebundling the risks and stuffing them down the throats of any investor we could find," found a public entity victim in Orange County that lost USD 2 billion in 1994 in deals that yielded Merrill Lynch USD 100 million in fees. FRANK PARTNOY, INFECTIOUS GREED: HOW DECEIT AND RISK CORRUPTED FINANCIAL MARKETS 117 (2004).

November 1999, the President's Working Group on Financial Markets concluded that "to allow the United States to maintain leadership in these rapidly developing markets, … derivatives should be exempts from federal regulation."[301] Greenspan found regulation of derivatives "wholly unnecessary."[302] Larry Summers, the Secretary of Treasury in 1999-2001, said that one of his great achievements was ensuring that derivatives remain unregulated.[303] When the finance capital was able to beat back attempts to regulate derivatives and restrict predatory lending, its "victory over America was total."[304]

Besides the changes in U.S. regulatory regimes, the neoliberal financial reordering was also facilitated by changes in banking rules of the BSI,[305] and increased encroachment on economic sovereignty of states through an over-extension of U.S. law and jurisdiction.[306] Global

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[301] "Over-the Counter Derivatives Markets and Commodities Exchange Act," *Report of the President's Working Group on Financial Markets*, November 1999. *Accessed* July 21, 2010, at http://www.ustreas.gov/press/releases/reports/otcact.pdf.
[302] *Quoted in* JOHNSON AND J KWAK, 13 BANKERS, *supra* note _ at 8.
[303] STIGLITZ, FREEFALL, *supra* note _ at 46.
[304] *Id*. at 10.
[305] The 1988 Basil Capital Accord, designed in the aftermath of the Latin American debt crisis, of the early 1980s, required all banks to maintain capital reserve fund of 8 percent of risk-adjusted assets. *See* BCBS, *International Convergence of Capital Measurement and Capital Standards* (1988). In the m*id*-1990s, US Federal Reserve sought replacement of regulation by a supervisory regime that replaced capital requirements with review of banks' internal risk management procedures. Eric Newstadt, *Neoliberalism and the Federal Reserve*, in AMERICAN EMPIRE AND POLITICAL ECONOMY OF GLOBAL FINANCE 107 (Leo Pantich and Martijin Kinings, eds., 2009). Under the 1996 amended Capital Accord, capital reserves of 8 percent against both credit and market risks are required. However, banks could use their own internal risk models for measuring their market risk. This created a tow-tier system of banks. The global conglomerates that had resources to set up internal risk-measurement and risk-management systems, determine their own capital requirements. The smaller banks have their market risk determined by the "standard measurement method" specified in the amendment. BCBS, OVERVIEW OF THE NEW BASIL CAPITAL ACCORD (2003). The risk-based capital requirement forces banks to cut back lending during a financial crisis as the value of equity, the largest part of a bank's capital, falls. Therefore, capital requirements become more burdensome during a financial crisis and banks cut back issuing of credit. The credit squeeze in a depressed market exasperates the downward pressure on the market. In effect, then, the Basil standards end up with "a global banking and financial system that in stabilizing itself, destabilizes the underlying macroeconomy." Rude, *supra* note _ at, 93.
[306]*See* B. S. Chimni, *International Institutions Today: An Imperial State in the Making*, 15 EUROPEAN J. INT'L L 1 (2004). The exponential rise of extra-territorial jurisdiction in unilateral and multilateral forms has become an avenue to govern matters beyond international territorial boundaries by reaching deeply inside domestic jurisdiction of states and enforcing the neoliberal agenda upon reluctant states in the global South. The United States, for example, increasingly uses certification mechanisms "to create laws for other States and to monitor its observance, while the United States itself remains unbound and unmonitored." N. Kirsch, *More Equal than the Rest? Hierarchy, Equality and US Predominance in International Law*, in UNITED STATES HEGEMONY AND THE FOUNDATIONS OF INTERNATIONAL LAW 161 (M. Byers and G. Nolte eds., 2003). This combines with "substantivism" in US courts "a choice-of-law methodology whose goal is to select the better law in any given case." H. L. Buxbaum, *Conflict of*

operations of American investment banks played a role in transforming not only financial markets but business practices in Europe and East Asia.[307] A truly global financial system "based on the deregulation and internationalization of the US financial system is neither a myth not even an alarming tendency, but a reality."[308] These redesigned rules of the game instantiate neoliberalism as the hegemonic global economic order.

With the neoliberal counterrevolution underway, equity markets in the U.S. began to rise propelled by inflow of funds from newly created funded pension schemes, and big companies increasingly started to rely on equity markets for finance.[309] In response, commercial banks pushed lending into more marginal markets and developed new financial instruments and fee-and-commission activities.[310] The banks expanded the scope of the market by hunting out economically marginal groups for mortgage and consumer credit. In this process, "[e]conomically marginal people constituted, in effect, *a 'developing country' within the United States*, and the banks' strategy was parallel to the way they recycled petrodollars from oil

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Economic Laws: From Sovereignty to Substance, 42 VA J, INT'L L 932, 957 (2002). This results in "over-application of US law" in international disputes, and acts "as a lever of forcing convergence … outside the political process that generally structures the harmonization movement." *Id*. at 966 and 972. *See also* J. BRAITHWAITE AND P. DRAHOS, GLOBAL BUSINESS REGULATION 475-7 (2000) (showing how this has impacted the fields of banking, securities regulation, civil aviation, cyber law). The multilateral form is exemplified by WTO's compulsory jurisdiction over disputes that lie within its extensive regimes which opens the door for unilateral prescriptions and measures related to trade and environmental policies of states in the global South. *See, e.g., United States – Import Prohibition of Certain Shrimp and Shrimp Products: Recourse to Article 21.5 of DSU by Malaysia* WT/DS58/AB/RW, 22 October 2001: report of the Appellate Body. *See also* B.S. Chimni, *WTO and Environment: The Legitimization of Unilateral Trade Sanctions*, ECO. & POL. WEEKLY, 133 Jan. 12, 2002; B. S. Chimni, *India and the Ongoing Review of the WTO Dispute Settlement System: A Perspective*, ECO. & POL. WEEKLY 264, 30 January 1999. Increasingly, courts of the global South are deemed unsuitable for adjudicating claims against multinational corporations, thus creating "new national frontiers of responsibility for the conduct of global capital." Upendra Baxi, *Mass Torts, Multinational Enterprise Liability and Private International Law*, 276 RECUEIL DES COURS 297, 312 (1999). *See also* H. Zhenjie, *Forum Non Conveniens: An Unjustified Doctrine*, 48 NETH. INT'L L. REV. 143 (2001); M. Anderson, *Transnational Corporations and Environmental Damage: Is Tort Law the Answer*, 41 WASHBURN L. J. 399 (2002).

[307] *See* R. C. SMITH, THE GLOBAL BANKERS 45-6 (1990).

[308] John Grahl, *Globalized Finance: The Challenge to the Euro*, 8 NEW L. REV. 43-44 (2001). *See also*, Robert Ward, *Globalization as the Institutionalization of Neoliberalism: Commodification, Financialization, and the Anchorless Economy*, in INSTITUTIONS AND MARKET ECONOMIES: THE POLITICAL ECONOMY OF GROWTH AND DEVELOPMENT 250-77(W. Garside ed., 2007).

[309] Wade, *The First-World Debt*, sputa note_ at 30.

[310] For practices of banks during this period, *see* JOHNSON AND KWAK, 13 BANKERS, *supra* note _ at 57-119; STIGLITZ, FREEFALL, *supra* note _ at 77- 108.

exporters to developing countries, especially Latin America, in the 1970s."[311] Lifting of New Deal banking restrictions and the 1988 Basel standards for bank capital adequacy accelerated the change towards fee and commissions and propriety trading of financial assets.[312] This originate-and-distribute model rested on creation of complex financial products and selling those quickly to investors and speculators around the world.[313] Rating agencies played a crucial supportive role.[314] The model grew exponentially after the mid-1990s, as bundling and securitization of debt became ubiquitous. Complexity of the financial products helped to conceal the risks from buyers, rating agencies, and regulators.[315]

The widening gap between the rich and the poor gave further impetus to financialization. In the US, for example, between 1973 and 2002, average real incomes of the bottom 90 percent fell by 9 percent, while incomes for the top one percent increased by 101 percent, and those of the top 0.1 percent rose 227 percent.[316] While in 1991, the wealthiest one percent of American's

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[311] Wade, *The First-World Debt*, sputa note_ at 31. Emphasis added.

[312] For detailed analyses, see NASSER SABER, SPECULATIVE CAPITAL: THE INVISIBLE HAND OF GLOBAL FINANCE (1999); PHILIP AUGAR, THE GREED MERCHANTS: HOW THE INVESTMENT BANKS PLAYED THE FREE MARKET GAME (2006).

[313] Anastasia Nesvetailova and Ronen Palan, *A Very North Atlantic Credit Crunch: Geopolitical Implications of the Global Liquidity Crisis*, 62:1 J. INT'L AFFAIRS 165, 170-1 (2008). The originate-and-distribute model entailed no incentive for banks to evaluate borrowers as the risk would be borne by the final buyer The originate-and-distribute model distanced lenders from the consequences of their lending decisions, thus injecting moral hazard into the heart of the financial system. *See* JOHNSON AND KWAK, 13 BANKERS, *supra* note _ at 60-87; STIGLITZ, FREEFALL, *supra* note _ at 6-17.

[314] Rating agencies role became move important as their stamp of approval over new financial instruments as investment-grade became the only signal of due diligence. Rating agencies however were marred by conflicts of interest. They depend on fees by referring parties and thus not obliging any and all *see*kers with their endorsement risked losing business. In addition, the rating agencies had a parallel business of advising how to structure financial products. The hope that the products on which they advised would later come before them for rating, gave them a double stream of revenue and incentives to overrate. The law leant a helping hand. Under U.S. securities law, rating agencies are entitled to take the information provided by a seller of a financial product more or less on face value without any legally binding obligation to their own due diligence about risks of the product. *See* Wade, *The First-World Debt*, *supra* note_ at 32. *See also*, JOHNSON AND KWAK, 13 BANKERS, *supra* note _ at 139140; STIGLITZ, FREEFALL, *supra* note _ at 92-94.

[315] *See* JOHNSON AND KWAK, 13 BANKERS, *supra* note _ at 74-87.

[316] McNally, *From Financial Crisis to World-Slump*, *supra* note _ at 60.

owned 38.7 percent of corporate assets, by 2003 their share rose to 57.5 percent.[317] While the wealthy needed ever newer financial instruments to invest in, the working poor turned to credit markets, particularly mortgages and credit cards, to sustain their living standards. In the loose monetary environment after 1997 and 2001, financial institutions were able to link both these demands – providing relatively cheap credit and then bundling and securitizing this debt to market to investors around the world. Loosened regulatory regimes allowed the financial sector to leverage and increase its own debt exponentially. Between 1980 and 2007, while US consumer-debt relative to GDP doubled, the financial-sector debt more than quintupled.[318] Demand for the complex financial products did not naturally flow from their supply, it had "to be created and liquidity relied critically on demand being whipped up."[319] The financial markets relied on the Federal Reserve to keep the system awash with liquidity to sustain the credit-driven financialization. Particularly in response to the dot.com crash of early 2000s, the Federal Reserve lowered interest rates and kept them low incessantly creating liquidity and a credit-fueled boom.[320] The supply of asset-backed securities doubled between 2003 and 2004, and doubled again between 2004 and 2005.[321]

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[317] *Id*.
[318] *Id*. at 61.
[319] Anastasia Nesvetailova and Ronen Palan, *A Very North Atlantic Credit Crunch: Geopolitical Implications of the Global Liquidity Crisis*, 62:1 J. OF INT'L AFFAIRS 165, 166 (2008).
[320] McNally, *From Financial Crisis to World-Slump*, *supra* note _ at 34-5. This, in turn, propelled "artificial liquidity," "liquidity black holes," liquidity illusion," and "ponzi finance," the ubiquitous characterizations of the financial boom that rested substantially on derivatives based on bundled and securitized sub-prime mortgages. *See*, Anastasia Nesvetailova and Ronen Palan, *A Very North Atlantic Credit Crunch: Geopolitical Implications of the Global Liquidity Crisis*, 62:1 J. OF INT'L AFFAIRS 165, 168 (2008). Liquidity can and does evaporate overnight. Assets that are easy to sell when market participants share a sense of optimism about their safety and profitability. When the sense of optimism evaporates, so does liquidity, leaving behind unwanted burdens of illiquid debt. *See* Hyman Minsky, *A Theory of Systemic Fragility*, in FINANCIAL CRISIS: INSTITUTIONS AND MARKETS IN A FRAGILE ENVIRONMENT (Edward Altman and Arnold Sametz eds., 2007); HYMAN MINSKY, CAN 'IT' HAPPEN AGAIN? (1982); ANASTASIA NESVETAILOVA, FRAGILE FINANCE: DEBT, SPECULATION AND CRISIS IN THE AGE OF GLOBAL CREDIT (2007).
[321] Wade, *The First-World Debt*, *supra* note_ at 35.

