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Rethinking the Global Financial Crisis: Theoretical Perspectives from Heterodox Economics

Küresel Finansal Krizi Yeniden Düşünmek: Heterodoks İktisat'tan Teorik Perspektifler

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ÖZ

Küresel kriz, her şeyin yolunda gittiğinin kabul edilmesiyle büyük ılımlılık denilen bir dönemin sonunda ortaya çıktı. Bu çalışma, 2008 Mali Krizinde etkili olan makroekonomik dinamiklerin yanı sıra kurumsal faktörlerin rolünü ortaya koymayı ve krizle mücadelenin başarısı ve gelecekte benzer durumların yaşanmaması için yapılması gerekenleri açıklamayı amaçlamaktadır. Krizlerin nedenleri üzerine yapılan değerlendirmelerden hareketle kurumsal başarısızlıklar, finansal yeniliklerin ve liberalleşme sürecinin etkisi ve kapitalizmin sistemik kriz eğilimine ilişkin görüşlerin ön planda olduğu anlaşılmaktadır. Ana akım iktisadın gündeminde olmayan krize ilişkin açıklamalar, ağırlıklı olarak heterodoks iktisadın temsilcilerinden gelmiştir.

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ABSTRACT

The global crisis appeared at the end of a period called great moderation when it was accepted that everything was going well. This study aims to reveal the role of institutional factors as well as the macroeconomic dynamics that were effective in the Financial Crisis of 2008. We present general description of the crisis, evaluations about the process that led to the crisis, the global spread, the degree of success of the struggle, and what needs to be done to prevent similar situations in the future. Based on the evaluations on the causes of the crises, it is inferred that the views on institutional failures, the effect of the financial innovations and liberalization process, and the systemic tendency of capitalism to a crisis are at the forefront. The explanations for the crisis, which was not on the agenda of mainstream economics, mainly came from the representatives of heterodox economics.

1. Introduction

The technological transformation, which led to radical changes in almost every aspect of life during the 1990s, has increased the opportunities of the society in accessing capital and investment instruments more than ever before, in addition to the conveniences it has provided in subjects such as data collection, analysis, and risk assessment, and has allowed the change of traditional habits. On the one hand, the instruments in the financial system have become more diverse and complex, the nature of the transactions has changed, access has become easier, and participation and

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thus the breadth and depth have increased, on the other hand, wide participation and the fact that the participants did not have sufficient knowledge and experience about the operation behind the system led to the spread of risks to a broader area (Rajan, 2005).

The global crisis appeared at the end of a period called great moderation when it was accepted that everything was going well. To this end, in a speech he made just a few years before the crisis, Bernanke, the President of the US Federal Reserve, stated that there had been a significant decrease in macroeconomic volatility since the 1980s and suggested that this could be primarily due to the successful macroeconomic policies implemented and the improvement of monetary policy (Bernanke, [10/10/2020]).

One of the key elements in the process leading to the crisis is undoubtedly the mortgage-backed securitization process. While the said financial innovation created an important source of income for the American financial institutions and the financial markets that took these innovations as an example, especially the United Kingdom, it also served as a tool for the society to both acquire wealth and ensure the continuity of consumption. This situation caused an artificial valuation and bubble formation in the housing markets.

The close relationship between financial markets in the globalizing world has been effective in the spread of the crisis, which started with the collapse in the American housing market, to wide geography in a short time. A closed economy, of course, does not experience a crisis due to foreign fund inflows and outflows. On the other hand, allowing capital inflow and outflow to and from the country increases the economy's efficiency and raises the welfare level of the citizens of the country. Avoiding crises requires changing things. This may make the banking system less efficient or less supportive of economic growth. Even with crises, the welfare of countries may be better than an economy that does not allow crises and where freedoms are limited (Baier, Clance, and Dwyer, 2012). At this point, there is a preference situation between the benefit to be obtained from global transactions and the cost of disruptions that may arise as a result of these transactions. Besides, the degree of freedom of financial markets is important in terms of effective management of resources. The financing system, which provides low-cost capital support in a competitive environment, offers significant advantages for investors. This system results from a long evolutionary process of partnership between public and private participants (Integrated Financial Engineering, Inc., 2006). The general question is how much financial instability must be accepted to best exploit long-term growth potential (Alessi and Detken, 2009).

Considering the situations mentioned above, the importance of the actions of the public authority, decision-makers, and private enterprise for financial efficiency or failure is clearly seen. The behaviors of all these decision-makers and market agents occur within a certain institutional framework. The said institutional framework and the effective behavioral patterns when making decisions and choosing between alternatives reflect the transformation processes that countries have experienced from past to present.

In respect to this background, this study aims to reveal the role of institutional factors as well as the macroeconomic dynamics that were effective in the Financial Crisis of 2008. After the introduction chapter, the literature on crises is examined in the second chapter, a general description of the crisis is presented in the third chapter, and in the following chapter, evaluations are presented about the process that led to the crisis, the global spread, the degree of success of the struggle, and what needs to be done to prevent similar situations in the future. A general evaluation is discussed in the conclusion chapter

2. Literature on Crises

It is seen that there is a limited effort of mainstream economics, which accepts the economy in a stable equilibrium state, in studies aimed at understanding and explaining economic crises. There is a prevailing view that the disruptions experienced in mainstream economics are caused by an unforeseen reason, and that when it disappears, a balance will be reached again. In this context, it would not be wrong to say that the biggest contribution to the crisis literature comes from heterodox schools.

At the forefront of the explanations for possible depression that may arise in the modern economic system are Marx's predictions about capitalism. Marx defines these crises not as an extraordinary situation but as a normal situation due to the internal contradictions of capitalism and a process rather than a sudden shock. According to Marx, the cause of crises is the faster expansion of production than the markets, that is not everything produced is consumed contrary to Say's Law (Marx, 2010)

Kondratieff, based on the idea that the dynamics of the capitalist economic system are not simple and linear but rather complex and cyclical he focuses on the waves that emerge over time. Unlike other researchers, Kondratieff's works focus on long waves, covering a period of fifty years rather than short and medium-term cycles. While Kondratieff claim the existence of long waves, he denies that they were cause by random causes and at the same time argue that long waves were cause by causes inherent in the capitalist economy (Kondratieff, 1979).

