

The Revenge of the Market on the Rentiers

Why neo-liberal reports of the end of history turned out to be premature

José Gabriel Palma

Faculty of Economics
Cambridge University
jgp5@cam.ac.uk

Abstract

Starting from the perspective of heterodox Keynesian-Minskyian-Kindlebergian financial economics, this paper begins by highlighting a number of mechanisms that contributed to the current financial crisis. These include excess liquidity, income polarisation, conflicts between financial and productive capital, lack of intelligent regulation, asymmetric information, principal-agent dilemmas and bounded rationalities. However, the paper then proceeds to argue that perhaps more than ever the 'macroeconomics' that led to this crisis only makes analytical sense if examined within the framework of the political settlements and distributional outcomes in which it had operated. Taking the perspective of critical social theories the paper concludes that, ultimately, the current financial crisis is the outcome of something much more systemic, namely an attempt to use neo-liberalism (or, in US terms, neo-conservatism) as a new technology of power to help transform capitalism into a rentiers' delight. And in particular, into a system without much 'compulsion' on big business; i.e., one that imposes only minimal pressures on big agents to engage in competitive struggles in the real economy (while inflicting exactly the opposite fate on workers and small firms). A key component in the effectiveness of this new technology of power was its ability to transform the state into a major facilitator of the ever-increasing rent-seeking practices of oligopolistic capital. The architects of this experiment include some capitalist groups (in particular rentiers from the financial sector as well as capitalists from the 'mature' and most polluting industries of the preceding techno-economic paradigm), some political groups, as well as intellectual networks with their allies – including most economists and the 'new' left. Although rentiers did succeed in their attempt to get rid of practically all fetters on their greed, in the end the crisis materialised when 'markets' took their inevitable revenge on the rentiers by calling their (blatant) bluff.

Key words: Ideology, Neo-liberalism, Neo-conservatism, Foucault, Causes of financial crisis, Investment, Risk, Uncertainty, Income distribution, Rent-seeking

JEL classifications: E22, E24, F02, F36, F59, G20, G30, N20, O16, O43

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They constantly try to escape
From the darkness outside and within
By dreaming of systems so perfect that no one will need to be good.

T S Eliot

I believe that banking institutions are more dangerous
to our liberties than standing armies.

Thomas Jefferson

Today the appeal to newness, of no matter what kind, provided
only that it is archaic enough, has become universal

Theodor Adorno

New Labour is my finest creation

Margaret Thatcher

Sometime in the next five years you may kick yourself for not reading
and re-reading Kindleberger's *Manias, Panics and Crashes*.

Paul Samuelson (writing in 2005)

Globalization opened up opportunities to find new people
to exploit their ignorance. And we found them.

Joseph Stiglitz

These days America is looking like the Bernie Madoff of economies: for many years
it was held in respect, even awe, but it turns out to have been a fraud all along.

Paul Krugman

[...] and, above all, let finance be primarily national.

John Maynard Keynes

1.- *Introduction:*¹ *The dance of the trillions*

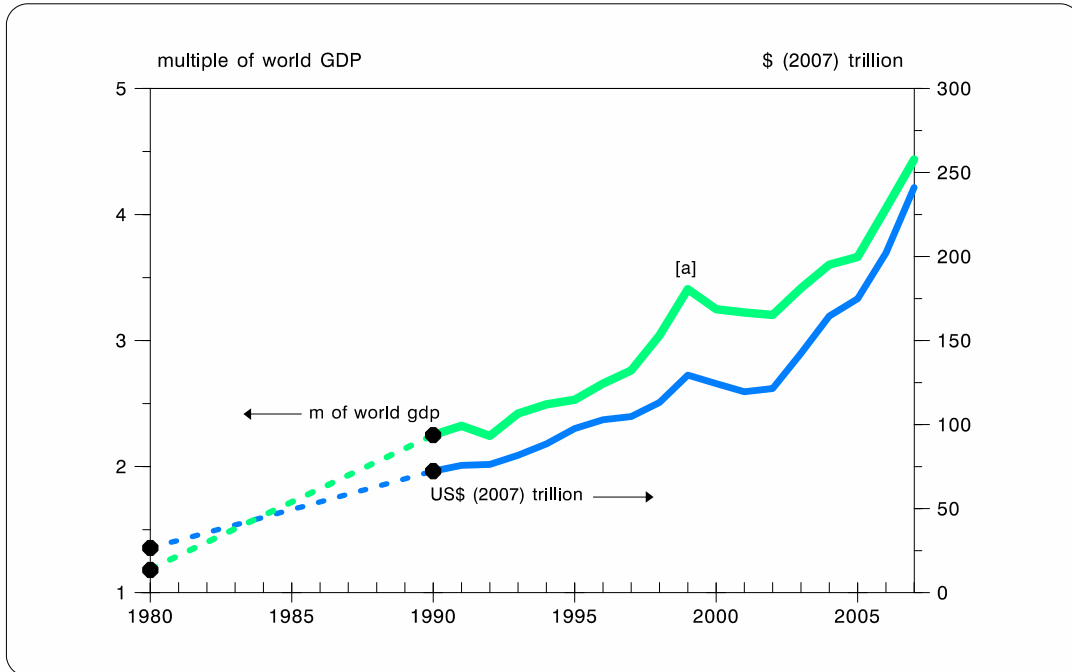
Even for those familiar with events and figures in international financial markets, the sheer magnitude of the numbers both in the upswing and in the downswing of the current cycle is truly remarkable. For example, in the upswing (1980-2007), in real terms the four components of the stock of global financial assets (equity, public and private bonds and bank assets) jumped *9-fold*, increasing from US\$27 to US\$241 trillion (US\$ at 2007 value). As a result, the multiple of the stock of financial assets to world output augmented nearly 4-fold (from just under 1.2 to 4.4; see Figure 1).²

¹ I would like to thank Paulo Arantes, Jonathan Di John, Daniel Hahn, Geoff Harcourt, Mushtaq Khan, Jacqui Lagrue, Javier Nuñez, Isidoro Palma Matte, Carlota Pérez, Jonathan Pincus, Bob Rowthorn, Ignês Sodré, Robert Wade and especially Stephanie Blankenburg and Samer Frangie for very helpful observations. My much missed friends Daniel Chudnovsky and Andrew Glyn, four anonymous referees and participants at various seminars also made valuable comments. Lastly, I am very grateful to my former Ph.D. students Jaime Crispi and Carlos Lopes for the many lively discussions we had on financial crises before their sudden deaths; I dedicate this paper to them. The usual caveats apply.

² During this 27-year period, the capitalization of equity markets increased from US\$7 to US\$65

FIGURE 1

Stock of Global Financial Assets, 1980-2007



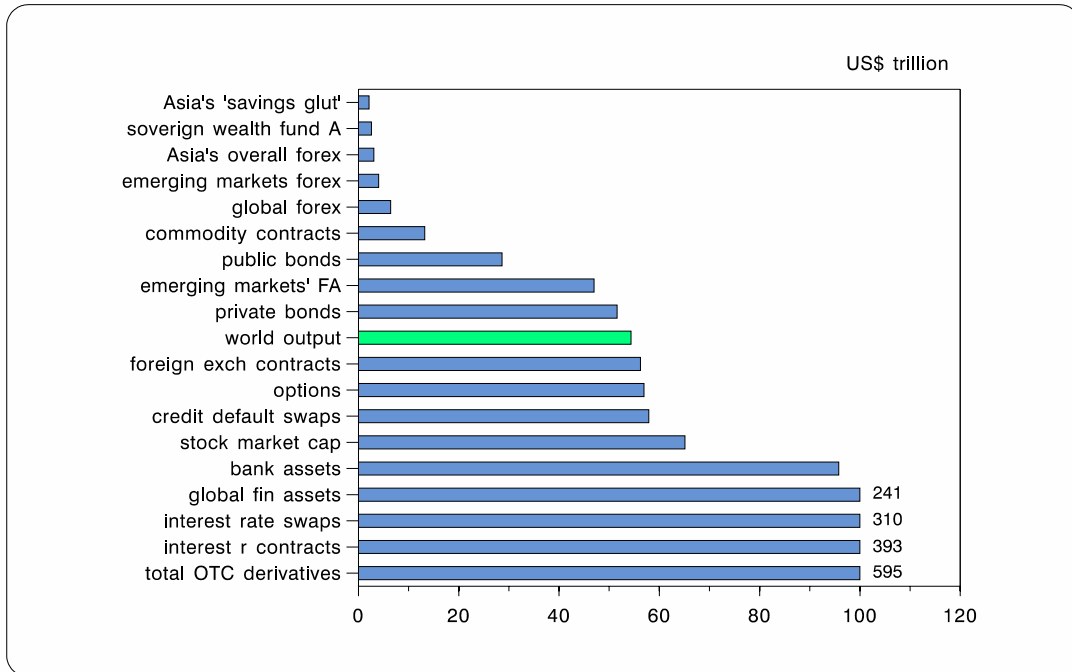
• **[a]** = collapse of the 'dotcom' bubble. **Source:** for 1990-2007, IMF (2009), and for 1980, McKinsey (2009; data available only for 1980; McKinsey's data are based on IMF statistics, but include bank deposits rather than bank assets).

In turn, Figure 2 gives a more detailed breakdown of different components of international finance, and their relative size vis-à-vis world output; this is particularly important as (among other things) it helps to put Asia's now infamous 'savings glut' into perspective.

trillion; the value of private and government debt securities from US\$9 to US\$80 trillion; and bank assets from US\$11 to US\$96 trillion (on the latter number, see notes below Figure 1; all figures in US\$ at 2007 values).

FIGURE 2

Global Financial Statistics: amounts outstanding, 2007



• **Asia's 'savings glut'** = increase in the level of Asia's foreign exchange reserves, including Japan, since 1997 (in US\$ at 2007 values); **A** = assets; **forex** = foreign exchange reserves (excluding gold); **emerging markets' FA** = stock of financial assets in emerging markets; **exch** = exchange; **cap** = capitalisation; **fin** = financial; **r** = rate; **total OTC derivatives** = notional amounts outstanding of all over-the-counter derivatives. **Source:** IMF (2009), and BIS (2009).

As is well known, regarding the current financial crisis many financial analysts still insist that Asia's 'savings glut' is where it all started.³ However, as is evident from Figure 2, the US\$2.2 trillion increase in Asia's reserves since 1997, although significant in size, is actually dwarfed by the size of most other financial variables relevant to the current financial crisis. For example, in the case of asset-backed securities by the end of 2006 only those relating to Ginnie Mae, Fannie Mae and Freddie Mac had reached double the size of the overall Asian 'savings glut' (HFR, 2007). In turn, outstanding over-the-counter derivative contracts involving credit default swaps (CDS) increased *170-fold* in just ten years (1997-2007), with their notional value growing in real terms from US\$265 billion to US\$58 trillion (or 67% per annum; US\$ at 2007 values). At the same time, in just the four years to the end of 2008 their gross market value grew 42-fold. In all, according to the BIS

³ Asia's 'savings glut' refers to the rapid increase of foreign exchange reserves in many Asian countries since the 1997 financial crisis, especially in China, Japan and Korea. The view that the recycling of these reserves is the main source of the excess liquidity found in financial markets is shared by people from a wide range of political perspectives, such as Greenspan, Ferguson and Aglietta (see Greenspan's testimony to Congress in October 2008; Ferguson, 2009; and Aglietta, 2008).

(2009), in the ten years leading up to the crisis the outstanding amounts of over-the-counter derivative contracts jumped from US\$93 to US\$595 trillion – or from 2.4 to 11 times the size of global output. In turn, their gross market value increased from US\$3.3 to US\$20.4 trillion (and US\$34 trillion by the end of 2008); i.e., the gross market value of these 'financial weapons of mass destruction' (as Warren Buffett famously labelled them) grew about eight times faster than world output (all figures in US\$ at 2007 values).⁴ In fact, just those involving commodities (excluding gold) increased 59-fold during the same decade, reaching in June 2008 a gross market value of US\$2.2 trillion (and a notional one of US\$12.6 trillion). This frantic speculation in commodities is probably much more important than demand from China in explaining the relatively generalized boom in commodity prices in the years preceding the onset of the current crisis (and the differential behaviour of commodity prices since then).

The bottom line is that while Asia's reserves grew by US\$2.2 trillion between 1997 and 2007, the overall stock of financial assets grew by US\$140 trillion (US\$ at 2007 values). As a result, by 2007 the overall Asian 'savings glut' was equivalent to less than 1 per cent of the global *stock* of financial assets (at the time, equity, bonds and bank assets were worth US\$241 trillion; see Figures 1 and 2). If this 'glut' were in fact the 'smoking gun' of the current crisis, never in the history of finance would anything have had such a multiplier effect...

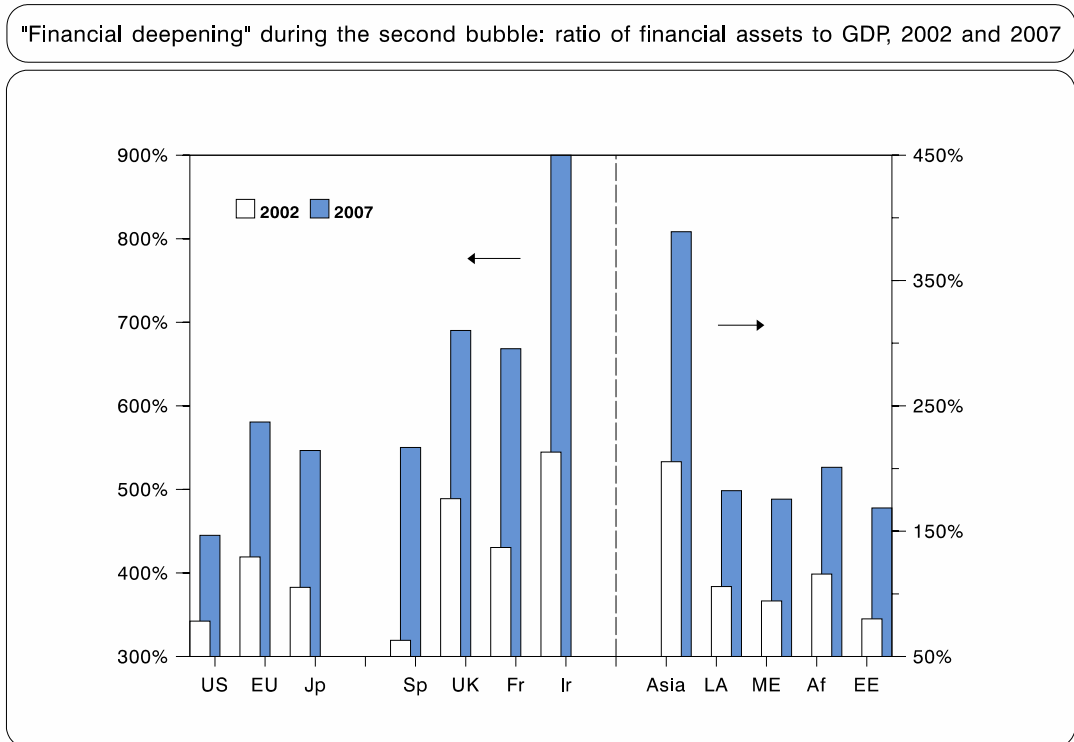
In terms of players in the 'shadow financial market', the total number of hedge funds and funds of funds grew from 610 to nearly 10 thousand between 1990 and mid-2007, with total assets at that time of nearly US\$2 trillion (and total market 'positions' of US\$5.3 trillion). In fact, even after the debacle of The Long Term Capital Management (LTCM) in 1998 the number of hedge funds (and LTCM's business model) continued to expand as if nothing had ever happened – or, rather, that life can now continue as if nothing had ever happened as there was now the guarantee that the Fed would always be available at the other end of a 911 call... And an indication of their 'shadowiness' is that of these funds 36% were registered in the Cayman Islands, 25% in Delaware, 10% in the British Virgin Islands and 7% in Bermuda – and only 1.3% in New York...

In terms of emerging markets, total assets for single manager hedge funds whose primary investment focus were these markets grew 4.5-fold in the three and a half years before the beginning of the crisis – with emerging market equity managers being the best niche group in the hedge fund industry in 2006, returning an average of 37% while fixed income focused managers returned 21% (see HFR, 2007).

Figure 3 indicates the remarkable size of the second financial bubble of the period (following the recovery from 9/11). This bubble was especially large in some countries of the European periphery (such as Iceland, Ireland and Spain), and in emerging markets.

⁴ Even after the beginning of the crisis, the involvement in derivative markets by US banks are staggering; according to the Office of the Comptroller of the Currency, by the end of the first quarter of 2009 JP Morgan Chase still controlled US\$81 trillion of notional value in derivative contracts, followed by Bank of America with US\$78 trillion and Goldman Sachs with almost US\$42 trillion (trailed not far behind by Morgan Stanley and Citigroup; see <http://www.forbes.com/2009/07/30/credit-default-swap-personal-finance-investing-ideas-goldman-sachs.html>).

FIGURE 3



• **US** = United States; **EU** = European Monetary Union; **Jp** = Japan; **Sp** = Spain; **UK** = United Kingdom; **Fr** = France; **Ir** = Ireland; **LA** = Latin America; **ME** = Middle East; **Af** = Africa; **EE** = Eastern Europe. **Source:** IMF (2009).⁵

As is well known, one of the main problems of the current crisis is that the remarkable globalisation of financial markets, the huge volume of finance and the intricacies of financial engineering brought about a huge increase in the *volatility* and in the *correlation* of returns on financial assets. In fact, now shockwaves are transmitted – and amplified – to such an extent that a simple way to look at the onset of the current financial crisis would be to say that concerns over US\$400 billion sub-prime lending in the US housing market led to the wiping off of about US\$40 trillion in global asset markets...

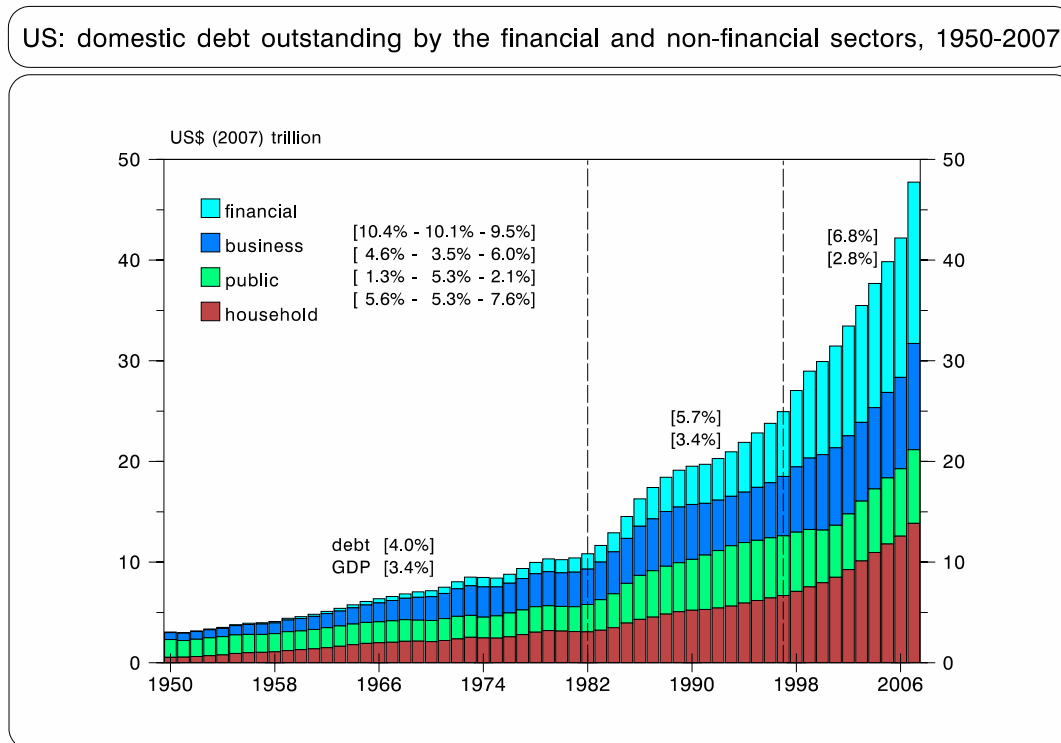
This phenomenon has major policy implications; for example, what is the optimal level of capital account openness for a developing country under these circumstances? Is it full openness? Or is it some degree of capital controls along the lines of Keynes' argument that what is needed (and is probably needed today more than ever) is an international financial and payments system that at least partially insulates nations from the economic maladies of other nations?⁶ Keynes also argued (and especially successfully at Bretton Woods) for the right of nations to defend themselves from the predatory nature of international finance.

⁵ Unfortunately, the IMF does not report data on Iceland. According to a senior IMF official, what one has to understand is that "Iceland is now no longer a country. It is a hedge fund" (quoted in Lewis, 2009).

⁶ It would be the equivalent of quarantining nations where swine flu develops so they do not affect other people around the world (see Davidson, 2009).

Turning to the core country of the system, Figure 4 illustrates the remarkable increase in the level of domestic debt in the US economy.

FIGURE 4



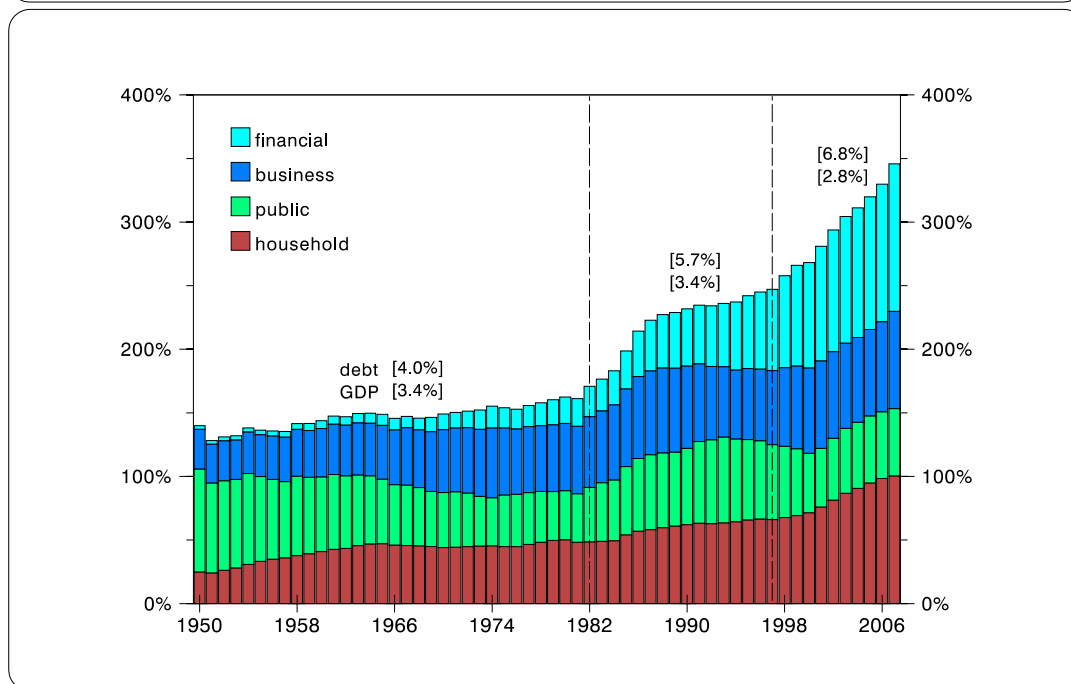
• **Household** = total household sector domestic debt (consumer and mortgage debt); **public** = total public sector domestic sector debt (local and federal); **business** = total non-financial business sector domestic debt (corporate and non-corporate); **financial** = total financial sector domestic debt. Percentages shown in the graph above the bars are average annual real rates of growth of overall domestic debt and of gross domestic product (GDP) in each period, respectively; those next to the legends are rates of growth of the respective sectors for the three periods. **Source:** US Federal Reserve (2009).

Of the many issues that emerge from Figure 4, from the perspective of this paper the two outstanding ones are the (better-known) increasing detachment of the growth of overall domestic debt from that of output; and the (lesser-known) fact that the rapid *acceleration* of the rate of growth of domestic debt after the 1997 East Asian crisis (and the 1998 Brazilian one) is entirely due to the *non-financial* private sector (both business and household). As middle-income developing countries turned less attractive (and more able to generate their own foreign-exchange denominated finance), and as the US's public sector began to tap into the Asian 'savings glut', the non-financial private sectors of the US and other industrialised countries became the target of ever more liquid financial markets. That is, the specificity of this crisis results from the fact that the business and the household sectors of industrialised countries increasingly became the financial markets' customers of 'last resort'. And if the demand from these private agents was not growing fast enough, imaginative 'financial engineering' could give it a bit of a push. In fact, household mortgage debt, after having grown between 1982 and

1997 at exactly the same pace as between 1950 and 1982 (about 5.7% per annum), then jumped to an 8.7% annual real rate of growth (1997-2007). And that of the non-financial business sector nearly doubled from 3.5% (1982-1997) to 6% (1997-2007) – all figures in US\$ at 2007 values. Figure 5 shows the same data, but as a share of GDP.

FIGURE 5

US: domestic debt outstanding by the financial and non-financial sectors as % of GDP, 1950-2007



• **Household** = total household sector domestic debt (consumer and mortgage debt); **public** = total public sector domestic sector debt (local and federal); **business** = total non-financial business sector domestic debt (corporate and non-corporate); **financial** = total financial sector domestic debt. Percentages shown in the graph are average annual real rates of growth of overall domestic debt and of gross domestic product (GDP) in each period, respectively. **Source:** US Federal Reserve (2009).

As could have been already deduced from Figure 4 above, total domestic debt remained relatively stable as a share of GDP before 1980 (only increasing from 140% to 158% in the nearly three decades between 1950 and the year before the appointment of Paul Volker to the Fed). After that, it jumped from 158% to 247% in the next nearly two decades (1978 to 1997), to add no less than a whole 100 percentage points in the decade that followed. How could anyone think that such remarkable increases in the level of debt by both the financial and the non-financial sectors could be sustainable in the long run, as if time and chance, which happen to us all, would make an exception to the world of finance? Or how could anyone think that if (as a result of the inevitable financial fragilities emerging from this debt explosion) banks could not dazzle investors and regulators with might, it was perfectly acceptable that they could puzzle them with increasingly fudged balance

sheets?⁷ How anyone could think that the markets would never call this blatant bluff is anybody's guess!

Turning to the downswing and bust of the cycle, Greenspan (2009) estimates that "[...] the aggregate equity loss amounts to well over US\$40 trillion, a staggering two-thirds of last year's global gross domestic product." Recent estimates have increased this figure to over US\$50 trillion, as just the loss in terms of household net worth in the US has already reached US\$14 trillion.⁸ Furthermore, according to the Stiglitz UN-Commission, up to 50 million people could become unemployed in 2009, and "[s]ome 200 million people, mostly in developing economies, could be pushed into poverty [...]". (Stiglitz, 2009).

2.- *How did we get into such a mess?*

According to the central postulate of mainstream economics of the neo-classical-type, if rational (i.e., utility-maximising) and selfish economic agents are allowed to interact freely in competitive markets, the outcome will be something called 'equilibrium'. Furthermore, this equilibrium is not only bound to be optimal, but also intrinsically stable and capable of 'self-correction'. All that is required in order to achieve these remarkable features are that the markets are allowed to work freely (i.e., prices and wages are allowed to adjust without restraint so that the markets can clear), and that property rights are well-defined and properly enforced (so that this can be achieved with minimum transaction costs).⁹

Furthermore, according to this approach, financial markets are supposed to play only an essentially *passive* rôle of discounting a future that is predictable (in a probabilistic sense), and are able to do so with amazing accuracy. So, within this framework, financial crises can only occur due to external interference in otherwise perfectly efficient market mechanisms such as governments behaving irresponsibly (e.g., monetising large fiscal deficits, as in so-called 'first generation' models of financial crisis); due to bad luck (e.g., self-fulfilling runs on central banks without enough reserves, as in 'second generation' models); or due to something – it could be almost anything – causing a sudden large currency depreciation in economies that are not fundamentally unsound (e.g., a moral-hazard-driven bubble with an excessive build-up of external debt, open-economy bank-runs, or currency mismatches on the liability side of balance sheets, as in different versions of 'third generation' models).

⁷ At the end of 2008 the US's four biggest banks by assets did not have that much less assets in 'off-balance-sheet vehicles' than on their books (US\$5.2 and US\$7.2 trillion, respectively). And those on their balance-sheet were also subject to virtual accounting (see below Section 6.2).

⁸ See <http://www.federalreserve.gov/releases/z1/Current/>.

⁹ The unspoken exception, of course, is intellectual property rights (IPRs) – the more narrowly defined and the more intimidatingly enforced, the more likely they will be associated with higher transaction costs... It is often forgotten that there are several necessary conditions for IPRs having a growth-enhancing effect at all; these are that their aim should be to capture Schumpeterian (rather than just monopoly) rents; that these rents should be used effectively in the search for new innovations; that if they do result in further innovations, these should again be priced 'Schumpeterianly' (rather than just monopolistically); and so on. That is, as usual, a rather long sequence of 'ifs'...