c. Scorecard of Neoliberal Re-regulation

The score-card of neoliberal counterrevolution shows spectacular gains for finance capital at the expense of the larger economy and the working classes.[322] The record of neoliberalism in stimulating economic growth remained dismal even before the 2007-09 financial meltdown. Annual growth rates in the quarter century after 1973, while higher than earlier period of global capitalism from 1820 to 1945, were below those achieved in the post-war "golden age."[323] While aggregate growth rates were about 3.5 percent in the 1960s and 1970s, in the 1980s they were 1.4 percent, in the 1990s 1.1 percent, and below 1 percent after 2000.[324] Income inequality increased in more than three-quarters of OECD countries between the mid-1980s and mid-2000s.[325] As the share of labor income shrank, the phenomenal expansion of the financial sector and its profits helped the share of business income in the OECD countries to rise from 28 percent in 1980 to 36 percent in 2003.[326] While in 1982, financial corporations generated 8 percent of total U.S. corporate value added and 5 percent of total corporate profits, by 2007, their share of corporate value added rose to 16 percent, and their share of corporate profits went up eight times to 41 percent.[327] By 2006, the profits per employee in banking were twenty-six times higher than the average in all other industries worldwide.[328] Between 1973 and 2002, average real income for the bottom 90 percent fell by 9 percent, for the top one percent

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[322] *See* Tony Cutler and Barbara Waine, *Social Insecurity and Retreat from Social Democracy: Occupational Welfare in the Long Boom and Financialization*, 8 REV. INT'L POL. ECON. 96 (2001),
[323] ANGUS MADDISON, THE WORLD ECONOMY, A MILLENNIAL PERSPECTIVE 265 (2001).
[324] HARVEY, NEOLIBERALISM , *supra* note_ at 33. (2007).
[325] OECD, GROWING UNEQUAL? INCOME DISTRIBUTION AND POVERTY IN OECD COUNTRIES, (2008).
[326] *See* Robert Wade, *Globalization, Growth, Poverty, Inequality, Resentment, and Imperialism*, in GLOBAL POLITICAL ECONOMY 373-409 (John Ravenhill ed., 2nd ed., 2008); WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 64.
[327] Wade, *The First-World Debt*, *supra* note_ at 33.
[328] Tony Jackson, *Has the Supercharged Banking Model Run Out of Control?,* FINANCIAL TIMES, Jan. 21, 2008. *Quoted in* Wade, *The First-World Debt*, *supra* note_ at 33.

rose by 101 percent, and for the top 0.1 percent rose by 277 percent.[329] The share of national income by the top 1 percent of earners in the U.S. fell from pre- World War II high of 16 percent to less than 8 percent by 1978. The neoliberal turn helped reverse the trend and by 2000, this share climbed back to 15 percent. Top 0.1 percent of income earners increased their share of the national income from 2 percent in 1978 to 6 percent by 1999. The ratio of median compensation of workers to the salaries of CEO increased from thirty to one in 1970 to more than four hundred to one in 2000.[330] Average hours worked by the average American have risen by equivalent to an extra month's work per year.[331] The household debt and the corresponding debt servicing burden grew exponentially.[332] The debt held by the US financial sector grew from USD 2.9 trillion, or 125 percent of GDP, in 1978 to over USD 36 trillion, or 259 percent of GDP, in 2007.[333] Between 1980 and 2000, assets held by the commercial banks and securities firms grew from 55 percent of GDP to 95 percent.[334] Financial sector profits grew for 13 percent of all domestic corporate profits from 1978 to 1987 to 30 percent from 1998-2007.[335] By 2004, the proportion of corporate profits in the US going to finance doubled to over 28 percent, the shares going to the broader financial sector, combining finance, real estate and insurance, doubled to nearly 50 percent.[336]

The new architecture of global finance did achieve another primary goal of the neoliberal counterrevolution. It helped to embed the imperial role of the U.S. into global financial flows. In

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[329] McNally, *supra* note _ at 60.
[330] TASK FORCE ON INEQUALITY AND AMERICAN DEMOCRACY, AMERICAN DEMOCRACY IN AN AGE OF RISING INEQUALITY 3 (2004); HARVEY, NEOLIBERALISM, *supra* note _ at 28. (2007)
[331] *See* JULIET B. SCHOR, THE OVERWORKED AMERICAN 23, Table 2.3 (1991).
[332] For the growth of U.S. household debt from 1980 to 2006, *see* WOLF, FIXING GLOBAL FINANCE, *supra* note_ at 107 Fig 4.31.
[333] JOHNSON AND KWAK, 13 BANKERS, *supra* note _ at 59.
[334] *Id*. at 85.
[335] *Id*.
[336] David Leonhardt, *Bubblenomics*, NEW YORK TIMES, September 21, 2008; Greta R. Krippner, *The Financialization of the American Economy*, 3 SOCIO-ECON. REV. 173 (2005); GERARD DUMENIL AND DOMINIQUE LEVY, CAPITAL RESURGENT: ROOTS OF NEOLIBERAL REVOLUTION CHAPTER 13 (2004).

particular, the deepening and the global expansion of financial markets also made it possible for global savings to flow to the U.S. at an unprecedented scale.[337] These capital flows are rightly seen as "an *imperial tithe* the US imposes on other countries."[338] It is because of the dominant imperial role of the U.S. in global finance that balance of payments deficits appear not to have the same implications for the U.S. as they do for any other state.[339] As early as 1971, the Federal Reserve of Boston pointed that "*this asymmetry appears to be appropriate, for it corresponds to an asymmetry in the real world*."[340] In tune with this position, Paul O'Neill, US Treasury Secretary, argued that for the US the current account was a "meaningless concept."[341] Alan Greenspan placed "the U.S. current account [deficit] far down the list of imbalances to worry about."[342] This is where an overwhelming non-market force comes into play, i.e., the U.S. imperial domination ensured that foreign exchange surplus from around the world, particularly from Asia, would fund escalating U.S. fiscal and current account deficits.[343] Under the weight of this factor, the theory that exchange rates adjust in response to external imbalances became inoperative for the U.S.[344] The imperial hegemon could now also become "the superpower of borrowing."[345] Global savings support the USD, while the ability to borrow in a currency that it

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[337] For comparative global current accounts in 2006, *see* WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 78 Fig 4.14.
[338] Panitch and Gindin, *Finance and American Empire*, *supra* note _ at 69. Emphasis added.
[339] For U.S. current account from 1970 to 2006, *see* WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 62 Fig. 4.3.
[340] *Quoted in* MICHAEL HUDSON, SUPER IMPERIALISM: THE ORIGINS AND FUNDAMENTALS OF U.S. WORLD DOMINANCE 327 (2003). Emphasis added. Kindleberger was also of the view that transactions underlying the deficit were largely a "trade in liquidity profitable to both sides," rather than a trade deficit or over-investment abroad as was commonly understood. CHARLES P. KINDLEBERGER, INTERNATIONAL MONEY: A COLLECTION OF ESSAYS 43 (1981).
[341] *The O'Neill Doctrine*, ECONOMIST, April 25, 2002.
[342] ALAN GREENSPAN, THE AGE OF TURBULENCE: ADVENTURES IN A NEW WORLD 347 (2007).
[343] WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 98-114.
[344] For change in value of foreign currencies against the USD between 2002 and 2007, *see* WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 96 Fig. 4.26. The patterns of global capital flows substantiate this development. Between 1996-2006, countries with the biggest external deficits experienced appreciation of real effective exchange rates, while countries with biggest surpluses tended to experience depreciation. UNCTAD, TRADE AND DEVELOPMENT REPORT, table 1.6 (2007).
[345] WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 4.

issues, the U.S. monetary and fiscal policy "suffers from no external constraints … not so much a free lunch as an apparently ongoing free banquet."[346]

The net effect of global neoliberal financial flows is to transfer capital from high-saving to low-saving countries.[347] This has translated into flows from less developed countries with high savings, particularly in Asia, to the industrialized economies, particularly the U.S.[348] The U.S. requires access to foreign capital as its household savings rate is the lowest among industrialized economies.[349] Its hard line in favor of unfettered capital mobility reflects its strategic interest in tapping the foreign savings pools, particularly those in Asia. As the U.S. turned from a net creditor to a net debtor in 1985, increased liberalization of global finance enhanced its ability to sell its debt globally.[350] In the absence of the gold standard, US Treasury bills have come to stand for the world's monetary reserve. Today the U.S. Treasury market is the largest, the deepest, and the most liquid financial market around with USD 4.84 trillion in securities, and about USD 531 billion transactions daily.[351] The resulting inflow of capital keeps the USD high, and allows American consumers to import goods cheaply.

The escalating US current-account deficit and credit-driven consumer spending allowed the US economy to function as "the 'Keynesian engine' of the global economy."[352] As the US

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[346] WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 100, 112.
[347] For savings, investment, and current account of high-income, emerging market, and oil exporting countries, *see* WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 66 Fig. 4.5, 67 Fig. 4.6
[348] For current account balances of developing economies, *see* WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 38 Fig. 3.2.
[349] Robert Wade and Frank Veneroso, *The Gathering World Slump and the Battle Over Capital Controls*, 231 NEW LEFT REV. 41 (1998); Robert Wade, *The Coming Fight Over Capital Controls*, 113 FOREIGN AFFAIRS, December 22, 1998, at 41.
[350] *See* Matthias Thiemann, *American hegemony and the ascendance of direct finance*, 62:1 J. OF INT'L AFFAIRS 244 (2008); LEONARD SEABROOKE, U.S. POWER IN INTERNATIONAL FINANCE: THE VICTORY OF DIVIDENDS 111 (2001).
[351] Konings, *American Finance* , *supra* note _ at 72. In light of 2007-09 financial meltdown and continuing vulnerabilities of the U.S. economy, there is the possibility that "US treasuries are a safe haven the way Pearl Harbor was a safe haven in 1941." Ferguson, *Fiscal Crises and Imperial Collapses*, *supra* note _ at 11.
[352] McNally, *From Financial Crisis to World-Slump*, *supra* note _ at 63.

economy became "the consumer of last resort," by 2000, US imports accounted for one-fifth of world-exports and four percent of world GDP.[353] This could be sustained only at the cost of an USD 857 billion current-account deficit by 2006.[354] While no other country could have sustained such deficits, foreign capital kept pouring into the US economy.[355] It was only in 2002, as overcapacity weighed down profit-rates, and vulnerability of the US economy started to show signs, that private investors started to move out of USD-based investments.[356] Private-capital flows into the US turned abruptly negative in the third quarter of 2007, with an annualized out flow of USD 234 billion while the previous quarter had an inflow of USD 823 billion.[357] What saved the USD at this juncture was again the non-market force of imperial domination - continued investment by central banks in East Asia and oil-producing Middle-Eastern states induced by considerable prodding by U.S. political authorities.[358] Today, China is, in effect, the banker of the US.[359] In 2006, China's increase of foreign exchange holdings almost matched the net issuance of US Treasury and government bonds."[360] Centuries ago, nearly a third of the silver from the Americas that tripled Europe's supply ended up in China in exchange for silks, spices,

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[353] *Id*.
[354] *Id*.
[355] For global surplus savers and the U.S. as borrower between 1995 and 2006, *see* WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 121 Fig. 5.3.
[356] ROBERT BRENNER, THE ECONOMICS OF GLOBAL TURBULENCE 237 (2006).
[357] GRAHAM TURNER, THE CREDIT CRUNCH: HOUSING BUBBLES, GLOBALIZATION AND THE WORLDWIDE ECONOMIC CRISIS 90-91 (2008).
[358] McNally, *From Financial Crisis to World-Slump*, *supra* note _ at 65. For global current account balances between 1997 and 2007, *see* WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 79 Fig. 4.15. For financing of the U.S. current account, *see id*. at 123 Fig 5.4
[359] FERGUSON, ASCENT, *supra* note _ at 335. In 2008, when Bank of China cut its exposure to U.S. Treasury bills, Treasury Secretary Paulson "found himself with a fait accompli. The federal government had to give reassurances to foreign investors in agency debt if it wanted to avoid chaos in financial markets and a run on the dollar." John Grapper, *A US Government Bail-out of Foreign Investors*, FINANCIAL TIMES, September 8, 2008, at A1. Grapper added: "It smacks of debt crises past in Latin American countries, where the ultimate pressure for a bail-out came from foreign investors." *Id.*
[360] FERGUSON, ASCENT, *supra* note _ at 335. For the balance of payments of China from 1996 to 2007, *see* WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 86 Fig 4.19.

