Politics of crisis

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There is broad agreement that the 2008 crisis has been caused by financial speculation, enabled by deregulation, in short by 'permissive capitalism'. After crisis then, we would expect that the Keynesian party of regulation and government intervention should win. Instead, in the US the political winners have been the GOP and the Tea party, and in the UK, the Tories. How do we explain this perplexing phenomenon?

The usual account is the electoral pendulum swing going against incumbents (which implies its swinging back again next time). Also often mentioned is the role of media promoting free market policies. Besides, the incumbents, Democrats in the US and Labor in the UK, have been a party to deregulation and to bailouts of the financial sector without strings attached.

Rather, the general climate is one in which deficits trump regulation; deficit hawks rule across the Atlantic. Regulations of the banking sector, the Frank-Dodd bill in the US and the Vickers Report in the UK, have been thin and meager. In the UK, according to the April 2011 report of the Independent Banking commission headed by Sir John Vickers, banks must carry higher reserves in relation to lending, rising from 7 percent to 10 percent, retail banking is to be fenced off from investment banking, and banks such as Lloyds are to cut back their retail branches. Editorials comment: 'Sensible proposals—but the bankers win' (Evening Standard, 11 April 2011, 14), 'nothing in this bank report can stop a new crash' (Chris Blackhurst, ibid.). The reforms are intended to make banks more resilient which is 'central to maintaining London's position as a leading global financial center' (Evening Standard 11 April 2011, 6). The bank reforms in the US have also produced even bigger banks. JP Morgan Chase, Goldman Sachs, Citigroup gobbled up Lehmann, Merrill Lynch, Bear Stearns, Salomon Brothers and others. Not only has this not solved the problem of too big to fail but it has created an even larger problem, too big to save (Johnson and Kwak 2011). In the Treasury and the Exchequer the thinking is that with financial deepening in emerging markets it takes large financial institutions to hold front seats, which outweighs the risk their size poses. In effect, regulation has morphed into consolidation.

In both countries the issue of regulation has been crowded out by the deficit and budget discussions, under the sign of cutbacks—cut how much, where? This is odd because the deficit didn't cause the crisis. In fact, for all the talk about the deficit there is little discussion of how it has come about (which in the US includes tax cuts, mostly for the wealthy, wars fought on borrowed money, stimulus and bailouts of the financial sector, defense spending, and vast entitlement programs such as Medicare, organized as bonus systems for the pharmaceutical and health care industries). Nor have there been prosecutions or indictments of bankers—quite unlike after the Savings and Loan scandal in the early 1980s. Lax policies, according to a law professor 'have created an exceptional criminogenic environment'. 'In effect, the same dynamic that helped enable the crisis—weak regulation—also made it harder to pursue fraud cases in its aftermath' (Morgenson and Story 2011). Also strangely missing is a public outpouring of moral outrage—tens of thousands marching in the streets furious about financial crisis and government indulgence, crisis-prone behavior on a scale comparable to the Iraq war and the Gulf oil disaster. Remuneration of CEOs and bankers is largely back to where it was before crisis, also in continental Europe, with cosmetic changes (such as bonuses changed into other forms of pay).

There are also marked differences between the US and UK. While in the UK the keynote is austerity, US policies have included several rounds of stimulus. 'Quantitative easing', the Federal Reserve buying up debt, including the November 2010 'QE2' round of $600 billion, adds to the deficit, to de facto dollar depreciation and to inflation in emerging markets. Rather than stimulating the US economy many funds have flowed into commodities and emerging markets, triggering inflation including of food. (This has been a factor in the Arab Spring by cranking up staple food prices in the Middle East. It has also contributed to inflation in China and Brazil has imposed a tax on foreign capital inflows.) While in the US tax cuts dominate, the Tories have maintained a high 50 percent income tax rate on the wealthiest individuals—which places the British Conservatives well to the left of the GOP and closer to the Obama approach to the budget (Thomas 2011). The GOP seeks to fix the budget by spending cuts combined with tax cuts while the Obama plan combines revenue increases with spending cuts. The GOP budget plan would use spending cuts mainly to pay for tax cuts rather than deficit reduction: 'the obvious goal was to use deficit fears to impose a vision of small government and low taxes, especially on the wealthy' (Krugman 2011).