Additionally, according to the 'efficient capital market theory', in financial markets prices at all times (in Eugene Fama's words) "fully reflect" *all* available information; basically, there cannot be an *endogenous* gap between market prices and fundamentals – let alone a bubble. That is, asset prices deserve a pedestal, and stock options are the most rational reward for good performance. At the same time, stock prices are supposed to be a 'random walk'; i.e., particularly under risk neutrality, there is no scope for profitable speculation because a rational stock market cannot be beaten on any consistent basis (market prices are impossible to predict). The key point here is that if financial markets get misaligned, they always 'self-correct'. Smart market players would simply force stock prices to become rational by doing exactly *the opposite* of what they do in real life: take the other side of trades if prices begin to develop a pattern (as this is bound to have no substance). In other words, for the efficient market theology a 'rational surfer' is not the one that has fun riding waves, but the one that gets drowned trying to create undertows.¹⁰

In sum, in the words of the current Director of the White House's National Economic Council, "[in financial markets] prices will always reflect fundamental values [...]. The logic of efficient markets is compelling." (Summers and Summers, 1989). So 'compelling', in fact, that it crowded out all other ideas in financial economics.¹¹ And as always happens when there is an unremitting need to idealise something, for neo-classical analysis to be able to sustain its remarkable idealisation of competitive markets it needs simultaneously to demonise something else – in this case anything to do with government intervention.¹² In fact, we now know that Alan Greenspan was even against tightening regulation against financial fraud, as rational markets can take care of themselves.¹³

In turn, in some mainstream economics of the 'new' type endogenous market failures are finally allowed to exist, and they can lead to sub-optimal (and multiple) equilibria; i.e., the first law of Welfare Economics is obviously wrong. Nevertheless, although a rôle for policy is therefore (reluctantly) accepted, but only under very strict governance structures, these outcomes (including those in financial markets) are still understood as intrinsically of the 'equilibrium' type. In fact, New Keynesian theorists (like New Classics) still work within a 'complete markets paradigm', and with the strongest version of the efficient markets hypothesis (see Buiter, 2009B).

Furthermore, within mainstream economics the acceptable range of ideas has narrowed down continuously since the famous 'capital controversies', and the monetarists versus Keynesian debates of the 1970s. A student of economics today could be forgiven for believing that the range of debate in economic theory only

¹⁰ When I participated in 2008 in a panel to nominate candidates for the biannual 'Deutsche Bank Prize in Financial Economics' (worth 50,000 euros), organised by The Center for Financial Studies of the Goethe University in Frankfurt, I learned that the first prize, awarded in 2005, had been given to Eugene Fama from Chicago University. According to the citation, he had been honoured for his theory of efficient markets; that is, for developing what proved to be quite an effective intellectual weapon of mass destruction (see <http://www.ifk-cfs.de/index.php?id=901>). Surprisingly enough, he was not included in a recent Time's list of the '25 People to Blame for the Financial Crisis' (http://www.time.com/time/specials/packages/article/0,28804,1877351_1878509_1878508,00.html). As with the traders who got bonuses for placing silly bets, maybe one day someone will ask him to donate the money to charity...

¹¹ For critical views on the efficient market hypothesis, see Bernstein (1996), and Fox (2009).

¹² On idealisation, see Sodré (2009).

¹³ See <http://www.dailykos.com/story/2009/3/27/172419/727>.

spans two competing schools of thought within dynamic stochastic general equilibrium models: those that engineer them as real business cycles and those that do so as micro-foundations models. More specifically, mainstream economics tells us that endogenous market outcomes depend only on whether or not prices and wages are a bit "sticky" (due to potential price and wage inflexibilities) and related market failures. That is, market outcomes depend only on (say) whether 'markets' perform as smoothly and predictably as a car made in Japan, or bit more capriciously (like one made in Britain).¹⁴

And as far as whether money and finance can affect long-term growth, Lucas' proposition that only real forces can truly affect employment and production became the only game in town (see Lucas, 1995). So, in first and second generation models of financial crises, as these are mainly about ill-advised monetary policy, crises are supposed to be harmless to the real economy. Only in third-generation models can crises become 'real', but this is only due to sudden currency depreciations causing havoc in features such as balance sheets – so the real economy can plunge into a crisis (see Krugman, 2001).

Therefore, within the mainstream framework it is simply not possible to understand the complexities of current events – let alone devise effective policies to avoid their repetition. In fact, in his recent Lionel Robbins Memorial Lecture at the London School of Economics Paul Krugman argued that for much of the past 30 years macroeconomics was "spectacularly useless at best, and positively harmful at worst."¹⁵ And according to Willem Buiter, writing in the *Financial Times*, "[...] the typical graduate macroeconomics and monetary economics training received at Anglo-American universities during the past 30 years or so, may have set back by decades serious investigations of aggregate economic behaviour and economic policy-relevant understanding. It was a privately and socially costly waste of time and other resources" (2009B).¹⁶

From this perspective, perhaps what defines an alternative understanding of financial markets as 'heterodox' is that it postulates that the *endogenous* outcome of the free interaction in financial markets of 'intelligent', 'rational', 'utility-maximising' and 'selfish' individuals can be not just a sub-optimal equilibrium but, at times, a financial crisis proper - now, why in economics today one has to be 'heterodox' to

¹⁴ In his Marshall Lecture at Cambridge University, Stiglitz told the story that when he was appointed by Bill Clinton to the Council of Economic Advisers his first task was to try to do something about unemployment. He needed staff, so he advertised for an economist; when interviewing he had to go down to about the fifteenth name on the shortlist before he found a candidate who thought that at least it was theoretically possible that on the subject of unemployment there could be more issues involved than just workers refusing to accept a market wage...

¹⁵ See http://cep.lse.ac.uk/_new/events/event.asp?id=92.

¹⁶ One of a rather large number of examples of the irrelevance of mainstream economics to understanding the real world, as Michael Spence of (none other than) the Hoover Institute explains, is that "[...] the failure of theoretical models to explain extreme macroeconomic fluctuations makes effective action difficult to implement. Currently, economic models forecast an infinite path of either endless positive or negative growth. Economists are therefore forced to explain deviations from or transitions between these two different dynamics (e.g. moving from a period of growth to a period of recession) as a 'jump' onto a new model or growth path. This makes them little use for government policy formulation, as the understanding of the 'jump' is exogenous to the model" (http://www.magd.ox.ac.uk/___data/assets/pdf_file/0012/6510/Trinity-09.pdf).

understand such an obvious fact is another matter altogether.¹⁷ One of the crucial issues here, as Keynes' liquidity theory points out, is that decision makers do not really know, and cannot possibly know, the future outcome of current financial decisions – the future is uncertain and not merely probabilistically risky (see Minsky, 1975, Davidson, 2007, and Bibow, 2009). In fact, financial fragilities are an intrinsic part of the normal economic cycle, with speculative bubbles endogenous to financial markets.¹⁸ According to Minsky: "[a] fundamental characteristic of our economy is that the financial system swings between robustness and fragility and these swings are an integral part of the process that generates business cycles." (1974, p. 269). At the same time, "[...] over a protracted period of good times, capitalist economies tend to move from a financial structure dominated by hedge finance units to a structure in which there is large weight to units engaged in speculative and Ponzi finance." (Minsky, 1992, p. 8)¹⁹ That is, from time to time financial markets are likely to become intrinsically unstable and (particularly with excess liquidity) unable to self-correct (see Kindleberger, 1986). In fact, instead of 'automatic stabilisers', they can easily be derailed even further by 'automatic de-stabilisers' (see Stiglitz, 2003).²⁰ So, in financial markets it often pays to look at 'rational' market players and follow Warren Buffett's advice: "Be fearful when others are greedy, and be greedy when others are fearful." (Buffett, 2006).

From this viewpoint, Barry Eichengreen's now famous remarks in a way miss the point:

"The Great Credit Crisis has cast into doubt much of what we thought we knew about economics. We thought that monetary policy had tamed the business cycle. We thought that because changes in central-bank policies had delivered low and stable inflation, the volatility of the pre-1985 years had been consigned to the dustbin of history; they had given way to the quaintly dubbed "Great Moderation." We thought that financial institutions and markets had come to be self-regulating – that investors could be left largely if not wholly to their own devices. Above all we thought that we had learned how to prevent the kind of financial calamity that struck the world in 1929." (2009)

In fact, the Great Credit Crisis (as Eichengreen calls it) has only cast into doubt much of what *mainstream economists* thought they knew about economics. From Keynes to Minsky, Kindleberger, Galbraith, Stiglitz, Krugman, Davidson, Roubini, Buiter and many others, there was a comprehensive body of literature perfectly capable of understanding why 'rational' borrowers and lenders (both in industrialised and developing countries) could easily accumulate far more risk than is privately efficient – let alone socially efficient; and that financial crises could occur for more reasons than monetised government deficits, moral hazards due to government guarantees, bad luck, mob-psychology, crony capitalism, Chinese conspiracies, incompetent regulations, misguided policy or other *exogenous* factors interfering with the otherwise perfectly efficient allocation of resources by financial markets.²¹

¹⁷ According to (the not-very-heterodox) Niall Ferguson (2008), the inability of mainstream economists to understand the likelihood of financial crisis can only be the result of their lack of knowledge of financial history.

¹⁸ For analyses of financial bubbles, see Galbraith (1954, and 1993).

¹⁹ See also Minsky (1982) and (1986). McCulley, for example, discusses how the sub-prime crisis fits neatly into Minsky's financial fragility hypotheses (McCulley, 2009).

²⁰ For a critical examination of financial theory, see Toporowski (2005).

²¹ For an analysis of this idea in the context of recent financial crises in developing countries, see

The current global financial crisis is a paradigmatic case of this. That mainstream economics had conveniently chosen to ignore that whole body of literature is another matter altogether.²²

So, it should not be that surprising that despite much effort – remember those blaming everything on China, or pointing at ‘liberals’, or even tracing the sub-prime crisis back to the fall of the Berlin Wall? – mainstream economists have not been able to produce for the current crisis a credible smoking gun explanation of the ‘exogenous’ type.²³ That is, this time there has not been much room for market devotees’ excuses of the blaming something/someone else variety. This does not mean that market aficionados have given up their ‘buck stops somewhere else’ search.²⁴

In fact, even Greenspan, like a general who decides to rethink his military strategy only after losing the war, has lately moved slightly in the ‘financial crises as *endogenous* free markets phenomenon’ direction. For example, he famously acknowledged in October 2008 (in his testimony to Congress) that he – and his free-market ideology – was “in a state of shocked disbelief”; and that he had “found a flaw” in the foundations of his economic thinking. His real business cycle-type philosophy had been behind his conviction that in financial markets there are no major market failures; and that the incentive of shareholders to maximise their value would lead them to control the behaviour of managers and traders properly. As a result, he had entirely missed the possibility that financial deregulation could unleash such destructive forces on the economy.²⁵ He also acknowledged that the current crisis shows that the basic premises of the traditional risk-management theory are wrong; and that financial markets can indeed be inherently unstable, especially due to their increasing complexities. Furthermore, for post-2007

Palma (2008C).

²² In August 2007, when the current global financial crisis began, the *Wall Street Journal* rediscovered an ‘obscure’ economist called Minsky, and ran an article called ‘In Time of Tumult, Obscure Economist Gains Currency. Mr. Minsky Long Argued Markets Were Crisis Prone; His ‘Moment’ Has Arrived’ (<http://online.wsj.com/article/SB118736585456901047.html#articleTabs%3Darticle>). One exception was Samuelson; little did he know how accurate he would be when he wrote on the front cover of the fifth edition of Kindleberger’s *Manias, Panics and Crashes*, published in 2005, that in the following five years one might kick oneself for not having read Kindleberger’s book! (See epigraph at the beginning of the paper).

²³ Regarding China (how could it not be China’s fault!), not only its large level of reserves and undervalued currency have been blamed for the crisis, but also its low export prices (as the latter would have created downward pressures on tradable prices, allowing monetary authorities in industrialised countries to run excessively expansionary monetary policies and still hit their inflation targets). In the case of ‘liberals’, they have been blamed for a 1977 law that helps low-income people get mortgages (see, for example, http://www.prospect.org/cs/articles?article=did_liberals_cause_the_subprime_crisis). And, among several other supposedly external causes of the crisis, a CEO of a financial market advisory firm (described by *The Financial Times* as “one of Washington’s premier insiders”) has blamed the crisis on the fall of the Berlin Wall... (<http://www.weeklystandard.com/Content/Public/Articles/000/000/016/763ixjus.asp?pg=2>).

²⁴ The contributors to Booth (2009), for example, conclude that government and central bankers must take all the blame for the financial crisis; bankers, investors and *all* other market players, of course, should be totally exonerated.

²⁵ So, instead of behaving as a good old-fashioned central banker – one who takes away the punchbowl when the party gets going – he was happy instead to fill it up with ‘high-spirited’ easy money and easy credit.

Greenspan, when financial markets are shocked out of equilibrium they may well be unable to self-correct – as in the recent bubble (see Greenspan, 2009).

This paper begins by highlighting a number of mechanisms that have led to the current financial crisis from the perspective of heterodox Keynesian-Minskyian-Kindlebergian financial economics (more recently enriched by, among others, those economists mentioned above, as well as by behaviourist and psychoanalytic approaches to finance, Evolutionary economists and Neo-Schumpeterian long-term views of the relationship between technology and finance).²⁶ However, the paper then proceeds to argue that perhaps more than ever the 'macroeconomics' that led to this crisis only makes analytical sense if examined within the framework of the political settlements and distributional outcomes in which it had operated. So, the analysis then takes on the perspective of critical social theories (especially Marxian and Foucauldian) and concludes that, ultimately, the current financial crisis is the outcome of something much more systemic, namely an attempt to use neo-liberalism (or, in US terms, neo-conservatism) as a new technology of power to help transform capitalism into a rentiers' delight. And in particular, into a system without much 'compulsion' on big business; i.e., one that imposes only minimal pressures on big agents to engage in competitive struggles in the *real* economy (while inflicting exactly the opposite fate on workers and small firms).²⁷ A key component in the effectiveness of this new technology of power was its ability to transform the state into a major facilitator of the ever-increasing rent-seeking practices of oligopolistic capital. The architects of this experiment include some capitalist groups (in particular rentiers from the financial sector as well as capitalists from the 'mature' and most polluting industries of the preceding techno-economic paradigm – that of the age of the automobile, oil, petrochemicals and mass production), some political groups, as well as intellectual networks with their allies – including lots of economists and the 'new' left. Although rentiers did succeed in their attempt to get rid of practically all fetters on their greed, in the end the crisis materialised when the markets took their inevitable revenge on the rentiers by calling the neo-liberal bluff.

So, how did we get into such a mess? This paper will argue that this crisis was the result of a unique combination of an ideology that became toxic, powerful and intrinsically rentier special-interest groups, populist politics (led by the most remarkably unimaginative and accommodating political élite for generations), bad economics, and downright incompetence.

²⁶ On the latter four, see for example Broihanne et. al. (2008); Tuckett and Taffler (2008); Nelson and Winter (1982); and Pérez (2002), respectively.

²⁷ For an analysis of the rôle of 'compulsions' within capitalism, see Foucault (2004); for him, the emergence of modernity and of capitalism was not at all about the 'relaxation' of compulsions (as most liberals believe), but about the development of new (and more effective) forms of compulsion. In turn, for Khan (2005) "[...] capitalism is characterised not just by the presence of market opportunities, which have always been present in societies with markets, but also by a hitherto unknown introduction of market compulsions, which ensured that both capitalists and workers continuously had to strive to improve their performance just in order to survive. [...] Only capitalist appropriation depends on market competition and therefore on the systematic improvement of labour productivity. Only capitalism, then, depends on constantly improving the forces of production. And only in capitalism is it necessary to grow just to stay in the same place". (2005, p. 72)

3.- *What is neo-liberalism – and why did it become so toxic?*

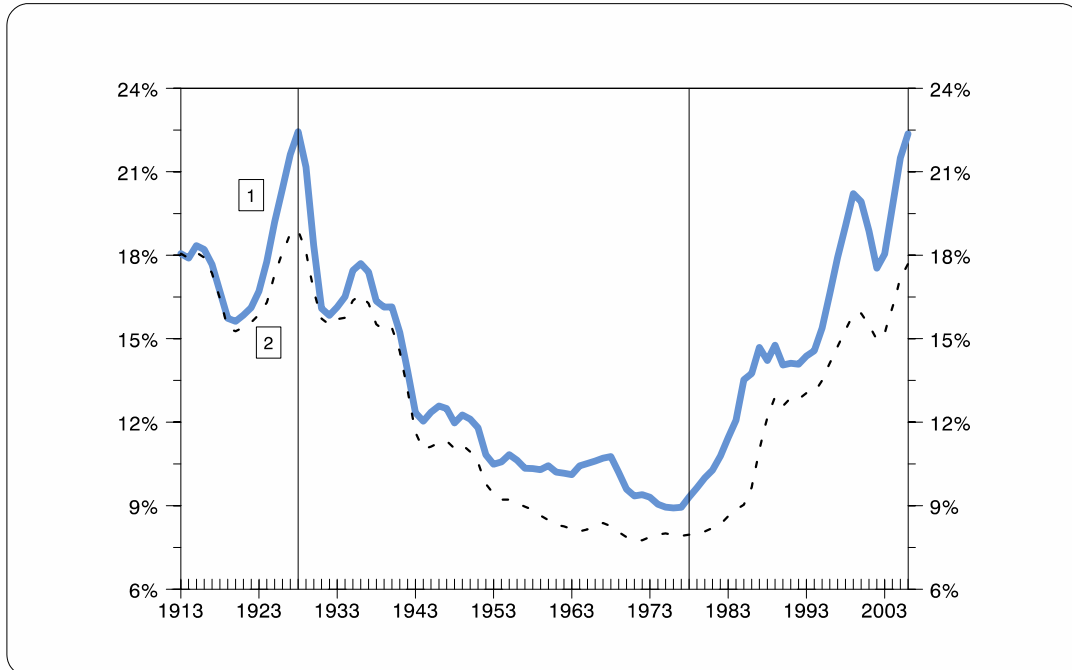
Polanyi (1944) was one of the first to suggest that capitalism will tend to alternate between periods with little market regulation, and periods in which society intervenes actively to regulate market activity, especially in the labour market and finance. Kalecki (1943) had also envisaged long-term cycles within capitalism, led by 'countercyclical ideologies' (see below). Evolutionary and neo-Schumpeterian economists also tell us that capitalism will move along long-term technological cycles due to the different nature of the 'installation' and the 'deployment' phases of new techno-economic paradigms (see Pérez, 2002). And Hirschman (1982) too discussed what he saw as long-term cycles of preferences for public versus private provision of goods. According to him, the backlash against Keynesianism and dirigiste policies had a lot to do with the stagflation in the 1970s. This accelerated a growing collective frustration concerning the effectiveness of state regulation and led to radical calls for more *laissez-faire* policies. He argued that sustained frustration and disappointment with existing institutions can lead to dramatic 'rebound effects' demanding radical changes in policy. Long-term cycles of preferences for public versus private provision of goods may be explained by such mechanisms. For Hirschman, such disappointment must often go through a threshold before it is consciously acknowledged; people have a tendency to deny bad choices and stick to them for too long. But when they do finally admit to their disappointment, there will be a 'rebound effect'. That is, Hirschman thinks that 'reverse shifts' are more radical as a result. In fact, he thinks that "a good portion of the so-called puzzle of collective action and participation in public affairs disappears when the rebound effect is taken into account" (1982, p. 81).²⁸

Probably the most transparent and remarkable of these 'rebound effects' took place towards the end of the 1970s and the beginning of the 1980s (at the same time as the prevailing techno-economic paradigm was reaching maturity, while the new 'IT' technological revolution was only just beginning its 'installation' phase). Perhaps the simplest way to illustrate statistically the nature of this 'reverse shift' (from the liberal-Keynesian to the neo-liberal era) is by showing what happened to the share of income of the top 1 per cent in the US between the financial meltdowns in 1929 and in 2007 (see Figure 6).

²⁸ See http://www.politicalreviewnet.com/polrev/reviews/CONS/R_1351_0487_046_1005623.asp.

FIGURE 6

US: income share of the top 1%, 1913-2006



• **[1]** = including realised capital gains; and **[2]** = excluding capital gains. 3-year moving averages. **Source:** Piketty and Sáez (2003; updated to 2006 in <http://elsa.berkeley.edu/~saez/TabFig2006.xls>).²⁹ This is the source of all data on income distribution in the US below.

As is evident from Figure 6 the fortunes of the richest 1 per cent in the US took a rather remarkable turn after the appointment of Paul Volker (and his flamboyant monetarism) to the Fed in 1979, and the election of Reagan as president a year later: including realised capital gains, the share in national income of this small group increased from 8.9% to 22.8% between then and 2006 – or from 8% to 18% if capital gains are excluded.³⁰ And recent estimates for 2007 indicate that the

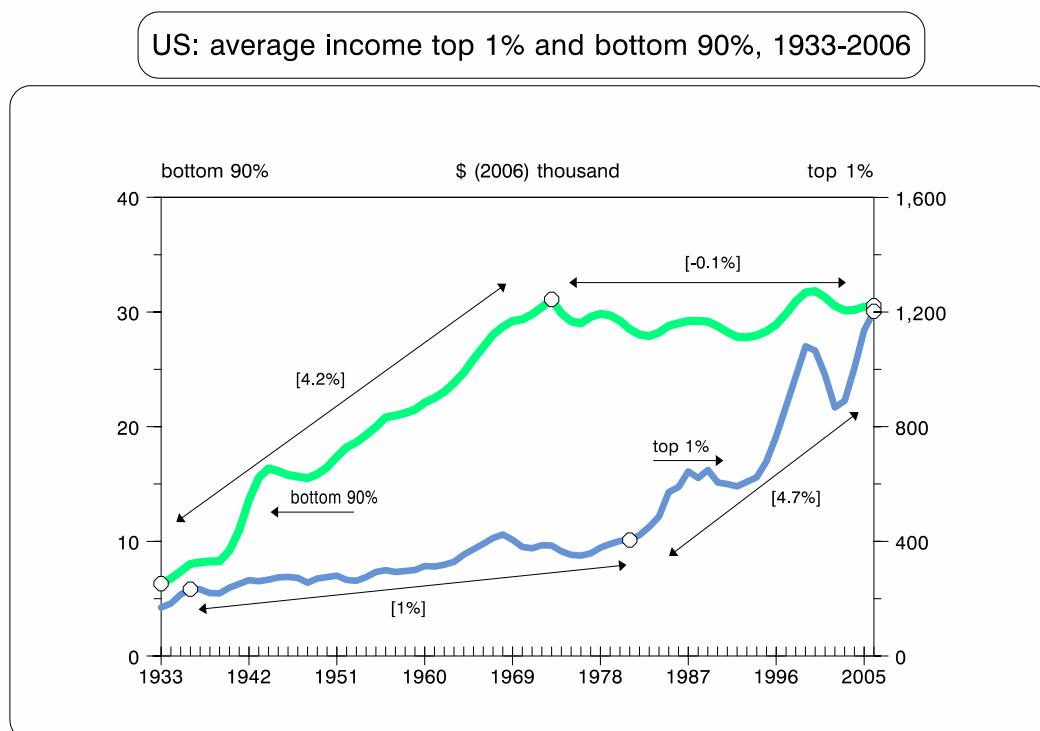
²⁹ Computations by authors on tax return statistics (the number of tax returns in 2006 was 138 million). Income defined as annual *gross* income reported on tax returns excluding all government transfers (such as social security, unemployment benefits, welfare payments, etc.), and before individual income taxes and employees' payroll taxes (but after employers' payroll taxes and corporate income taxes).

³⁰ In turn, including capital gains, the share of the richest 0.5 per cent increased from 6.2% to 18.6%; that of the top 0.1 per cent jumped from 2.7% to 12.6%; and that of the 0.01 per cent shot up from 0.9% to 5.5%. Remarkable as this income polarization may be, as these data are based on income tax statistics it is likely that they may underestimate (perhaps significantly) the increase in the income share at the top of the distribution after 1980. Financial liberalization, increased capital mobility, and the proliferation of 'tax havens' made it much easier for this income group to evade taxes (see, for example, <http://www.nybooks.com/articles/22245>). UBS, for example, has recently acknowledged that it helped 47,000 wealthy individuals in the US to evade taxes and has agreed to disclose the relevant information to the US government (see <http://www.livemint.com/2009/03/05100631/UBS-says-47000-Americans-had.html>). And the disclosure of this information has led several prominent US divorce lawyers to re-open many divorce

share of the top 1% increased even further to 23.5% – so, while about 1.5 million families got hold of 24% of taxable income (and the next 13.5 million acquired 26% of the total), 135 million families (bottom 90%) only received the remaining 50%.³¹

In fact, (as Neo-Schumpeterian economists working on techno-economic paradigms anticipated) by 2006 the share of the top 1 per cent in the US had already returned to its pre-1929 level. A relatively similar scenario is found in the UK after the election of Margaret Thatcher in 1979 (see Atkinson, 2007), and in Australia (see Harcourt, 2001). In turn, Figure 7 shows the remarkable reversal of fortune between the top 1 per cent and the bottom 90 per cent of the US working population.

FIGURE 7



● Percentages shown in the graph are average annual real rates of growth in respective cycles (1933-1973 and 1973-2006 for the bottom 90 per cent, and 1936-1980 and 1980-2006 for the top 1 per cent). 3-year moving averages. **Source:** Piketty and Sáez (2003).

While average income of the bottom 90 per cent was growing four times faster than that of the top 1 per cent during the long Keynesian cycle, in the following one the former stagnated as the latter surged ahead. In fact, as Kalecki had analysed in 1943, both Keynesian-style liberalism and neo-liberalism are basically counter-cyclical, but each for a different phase of the cycle. Both seek to change the balance of power between income groups: Keynesianism in order to prevent the

settlements in which these monies had previously been denied... (See, for example, <http://www.time.com/time/business/article/0,8599,1917829,00.html>).

³¹ See http://www.nytimes.com/2009/08/21/business/economy/21inequality.html?_r=1&ref=business.

disruptive effects of crisis-ridden capitalism, neo-liberalism in order to return power and control to their 'rightful owners' – capital.³²

A summary along Kalecki's lines of this switching-cycles logic is given by Alan Budd (a top UK Treasury civil servant, and strong supporter of monetarism at the time, who was later knighted by the Queen and became Provost of The Queen's College, Oxford):

"The Thatcher government never believed for a moment that [monetarism] was the correct way to bring down inflation. They did however see that this would be a very good way to raise unemployment. And raising unemployment was an extremely desirable way of reducing the strength of the working classes. [...] What was engineered – in Marxist terms – was a crisis of capitalism which re-created the reserve army of labour, and has allowed the capitalists to make high profits ever since." (Quoted in Cohen, 2003, p. 13).

To analyse further what the new neo-liberal counter-cyclical transformation was really about one should perhaps begin by indicating that what is common to its ideological discourse and that of nineteenth-century liberal thinking is the supposed harmony between the private and the social spheres (in the context of a 'minimal' state).³³ The implication is that this 'harmony' happens because the (supposedly class-blind) 'invisible hand' is the mechanism in charge of translating private self-interest into optimal social outcomes. So, as mentioned above (Section 2), competitive markets in which enlightened economic agents are able to maximise their own private selfish interests becomes the stuff that social optimum dreams are made of.

Of course, the automatic and necessary translation of selfish private interests into social optima is a rather useful story for the liberal discourse. Not everybody will be happy in capitalism, but whenever individuals are not happy it is because they have just had bad luck, or have lacked useful skills, have operated in an institutional setting that has hindered competitive free markets, or have themselves been guilty of resisting the harmonising magic of the invisible hand (which is their own fault anyway, and can be changed). As a result, distributive outcomes are supposedly not the product of any form of exploitation or power relations that favour some and disadvantage others in any systematic way. There are bound to be winners and losers, but only in a strictly Darwinian sense. In sum, within this framework it cannot be said that in capitalism there are systematic inequalities or injustices, only anonymous market forces that produce an efficient distributive outcome (given certain conditions). Furthermore, the story of anonymous free market forces and optimum equilibria allows one to blame the state (and those who do not respect the rules of the game) rather than capitalism or unregulated markets for anything that goes wrong.

However, there are also huge differences between the classical-liberal and the neo-liberal discourses. Smith and the Enlightenment were of course right about the fundamental issue that human beings can look after their own interests without needing a Church or a King to tell them what to do. This was a remarkably progressive proposition for its time. In fact, the three pillars of the classical liberal

³² See also Wood (1999).