and other goods that Europe imported.[361] Today, U.S. imperial weight is able to bring back Chinese foreign exchange surplus to the U.S. Global finance profits from this development as the growing Chinese surpluses and growing U.S. deficits generated a surge in global credit relative to gross world product.[362] While China's ability to supply consumer goods at a low price kept consumer price inflation in check, reinvestment of China's surplus in the U.S. helped propel asset price inflation, including in property and financial assets.[363] Ballooning U.S. trade deficits were matched by rapid growth of world's foreign exchange reserves, mostly denominated in USD. Global foreign exchange reserves doubled between 2004 and 2008, increasing as much as they had in the previous century.[364] Global finance capital profits from this unprecedented global movement of capital, while the U.S. feeds off global savings and foreign exchange surpluses.[365]

d. Transforming the IMF into the Global Enforcer of Neoliberalism

With the neoliberal global financial reordering underway, captains of global finance understood that, as Robert Rubin put it, "periodic financial crises of one sort or another are virtually inevitable," and that the U.S. would act as "chief of the fire department."[366] The IMF now became, in Larry Summer's words, "the cheapest and most effective way" to promote U.S. interests in international financial affairs.[367] This required repositioning of the IMF as the global

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[361] FERNAND BRAUDEL, CIVILIZATION AND CAPITALISM, 15TH-18TH CENTURY vol. 2 at 198, vol. 3 at 490-91 (Stan Reynolds trans., 1992).
[362] Wade, *The First-World Debt*, *supra* note_ at 36.
[363] *Id*.
[364] *Id*, _ at 37. *See also* RICHARD DUNCAN, THE DOLLAR CRISIS: CAUSES, CONSEQUENCES, AND CURE (2005).
[365] For a comparative chart of net savers and net lenders in 2006, *see* WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 68 Fig. 4.7.
[366] ROBERT RUBIN AND JACOB WEISBERG, IN AN UNCERTAIN WORLD: TOUGH CHOICES FROM WALL STREET TO WASHINGTON 213-15 (2004).
[367] *Quoted in* EVA RIESENHUBER, THE INTERNATIONAL MONETARY FUND UNDER CONSTRAINT: LEGITIMACY OF ITS CRISIS MANAGEMENT 125 (2001). *See also*, Ruth Felder, *From Bretton Woods to Neoliberal Reform: The*

enforcer of the new neoliberal order. The role of the U.S.-dominated IMF was changed from being a currency stabilization fund to that of a manager of foreign debt crises. Concurrently, the IMF became a global enforcer of neoliberalization through structural adjustment programs imposed upon any state that needed its assistance with debt repayments. Debt crises are now used to enforce fiscal austerity, privatization, and market liberalization, the interlinked pillars of the Washington Consensus.[368] In 1978 IMF's Articles of Agreement were amended to redefine surveillance and expanded the scope of state policies that could be subjected to IMF scrutiny.[369] New Guidelines on Conditionality released in 1979 ratified the expanded surveillance power and laid the basis for conditionality of structural adjustment that would henceforth accompany IMF assistance.[370] In order to perform its new mandate the IMF purged Keneysian economists from its ranks in 1982 and replaced them with neoliberal monetarists.[371] Concurrently the World Band was turned into "strictly a junior partner, with the guidelines of the programs dictated by the IMF."[372] World Bank's lending was switched from project-loans to structural adjustment loans subject to IMF's approval and accompanied by IMF-imposed conditionalities.[373]

As the Bretton Woods schema of capital controls yielded to neoliberal orthodoxy, IMF which was "founded on the belief that markets often worked badly, now champions market supremacy with ideological fervor."[374] Keynesian cautions about international capital mobility were jettisoned. The new IMF dogma about unfettered mobility of capital was summed by Stanley Fischer, then chief economist of IMF: 'free capital movements facilitate a more efficient

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International Financial Institutions and American Power, in AMERICAN EMPIRE AND POLITICAL ECONOMY OF GLOBAL FINANCE 175-184 (Leo Pantich and Martijin Kinings, eds., 2009).
[368] JOSEPH E. STIGLITZ, GLOBALIZATION AND ITS DISCONTENTS 53-88 (2002).
[369] ERIC HELLEINER, STATES AND THE REEMERGENCE OF INTERNATIONAL FINANCE, *supra* note _ at 110.
[370] Louis Pauly, *Good Governance and Bad Policy: The Perils of International Organization Overextension*, 6:4 REV. OF INT'L POL. ECON. 401, 415(1999).
[371] HARVEY, NEOLIBERALISM , *supra* note_ at 32. (2007).
[372] STIGLITZ, GLOBALIZATION , *supra* note _ at 14.
[373] *Id*, at 13-14.
[374] *Id*. at 12.

global allocation of savings, and help channel resources into their most productive uses, thus increasing economic growth and welfare."[375] This is contrary to the historical record, which shows that periods of high international capital mobility have repeatedly produced international banking crises.[376] Indeed, financial liberalization often precedes banking crises; indeed it helps predict them.[377]

As a condition of providing loans to overcome balance of payment crises, IMF dictates macroeconomic policies of the debtors "leaving domestic governments with little scope for input."[378] The new IMF policies "reflect a quite extreme free market ideology."[379] Conditionalities to availability of funds now required structural adjustment programs, a policy package widely labeled "the Washington Consensus" dictated a comprehensive neoliberal economic policy.[380] The package typically includes, "harsh fiscal austerity,"[381] privatization, and

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[375] Stanley Fischer, *Capital Account Liberalization and the Role of the IMF*, September 19, 1997. *Accessed* July 21, 2010, at http://www.imf.org/external/np/apd/asia/FISCHER.HTM. Calling the apex of global financial management the "Wall Street-Treasury complex," noted international economist, Jagdish Bhagwati, argued that "it is a lot of *id*eological humbug to say that without free portfolio capital mobility, somehow the world cannot function and growth rates will collapse. Interview in TIMES OF INDIA, December 31, 1997, *quoted in* Robert Wade and Frank Veneroso, *The Asian Crisis*, *supra* note _ at 18-19.

[376] REINHART AND ROGOFF, THIS TIME IS DIFFERENT, *supra* note _ at 155.

[377] Graciela L. Kaminski and Carmen M. Reinhart, *The Twin Crisis: The Causes of Banking and Balance-of-Payment Problems*, 89:3 AM. ECON. REV. 473 (1999); Asli Demirguc-Kunt and Enrica Detragiache, *The Determinants of Banking Crisis in Developing and Developed Countries*, 45 IMF STAFF PAPERS 81 (1998). *Accessed* June 11, 2010, at http://204.180.229.21/external/pubs/ft/staffp/1998/03-98/pdf/demirguc.pdf; REINHART AND ROGOFF, THIS TIME IS DIFFERENT, *supra* note _ at 159 .

[378] ROSS P. BUCKLEY, INTERNATIONAL FINANCIAL SYSTEM: POLICY AND REGULATION 11 (2009).

[379] *Id*. at 12.

[380] Typically, the package includes fiscal discipline, taxation reform, liberalization of interest rates, protection of property rights, privatization of industries and services, deregulation of markets, floating exchange rates, liberalization of trade, and removal of barriers to foreign direct investment. John Williamson, *What Washington Means by Policy Reform*, in LATIN AMERICAN READJUSTMENT: HOW MUCH HAS HAPPENED ? (John Williamson ed., 1989).

[381] Susan George, *A Short History of Neo-liberalism: Twenty Years of Elite Economics and Emerging Opportunities for Structural Change* (1999). *Accessed* July 14, 2010 at http://www.globalexchange.org/campaigns/econ101/neoliberalism.html; SUSAN GEORGE, A FATE WORSE THAN DEBT: THE WORLD FINANCIAL CRISIS AND THE POOR (1990).

liberalization.[382] If a country rejects IMF mandates, it also forfeits the right to assistance from the World Bank.[383]

The IMF today "reflect[s] the interests and ideologies of the Western financial community,"[384] and IMF conditions go "beyond economics into areas that properly belong in the realm of politics."[385] It symbolizes "*global governance without global government*"[386] The IMF decisions are "a curious blend of ideology … bad economics …[and] thinly veiled special interests."[387] The contradictory prescriptions to cope with financial crises - structural adjustment in the Global South versus monetary easing in the Global North - emerged as the IMF was redesigned to impose structural adjustments on debtor countries in the 1980s in response to the Latin American debt crisis. Besides, the austerity imposed by the IMF aims to prevent the turmoil from spreading to the Global North, while monetary easing aims to end the turmoil itself.[388]

As part of the "Big Push … to institute a world-wide regime of capital mobility," [389] the Wall Street-Treasury-IMF complex also worked hard to promote the WTO's agreement on liberalizing financial services. In response to resistance from developing economies, "Executives of groups including Barclays, Germany's Dresdner Bank, Societe Generale of France and Chubb

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[382] Supervising comprehensive reordering of economies of former Soviet Union and Eastern Europe furnished opportunity to the IMF to legitimize its operations beyond its traditional concern with balance-of-payment adjustments and to enforce its prescriptions on a continental scale. Wade and Veneroso, *The Asian Crisis*, *supra* note _ at 18.
[383] *Id*. at 12.
[384] STIGLITZ, GLOBALIZATION , *supra* note _ at 130.
[385] *Id*. at 44-45.
[386] *Id*. at 21.
[387] *Id*. at xiii.
[388] Rude, *supra* note _ at 92. When faced with the financial meltdown, US authorities "chose the blank check option, over and over again. … the opposite of what the US had pressed upon emerging market governments in the 1990s." Simon Johnson and James Kwak, 13 Bankers, The Wall Street Takeover and the Next Financial Meltdown 173 (2010). If IMF prescribed to the US the same remedy as it does to the Global South, it would be "nationalize troubled banks and break them up as necessary." *Id*.
[389] Wade and Veneroso, *The Asian Crisis*, *supra* note _ at 19-20.

Insurance, Citicorp, and Ford Financial Services of the US … agreed discreetly to impress on finance ministers around the world the benefits of a WTO deal."[390] Again, a debt crisis was used to accomplish the objective. As the Asian crisis heated up, Asian leaders dropped their objections as they "saw no choice: either they signed or their receipt of IMF bailout funds would be complicated." [391] On December 12, 1997, more than 70 countries signed the agreement that commits them to open banking, insurance and securities markets to foreign firms. In 2000, two publicists of neoliberalism claimed with satisfaction that "[t] Today's international system is built not around a balance of power but around American hegemony. The international financial institutions were fashioned by Americans and serve American interests."[392]

With the neoliberal financial regulatory regime of the U.S., the repositioning of the IMF, and WTO's agreement on financial services in place, the hegemony of global finance capital under the U.S, imperial umbrella was complete.[393] This neoliberal global financial regime thrives not only during phases of stability and growth, but also during phases of instability and crises.[394] This is the context in which international debt crises increasingly served to entrench neoliberalism globally while feeding finance capital through accumulation by dispossession. We now turn to some of the signal moments in this journey.

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[390] Guy de Jonquieres, *Vision of a Global Market: WTO Members are Hoping to Deregulate Financial Services*, FINANCIAL TIMES , April 10, 1997, at 28.
[391] Wade and Veneroso, *The Asian Crisis*, *supra* note _ at 19-20.
[392] Robert Kagan and William Kristol, *quoted in* GOWAN, A CALCULUS OF POWER, *supra* note _ at 17.
[393] The U.S. domination of this global financial order is evidence by the fact that during the Mexican debt crisis of the mid-1990s, the U.S. Treasury without even consulting European or Japanese simply instructed the IMF to bailout U.S. bond-holders overnight, and channeled IBS resources towards that objective. GOWAN, A CALCULUS OF POWER, *supra* note _ at 9.
[394] *See* PETER GOWAN, THE GLOBAL GAMBLE: WASHINGTON'S FAUSTIAN BID FOR WORLD DOMINATION 35 (1999); NAOMI KLEIN, THE SHOCK DOCTRINE: THE RISE OF DISASTER CAPITALISM (2007).