Mandel, like his processors sees periods of depression as an intrinsic element of the capitalist economy. According to Mandel, depending on market competition, capitalist production follows a cyclical course in the form of successive expansion and contraction and another cyclical expansion and contraction in the realization of surplus-value and capital accumulation corresponds to this. In terms of timing, volume and rate, the realization of surplus-value and the accumulation of capital are not entirely identical with each other nor with the production of surplus-value itself and this inconsistency provides an explanation for crises of

capitalist overproduction. Mandel argues that the fact that these inconsistencies cannot be attributed to chance and are due to the internal laws of the capitalist mode of production is the reason for the inevitability of cyclical fluctuations in capitalism (Mandel, 1976).

Studies on economic disruptions also have an important place in the institutional economics literature. The importance of an economically and politically stable institutional tradition that encourages and rewards innovation for economic development cannot be denied. On the other hand, institutions have a great role in the emergence of economic depressions and crises.

In the first period analyzes of institutional economics, crises are seen as an unavoidable feature of the capitalist system and free market economy. Periodic disruptions and collapses in welfare cycles are inevitable. However, on the other hand, there is the belief that the effects of disruptions can be alleviated by institutional interventions and regulations regarding the financial system (Veblen, 1905; Commons, 1934; Mitchell, 1913).

The new institutional economics, on the other hand, focused on three basic facts: transaction cost, private property and contracts. These three basic facts are the determinants of economic success or failure. That is, in an environment where transaction costs are low, private property is protected, and trust is dominant in the parties' compliance with the contract, the economic system will function effectively, otherwise an unstable economic structure will be in question (Coase, 1992).

In the recent analyzes of the crises, it is seen that especially the problems in the financial system are emphasized. Pioneering studies on this subject are generally about the problems experienced in Developing Countries, mainly arising from political failure and inadequate institutional structure (Krugman, 1979; Mishkin, 1990; Mishkin, 2001; Goldstein and Turner, 1996; Kaminsky and Reinhart, 1999).

Initially, the crisis literature emphasized that crises were caused by weak economic fundamentals such as excessively expansionary fiscal and monetary policies. However, the crises experienced afterward and the models developed in this regard have shown that crises can occur without significant changes in the policy basis (Kaminsky, Lizondo, and Reinhart, 1998). In the USA, the last financial crisis, which started with the collapse in the banking sector in 2007 and reached a global dimension in 2008, once again revealed the inadequacy of weak economic fundamentals and weak financial markets judgment as a starting point.

Using the Probit model, Estrella and Mishkin (1996) estimated the past recessions and crises for the US economy with the help of macroeconomic data between 1959 and 1995 and sought clues for possible future situations. This model, which was developed to predict recessions in the USA within the framework of financial parameters, is one of the pioneering studies for estimating financial recessions. The model suggests that tracking a few well-chosen financial variables related to recessions can be helpful for market participants and policymakers.

Using the logit model, Demirgüç-Kunt and Detragiache (1998) analyzed the determinants of banking crises with the data of 29 developed and developing countries that experienced banking crises between 1980-1994. The model makes comparisons between developing and developed countries and focuses on common points. According to the research results, when the macroeconomic environment is weak, the tendency of banking crises to occur is high. In particular, low GDP growth is significantly associated with increased risk in the banking sector. High inflation plays a fundamental role in increasing the risks regarding the banking sector because high and variable nominal interest rates associated with high inflation make it difficult for banks to realize maturity transformation. There is some (not very strong) evidence that high real interest rates significantly increase the probability of banking crises, even if real interest rates are controlled. The findings show that weak institutional structures and unstable economies, which are the basis of the crises, are open to crises, and as such, they are more of a problem for developing countries. Therefore, there is a limited contribution to explaining financial disturbances in developed countries.

Using the signal reception model developed by Kaminsky and Reinhart (1999), Kaminsky, Lizondo, and Reinhart (1998) performed the analysis of a common macro-economic background of the balance of payments and banking crises with the data of 20 countries that experienced banking and balance of payments crisis between 1980-1994. Hence, this study aims to reveal the causality relationship between the currency crisis and the banking crisis. The model plays a leading role in designing an early warning system designed to help detect when a crisis is approaching.

Hardy and Pazarbaşıoğlu (1999) presented a model covering 50 countries exposed to or experienced serious problems in the observation period to determine the leading indicators of the problems and crises in the banking system. The study examined the role played by the cyclical movements of the banking sector and real sector indicators on banking crises. A three-variable dummy variable that separates the crisis year, pre-crisis year and other times was used so that it is aimed to observe the unusual behavior trend that emerged before the crisis phase and enable the predictive power of leading indicators to be established independently of what is known only in the crisis year. According to the findings, banking crises were associated with a decrease in real GDP growth, excessive volatility in inflation, credit expansion, and capital flows, rising real interest rates and a decrease in the capital-output ratio, a sharp fall in the real exchange rate and an adverse trade shock.

Aka (2006) asserted the probable duration of financial stability and the determinants of this period, based on the effect of time on the probability of a crisis. With this model, which he designed to determine the possible duration of banking crises related to the stagnation of the financial

system, his analysis using data from 68 developing countries until 2004, concluded that the probability of banking crises occurring approximately every ten years is high. In this context, he stated that market participants and policymakers should not overlook the fact that financial stability is not an endless process, and he argued that policymakers should be constantly vigilant in supervising the financial system since the impression of failure is permanent. He also reported that under globalization, where international coordination in prudential control and regulation policies is required, fewer policy tools are available for individual country policymakers. This study by Aka supports the theoretical analysis of business cycles. Besides, it was suggested that the contagion phenomenon of crises and past experiences related to banking crises are largely valid.

Using a logit model to develop an early warning system to predict financial crises, Bussiere and Fratzscher (2006) conducted an analysis with the data of 20 developing countries that experienced financial crises between 1993 and 2001. Unlike standard practices, it has used a triple dummy instead of two by keeping the crisis moment and aftermath separate, thus aiming to create a more consistent forecast model by determining a trend for the post-crisis period, in which economic variables go through an adjustment process before reaching a more sustainable level or growth. Within the framework of this analysis, they concluded that not making a distinction between the "crisis period/post-crisis period" in crisis prediction models would lead to a significant deviation in the forecast results and thus weaken the ability of the models to predict financial crises. However, for this method, it is a very compelling assumption that the criteria determined while defining the post-crisis adaptation process are universal and valid for all times.