³³ The state should also have no right to interfere in private lives; i.e., the state as 'night-watchman' – for example, religion should be strictly a private affair. See Hirschman (1997).

discourse – ‘markets’, ‘knowledge’ (i.e., sciences and rationalism) and (individual) ‘freedom’ – had this progressive characteristic. So did the Keynesian-style liberalism that emerged in the previous switching of long-run cycles (mid-1930s) mostly as a result of a ‘rebound effect’ due to the long depression, the deployment of the ‘mass-production-for-mass-consumption’ techno-economic paradigm, and events in Russia and Germany. In actual fact, its innovative vision not only tried to reformulate all three pillars of the liberal discourse, but went so far as to question the supposed harmony between the private and the social spheres.³⁴ Basically, for Keynesian-style liberalism unregulated market forces could, at best, offer sub-optimal equilibria and unemployment, and at worst, crises of the magnitude of that of the 1930s. So, in order to be able to translate private self-interest into optimal social outcomes what was necessary was a new strong agency from the state. In this new vision, the three pillars of the liberal discourse had to be reformulated. ‘Markets’ should only be understood as good servants, but bad masters of economic life; ‘knowledge’ now had the crucial task of helping to engineer the new agency from the state; and individual ‘freedom’ would only be meaningful if it embraced social justice (otherwise, it would be mostly empty rhetoric).

Neo-liberalism, meanwhile, is a different discursive story altogether – and one that *in practice* has taken this long line of progressive liberal thinking not forward but backwards. Its huge complexities are reflected in the fact that there are many competing narratives regarding both its nature and success. In this paper I shall concentrate on two competing narratives of its nature emanating from the perspective of critical social theories (the Marxian and the Foucauldian). According to the former, neo-liberalism is not a revolution but a *counter-revolution* (along the lines of the above quote by Alan Budd). According to the Foucauldian, it is a novel reconfiguration of power leading to a new type of *Governmentality* – i.e., a new form of interaction between political power (and knowledge and discourse) and the dynamics of unregulated markets.

In the Marxian narrative, the neo-liberal project represented a counter-offensive by capital, following decades of continuous full-employment, rising real wages, improving income distribution, welfarist policies and all forms of government intervention, which reached its culmination with the difficult economic environment during the stagflation of the 1970s (due only in part to exogenous shocks, such as the oil price increase that followed the ‘Yom Kippur’ war). This counteroffensive was helped (among many other things) by the lack of credible opposition that followed the collapse (mostly from within) of communism. In short, what the neo-liberal discourse was really about was capital attempting to regain its power and control through a new form of legitimisation and more sophisticated technologies of dispossession. That is, it was an attempt by the so-called ‘angry right’ to reassert class power – ‘angry’ in the sense that although rentiers had already been furious for a long time (as they had been the main losers of the welfarist ‘pact’ between unions and industrial capital that characterised the Keynesian era)³⁵, during the 1970s they were joined in their discontent by industrial and other productive capitalists who had previously done rather well during the ‘Golden Age’. For the

³⁴ According to Deane, “[t]he iconoclastic conclusion of [Keynes’] analysis was that there was no invisible hand translating private self-interests into social benefit. This was the nub of the Keynesian heresy” (1980, p. 182).

³⁵ This has led some analysts in the past to label the post-1980 neo-liberal period as that of ‘the revenge of the rentier’...

latter, things had become difficult due to the so-called 'profit squeeze' that began during the late 1960s (as the techno-economic paradigm of the time was reaching maturity), and the stagflation of the 1970s.³⁶ In short, the success of this counteroffensive by capital had a lot to do with its capacities to muster both a sufficient degree of 'outrage' against Keynesianism, and a sufficient degree of 'passion' for its alternate discourse (neo-liberalism).

A complementary narrative along the lines of neo-liberalism as an overwhelming right-wing offensive can be constructed along Acemoglu and Robinson (2005) lines: the above political and (in particular) economic problems lay at the root of the ascent of neo-liberalism in the sense that they helped the different factions of the capitalist élite both (finally) to solve their 'collective action' problem, and to start committing sufficient economic resources to achieve the *de facto* political power needed to succeed in this project.³⁷

In the traditional Marxian reading, neo-liberal theories are mostly an ideological cover for the process of restoration of capitalist class power. As such, neo-liberalism as a social theory is not that relevant as it is mainly an exercise in the legitimization of the economic practices taking place (see Harvey, 2005).

The most common criticism of the Marxian account is that although it rightly unmasks the class interests behind neo-liberalism, it does not explain sufficiently how neo-liberalism came to be a dominant ideology, or how this ideology was able to reshape the social world in order to secure its goals of dispossession and restoration of class power – let alone how was it able to achieve this within a democracy via a 'spontaneous consensus' type of hegemony (in the Gramscian sense). To say that this happened because it was useful for capital would be a functionalist explanation. Such an explanation would lack a proper historical subject and would not provide an adequate account of the rise of neo liberalism (especially its grounding in the difficult economic and political environments that always characterises the process of switching techno-economic paradigms). Furthermore, it is not at all obvious that those (successfully) conspiring to bring about their own short-term goals had a clearly defined and spelled-out ideology/legitimation strategy ready at hand or in mind that would work in the medium or long term (somehow without much resistance from the loser). The main point here is that the story is a lot more complex than an overwhelming right-wing offensive against a weakened opposition – although these two elements are obviously crucial components of the story of the success of neo-liberalism. This complexity is not just for complexity's sake, but absolutely necessary to understand the intricate dynamic of the switching of long-term political and economic cycles.

In short, there is no doubt that a powerful fight took place during the 1970s between those interests backing the welfare state (working class, some industrial capitalists, some political parties and intellectuals) and those wanting to dismantle it (financial rentiers, other industrial capitalists whose life was becoming increasingly

³⁶ As a result, these groups were facing the combined effect of (among other things) a further decline in their share of income and a squeeze of their profit rates (Figures 6, 7 and 8), an increase in taxation (Figure 14), a significant decline in corporate capitalisation (Figure 20; which had led to a plunge of their 'Tobin's Q' – Figure 21), and a collapse of their 'net worth' (Figure 24).

³⁷ Lobbying and campaign contributions also bring nice rewards at time of distress: the ten largest recipients of federal 'Troubled Assets Relief Program' funds had spent more than half a billion dollars on both accounts over the past 10 years (see <http://www.washingtonpost.com/wp-dyn/content/article/2009/07/26/AR2009072602190.html>).

difficult as the fourth techno-economic paradigm was reaching maturity and new opportunities for productivity growth were becoming scarce at the same time as competition from some East Asian countries was intensifying, some political parties and intellectuals, including a great deal of economists). Equally there is little doubt that this struggle was won by one side via varying historical processes. Furthermore, as analysed below, what followed had unintended consequences that culminated in the current financial crisis. However, there is not much evidence of a political 'invisible hand' guiding this transformation through the remarkable institutional and social complexities that characterised the places in which neo-liberalism was developed as an ideology.

One line of criticism of the Marxian analysis of neo-liberalism comes from the work of Michel Foucault. He attempts to provide a *description* of the content of the neo-liberal ideology rather than an explanation of why this ideology became hegemonic. According to Foucault the core aspect of neo-liberalism is linked to the problem of the relationship between political power and the principles of a market economy – that is, the projection of the principles of a market economy onto the arts of governing. In this respect, neo-liberalism is better seen as a characteristic way of problematising social reality rather than a set of fully developed theories. It represents a 'positive' form of social regulation and not simply a set of 'negative' answers—such as the retreat of the state, the absence of regulation, or the disappearance of the nation-state (see especially Frangie, 2008).

Neo-liberalism, according to Foucault, encompasses the various problematisations of the state, the social and the economy, which followed what was perceived as a long period of inefficient state interventions, stifling both society and the economy, and bordering, in a logical series of displacements, on becoming versions of the totalitarian state. Starting from the belief in the market as the optimal form of social organisation, and acquitting markets of the ills of which they were accused, the guiding question for neo-liberals was how to reformulate the political and the social in a way compatible with the 'rationality of the (unregulated) market economy'. Different answers were provided to this dilemma, representing various brands of neo-liberalism, united by the "question concerning the extent to which competitive, optimizing market relations and behaviours can serve as a principle not only for limiting governmental intervention, but also rationalizing government itself" (Burchell, 2001, p. 23).

Trying to make some elements of the Marxian and the Foucauldian accounts of neo-liberalism fit together (as I attempt in this paper) is a rather problematic exercise. The upholders of the former consider the Foucauldian 'governmentality' understanding as missing the crux of the neo-liberal revolution, namely its grounding in a class process of dispossession. For the latter, the Marxian account is at best incomplete, and at worst ignores the novel reconfigurations of political and institutional power encapsulated by the neo-liberal revolution. Underneath the theoretical differences between these two approaches, a deeper disagreement lurks regarding the understanding of 'critique'. Governmentality, by bracketing the evaluation of the arts of rationalities it investigates, has been opposed to Marxism or at least indifferent to its critical edge, imposing "a restriction that precludes problematising effects, and thus presumably eliminates the possibility of assigning costs to any mentality of rule" (O'Malley et al., 1997, p. 509). In other words, Foucauldian accounts of neo-liberalism suspend judgement in their analysis, grounded in their scepticism regarding Marxian accounts of agency and historical development. Neo-liberalism, according to this account, is a serious attempt at

instituting new forms of rule almost irrespective of their effect on the pattern of inequality; they can be contingently used for the legitimation of increased inequalities but do not have to be so by necessity. In a traditional Marxian reading, meanwhile, neo-liberalism is just a discourse that is used to legitimise a new technology of dispossession and extreme forms of rent-seeking accumulation.

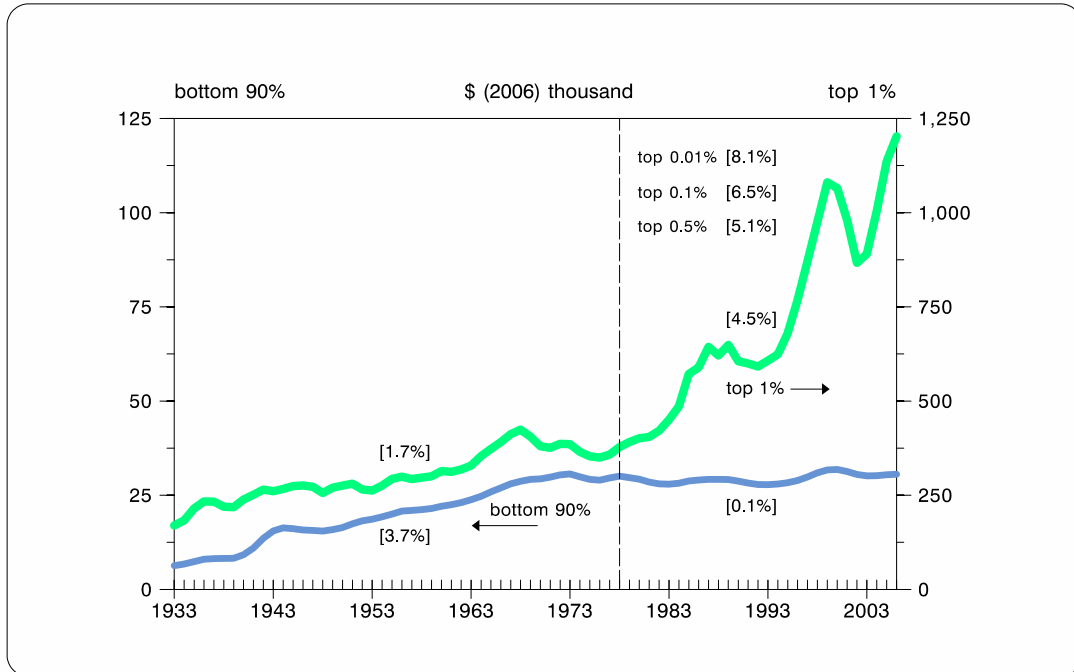
From the perspective of this paper one of the few indisputable characteristics of neo-liberalism is that it emerged in opposition (in the form of an undertow) to the Keynesian consensus of the 'Golden Age'. Then, after many years on the fringes, it suddenly became mainstream among right-wing circles during the stagflation of the 1970s. This happened at the same time as the emergence of important economic problems and of political changes in right-wing parties. Among the former, the crucial one was the beginning of the already-mentioned relative exhaustion of the fourth techno-economic paradigm; and among the political changes in right-wing parties, the most important ones took place first in Great Britain and then in the US – in the former, this was the time when the Conservative Party switched from being the party of 'state-owners' to being the party of 'state-agents'; and in the latter, it was the time when the GOP switched to its 'Southerner Strategy' ("government is the problem because it takes your money and gives it to Those People").³⁸ And it wasn't long before governments began to be run by people who hated governments... So, this was the time when the neo-liberal concern with 'prudent-macroeconomics-cum-smaller-governments' became just a tactical discursive strategy, successfully framed within the 'politics of resentment' and a bogus (but remarkably ingenious) disguise of 'modernity'.

As in Figures 6 and 7 above, Figure 8 indicates that the extreme redistributive success of the post-1980 'neo-liberal rebound effect' was due to its 'winner-takes-all' nature (the same is found in Latin America; see Palma, 2007).

³⁸ On the latter, see <http://www.nytimes.com/2009/01/02/opinion/02krugman.html>.

FIGURE 8

US: average income of the bottom 90% and of the top 1%, 1933-2006



• Percentages are average annual real rates of growth between 1933-78 and 1978-06. Includes capital gains. 3-year moving averages. **Source:** Piketty and Sáez (2003).

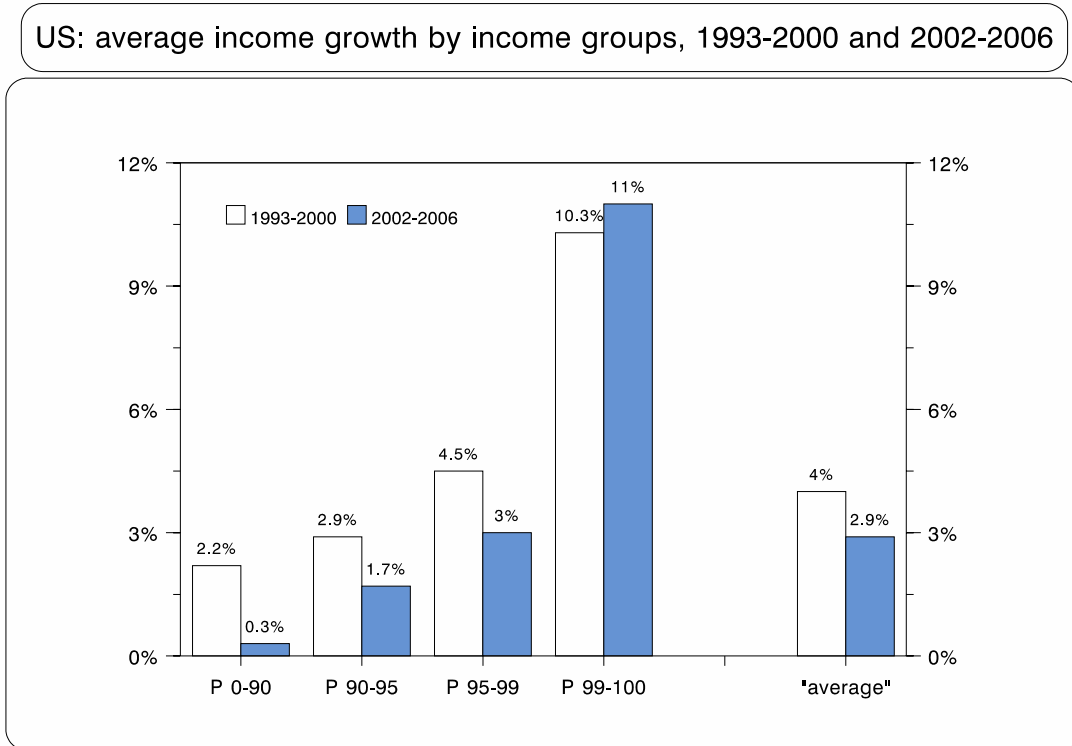
In fact, according to the source, in real terms (i.e., US\$ at 2006 values) the average annual income of the bottom 90 per cent actually *fell* during the 33-year period between the 1973-oil crisis and 2006 (from US\$31,300 to US\$30,700).³⁹ Meanwhile, that of the top 1 per cent increased *3.2-fold* (from US\$386 thousand to US\$1.2 million) – who said that a rising tide should lift all boats!

Figure 9 shows just how little difference there is between Democrat and Republican administrations from this perspective during the neo-liberal cycle. During the seven-year period of economic expansion of the Clinton administration (1993-2000), and the four-year period of expansion of Bush's (2002-06), 'average' real family incomes grew by 4% and 2.9% annually, respectively. However, these averages disguise remarkable asymmetries: in fact in both periods 'average' income

³⁹ As is usually the case, a stagnant average real income for the bottom 90 per cent did not mean that nothing was actually happening in the labour market. In terms of employment, for example, between the election of Reagan and 2005 the US economy added no fewer than 45 million jobs. However, this total is the net outcome of two very different stories: while services gained 48 million jobs, manufacturing lost 5.5 million. Although this remarkable overall increase and structural change in employment must have helped sustain downward pressures on wages (especially the fact that 12 million of those jobs were created in wholesale and retail trade, hotels and restaurants), the 15 million jobs created in finance, insurance and real estate must have had the opposite effect...

growth corresponds to the one taking place in percentiles 95-99 (something that did not happen even in Pinochet's Chile; see Palma, 2007).

FIGURE 9



• P = percentiles. **Source:** Piketty and Sáez (2003).

As a result, during the seven-year period of economic expansion of the Clinton administration the top 1 per cent of income earners captured 45% of the total growth in (pre-tax) income, while during Bush's four-year period of expansion no less than 73% of total income growth accrued to the top 1 per cent.⁴⁰ Perhaps the neo-liberal ideology associated with the post-1980 period (and its incredibly successful process of 're-legitimation' of capital) is just shorthand for 'the art of getting away with a remarkably asymmetric distributional outcome *within a democracy*'... An alternative formulation would be that it is shorthand for 'the art of generating a "spontaneous consensus-type of hegemony" that such a remarkably asymmetric distributional outcome is the only game in town' – or, in Mrs Thatcher terms, a spontaneous consensus that 'there is no alternative'. And in terms of the language of game theory, another working definition could be 'the art of transforming a particularly asymmetric set of distributive strategic choices, and the corresponding payoffs, into a Nash equilibrium' – as the majority becomes convinced that there is no point in trying to change such asymmetric distributive strategies while the all too powerful top income players keep theirs unchanged (despite the obvious fact that they could clearly improve their payoffs if only they could somehow agree on a strategy different from the current one).

⁴⁰ See Piketty and Sáez (2003). There does not seem to be much evidence in the US since the late 1970s to support a 'median voter' scenario, or trickle-down economics...

From the latter's perspective, the key question here is whether or not this Nash equilibrium was the outcome of a so-called 'game of chicken' – a model of conflict associated with a diverse range of social conflicts (also known as the 'hawk-dove' game). In this game the key issue is which player yields first (or blinks first). The best-known example takes place in the 'chicken race' between James Stark (played by James Dean) and the local bully (Buzz Gunderson) in the 1955 film *Rebel Without a Cause*; they raced stolen cars towards an abyss, and the one who would first jump out of the car would lose and would be deemed a 'chicken'. Bertrand Russell (1959) also made it famous as a metaphor for the psychotically dangerous game of nuclear stalemate. This game is an 'anti-coordination' one because the shared resource is *rivalrous* (although non-excludable). That is, sharing comes at a cost – i.e., it is subject to a negative externality (although in an income distribution game this does not have to be the case if the players are involved in a Marshallian 'efficiency wage' scenario – but try to explain that to a neo-liberal...).

The unstable situation that characterises a game of chicken leads to a situation in which there is more than one outcome that could end up in a Nash equilibrium. In fact, an anti-coordination game of this type can have three Nash equilibria. Two of these are the pair of 'pure' strategies; in these, the 'chicken' player decides that he or she has too much to lose, and little to gain, by challenging the other player's strategy. One example would be if the reason why the bottom 90 per cent gave in to top income earners appropriating *all* income growth after 1980 was that they saw no realistic gain – and great deal to lose – from increasing distributional conflict at that point in time. So one effective tactic in this game (relevant for this story) would be for one party to signal his or her intentions convincingly enough – i.e., it could become a game of "brinkmanship" (a strategic move designed to avert the possibility of the opponent switching to aggressive behaviour). One example of this, is found in Stanley Kubrick's *Dr. Strangelove*; in this film the Russians seek to deter American attack by building a 'doomsday machine' – a device that would trigger automatic world annihilation if Russia was hit by a nuclear attack.

The third possible Nash equilibrium (the 'symmetric' one) is a mixed equilibrium, in which both players probabilistically choose between the two pure strategies. This is the potential cooperative outcome of a 'game of chicken'. Basically, it may not be such a bad idea for both players to jump out of the car at the same time before the abyss (or swerve before a head-on coalition); both come out alive, and no one can call the other 'chicken'. One example of this would be settling for a set of distributive strategic choices, and their corresponding pay-offs, in tune with a more even-handed welfare state – and thus avoiding the risk of an escalating distributional conflict.

As Polanyi, Kalecki and Hirschman envisaged, from the point of view of the issues discussed in this paper the key argument is that the distributional outcome in the US during the 78-year period between the financial meltdowns of 1929 and 2007 (and in some other industrialised countries such as Great Britain) is characterised by a remarkable switch between the two alternative Nash equilibria associated with the two 'pure' strategies – see especially Figure 7 above. First, the post-1930s welfare state ended up in a situation in which the bottom 90 per cent appropriated the lion's share of the increase in income; i.e., in the eyes of the top income earners it became something resembling a workers' 'pure' strategy (taking the appropriate cycles, income growth of the bottom 90 per cent was more than four times faster than that of the top 1 per cent – see Figure 7). Then, after 1980

this outcome was reversed to the opposite 'pure' strategy, but this time to an even more extreme version of it – one in which the top income earners ended up appropriating *all* the growth of income (respective average income growth was 4.7% and -0.1%).

The key question here, of course, is whether the bottom 90 per cent gave up its long-standing (and hard-fought) property rights over the appropriation of a large share of income growth because they suddenly became involved in a hopelessly unfavourable asymmetrical game of chicken (i.e., even in a democracy being 'chicken' is better than being crushed), or because many in the bottom 90 per cent somehow became *ideologically* convinced that this (short-term unfavourable) outcome would nevertheless benefit their future pay-off (e.g., some sort of 'trickle-down' story). Capital gains from multiple asset bubbles and easy access to credit could help sustain popular support for the latter discourse. The point here is that there would be a big difference between the bottom 90 per cent entering into such an unfavourable Nash equilibrium out of 'conviction' or out of 'necessity' (adverse power structure). If the former dominates, the game would then cease to be one of 'chicken'. And the most probable answer to this question is that what happened to the bottom 90 per cent after 1980 was the result of a mixture of the two situations (unfavourable power structures in a game of chicken, somehow helped by an 'alienated' ideology).⁴¹ That is, those in the bottom 90 per cent who wanted to resist the 'pure' strategy of the top income earners had a serious 'collective action' problem to solve.

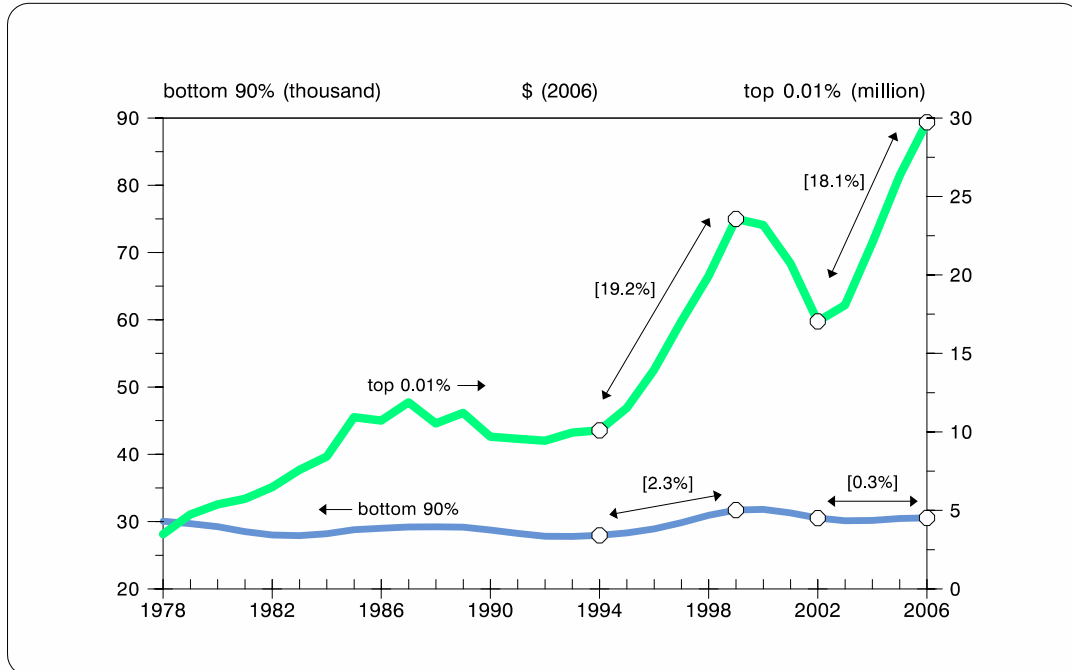
At least we now know for certain that the top income earners' 'pure' strategy, even if it was able to generate a Nash equilibrium within a democracy, was not capable of avoiding generating unsustainable financial dynamics. So, this specific outcome is a rather good example of a Nash equilibrium that is not Pareto optimal – in a 'game of chicken' scenario an 'irrational' player almost always has the upper hand...

Figure 10 shows how the contrast between the fortunes of the great majority and those of the powerful minority gets even more extreme when the comparison is made with the very few at very top of the income distribution.

⁴¹ Krugman tells the following story: "At a recent town hall meeting, a man stood up and told Representative Bob Inglis to "keep your government hands off my Medicare." The congressman, a Republican from South Carolina, tried to explain that Medicare is already a government programme – but the voter, Mr. Inglis said, "wasn't having any of it."... (<http://www.nytimes.com/2009/07/31/opinion/31krugman.html>). Another similar incident happened later at a town hall meeting held by Representative Gene Green, D-Tex. An activist turned to his fellow attendees and asked if they "oppose any form of socialized or government-run health care." Nearly all did. Then Representative Green asked how many of those present were on Medicare. Almost half raised their hands... (<http://www.nytimes.com/2009/08/07/opinion/07krugman.html>). And yet another incident took place in another related town hall meeting when a member of the public compared Obama's health reforms with Hitler's 'final solution'. (BBC News, 9 August 2009). People with this type of world-views could well enter into an unfavourable Nash equilibrium out of conviction...

FIGURE 10

US: average income of the top 0.01% and of the bottom 90%, 1978-2006



• Percentages are average annual real rates of growth in respective periods (1994-2000 and 2002-2006). Includes capital gains. 3-year moving averages. **Source:** Piketty and Sáez (2003).

While the average income of about 120 million families remained stagnant during this 28-year period, the average of the top 0.01 per cent increased 8.5 times.⁴² So the multiple between the two incomes shot up in a way that 'defies gravity' – from its lowest point in the 1970s to its peak in 2006 it jumped from 115 to 970. In sum, if during the 'Keynesian-liberal' period the 'American Dream' seemed to belong to the majority of the US population, it has since been hijacked by a rather tiny minority – for the rest, it has only been available on credit...