IV. International Debt Crises and Accumulation by Dispossession

d. Latin America: From Petroleum to Tequila

By the mid-1970s, "hot money, which had been outlawed at Bretton Woods, was hot again."[395] Its first victim was Latin America, particularly Mexico. The debt crisis that it triggered in Latin America in 1982 was one of the most damaging and far reaching financial crises of the 20th century.[396] Ever since independence in the early nineteenth century, debt crises have been a recurrent feature of Latin American states. [397] However, these crises were linked to the boom and bust cycle of the economies of the region, and matched neither the scale of the 1980s crisis nor the new vulnerability of the region to external machination. Historically, foreign capital had come to Latin America through bonds, direct foreign investment, and official loans.[398] Starting in the early 1970s lending by major U.S. banks rapidly became the major source of foreign capital.[399]

The fiction has been long cultivated that bad loans are always the debtor's fault.[400] However, in the case of Latin American, as in subsequent cases, opportunistic and imprudent overlending by the banks fueled by access liquidity was the primary cause of excessive debt and

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[395] FERGUSON, ASCENT, *supra* note _ at 310.
[396] *See* CARLOS A.. MARCHAL, A CENTURY OF DEBT CRISES IN LATIN AMERICA 95 (1999); J. Livingston, *The International Financial System: A Flawed Architecture*, 23 FLETCHER FORUM OF WORLD AFFAIRS 1 (1999).
[397] MARCHAL , *supra* note _ at 238.
[398] F. G. DAWSON, THE FIRST LATIN AMERICAN DEBT CRISIS: THE CITY OF LONDON AND THE 1822-1825 LOAN BUBBLE 237 (1990).
[399] B. Eichengree and R. Portes, *After the Deluge: Defaults, Negotiations and Readjustments during the Interwar Years*, , in THE INTERNATIONAL DEBT CRISIS IN HISTORICAL PERSPECTIVE (B. Eichengreen and P. H. Linder eds., 40-41 (1989). By the early 1980s the total exposure of US banks to Latin America represented 176 % of bank capital, and the 1983 exposure of the nine largest US banks to Argentina, Brazil, and Mexico was 115% of the capital of those banks. Jeffery D. Sachs, *Introduction*, in DEVELOPING COUNTRY DEBT AND THE WORLD ECONOMY 11 (Jeffery D. Sachs ed., 1989). For net capital flow to Latin America between 1980 and 2006, *see* WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 47 Fig. 3.8.
[400] Livingston, *supra* note _ at 36-37. Emerging market borrowing tends to be extremely procyclical; favorable terms of terms of trade lead to high borrowing and with drops in commodity prices borrowing collapses and defaults go up. *See* Mark Aguiar and Gita Gopinath, *Emerging Market Business Cycles: The Cycle is the Trend*, 115:1 J. OF POL. ECON. 69 (2007).

the subsequent crisis.[401] The massive lending to Latin America by U.S. banks in the 1970s was a prime mechanism to recycle petro dollars - the massive transfer of funds to the OPEC cartel as a result of the quadrupling of oil prices in 1973-74.[402] The U.S. had quietly favored the oil price hike as a means of regaining competitive edge against Europe and Japan given their comparatively larger dependence on imported oil.[403] The petrodollars quickly flowed back to Eurodollar deposits of U.S. banks.[404] The oil price hike had also triggered a recession in industrialized countries, and the resulting weakness of internal demand came at a time when the major US banks were losing market share at home and this made foreign lending more attractive.[405] New markets were quickly found in the Global South, and the surplus capital in the U.S. started funding a lending boom in Latin America.[406] Large US banks dominated the syndicated lending to Latin America, though Canadian, European and Japanese banks also participated.[407] Europe and Japan also used these loans to improve their trade balance, by shifting to the Global South their trade deficits with OPEC.[408] This recycling of petro-dollars was

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[401] UNCTC, TRANSNATIONAL BANK BEHAVIOR AND THE INTERNATIONAL DEBT CRISIS, 50-51(September 1989). Even a former General Manager of BIS takes the position that behavior of lenders and investors from the industrialized world played a major role in spurring financial crises in developing countries. *See* ALEXANDRE LAMFALUSSY, FINANCIAL CRISES IN EMERGING MARKETS 47-66 (2000).

[402] *See* FERGUSON, ASCENT, *supra* note _ at 309.

[403] *See* PETER R. ODELL, OIL AND WORLD POWER 223-225 (8th ed. 1986). This was not the first or the last time the US actively orchestrated formation of global cartels. For example, the US State Department and other agencies actively supported the establishment of a global aluminum cartel following the plummeting of aluminum prices in 1994. A central actor in this development was Paul O'Neil, CEO of Alcoa and later Treasury Secretary. *See* STIGLITZ, GLOBALIZATION, *supra* note _ at 173-176.

[404] By the end of 1975, 13.8 billion OPEC dollars had been deposited in US banks. PHILIP A. WELLONS, WORLD MONEY AND CREDIT: THE CRISIS AND ITS CAUSES 23 (1983).

[405] P. A. WELLONS, WORLD MONEY AND CREDIT: THE CRISIS AND ITS CAUSES 27 (1983).

[406] MARCHAL , *supra* note _ at 95, 41-42; FERGUSON, ASCENT, *supra* note _ at 309.

[407] BUCKLEY, INTERNATIONAL FINANCIAL SYSTEM, *supra* note _ at 22, *quoting* a United Nations study.

[408] P. A. WELLON, PASSING THE BUCK: BANKS, GOVERNMENTS AND THE THIRD WORLD DEBT 58-63 (1987). Between 1973 and 1979, the trade surplus of France with its former colonies in Africa increased for 550 million to 2.2 billion dollars. UNCTC, TRANSNATIONAL BANK BEHAVIOR AND THE INTERNATIONAL DEBT CRISIS, 11-12 (September 1989).

presented as a positive development and "banks were applauded for smoothing the transition to higher oil prices."[409]

The lending banks were very aggressive in marketing these loans and came to "depend on income from special deals with riskier clients willing to pay higher fees, commissions and interest to gain market access."[410] In the rush to lend mounting petrodollar deposits, "the banks sent salesmen to Mexico, not analysts."[411] The majority of the loans went to major industrial, oil and energy corporations of the region, many of which were wholly or partially state-owned, and state-owned development banks.[412] And as loans became due, "new lending to repay old loans made sense in the circumstances."[413] Banks found comfort in the fact that, as the Chairman of Citicorp put it, "Countries never go bankrupt."[414] The primary beneficiaries of the loans were "technocrats, generals, and businessmen who received secret commissions and contracts on the huge flow of foreign funds. In no period of modern Latin American history has financial corruption reached such heights."[415] The massive debt was accompanied by massive capital flight from Latin America. The capital flight was propelled, one the one hand, by the incentives of the combination of high exchange rates and the history of inflation in the region, and, on the other, to distance assets from its often tainted origins. During the 1970s, which Mexico accumulated 75 billion on foreign debt, its private sector accumulated 40 billion of foreign

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[409] *See*, e.g., Jonathan D. Aronson, *International Lending and Debt*, 6:4 THE WASHINGTON Q. 62, 66 (1983).
[410] UNCTC, DEBT EQUITY CONVERSIONS – A GUIDE FOR DECISION- MAKERS 24 (1991).
[411] DARRELL DELAMAIDE, DEBT SHOCK: THE FULL STORY OF THE WORLD CREDIT CRISIS 102 (1984).
[412] MARCHAL , *supra* note _ at 235.
[413] Sachs, *supra* note _ at 9.
[414] *Quoted in id*. at 8. The massive lending was proving very profitable. In the case of Citibank, for example, 72% of its 1976 earnings came from its international operations, and in 1977 profits from its Brazilian business exceeded those from its entire US operation. *Id*.; DARRELL DELAMAIDE, DEBT SHOCK: THE FULL STORY OF THE WORLD CREDIT CRISIS 117 (1984).
[415] MARCHAL , *supra* note _ at 238. This underscores that benefits and costs of liberalized financial flows accrue differentially within societies. Note that "crony capitalism" has been characterized as "the market economy's most familiar and durable form." WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 14.

assets.[416] In 1980-81, outflow of private capital from Argentina was 84% of the inflow of debt, and in the case of Venezuela, the outflow exceeded the inflow.[417] For Argentina, Mexico, and Venezuela combined, the three countries hit hardest by the debt crisis, capital flight during 1979-1982 amounted to 67% of capital inflows.[418]

The primary trigger of the debt crisis was the 1979 Volcker Shock that dramatically raised U.S. interest rates.[419] As a spillover, Euromarket interest rates doubled between 1978 and 1981, peaking at 19.5% in March 1980.[420] Given their recently accumulated debt load, "the effect on the borrowing developing nations was catastrophic."[421] Aggressive monetary policy in advanced capitalist countries, particularly the U.S., designed to prevent domestic inflation, "imposed a frightful cost on the less developed world under the very loans the OECD governments had encouraged their banks to make."[422] When the crisis hit, banks resisted advancing new funds,[423] and Latin American governments imposed harsh austerity measure "at the behest of creditors,"[424] The banks had no doubt who was responsible for the debt crisis: "debtor's inappropriate demand management and recourse allocation policies prior to 1982, and their inadequate adjustment to the adverse global environment that followed."[425] This view of

[416] Sachs, *supra* note _ at 12.
[417] *Id*. at 9.
[418] WORLD BANK, WORLD DEVELOPMENT REPORT 64 (1985).
[419] For the Volcker Shock, *see supra* notes _ and accompanying text.
[420] BUCKLEY, INTERNATIONAL FINANCIAL SYSTEM, *supra* note _ at 27, f.n.71.
[421] Robert A. Pastor, *The Debt Crisis: A Financial or a Development Problem?* in LATIN AMERICA'S DEBT CRISIS: ADJUSTING TO THE PAST OR PLANNING FOR THE FUTURE 8 (Robert A. Pastor ed., 1987).
[422] *Id*. _ at 35-37.
[423] R. Macmillan, *The Next Sovereign Debt Crisis*, 31 STANFORD J. INT'L L. 328-329 (1995).
[424] BUCKLEY, INTERNATIONAL FINANCIAL SYSTEM, *supra* note _ at 39..
[425] Chief Economist of Morgan Guarantee Trust Company, *quoted in id*. at 25-26.

responsibility justified banks' resistance to debt relief resulting in "appalling human suffering."[426]

The decisive response to the crisis was not market-driven but was choreographed by the U.S. state. As the crisis escalated and triggered political instability, the U.S. Treasury Department stepped in. After the aborted "Baker Plan," the "Brady Plan" was put in place in 1990.[427] Skirting the option of debt forgiveness by official lenders to ease the debt burden, it focused on the debt to commercial banks through conversion of loans into collateralized bonds and debt-equity swaps. In the case of Mexico, to make the restructuring plan attractive to the banks, the SEC issued a new interpretation of Financial Accounting Standards (FAS 15) whereby banks did not have to recognize a loss if "the total future undisclosed cash receipts specified by the new terms of the loan, including receipts designated as both principal and interest, equal or exceed the book value of the loan."[428] "Turning reality on its head," SEC created a mechanism to treat interest as principle and make the value of the loan in thirty years equal to its current value.[429] After Congress rejected the Treasury's bailout proposal, Treasury moved ahead without congressional approval and "strong-armed other governments to participate," and "seemed to revel in its ability to outsmart Congress."[430] After conservable arm-twisting by regulators, banks converted 41% of the total debt into discounted principal bonds, 49% into discounted interest bonds, and advanced new money for the remaining 10%.[431]

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[426] Ross P. Buckley, *The Facilitation of the Brady Plan: Emerging Market Debt Trading from 1989 to 1993*, 21 FORDHAM INT'L L. J. 1803-1818 (1993).
[427] For details, see BUCKLEY, INTERNATIONAL FINANCIAL SYSTEM, *supra* note _ at 39-54.
[428] July 14, 1989, SEC letter, *reproduced in* J. Hays and N. PAUL, REGULATION AND TAXATION OF COMMERCIAL BANKS DURING THE INTERNATIONAL DEBT CRISIS 128 (1991).
[429] BUCKLEY, INTERNATIONAL FINANCIAL SYSTEM, *supra* note _ at 43-44.
[430] STIGLITZ, GLOBALIZATION, *supra* note _ at 256, f.n. 10.
[431] BUCKLEY, INTERNATIONAL FINANCIAL SYSTEM, *supra* note _ at 44. These are aggregate figures. Banks of different countries chose different combinations of the three parts. German banks converted most of their share into par bonds, Japanese banks chose discount bonds. Only US and French banks advanced new funds. Differences in regulatory and tax regimes accounted for the variations. *Id*. at 44-45.

For the banks the restructuring worked out rather well. It signaled an end of the debt crisis to the broader markets, and debtor countries could borrow and issue bonds again, generating fees for the banks. Loans having been converted into bonds, distressed assets went off the balance sheets and freed up capital for other uses. It gave the banks liquid bonds in place of the relatively illiquid loans, and triggered a turn-around in secondary market prices of these assets. By 1997, USD 305 billion of loans and USD 2,403 billion of Brady bonds were traded in secondary markets.[432] While the Brady Plan resolved the debt crisis from the perspective of creditors, the debt remains in place, to be serviced at the cost of domestic development and social services expenditures. Between 1982 and 1990, Latin America repaid far more than it received in new credits.[433] Total indebtedness of Mexico, the country hardest hit by the crisis, remained unchanged as the relief afforded by the discounted bonds was offset by new loans. While before restructuring, Mexico's net annual transfer to lending banks was USD 3.24 billion, after the restructuring it was USD 3.59 billion.[434] The debt-servicing burden was borne by the most vulnerable denied health, education, housing, and life with dignity. The economic cost of the Latin American debt crisis was over two percent growth per year for the 1980s, and as a result it is considered the "lost decade in Latin America."[435]

The cycle repeated itself in Mexico within ten years in the shape of the so-called "tequila crisis," which spilled over into other Latin American economies.[436] By 1993, "60 million more

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[432] *Id*. at 53.
[433] Sachs, *supra* note _ at 10.
[434] BUCKLEY, INTERNATIONAL FINANCIAL SYSTEM, *supra* note _ at 46.
[435] *Id*. at 22.
[436] Just when there was talk of the "new" Latin America, and the "Mexico miracle" following a lending boom of the 1990s, the so-called "tequila crisis" hit Mexico in late 1994. PAUL KRUGMAN, THE RETURN OF DEPRESSION ECONOMICS AND THE CRISIS OF 2008 31-32 (2009). Prescribed tight monetary policy had kept the peso high and hurt Mexico's exports. The current account deficit was being made up by a capital account surplus – selling assets to foreign investors. In December 1994, Mexico devalued the peso, hot capital made for the exits, and the peso tumbled to half its pre-crisis value and by early 1995, Mexico was paying investors an interest rate of 75 percent. *Id.* at 47-48. During 1995, Mexico's GDP plunged 7 percent and its industrial production by 15 percent, and the

Latin Americans had been driven below the poverty line, bringing the total to nearly half of the population."[437] A decade later, wages for Mexican workers were lower and inequality higher.[438] When all was over, the big winners were the lending banks and the wealthy and politically well-connected borrowers, and the losers were the tax-payers and the impoverished.[439] In yet another instance of accumulation by dispossession, extra-market forces had choreographed the market to facilitate accumulation of capital.

e. Asian Flu and the Second Opium War

In light of the fire sale of Asian assets to foreign interests triggered by the Asian debt crisis,[440] it is evocatively dubbed "The Second Opium War"[441] Nobel Laureate economist Joseph Stigler, who observed the crisis closely, argues that "capital account liberalization was *the single most important factor leading to the crisis*."[442] In a similar vein, Nobel laureate economist James Tobin takes the view that Asian countries were "victims of a flawed international exchange rate system that, under U.S. leadership, gives the mobile of capital priority over all other considerations."[443] The debt that became a problem in Asia was private, as opposed to public or

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financial crisis started to spill to other Latin American countries. *Id*. at 48. Mexico had to be rescued with a USD 50 billion. *Id*, at 51. The cost of Mexico's bank rescue in 1994-97 was equal to 15 percent of its GDP and a substantial part of that went to owners of banks. STIGLITZ, FREEFALL, *supra* note _ at 41.