Reinhart and Rogoff (2008) compared the financial problems that started in the USA in 2007 with the crises experienced in the past in terms of asset prices, real economic growth, and public debt. They drew attention to the risks posed because financial assets that are not yet regulated or partially regulated have an essential place in the financial system, emphasizing that while technological developments eliminate some risks to the financial system, they also create new risks. They observed a similar trend in asset prices, especially in housing prices, and noted that stock prices reacted later than in the past due to the extraordinary amount of incentives by the US Federal Reserve. Reinhart and Rogoff, who suggested that the growth figures show parallelism with the previous periods, underlined that the public debts tend to increase more slowly than in the past.

Using a univariate signaling model, Alessi and Detken (2009) analyzed leading indicators of bubble formation and collapse in asset prices with data from 18 OECD countries between 1970 and 2007. In this way, they aimed to present an early warning system compatible with the real world as much as possible for decision-makers regarding asset cycles, and unlike previous studies, the importance of global variables related to crises was highlighted. Within the framework of the analysis in question, they concluded that the global M1 money supply deficit and the global private credit deficit were the best early warning indicators and that the best indicators were global variables, which can be explained by the fact that the bubble and collapse cycles in asset prices are mostly international phenomena.

Barrell et al. (2010) developed an early warning system for banking crises using the logit model, with data from 14 OECD countries that experienced banking crises between 1980 and 2006. Based on the idea that the triggers of any crisis depend on the type of economy and the nature of the banking system, the study focused on banking sector data instead of macroeconomic and financial variables, unlike previous crisis forecasting models. According to the results obtained from the analysis, high capital adequacy and liquidity ratio in the banking sector have a positive effect on reducing the probability of a crisis. Banking systems with healthy capital levels that held relatively high levels of cash and securities on their balance sheets a year before the crisis is less likely to collapse. The massive increase in real house prices three years before the crisis would clearly increase the likelihood of a crisis, as banks made long-term risky mortgage loans and the possibility of debtor default. Additionally, optimizing banks' liquidity and capital adequacy ratios and suppressing rapid real estate price increases may alleviate the possibility of a future crisis.

Keen (2011) developed and extended the Financial Instability Hypothesis Model (Keen, 1995), which was based on Minsky's hypothesis to explain the cycle that resulted in a period of moderation followed by a period of instability, then re-instability and a serious economic crisis, to create a monetary macroeconomic model. Within the framework of the relevant model, it aims to theoretically clarify the great recession and the great moderation period by highlighting both the monetary and real qualitative characteristics of the financial crisis and the transformation before it.

Baier, Clance, and Dwyer (2012) attempted to determine the effect of economic freedoms on the banking crisis with the data of 142 countries between 1976 and 2008 by using a linear probability model and exhibited the existence of an inverse relationship. In other words, the results show that contrary to assumptions, more economic freedom makes banking crises less likely. Nevertheless, the criteria on which the freedom index used in this study is based is also important. Implementations such as restricting the anti-competitive actions of market agents, securing contracts with laws, the existence of regulations regarding property rights, and sanctions for fraudulent acts emerge as a necessity of economic freedom. To this end, it could be suggested that countries with a high degree in the freedom index prepared by the Fraser Institute used in the research are subject to strict regulations on these issues.

Babecký et al. (2012) conducted an analysis using the Bayesian model with the data of 36 European Union and

OECD countries between 1970 and 2010 to determine the early warning indicators that could enable the detection of important risks in developed economies and which indicators are most useful in explaining the economic developments after the crises. In this study, firstly, by combining a continuous real cost index with a bilateral crisis occurrence index, they tried to improve the measure of the cost to the economy of crises and characterize the real costs of crises in developed economies. Then, unlike the existing models, they treated the duration of the early warning signal on a variable basis, using panel vector autoregression to determine the optimal time delay for each potential leading indicator. Finally, they used the Bayesian model mean to identify the most useful leading indicators. According to the findings obtained from this analysis, the most useful leading indicators for developed countries are both on a local and global scale. Among the local variables, the decrease in housing and share prices and the increase in private sector credit, and the decrease in private sector credit among the global variables were the most important indicators. The most key indicator of giving a clue about the crisis is domestic credit growth.

Using the error correction model, Chenguel (2014) attempted to determine the spillover effect of the crisis, which started with the payment problems in subprime mortgages in the USA in 2007, by testing the correlation between pre-crisis and crisis-period countries by observing whether they show a common behavior. He also analyzed this relationship through the stock market index movements of the G7 and BRIC (Brazil, Russia, India, and China) countries and determined that the crisis in the American financial markets started with developed countries and followed a path towards developing countries.

Laina, Nyholm, and Sarlin (2015) analyzed the leading indicators of systemic banking crises with the data of 11 EU countries that experienced crises between 1980-2013 using the signal reception model and logit model. This study focuses on the determinants of the banking crisis within the framework of a relatively homogeneous cluster of economies, focusing only on European countries. In the analysis, the logit model and the signal reception model were used together, and it was shown that the obtained findings supported one another. According to the findings, the growth in the loan/deposit ratio and housing prices were the most successful leading indicators. The increase in household and private sector debts, the growth in mortgage loans, and the deviation from the trend were also useful leading indicators. There is no evidence that macroeconomic variables such as inflation and current account balance, particularly the change in GDP, were good leading indicators.

Miao and Wang (2015) put forward a theoretical analysis to develop a macroeconomic model that can be traced through the assumption of a banking sector where banks are faced with internal borrowing constraints within the scope of asset bubbles, banking crisis, and welfare effects, and they reached the following conclusions in this framework: In this study, in which agents were triggered by changes in the opinions of banks about the stock market value, it is shown that while fundamental shocks can cause a financial crisis, loss of confidence may also play an important role. The positive feedback loop mechanism creates banking bubbles. The existence of a banking bubble relaxes a bank's borrowing restrictions and allows the bank to lend more, positively contributing to economic growth. As long as there is no collapse, the bubble equilibrium provides higher economic efficiency than the bubbleless equilibrium. Another prominent point in this study is the negative nature of the bubbleless equilibrium state, which does not allow for an asset bubble in terms of economy. Under such a balance, households invest fewer deposits in banks, fearing that they will not be repaid in the future, and accordingly, banks lend less to non-financial firms. This results in lower capital stock and lower production. Based on this argument, it can be assumed that instead of a static balance that provides stability, dynamic institutional structures that can cause fluctuations and crises from time to time, but allow innovation and transformation, enabling higher levels of welfare to be achieved.