At the same time, this huge income polarisation – between 1980 and 2006 just the taxable income of the top 1 per cent increased by nearly US\$2 trillion, and that of the top 10 per cent by US\$3.5 trillion – obviously became one of the major contributors (and one probably more important than the Asian 'savings glut') to the increased liquidity in the US financial markets (the abundance of which transformed financial markets into fundamentally unstable institutions, totally unable to self-correct). In fact, in 2007 no less than 3 million families in the US declared to the Internal Revenue Service (IRS) that they had liquid investable assets of more than US\$1 million.⁴³ So, the current crisis may have many roots, but (as discussed in more detail below) a crucial one relates to income polarisation. In particular, as

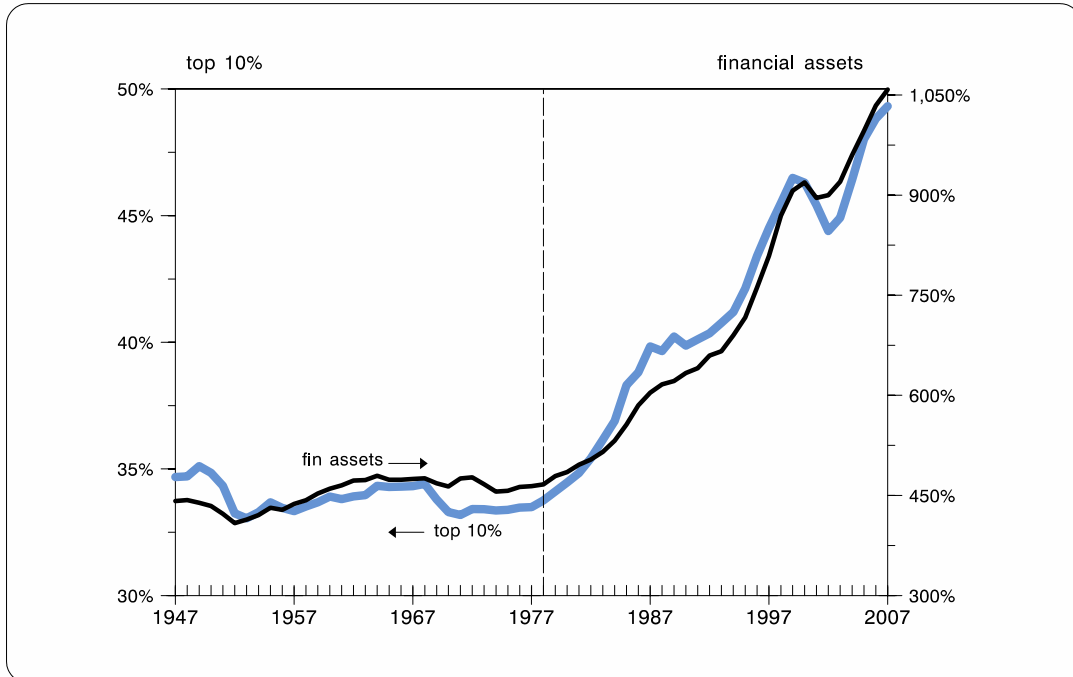
⁴² In turn, in US\$ at 2007 values, at the time of Reagan election one needed about US\$2 million in order to 'qualify' for this selected club, by 2007 the bar had jumped to US\$11.5 million.

⁴³ See http://www.nytimes.com/2009/08/21/business/economy/21inequality.html?_r=1&ref=business.

Figure 11 indicates (and as good old-fashioned Keynesian economics has always emphasised) the current crisis has again shown that developments in financial markets are closely related to the distribution of income, so the latter is a crucial component in the understanding of the crisis and in the planning of how to get out of it.

FIGURE 11

US: income share of the top 10% and value of financial assets as % of GDP, 1947-2007

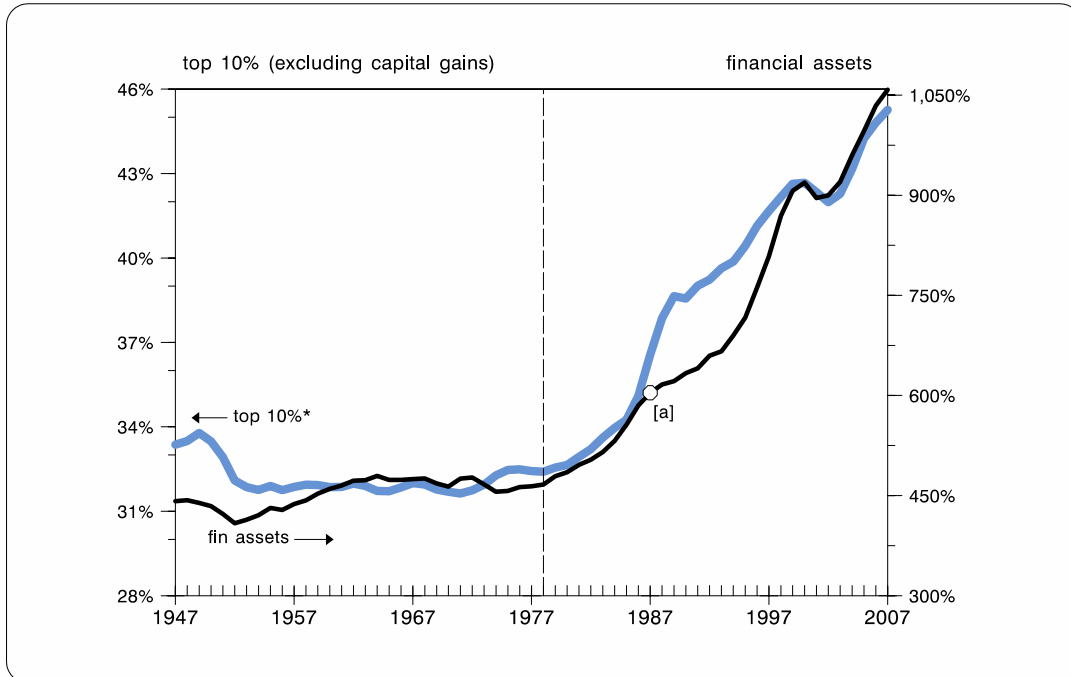


• **fin assets** = value of financial assets as percentage of GDP; and **top 10%** = income share of the top 10% (includes realised capital gains). 3-year moving averages. **Sources:** Piketty and Sáez (2003), and US Federal Reserve (2009).

It could be argued, however, that this is a case of simultaneous causation; the rich own most financial assets, and anything that causes the value of financial assets to rise rapidly will also cause inequality to rise fast. However, this close relationship stands even when capital gains are *excluded* from tax-payers' income (see Figure 12).

FIGURE 12

US: income share of the top 10% and value of financial assets as % of GDP, 1947-2007



- As Figure 11 (but excluding capital gains). **[a]** = 'Black Monday'. 3-year moving averages.

In fact, the only time when the two series temporarily diverge is a short period that starts in October 1987 with 'Black Monday' (the largest one-day decline in stock market history). However, this 'glitch' was soon reversed and both series returned to their long-standing common path – that is, like an experienced tango-dancing partnership, after suffering a minor hitch, these two series are able to return swiftly to their long-standing 'cointegration'.

This close relationship between developments in financial markets and distributional outcomes (even when they exclude capital gains) will be the subject of Section 5; but let us first attempt to deconstruct in Section 4 the 'art' of achieving this remarkable polarisation of income, in such a short period of time – and within a democracy.

4.- *How to achieve the new legitimisation of capital and how to develop the technologies of power with the required degree of sophistication to sustain it*

Understanding what neo-liberalism is really about, and clarifying its rôle in bringing about the current global financial crisis, requires more than simply highlighting how it was able to bring about the most unlikely Nash equilibrium (in which a tiny minority managed within a democracy to get away with extreme income polarisation and little political and social tensions from such a remarkable asymmetry), and how

this income inequality was somehow closely associated with an ever increasing financial 'fragility'. It also requires an understanding of how this process of dispossession was part and parcel of a wider attempt by some capitalists (especially rentiers from financial capital, and from the 'mature' and the most polluting industries of the previous techno-economic paradigm), some politicians and intellectual networks to discipline the state and to transform capitalism into a system with minimal 'compulsions' for big business. The unintended result, of course, was to transform it into an emasculated, 'sub-prime' economic system that not only lost a great deal of its capacities to develop the productive forces of society, but also became particularly prone to accumulating ever-increasing financial fragilities. It is from this perspective that the current crisis can also be understood as the markets bursting the 'ideological bubble' that characterised the neo-liberal economic and political experiment. That is, that the global financial crisis took place when the 'end of history'-type neo-liberal manic discourse was brought down to earth by market's law of gravity.⁴⁴

The remarkable income polarisation of the neo-liberal period (particularly in the US) does not seem to give much support to the Foucauldian proposition that the new form of 'governmentality' sought by neo-liberalism, even though it can be contingently used for the legitimation of increased inequalities, is not about that by necessity. Instead, it seems to support the narrative that emphasises that neo-liberalism is mostly a new (and particularly effective) *technology of dispossession*. From this perspective, a crucial mechanism for setting in motion this transformation was rather ingenious: the reintroduction of risk and the heightening of uncertainty at the heart of a by then too self-confident 'welfarised' population and a (supposedly) too autonomous state.⁴⁵ In fact, the neo-liberal counter-revolution could thus be understood as a deliberate attempt to shift the economy (and much else) from a 'stable' to a somehow 'unstable' equilibrium. That is, a movement away from Keynesian attempts to manage risk and reduce uncertainty via national and international policy coordination, closed capital accounts, stable exchange rates, low and stable interest rates, low levels of unemployment and unemployment benefits for those out of work, public health services and the other aspects of the welfare state, and a state autonomous enough to be capable of at least some 'disciplining' of the capitalist élite, towards an intended movement in reverse. And this as a means to an end: to try to develop an environment in which capital could exercise both a more effective politics of dispossession and a more rent-seeking form of accumulation.

What some capitalists, politicians and intellectual networks thought best for capitalist development was that capital should regain the upper hand via an economic environment that was permanently unstable and highly insecure for the majority of the population and the state. That is, one that could have the necessary

⁴⁴ Only six months before the collapse of A.I.G., Joe Cassano, its chief financial officer, said of the US\$441 billion portfolio of CDS's he had bet on that "[i]t is hard for us, without being flippant, to even see a scenario within any kind of realm of reason that would see us losing one dollar in any of those transactions" (quoted in Schreiber, 2009). See also Shnayerson, (2009). Perhaps what he really meant was that "[i]t is hard for us, without being flippant, to even see a scenario within any kind of realm of reason that would see us losing one dollar of the bonuses that we have given to ourselves for taking the risks that are now likely to bring the down the corporation"...

⁴⁵ Neo-liberals seem to have been the only political group who really understood Kalecki's main message in his 1943 article on the 'Political aspects of full employment': capitalism just cannot endure the political consequences of sustained periods of full employment.

debilitating effect both on workers and the state. In this kind of environment, a highly mobile and malleable factor of production (especially finance capital) would have an unrivalled power to thrive.

In short, when 'excessive' Keynesian macro-stabilities, government regulations (such as more effective financial regulation, tougher competition laws, strong capital controls and greater accounting transparencies), labour-securities and social safety nets laid the grounds for both an increased degree of 'compulsion' for capital, and a significant challenge to its legitimacy by large segments of society, what capital urgently needed was the reintroduction of risk and the spiralling of uncertainty right into the soul of what were by then rather too self-assured 'welfarised' institutions and populations. So what was needed was a return to an environment in which the state had to live permanently under the logic of a 'state of emergency' (see especially Arantes, 2007); and a return to precarious jobs, with (among other anxieties) the constant threats of the transfer of jobs to China, India or Mexico, higher levels of unemployment, highly-constrained unions, increasingly porous safety-nets, insufficient and insecure pensions and so on – and, of course, high levels of persecutory personal debt could also be of great help.⁴⁶

In the language of game theory discussed above, what happened could be described as a three-step process. First, the welfare state became a Nash equilibrium close to a 'near-pure' workers' strategy. Second, during the 1970s the welfare state ceased to be a Nash equilibrium because the top income earners felt confident enough to switch to an aggressive strategy – as they became convinced that (thanks to a changing political and a worsening economic environment) they now had a good chance of changing the existing distributive outcome even if the workers kept their distributional strategic choice unchanged. Third, once the top income earners succeeded in transforming the distributional outcome into their own 'pure' strategy, the only way that they could make it into a Nash equilibrium *within a democracy* (i.e., convincing others not to challenge it) was through the methods described above – and a bit of ideological spin could also be of great help. All part of a political transformation that a former chief economist of the IMF (and current professor at MIT) has appropriately called 'The Quiet Coup' (see Johnson, 2009). The bottom line was thus the question of how to reconstruct an economic and institutional scenario in which everybody knew that capital could pull the plug whenever it wanted to.

As Tony Lawson has argued:

"[...] a central and great Darwinian insight is that a subset of members of a population may come to flourish relative to other members simply because they possess a feature, which others do not, that renders them relatively suited to some local environment. The question of the intrinsic worth of those who flourish most is not relevant to the story." (Lawson, 2003, p. 251).

Natural selection mechanisms of this sort help us understand what the neo-liberal discourse is really about: it is about an attempt to create an economic environment best suited to those features that capital has and others do not. In the jungle, capital is king! (And workers have much to lose).

⁴⁶ Much has been said of Mrs Thatcher's attempt to create a 'property-owning' democracy; it would be more appropriate to call it a 'mortgage-owning' democracy. Krugman (2005) calls it 'the debt-peonage society'.

The neo-liberal discourse may have burst onto the political scene in the 1970s promoting 'order', market efficiency and a new concept of the state based on freedom, individual initiative and sound macroeconomics, and about fighting paternalism. However, this discourse ended up being as transparent as a bank's balance-sheets since what was actually on offer for workers and the state was life 'on the edge' – as in a high-risk and unstable 'order' only capital could thrive.

In developing countries the challenge for capital to develop more effective forms of legitimacy, and more sophisticated technologies of dispossession, was even greater: in the new complexities of a post-Cold-War scenario, just having a Pinochet or two may not do any longer. As it happened, in many developing countries (especially in Latin America and South Africa) the new process of legitimisation of capital has become so remarkably successful, and the new technologies of power so surprisingly effective, that neo-liberalism has been able to turn the tables on progressive forces and has become ('low-intensity') liberal-democracy's best friend...

Before the domestic economic and political difficulties that culminated in the 1982 financial crisis, and before neo-liberalism became dominant in industrialised countries, capital could not even dream of becoming hegemonic in developing countries via a Gramscian 'spontaneous consensus' scenario – remember the brutal ways in which a dictatorship had to impose its own 'not-so-spontaneous-consensus' brand of neo-liberalism in Chile? In developing countries capital always saw democracy as its main threat. However, following the success of its new form of legitimisation, and helped by the collapse of most of the opposition, the even more remarkably precarious life of most of the working population, and the weakness of a state mostly reduced to a 'fire-fighting' rôle (i.e., having to live constantly under the logic of a 'state of emergency'), 'low-intensity' democracy (as opposed to popular or radical democracy) has become a crucial component of capital's new technology of power to rule and dispossess the working population, and to restrain the state and to subject it to greater market accountability.

In other words, middle-income developing countries, such as those in Latin America and South Africa, are the best examples of how neo-liberalism in practice contains elements of both narratives, the Marxian and the Foucauldian. On the one hand, what was discussed above gives strong support to Foucault's main proposition: neo-liberalism is not a set of economic policies but a new and more effective technology of power. On the other, the capitalist élite (with the helping hand of the 'new' left), mainly because of its intrinsically rentier nature and the lack of credible opposition, instead of using this new technology of power for its intended 'rationalising' effects, ended up misusing it just to support more effective forms of dispossession and more rentier forms of accumulation. This has transformed capitalism into a ('sub-prime') system with much-reduced capacities to develop the productive forces of society – i.e., one that has lost most of its only historical legitimacy.

From this perspective, the *good governance* agenda of the World Bank – with its call for the 'de-politicisation' of the state, for the 'independence' of crucial government institutions such as central banks, for increased 'transparency', 'accountability' and so on – is part of an attempt at disciplining and rationalising state action along free market principles (as in a Foucauldian narrative). However, as long as all forms of opposition continue to be so weak, the life of most of the working population so precarious, and the state so caught up in its fire-fighting rôle, 'good-governance' democracy becomes an effective institutional structure both to chart the whole of the state's actions on the 'rentier will' of the capitalist élite

(including helping their 'minimalist' approach to 'compulsions') and to make possible such a remarkable 'dispossession feat' within a democracy.

In sum, 'low-intensity' democracy becomes in practice a successful instrument to *block* any attempt to implement a progressive nationalist development agenda, or the exercise of a Keynesian or of more radical forms of state agency. That is, it becomes a valuable insurance against any significant challenge to the rent-seeking practices of big business, and against any meaningful challenge to the new attempts at country-subordination. In this respect, for oligopolistic capital low-intensity liberal-democracy replaces the rôle of military regimes as an effective hedge against the risk that a new political élite (including, of course, the 'new left') might come to power and threaten their brand of rent-based capitalism. That is, the new 'democratic' agenda of capital ensures that the state will fulfil its sole function of reproducing the new capitalist system, and could not possibly become a threat to the (ineffective) functioning of unregulated markets, or exert restraint on some of its most detrimental rent-seeking tendencies or financial manias.

In terms of Marxian debates, neo-liberal low-intensity democracy becomes a 'Poulantzas-type' strategy (as opposed to a Miliband 'social-network' one) in the sense of providing a *structural mechanism* to ensure that state actions (including, of course, economic policies) will not deviate from their goal of promoting its own brand of unregulated market, *irrespective of which ruling élite is in power*. It is a structural mechanism to ensure that state action will remain linked to a particular ideological agenda. In fact, in the new framework even the *legitimacy* of the state becomes linked to the effectiveness to which it adheres to the logic of unregulated markets.

Perhaps the ideological epiphany of the 'new left' in Latin America (and other parts of the developing and industrialised worlds) could be understood partly along these lines: as it believes that in this new scenario it cannot get political power to implement its own progressive agenda (or, as in South Africa, believing that though the ANC could easily get political power it might not be able to sustain it without major economic and political upheavals if it really meant to implement its own progressive agenda), it then tries to gain power to implement someone else's economic agenda (see Palma, 2009a; for the related concept of 'upside-down hegemony', see Oliveira, 2006; see also Arantes, 2007). In fact (as quoted in the epigraph at the beginning of the paper), Mrs Thatcher once branded 'New Labour' as "my finest creation". Likewise, perhaps the greatest political achievement of Pinochet and other dictators of that time is the proliferation of Latin American 'neo-liberal-lefts' – with their façade of 'modernity' and their manic managerial defences as tactical discursive strategies acquired on their Road to Damascus.

In terms of the rôle of increased risk in all this, a Foucauldian analysis would emphasise instead that neo-liberalism is not about increased risk *per se*, but about deploying a different understanding of risk – and of the ensuing social institutions that should regulate it. As Donzelot (1991) noted, it is about a modified conception of social risk, which shifts the emphasis from the principle of collective indemnification of the consequences of risks to an emphasis on the individual civic obligation to moderate the burden of risk he or she imposes on society. As such, neo-liberalism might in the end have led to an increase in risk, but as a theory it attempted to justify the dismantling of earlier Keynesian forms of social risk management through new conceptions of risk and the rôle of individuals in dealing with it. From a Marxian perspective, instead, increased risk was a *necessary* condition for transforming the top income earners' 'pure' distributional strategy into a Nash equilibrium.

Another important element of the analysis of the Foucauldian tradition is that although for all liberal perspectives 'markets' are a superior form of social organisation, there are crucial differences between a classical liberal and a neo-liberal understanding of the markets. For the former, markets are a 'quasi-natural' reality (whose laws have to be respected by the state), whereas for the latter the markets are historical constructions that must be constantly supported by a strong political agency of active governance (in this and what follows, see Frangie, 2008). Accordingly, for classical liberalism the state and the markets each have their own space, separate from one another. For neo-liberalism, in contrast, the distinction between the space of the state and that of the markets disappears; so the state (and everything else) should be mapped out as a function (or as a sub-set) of unregulated markets.

This view, of course, is not only very different from that of classical liberalism, but is also the opposite of the Keynesian-style liberal understanding of the rôle of the state, in which the relative autonomy of the state is the most critical governance issue; this autonomy is essential for the state to be able to improve upon the sub-optimal equilibria brought about (at best) by unregulated markets (with its many market failures), and for the state to protect society from the excesses of 'free' markets – in particular to protect those who become redundant to the logic of capital accumulation. For neo-liberals, meanwhile, market failures are not innate to the logic of capital but have a purely *contingent* historical nature. As such, the market economy is 'open' and should be facilitated through politico-institutional agency.

So, for example, Bush asks polluters to write environmental regulation, discards what little Clinton had left of the financial regulation erected during the 'New Deal', was happy to go along with exempting over-the-counter derivatives (like credit-default swaps that brought down AIG) from regulation by the Commodity Futures Trading Commission, and (after opposing the attempts by William Donaldson, the head of the Securities and Exchange Commission, SEC, to boost regulation of mutual and hedge funds, an obstruction that led to Donaldson's resignation), he cut the budget and the investigative staff of the SEC.⁴⁷ And when 'New Labour' Gordon Brown (as newly appointed Chancellor of the Exchequer) created in 1997 a new regulatory body for the financial industry, the Financial Service Authority (FSA), he set it up not only as an 'independent *non-governmental* body' (i.e., a company limited by guarantee), but one that was actually financed by the financial services industry (that was supposed to regulate). Furthermore, he appointed ex-bankers as Chairman, Chief Executive Officer and non-executive directors. That is, he set the FSA up as operationally independent of Government, funded entirely by the financial

⁴⁷ The fines and other penalties imposed by the SEC dropped by more than half during the second term of the Bush administration; and its enforcement staff shrunk by an extra 11 per cent in the two-year period prior to the onset of the sub-prime crisis. Bernard Madoff was also allowed to keep operating even after the SEC having been alerted to his misdeeds by Harry Markopolos, an accountant and investment investigator who began pushing the SEC to investigate Madoff as early as 1999. (For a detailed analysis of Markopolos's quest and the documents he submitted to the SEC to show that Madoff's record of consistent low-double-digit returns simply couldn't be legitimate, see the *Wall Street Journal*, December 18, 2008, especially the 19-page document Markopolos sent to regulators in 2005, 'The World's Largest Hedge Fund Is a Fraud', where he concludes that "I am pretty confident that BM [Bernard Madoff's hedge fund] is a Ponzi Scheme." The *WSJ* article also explains how the SEC investigators had actually discovered by themselves as early as 2006 that Madoff had seriously misled the agency about how he managed customer money, yet the government decided not to take any action.

corporations it is supposed to regulate, and led by financial-industry insiders. As became evident after the onset of the current financial crisis, the FSA had been acting more as a 'service provider' to the financial industry than as an industry regulator. Moreover, when the later became Prime Minister, Brown appointed the former CEO of a bank that had collapsed with the crisis (to whom he had previously granted a knighthood) as deputy chairman of the FSA – I suppose the idea was that convicted felons make the best prison guards...⁴⁸

Thus, New Labour found a rather ingenious solution to the problem of 'regulatory capture'; if lobbyist and industry inevitably succeed in capturing the regulators, why not make them the regulators in the first place? If all that matters is self-regulation and market discipline, why bother with unnecessary government meddling in the economy?⁴⁹ Not surprisingly, self-regulation became freedom to run amok, and market discipline became irrational exuberance.

The main issue here is the reversal of the Keynesian logic of the interaction between political power and the dynamics of unregulated markets. Among other things, this reversal brought to an end the rôle of the state as a 'constrainer' of the rent-seeking practices of oligopolistic capital (in order to foster competition). The neo-liberal attempt to project the logic of unregulated markets into the heart of government created a *de facto* situation in which the new rôle of the state became one of a *facilitator* of the rent-seeking practices of big business. In fact, for liberals of the classical tradition (and liberal-Keynesians) governments had to preserve competition, because "[p]eople of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices". (Smith, 1776). In practice, when people of the same trade meet together to conspire against the public, neo-liberal governments (especially those of the 'new' left) don't just turn a blind eye, they end up setting the table, cooking the meal, serving the drinks, and paying the bill... The irony is that in the end both Keynesian-liberalism and neo-liberalism ended up implementing a similar strong agency from the state; however, that agency had a very different aim.

In sum, as Foucault remarks, according to neo-liberalism what is needed is "[a] state under the surveillance of the market, rather than a market under the surveillance of the state" (2004, p. 120). From this perspective, if for Smith and the Enlightenment the fundamental (anti-feudal) issue was that human beings could look after their own interests without the need of a King or a Church to tell them what to do, neo-liberal oligopolistic capital became a *de facto* new King, and the neo-liberal ideology a *de facto* new Church, that again is able (and eager) to tell people and the state what to do.

⁴⁸ Brown appointed James Crosby to the FSA in December 2007, two years after Crosby – then the chief executive of Halifax Bank of Scotland (HBOS) and already a non-executive director of the FSA – had sacked a member of his staff who warned him that the FSA's rules (for whose design he was partly responsible) were being broken at his own bank! (See: <http://thescotsman.scotsman.com/latestnews/Brown-on-spot-as-former.4971845.jp>).

⁴⁹ According to Brown, his policy on financial regulation was "[n]ot just a light touch, but a limited touch" (see <http://www.cbi.org.uk/ndbs/press.nsf/0363c1f07c6ca12a8025671c00381cc7/ee59d1c32ce4ec12802570c70041152c?>). And, according to the present British Chancellor, this policy should not be changed now as "current financial regulation is not to blame for the credit crunch" (<http://news.bbc.co.uk/2/hi/business/8104340.stm>).

As is obvious by now, an unintended consequence of this new environment is that it has hugely increased the likelihood that capitalism would be even more crisis-ridden from within. That is, especially the wide-ranging financial liberalisation policies at a global level and those of liberalisation, privatisation and deregulation at a local one favoured by neo-liberalism, have driven the self-destructive tendencies of capital to their extreme (as, among other things, in this kind of environment issues such as prisoner dilemmas and fallacies of compositions were brought to their head).⁵⁰ But as in this new environment the downturns are just too horrifying even to contemplate, when instability got totally out of hand and became crushingly dysfunctional, capital, as in every good old Western, could always count on the most ancient rôle of the state – to call in the cavalry in the nick of time.⁵¹

5.- Income polarisation, 'financialisation', and 'sub-prime' capitalism – one with only modest capacities to develop the productive forces, and intrinsically unstable

From a macroeconomic point of view, the crucial aspect of the huge increase in inequality and in financial 'deepening' was that they were associated with a meagre-macro. In particular, they are linked to a disappointing rate of productivity growth; an ever-increasing level of 'financialisation'; a massive drop in the overall level of private savings; and a particularly poor rate of private investment – poor especially since increased inequality took place side by side with a relatively dynamic increase in personal consumption, high profit rates, easy finance and social tranquillity.⁵² Perhaps the least surprising part of this story is the collapse in the level of personal saving (see Figure 13).

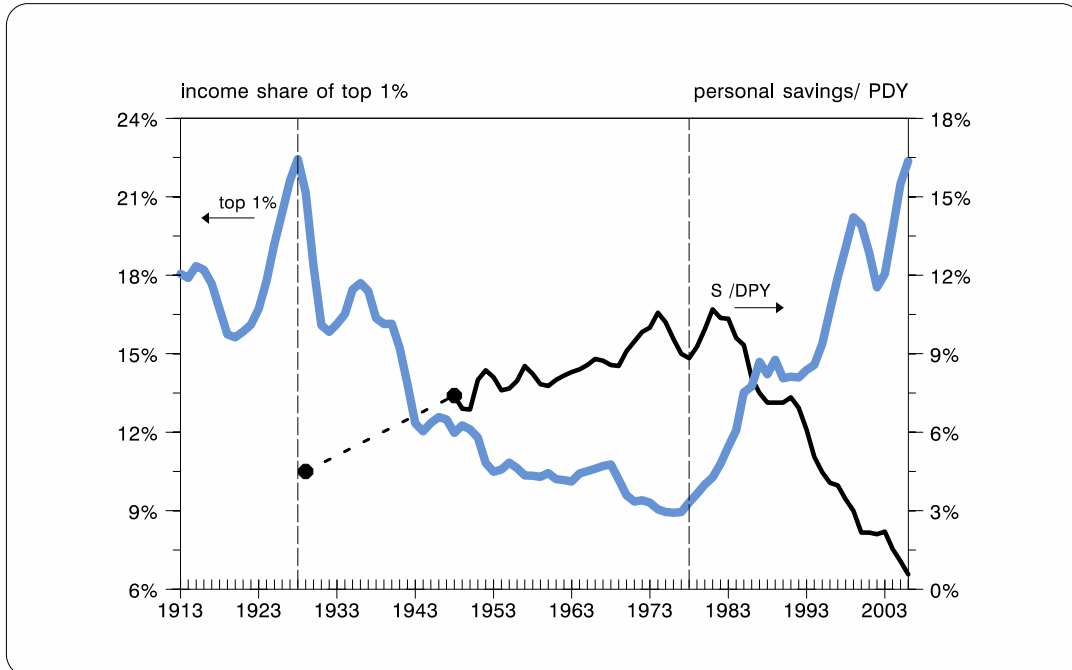
⁵⁰ Given current events, for most people it should come as no surprise to learn that in 2008 25 per cent of countries in the world had a banking crisis. However, what would perhaps be more surprising would be to learn that this percentage was also the annual average for countries with banking crises during the 15-year period between 1986 and 2001 (see Reinhart and Rogoff, 2008; countries are weighted by their share of world income).

⁵¹ As has become evident in the current financial crisis, when in the business cycle the down-swing is just too steep, the very-neo-liberal Washington Consensus also tells us (but very quietly) that we should all be 'closet Keynesians' and not allow market discipline to run its full course – i.e., as far as financial capital is concerned, governments should never let the chips fall where they may.

⁵² For a pre-2007 crisis critical analysis of this period, see Harcourt (2006).

FIGURE 13

US: income share of the top 1% and personal savings as a % of DPY, 1913-2006



• **top 1%** = income share of the top 1 per cent; **S/DPY** = personal saving as a percentage of disposable personal income. 3-year moving averages. Data on personal savings between 1929 and 1948 are not shown due to sharp fluctuations during both the 1930s recession and the Second World War (the same will be the case for other figures below). **Sources:** Piketty and Sáez (2003), and US Census Bureau (2008).