[437] D. Green, *Hidden Fist Hits the Buffers*, NEW INT'L, October 1995, at 35.

[438] STIGLITZ, FREEFALL, *supra* note _ at 42.

[439] This is tune with the broader pattern that once a debt crisis has passed "the big winners are the wealthy, politically influential risk takers, and the biggest losers are the taxpayers in countries like Mexico or Indonesia." Charles W. Calomiris, *The IMF's Imprudent Role as Lender of Last Resort*, 17 CATO J. 275, 276-277 (1998).

[440] STIGLITZ, GLOBALIZATION, *supra* note _ at 129-30.

[441] Wade and Veneroso, *The Asian Crisis*, *supra* note _ at 14. For detailed accounts of the First Opium War (1840-42), *see* CARL TROCKI, OPIUM, EMPIRE AND THE GLOBAL POLITICAL ECONOMY: A STUDY OF THE ASIAN OPIUM TRADE 1750 – 1950 (1999); PETER WARD FAY, OPIUM WAR, 1940-1842 (1998).

[442] *Id*. at 99.

[443] James Tobin, *Why We Need Sand in the Market's Gears*, WASHINGTON POST, December 21, 1997.

quasi-public as the case in Latin America. It started as a currency crisis and metastasized into a general economic crisis with long-term impact on the region and beyond.

The Asian crisis struck when no one expected it. As opposed to the Latin American crises of the 1980s, the Asian crisis occurred within "a benign international environment with low interest rates and solid growth in output and exports."[444] Interest rates in the lending countries were low and stable, bank lending was rising to record levels, Asian economies were booming, and rating agencies were lavishing praises upon the governments in the region.[445] The macroeconomic fundamentals were strong – low inflation, healthy fiscal profiles, and stable or rising exchange reserves. In the 1990s, the region, while accounting for a quarter of world output, accounted for over half of world growth and almost two-third of world capital spending.[446] During 1990-96, capital formation in East Asia (excluding Japan) jumped by nearly 300 percent, while it was 40% in US and Japan, and a mere 10% in Europe.[447] International debt crises arise when a country's total indebtedness exceeds its capacity to service the debt. The measures of this capacity are debt-export ratio and debt-service ratio. These crises are generally signaled by a debt-export ratio over 200%, and a debt-service ratio over 20%.[448] These ratios for East Asia and Pacific region were 99% and 12% respectively in 1996.[449] Consequently, this was not a conventional debt crisis. The countries at the center of the Asian crisis were following neoliberal prescription to the letter. Tight fiscal and monetary policies, low inflation, high private savings and investment rates, open capital markets and export-led growth had come to define

[444] THE WORLD BANK, 1 GLOBAL DEVELOPMENT FINANCE 1998 4, 30 (1998).
[445] Wade and Veneroso, *The Asian Crisis*, *supra* note _ at
[446] *Id*. at 4.
[447] ROBERT BRENNAR, THE ECONOMICS OF GLOBAL TURBULENCE 300 (2006)
[448] Jonathan D. Aronson, *International Lending And Debt*, 6:4 THE WASHINGTON Q. 62, 68 (1983).
[449] THE WORLD BANK, 1 GLOBAL DEVELOPMENT FINANCE 1997 160 (1997).

these "Asian Tigers" and the "Asian miracle."[450] These countries, with some of the highest saving rates in the world, had been capital exporters. They had all the capital they needed for their development.

Working "in the interests of owners and managers on international capital," IMF sought to open up Asian economies to global capital "in one way or another."[451] Urged on by the IMF, Thailand, Indonesia, and Korea opened their economies to global capital flows prematurely without adequate regulatory supervision.[452] Hot capital rushed in quickly and these economies became vulnerable to "self-fulfilling speculative attacks."[453] Following the historic "capital-push" model,[454] in the two years preceding 1997, excess liquidity in the U.S. and Europe resulted in record quantities of capital flowing into the Asian region.[455] The capital inflows went primarily into property and stock market investments, driving up the prices of those assets in speculative bubbles. Faced with steep yield curves, local banks borrowed short term and lent long term without adequately hedging their foreign exchange exposure.[456] Crony capitalism prevalent in many countries of the region engendered the moral hazard for local banks owned or controlled by influential quarters, and high-risk and highly lucrative ventures were influenced by

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[450] The Asian economies had a high-debt model, with debt/equity ratios commonly two to one, primarily because savings and bank deposits are much higher. The high ratios of bank deposits to GDP and of corporate debt to equity make the financial structure vulnerable to shocks that depress liqu*id*ity. This requires cons*id*erable support and guidance from the governments in tune with a national industrial strategy. This is at the root of the developmental state in Asia that combines high household savings, high corporate debt/equity rations, bank-firm-state collaboration, a national industrial strategy, and investment incentives conditioned on international competitiveness. *See* ROBERT WADE, GOVERNING THE MARKET: ECONOMIC THEORY AND THE ROLE OF GOVERNMENT IN EAST ASIAN INDUSTRIALIZATION (1990); CHALMERS JOHNSON, MITI AND JAPANESE MIRACLE: THE GROWTH OF INDUSTRIAL POLICY, 1925-1975 (1982).

[451] Wade and Veneroso, *The Asian Crisis*, *supra* note _ at 18.

[452] For composition of net capital flows to Asian emerging market economies between 1980 and 2006, *see* WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 48, Fig 3.9.

[453] KRUGMAN, *supra* note _ at 110.

[454] Excess liquidity in creditor nations has historically triggered capital moving to debtor nations. *See* MARCHAL , *supra* note _ at 95, 212-213; DARRELL DELAMAIDE, DEBT SHOCK: THE FULL STORY OF THE WORLD CREDIT CRISIS 95-96, 99, 120 (1984).

[455] Investors in US were confronted with very low interest rates and an inflated stock market. BUCKLEY, INTERNATIONAL FINANCIAL SYSTEM, *supra* note _ at 58.

[456] For share of short-term borrowing in foreign-currency borrowing of Asian Crisis countries, *see* WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 54 Fig 3.14,

the prospect of local bailout should things turn sour. Lack of exchange rate flexibility added to the problem. Thailand, Malaysia, and Korea had pegged their currencies to the USD in mid-1990s. The USD was appreciating and so were the pegged currencies. With increasingly high-tech exports these economies were now competing with Japan at a time when Japanese currency was depreciating, putting pressure on export competitiveness of the pegged-currency countries in the region. China's devaluations of early 1990s and US-Japan arrangement before the 1996 election,[457] resulting in depreciation of the yen, seriously impacted Korean and Southeast Asian competitiveness. As export earnings and stock markets fell, there was a rush by the banks to call in the loans across the board. When the size of impending losses became apparent, capital fled the region in a panic. The sudden swing from a capital inflow to an outflow in late 1997 was over 10 percent of the GDP of the countries involved.[458]

The financial turmoil that began with the devaluation of the Thai baht in July 1997, spread quickly to Indonesia, Thailand, the Philippines, and South Korea.[459] By the end of 1997, all these countries were in deep contraction. When loss of confidence struck, it led to rapid outflow of hot capital, and a freezing of external re-financing.[460] This led to deep depreciation of local currencies and exposed massive unhedged foreign exchange exposures, severely damaging balance sheets of local corporations.[461] Fleeing foreign capital treated the whole region as one,

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[457] The USD appreciated against the yen after 1995 as a result of an agreement between US Treasury and Japanese Finance Ministry to help Japan export its way out of its recession, use the surpluses to buy Treasury bills, thus helping to keep US interest rates at politically desirable levels. *See* Klaus Engelen, *How Bill Clinton Really Won*, THE EUROPEAN, November 1996, at 14-20; Chalmers Johnson, *Cold War Economics Melts Asia*, THE NATION, February 23, 1998, at 16-20.
[458] Rude, *supra* note _ at 95.
[459] *See* Christopher Rude, *The 1997-98 East Asian Financial Crisis: A New York Market-Informed View*, in GLOBAL FINANCIAL TURMOIL AND REFORM 369-403 (Barry Herman ed., 1999).
[460] In a deregulated capital market, capital flows are pro-cyclical – capital flows out in a recession, precisely when it is needed most, and flows in during a boom, exacerbating inflation.
[461] THE WORLD BANK, GLOBAL DEVELOPMENT FINANCE 1998 5, 30 (1998).

failing to distinguish between economies of Thailand, Malaysia, Indonesia, Philippines, and Korea, that had quite different strengths and weaknesses.[462]

When problems began, IMF advice exasperated the situation.[463] The IMF diagnosed that Thailand had "a conventional demand-management problem – excessively easy fiscal and monetary policy and a deteriorating current account – requiring a general policy of tightening."[464] The IMF sought increased interest rates, tightening of credit, and fiscal austerity. These caused domestic deflation and worsened the crisis by causing widespread bankruptcies and further erosion of confidence. The IMF strategy "discourage[d] investment. Compound[ed] the recessionary impact of the reversal in capital flows, and generally exacerbate[d] the difficulties faced by firms, banks, and public finances."[465] Thailand required the opposite treatment to which it was subjected – a supportive rather than tight fiscal policy.[466] Analysts agree that the IMF funds should have been used "not for rescuing foreign creditors – nor for financing capital flight – but for financing compensating fiscal expansion."[467] Even when financial crises are partly caused by weakness of an economy's economic fundamentals, the time to deal with the structural issues is not while the crisis is at its peak. The short-term focus must be on minimizing the damage by counter-cyclical interventions, with long-term reforms left for

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[462] Asian economies, while only modestly linked by way of flow of goods, were "linked in the mind of investors." KRUGMAN, *supra* note _ at 94. Flow of capital into Asia was often channeled through "emerging market funds" that lumped the countries together; when bad news came from Thailand, capital flew out from all the regional economies." *Id*. At 93.

[463] *See, e.g*., G. De Brouwer, *The IMF and East Asia: A Changing Regional Financial Architecture*, in THE IMF AND ITS CRITICS (C. Gilbert and D. Vines eds., 2003); R. Weissman, *Twenty Questions on the IMF*, in DEMOCRATIZING THE GLOBAL ECONOMY (K. Danaher ed., 2001).

[464] De Brouwer, *supra* note _ at 3.

[465] ARIEL BUIRA, AN ALTERNATIVE APPROACH TO FINANCIAL CRISES 20 (1999). *See also*, WARNER M. CORDEN, THE ASIAN CRISIS: IS THERE A WAY OUT? (1999).

[466] De Brouwer, *supra* note _ at 14; The misdiagnosis is captured by this summary: "[IMF] failed to anticipate the severity of the Asian downturn or *see* that the restrictive fiscal policies it recommended would themselves make that downturn worse … the Fund's fiscal targets were too tight and … larger deficits should have been encouraged." BARRY J. EICHENGREEN, TOWARDS A NEW FINANCIAL ARCHITECTURE: A PRACTICAL POST-ASIA AGENDA 110 (1999).