Huang and Chiang (2017) developed an early warning system under the threshold unobserved components model, considering the 20 most populous states of the USA and half of the data from 1975-2011. In the proposed model, the existence of a housing bubble was tried to be determined by focusing on the non-linear relations between the housing market and the real economy. In the evaluation, it was suggested that thanks to a well-functioning early warning system regarding the housing bubble, investors could reduce the investment weight of real estate assets under the possibility of a collapse in the housing market and reduce the loss of wealth. However, such a foresight may cause panic in the housing market and precede a possible crisis, and even an erroneous prediction may cause a collapse even in a healthy market. As a result of this study, according to the findings obtained regarding the bubbles in the housing market, housing price dynamics are highly related to historical paths rather than economic fundamentals, and it is seen that the valuation in housing prices continues for several periods. While housing markets were closely related to macroeconomic totals until 2000, it was observed that housing prices started to rise despite the macroeconomic collapse experienced with the 2001 recession. Three signs of an early warning system were suggested: the persistence of autoregressive patterns in house price, interactions between house price dynamics and economic fundamentals, real per capita income growth at the state level, and whether trends act as drivers of house price dynamics.

Pedro, Ramalho, and da Silva (2018) conducted an analysis using the probit model under original effects with the data of 33 OECD countries between 1991 and 2011 to determine the main determinants of banking crises in these countries. With this study, they tried to seek an answer to the question "Do the country-specific banking sector and

macroeconomic conditions affect the probability of banking crisis?" and the spillover effect of the crises was also mentioned. The analysis reached the following conclusions: In addition to high bank debt, low GDP growth is the primary determinant of banking crises. Crises are contagious between countries in the same geographical region and from the G7 to other countries. Bank-based financial systems are more resilient to cross-border banking crises. Regulation and supervisory activities are not related to the prevention of bank failure.

3. Global Financial Crisis

The collapse in financial markets, which started with financial instability and bankruptcies in the USA and the UK in 2007, suddenly became widespread in vast geography with the effect of the integration in the global financial system and investment relations between countries. In addition to the technical and technological developments experienced in the last quarter of the 20th century, the long-standing moderate growth process was interrupted by an unexpected crisis.

Stiglitz stated that consumption should continue for the growth of the global economy, but when income did not increase and savings fell, a debt-based consumption network was created with the mortgage-based credit system, which emerged as a way to overcome the said dilemma. The whole system was built on the erroneous prediction that housing prices would increase or at least would not decrease. It was only at the time of the collapse that it was understood that the banks did not know either that their customers borrowed much more than the asset values nor that they did not know the positions of other banks (Stiglitz, 2012).

According to Roubini and Mihm, housing is considered a safe harbor, and mortgage-backed loans are considered safe even if there are problems in payments due to the real estate shown as collateral. However, as people's salaries remained stable, they used loans by providing collateral for their homes to benefit from the rise and gain more consumption opportunities, and some of the loans they received were spent on consumption and some on acquiring new housing. The upward impact of this revival in the housing market on prices led to an increase in collateral-based credit limits and a vicious upward circle. When the bubble burst and the cycle reversed, not only those who had difficulty in paying their debts but also almost everyone who bought real estate on credit suddenly became a seller (Roubini and Mihm, 2012). To this end, as Stiglitz stated, in mortgage-backed loans, it is logical for a rational individual not to pay the loan when the value of the real estate subject to the loan falls below the loan obtained (Stiglitz, 2012).

Reinhart and Rogoff reported that the liquidation of real estate through securitization is the basis of the market rise. Thanks to the credit opportunities that emerged in this way, American citizens could increase their consumption, but the tendency to save decreased. In the pre-crisis period, global savings tended to increase, and the consumption of the American society was funded in this way (Reinhart and Rogoff, 2010).

With the recent financial crisis, which emerged as a result of the asset bubble bursting in the housing market, a serious weakening was observed in the US banking sector, the stock values of the banks decreased, and bankruptcies were experienced. After the great economic recession in the banking sector, banks increased their credit conditions and standards to unprecedented levels in response to the bad conditions experienced. Despite the "Interagency Statement on Meeting the Needs of Creditworthy Borrowers" published under the leadership of the FED in November 2008 to encourage the borrowing of financial institutions, it was observed that the strict attitude in the financial markets continued throughout 2009 (Kwan, 2010). In other words, despite the incentives for the abolition of credit restrictions, post-crisis financial institutions showed a restrictive attitude to their activities due to uncertainty and pessimism in the markets. This disruption in the financial markets also profoundly affected the real economy by causing the economy not to be able to provide the cash flow it needs to continue its activities, that is, the financial transmission mechanism to be disabled and economic activities to be interrupted.

The panic, which started in the financial markets of the USA and the UK, quickly moved to a global dimension and spread too many countries with the influence of the national banks, which hold the so-called toxic funds that are traded in international markets, regardless of similar financial problems and/or asset bubbles. A global recession period began as international trade suffered greatly from these disruptions.

Krugman stated that the Crisis of 2008 was a summary of almost all the crises in the past. The real estate bubble burst in the late 1980s, as in Japan, banks were stormed as in the early 1930s, and liquidity traps emerged in all regions similar to the crisis in Japan, and international capital movements were interrupted similar to what happened in Asia in the second half of the 1990s. The loss of confidence experienced by the US Federal Reserve and the weakening of its leadership power also emerged as a factor that made it difficult to get out of the crisis (Krugman, 2010).

Acemoğlu argued that with the crisis, the arguments that excessive fluctuations in business cycles can be prevented by a clever policy and new techniques-technology and the risks are removed, free markets do not require any regulation to restrict personal interests, and large and established companies can be trusted to monitor their activities to protect their nominal capital have become invalid. However, on the other hand, he emphasized that due to the crisis, financial innovations that would contribute to economic efficiency under ordinary conditions should not be put forward as the cause of the crisis (Acemoğlu, 2009). In this matter, the psychological effect caused by the crisis has led to the formation of a pessimistic audience for every innovation that facilitates social life in the following period.