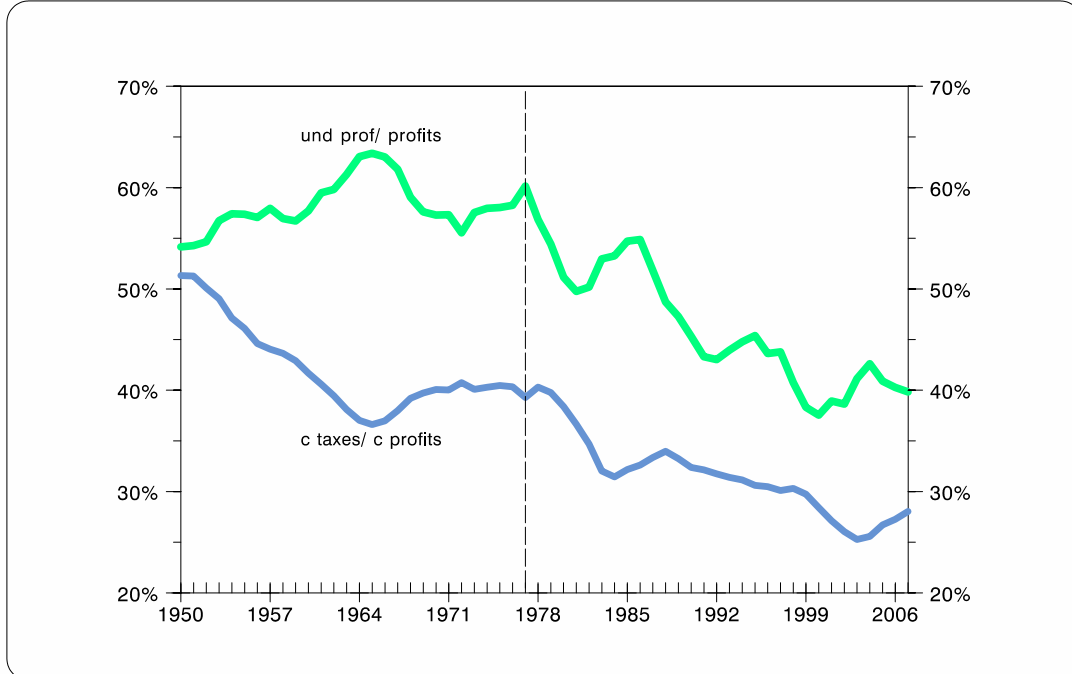
Obviously, three decades of stagnant average real income for the bottom 90 per cent, coupled with a dynamic rate of growth of consumption expenditure, is not the ideal environment for personal saving (at least, as traditionally measured in national accounts).⁵³

Furthermore, contrary to what was widely predicted by the 'supply-siders' of the Washington Consensus, in this new neo-liberal-type capitalism a remarkable fall in corporate taxation led to a *decline* in corporate saving as a share of corporate profits (as opposed to what had happened for most of the 'financially repressed' Keynesian period; see Figure 14).

⁵³ As shown in Figure 23 below, households enjoyed a huge increase in net worth after 1980. As individuals feel richer, they may well have deceived themselves into believing that their 'permanent' income was also growing rapidly (by adding unrealised asset appreciation to their actual cash flow). And if individuals spend a relatively fixed proportion of their perceived income, their spending as a fraction of their actual disposable personal income would tend to rise in periods of asset inflation. Thus, their conventionally GDP-measured savings rate would fall.

FIGURE 14

US: undistributed corporate profits and corporate taxes as % of corporate profits, 1950-2007



• **und profits/profits** = undistributed corporate profits as a share of corporate profits; and **taxes/profits** = corporate taxes as a share of corporate profits. 5-year moving averages. **Source:** US Census Bureau (2008).

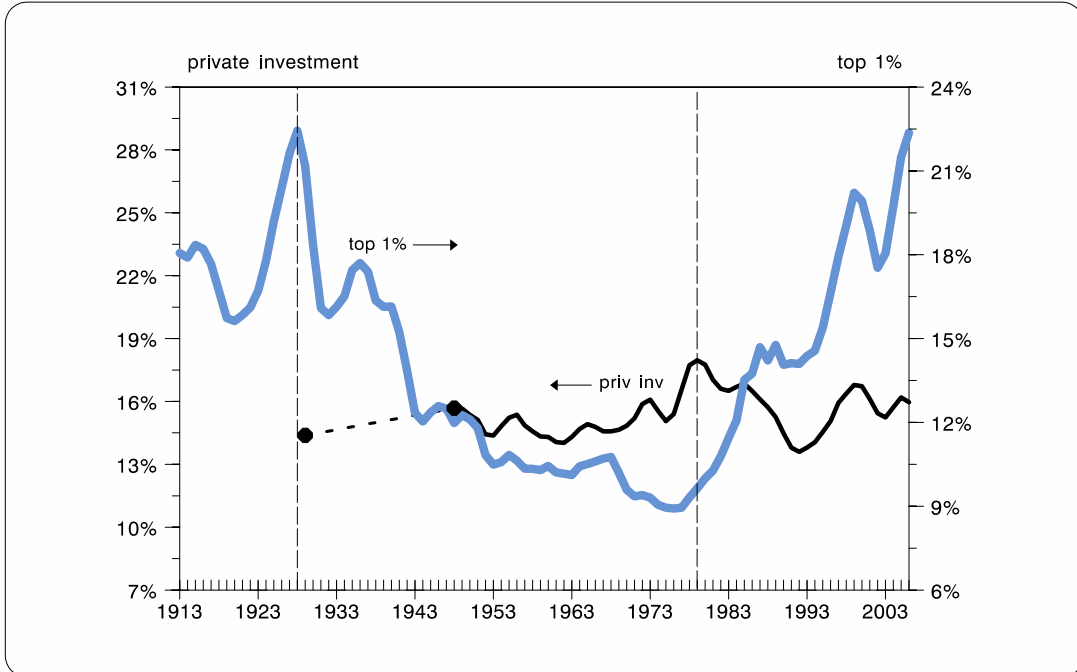
So, despite the amazing things that were predicted to happen if taxes on high-income groups and big corporations were to be cut, what actually happened (as Krugman reminds us) is further evidence that “when you cut taxes on the rich, the rich pay less taxes; when you raise taxes on the rich, they pay more taxes – end of story”.⁵⁴

The combined effect of the collapse of personal savings and the decline in corporate saving led, of course, to a huge decline in the overall level of private saving – as a share of gross national income net private savings fell from 11.2% to 3.3% (1984-2006). However, the really remarkable nature of this neo-liberal (and ever more financially rent-seeking) type of capitalism is revealed in the relationship between income polarisation and private investment (see Figure 15).

⁵⁴ <http://select.nytimes.com/2007/09/10/opinion/10krugman.html?hp>.

FIGURE 15

US: income share of the top 1% and share of private investment in GDP, 1913-2006



• **top 1%** = income share of the top 1 per cent; **priv inv** = private investment as a percentage of GDP (current prices; excludes private inventories). 3-year moving averages. **Sources:** Piketty and Sáez (2003), and US Census Bureau (2008).

Even having said all of the above, it is still truly remarkable to see how private investment failed to respond positively to the combined incentives of huge income polarisation cum political stability and dynamic growth of personal consumption, high profit rates, and overabundance of finance. Private investment instead actually *declined* as a share of GDP, falling cyclically from its peak of 18.5% of GDP in 1979, to just 15.5% in 2007. In fact, what happened to investment during the neo-liberal period challenges *all* available economic theories of investment. Not surprisingly, low levels of investment were also a key component of Greenspan's 'conundrum'.⁵⁵ That is, and not for the first time, we are faced with a 'macro' that only makes analytical sense if examined within the framework of the political settlement and distributional outcome in which it operates.

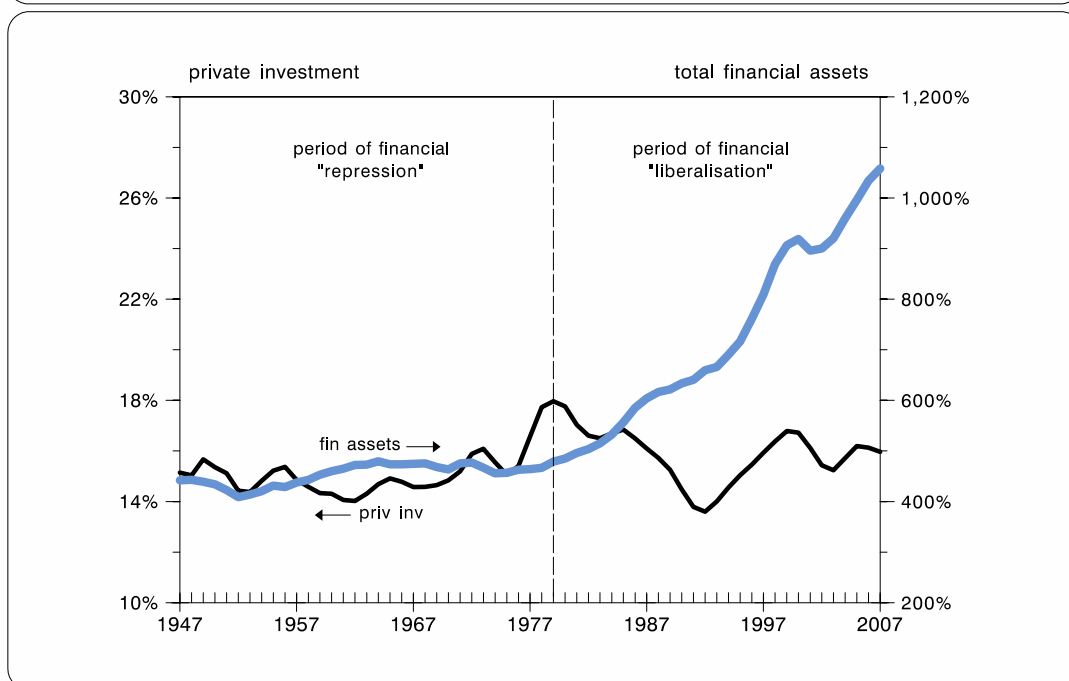
Figure 15 helps us in this direction by also revealing the changing nature of the process of accumulation between the Keynesian and the neo-liberal periods. In the former, the increased 'compulsions' for big business (brought about mostly by pro-competition regulations and workers' strength) and the declining shares of income for top earners had forced the capitalist élite to accumulate moving away

⁵⁵ However, no investment 'conundrums' for Karl Rove. In a recent assessment of the Bush administration, written as a column for the *Wall Street Journal*, he states that: "Mr. Bush [...] cut taxes on capital, investment and savings. The result was 52 months of growth" (2009, 3). Well, if he says so...

from sheer surplus extraction and into increased productive capacities. This (more productive) orientation was also helped by the fact that the prevailing techno-economic paradigm was still in its dynamic 'deployment' phase. The latter period, in contrast, is characterised by a 'scissor' movement in reverse (see Figure 15 above), in which growing income inequality and rapidly disappearing 'compulsions' for big business took place side by side with a declining share of investment – at a time when the fourth techno-economic paradigm was also becoming relatively exhausted, and the complex 'installation' phase of the new ('IT'-based) one was still taking shape. Figure 16 (like Section 1 above) also shows how the post-1980 process of 'financialisation' led to an increasing decoupling between the real and financial worlds.

FIGURE 16

US: total financial assets (all sectors) and private investment as % of GDP, 1947-2007



• **fin assets** = total financial assets (all sectors); and **priv inv** = private investment (excludes private inventories). Both series are expressed as percentage of GDP. 3-year moving averages. **Sources:** US Census Bureau (2008), and US Federal Reserve (2009).

During the period of so-called 'financial repression' that followed the Bretton Woods agreement in 1944, total financial assets remained relatively stable as a share of GDP for about three decades (at a level of about 500%), while private investment experienced some acceleration (the two extreme points in the cycle were 13.8% of GDP in 1961 and 18.5% in 1979). The subsequent period of 'financial liberalisation', a period of huge asset inflation (that more than doubled the value of total financial assets as a share of GDP) was accompanied by a *slowdown* of the rate of private investment (from 18.5% of GDP in 1979 to 15.5% in 2007). During this period the value of financial assets not only decoupled from the real economy, but the abundance of finance and the associated asset-price-led (not so) 'irrational

exuberance', instead of having a positive pulling effect on private investment, had instead the effect of 'friendly fire'.⁵⁶ Therefore, there is not much evidence here to support the McKinnon and Shaw-type argument in favour of financial liberalisation – one of the most influential ideas behind the emergence of the Washington Consensus (see Chesnais, 2002, Epstein, 2005, and Fine 2009).

As Figure 16 also indicates (as Figure 5 above has already shown), possibly what financial 'liberalisation' was really about was an attempt at introducing a 'unit root' into the post-Bretton Woods stationary financial processes; once this was done, then it could be 'shocked' (via policy, as well as via ideology) with (hopefully) permanent upward effects...

Furthermore, policy-makers totally ignored the damage that the disproportionate growth of the financial sector was inflicting on the real economy via a special version of the 'Dutch disease' – in this case, the crowding out of the non-financial tradable sector (both exports and import-competing sectors) by the excessive growth of the financial sector (and of construction).⁵⁷ In fact, financial markets were allowed to expand to such an extent that industrialised countries moved from a situation in which banks and other financial institutions were 'too large to fail' (e.g. LTCM in 1998), to one in which they became almost 'too large to be rescued' – the list of stocks making up the Dow Jones Industrial Average did not contain a single financial company until 1982, while at the beginning of 2008 the Dow contained five – including such 'citadels' as AIG, Citigroup and Bank of America. In turn, at the beginning of the current crisis finance and insurance accounted for 8% of GDP, more than twice their share in the 1960s (with the sector called 'securities, commodity contracts and investments' growing particularly fast, from only 0.3% of GDP in the late 1970s to 1.7% in 2007). Also, the share of the financial sector in overall corporate profits increased from 10% to about one-third between 1986 and 2006; and in terms of the S&P 500, the financial sector comprised 45% of all earnings in 2006.⁵⁸

And since capitalism without compulsions and excess finance is probably as efficient as Communism without workers' control over the bureaucracy, it should probably come as no surprise that the 'collateral damage' of all of the above is productivity growth (see Figure 17).

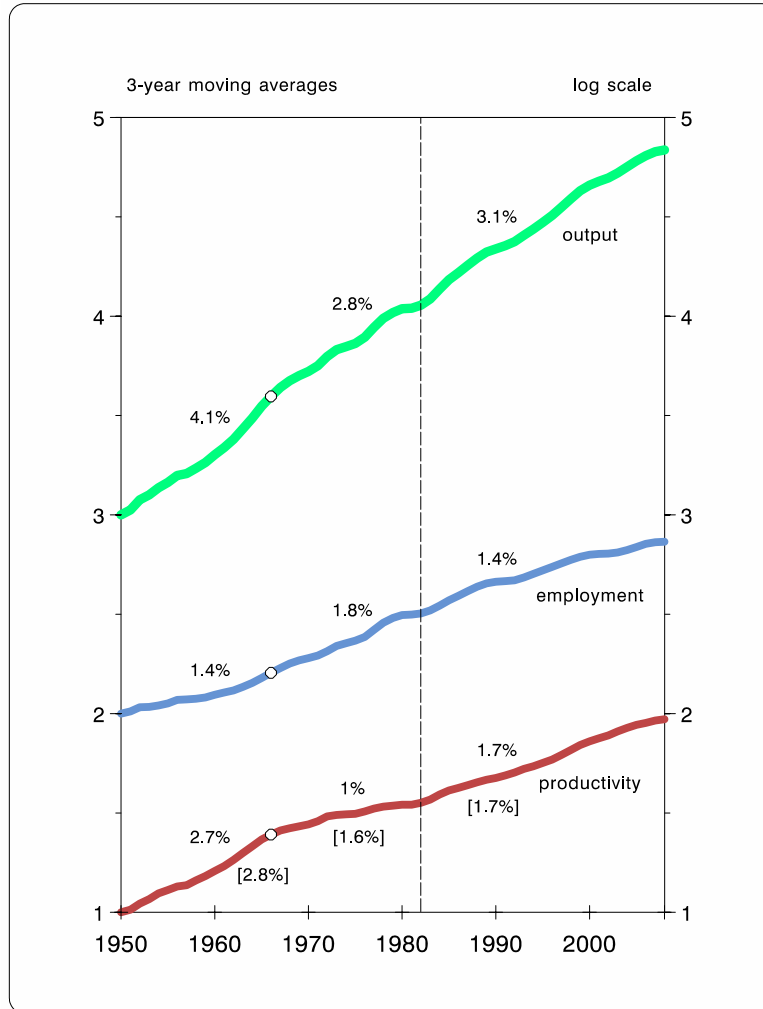
⁵⁶ According to Keynes, a greater degree of linkage between financial and productive capital was also essential for the recovery of the 1930s crisis: "[t]here cannot be a real recovery, in my judgment, until the ideas of lenders and the ideas of productive borrowers are brought together again. [...] Seldom in modern history has the gap between the two been so wide and so difficult to bridge" (1931, p. 146; also quoted in Pérez 2002, 167).

⁵⁷ See Buiter (2009A); for analyses of the 'Dutch Disease', see Rowthorn and Coutts (2004), Bresser-Pereira (2008), and Palma (2008B).

⁵⁸ See especially Krugman (2009A), and <http://www.thestreet.com/print/story/10589081.html>.

FIGURE 17

US: output, employment and productivity, 1950-2008



● Percentages shown in the graph are average annual real rates of growth in respective periods (1950-66, 1966-83, and 1983-08; this periodisation is due to the productivity cycle having had two clear phases during the 'Golden Age'). Percentages in brackets correspond to productivity *per-hour worked* for the same periods. 3-year moving averages. **Source:** GGDC (2009).

In fact, as Figure 17 indicates, the much heralded GDP growth-acceleration in the US after 1983 is not that much more dramatic than three decimal points' improvement from the average growth rate of the previous period (characterised by a 'profit-squeeze' and stagflation); namely, from 2.8% (1966-1983) to 3.1% (1983-2008). Nonetheless, as this relatively minor increase came together with a drop in employment creation (from 1.8% to 1.4%, respectively), productivity growth seemed to have increased significantly (from an average of 1% to one of 1.7%). Yet some of the huge amount of the Amazon that was deforested to keep up with publications regarding this apparent productivity growth bonanza could have been spared if those working on the subject had looked at productivity growth from the point of view of output *per hour-worked* (rather than output per worker). From this

more accurate perspective, all that happened was just a *one decimal point* boost – i.e., a change from an average of 1.6% (1966-1983) to one of 1.7% (1983-2008).⁵⁹ And in TFP terms, despite some mild recovery during the Clinton years, productivity growth was equally disappointing – TFP not in the (not very useful) traditional Solow-residual sense, but in the sense of adjusting productivity growth by factor accumulation following the Hall and Jones (1999) methodology. In actual fact, and despite all the fuss, when the appropriate decomposition of output per worker is applied to the GGDC data, the average productivity growth rate for 1983-2008 gains just one decimal point in TFP-terms (increasing from 1.7% to 1.8%; see Acharya, 2009; and Palma, 2009C).

However, as is always the case, these overall average rates hide important sectoral differences; in the case of the US during the post-1983 period the sectoral range spans agriculture (4.4%) to services (0.7%). One sector that apparently stands out is manufacturing, with a remarkable 4.1% average productivity growth (up from 2.4% for 1966-83). However, this impressive rate has a significant 'factor composition bias' as this sector lost no less than *one quarter* of its labour force between the election of Reagan and 2008 (5.5 million jobs) – cricket might even be a fun game to watch if tests were decided not on runs and wickets but on top batting averages; i.e., if teams could get rid of some of its middle and practically all of its lower order batting scores...⁶⁰

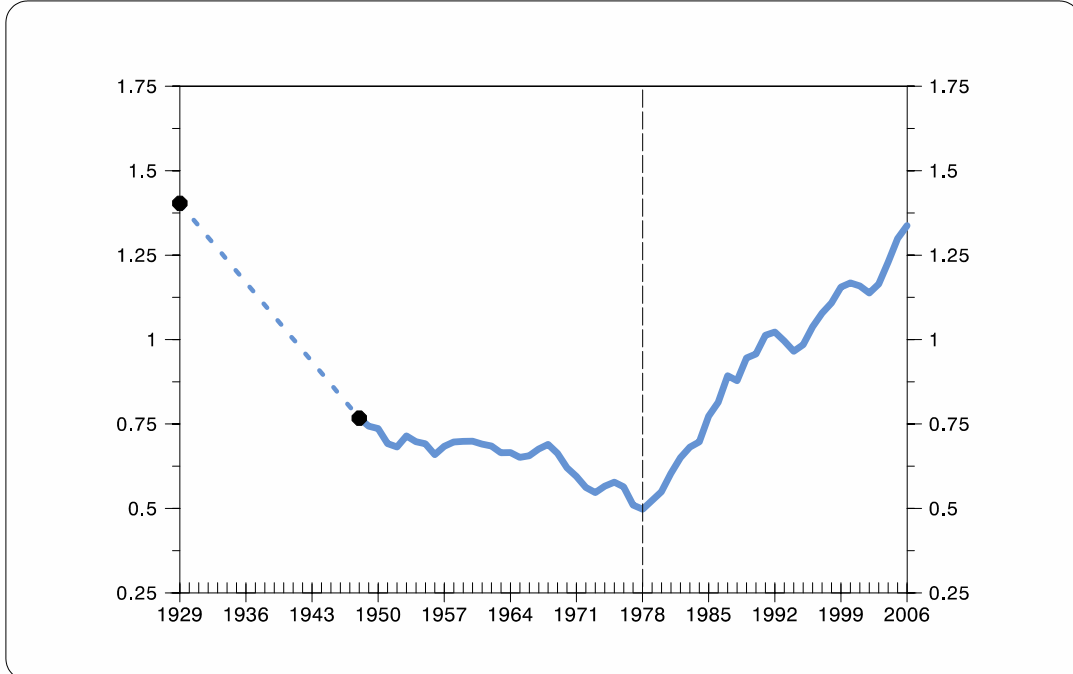
In turn, Figures 18 and 19 again show how the changing relationship between income distribution and private investment evolved through the politico-economic cycle, but this time from the perspective of the 'rebound effect' of the multiple between these two variables.

⁵⁹ One day someone will explain why the neo-liberal ideology was so successful in shrinking people's expectations, so that minor improvements like these could be credibly heralded as major developments... In fact, the rate of productivity growth (per hour-worked) in the US between 1983 and 2008 (1.7%) was lower than that of Japan (2.4%), and the United Kingdom (2.2%); it was also lower than that of smaller industrialised countries such as Ireland (3.1%), Finland (2.7%), Norway (2.3%), Austria (2.2%) and Sweden (1.8%). And it was identical to that of Germany, despite all the upheaval of unification (see GGDC 2009; data for Germany are only available since the start of unification in 1989).

⁶⁰ The collapse of the share of manufacturing in GDP defies belief: it fell from 23.1% to just 11.5% of GDP during this 28-year period (1980-2008, nominal terms; see GGDC, 2009, and http://www.bea.gov/industry/gdpbyind_data.htm). Not surprisingly, by 2004 the US had already fallen behind China in the value of high-tech exports, and has continued to fall behind every year since. (See, <http://www.washingtonpost.com/wp-dyn/content/article/2009/08/11/AR2009081102934.html>). According to a 2008 report by the global accounting firm KPMG, within five years China should become the leading country in IT and telecom, while the US is doing effectively nothing to promote and protect these 21st-century industries. Basically, "It's not just that the United States uniquely lacks an industrial policy. It's that the United States uniquely has an anti-industrial policy." (Ibid.).

FIGURE 18

US: income share of the top 1% as a multiple of private investment in GDP, 1929-2006



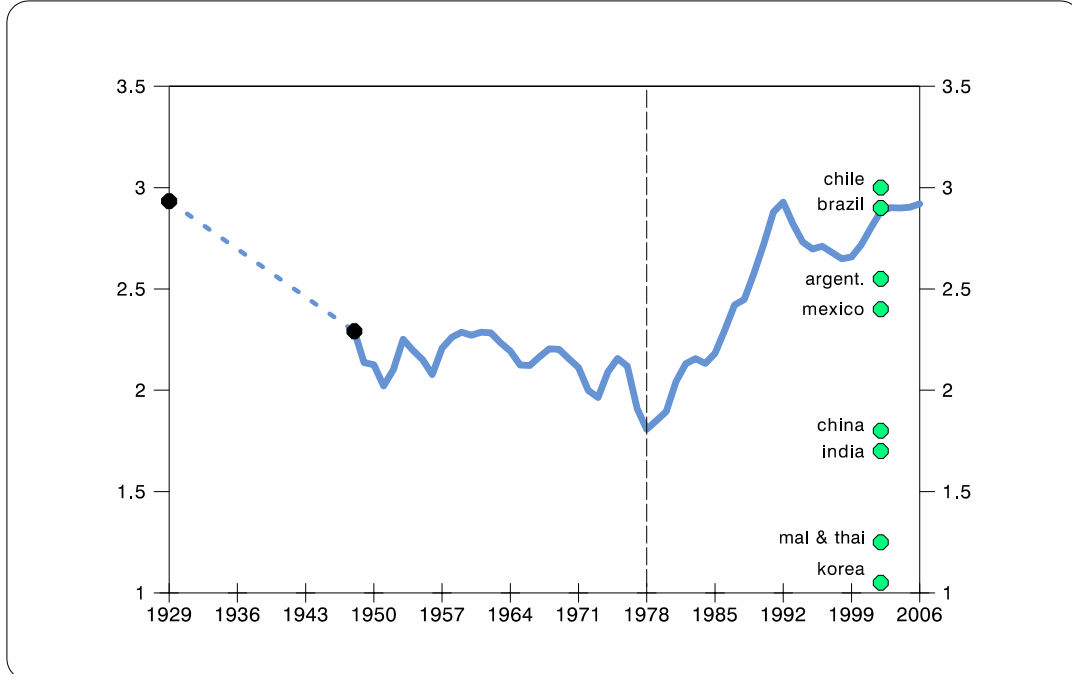
- 3-year moving averages. **Source:** US Census Bureau (2008).

This statistic could be understood as a proxy for the changing nature of the process of accumulation; i.e., for the changing relationship between what top income earners take away from the economy and what they put back into it in terms of improved productive capacities. In fact, towards the end of the period this relationship had changed so much that even the income share of the top 0.5 per cent (i.e., only about seven hundred thousand families, earning 18.6% of the total in 2006) ended up well above the share of *all* private investment in GDP (15.5%).

Finally, probably no other statistic communicates better the increasingly rent-seeking nature of the capitalist élite during the neo-liberal period in the US than that in Figure 19.

FIGURE 19

US: income share of the top 10% as a multiple of private investment in GDP, 1929-2006



● **argent.** = Argentina; **mal & thai** = Malaysia and Thailand. 3-year moving averages. **Sources:** US Census Bureau (2008), and WDI (2008).⁶¹

It seems that the main aim of the neo-liberal capitalist élite in the US was to create a 'post-industrial' capitalism – one with only carrots but no sticks for the capitalist élite, where, among other things, productive investment could become an optional extra on top of assured rent-earnings opportunities and increased surplus extraction. And also probably no other statistic demonstrates better than that in Figure 19 how the US seems to be increasingly in a state of 'projective identification' with Latin American-style capitalism (see also Palma, 2009B). That is, neo-liberalism has also ended up as an effective *de facto* mechanism for bringing Latin American style institutional structures, distributional outcomes, and financial fragilities into industrialised countries!

This became evident in the current financial crisis. As a former chief economist of the IMF argues:

"In its depth and suddenness, the US economic and financial crisis is shockingly reminiscent of moments we have recently seen in emerging markets (and only in emerging markets): South Korea (1997), Malaysia (1998), Russia and Argentina (time and again). In each of those cases, global investors, afraid that the country or its financial sector wouldn't be able to pay off mountainous debt, suddenly stopped lending. And in each case, that fear became self-fulfilling, as banks that

⁶¹ Note that the income distribution data from the US come from a different source to those of the other countries – i.e., in the former from tax returns and in the latter from household surveys. See also TDR (1997).

couldn't roll over their debt did, in fact, become unable to pay. This is precisely what drove Lehman Brothers into bankruptcy on September 15, causing all sources of funding to the U.S. financial sector to dry up overnight. Just as in emerging-market crises, the weakness in the banking system has quickly rippled out into the rest of the economy, causing a severe economic contraction and hardship for millions of people.

But there's a deeper and more disturbing similarity: elite business interests—financiers, in the case of the US—played a central role in creating the crisis, making ever-larger gambles, with the implicit backing of the government, until the inevitable collapse. More alarming, they are now using their influence to prevent precisely the sorts of reforms that are needed, and fast, to pull the economy out of its nosedive. The government seems helpless, or unwilling, to act against them." (Johnson, 2009)

How things have changed! There was a time when things were the other way round – as Marx explained in the Preface to the first edition of *Das Kapital* "[t]he country that is more developed industrially only shows, to the less developed, the image of its own future" (Marx, 1867). Well, maybe at that time, but not any more...