[467] CORDEN, *supra* note _ at 59.

another day.[468] IMF made matters worse by overemphasizing supposed structural causes of the crisis.[469] The IMF policy of encouraging bank closures in crisis countries caused "a bank panic that helped set off financial market declines in much of Asia."[470] Instead of highlighting their flaws, it would have been "better to try to calm markets by emphasizing the positive features of these economies."[471] Instead, the IMF "engineered a simultaneous contraction in aggregate demand *and* supply."[472] Contractionary policies advocated by the IMF "exacerbated the *contagen* – spread of the downturn from one country to the next."[473] In Jeffery Sachs' evocative words, "Instead of dousing the fire, the IMF in effect screamed fire in the theater."[474] IMF's insistence on closing down banks in the absence of deposit insurance induced runs on banks, and its insistence on cutting demand and liquidity caused bankruptcies of even efficient and profitable firms.[475] Bank closures and bank-run in Indonesia induced by the IMF, exacerbated political unrest and ethnic divisions in Indonesia and when food and fuel subsidies were drastically cut back, riots exploded.[476]

The Asian crisis proved once again that "financial crises have always caused transfers of ownership and power to those who keep their own assets intact and who are in a position to create credit."[477] During and after the Asian crisis, very little excess capacity was shed; it was "re-organized and snatched up by foreign investors seeking to capture valuable assets from

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[468] De Brouwer, *supra* note _ at 3; H. K. Pyo, *The Financial Crisis in Korea and its Aftermath: A Political Economic Perspective*, in CAPITAL FLOWS WITHOUT CRISIS: RECONCILING CAPITAL MOBILITY AND ECONOMIC STABILITY 243 (D. Dasgupta, M. Uzan and D. Wilson eds., 2001); CORDEN, *supra* note _ at 45.
[469] *Id*. at 48; De Brouwer, *supra* note _ at 2.
[470] David E. Sanger, *IMF Now Admits Tactics in Indonesia Deepened the Crisis*, NEW YORK TIMES, January 14, 1998, at B1.
[471] CORDEN, *supra* note _ at 48.
[472] STIGLITZ, GLOBALIZATION, *supra* note _ at 111.
[473] STIGLITZ, GLOBALIZATION, *supra* note _ at 107.
[474] Jeffery Sachs, *The IMF and the Asian Flu*, THE AMERICAN PROSPECT, March-April 1998, at 16, 17,
[475] Robert Wade and Frank Veneroso, *The Asian Crisis*, *supra* note _ at 5.
[476] STIGLITZ, GLOBALIZATION, *supra* note _ at 117 - 119.
[477] Wade and Veneroso, *The Asian Crisis*, *supra* note _ at 20.

distressed and ailing firms."[478] The euphoria the fire-sale of Asian assets created for global finance capital was captured well by an investment banker: "If something was worth $1 billion yesterday, and now it's only $50m, it's quite exciting."[479] The combination of devaluations, and IMF-imposed liberalization, and IMF-assisted recovery precipitated "the biggest peacetime transfer of assets from domestic to foreign owners in the past fifty years anywhere in the world, dwarfing the transfer from domestic to U.S. owners in Latin America in the 1980s."[480]

While aggravating the crisis, the IMF used it to expand the enforcement of the neoliberal agenda in the region. Even after the crisis had begun, at the September 1997 annual meeting of the IMF and the World Bank in Hong Kong, IMF put pressure on developing countries to liberalize capital markets.[481] The IMF's stand-by agreement with Korea exemplifies IMF's to push for structural and institutional changes in the middle of a financial crisis.[482] The U.S. Treasury Department was directly involved in stiffening IMF's insistence on radical financial opening in Korea,[483] The IMF package called for closing down or recapitalizing troubled financial institutions, allowing foreign institutions to freely buy domestic ones, requiring banks to follow Basil prudential standards, requiring international accounting standards to be followed and international accounting firms to used for auditing. The government was prohibited from intervene in lending decisions of banks, or to give credit and tax concessions to firms to avoid bankruptcies. Capital accounts were to be opened and all restrictions on foreign borrowings by

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[478] McNally, *From Financial Crisis to World-Slump, supra* note _ at 63. *See* also, Paul Burkett and Martin Hart-Landsberg, *Crisis and Recovery in East Asia: The Limits of Capitalist Development*, 8 HIST. MATERIALISM 3, 27 (2001).
[479] Clay Harris and John Ridding, *Asia Provides Golden Buying Opportunities, Financial Times, February 26, 1998, at 16. See also South Korea: Bargains Galore*, ECONOMIST, February 7, 1998, at 67-8.
[480] Wade and Veneroso, *The Asian Crisis*, *supra* note _ at 20-21.
[481] STIGLITZ, GLOBALIZATION, *supra* note _ at 93.
[482] For the text of the agreement, *see Republic of Korea - IMF Stand-by Arrangement: Summary of the Economic Program*, December 5, 1997. *Accessed* July 16, 2010, at http://www.imf.org/external/np/oth/korea.htm.
[483] The Treasury made it clear that Korean financial liberalization was a precondition of US contribution to the bailout. Paul Blustein and Clay Chandler, *Behind the S. Korean Bailout: Speed, Stealth, Consensus*, WASHINGTON POST , December 28, 1998, at 1.

corporations eliminated. The trade regime was to be liberalized by eliminating restrictive import licensing and trade-related subsidies. Labor markets were to be liberalized to improve labor market flexibility. Added to this were tighter monetary and fiscal policies to restrict domestic demand. Here, neoliberalism by mandate was imposed in one sweep.

U.S. Treasury joined the IMF to squelch Japan's offer of USD 100 million to create an Asian Monetary Fund in order to finance urgently needed stimulus.[484] The alternative IMF package consisted of long-term loans of from USD 15 billion in the case of Thailand to USD 57 billion for South Korea, made on the condition that they would be used to repay creditors. These loans thus became long-term public debts for these countries and the bailouts for the creditors.[485] The IMF bailouts were made available for the purpose of fully repaying short-term bank debt – the very debt that had triggered the crisis. They rewarded sort-term speculative creditors and inflicted severe adversity upon the economies of the region. It has been noted that "[f]oreign creditors were thus the main recipients of the money loaned to crisis countries."[486] Indeed, the bailouts amounted to being "a welfare system for Wall Street."[487] While the IMF later admitted that the tight fiscal policy it had recommended was excessively austere,[488] BIS applauded that large banks "have been able to avoid significant loss," and credited "risk mitigants …solvency [capital] requirements of G10 banks ... [and banks were much better diversified than in past

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[484] As financial clouds gathered in Asia, in summer 1997 Japan proposed to establish an Asian Fund to assist economies of the region in trouble. Not wanting Japan to send its capital to Asia rather than to U.S. by buying Treasury bills, and not wanting Japan to emerge as the bailout leader, the US Treasury, and Deputy Secretary Larry Summers, in particular, insisted that the cleanup be entrusted to the IMF. Japan agreed to desist in a November 1997 meeting in Manila. *See* Chalmers Johnson, *Cold War Economics Melts Asia*, THE NATION, February 23, 1998, at 16-20; STIGLITZ, GLOBALIZATION, *supra* note _ at 112-13.
[485] Charles W. Calomiris and Allan H. Meltzer, *Fixing the IMF*, 56 THE NATIONAL INTEREST 88 (Summer 1999).
[486] BUCKLEY, INTERNATIONAL FINANCIAL SYSTEM, *supra* note _ at 69. *See also* GEORGE SOROS, OPEN SOCIETY: REFORMING GLOBAL CAPITALISM 269 (2000).
[487] Charlotte Denny, *IMF Sheds No Tears for Argentina*, THE GUARDIAN, April 29, 2002, *quoting* a senior G-7 official.
[488] IMF, ANNUAL REPORT OF THE EXECUTIVE BOARD FOR THE FINANCIAL YEAR ENDED APRIL 30, 1998 25 (1998).

crises, in terms of both countries and types of counterparties."[489] The public bailout of the lenders only reinforced the moral hazard for short-term speculative capital which quickly found a new outlet in Russia for massive credits in late 1997 and early 1998, this time triggering Russia's crisis in August 1998.[490]

While speculative hot capital was made whole, the vulnerable had to bear the brunt of the crisis, and millions of people were plunged into dire poverty In Korea, for example, there was an increase in absolute poverty and an increase in income and wealth inequality as "the labor and capital income of the highest 10% in 1998 increased by 8%, while that of the other 90% of

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[489] BCBS, *Supervisory Lessons to be Drawn from the Asian Crisis*, Working Papers, Number 2 (1999), at 15-16. *Accessed* July 13, 2010, at http://www.bis.org/publ/bcbs_wp2.htm.

[490] Ross P. Buckley, *A Force for Globalization: Emerging Markets Debt Trading from 1994 to 1999*, 30 FORDHAM INT'L L.J. 185 (1999). The road to disaster began with the "shock therapy" path chosen in 1992 by Russia following IMF advice and direction. *See* THE NEW RUSSIA: TRANSITION GONE AWRY (Lawrence R. Klien and Marshall Pomer eds., 2001); ARIEL COHEN, RUSSIA'S MELTDOWN: ANATOMY OF THE IMF FAILURE (1998); STEVEN F. COHEN, FAILED CRUSADE: AMERICA AND THE TRAGEDY OF POST-COMMUNIST RUSSIA (2000); PETER REDDAWAY AND DIMITRI GLINSKI, THE TRAGEDY OF RUSSIA'S REFORMS: MARKET BOLSHEVISM AGAINST DEMOCRACY (2001); MICHAEL MCFAUL, RUSSIA'S UNFINISHED REVOLUTION: POLITICAL CHANGE FROM GORBACHEV TO PUTIN (2001). Fearful of inflation, IMF insistence that Russia maintains an overvalued currency and support it with billions of dollars in loans ultimately crashed the economy. The first round was the instantaneous price liberalization that set in motion an inflationary spiral that wiped out domestic savings. The second round was tightening monetary policy by raising interest rates. Natural resources prices were kept artificially low to attract foreign investment. The end result was that between 1990-99, Russian GDP fell 54 percent and industrial production fell 60 percent, devastation greater than the one suffered during World War II. STIGLITZ, GLOBALIZATION, *supra* note _ at 135-143. The overvalued rubble had flooded the market with foreign goods and led to massive contraction of the domestic manufacturing sector. The ill-fit between market principles and a centralized governance system led to an explosion of corruption and the creation of state-backed oligarchs. *See*, P. Murrell, *Can Neo-Classical Economics Underpin the Economic Reform of the Centrally Planned Economies?* 5:4 J. OF ECON. PERSPECTIVES 59 (1991). When the Asian crisis resulted in a dramatic fall in crude oil prices – 40 percent between 2007 and 2008 -, the weight of servicing the huge foreign debt became unbearable. By the middle of 1998, it became clear that Russia would need outs*id*e assistance to maintain its exchange rate. As confidence in the currency eroded, the yield on local currency government bonds went up to 150 percent. Yields on dollar-denominated bonds rose from 10 percent to 50 percent. As the crisis mounted, IMF offered the first rescue package of USD 4.8 billion in July 1998. IMF insisted that Russia borrow more in foreign currency than in rubbles, discounting the risk of imminent devaluation that would make repayment of foreign currency loans more expensive. Under "enormous political pressure from the Clinton administration to lend money to Russia," the IMF and the World Bank crafted another rescue package of USD 22.6 billion. STIGLITZ, GLOBALIZATION, *supra* note _ at 148-49. The rescue came too late, and on August 17, 1998, Russia announced a unilateral suspension of payments and a devaluation of the rubble. The rubble crashed, losing 45 percent in real terms by January 1999. The Russian default precipitated a global financial crisis, interest rates soared and even relatively sound developing economies could not raise credit. Brazil, Argentina, and other Latin American economies were pushed into currency and financial crisis. New York Federal reserve was forced to engineer a private bailout of LTCM. An industrial giant had been turned into a natural resource exporter. The human costs of the transition were enormous. While in 1989, only 2 percent of Russians lived in poverty, by 1998 the number had soared to 23.8 percent, and 50 percent of children were living in families in poverty. *Id*. at 153.

income earners decreased sharply."[491] In Indonesia alone, 30 million more people dropped below the $1 per day poverty-line.[492] Banks closed, unemployment soared and GDP plummeted. Unemployment rate went up fourfold in Korea, threefold in Thailand, and tenfold in Indonesia.[493] In 1998, GDP in Thailand fell by 10.8 percent, in Indonesia by 13.1 percent and in Korea by 6.7 percent.[494] Currencies in countries that followed IMF prescriptions fell rapidly – the Thai baht fell by 50%, the Indonesian rupiah by 75 % and the Korean won by 40%.[495] By increasing unemployment and poverty throughout the global South, the Asian crisis "put downward pressure on wages worldwide, thus increasing the global rate of exploitation."[496] The crisis was also used by speculators to attacks currencies and stock markets in the region, particularly Hong Kong and Malaysia.[497]

The crisis brought to an end the longest period of rapid growth in the global South and the so-called "Asian miracle." Japanese banks, invested heavily in the region, were hit particularly hard. Coming on top of collapse of the "bubble economy" in the early 1990s, the Asian flu pushed Japan further into long-term deflation; one that it has not recovered from since. The crisis led global finance to reduce its exposure to the global South generally. This had immediate adverse effect on "emerging economies," that were forced to adopt tighter fiscal and

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[491] H. K. Pyo, *The Financial Crisis in Korea and its Aftermath: A Political Economic Perspective,* in CAPITAL FLOWS WITHOUT CRISIS" RECONCILING CAPITAL MOBILITY AND ECONOMIC STABILITY 248 (D. Dasgupta, M. Uzan and D. Wilson eds., 2001);

[492] *Crisis in Asia Spawns Millions of 'Newly Poor*, WALL STREET JOURNAL, April 6, 1999. Likewise in Mexico two years earlier, "[t]he austerity program the Mexican government put in place when its economy faltered was a devastating blow to the country's working poor, but the big investors emerged largely unscathed." David E. Sanger, *Maybe a Bankrupt Nation Isn't the Worst Thing in the World*, NEW YORK TIMES, October 12, 1997.

