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After the Crash

Understanding the Social, Economic and Technological Consequences of the 2008 Crisis

Orhan Erdem

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After the Crash

"The Great Depression has not only caused economic tragedy throughout the globe but also paved the way to WWII. Now, it's been more than a decade since the 2008 crisis. The big question is 'what awaits us next?' *After the Crash* provides a very accurate narrative of events and theories that led to the 2008 crisis. How did this crisis give birth to digital technologies such as blockchain and sharing economy among others? How did it make our world vulnerable to increased polarization and authoritarianism? Erdem is a scholar trained both in economics and physics, who has years of experience in both financial and scholarly world. Combined with his powerful storytelling, his book is a must read for anyone who wants to gain insight on 'what awaits us next' in the aftermath of the 2008 crisis!"

—Burak Can, *Assistant Professor of Data Analytics and Digitalisation*, *Maastricht University*

"Orhan Erdem provides a thorough investigation of how static economic theories enforced rigid mental models of human behavior that obfuscated warnings of the 2008 crisis. A book that should be required reading for any social science scholar, this narrative crafts a clear understanding that economics incorporates the varied intricacies of the irrationality of human decision-making."

—Mandolen Mull, *Assistant Professor of Leadership*, *Rockford University*

"Orhan Erdem's *After the Crash* is an engaging, important, and highly readable exploration of how the 2008 financial crisis reshaped the world. Through fascinating historical anecdotes, penetrating insights into economics research, and complementary ideas from psychology and political science, Erdem's analysis of the many ways in which our economy and society have changed in response to the crisis and how they are likely to continue to be impacted in the future is worth reading for scholars of any field."

—Roxana Idu, *Assistant Professor of Economics*, *Elgin Community College*

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I would like to dedicate this book to my wife, Şükran Erdem, and my sons Osman and Ömer whom I missed for two and a half years during which I wrote this book.

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It is not always happy and comfortable life that teaches us. I owe my thanks to one comfort and one discomfort. A three-year time of painful separation from my family due to a political crisis in Turkey in 2016 provided me time to think about how the global arena has been shaping and where the world has been heading. I owe my thoughts to this time of stress and endless motivation and encouragement of my wife, Sukran Erdem.

Having a good student and curious colleague profile has always been a comfort. I would like to extend my sincere thanks to all my students at Rockford University and friends who helped improve this book, especially Annie Daab, Leslie Johns, Monna Ohme, and Leah Zahn. I also feel lucky to have three great and in-the-know reviewers, Maastricht University professor Dr. Burak Can, who provided continuous feedback while I was drafting the book, Rockford University professor Dr. Mehmet Dik, who read the whole manuscript two times and extensively commented on it, and my dear friend Mehmet Berksan, who read the book meticulously and spent hours on the phone, discussing my ideas. They both deserve special thanks. My copy editor Paula Buckner's critiques and questions helped shape this book as good as you have now.

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CHAPTER 1

Introduction

Abstract This chapter introduces the main idea and presents the flow and the plan of the book.

Keywords Financial crises · Transformation · Recovery · Technology

Financial crises do not always result in economic consequences only. Changing political arena, new institutions and social unrest often accompany economic consequences. Analyzing 20 developed countries (Funke et al. 2016), for example, reveal that after a financial crisis, democratic tendencies weaken, political polarization rises, and voting share of the extreme right parties increase by an average of 30 percent. Some of the offsprings of the crises might include new governments with new promises, new laws or new financial, and economic institutions. These offsprings are mostly analyzed alone, excluded one from the others; economists call this ceteris paribus—everything else is kept constant. Political scientists would like to discuss the crises from their perspective, sociologists prefer to analyze the cases from social points of view, and economists study economic consequences. However, a broader discussion without excluding the other disciplines provides us with a better understanding as the world is getting more and more complex. The question I am trying to answer in this book is "What are the social, economic, and technological consequences of the 2008 crisis?"

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Eleven years after the 2008 global financial crisis, much has been said and written about its causes and the lessons to be learned.[1] However, as Mian and Sufi (2014) say "the recovery from the Great Recession has been terrible." Thus, the changes that took place afterward deserve to be discussed from a broader perspective.

The 2008 crisis was one of the biggest the world has experienced.[2] Millions of people were hurt, economically or psychologically. Many companies went bankrupt or were rescued by the governments, causing billions of dollars of losses to taxpayers. Many economies have gone through recessions, and some have not recovered yet. Even though the U.S. economy has recovered almost fully from the crisis, it is estimated that the crisis cost every American a lifetime present-value income loss of $70,000 (Barnichon et al. 2018). However, its effects were not restricted to financial damages only. It marked the beginning of a new era, which was associated with a new understanding of theoretical and practical economics.