In sum, US rentiers did certainly succeed in their attempt to get rid of practically all obstacles to their greed. When the market eventually called their bluff, it became evident just how self-destructive and short-sighted this strategy had been.⁶²

6.- Six key 'rent-seeking-à-la-post-modern' dynamics that characterised the neo-liberal paradigm

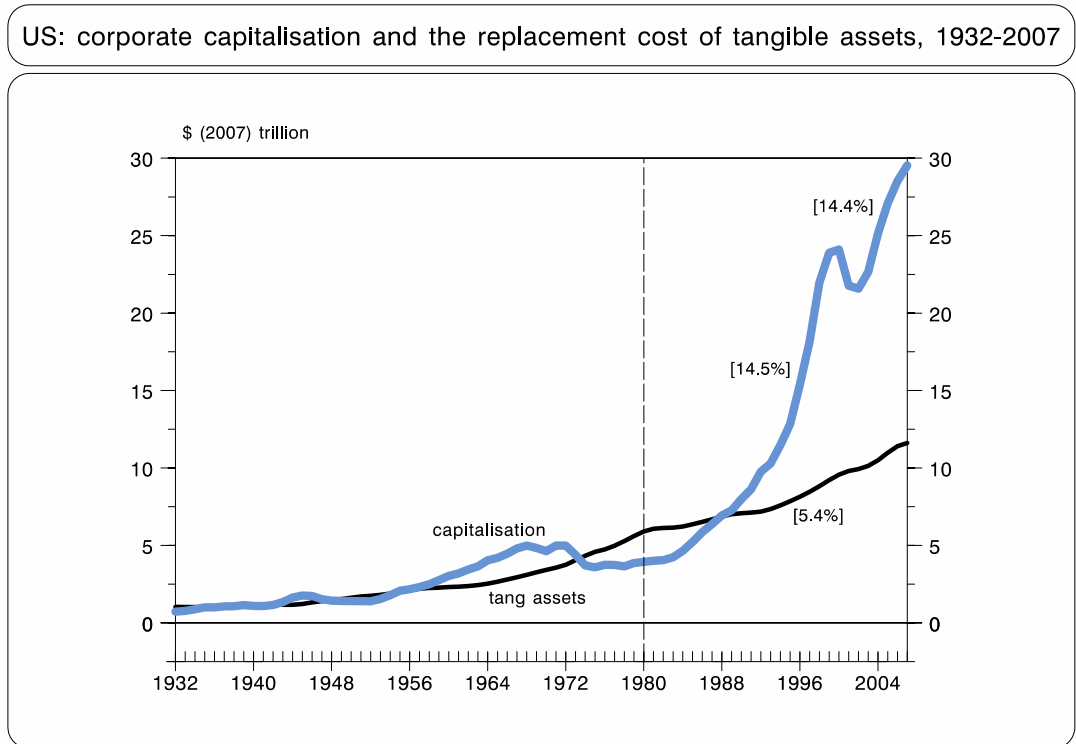
This section discusses six rent-seeking dynamics that will help to illustrate the rôle that neo-liberalism played, as it was *de facto* applied in the real world, in the current global financial crisis.

6.1 Greenspan-style virtual wealth creation

According to what I call the first neo-liberal rent-seeking economic law, there is supposed to be no fundamental difference between what was happening in the paper (casino) economy and in the real economy. Therefore, the increase in net worth resulting from asset price inflation (even if it is only based on unlimited growth of finance) is tantamount to real wealth creation. For example, Figure 20 shows that since 1980 there has been a complete breakdown of the long-standing relationship between corporate capitalisation and the replacement cost of fixed (or tangible) assets – i.e., between the value of corporate equities and bonds and the replacement cost of plant and equipment.

⁶² For analyses of events leading to the crisis, see Krugman (2008), and Shiller (2008).

FIGURE 20



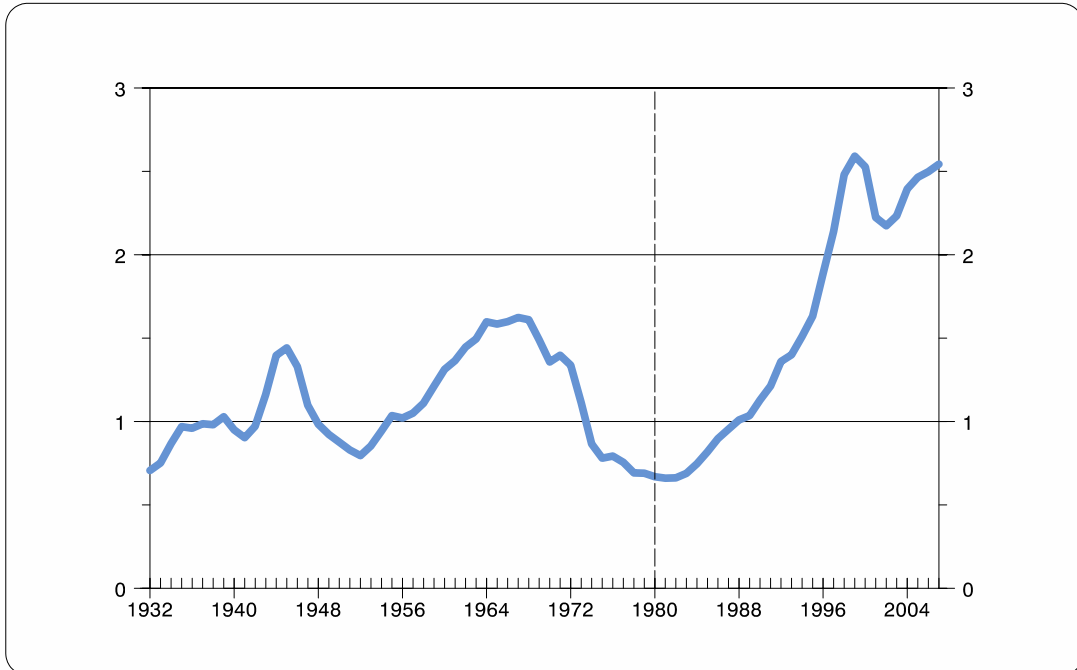
• **capitalisation** = total corporate capitalisation (equities and bonds); **tang assets** = replacement cost of tangible assets. Percentages are average annual real rates of growth between 1980-2007 (but in the case of capitalisation it excludes the two years of the collapse of the technology bubble; i.e., they are the growth rates between 1980-1999, and 2001-2007). 3-year moving averages. **Source:** Bichler and Nitzan (2009). The market value of equities and bonds is net of foreign holdings by US residents.

Between 1932 and 1956 both series (with different cycles) had a similar overall average annual rate of growth (8%); then corporate capitalisation surged ahead until the 1973 oil crisis, when the stagflation that followed overcorrected this asymmetry. Finally, from the early 1980s until the 2007 crisis the annual real rate of growth of corporate capitalisation nearly trebled that of the replacement cost of fixed assets. In fact, even the collapse of the 'dotcom' bubble in 1999 did not have much long-lasting effect.⁶³ In turn, Figure 21 shows the changing pattern of the ratio between these two variables (representing one version of the 'Tobin's Q').

⁶³ On why the collapse of the 'dotcom' bubble was not enough to bring an end to the casino economy, see Pérez (2009). One of the few early warnings that what was happening in technology stocks was a 'bubble' can be found in the 1996 edition of Kindleberger (1986). Also, after switching his own savings to certificates of deposits, money-market funds and bonds, Kindleberger advised investors that they should follow the following rule: "[s]ubtract your age from 100, and that is the percentage you should have in equities." (See <http://www.telegraph.co.uk/news/obituaries/1437034/Charles-Kindleberger.html>).

FIGURE 21

US: Tobin's "Q", 1932-2007



• **Tobin's Q** = ratio of the value of corporate capitalization to that of the replacement cost of tangible assets. 3-year moving averages. **Source:** Bichler and Nitzan (2009).

It is not unreasonable to expect that the capitalisation of a corporation should represent the value of its entire productive capacity (that of its tangible and non-tangible assets). However, the 'Tobin's Q' only captures the ratio between capitalisation and the value of tangible assets – i.e., between the whole and only one of its parts. Therefore, under 'normal' circumstances this ratio should be greater than 1. The question is, by how much? This is where a twisted version of the 'knowledge economy'-type discourse conveniently comes to the rescue of rentiers and bubble-blowers. What was happening in equity markets was absolutely not a bubble due to the practically unlimited growth of finance; it was simply the markets doing their job properly – i.e., pricing the ever-increasing value of intangible assets accurately (intangible assets such as intellectual property rights, firm-specific knowledge, proprietary technology, goodwill and other 'metaphysical' assets). In short, from a real business cycle perspective all that was supposed to be happening was an efficient market response to an *exogenous* transformation in the *real* (knowledge-based) economic environment. Bubble? What bubble?

In fact, according to a study by Standard & Poor, this 'intangible revolution' meant that the value of intangibles grew from 17% of total corporate assets in 1975, to 80% in 2005 (for a detailed analysis of this issue, see Bichler and Nitzan, 2009). What is ironic is that if this were true, the 2007-2008 collapse of the stock

market should be interpreted as the markets pricing down the value of corporate sector intangible productive capacities by more than half.⁶⁴

In turn, 'Greenspan-style virtual wealth creation' meant that between 1982 and 2007 households' net worth in the US increased by US\$42 trillion, or by a factor of 3. Basically, each had its net worth increased on average by about US\$400,000 – or by 12 times the average income of the bottom 90 per cent.⁶⁵ Conversely, between the bubble blowing up and early-2009, the average net worth of households has declined by US\$130,000, or by an amount larger than the average household debt. In fact, as a share of personal disposable income, by mid-2009 household net worth had reverted to where it was in 1992. Bubble? What bubble?

6.2 No need for financial markets to be either boring or small

According to the second rent-seeking economic law of neo-liberalism, there is nothing as magical as financial markets, and nothing as valuable as the skills of the wizards who perform that magic (otherwise known as the new masters/mistresses of the universe, the new jugglers of 'risk-less risk' and perpetual profits). With the advent of neo-liberalism, gone were the years when "[b]anks attracted depositors by providing convenient branch locations and maybe a free toaster or two; [... and then] they used the money thus attracted to make loans, and that was that" (Krugman, 2009A). And gone were the years when finance and insurance together accounted for less than 4% of GDP, and when the list of stocks making up the Dow Jones Industrial Average did not contain a single financial company.

However, with the deregulation-minded neo-liberal era, "[o]ld-fashioned banking was increasingly replaced by wheeling and dealing on a grand scale." (Krugman, 2009A). In fact, as Figures 4 and 5 above showed, domestic debt grew 5-fold in real terms (to almost US\$50 trillion) between 1980 and 2007, or from a relatively stable 150% of GDP before 1980 to about 350% in 2007. In turn, securitised debt grew fourteen times faster than bank loans leading to a situation in which by 2007 more than half of US's banking was being handled by (what Geithner's likes to call) a "parallel financial system" – better known as "shadow banking" (a term coined by Paul McCulley in August 2007 at a annual Fed symposium). That is, by institutions that exist outside even the very minimum current standards for safety and soundness that apply to banks, and without obligation to make clear the extent of their debt, leverage, capital or reserves.

Furthermore, as discussed above, the neo-liberal discourse totally ignored the damage that the disproportionate growth of the financial sector was inflicting on the real economy via 'Dutch disease' crowding-out effects (it more than doubled as share of GDP between the 1960s and 2007).

In a way, as far as securitisation is concerned, the logic of an increasingly liquid and unregulated financial market was remarkably simple. More financial innovation of the 'slicing, dicing and repackaging' financial claims type resulted in more fees, more underwriting and more shifting of risk. And the securitisation food chain went on and on (following the lead of the 'Junk Bond King' path-breaking 1987 innovation – as the firm of none other than Michael Milken created the first proper

⁶⁴ On the crash of the 'knowledge economy', see Pagano and Rossi (2009).

⁶⁵ See <http://www.federalreserve.gov/releases/z1/Current>.

'collateralized debt obligation' – CDO).⁶⁶ Basically (and very briefly), first, mortgage-lenders made loans (financed with credit from Wall Street) until a 'mortgage pool' was created (either by normal means, or by more inventive ones such as 'teasers' and NINJA-mortgages).⁶⁷ Second, Wall Street would then buy the 'pool' – and lenders collected 'origination' fees, and Wall Street firms earned the 'carry' (excess) between the interest paid on the mortgages and their own low borrowing costs. Third, Wall Street would use payments from the mortgage pool to create securities with different tiers of risk (i.e., mortgages would become 'asset-backed securities', ABSs) – and Wall Street firms collected fees for the packaging and the managing, law firms for the legal engineering, accountancy firms for the information, rating agencies for the assessing, and insurers for the protection; and investors collected the cash-flows originating from these securities. Fourth, as institutions such as Fannie Mae and Freddie Mac were only interested in the AAA-rated ABSs, the lower-rated ones became difficult to sell; so Wall Street firms repackaged them (with other assets of varying quality, including junk-bonds) into CDOs of different tranches, with the top layer again being rated AAA (because it was now protected from losses by the lower tiers) – so a newly created 'special purpose entity' (SPE) collected fees for the operation, underwriters got their fees and spreads for the repackaging, the structuring, the arranging, the pricing and the placing of the CDO, law firms charged their fees for creating the SPE (typically as an 'orphan' company incorporated in the Cayman Islands to avoid being consolidated with the financial firm whose assets were to be securitised – otherwise the SPE would be consolidated with the rest of the firm for regulatory, accounting, and bankruptcy purposes, which would defeat the very point of the securitisation), accountancy firm got their fees for performing the 'due diligence' on the CDO's portfolio of debt securities, rating agencies for assessing the CDOs, insurers for selling protection against losses, and investment managers for feeding their clients' money into these securities (the so-called feeders); and investors collected the cash-flows coming from these securities (but only after the investors in the top-tier ABSs of the previous stage had collected theirs).⁶⁸ Although buyers did show some interest in the lower-tier CDOs, it was not enough;⁶⁹ so, a further stage was necessary, which consisted of Wall Street firms doing further repackaging into a next-generation-type security called CDOs-squared, with the top tier getting (once more) an AAA-rating because they were again protected by lower-tiers – and Wall Street firms earned more fees from this new trick, law firms for engineering the virtual reality, accountancy firms for the disclosure to investors of the CDO's

⁶⁶ Although Lew Ranieri was the first to package mortgage loans together in the late 1970s. See, for example, Das (2005).

⁶⁷ A teaser rate will typically be below the going market rate; it is used by lenders to entice borrowers. This rate will only be in effect for a short period, at which point it will gradually climb until it reaches the full rate. A NINJA-mortgage is one given to someone with 'no income, no job and no assets'.

⁶⁸ According to Credit Suisse, during the good times AAA-rated CDOs gave returns of up to 10%; that was far above the average yield on a similarly rated corporate bond (see <http://www.bloomberg.com/news/marketsmag/ratings.html>). So why buy a corporate bond yielding 5% when you can invest in a CDO with the same credit rating and the promise of a return twice as high? But as Tomlinson and Evans (2007) explain, "[t]here are two caveats: It's nearly impossible to find out exactly what's in a CDO, and CDOs aren't regulated."

⁶⁹ Morgan Stanley reports that investors did buy US\$60 billion of these lower-tier CDOs in 2006; however, there was still a large excess supply (see <http://www.morganstanley.com/institutional/research/index.html>).

material information, rating agencies for assessing them, insurers earned premiums for their credit default swaps (CDS), 'feeders' for diverting their client's money into these (in)securities (by now especially for making sure that their clients did not fully understand the risks that they were taking); and investors collected the cash-flows from these new securities (but only after the previous two top-tiers had collected theirs).⁷⁰ As lower-tier CDOs-squared became again difficult to sell, then (no prizes for guessing) the merry-go-round continued with some Wall Street firms doing a further repackaging to create CDOs-cubed, which by now could contain thousands of different securities (so, by this time not a soul had a clue as to the repetition of exposures in the underlying CDOs) – and the game of Monopoly went on and on.

Needless to say, little did the average mortgage-owner know that on top of his family he also had an ever-increasing army of rentiers, legal advisors and accountants to feed. And as so many mouths were eating from the same hand, volume was the *only* way to boost profits – according to data compiled by Morgan Stanley, sales of CDOs worldwide reached US\$503 billion in 2006, a fivefold increase in three years, leading to an overall stock of US\$2 trillion (Ibid.).⁷¹ And in order to increase volume, there is little choice but for the quality of the assets to become an optional extra – according to Moody's, about half of the CDOs sold in the US in 2006 contained sub-prime debt; and on average, 45% of the contents of those CDOs consisted of sub-prime home loans (Ibid.). In fact, S&P and Fitch estimate that the concentration of sub-prime in the asset-backed CDOs of the middle ('mezzanine') tier was no less than 70%. The poor quality of even the top-tier assets became evident after the crash, when an index of 20 'AAA' mortgage-backed securities indicated that by May 2009 they were trading at less than one quarter of their original price.⁷² If these were securities with an AAA-rating, surely the way in which those helpful rating agencies operate (whose income also depends on the volume of business they are able to attract) needs to be urgently re-examined.

In turn, there were cash CDOs, synthetic CDOs and hybrid CDOs, and imaginative financial engineering also transformed CDOs into CLOs, CBOs, CSOs, SFCDOs, CRE-CDOs and CIOs.⁷³ In all, securitized debt grew in real terms nearly 50-fold between 1980 and 2000; by 1998 it already exceeded traditional bank lending, and by the beginning of the 2007 crisis Wall Street accounted for two-thirds of all private debt.⁷⁴ And at each step there were more fees and more underwriting,

⁷⁰ According to the spin put by a CEO of an investment firm at the time: "CDO squareds give another dimension to achieve portfolio diversification." (Quoted in <http://all-about-saham.blogspot.com/>). As at this stage was nearly impossible to know what was inside the package, he must have been referring to the dimension characterised by the 'thrill of the unknown'...

⁷¹ According to Morgan Stanley, until the mid-1990s CDOs were little known in the global market, with issues valued at less than US\$25 billion a year. However, investment banks eventually realised that by bundling high-yield bonds and loans and slicing them into different layers of credit risk, they could make more money than they could from holding or selling the individual assets. (See <http://www.morganstanley.com/institutional/research/index.html>).

⁷² See <http://www.markit.com/en/products/data/cds-pricing/cds-pricing.page?>.

⁷³ See, for example, <http://www.washingtonpost.com/wp-srv/business/interactives/frenzy/?referrer=emallink>. For a detailed analysis of the new financial alchemy, see Tett (2009).

⁷⁴ By the time of the crisis, Lehman was leveraged to the tune of 22 times its net worth (see McDonald and Robinson, 2009). As for Merrill Lynch, by 2006 it had US\$44 billion in CDOs and mortgage bonds (a 13-fold increase in three years), with fees flowing from them reaching \$700 million. By then, their exposure to sub-prime securities was already higher than their entire

and (crucially) more opportunities to transfer the risk to someone else down the line: "from those who understand it a little to those who do not understand it at all".⁷⁵ As Stiglitz puts it (and as quoted in the epigraph at the beginning of this paper), "[g]lobalization opened up opportunities to find new people to exploit their ignorance. And we found them."⁷⁶ Or, in the words of a market practitioner:

"Investors have little idea how toxic some of these CDOs are. We compose CDOs with a bunch of this stuff. [...] we just jack up the risk, [and then we] jack up the misunderstanding." (Quoted in Tomlinson and Evans, 2007).

So, a new (neo-liberal) Robin Hood was born: one that robs from the rich to give to the very rich...

Among the basic ideas, six were key. First, if one is stuck with a bunch of third-rate assets, one can always wave a magic wand and some would become first-rated securities simply because in the new mix they would be protected from losses until (the supposedly implausible scenario in which) the lower-tier securities have been wiped out – first, the so-called 'equity tranche', then the 'junior tranche', and so on.⁷⁷ Second, as lower-tier securities absorbed the first losses if mortgage-owners defaulted (i.e., interest and principal payments are made in strict order of seniority), the lower the tranche, the higher the coupon payment and interest rate that would have to be paid (or the lower the price) to compensate for the additional default risk.⁷⁸ Third, investors in a new generation of securities would also have to wait behind top-tier holders at the previous stages before getting their rewards. Fourth, the securitisation business opened up opportunities for an ever increasing number of rentiers – as mortgages were typically originated by one firm, packaged by another, sold by a third, repackaged by a fourth, serviced by yet another, and so on. Fifth, as so many rentiers were milking the same mortgage, volume was the only way to boost overall profits – so quality had to become a luxury. And sixth, none of this ever increasing number of rentiers had to lose much sleep about whether the mortgages would be repaid, because none of them had to keep the loans on their books. And all thanks to ingenious tricks that were thought to have been devised by Dumbledore, but which were actually the work of Voldemort...

Then suddenly the bubble in real estate began to falter and defaults rose to a critical mass leading to mortgage securities in the original pool experiencing shortfalls in cash much greater than rating agencies had anticipated. The combination of interest shortfalls and downgrades triggered provisions in CDOs

shareholders' equity value.

⁷⁵ <http://www.nytimes.com/2009/06/26/business/26norris.html?hp>.

⁷⁶ <http://www.newsweek.com/id/207390/output/print>.

⁷⁷ The lower-tier securities were called 'equity tranches' because their holders are the first to suffer losses and the last in line to collect in the case of a collapse triggered by defaults of the underlying debt – just as shareholders stand behind bondholders when a public company goes bust.

⁷⁸ According to Morgan Stanley, BBB-rated portions of CDOs (the lowest investment grade) paid 7-10 percentage points above the three-month forward LIBOR. Just before the onset of the crisis (August 2007), that amounted to an annual return of about 13% (see <http://www.morganstanley.com/institutional/research/index.html>). And as most CDO tranches promise returns at a fixed spread over LIBOR, their value was not affected by changes in interest rates in the way the value of a fixed-rate bond would be.

contracts that declared them in default – and the house of cards came crashing down.⁷⁹

In a recent article, Robert Skidelsky explains the key characteristic of the securitisation boom:

“[...] in contrast to the dot-com boom, it is difficult to identify the technological ‘shock’ that set off the [subsequent] boom. Of course, the upswing was marked by superabundant credit. But this was not used to finance new inventions: it was the invention. It was called securitized mortgages. It left no monuments to human invention, only piles of financial ruin.” (Skidelsky 2009, 2).

Also, financial innovation aimed at increased *lack* of transparency was often the name of the game as there were also huge rewards for helping corporations to take “risk off-balance sheet, where it is not as readily observed and monitored”, and for helping them to “dodge taxes and accounting rules.”(ibid.). There were also financial companies that specialised in providing money managers and hedge funds with fast-trade execution (often with an ‘immediate or cancel’ feature) that insure that the trades cannot be traced.⁸⁰ These hidden stock-trading venues, also known as ‘dark pools’ (in part because the trading takes place away from any exchange and therefore without any reports being filed) have captured an increasingly large share of US equity volume in recent years. “The leading “dark pool” is Goldman Sachs’ “Sigma X,” which executed about 162 million external orders in April 2008” (Ibid.).⁸¹

In the meantime, the financial sector ended up generating about a third of all corporate profits in the US. No wonder gambling was one of the few industries struggling during the boom years – who needs Las Vegas if we have Wall Street’s casinos offering so much more fun and hugely improved odds?⁸²

The key point here is the delusion that all these financial rent-seeking and corrupt dynamics were sustainable, and that they were making a positive contribution to growth. However, as is now patently clear:

“[...] the wizards were frauds, whether they knew it or not, and their magic turned out to be no more than a collection of cheap stage tricks. Above all, the key promise of securitization – that it would make the financial system more robust by spreading risk more widely – turned out to be a lie. Banks used securitization to

⁷⁹ For an early analysis of the delusional world of Wall Street, see Bernstein (1996); for analyses that include events up to the onset of the current crisis, Fox (2009), and Tett (2009).

⁸⁰ See, for example, http://money.cnn.com/2009/07/14/news/companies/sergey_aleynikov_getco_goldman.fortune/index.htm?postversion=2009071510.

⁸¹ According to Forbes, during the first quarter of 2009 Goldman Sachs wrote credit derivative protection for others equal to US\$3.2 trillion, or 12% of the US\$26 trillion notional value of these derivatives existing. (<http://www.forbes.com/2009/07/30/credit-default-swap-personal-finance-investing-ideas-goldman-sachs.html>)

⁸² Those better odds reflected the fact that, as opposed to a normal casino, there were no near zero-sum games in Wall Street – if you win, the casino also wins (as they work on fees and virtual performance...). Besides, (and with apologies to animal lovers), in asset bubbles even a monkey can make money – all he or she needs to do is to buy an index-tracking bunch of stocks, or a random selection of real state, and then hold on to them. Besides, it is unlikely that a monkey would charge exorbitant fees for doing just that. (Probably a banana or two would do).

increase their risk, not reduce it, and in the process they made the economy more, not less, vulnerable to financial disruption." (Krugman, 2009A)⁸³

And few of the 'wizards' seem to have had much capacity to learn from experience; for example, there is little evidence that the two basic lessons from LTCM's demise in 1998 were absorbed by 'rational' agents in financial markets: many financial assets have risks that are more correlated than they appear; and high returns based on high leverage are likely to be just an optical illusion.

Also, the wizards may have been frauds, but this did not stop them from keeping the income they received while the magic was going on; Angelo Mozilo, for example, the CEO of Countrywide not only could keep the US\$656 million that he made between 1998 and 2007, but he was also given an extra US\$77 million as a 'buy-out bonus' when the game was up.⁸⁴

What is also crucial to understand in this game of Monopoly is the rôle of rating agencies. First, financial regulators have effectively outsourced the monitoring of CDOs to the rating companies: "As regulators, we just have to trust that rating agencies are going to monitor CDOs and find the subprime," said (before the onset of the crisis) Kevin Fry, Chairman of the Invested Asset Working Group of the US National Association of Insurance Commissioners. "We can't get there. We don't have the resources to get our arms around it." (Quoted in Tomlinson and Evans, 2007).⁸⁵ However, second, all three leading rating agencies clearly stated they wanted to have none of it: policing CDOs was not what they are in business for. According to Noel Kirnon, senior managing director at Moody's (which at the time of the commended 39 per cent of the global credit rating market by revenue), his firm just offered its educated opinion: "[w]hat we're saying is that many people have the tendency to rely on [our ratings], and we want to make sure that they don't." (Ibid.). So, Moody's publishes the following disclaimer: "Moody's has no obligation to perform, and does not perform, due diligence".⁸⁶ S&P, in turn (which controls 40 per cent), asks investors not to base any investment decision on its analyses. Specifically, its disclaimer about the reliability of its analyses of CDOs says in the small print: "[a]ny user of the information contained herein should not rely on any credit rating or other opinion contained herein in making any investment decision."⁸⁷ And Fitch (which has 16 per cent of the worldwide credit rating field),

⁸³ See also Rajan (2005).

⁸⁴ Countrywide was the US's top sub-prime lender, which was bought by Bank of America in July 2008 for just US\$2.5 billion when it was about to go bust. See <http://www.gregpalast.com/elliott-spitzer-gets-nailed/>). Mozilo has recently being charged by the SEC (with two other company executives) for civil fraud, including insider trading (he used this information to sell his shares and reap nearly US\$140 million in illicit profits; see <http://www.msnbc.msn.com/id/31108985/>).

⁸⁵ Similarly, according to the deputy comptroller for credit and market risk of the US Office of the Comptroller of the Currency, which regulates banks, "[w]e rely on the rating agencies to provide an assessment." (Ibid.).

⁸⁶ The term 'due diligence' was introduced by the Securities Act of 1933. This Act included a defence that could be used by broker-dealers when accused of inadequate disclosure to investors of material information with respect to the purchase of securities. So long as they have conducted a 'due diligence' investigation into the company whose equity they were selling, and disclosed to the investor what they found, they would not be held liable for nondisclosure of information that was not discovered in the process of that investigation.

⁸⁷ See <http://www2.standardandpoors.com/spf/pdf/media/GlobalRegReport.pdf?vregion=us&vlang=en>.

says its analyses are just 'opinions' and investors should not rely on them. So, as Joseph Mason (a finance professor at Philadelphia's Drexel University and a former economist at the US Treasury Department), says:

"I laugh about Moody's and S&P disclaimers. [...] The ratings giveth and the disclaimer takes it away. Once you're through with the disclaimers, you're left with very little new information." (Quoted in Tomlinson and Evans, 2007).