4. Institutional Structure that Brought about the Crisis

The effect of institutions on economic success or failure has always been on the agenda of researchers in this field in the historical process, especially institutional economists. In many texts, it is seen that crises are accepted as a systemic problem of capitalism. The market system, which is an institutional structure, is based on very complex dynamics and according to many views, the supply-demand balance is not a general but a special situation of the market. In particular, the developments in the financial system, on the one hand, provided ease of access and transaction, on the other hand, wide participation and the lack of sufficient knowledge and experience of participants about the functioning of the system further increased the uncertainty (Rajan, 2005). In this new financial architecture, it is seen that the factors that cause market failures such as moral hazard, asymmetric information and principal-agent problem that harm the security of contracts come to the fore. These factors also played a leading role in the 2008 financial crisis.

After the Great Depression, there have been many evaluations regarding the 2008 Crisis, the second biggest crisis faced by capitalism in terms of the length of the process, the depth of the destruction it caused, and its area of influence. These assessments appear to come mostly from outside mainstream economics. These evaluations can be classified into four categories: the process leading to the crisis, the factors affecting the spread of the crisis, the effectiveness of the policies implemented in the resolution of the crisis, and what should be done to prevent similar disasters that may occur in future. These explanations, which sometimes overlap, complement, and contradict each other, almost reflect the assumption that institutional economists often emphasize that every researcher is influenced by the environment and his mindset while expressing his opinions.

King claimed that the Crisis of 2008 was a failure of the system and the ideas that supported it, not of individual policymakers or bankers, and it was caused by a general misunderstanding of how the world economy works. Additionally, he argued that economics, or at least dominant economic thought, promotes ways of thinking that make crises more likely (King, 2017).

Hodgson expressed that the reason behind the failure to see or ignore the crisis is that the academicians working in the field of economics isolate themselves from the real world in their studies and that the academicians working in the field of business and finance are more involved in the system as consultants and similar duties (Hodgson, 2009). In today's world, consultancy activities for many schools have become an element of prestige. However, in this case, the preferred route has been chiefly to bring the relevant sector to the forefront rather than responding to the needs of the economy as a whole.

The reaction of especially the representatives of the mainstream economy and policymakers towards the collapse in the markets after the crisis was unexpected events. However, Roubini and Mihm, when past experiences are examined, stated that what has happened was ordinary and that crises were not an exception but a standard for modern capitalism. In order to characterize this situation, he preferred the concept of "white swan" as opposed to the concept of "black swan," which is commonly used to express extraordinary situations. Roubini and Mihm drew attention to the importance of the moral hazard problem for the Crisis of 2008, emphasizing the willingness of intermediaries to take risks that they would not take if they would be responsible for the consequences before the crisis. They also stated that the principal-agent problem lies at the root of this situation. Another oddity they noted regarding the elements of the system is the structure of financial rating agencies. The contradiction that the auditor's salary is paid by the audited, the competition caused by the fact that the company that cannot get the desired grade can turn to another rating company causes the moral hazard problem to be seen in this situation as well (Roubini, Mihm, 2012).

Similarly, Kotz asserted that periodically occurring crises are a systemic condition of capitalism and that the experienced crisis should be seen as a part of greater development. He underlined that accepting the crisis as systemic means that a major restructuring of the system can only solve the problem. Kotz also stated that if the experienced financial and real economic crisis is a systemic situation of neoliberal capitalism, as he claims, the system cannot be sustained with limited interventions, and neoliberal capitalism can be expected to transform and take a new form, and similar transformations were experienced after the Great Depression and the Second World War. In this context, Kotz argued that a system in which the fragility of the financial sector rises, an asset bubble of increasing scale is needed for each new expansion, and wages are suppressed so severely that economic expansion is only possible with increasing household debt is unsustainable (Kotz, 2009).

Crotty expresses that the strict financial regulation system built after the Great Depression was deconstructed through radical deregulation, which was enforced by financial institutions after the 1980s and justified by efficient financial market theory, and added that these developments accelerated the transition to a new, globally integrated, and deregulated neo-liberal capitalism. In this context, he argued that although the problems in the subprime mortgage market triggered the financial crisis, the main reason underlying the crisis was this "new financial architecture." Crotty describes the structural flaws of the new financial architecture as a system in which commercial banks distribute nearly all risky assets to capital markets, where financial products are built on a weak theoretical foundation, create excessive risk, have widespread adverse incentives that produce crises, and exacerbate booms, where financial products are too complex to be priced correctly within the framework of financial

innovation. He also regarded this case as a system in which banks are allowed to hold assets off the balance sheet and have no capital requirement to support them, allowing huge banks to measure their risks and determine their capital requirements and facilitate dangerously high leverage growth (Crotty, 2009).

Krugman pointed to hedge funds and underlined that the purpose of their emergence was to protect wealth from fluctuations in the markets, but in practice, on the contrary, it became used to obtain the highest possible return from these fluctuations (Krugman, 2010). According to Stiglitz, the purpose and/or duty of institutions is to reduce transaction costs. However, in the pre-crisis period, financial institutions built their revenues on increasing transaction costs. Stiglitz also argued that in the two decades before the crisis, banks around the world were repeatedly supported by bailouts that increased the risk of moral hazard. Stiglitz also noted the "self-fulfilling prophecy" regarding the bankruptcy of financial institutions. If there is an insurance policy demand for the bankruptcy of a financial institution in the market and mutual funds large enough to manipulate the markets make such a demand, the loss of confidence in the market makes this expectation a reality. As a matter of fact, this situation was one of the most severely experienced issues in the Crisis of 2008. Stiglitz also reported that faulty incentives caused by problems in corporate governance encourage banks to take risks without foresight. However, according to Stiglitz, at this point, new financial products and new methods that allow banks to make troubled debts invisible on their balance sheets led to the growth of the financial bubble (Stiglitz, 2012).

Besides, the application of deposit insurance created a similar risk. Mishkin argued that the deposit insurance application, which was implemented to prevent bank panics after the Great Depression, has become the norm for many countries today. He also claimed that the said practice was very effective in preventing bank panics but suggested that the moral hazard problem caused by encouraging banks to take more risks could create new problems for the system. Mishkin, who suggested that the moral hazard problem created by a safety net would have even more serious consequences in the case of large-scale financial institutions, underlined that failure on this scale could lead to a systemic risk that the entire banking system was threatened and that it may spread to other banks and financial institutions and cause a crisis of confidence. Mishkin stated that in case of bankruptcy, that is, in the case of a banking panic, the knowledge capital they developed would also disappear and that this situation can also seriously impede the ability of the economy to provide funds to those who have efficient investment opportunities, and with this financial crisis, there may be a considerable decline in investment and production (Mishkin (2005).