[493] STIGLITZ, GLOBALIZATION, *supra* note _ at 97.

[494] *Id*.

[495] BUCKLEY, INTERNATIONAL FINANCIAL SYSTEM, *supra* note _ at 67.

[496] Rude, *supra* note _ at 75.

[497] At the height of the crisis, in "possibly the largest market conspiracy of all time," speculators took short positions worth USD 30 billion in the Honk Kong stock market. KRUGMAN, THE RETURN OF DEPRESSION ECONOMICS, *supra* note _ at 130. Hong Kong aggressively used its monetary authority's sizable reserves to intervene in the market and routed the speculators. *Id*. at 130-31. While Malaysia accused speculators to be doing Americas bidding "to cut assertive Asians down to size," Hong Kong officials claimed that hedge funds had paid reporters to run stories about impending devaluations to engineer a run on the currency. *Id*. at 95, 129.

monetary policies to counter the downward pressure on their currencies. Quickly signs of acute financial stress appeared in Russia, Brazil, and Argentina. Russia defaulted in August 1998, followed by the collapse of the LTCM hedge fund, with the later leading to a general panic in financial markets.[498]

Note that the countries in the region that did not follow the IMF model of free capital mobility weathered the crisis better. For example, Malaysia, instead of following IMF prescriptions and in the face of opposition by its central bank, pegged the ringgit to USD in September 1998, decreed repatriation of all offshore ringgits within a month, and froze repatriation of foreign capital for twelve months, later turning the capital exit control into an exit tax.[499] These capital controls allowed Malaysia to have a shallower downturn and to recover quickly.[500] Similarly, China and India avoided the contagion from the Asian crisis, enjoying growth of 8 and 5 percent respectively during the period, due to strong capital control regimes.[501]

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[498] On LTCM, *see* NICHOLAS DUNBAR, INVENTING MONEY: THE STORY OF LONG-TERM CAPITAL MANAGEMENT AND THE LEGENDS BEHIND IT (2000); ROGER LOWENSTEIN, WHEN GENIUS FAILED: THE RISE AND FALL OF LONG-TERM CAPITAL MANAGEMENT (2000); Donald MacKenzie, *Long-Term Capital Management and the Sociology of Arbitrage*, 32:3 ECON. & SOC. 374 (2003). LTCM, the hedge fund founded in 1994, and had by 1998 leveraged USD 4.8 billion in capital into more than USD 125 billion in assets and several times more in off-balance sheet positions. With a 25 to one leverage ratio, LTCM delivered returns over 40 percent in 1995 and 1996, had 60,000 trades on its books in August 1998, and held positions of over USD 50 billion in 500 150 billion. HAL S. SCOTT, THE GLOBAL FINANCIAL CRISIS 15-16 (2009). The brains behind LTCM and the Black-Scholes model of options were awarded the Nobel Prize in economics in 1997. The number of options sold, and involvement of other financial institutions earned LTCM the title "the Central Bank of Volatility." DUNBAR, INVENTING MONEY, *supra* note _ at 178. In October 1998, LTCM had lost 90 percent of its capital and the New York Federal Reserve and the US Treasury engineered a bailed out with an infusion of USD 3.6 billion in capital by a consortium of 14 Wall Street banks that were both lenders to and counterparties of LTCM. FERGUSON, ASCENT, *supra* note _ at 328; HAL S. SCOTT, THE GLOBAL FINANCIAL CRISIS 16-17 (2009). The unwinding of LTCM's highly leveraged derivative positions caused the otherwise deep and liqu*id* US Treasury market to freeze up and threatened to unravel the very foundations of the global financial system. Rude, *supra* note _ at 95. Reviewing the LTCM crisis, BIS concluded that "Policy makers should appreciate that the fallout from last year's financial market strains was less pronounced on real activity in the industrialized countries." Committee on the Global Financial System, *Review of Financial Market Events in Autumn 1998*, (1999) at 2. *Accessed* July 13, 2010, at http://www.bis.org/publ/cgfs12.htm.

[499] STIGLITZ, GLOBALIZATION, *supra* note _ at 123.

[500] *See* Ethan Kaplan and D. Rodrik, *Did the Malaysian Capital Controls Work?* in PREVENTING CURRENCY CRISES IN EMERGING MARKETS (Sabastian Edwards and Jeffery Frankel, eds., 2002).

[501] STIGLITZ, GLOBALIZATION, *supra* note _ at 125-6**.** *See also*, Carmen M. Reinhart and Richard T. Smith, *Temporary Controls on Capital Inflows*,57:2 J. OF INT'L ECON. 327 (2002); Sebastian Edwards, *How Effective are Capital controls?* 13:4 J. OF ECON. PERSPECTIVES 65 (1999); Akira Ariyoshi, et. al., *Country Experiences with the*

This relative insulation helped the two economies again during the 2007-2010 global financial crisis. Insulation from the crisis was also provided by the fact that while India's public debt is 80% of GDP, 90 percent of that is owed to its own citizens.[502] This demonstrates that effective capital controls, and reliance on domestic savings to fund public debt insulate an economy from speculations of hot capital and from the spread of destabilizing impact of debt crises.

a. Argentina: The Darling of the IMF and Dividends of defaults

The Argentinean debt crisis of 2001-2005 is yet another instance of unbridled capital flows combining with IMF debt-crisis management to trigger accumulation by dispossession. However, it is also a lesson of how sovereign default can be used to secure meaningful debt relief and to break free of the stranglehold of IMF. Argentina's crisis stemmed directly from IMF policies.[503] In its new role as enforcer of neoliberalism, the IMF had pushed for liberalization of capital accounts before prudential regulations were in place. This had "proved to be a recipe for disaster" during the Asian crisis, and did the same for Argentina.[504] Typically, short-term foreign capital rushed in attracted by speculative prospects, and while creating temporary booms in targeted markets, remains unconnected to economic fundamentals. Of course, at the first sign of trouble, it flees leaving disaster in its wake. The situation in Argentina was exacerbated by the fact that throughout the 1990s, with the flow of credits available due to the high liquidity in the

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Use and Liberalization of Capital Controls, IMF OCCASIONAL PAPER 190, (2000). RAMKISHEN RAJAN, THE SOUTHEAST ASIAN CURRENCY AND FINANCIAL CRISIS: A CASE OF 'SUDDEN DEATH' OR DEATH FORETOLD'? (2010); S. H. Poon, *Malaysia and the Asian Financial Crisis A View From the Finance Perspective*, 2 AFRICAN FINANCE J. 13 (2000).

[502] Vikas Bajaj and Keith Bradsher, *Asia's Economies Prove Resilient Despite the Danger of Deficits*, NEW YORK TIMES, February 8, 2010, at B1.

[503] L. Rother, *Giving Argentina the Cinderella Treatment*, NEW YORK TIMES, August 11, 2002, at A14. In a classic case of contagion, Argentina's financial collapse in 2001 can be traced back to the fallout from the 1995 Mexican crisis, and was later exacerbated by the Asian crisis of 1997, and the Brazilian crisis of 1998. STIGLITZ, FREEFALL *supra* note _ at xiv.

[504] BUCKLEY, INTERNATIONAL FINANCIAL SYSTEM, *supra* note _ at 79.

industrialized countries, Argentina relied on foreign capital to fund its budget and capital account deficits.[505] Security firms reaped USD 1 billion in fees to underwrite government bonds during 1991-2010, as a "gusher of foreign money" poured into Argentina with "reckless abandon."[506]

Having subscribed to the neoliberal prescriptions, Argentina became a "darling of the IMF and the financial markets,"[507] and was held as "the best case of 'responsible leadership' in the developing world."[508] It privatized a broad range of industries, doubled its exports, achieved record levels of agricultural and industrial output, and experienced marked growth in oil and mineral production. Between 1991 and 1998, GDP increased by 44% and inflation remained under control.[509] By the end of 1998, however, partly due to the global fall in commodity prices induced by the Asian flu, Argentina entered a severe recession that by 2001 developed into a severe crisis.[510] IMF and neoliberal prescriptions precluded countercyclical policies. Instead, in 1999 taxes were raised along with a 13% wage cut for public workers, and deep cuts in education and pensions.[511] The neoliberal shock-therapy only aggravated the crisis. A 2004 IMF internal audit found that the fund "significantly contributed to one of the most devastating financial crises in history, … [and] certainly deepened a recession that threw millions of Argentineans into poverty."[512]

The principal cause the crisis was the earlier decision to peg the Argentinean peso to the USD, and the massive inflows of foreign capital facilitated by complete liberalization of capital

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[505] Miguel Kiguel, *Structural Reforms in Argentina: Success or Failure?* 44 COMP. ECON. STUD. 83, 101 (2002).
[506] Paul Blustein, *Argentina Didn't Fall on Its Own; Wall Street Pushed Debt Till the Last*, WASHINGTON POST, August 3, 2003, at A1. In 1998, Argentinean bonds accounted for 28.8 percent of the bellwether Emerging Markets Bond Index-Plus, which "virtually forced" investors to lend to Argentina even if its long-term solvency was in doubt. *Id.*
[507] BUCKLEY, INTERNATIONAL FINANCIAL SYSTEM, *supra* note _ at 76.
[508] *Chaos in Argentina*, THE NATION, January 21, 2002, at 3.
[509] BUCKLEY, INTERNATIONAL FINANCIAL SYSTEM, *supra* note _ at 75.
[510] EICHENGREEN, GLOBALIZING CAPITAL, *supra* note _ at 207.
[511] S. Jeffery, *Crisis in Argentina*, THE GUARDIAN, January 4, 2002.
[512] Paul Blustein, *IMF Says Its Policies Crippled Argentina; Internal Audit Finds Warnings Were Ignored*, WASHINGTON POST, July 30, 2004, at E1.

account.[513] The peg effectively controlled inflation and made Argentina very attractive to foreign capital. However, by fixing the exchange rate, Argentina gave up the principle means to deal with balance of payment problems – adjustment in exchange rate for its exports to remain competitive. For example, Brazil faced with similar pressure on its balance of payments, devalued its currency by 40% and avoided a crisis.[514] Pegging peso to the USD meant that to be able to guarantee convertability, the central bank had to back each peso in circulation with a USD at hand.[515] Once hyperinflation had been put under control by 1994, a gradual decline in value of the peso would have boosted exports and made the economy stronger.[516]

IMF's initial response to the crisis in 2000 was a USD 40 billion bailout to service a mix of public and corporate debt.[517] Concurrently, the IMF required the so-called "pesofication" – domestic banks were required to convert their assets into pesos at a one-for-one rate and their liabilities into pesos at a rate of 1.4 to 1. The government then compensated the banks for the losses this entailed by a massive issue of government bonds.[518] With these moves, the shift of the burdens of private losses was shifted to the public. A former president of Argentina's central bank summed up the bottom line: "The government has transferred about 40% of private debt to workers....We are experiencing *a mega-redistribution of wealth and income unprecedented in the history of the capitalist world*."[519] The model followed the pattern of "massive returns to the

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[513] Martin Feldstein, *Argentina's Fall*, 81 FOREIGN AFFAIRS 8 (2002); EICHENGREEN, GLOBALIZING CAPITAL, *supra* note _ at 205.
[514] William Gruben and Sherry Kiser, *Why Brazil Devalued the Real*, Federal Reserve Bank of Dallas, *Expand Your Insight*, July 1, 1999. *Accessed* July 15, 2010, at http://www.dallasfed.org/eyi/global/9907real.html.
[515] Feldstein, *Argentina's Fall*, *supra* note _ at 8.
[516] Jeffery Sachs, *A Crash Foretold: Argentina must revamp its society and economy for a high-tech world*, 159 TIME INT'L, January 14, 2002, at 17; Ross P. Buckley, *Re-envisioning Economic Sovereignty Developing Countries and the IMF*, in RE-ENVISIONING SOVEREIGNTY: THE END OF WESTPHALIA? 279- 280 (Trydy Jackobson, et. al. eds., 2008),
[517] Eric Hershberg, *Why Argentina Crashed--And Is Still Crashing*, NACLA REPORTS ON THE AMERICAS , July-August 2002, at 32.
[518] Andres Gaudin, *Thirteen Days That Shook Argentina--And Now What?* NACLA REPORT ON THE AMERICAS, March/April 2002, at. 6; *Latin Banks: Eyes on Brazil*, EMERGING MARKETS MONITOR, August 19, 2002, at 12.
[519] *Quoted in* Gaudin, *Thirteen Days*, *supra* note _ at 6-9. Emphasis added.

rich" set by the earlier capital flows and debt crises in the Global South.[520] And, as before, the poor had to repay the debts through higher taxes, and suffer from unemployment and reduced spending on health care, education, and infrastructure.[521]

The 2000 currency delinking and austerity measures failed to contain the crisis. Between March 2001 and March 2002, domestic financial assets shank from USD 126.8 billion to USD 41 billion.[522] Argentina's GDP fell 10.9 percent in 2002, per capita income decreased by 23 percent, and unemployment rose to 26 percent.[523] The long term consequences for millions of Argentineans turned dire.[524] In once prosperous Argentina, over half of the population was pushed below the poverty line, and over a third of the population could not afford adequate food.[525] Faced with the government's reluctance for further austerity measures, the IMF denied further credits. In response, Argentina defaulted on its foreign debt of USD 132 billion in December 2001.[526] Argentina's president took the position that he would not service the debt from the "suffering and hunger of the people."[527]

In September 2003, Argentina demanded that the creditors write-off 75% of the USD 4.3 billion in debt and all the interest that had accumulated since the default. Wiping out the accumulated interest meant that the value of offer, which Argentina described as "unmoveable,"

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[520] *A Survey of Latin America*, Economist, November 13, 1993.