Third, but as a financial analyst explains, the rôle of rating agencies was not at all as at arm's length as they would like us to believe: "[t]he rating companies tell CDO assemblers how to squeeze the most profit out of the CDO by maximizing the size of the tranches with the highest ratings. It's important to understand that unlike in the corporate bond market, in the securitization market, the rating agencies run the show. This is not a passive process of rating corporate debt. This is a financial engineering business." (Quoted in *Ibid.*). Fourth, if all rating agencies are supposed to do is to provide a 'without prejudice' opinion (i.e., an opinion that cannot be used in evidence in any subsequent court case), why is it that their fees do not reflect that modest rôle? In fact, CDOs have been a bonanza for them – according to the financial reports of S&P, Moody's and Fitch all made more money before the crisis from evaluating structured finance (including CDOs and ABS) than from rating anything else, including corporate and municipal bonds. As published cost listings show, the companies charge as much as *three times* more to rate CDOs than to analyse bonds – in the words of a bond trader, "CDOs are the cash cow for rating agencies. They're clearly a gold mine. Structured finance is making a lot of Moody's shareholders and managers wealthy." (Partnoy, 2003).⁸⁸ Fifth, the unduly 'modest' rating agencies opinions were not only rather expensive, but they were also rather predictable (in that they would put their top-grade stamp on almost any flimsy security): difficult though it is to believe it now, on average more than 90 per cent of CDOs were rated 'investment grade' by those helpful rating agencies, even though they were loaded with risky debt, from junk bonds to sub-prime loans. Sixth, as there are so many moving parts in a CDO, rating companies had to assess the possibility that many combinations of things could go wrong. To do that, S&P, Moody's and Fitch used a well known statistical technique called Monte Carlo simulation; however, as Fitch acknowledged *before* the onset of the global financial crisis, the methodology and the data used by rating agencies in their work left a lot to be desired. As a CEO of an investment firm explains:

"We were on the March 22 [2007] call with Fitch regarding the sub-prime securitization market's difficulties. In their talk, they were highly confident regarding their models and their ratings. My associate asked several questions. "What are the key drivers of your rating model?" They responded, FICO scores [a method of calculating credit scores developed by a company with the same name] and home price appreciation (HPA) of low single digit (LSD) or mid single digit (MSD), as HPA has been for the past 50 years. My associate then asked, "What if HPA was flat for an extended period of time?" They responded that their model would start to break down. He then asked, "What if HPA were to decline 1% to 2% for an extended period of time?" They responded that their models would break down completely. He then asked, "With 2% depreciation, how far up

⁸⁸ Shares of Moody's, which is the only stand-alone publicly traded rating company, more than tripled between 2003 and 2006. S&P, for example, charges as much as 12 basis points of the total value of a CDO issue compared with up to 4.2 basis points for rating a corporate bond.

the rating's scale would it harm?" They responded that it might go as high as the AA or AAA tranches." (Rodriguez, 2007)

So, even if house prices were just to stabilise raters' models 'would start to breakdown'; and if prices were to fall even at a very modest rate, they 'would breakdown completely' – and the fall-out would go as high up as the AAA-tier... And finally, seventh, as the income of the rating agencies depended on the volume of business they could attract, truthfulness in the rating process could become rather expensive... In fact, keeping your clients 'sweet', by telling them what they wanted to hear, could turn out to be far more rewarding – and if your competitors in the rating business chose to do this, there was little choice left but to do the same to stay in business... Basically, as one S&P analyst wrote in an email, "[a CDO] could be structured by cows and we would rate it."⁸⁹

How could anyone have believed that this was a method of rating assets that could be taken seriously? (No wonder all the disclaimers...). How could anyone have believed that a real estate bubble could continue *ad infinitum*? How can one take seriously the current fashionable excuse that "2008 was a year where the unpredictable turned into the unimaginable"?⁹⁰ How can anybody say with a straight face that it was 'unpredictable' that a whole mountain of speculation, based entirely on the single assumption that house prices would continue to rise forever, would not eventually come crashing down? That markets would not eventually call this blatant bluff?

Basically, as has been suggested, if rating agencies are ever going to do their job properly they should be forced to do at least one of two things: make the (currently secret) information that issuers give them available to investors and insurers (or, even better, make that information available on the internet and let the market handle the rest); or make rating agencies a form of third-party insurance in which the issuer pays the rating company to insure the investor against loss – i.e., they have to issue *de facto* credit-default swaps, in which the premium they charge is based on their 'opinions' of the quality of the asset (and have to pay up to the counterparty on default).⁹¹

Given what was going on at all levels, it is quite remarkable that investors who lost large sums of money in the crash now claim that they did not know (or that it was not possible to know) what was happening in the 'shadow banking system'. Evidence was certainly not in short supply, from famous court cases that had clearly exposed early on the surreal world of securitisation (perhaps the most famous was the one against Credit Suisse for a US\$341 million CDO that it had sold in December 2000, which included the usual collection of subprime mortgage-backed securities and junk bonds (which went sour), and to which the 'usual suspect' raters had given a AAA to 85 per cent of the CDO), to well published huge early losses in the securitisation business (such as the US\$1 billion loss by American Express in 2001, as a result of having to write down its risky investments in CDOs; see Markham, 2006), to the collapse in the price of many CDOs well before the beginning of the

⁸⁹ http://www.time.com/time/specials/packages/article/0,28804,1877351_1877350_1877325,00.html.

⁹⁰ http://money.cnn.com/2009/08/12/news/companies/blackrock_trillionaires_club.fortune/index.htm?postversion=2009081710.

⁹¹ See especially http://www.bloomberg.com/apps/news?pid=20601039&sid=abiWn8b4_VyU#.

crisis (on top of previous losses, in many cases CDO-prices declined by an extra 50 cents on the dollar during the first half of 2007 because of growing expectations of large defaults, making indices of CDO value fall by nearly half), to Lehman Brothers and Bear Stearns share price declining well before August 2007 (the two largest underwriters of mortgage bonds), to all the other evidence discussed above. As a portfolio manager at an investment firm said before the crisis, when rating agencies first began to discuss the possible changes in ratings:

"Why now. The news has been out on subprime now for many, many months. The delinquencies have been a disaster for many, many months. The ratings have been called into question for many, many months. I'd like to know why you're making this move today instead of many months ago." (Quoted in <http://www.bloomberg.com/apps/news?pid=20601087&sid=aN4sulHN19xc&refer=worldwide#>).

With all the mounting evidence of growing financial fragilities, investors who wanted to play such a risky game should have tried a bit harder to get (and process) the necessary information.⁹² The bottom line was made painfully clear by one of the biggest hedge fund managers in an interview given half a year before events of August 2007; talking about one of his products, he said: "The consumer has to be an idiot to take on one of those loans, but it has been one of our best-performing investments."⁹³ Now, if what really happened was that investors *did not want to know*, then that is a different ball game altogether. And I suppose that the answer to the question: why is it that so many supposedly 'rational' players on both sides of the market did not want to know what was going on? is rather obvious: as the writer Upton Sinclair once said, how do you make someone understand something if his or her income depends on not understanding?⁹⁴

And, of course, the lack of transparency (to say the least) was not unique to the 'shadow banking system'; life in the 'non-shadow' lane was equally shady – and continues to be so after the onset of the crisis. As mentioned above, at the end of 2008 the US's four biggest banks by assets did not have that much less assets in 'off-balance-sheet vehicles' than on their books (US\$5.2 and US\$7.2 trillion, respectively). As Reilly explains, "[o]ff-balance-sheet vehicles helped inflate the credit bubble by letting banks originate and sell loans without having to put aside much capital for them. So as lending soared, banks didn't have an adequate buffer

⁹² Some investors seem to have been taken really by surprise; one example is John McAfee, an entrepreneur who created the antivirus software that guards my laptop very effectively, who saw his net worth drop from a peak of US\$ 100 million to about US\$4 million (he had a lot of his money in bonds tied to Lehman Brothers); in a recent interview he said: "I had no clue that there would be this tandem collapse." (http://www.nytimes.com/2009/08/21/business/economy/21inequality.html?_r=1&ref=business). The travesty in cases such as McAfee is that investors like him lost all their money when Lehman collapsed, but Dick Fuld, Lehman's CEO (nicknamed 'The Gorilla of Wall Street', who steered Lehman deep into subprime mortgage territory), was allowed to keep the US\$500 million that he made in compensation during his tenure as CEO (which only ended when Lehman failed; see http://www.time.com/time/specials/packages/article/0,28804,1877351_1877350_1877326,00.html).

⁹³ http://www.time.com/time/specials/packages/printout/0,29239,1877351_1877350_1877324,00.html.

⁹⁴ And according to Krugman during the health reform debate in the US, how do you make a politician understand something when his or her campaign contributions depend on not understanding? (<http://www.nytimes.com/2009/08/24/opinion/24krugman.html>).

against losses".⁹⁵ Furthermore, those in their balance-sheet were also subject to virtual accounting; for example, current accounting rules let lenders carry most of the loans on their books at historical cost, by labelling them as 'held-to-maturity' or 'held-for-investment'. This means that loan losses get recognised at management's discretion. However, using the alternative 'fair-value' accounting rules would speed up the recognition of loan losses and give a more accurate picture of balance-sheets' strength. So, for example, if Bank of America's loans were reported on the latter rules, as of June 30 their worth would be *US\$65 billion* less than what its current balance sheet says. This difference represented no less than 58 per cent of the company's 'Tier 1' common equity – a measure of capital used by regulators that excludes preferred stock and many intangible assets, such as goodwill accumulated through acquisitions of other companies.⁹⁶ Another 'well capitalised' bank is Wells Fargo; at the same point in time, its loans at fair value were worth *US\$34.3 billion* less than reported on their books – an amount equal to three-quarters of the bank's 'Tier 1' common equity (Ibid.). Even more extreme cases could be found in other firms, such as Regions Financial Corp.; as of June 30 the loans on its books were worth *US\$22.8 billion* less than what its balance sheet reported – and on that account it had negative equity.⁹⁷ Despite this, the government continues to classify Bank of America, Regions, SunTrust Banks Inc. and KeyCorp as 'well capitalised'. Banks already have the option to carry loans at fair value under current accounting rules; surprise, surprise, most banks elect not to do so for the vast majority of their loans.⁹⁸ Consequently, at the moment the difference between being 'well capitalised' and 'appallingly undercapitalised' may well come down to nothing more than a CEO's accounting whim...

And, finally, the financial house of cards may have come crashing down, but in current financial markets some things never change: as Matthew Lynn explains:

"In the past 18 months, just about every investment bubble in the world has burst. Property has collapsed, equities have plummeted, commodities have crashed, and even fine art isn't fetching the same fancy prices. But one bubble refuses to burst: banking bonuses." (Lynn, 2009)

For example, New York Attorney-General Andrew Cuomo said in a mid-2009 report that nine big US banks paid *US\$33 billion* in bonuses in 2008, despite heavy losses in some of them, and while receiving *US\$175 billion* in taxpayer funds (Cuomo, 2009). In the case of City, Merrill and Wells Fargo, despite a combined loss of nearly *US\$100 billion*, and the receipt of *US\$80 billion* in taxpayers money (from the Troubled Asset Relief Program – TARP), they paid *US\$10 billion* in bonuses.⁹⁹

⁹⁵ http://www.bloomberg.com/apps/news?pid=20601039&refer=columnist_reilly&sid=aRPE735QhI8U).

⁹⁶ See especially <http://www.bloomberg.com/apps/news?pid=20601039&sid=a04oVutXQybk>.

⁹⁷ Similar cases were found in SunTrust Banks Inc., and KeyCorp. (Ibid.).

⁹⁸ Although it is perfectly true that when markets are not functioning smoothly, fair-value accounting may be (at least in the short-term) an imperfect indicator of an asset's full worth, they are certainly more accurate than historical cost accounting – as the latter, in a financial crisis as the current one, could just have the value of 'historical curiosity'.

⁹⁹ Furthermore, some of its executives thought that they still were in a position to preach; for example, soon after the collapse of Merrill, writing in the *Financial Times*, one of its former chief investment strategist complained that government rescue action was simply "slowing the economy's dynamism and increasing rigidity"... (<http://www.ft.com/cms/s/0/1f64e9b6-7559-11de-9ed5-00144feabdc0.html>).

According to the report, the top 200 bonus recipients at JPMorgan Chase & Co. received US\$1.12 billion last year, while the top 200 at Goldman received US\$995 million; at Morgan Stanley the top 101 received US\$577 million and at Merrill the top 149 received US\$858 million.¹⁰⁰ In all, these 650 people received an average of \$5.5 million (Ibid.). And:

“That was 2008, during the depths of the crisis. With the markets stronger, and confidence returning, payouts this year will be even higher. [...] Goldman Sachs Group Inc. has already boosted compensation and benefits by 33 percent in the first half of this year, setting aside a record \$11.4 billion for such payments.” (Lynn, 2009).

That averages out to \$400,000 per employee, which is about what Wall Street firms were paying before the credit bubble collapsed in 2007.¹⁰¹ So, according to a leading expert on corporate pay, adjusted for inflation, “the banks are on track to pay out more than they did before the recession began. [...]. The good days of compensation are back.”¹⁰²

And there are other things that never change; one of these, of course, is how financial markets always have a special place in policy makers’ hearts. For example, it was rather generous from Henry Paulson to pay AIG’s gambling debts in full – US\$183 billion (and counting). Only cynics would say that it may have had something to do with his damaged legacy at Goldman... As it happened, at the time of Henry Paulson’s rescue of AIG (immediately after having refused to rescue Lehman Brothers, a long-time Goldman rival), Goldman Sachs was AIG’s biggest banking client – having bought US\$20 billion in credit-default swaps from the insurer back in 2005 (when Paulson was its CEO). As many analysts have reported, Paulson’s attempt at saving his damaged legacy at Goldman was rather blatant; in fact, during AIG’s rescue:

“it was hard to discern where concerns over AIG’s collapse ended and concern for Goldman Sachs began. [...] Of the \$52 billion paid to AIG’s counterparties, Goldman Sachs was the biggest recipient: \$13 billion, the entire balance of its claim [AIG had managed to pay Goldman US\$7.5 billion before going bust]. The amount was surprising: Banks like Merrill Lynch that had bought credit-default swaps from failed insurers other than AIG were paid 13 cents on the dollar in deals moderated by New York’s insurance regulator.” (<http://www.nymag.com/news/business/58094>).

In turn, among many other subsidies, the Federal Deposit Insurance Corporation is currently guaranteeing US\$28 billion of Goldman’s debt – that is equal to 10 per cent of all funds guaranteed under the government’s Temporary Liquidity Guarantee

¹⁰⁰ In the latter case, the SEC charged Bank of America with covering up for the outrageous bonuses given out at Merrill as the bank acquired the failed stockbrokerage, but let the bank off the hook with a ludicrously small fine. This was then rejected by New York federal Judge Jed S. Rakoff, who asked the Bank of America lawyer if Wall Street people expected to be paid large bonuses in years when their company lost US\$27 billion. The lawyer’s answer pointed to the fact that the ‘average’ bonus for the 39,000 Merrill employees was ‘only’ US\$91,000. “I’m glad you think that \$91,000 is not a lot of money”, replied the Judge, and then added “I wish the average American was making \$91,000.” (see <http://www.thenation.com/doc/20090817/scheer2>).

¹⁰¹ See http://www.forbes.com/2009/07/19/banks-bailout-recession-recovery-opinions-columnists-wall-street_print.html.

¹⁰² <http://finance.yahoo.com/news/Biggest-banks-in-US-reward-apf-4078596883.html?x=0>.

Program. (Ibid.) Basically, Goldman is arguably “[...] the richest welfare recipient you're likely to meet outside of the defense sector [...]”.¹⁰³

With a political and financial class like this, long-time critics of government intervention at times of crises (other than through active monetary policy), such as Anna Schwartz and Niall Ferguson, may actually have a point...¹⁰⁴

6.3 Capital accumulation via increased surplus extraction rather than improved productive capacities

As the income distribution and investment data above clearly show, like ‘rentier aristocrats’ whose wealth depends on their capacity to squeeze surpluses out of peasants, the post-1980 neo-liberal capitalist élite in the US also preferred to increase its wealth by developing a more effective technology of dispossession. That is, by improving its own coercive powers (on top of its remarkable talents for creating virtual financial wealth), rather than by increasing its capacities for developing further the productive forces of society – let alone by taking the risks associated with the ‘deployment’ phase of a new ‘IT’ and ‘clean’ techno-economic paradigm (although bubbles associated with the installation phase of the ‘IT’ technological revolution would do very nicely...) From this perspective, this third neo-liberal rentier economic law could also be understood as a new form of moral hazard: one characterised by the fundamental distortion of incentives.

6.4 No need any longer for paying taxes to finance free public goods

As is well known, the huge increase of the pre-tax income-share of the top income earners was actually accompanied by a remarkable fall in their tax-rates. For example, according to an Internal Revenue Service (IRS) report obtained by the *Wall Street Journal*, in 2005 the top 400 income-tax payers (with a combined gross income of more than US\$100 billion) controlled 1.2% of the nation’s total taxable income – twice the share they had in 1995. As if this huge increase in taxable income was not enough, this group also had their effective income tax rate cut by nearly half (from 30% to 18%; see Francis, 2008). And the 1995 effective income tax rate of this group (30%) had already been reduced by the Tax Reform Act of 1986, which had drastically cut the top marginal income tax rates (see Feldstein, 1995).

Taxes on corporate profits also declined remarkably; for example, these taxes as a percentage of public expenditure fell from 15% of the total in 1978 to just 6% in 1982, while at the same time the public deficit grew by an almost identical converse amount (from 6% to 16% of public expenditure). Again, by 2002 taxes on corporate profits were back at 6% of public expenditure, while the deficit went up again to 16%. In fact, the share of taxes on corporate profits in total public expenditure fell below even the lowest levels reached by this ratio during the

¹⁰³ http://www.forbes.com/2009/07/19/banks-bailout-recession-recovery-opinions-columnists-wall-street_print.html.

¹⁰⁴ See, <http://online.wsj.com/article/SB122428279231046053.html>; and Ferguson, 2009, respectively.

difficult years of the 1930s' recession (9%).¹⁰⁵ Furthermore, as tax cuts did very little to stimulate the economy, real stimulation was left to the Fed, which took up the task with unprecedentedly low interest rates and liquidity.¹⁰⁶

In all, it has been estimated that the Bush tax cuts amounted to \$1.8 trillion.¹⁰⁷ And that amount is almost identical to the US\$ 1.7 trillion increase in the debt of the Federal Government between the beginning of the first Bush administration in 2001 and the start of the financial crisis in 2007 (see US Federal Reserve, 2009).

So, basically this fourth neo-liberal rentier economic law could be summarised in the following terms: rather than paying taxes to get free public goods, it was much more fun for the top income earners and big corporations to 'part-pay/part-lend' these taxes to the government. The end result of the delusion that this was a sustainable policy is that the current sum of *all* government liabilities (from Treasury bonds to Medicare and military pensions) amounts to the staggering figure of US\$63.8 trillion.¹⁰⁸ And if one divides this figure by the number of households in the US, the result is the rather shocking figure of US\$547,000. Again, if this debt and the household private debt were to be paid in the next 30 years, and even assuming a *real* interest rate of 0%, each household would have to contribute no less than US\$22,274 per year – an amount equivalent to more than 70% of the current average annual gross income of the bottom 90 per cent. And this, of course, assuming that the federal government closes the deficit, and each household does not incur any additional debt (both rather doubtful scenarios, to say the least).¹⁰⁹

Thus, as so many other things these days, the 'part-pay-part-lend' your taxes also means 'part-pay-part-someone-else-pays' your taxes to the government... at the same time, the current outburst of public sector liabilities in many industrialised countries may signal the beginning of an inevitable period of Brazilian-style public sector Ponzi-finance (see Palma, 2006).¹¹⁰ That is, following what I have always

¹⁰⁵ According to the Government Accountability Office, most US corporations do not pay federal income tax anymore. Additionally, the US's effective corporate tax rate became the third lowest in the industrialised world. (See reports in <http://www.gao.gov/>).

¹⁰⁶ See <http://www.vanityfair.com/magazine/2009/01/stiglitz200901>.

¹⁰⁷ See <http://www.nytimes.com/2009/06/22/opinion/22krugman.html>.

¹⁰⁸ See especially http://www.usatoday.com/news/washington/2009-05-28-debt_N.htm. See also <http://www.washingtontimes.com/news/2009/aug/24/time-for-budgetary-truth/>. The current accounting system (called the 'unified budget'), was created by Lyndon Johnson to disguise the real cost of the Vietnam War. At a federal level, this virtual accounting system allows for a "[...] myriad off-budget gimmicks, unrecorded liabilities, and financial manipulations on a scale that would put many executives of publicly traded companies in prison for securities fraud. [... it] grossly underreport the US annual deficit. This allows for a "Ponzi scheme" on a grand scale [...]." (Ibid).

¹⁰⁹ See http://business.theatlantic.com/2009/05/us_debt_668621_per_household.php. In turn, if the real interest rate is assumed to be 3% during this 30-year period, what each household would have to contribute per year on average rises to US\$34,092; and if 5%, to US\$43,469...

¹¹⁰ According to the US Congressional Budget Office, the huge budget deficit will have to run for at least for another decade, and (even under the current narrow virtual accounting of the 'unified budget') will still exceed US\$1.2 trillion by 2019. By then the national debt would have doubled to over US\$17 trillion; and interest payments could well end up absorbing about *one-third* of all revenues (see <http://www.cbo.gov/doc.cfm?index=9957>). An alternative estimate (also done under the rules of the 'unified budget') projects the national debt to exceed US\$20 trillion by 2020, (and worst still) it projects that the annual interest on the national debt alone will exceed

thought to be the first law of macroeconomics – ‘one can only solve a macroeconomic problem by creating another one in the hope that that one would be easier to handle’ – I think that it is fairly safe to predict that the roots of the next financial crisis are likely to be found amid the debris of the current one...

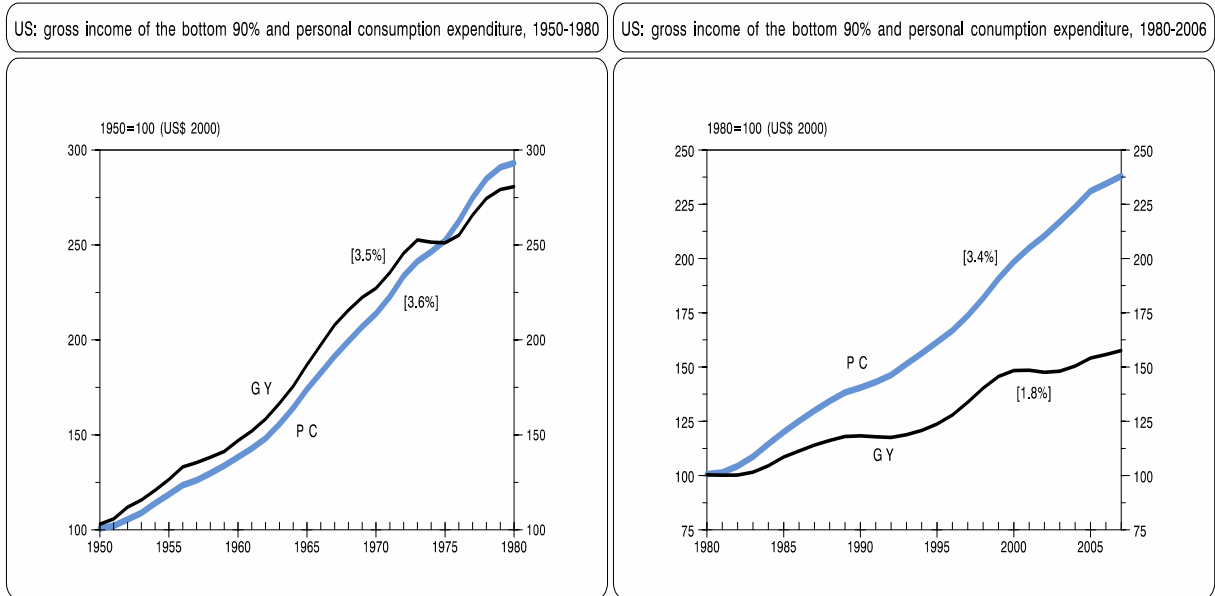
6.5 No need any longer to pay the level of wages required for aggregate demand growth to sustain capital accumulation

An obvious question that emerges from the income distribution data discussed above is how was it politically feasible in the US to keep the average real wage of the bottom 90 per cent stagnant for 30 years? This is an issue with many facets, with both carrots and sticks. On the economic side, the carrots included the mirage of an ever-increasing household net worth due to asset price bubbles – which was also the basis for an ever-increasing access to credit (see Figure 24 below). And on the political and ideological sides, the carrots included some remarkably effective ‘bait and switch’ topics – such as the ‘refocusing passion’ of what Karl Rove once called ‘wedge issues’ (God, guns, gays, abortion, military adventures and the war on terror). The sticks included those issues analysed in Section 4, such as the constant threats of transferring jobs to China, India and Mexico.

Much has been said regarding the increase in household debt before the 2007 financial crisis, and the huge dead-weight that this is bound to bring to the eventual recovery. However, not enough attention has been paid to the fact that this debt was essential to sustain the growth of aggregate demand in the face of stagnant *average* incomes in the bottom 90 per cent of the population (see Figure 22).

US\$1 trillion (see <http://www.washingtontimes.com/news/2009/aug/24/time-for-budgetary-truth>). And in the UK, according to the National Audit Office, the public sector borrowing is set to reach £175bn during the current financial year (with tax receipts falling by 10% – the biggest fall since 1923). In all, as a percentage of GDP, by mid-2009 the total outstanding government net debt is already twice the level it was in 2004, and two-thirds higher than before the beginning of the 2007 crisis (see <http://news.bbc.co.uk/1/hi/business/8160614.stm>).

FIGURE 22



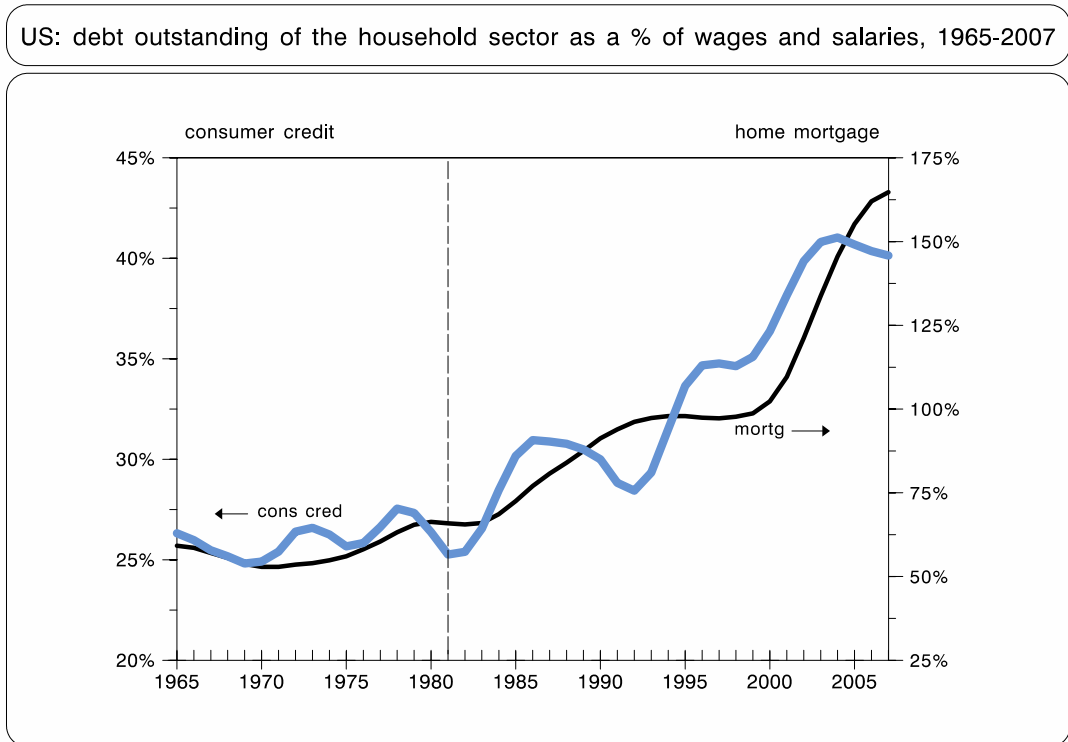
• **GY** = gross income of the bottom 90 per cent; and **PC** = Personal Consumption Expenditure.¹¹¹ 3-year moving averages. Percentages are average annual real rates of growth in respective periods. **Source:** US Census Bureau (2008).

As Figure 22 indicates, the fall in the rate of growth of *aggregate* income of the bottom 90 per cent – from 3.5% (1950-1980) to 1.8% (1980-2006) – is associated with *practically the same rate of growth of personal consumption expenditure* in both periods (3.6% and 3.4%, respectively). Again, no prizes for guessing what made up the difference.

The above gives rise to the fifth neo-liberal rent-seeking economic law: rather than paying the level of wages that were necessary to achieve the growth of aggregate demand required to sustain the process of capital accumulation, it was much more fun for the capitalist élite to ‘part-pay/part-lend’ the required level of wages. Figure 23 indicates the resulting huge increase in the level of household debt (both consumer credit and home mortgage debt) after the election of Reagan.