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Neoliberalism, the common shortcut explanation of these trends, is crucial but not sufficient. 'Neoliberalism' doesn't account for the actual variety of ideas nor does it explain why neoliberalism is accepted. To account for this perplexing situation I offer two main hypotheses—*intellectual deficit* and *power deficit*. According to the first hypothesis, the key problem is the lack of alternative ideas. At first sight this is patently untrue. In the major US and UK newspapers during recent years there has been a steady stream of articles and comments by noted economists making the case for continued stimulus, rather than austerity, and for stronger regulation—such as Paul Krugman, Joseph Stiglitz, Amartya Sen, Robert Reich, Martin Wolf, John Kay, Jeff Madrick, Robert Kuttner, George Soros, and many others. Yet, the argument can't be entirely dismissed. Part of the problem is what John Kay (2011) calls 'confirmation bias': 'the lesson most people have learnt [from the crash] is that they were right all along'. Thus, even when Alan Greenspan acknowledged that his assumption of the self-regulating market was wrong, shortly after he came around to rail against further regulation. So yes there were alternative ideas, but their resonance in the public sphere was not strong enough to sway the prevailing pro-market ideology in mainstream media and public discourse. A mere crash does not undo thirty years of free market socialization, since Thatcher and Reagan. On the pages of the Wall Street Journal free market economists (such as Martin Feldstein, Gary Becker, Alan Blinder) have continued their zeal also after the crash.

Besides, ideas without organizational momentum carrying them fall short of ideologies. Thus we turn to the second hypothesis, power deficit. That is, there are alternative ideas but the political and public momentum backing them isn't strong enough and the ideas fall on deaf ears. I think there are three major reasons for this, structural: deindustrialization and financialization, and ideological: free market ideology, and it is their interaction that matters.

First, in the US, the political economy of labor, the coalition of Democrats and trade unions, anchored in the industrial Northeast and Midwest, has been steadily eroded by thirty years of deindustrialization. Gone from the public sphere are the Keynesian principles of full employment and deficit spending, viewing trade unions as partners in growth, and Fordist principles of labor productivity and wage growth moving in tandem—not because the ideas have vanished but because the power bloc backing them, in congress and on main street, has crumbled.

In its stead has come the political economy of services—in finance, insurance, real estate (FIRE), health care, software (Silicon Valley), the cultural industries (Hollywood), retail, education, and the government social sector. Financial services and health care are the biggest employers and the largest segments of GDP. The service sector is disparate, ideologically dispersed, unorganized (except for public sector workers), and many services are beneficiaries of deregulation. Wall Street and Silicon Valley are progressive factions of capital that are part of the power base of the Obama administration, that is, progressive in a technological sense. Their main ideological umbrella, if any, is innovation, a techno fix that eschews difficult political and economic questions (Nederveen Pieterse 2010).

The power shift from manufacturing to services is a general feature of postindustrial society, but there are *degrees* of postindustrialism. In northwest Europe and Japan offshoring and outsourcing to low-wage countries have generally been *balanced* by inward investment in technologies and factories, while in the US and UK the balance has tilted and deindustrialization has been far more drastic.

In the UK, what manufacturing remains are mainly smaller companies and Asian investors. In the US what industry remains (besides the defense industries) or new industry develops is mostly in the South. With the American South in the lead, Dixie capitalism has gradually taken over from Frost Belt capitalism. Starting in the seventies when industries moved from the northeast they went south. Dixie capitalism and Dixie politics trump northeast, Frost Belt capitalism. The politics of the GOP and the Tea Party reflect different shades of the ethos of the South: low taxes, low services, low wages, no unions. The new Republican governors in Wisconsin, Ohio and Indiana represent the politics of extreme capitalism. About developments in Wisconsin, The Nation comments: ‘this is a war working people have been losing for decades without much of a fight’ (Editorial 2011). It feeds on resentment: if in the private sector there are no or meager benefits and no collective bargaining then public sector workers should not have them either. It is a politics of bringing everyone down to the Dixie level. Since the Reagan era the political economy of the poor South has gradually become the national norm, the flipside of ‘good morning America’. In America this is what decline looks like. This structural trend is a script much darker than a mere pendulum swing.

Because deindustrialization means import dependence it produces chronic trade and current account deficits. For some time this has been papered over by credit expansion, the Federal Reserve low interest regime, and debt as way of life—which works in a growing but not in a shrinking economy. Accumulated household, state and federal debt now comes knocking at the door. Financialization emerged first as an antidote to deindustrialization, masked its effects and enabled the boom of the ‘roaring nineties’ but has increasingly emerged as a major destabilizing factor, from the Nasdaq crash and the Enron scandals (enabled by creative accounting) culminating in the crash of 2008. Financialization per se is a part of mature economies, a corollary of contemporary accelerated globalization and a general structural condition. The problem is not financialization per se but the combination of financialization and deregulation, the problem of the ‘sleeping watchdog’.

