

## Prologue

**IN THE WAKE OF** the ongoing financial crisis, academic and public opinion on the nature of finance has changed dramatically. Prior to the crisis, financial markets seemingly embodied all that was rational about capitalism. Finance was widely hailed as the most efficient and dynamic sector in the U.S., even the world, economy; financial innovators were praised for their talent and courage in spotting new opportunities for investment and generating new wealth; and increased access to financial services, especially in the market for mortgages, seemed to point the way toward a new capitalist utopia: the “ownership society,” where wealth and financial security would finally be within reach of most. It was widely argued that freeing up markets, deregulating banks and financial transactions, and giving financial firms and their managers new incentives (and adequate remuneration) to innovate would unleash the full potential of rational capitalism.

When the financial crisis hit in 2007, only to explode on a larger scale in 2008, it injured society’s trust in this ideology. Greenspan had complained about the irrational exuberance of financial markets as early as 1996. But in 2007 and 2008, for the first time in more than half a century, politicians and their economic advisers came face to face with the danger of this mindset on a large scale. Suddenly, they came to see finance as driven by speculative behavior, and the current crisis as a pathological outcome of this underlying foundation. Arguments about the irrationality of finance finally found serious intellectual footing in new theories emphasizing the emotional, even the temperamental, aspects of economic behav-

ior in general, and financial behavior in particular. Rather than depicting rationality, finance unleashes “animal spirits.” Rather than a solution to inefficient allocation of resources, finance, especially unregulated finance, came to be understood as an integral part of our woes.

It would be difficult to exaggerate the magnitude of these changes in intellectual climate and public opinion. And yet, it would be deeply problematic to ignore what has *not* changed in the wake of the crisis. A major element of continuity in economic approaches to finance—an element that has proved to be remarkably resistant to change—is the tendency to take an individualistic approach—to argue that the individual rational actor (and his/her potential shortcomings) is the bedrock of economic processes. One of the problems that immediately results from accepting the individual as the basic unit of analysis is that economic approaches are then relegated to psychological explanations. Was this or that analyst rational or irrational in his or her financial behavior? This becomes the root question in order to explain why financial processes can unfold so smoothly for so long, to then be so quickly, and spectacularly, disrupted.

But when we look back in history from the distant future, we will not count this crisis as one of individual rationality. We will see it, I believe, as a crisis of collective behavior. This requires that we shift attention from individuals to *organized financial groups*. In this light, we can see that finance is about conflict, centered around turf wars and ideologies that play out on a quiet, buttoned-up battlefield such as Wall Street. And finance becomes stable only so long as warring factions of bankers and financiers lay down their arms and embrace *collective* arrangements that curtail their freedom to innovate. Understanding finance, in other words, means understanding in detail how these factions organize themselves and maneuver in order to gain control—until a systemic equilibrium is reached, only in time to be broken by a new battle. Revealing this storyline, its actors, and its influence is the main goal of this book. As we proceed, history will illustrate this perspective—reflecting this most recent crisis as the twenty-first-century version of an ongoing financial pattern, shining a distinctly different light on our current circumstances.