Kaminsky and Reinhart reported that financial crises followed a period of financial liberalization and that crises emerged as a collapse following an increase in credit and capital inflows during this period. In this context, the crisis is seen to be directly related to institutional decisions. Considering this thesis suggested by Kaminsky and Reinhart for the developing countries for the Crisis of 2008, it can be said that in the economies that are already quite financially free, the path to the crisis has been opened by the fact that the financial innovations that have taken place have further stretched the existing institutional framework (Kaminsky and Reinhart, 1999).

Similarly, Reinhart and Rogoff asserted that the financial liberalization process weakens the immunity of countries to crises, and this is due to the illusion that there are necessary control mechanisms for the functioning of the system and the detection of possible malfunctions in the deregulation process (Reinhart and Rogoff, 2010).

Galbraith, specified that when the 1929 Depression was considered, the evaluations before the crisis were mostly in the direction that the fundamentals of the economy were considered sound, but he added that in reality, it was not like that at all. According to Galbraith, high level of income inequality, bad corporate structure eroded by corruption and fraud, flawed banking system eroded by the effect of loss of value in collateral, dubious state of external balance, uncertainty caused by the risk of non-repayment of foreign loans given due to constant current account surplus, and insufficient knowledge, and foresight about the functioning of the economy are the most important deficiencies of the system (Galbraith, 1979). Looking at the points that Galbraith pointed out about the American economy before 1929, it can be argued that more or less similar problems existed before 2008, except for the current account deficit and debt issue. In addition to all these problems, this time, there is an American economy with a high current account deficit and high debt burden.

Posner suggests that there are two main reasons behind the financial problems: the unsound monetary policy of the US Federal Reserve in the early 2000s and the inadequate regulation of financial intermediation. These are related to the fact that the low interest policy implemented triggered a bubble, and the deregulation policy implemented since the 1970s, which reached its peak in the 2000s, left the system unprotected. She also stated that the policy makers' lack of knowledge about the rise and risks of the shadow banking sector was effective in being caught unprepared for the crisis and in the mismanagement of overcoming the crisis (Posner, 2011).

King noted that while savings in the West decreased in the pre-crisis period, developing countries, especially China, followed policies to give a surplus in foreign trade, with the experience of foreign exchange insufficiency in the banking systems that emerged in the crisis in East Asia, thus increasing their savings and foreign exchange reserves. This abundance of savings brought down long-term interest rates around the world. Furthermore, in countries facing permanent trade deficits, especially in the USA and the United Kingdom, central banks took short-term measures of

lowering long-term interest rates to accelerate the growth of domestic demand through monetary expansion and increasing credit opportunities to maintain stable growth and low inflation and to compensate for the pressure of the trade deficit on aggregate demand. Such low interest rates in all maturities encouraged spending, which has become unsustainable in many countries. Despite the high saving levels in Asia, with the increasing debt in the West, a savings-investment imbalance has emerged in the world economy as a whole (King, 2017).

At the heart of the Crisis of 2008 lies the shadow banking system. Krugman expressed that today the system in which non-banks but operating as banks take place is called "parallel banking" or "shadow banking." According to Krugman, the inclusion of some of the risky financial instruments created in the rising period in the off-balance sheet transactions of commercial banks can be among the causes of the crisis, but it would be more accurate to claim that the crisis stems from the risks assumed by the institutions that have not yet been regulated, rather than deregulation. In this context, he noted that the authority overlooked this situation when it was necessary to understand that shadow banking created the kind of financial vulnerability that made possible the Great Depression as shadow banking expanded to compete with and even surpass traditional banking, and to create a safety net to cover this new system (Krugman, 2010). Similarly, Acemoğlu asserted that what happened was not a failure of capitalism or free markets per se, but a failure of unregulated markets, especially an unregulated financial sector and risk management (Acemoğlu, 2009).

Although not pronounced for the Crisis of 2008, Minsky is one of the economists who came to the agenda again after the crisis due to the timeless nature of his assessments. At the heart of Minsky's views is the argument that instability is a fundamental element of capitalism. Minsky showed the capitalist financing system as the cause of the instability and drew attention to the investment boom that emerged due to financing facilitation. Minsky stated that the erosion of the safety margins in this process could increase the interest rates and that the increased interest rates may cause a slowdown in investments and then a crisis (Minsky, 2013).

Minsky divides the financing status of agents into three: hedge, speculative, and Ponzi finance. In the case of hedge finance, the debtor has enough cash to meet its payment obligations. In speculative finance, the debtor cannot fully meet its debt obligation in the short term, and the difference between income and debt obligation is met by refinancing. On the other hand, Ponzi finance involves a constant erosion of equity and refinancing liabilities. Minsky argued that the wide spread of this form of financing, which can be considered legitimate in industries with long-term investments and seasonal characteristics, could create pressure that increases the fragility of the financial system. Similar to the one here before the Crisis of 2008, it is seen that the risks for both the borrower and the lender were completely ignored due to financial ambitions, and a borrowing system independent of income, assets, and employment status was built (Minsky, 2013).

According to Krugman, the reason behind the rise in the housing market is the low interest rates, as well as the abandonment of the principles of lending institutions and ignoring basic loan requirements such as solvency. In addition to those who participated in this irrational caravan of excesses, aiming to take advantage of the rapid rise in housing prices and not considering how to make payments, credit institutions also ignored such details and did not care about the quality of the loans they gave (Krugman, 2010).

Krugman discussed that although the increase in the housing market did not reach the level of the increases experienced in the stock market in the early 1990s, there were two main reasons for its great impact on the economy. The first is that, unlike the housing sector stock market, it appeals to almost all of the middle class. The second is the unequal distribution of changes in prices across the country (Krugman, 2010).

Roubini and Mihm similarly indicated that the underlying reason for the boom in the markets is the sale of mortgage-backed real estate by speculators as shares, as well as technological innovations and financial innovation, and ordinary members of the society gambling in the stock market by being attracted to the new economy without any experience. They also stated that in this process, politicians encouraged the problem rather than hindering it, causing the problem to outgrow. The securitization of toxic assets is only a starting point for the formation of a financial bubble. Corporate governance, premium-based wages, government policies promoting housing, and high financial leverage ratios implemented by banks were also influential factors in this process (Roubini and Mihm, 2012).