When it comes to finance there IS no party of regulation in the US and UK. This is a function of their deep history, the London City as a pivot of Empire and the Commonwealth and Wall Street as a power house central to American hegemony going back to the late 19th century and the bel époque, and their resurrection since the 1970s (with OPEC and the recycling of oil dollars). The comeback of finance capitalism during the era of neoliberal globalization came with a host of new financial instruments—derivatives, hedge funds, quantitative investments, credit default swaps, subprime mortgages, etc. US Democrats have been just as wired to Wall Street as the GOP.

Low taxes, the trump card of Dixie capitalism, resonate with the market society ethos of possessive individualism. In the US, under the sign of low taxes, liberty trumps equality. In both the US and UK, major political forces represent ‘anti-government government’. The motto of the Tory-led coalition in the UK, according to chancellor of the Exchequer George Osborne, is ‘pro-enterprise, pro-business and pro-aspiration’ (Clark 2011). The Tories call on the Big Society, which is reminiscent of the elder Bush in the US calling on a ‘thousand points of light’ and Bush junior relying on faith-based initiatives, so voluntarism would take over state welfare functions. The paradox of this situation is that it is a call to a society in which, through the retreat of the state, market forces have been unleashed. A society governed by consumerism and market values is to respond to a call to social values. Government promotes selfish capitalism (James 2008) and then calls on selfless solidarity, at a time when the endowments of charities and foundations have been eroded by crisis.

William Mitchell (2011: 11)refers to 'the homogenization of political debate' as the setting of the budget debates.

> In the United States and among most parties in Europe—whether in government or opposition—the unquestioned dominance of neoliberal ideology has reduced economic debate to questions of nuance. So conservatives eschew tax increases and want larger spending cuts, whereas progressives favor a combination of spending cuts and tax increases. … What began as a problem of unsustainable private debt growth, driven by an out-of-control financial sector aided and abetted by government deregulation, has mysteriously morphed into an alleged sovereign debt crisis.

A similar metamorphosis occurred during the 1997-98 Asian crisis. The crisis was prompted by private sector speculation, beginning with commercial real estate in Thailand, but IMF intervention urged public sector cutbacks, so private abandon morphed into a call for public austerity. However, simply referring to neoliberalism as Mitchell does is not precise enough, analytically and politically. At issue isn't just free market thinking, but free market approaches *in combination with* deindustrialization and financialization. Hence the issue is not simply ideology but what Galbraith called countervailing power.

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What future trends and options do these conditions generate? Let's note that the impact of the 2008 crisis is severe in the US, UK, and PIGS (Portugal, Ireland, Greece, Spain), moderate in most of the rest of Europe and the world, while emerging markets are booming.

Given that major trends are of a structural nature—postindustrialism, services, financialization—in the next 10, 15 years major changes are not in the cards. The US and UK will likely undergo gradual decline, mitigated to the degree that they play their cards well. Both rely too much on narrow sectors, especially finance, and anti-government ideology undercuts their capacity for self-correction. In April 2011 Standard and Poor's expressed concern for the US credit rating. The IMF cut its estimate of UK growth in the first quarter of 2011 to 0.2 percent, which comes with gloomy figures on youth unemployment and the effects of government cutbacks taking effect in April.

Northwest Europe and Scandinavia are undergoing milder versions of these trends because industry, regulation and social contracts are stronger and free market ideology has less support. The problem of financialization, its size and lack of regulation, however, is a common factor but on a smaller scale than in US and UK (Goldstein and Véron 2011).

The PIGS, Portugal, Ireland, Greece and Spain face different problems, generally GDP growth outstripping productivity growth, weak regulation, and growth borrowed from external financing. Ireland's National Competitiveness Council characterized the boom time economy as ‘growth derived from asset price inflation, fueled by a combination of low interest rates, reckless lending and speculation’ (O’Toole 2009: 22). Like Iceland, Ireland is a case of financialization and lack of regulation moving in tandem. Ireland became Cayman Ireland, ‘the Wild West of European finance’ (O’Toole 136). At the height of the Celtic boom construction represented 24 percent of GDP.

The major changes will take place rather in emerging societies, the BRIC and others. They combine industrialization and financialization while the West combines postindustrialism and financialization. Financialization in emerging societies is inevitable in view of growing global trade and the influence of international finance. The other main difference is state capitalism or developmental states in the emerging markets, so neoliberalism has limited appeal and status. Their main challenge is to include the poor majority, rural and urban, while avoiding inflation and real estate booms.

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