This book looks at the crisis with the perspective that the 2008 crash had epochal changes in our lives. These changes point to an era whose characteristics are fundamentally different from those of pre-2008 years. It has been famously said, "Every cloud has a silver lining," and this crisis is no exception. What did the crisis change and what are its implications for us?

I begin by explaining that the first thing that was deeply affected by the crisis was the economic theory. The classical economic theory, which was central to the economic policies of several countries, is not well-suited for error-making humans, and it needs to be updated. We were imagined to be creatures with perfect foresight, calculation ability, and consistency; these assumptions provided easy, elegant solutions to problems. However, some of its main assumptions are unrealistic and provide useless results in real life. For example, Gary Becker, who received the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel[3] in 1992, claimed that people had children because children were durable goods (Becker 1960), no different than a refrigerator, washing machine, or hairdryer. The 1982 Nobel laureate, George Stigler, wrote in 1977 that the tastes of people are similar and do not change over time (Stigler and Becker 1977). This claim means that everybody has the same preferences over choices, like food, cars, and houses. This is done for the sake of easy and simple solutions to economic problems. Once it is assumed that everybody has the same tastes, it will be straightforward to calculate how a nation would behave. However, the prediction will not be accurate.

These were some stunning examples of a broader idea, called rationality, which formed the basis of current economic models. We had to update the economic models to understand the economic decision-making of humans, but we could not. The economists kept using outdated models, which paved the way to a financial crisis. Even though many researchers warned academia about the downsides of these assumptions, they were not heeded. The idea that people and companies act rationally was shaken heavily when market participants did not behave during the crisis as the theory said they should. The results of the incomplete formulations and unrealistic assumptions were devastating. Barry Eichengreen, professor of economics at the University of California at Berkeley, described this situation: "The great credit crisis has cast into doubt much of what we thought we knew about the economics" (*The Economist* 2009) In other words, the aim to solve the economic problems of humanity was simplified so heavily that it became useless.

In 2017, nine years after the crisis, an economist received a Nobel Prize simply for saying that humans make mistakes, they are not robots. His outstanding works, which were ignored and even ridiculed for decades, are now appreciated at the highest level. The crisis led us to rethink and redesign the economic theory, which will totally change the markets and economic policies in the future. Most of the new research in economics is no longer assuming fully rational agents acting in perfect free markets. New theories and policy assertions now consider humans as error-making and evolving. Thus, this era can be identified with more humane values. The social life, science, even economic policies, will be designed in a way that better suits human needs. This would not have happened if there had been no crisis because economics was previously referred to as one of the most isolated sciences.

The after-the-crisis-changes are barely restricted to economic theory, which I explain next. On the governmental side, we have been observing a natural parallel between authoritarianism and the way many democratic countries are being governed. Liberalism seems to have failed.[4] People have been losing their trust in economic regimes. Driven by the anger over the crisis and thanks to technology, people invented new ways of trading, traveling, lodging, and living that once seemed contrary to capitalism. Some of these are practical changes, such as cryptocurrencies, sharing economy, and service subscriptions. Bitcoin was a manifesto to the monetary system; sharing economy was a rebellion to the consumerist lifestyle; and subscriptions were a threat to ownership, the basis of capitalism. Without a crisis, these would never have been created.

We are experiencing a profound transformation driven mainly by the consequences of the crisis, and winding back the clock is not an option. What do they imply and how are they shaping our lives? What do they mean for the future? This book, which derives conclusions from several research, including mine, and political developments, aims to answer these questions. A few pieces which are related to the behavioral finance are paraphrased from my earlier empirical works. I use a narrative way of presentation, and aim to make the book a scholarly one which targets scholars from all disciplines.

The book proceeds as follows: Chapter 2 starts with the precrisis period. It mentions a couple of main breakthrough events in history. Chapter 3 talks about the crisis and how it happened, and Chapter 4 reviews how the crisis helped to change the economic theory. Chapter 5 focuses on what other changes we have in our economic lives and what we can expect in the near future. Chapter 6 reviews my main argument and concludes. This book can be a good start to understand the changing world but never a good place to stop.

Notes

1. See for example Skidelsky (2009, 5), Mian and Sufi (2014), Gjerstad and Smith (2014), and Bernanke et al. (2019, 29–30) for a long list of reasons.
2. By any measures, Reinhart and Rogoff (2009, 208) refer this crisis as the "most serious global financial crisis since the Great Depression."
3. Sveriges Riksbank (Sweden's central bank) Prize in Economic Sciences in Memory of Alfred Nobel is commonly referred to as the Nobel Prize in Economics. The first Prize in Economic Sciences was awarded to Ragnar Frisch and Jan Tinbergen in 1969 (Source: www.nobelprize.org). From here on, I will use Nobel Prize in Economics for the sake of simplicity.
4. After mentioning the problems associated with the liberalism, Harari (2018) concludes liberalism is losing credibility.

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