Nelson and Katzenstein suggested that only one of the four basic elements at the center of the Crisis of 2008, namely excessive risk-taking, mortgage securitization, risk management models, and central bank practices in financial markets, can be explained by rational behavior. In this framework, he stated that excessive risk-taking only with the incentives brought by a competitive environment could be considered rationally consistent, while in the other three elements, social contracts play an important role in shaping the decision-making of representatives (Nelson and Katzenstein, 2014).

Taylor, as one of the most important representatives of rule-based monetary policy, stated that financial crises are mainly policy-induced, resulting from excesses that lead to a boom and inevitable collapse, often being monetary excesses. To this end, he argued that before the Crisis of 2008, the US Federal Reserve deviated from the rule due to a Japanese-like deflation concern and deliberately applied an unusually low interest rate, creating an asset bubble and paving the way for the crisis (Taylor, 2009).

On the other hand, Kindleberger and Aliber suggested that the cycle of excess and panic was caused by cyclical changes

in the credit supply and noted that the credit supply increased relatively quickly during the expansion period, while it generally decreased sharply when economic growth slowed down. In this context, he indicated that the excess includes the increases in the prices of real estate, stock, and/or a commodity in the present and near future, which are not consistent with the same real estate, stock, and/or commodity prices in the distant future. Stating that monetarists' view that financial excess does not occur if the growth rate of the money supply is balanced or constant, Kindleberger and Aliber argued that although this may reduce the frequency of excesses, it does not entirely eliminate them (Kindleberger and Aliber, 2005). At this point, Kindleberger and Aliber seem to contradict Taylor's assessment that rule-based monetary policy prevents the crisis. Moreover, there are evaluations that this is not a choice for policymakers and that expansionary monetary policy should be maintained for the continuation of growth; otherwise, it is possible to enter a recession much earlier.

Stiglitz proposed that what caused the housing bubble was the liquidity and low interest policy applied to relieve the markets after the bursting of the technology bubble. He added that the increased oil prices with the Iraq War increased the import and current account deficit, and the housing bubble supported by the low interest policy was used as an incentive to continue consumption. Floating-rate loans, on the other hand, have been one of the biggest threats to the system. With the new financial system created, it opened the way for market agents to gain higher profits by taking more risks, and the supervisors ignored the risks. The exclusion of extremely risky actions in financial markets from regulatory and supervisory mechanisms with the effect of tight lobbying led to the formation of a system that creates negative externalities for the entire economy. From this perspective, it can be claimed that politicians have two options: They either ignore the risks involved and pursue growth—which has caused bigger problems and only delayed the possible collapse—or they accept the recession (Stiglitz, 2012). Considering that economic recession threatens the continuity of political power, it would not be wrong to say that the first option outweighs the latter.

5. Assessments about the Contagion of the Crisis

As well as the emergence of the crisis, its rapid contagion in global markets and its impact on wide geography emerge as a matter that should be carefully considered. The fact that developed countries, which have a very high share of the world's GNP and realize a huge part of the consumption, are at the center of the crisis, which has also been the determinant of the level of impact.

At the point of the global contagion of the crisis, Roubini and Mihm stated that a bank bankruptcy in the UK similar to the one in the USA made the whole system questionable. In this uncertainty, investors have no longer evaluated the risks since no one has sound knowledge about the depth of financial problems (Roubini, Mihm, 2012).

Chudik and Fratzscher evaluated the global transmission process that led to the contagion of the crisis within the framework of the tightening in liquidity conditions and credit markets, the serious repricing of risks and investors fleeing to safe asset classes, and added that both factors play an important role in the global transmission process (Chudik and Fratzscher, 2011).

Stiglitz, on the other hand, asserted that the crisis quickly took a global turn since a significant part of American toxic assets went abroad, that this was a chance for the American economy; otherwise, a much worse scenario would be faced. After the deregulation approach of the markets, the USA also exported the recession (Stiglitz, 2012).

6. Assessments on the Recovery Process of Crisis

The recovery process of the crisis is at least as complex and challenging as the process leading to the crisis. Krugman implied that macroeconomic policies have three dimensions, that is, three situations that the authorities want regarding their economy can be mentioned. These are discretion in formulating monetary policy to fight recession and inflation, stable exchange rates to eliminate the uncertainties that the business world may experience, and free international business life to attract foreign investment. However, it is not possible to have all three at the same time. At most, two can be possessed simultaneously, and in this context, the authorities have to make a choice (Krugman, 2010).

Roubini and Mihm evaluated the interventions made during the crisis within the framework of short-term policies and argued that this process, which emerged from financial excesses, could turn into a crisis without applications such as bailout packages, debt expropriation, and credit guarantees. However, when considered in the long term, they underlined that the solution to the problem is to reduce debt for everyone. Additionally, Roubini and Mihm expressed that the financial measures in the crisis period have a cost and that the increased public expenditures in a period of reduced taxes increase the budget deficits, which is unsustainable in the long run. In this context, the increasing borrowing requirement of the government increases the interest rates, increasing the cost of the loans to be used by the private sector to finance consumption and investment expenditures (Roubini and Mihm, 2012).

After the crisis, recovery programs were started by almost all authorities, but the effects of the implementations were limited, and the recovery period from the crisis took quite a long time. Stiglitz noted that this was caused by the increase in demand for money with the precautionary motive with the crisis and that the demand in question rendered the support provided by tax cuts ineffective for the revival of the markets. Similarly, lowering interest rates did not increase consumption and investment demand. The unwillingness of banks to lend was also effective in this situation. Stiglitz also argued that the judgments from the past created a path dependence on the arrangements made for the recovery from the crisis and explained that due to their compelling

interests, free-market advocates try to prove the correctness of their approach despite all the evidence to the contrary (Stiglitz, 2012).

According to Krugman, two matters need to be implemented to recover from the crisis: Bringing the credit mechanism into force and supporting expenditures to increase consumption. However, not repeating what happened in the long term requires radical reforms. The success of these reforms depends on a correct comprehension of the system (Krugman, 2010).

Reinhart and Rogoff suggested that international institutions take a more active role and increase international cooperation, as well as monitoring and controlling the financial system by creating long-term time series (Reinhart and Rogoff, 2010). These recommendations are in line with Mitchell's thoughts on the creation and monitoring of good statistical databases (Mitchell, 1913) and the Commons' ideas for increasing international cooperation (Commons, 1925).