521 *See* JORGE G. CASTANEDA, UTOPIA UNARMED: THE LATIN AMERICAN LEFT AFTER THE COLD WAR 5 (1993); Jerry Dohnal, *Structural Adjustment Programs: A Violation of Rights*, 57:1 AUSTRALIAN JOURNAL OF HUMAN RIGHTS, 72 (1994); Harold James, *Deep Red--The International Debt Crisis and Its Historical Precedents,* 56 AMERICAN SCHOLAR 340 (summer 1987); Ross P. Buckley, *The Rich Borrow and the Poor Pay: The Fatal Flaw of International Finance*, 19:4 WORLD POLICY J. 59 (2002).

[522] BUCKLEY, INTERNATIONAL FINANCIAL SYSTEM, *supra* note _ at 76-77.

[523] Hector E. Maletta, *A Catastrophe Foretold: Economic Reform, Crisis, Recovery and Unemployment in Argentina*, September 2007. *Accessed* July 20, 2010 at http://ssrn.com/abstract=903124.

[524] *See* Sophie Arie, *Rich Argentina Tastes Hunger*, THE OBSERVER, May 19, 2002.

[525] *See* Mark Milner and Charlotte Denny, *It's Penalty Time for Argentina*, THE GUARDIAN, May 8, 2002.

[526] The peso was floated and lost half its value overnight, and in April 2002 all banks were indefinitely closed.

[527] *Argentina and the IMF: Which is the Victim?,* ECONOMIST, March 6, 2004, at 63. Argentina's poverty rate doubled from 27% in 1999, to 54.7% in 2004, and the debt that represented 47.4% of GDP in 1999, rose to 140% of GDP in 2004.

was only 10% of the total outstanding debt.[528] In late 2004, Argentina improved the offer so that USD 82 billion of bonds would be converted into USD 42 billion in new bonds with lower interest rates and longer maturities. This amounted to agreeing to honor 50% of the outstanding debt, but not the USD 23 billion in past due interest. In March 2005, creditors holding 76% of Argentina's debt agreed to exchange the debt for bonds at a 66% discount of the present value. Argentina emerged as a "defaulting debtor on the most advantageous terms ever secured by a middle-income country in debt restructuring in history."[529] The Financial Times bemoaned the "dangerous precedent," claiming that "*Argentina gambled, and the gamble paid off*."[530] In April 2005, Argentinean President, Nestor Kirchner, declared: "*There is life after the IMF, and it's a good life*."[531]

The Argentina's experience of default provides a productive example for all developing economies carrying mountains of debt. It demonstrated that debtor economies "are in a good position to impose solutions on creditors … [and] that a determined sovereign is normally stronger than its creditors … unless they have the assistance of a great power."[532] Sovereign defaults had declined in recent decades substantially as a result of changes in US and UK laws restricting application of sovereign immunity when sovereigns engage in commercial activity.[533] The experience of Argentina, however, underscores that default is an attractive option for debtor states. When faces with excessive debt, historically the options have been "Cut, print, or

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[528] *The End of the Affair*, ECONOMIST, February 20, 2004.
[529] BUCKLEY, INTERNATIONAL FINANCIAL SYSTEM, *supra* note _ at 84.
[530] *Argentina sets a dangerous precedent: The IMF should set tough conditions for further lending*, FINANCIAL TIMES, March 7, 205, at 20. Emphasis added.
[531] Christopher Swann, *Hugo Chaves Exploits Oil Wealth to Push IMF Aside*, NEW YORK TIMES, March 1, 2007, at B1.
[532] WOLF, FIXING GLOBAL FINANCE, *supra* note _ at 8, 186.
[533] *See* Georges R. Delaume, *The Foreign Sovereign Immunities Act and the Public Debt Litigation: Some Fifteen Years Later*, 88 AM. J. OF INT'L L. 257 91994); G. W. Larson, *Default on Foreign Sovereign Debt: A Question for the Courts?* 18 INDIANA L. REV. 965 (1985).

default."[534] The IMF prescription is always to cut spending, which amounts to a default on the commitments to politically weak sections at home. The print option, i.e., vaporizing debt through inflation, is not a viable option because international debt today is mostly in foreign currency and thus immune to local currency inflation. Furthermore, condemning domestic bond holders to inflation-driver negative real interest rates is not a viable anymore as the term structure of government debt in local currency is often much shorter.[535] Attraction of the default option increases by the fact that historically new creditors are generally indifferent to sovereign debtor's default history.[536] If a single debtor state fears retaliation and being cut off from credit markets, the way out may well be a collective moratorium on servicing or repudiation of foreign debts by all or groups of developing countries. Such action, or even the threat of such action, may be sufficient to force favorable restructurings and changes in the global financial architecture. A collective default to force radical changes in the global financial architecture will also bring the non-market political nature of the international debt question out in the open. The case of forgiveness of Iraqi debt recently underscored this fact.[537] In the context of collective bargaining

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[534] Ferguson, *Fiscal Crises and Imperial Collapses*, *supra* note _ at 11.
[535] *Id*. at 12.
[536] R. M. Auerback, *Sovereign Debt: Default and Restructuring of Debts Owed to Private Creditor*, 18 J. OF INT'L BANKING L. AND REG. 442 (2003).
[537] Iraq under military occupation presents a vivid picture of neoliberal designs political-economy and exceptional treatment of foreign debt for political ends. Perhaps, the "shock and awe" of the bombing campaign in the Iraq War was deem a sufficient substitute for any monetarist shock-therapy to prepare the ground for implementing neoliberalism in one sweep. The September 19, 2003, orders of the Coalition Provisional Authority in occupied Iraq d*id* just that. *See* Antia Juhasz, *Ambitions of Empire: The Bush Administration Economic Plan for Iraq (and Beyond)*, 12 LEFT TURN MAG., February/March 2004, at 27-32. *Accessed*, June 13, 2010, at http://www.ifg.org/analysis/globalization/ambition.htm. The orders mandated full privatization of public enterprises, full ownership rights by foreign firms of Iraqi businesses, full repatriation of profits, opening of Iraq's banks to foreign control, national treatment for foreign companies, elimination of nearly all trade barriers, a flat tax, outlawing strikes, and banning unions in key sectors of the economy. The orders were to apply to all sectors of the economy, including manufacturing, services, finance, construction, transportation, and the media. An Iraqi member of the Authority called it "free market fundamentalism … a flawed logic that ignores history." Thomas Crampton, *Iraqi Official Cautions on Imposing Free Market*, NEW YORK TIMES, Oct. 14, 2003, at C5. At the end of 2004, the sovereign debt of Iraq stood at USD 120 billion, apart from the US 200 billion owed in reparations as a result of the first Gulf war. BUCKLEY, INTERNATIONAL FINANCIAL SYSTEM, *supra* note _ at 86-87. In late 2004, as a result of strong lobbying by the US the Paris Club, the standing group representing governments of 19 largest creditor states, agreed to write off 80% of the debt owed to them by Iraq. The agreed upon relief was designed to unfold in three

about international debt, the Global South should rekindle the demands for a New International Economic Order that were left by the wayside in the turn to neoliberalism.[538] This would call for a new accounting that balances the debt of the Global South against the siphoning of value from the Global South during the colonial era. Only such a historical settling of accounts can usher in a global economic system based on equity and justice.

V. Conclusion

The financial meltdown and the deep recession of 2007-09 have wrung the death-knell of the neoliberal free-market consensus that has exercised hegemony over national and global socio-economic policy making for over 30years. We are told that anemic growth and pervasive joblessness are the "new normal" of the U.S. economy.[539] Paul Volcker, the architect of the 1979 "Volcker Shock," reports that "People are nervous about the long-term outlook, and they should be."[540] These may be new developments for the U.S., but the wretched of the earth in Greece and other societies straddled with mountains of debt confront worse. Money may well make the world go around. But it is an extremely bumpy ride. The architecture of global finance distributes gain and pain of financial flows to the advantage of finance capital and to the

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phases: 30% of the outstanding debt as of January 1, 2005 to be cancelled immediately. A further 30% to be cancelled upon Iraq's subscription to a standard IMF program with the usual conditionalities. A further 20% to be cancelled upon completion of the last IMF board review of three years of implementation of standard IMF program. The remaining 20% was rescheduled over a period of 23 years including a grace period of 6 years. *Id*. at 88. The Iraqi Finance Minister had characterized Iraq's burden as an "odious debt, used to build up the war machine of the ousted regime, largely through arms purchases supported by lending countries." Joanna Chung & Stephen Fidler, *Restructuring Under Fire: Why Iraqi Debt Is No Longer a Write-Off*, FIN. TIMES, July 17, 2006, at 15, *quoting* Iraqi Finance Minster Ali Allawi. The Paris Club shied away from mentioning the term and rested their position on unsustainability of debt servicing given the war. It has been pointed out that even after the write-off, Iraq will remain "shackled with over USD 25 billion of debt, not to mention new loans being peddled by the IMF and World Bank. … Furthermore, IMF conditions – such as privatization and ending food rations – could further exacerbate the poverty and instability in Iraq." *Saddam's Debt, the IMF, and the Privatization of Iraq's Economy*, Jubelii Iraq, May 26, 2005. *Accessed* July 16, 2010, http://www.jubileeiraq.org/resources.htm.

[538] For detailed analyses of the demands for a New International Economic Order, see

[539] Nelson D. Schwartz, *Jobless and Staying that Way*, NEW YORK TIMES, August 8, 2010, at WK1.

[540] Louis Uchitelle, *Volcker. Loud and Clear*, NEW YORK TIMES, July 1, 2010, at C1, C7.

detriment of working and marginalized classes around the world. International debt crises that have become ubiquitous in recent decades testify to this phenomenon. All this is not some natural result of operations of the ostensibly "free" market. Extra-market forces and means channel the markets to achieve these results. It took a politically directed foundational reconstruction of international financial system to bring about this state of affairs.

In response to the Great Depression, the two World Wars, and struggles of working classes, a Keynesian compromise between capital and labor aimed at full employment and a welfare state gradually unfolded. As a necessary precondition, a global regime of capital controls was instituted to contain the predatory and destabilizing tendencies of global finance capital. The result was a prolonged phase of sustained economic growth and stability and incremental expansion of civil and economic rights of working classes. Falling rates of profit, expanding U.S. balance of payment deficits, and threats to U.S. economic hegemony brought this phase to an end in the 1970s. In its place a neoliberal economic order was put in place aimed at reversing the gains of the working classes and consolidating U.S. economic and political hegemony.

Through elaborate reordering of the U.S. and global financial regulatory regimes unbridled international mobility of finance capital was facilitated. This enabled finance capital to play a dominant role in the global economy, raise its rates of profit, and channel global savings to sustain U.S. fiscal and balance of payment deficits. The exponential expansion of financialized credit economy created debt peonage within advanced capitalist countries and mounting debt burdens internationally. International debt combined with absence of capital controls accentuated boom and bust cycles of debtor countries. Recurrent international debt crises have been the result. These crises are managed to further impoverish vulnerable section of the debtor societies and augment the power of finance capital. The international debt crises over the past three

decades have facilitated further expansion of neoliberalism. These crises are used to enforce neoliberalism on debtor countries through mandates and conditionalities of structural adjustment. Promotion of open financial markets generates further crisis-prone debt. And the cycle continues in an ever-escalating mode. Financial crises and their management have become functional to neoliberalism's reproduction and extension. They are exploited to reduce or remove barriers to capital that the market and diplomacy could not dislodge.

There has to be a better way. What is needed is a rollback of neoliberalism. In particular, finance capital needs to be contained and subordinated to the productive and distributive needs both globally and within states. In order to do this, effective international capital controls and a balance of payments stabilization fund free of imperial control are indispensible. Turning the clock back to Bretton Woods may not be sufficient. We have to imagine and design systems of global capital flows that are not subservient to predatory capitalism. A collective moratorium on debt servicing or even a default by developing economies is a viable means to force a reordering of the global financial architecture. Only this will enable all states to gain economic sovereignty and for the people to take charge of their collective destiny.