King stated that it is not possible to talk about an undisputed victory of capitalism, that the belief in capitalism has been shaken, but this belief must be re-established. According to King, capitalism is far from answering problems that require collective solutions and providing a fair distribution of income and wealth. However, it is the best way to create wealth, and capitalism provides incentives for productivity-enhancing innovation processes. Drawing attention to the importance of the money and banking system in the capitalist system, King noted that the said structure is the institutions that reflect the technology of the day and are constructed by people. These institutions, which are vital for economic growth and provide the necessary resources to accumulate capital, have transformed illiquid real assets into liquid financial assets through financial alchemy, and this alchemy has emerged with the crisis. According to King, the financial system must be redesigned and reshaped to support a prosperous and more stable form of capitalism (King, 2017).

Taylor, who argues that the depth of the crisis and its contagion over a long period of time, as in the process leading up to the crisis, are also due to the wrong policies applied, underlined that this was caused by deviating from historical experience and principles. Besides, Taylor argued that the international financial architecture should be rethought to be protected from possible disruptions in the future and that keeping policy interest rates in balance in a globalized economy helps to reveal the concept of a global inflation target (Taylor, 2009).

Stiglitz proposed that in addition to the debt burden from the current crisis period, a less competitive, more inefficient, and more fragile financial system may be encountered in the face of possible disruptions that might arise in the future. As a matter of fact, the bailout packages implemented in overcoming the crisis increased the money supply to levels never seen in history. Stiglitz claimed that the state's role should be the construction of a balanced economic system with the support of market and non-state institutions, in coordination with the market, in ordinary times, beyond recovery and re-operation of the system after the collapse (Stiglitz, 2012).

Veblen, the pioneer of institutional economics, suggested that modern companies' market value, especially companies operating in the banking sector, is generally above their real value. According to Veblen, this is the source of credit expansion during the welfare period. The use of funds secured by uncertain collateral for new purchases and the use of these as collateral for another loan creates an ever-expanding loan volume, and increasing effective demand pushes prices upwards. However, in the event that the collateral is not of an instant cashable nature and the collateral is above the real value of the market price, the loan-collateral relationship is not sustainable (Veblen, 1905). This situation, which was experienced many times in history, is one of the main reasons for the Crisis of 2008. When the belief in the society that prices would not rise anymore, the demand for investment loans decreased, and this development endangered the outcome of existing loans. Increasing uncertainty raises the cost of loans, and the cost of new loans sometimes exceeds the value of collateral, especially in a cycle where debts are already paid off with new loans. Under these conditions, the sale of properties, which are given as collateral in return for non-performing loans, also increases the downward pressure on prices. Commons expressed that in this case, those who acquire investment property tend to sell to exit the market with the concern of protecting their wealth (Commons, 1934).

7. Conclusions

The Crisis of 2008 necessitated updating our knowledge of the structure of the economy by invalidating many predictions about the state of the economy and the systems designed to detect financial disruptions. It is also noteworthy that the crisis started in developed countries, where their financial structures are considered strong and effective, and spread by following a path firstly to developed countries and then to developing countries. This study aimed to clarify the aspects that the Crisis of 2008 has similarities and differences with the previous crises.

Based on the evaluations on the causes of the crises, it is inferred that the views on institutional failures, the effect of the financial innovations and liberalization process, and the systemic tendency of capitalism to a crisis are at the forefront. As it was experienced in the Crisis of 2008, the problems that arose in one or more of the representatives of the sector due to the erroneous decisions and practices of the fund managers, also with the influence of personal interests, tended to spread to the whole sector in a short time. The tendency to sell shares that emerged in this process had an accelerating effect on the collapse.

Besides, it was observed that interest rates, which remained low for many years due to both international influences and

the policies implemented to ensure the continuity of growth, started to rise due to the increasing risks before the Crisis of 2008. In a system in which existing debts were tried to be rolled over with new loans, the rise in borrowing costs made this cycle unsustainable.

The instabilities in variables such as housing and stock prices, growth and industrial production, interest rates, public sector debt, and exchange rate are not the cause of the crisis but are under the common influence of the dynamics that led to the crisis. In fact, with the crisis experienced, they gain a quality that affects each other. Banking problems mainly result from prolonged deterioration in asset quality, such as a fall in real estate prices or escalating bankruptcies in the non-financial sector, rather than on the liability side. A collapse in the housing or stock market or suddenly rising interest rates, which are the triggers of the financial crisis, show more tremendous changes with the effect of increased risk and uncertainty with the crisis, and as a result, a process that feeds each other and leads to the deepening of the crisis emerges. However, we believe that it would be a correct assessment to indicate that the most fundamental factors in the crisis are the institutional tradition and the economic system. The capability of countries to continue the financial liberalization process flawlessly is directly related to solid banking regulation and supervision, a well-functioning institutional structure, and an effective legal system.

The Global Financial Crisis of 2008 had an impact that considerably shook and changed the thoughts and acceptances on the functioning of the economy. The technological transformation and financial innovation process, which has been effective since the 1980s with financial globalization, made access to financial systems easier than ever before. However, these new techniques and tools used led to the emergence of an equally complex and risky financial structure. In this new system, although access to information has become extremely easy, the margin of error of the decisions made by market agents has increased due to information pollution and asymmetric information. The reason for this is that the emerging system allows savers to invest directly or indirectly through a financial intermediary, in their own country or anywhere else in the world, without adequate knowledge of the risks, with the ambition of higher earnings.

When the analyzes on the causes of the economic crises and the prediction of the crises are examined, it is seen that the majority of them are aimed at explaining the crises in the developing countries. In these analyses, problems such as high inflation, high public and private sector debt, financial bubbles, currency pressure, current account deficit, and budget deficit, caused mainly by erroneous policies implemented by decision-makers, are emphasized. The Crisis of 2008, on the other hand, differs from what happened in the past in terms of its scope and structure. Although the crisis affected the whole world through the global financial network, the most affected were the financially developed countries, whose legal structure was established and which had a stable political regime. Additionally, as Krugman puts it, it is like a summary of the past, as it contains many features of past crises.

When the evaluations of the Crisis of 2008, which started with the collapse in the American financial markets and then reached a global dimension, are examined, it is concluded that many institutional dynamics are referred to, from the wrong policies implemented to the crisis-producing systemic structure of financial capitalism. The explanations before and after the crisis about this great collapse, which was not on the agenda of mainstream economics, mainly came from the representatives of heterodox economics. Hence, the rich content of this alternative world should not be ignored in the analyses and evaluations about the relevant period's events.

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