¹¹¹ Note that due to lack of data, this graph compares the gross income of the bottom 90 per cent with the level of personal consumption expenditure of the whole population (on this issue see Pollin (2005)). Also, note that in the right-hand panel the aggregate income of the bottom 90 per cent grows at 1.8% only due to a growing population.

FIGURE 23



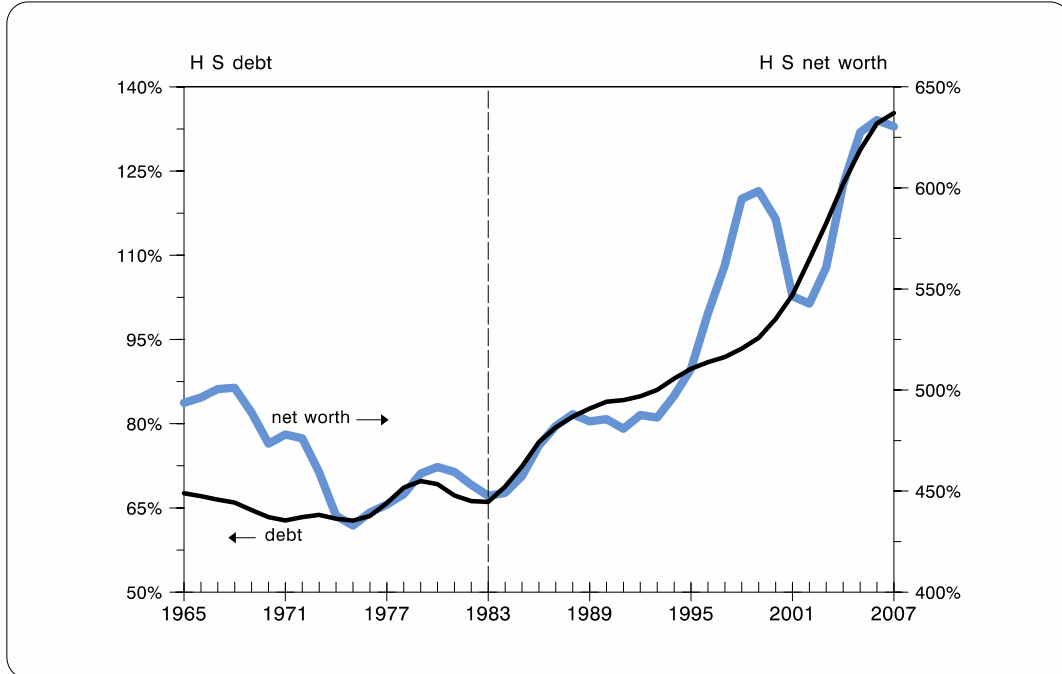
• **cons cred** = consumer credit of households; and **mortg** = home mortgage debt of households; both series are expressed as percentage of wages and salaries. 3-year moving averages.
Sources: US Census Bureau (2008), and US Federal Reserve (2009).

As Figure 23 shows, consumer credit of the household sector jumped from 25% to over 40% of wages and salaries between the early 1980s and 2007. In turn, home mortgage debt soared from 65% to 166%. And as is well known, a significant component of the increase in mortgage debt was devoted to finance consumption, because US households were allowed to transform the capital gains in their homes into ATM machines – home equity withdrawal reached US\$700 billion in 2005 (see Roubini, 2009). And all this just to keep personal consumption expenditure growing at about the same pace as before neo-liberalism...

Figure 24 illustrates the effects of the capitalist élite's preference to 'part-pay/part-lend' the required level of wages on household debt, and the mirage of an ever-increasing net worth of households. The latter not only provided the foundations for the ever-increasing access to credit, but was probably also a fundamental component of the material foundations of the neo-liberal 'spontaneous consensus'-type of hegemony found in the US since 1980 – with its ever-increasing tolerance for inequality, which helped the set of distributive strategic choices found during this period, and their corresponding payoffs, become (as mentioned above) the most unlikely Nash equilibrium.

FIGURE 24

US: household sector debt and net worth as a share of personal disposable income, 1965-2007



• **H S debt** = Household sector debt; and **H S net worth** = Household sector net worth. 3-year moving averages. **Source:** US Census Bureau (2008), and US Federal Reserve (2009).

During the 25-year period prior to 2007, real household net worth increased (as a share of personal disposable income) from 450% to 615%, having peaked at 645% in 2006;¹¹² in the meantime, household sector debt more than doubled as a share of disposable income (it jumped from 65% to 136%). The US was not alone in this boom of household debt; in many other industrialised countries, especially in the UK and Iceland, households were also allowed, indeed encouraged, to accumulate an excessive amount of debt. In the UK the latter reached roughly 1.7 times the level of household disposable income, and in Iceland more than 2 times. In the process, households have accumulated an amount of financial risk that has proved to be at levels that are obviously not privately efficient, let alone *socially* efficient. This excessive amount of risk has become evident in the alternate phase of the cycle, that of the 'sudden stop' to their access to additional financing.

In all, the average household in the US is currently carrying US\$122,000 in personal debts; to this one should add the above figure of US\$547,000, which represents the average household share in overall government liabilities (from Treasury bonds to Medicare and military pensions). The resulting two thirds of a million dollars defy belief.

¹¹² According to the S&P/Case-Shiller national home-price index, between 1997 and 2006 house prices in the US rose by 124%; in the same period prices in Great Britain went up by 194%, those in Spain by 180% and those in Ireland by 253% (see http://www.economist.com/specialreports/displayStory.cfm?story_id=9972381).

Abraham Lincoln famously said that “[y]ou can fool some of the people all of the time, and all of the people some of the time, but you cannot fool all of the people all of the time.” Well, maybe the long household net worth bubble in the US (and in many other industrialised and developing countries of the time) was the exception in which you could fool all of the people for rather a long time! So, perhaps another working definition of neo-liberalism could be ‘the art of making huge amounts of money by playing the rest of us for suckers’... Suddenly, as Krugman argues, it became evident that a lot of the people had been fooled for rather a long time:

“By now everyone knows the sad tale of Bernard Madoff’s duped investors. They looked at their statements and thought they were rich. But then, one day, they discovered to their horror that their supposed wealth was a figment of someone else’s imagination.

Unfortunately, that’s a pretty good metaphor for what happened to America as a whole in the first decade of the 21st century. [...]

The surge in asset values had been an illusion — but the surge in debt had been all too real.” (<http://www.nytimes.com/2009/02/16/opinion/16krugman.html>)

“So, how different is what Wall Street in general did from the Madoff affair? Well, Mr. Madoff allegedly skipped a few steps, simply stealing his clients’ money rather than collecting big fees while exposing investors to risks they didn’t understand. And while Mr. Madoff was apparently a self-conscious fraud, many people on Wall Street believed their own hype. Still, the end result was the same (except for the house arrest): the money managers got rich; the investors saw their money disappear.” (<http://www.nytimes.com/2008/12/19/opinion/19krugman.html>)

6.6 Capitalism can be reconstructed as a system with asymmetric ‘compulsions’ – minimum for oligopolistic capital, maximum for workers and small and medium firms

As discussed above (and in Foucault, 2004; and Khan, 2005), classical capitalism is characterised not just by the presence of market opportunities but by market ‘compulsions’, which ensure that both capitalists (of all sizes) and workers (of all skills) continuously have to strive to improve their performance in order to remain in the market. In no other economic system does continued existence depend on market competition, and therefore on the systematic improvement of labour productivity. Only in capitalism are there continuous pressures from competitive struggles, which lead to the need constantly to improve the forces of production. Therefore, like in *Alice in Wonderland*, only in capitalism is it necessary to run just to stay in the same place. However, what has emerged in practice from the neo-liberal experiment is a system in which some have been left with all the running, while others have preferred to catch a lift.

The key issue here is not one of equity or fairness (though issues like these are important enough); it is (as the five previous rent-seeking economic ‘laws’ have indicated) that those groups who have had the power to appropriate all the carrots have at the same time had the capacity to minimise the pressures they face for competitive struggles in the real economy (necessary for a capitalist system to become historically-progressive). As the head of Chile’s largest holding company, and former President of the Confederation of Chilean Industry explains, “[t]his is a market economy in name only. Competition has disappeared; mergers and

acquisitions have led to a huge degree of oligopolistic concentration".¹¹³ At the same time, large corporations have been able to increase 'compulsions' for other economic agents, such as ensuring that workers have to strive continuously in order to improve their performance just to survive in precarious labour markets, and small and medium-sized firms have to strive continuously in order to improve their performance just to stay above water. What oligopolistic capital has failed to understand is that in the long run capitalist development will necessarily take place *on its own terms*, 'warts and all'. Not surprisingly, the neo-liberal capitalist system has not only lost a good deal of its capacities to develop the productive forces of society, but has also become even more crisis-ridden from within.

Perhaps the key lesson here is that no matter how 'rational' the neo-liberal discourse may have been initially in a Foucauldian sense, an institutional environment (neo-liberal or not) in which the economic élite faces so little challenge (either politically or ideologically) is bound to self-destruct. In this, of course, most of the financial press also played a rôle in keeping the illusion of sustainability alive, especially due to the way in which they have interpreted economic news during the genesis and the outburst of the current crisis. First, in a long phase (lasting many years) that could be called the 'turning-a-blind-eye' stage, good news was usually exaggerated and bad news ignored. In the second (following events in August 2007), which could be called the 'first omnipotent stage', when eventually bad news could no longer be ignored and at least some had to be acknowledged, this was followed by an attitude of mostly 'nothing really to worry about, everything is under control'. In the final phase (following Lehman's demise), which could be called the 'second omnipotent stage' (and only after a brief period of 'shocked disbelief'), there was a turn towards an attitude best summarised by 'I can take all this on my chin without having to have my economic ideology knocked down'...¹¹⁴

How could anyone have believed that a debt-fuelled bubble of asset-price inflation was actually real wealth creation?¹¹⁵ How could anyone have believed that top income earners could switch the process of accumulation towards the appropriation of an ever-increasing share of national income in a sustainable way? How could anyone have believed that the top income earners and corporations could continue to part-pay/part-lend taxes and wages forever without creating unsustainable financial fragilities? How could anyone have believed that the financial sector could keep making huge amounts of money forever both by treating workers and governments as sitting ducks, and by exploiting the ignorance of 'second-tier' high income groups – the not-too-big-to-fail brigade? How could anyone have believed that a great deal of the financial press could keep putting such a positive spin in all this in a permanently credible way? How could anyone have believed that the markets would not eventually call the neo-liberal bluff? When this happened, as Krugman remarks (as quoted in the epigraph at the beginning of the paper), "America [began to look] like the Bernie Madoff of

¹¹³ <http://www.atinachile.cl/node/4629>.

¹¹⁴ For a psychoanalytical understanding of this type of awareness/lack of awareness cycle, see Steiner (1993).

¹¹⁵ Ferguson's favourite statistic of the crisis is that in January 2008, while there were just twelve corporations in the world with an 'AAA' rating, there were 64,000 structured financial products, like CDOs. For him, "[t]hat was the evolutionary process running amok, running out of all control." (Ferguson, 2009)

economies: for many years it was held in respect, even awe, but it turns out to have been a fraud all along". (2009B)

So, these six rent-seeking dynamics perfectly illustrate the 'have your cake and eat it' *de facto* nature of the neo-liberal paradigm, and its delusions that these rent-seeking dynamics were not only sustainable but even good for long-term growth. They also demonstrate the 'bad faith' nature of its discourse – 'bad faith' in Sartre's sense of *mauvaise foi* (i.e., of something aiming at deceiving oneself as much as at deceiving others).

We are now clearly paying the price for allowing rent-seeking-style 'sub-prime' capitalism to run wild, and for the delusional optimism of policymakers and regulators who believed that capitalism is at its most effective when they happily turn a blind eye to issues such as the risks associated with extreme income polarisation, multiple asset bubbles, artificially-created asymmetric information, and credit booms. 'How can you be sure it is a bubble?' 'Do you know better than the market?' In fact (and despite what had happened recently to real estate price in Japan and to technology stocks the world over), no policy-maker was willing to call the 'irrational exuberance' of asset prices a bubble since according to the efficient market hypothesis to call a bubble a bubble is a contradiction in terms.

Conclusions (and how to change things so that everything can remain the same)

Following Foucault, as neo-liberalism is not really a set of economic policies (as in most other ideologies, these are mostly contingent) but a new *technology of power*, the 'macroeconomics' of the post-1980 era only make analytical sense when examined within the framework of the political settlement and distributional outcome in which it operates. That is, when analysed from the perspective that what emerged *de facto* from the neo-liberal age was a new type of capitalism – one in which large segments of the capitalist élite wanted to have all the benefits that capitalism could possibly offer without having to worry about the usual inconveniences (such as competitive struggles) that normally come with these benefits; and one that inflicted exactly the opposite fate on workers and small firms.¹¹⁶

To be precise, what neo-liberalism helped to unleash was a type of capitalism characterised by an economic élite that thought that it could continue its practice of 'split and project' forever: keep the carrots, shift the sticks; get the upside, transfer the risks. Paraphrasing Gore Vidal, this convenient 'split and project' mechanism played a crucial rôle in helping to transform this system into one characterised by 'socialism for the rich and capitalism for the rest'.

It is not the first time in recent history that rentiers have tried to get rid of all fetters on their greed and transfer all associated risks; however, thanks to the remarkable success of 'The Quiet Coup', they have never succeeded on such a scale. When eventually the market called their bluff, it became evident how short-sighted

¹¹⁶ My late friend and teacher Andrew Glyn argued that what came with globalisation was 'capitalism unleashed' (Glyn, 2006); in fact, what was really unleashed was a very specific form of capitalism.

(and self-destructive) this strategy had been. And little seems to have changed since the onset of the 2007 crisis...

Schumpeter once famously said:

"This evolutionary [...] impulse that sets and keeps the capitalist engine in motion comes from [...] the new forms of industrial organization that capitalist enterprise creates. [...] The [...] same process of industrial mutation [...] incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one. This process of Creative Destruction is the essential fact about capitalism." (1942, p. 80-4).

In fact, while better than the plan of the former Treasury Secretary Henry Paulson (which would have provided him with US\$700 billion to spend at his sole discretion, without oversight or judicial review), there is not much evidence that the Geithner-Summers plan to deal with toxic assets has been designed to allow some healthy (and much needed) creative destruction in financial markets. In fact, it very much looks like the opposite: like having being specifically designed to avoid any healthy 'creative destruction'. So, the problems with this plan are not just confined to its better-known distributive bias – from the latter perspective, it has rightly been labelled by Krugman as 'lemon socialism': "taxpayers bear the cost if things go wrong, but stockholders and executives get the benefits if things go right" (2009C).

Since 1980 (alongside some Schumpeterian innovators in the new information technologies, some venture capital involved in their operations, and the considerable investment in infrastructure for telecommunications that characterised the period of 'installation' of the current techno-economic paradigm – at least until the 'dotcom' bubble ruptured), what has emerged has been a new type of capitalism – one in which those resisting both the process of creative destruction and the subordination of finance to industry have had the upper hand. The outcome has not only been extremely unequal and highly rent-based, but has been characterised by large segments of the capitalist élite attempting to create an economic, political and social environment in which they could not only resist change but also have their cake and eat it: call it 'neo-liberal neo-Darwinism'. That is, a deliberate attempt (especially from financial capital, and from the 'mature' and the most polluting industries of the previous techno-economic paradigm) to create the economic and political environment best suited to the survival of the *un-fittest* – i.e., un-fittest vis-à-vis what was required for a successful deployment *in the real economy* of a new 'information-technology' and a 'clean' techno-economic paradigm.¹¹⁷

What also emerged was a new neo-liberal ideology that (maybe not in theory but certainly in practice) provided the required legitimisation needed by financial groups and segments of productive capital both to block the necessary transformations, and to identify and exploit every imaginable new source of rent – so that productive investment and technological transformation could become an optional extra on top of assured rent-earnings opportunities. It also provided the technologies of power with the required degree of sophistication for accomplishing the most remarkable 'dispossession endeavour' ever achieved within a democracy. In fact, after the remarkable behaviour of 'free' agents in financial markets and in

¹¹⁷ Among the important components of that strategy were not just the abolition of most of the financial regulation erected during the 'New Deal' and the refusal of the Bush administration to join the 'Kyoto agreement', but also the lax implementation of the remaining environmental, competition and financial regulations.

politics in the US during the recent past, mainstream economists and public choice theorists should perhaps take another look at their concept of the 'rational agent'. Undoubtedly the most complex issue to understand is the rôle of democracy itself – especially the unmasking of the material basis for the 'spontaneous consensus-type of hegemony' that allowed all this.

The neo-liberal discourse was also remarkably useful for providing the necessary façade of 'modernity' for this spontaneous consensus, which, as Adorno reminded us (see epigraph at the beginning of the paper), can be the most effective disguise; he also reminded us of its new attribute: "[n]ewness only becomes mere evil in its totalitarian format, where all the tension between individual and society, that once gave rise to the category of the new, is dissipated" (1974, p. 185). It can even be argued that (when it became unchallenged) post-industrial, 'geriatric' capitalism nearly brought to an end the specific culture in which it developed: the Enlightenment – and especially that crucial aspect that requires the submission of all authority to the scrutiny of critical reason.

There are, of course, many lessons to be learned from the current financial crisis, such as those regarding the need for intelligent and imaginative financial regulation (both global and domestic) and effective capital controls in intrinsically unstable and fast-changing financial markets.¹¹⁸ As mentioned above, Keynes argued strongly for an international financial and payments system that would insulate nations (at least partially) from the economic maladies of other nations, and from the predatory nature of international finance. This crisis also shows us the need for an economic environment that would favour 'stickers' rather than 'snatchers' (in Hicks' sense; see Penrose, 1995). It has also expose the irrelevance of the 'dismal science' – at least in its 'markets-always-know-best' variety. However, the main lesson is that it exposed the high degree of toxicity of the (otherwise probably 'rational', in a Foucauldian sense) neo-liberal ideology when it became uncontested and put to the test by an intrinsically rent-seeking capitalist élite, and by an intrinsically compliant political class. From this perspective, the roots of current financial crisis are not necessarily found in an ideology that is toxic *per se*. Rather, these roots can be found mostly in a rent-seeking and politically unchallenged capitalist élite transforming neo-liberalism into a toxic ideology capable of generating a monsoon of toxic assets.

Also, as mentioned above, it is clear by now that capitalism without the required level of 'compulsions' for oligopolistic capital, without a critical mass of opposition, and with such an amenable political class – and despite all the ever more dazzling financial pyrotechnics, and the ever more sophisticated breaking-down of value-chains in the global economy – is probably not that much more efficient than Communism without workers' control over the bureaucracy. I call this phenomenon "history's impossibility theorem": an economic system (neo-liberal or not) in which the élite facing little challenge either politically or ideologically not only becomes inefficient, but also prone to self-destruct. Under those circumstances, it seems that the 'death instinct' inevitably takes over – remember that in 'games of chicken' an irrational (and self-destructive) player always has the upper hand... That is, what no longer seems historically feasible for an economic and political élite is 'to have its cake and eat it' in a sustainable way. It seems that the inevitable outcome of this is

¹¹⁸ One of these lessons, of course, is exactly the opposite of the rather popular (Greenspan-inspired) view that there is not that much to be learnt from the current crisis as it is just one of those things that happens once-in-100-years...

a *predatory* system, doomed to self-destruct. What politically and economically looks 'too good to be true' is bound to be indeed too good to be true. So, from a Hegelian perspective, it seems that neo-liberal manic reports of the death of history turned out to be rather premature.¹¹⁹

It has become fashionable to blame mathematics for the poverty of mainstream economics, and for its *complete* failure to understand what was going on. However, as an Oxford mathematician explains, the problem is not the use but the *abuse* of mathematics, particularly "[. . .] the corruption of quality and the abuse of uncertainty in mathematical models" (quoted in Davidson, 2009).¹²⁰ In a way, mainstream economics of the last 30 years resembles those Hollywood films that are just special effects and little plot (consisting mostly of an unsophisticated ideological message) – with the special effects being provided by the ever more elegant algebra. By now it is fairly clear that mainstream macro and financial economists not only helped cause the crisis, but then failed to spot it; and now they also seem to have little idea of how to fix it properly and how to help prevent its repetition. However, most analysts still seem only to be surprised at the fact that practically nobody in the profession was able to predict the crisis – as if this were the only failure of mainstream economics that mattered.¹²¹

Some have argued that this failure was due to the nature of academic economists' financial incentives and the resulting conflicts of interest – something not dissimilar to what was happening on Wall Street. For example, writing in the *Financial Times*, Devesh Kapur argues that:

"Many academics, [...] now have serious business interests and an array of financial ties to the very institutions that their studies address. [...] But if financial incentives shape the behaviour of mere mortal human beings, might not they shape the behaviour of academics as well? [...] There would be little chance of being invited to give a lucrative talk at Citicorp if one were in favour of sovereign debt forgiveness in the 1980s, against capital account liberalisation in the 1990s or against stock options in the 2000s. [...] Tenure was meant to ensure academic freedom, not protect academics from financial wheeler-dealing."¹²²

Although this is a very important point, I would argue that mainstream economics' bad performance in predicting the future – and in understanding the present and the past – should be found mostly in its remarkable success in engineering an academic

¹¹⁹ Manias are found as much in ideologies as in asset prices... See for example Glassman and Hasset's *Dow 36,000* (1999).

¹²⁰ For an analysis of mainstream economics' 'ontological fetishism' with mathematics, see Palma (2008A).

¹²¹ Although for Friedman (1953) prediction was indeed the only thing that mattered; for him, if positive economics was to become a 'hard' science, prediction would have to be the only meaningful test for its ideas. If that were the case, the current crisis has shown that Friedman's economics (and that of his disciples) has failed rather badly...

¹²² <http://www.ft.com/cms/s/0/6584fd56-6027-11de-a09b-00144feabdc0.html>. From this perspective, Robert Schiller (one of the few economists that predicted the crisis) raised a few eyebrows with his recent prescription for reducing future financial fragilities: not fewer derivatives, but more of them. In his opinion "[...] errors are inevitable and we shouldn't overreact to them. [...] very few people are hedging their home-price risk. [So] We are launching on the New York Stock Exchange some single-family home securities [securities tied to house prices, and] we hope [that they] will be available to a broad spectrum of investors." (See http://www.rferl.org/content/US_Economist_Robert_Shiller_Prescribes_More_Derivatives/1512509.html).

environment in which it got rid of all forms of *critical thinking* (see for example Pasinetti, 2008). As a result, little by little academic economists began to resemble faculty from the University of Stepford... And although Stepford-economists can be great at many things, *by definition* predicting (or understanding) crisis cannot possibly be one of them...

From a psychoanalytic point of view, this then became a vicious circle; the more mainstream economics succeeded in purging all diversities of ideas, the poorer it became, and then *the more intolerant of dissent it had to be* – in relation to knowledge there seems to be a strong direct relationship between the expectation to understand the real world and the tolerance of dissent (see Britton, 2002; especially his understanding of fundamentalism).¹²³

Adam Smith (among others) warned us long ago that without true competition (on *all* fronts) there is no progress; and then Charles Darwin demonstrated that for the struggle for life to be properly successful what is required is not just competition but *diversity* in that competition.

In fact, I sometimes wonder whether the brand of economics engineered by mainstream thinking since the 1980s (reflected, among other things, in its remarkable uniformity) is just shorthand for 'nothing left to decide' – and, of course, 'nothing left to think about *critically*'. Indeed, its attitude towards the understanding of the economics of the real world resembles Lord Kelvin's attitude towards physics at the end of the 19th century, when he declared that "[t]here is nothing new to be discovered in physics now. All that remains is more and more precise measurement".¹²⁴

Some look at this crisis as 'opportunity', especially those who look at it from the perspective of evolutionary economics. Some, for example, expect that "[a]s with past forest fires in the markets, we're likely to see incredible flora and fauna springing up in its wake." (Andrew Lo, quoted in Ferguson, 2009). Others, that look at the crisis from the point of view of long technological cycles, tell us that things are bound to change for the better since this crisis is also bound to help bring about the phase of 'deployment' of the current 'IT' techno-economic paradigm. In the past, this phase has been characterised mostly by the reversal of the relationship between financial and productive capital, which allows the latter to take the lead and unleash all the potential of the new technological paradigm – including the considerable 'creative destruction' forces of the 'deployment' phase. Furthermore, in this reversal productive capital can benefit enormously from the 'over-investment' in new infrastructures (in this case in telecommunications) characteristic of the bubble during the 'installation' period (the 'dotcom' bubble). In sum, financial crises of the current type have in the past helped the 'deployment' phase of previous techno-economic paradigms which, in turn, have brought about 'golden ages' (see especially Pérez, 2002).

However, I think that this time recovery from the crisis may prove to be more complex and problematic than (say) in the 1930s. Basically, capitalism now faces a

¹²³ According to Britton, in fundamentalism what is important is not what you read, it is *how* you read it; it is not what you think, it is *how* you think it; it is not what you believe, it is *how* you believe it.

¹²⁴ See Kelvin (1990). Lord Kelvin was one of the most important physicists of the 19th century, who played key roles in the development of thermodynamics, electric lighting and transatlantic telecommunication; he was buried next to Isaac Newton in Westminster Abbey.

crisis 'without an enemy' – either from within (e.g. organised labour), or from the outside. That is, it is unlikely that in the 1930s Roosevelt would have been able to carry out all the political and economic transformations that were necessary to overcome the crisis, and help 'deploy' the fourth techno-economic paradigm were it not for the combined threat of increased domestic instability and growing external challenges from the Soviet Union and Nazi Germany.¹²⁵ In other words, the successful transformations of the 1930s had as much to do with the political imperative to come out of the recession in the face of internal and external challenges, as with the objective requirements of the 'deployment' period of the fourth techno-economic paradigm (e.g., mass production needing mass consumption fuelled by a fast-growing income of the bottom 90 per cent). The latter provided the logic; the former facilitated its implementation (and hugely reduced the political and economic transaction costs of this transition).

The same goes for the remarkable common sense of the Bretton Woods accord and the rapid development of the welfare state in many industrialised countries after World War II. Keynes' task would certainly have been more difficult had the participants of that meeting at Bretton Woods not desperately wanted some sanity after the madness of the war; and it was difficult for Churchill and his Conservative Party to offer unemployment, poverty and destitution to returning soldiers by completely opposing the welfare reforms of the new post-war Labour administration.

Furthermore, current problems are compounded by the fact that both financial and productive capital will probably emerge from the current crisis with an even higher degree of oligopolistic power and even less 'compulsions' – as Gary Cohn (Goldman's president) recently said, since old competitors like Bear Stearns and Lehman Brothers are no longer around, "now we don't have to outsmart the market [anymore]."¹²⁶ And private agents from the household and business sector will probably emerge even more desperately in need of finance (as so many of them are already involved in 'Ponzi-finance'). So it is hard to imagine how it will be politically feasible for the state even to start doing the necessary 'disciplining' of the capitalist élite along the lines of increased 'compulsions' for big business (needed for a successful transformation of the process of accumulation from its current mostly rent-seeking nature to one based on increased productive capacities). In fact, in Foucault's terms, what is required even to start injecting some efficiency into the system is a shift from the current neo-liberal state of affairs – in which 'the state is under the surveillance of the market' – to a liberal-Keynesian one where 'it is the market that is under the surveillance of the state'. Unless the severity of the current financial crisis is such that it finally ends up making an effective transition possible, perhaps this crisis will be remembered not just for its unique difficulties but for the length of time that it took to come out of it – or for the many 'false starts' of the recovery.

Those who, like Samuel Brittan, want to 'save capitalism' from a left-turn (as if capitalism were an endangered species), tell us that the 'danger' ahead is that:

¹²⁵ These transformations included tightening the regulation of financial capital – not just to control its excesses, but also to shift it towards financing productive investment (along the lines of Keynes' quote above; see footnote 50); a rapid increase in the marginal rate of income taxation; and the beginning of the welfare state.

¹²⁶ Quoted in <http://www.nytimes.com/2009/08/06/business/06goldman.html>.

“The assumption that the pursuit of self-interest within the rules and conventions of society will also promote the public interest is not likely to survive – if only because the content of these rules is up for grabs. But it is all too likely to be succeeded by a mushy collectivist pseudo-altruism, in which jealousy and envy are given a free ride.” (http://www.ft.com/cms/s/0/6e92328a-35b4-11de-a997-00144feabdc0,dwp_uuid=ae1104cc-f82e-11dd-aae8-000077b07658.html).

There are two things that analysts like Brittan do not seem to realise. One is that their project still needs to find a solution to a rather complex problem: how to construct a workable political and economic capitalist agenda when you are saddled with:

- i).- an intrinsically rentier capitalist élite that does not even seem to know what capitalism is all about – and that sometimes seems determined to become capitalism worst enemy...;¹²⁷
- ii).- a remarkably short-sighted and greedy managerial set. Remember that financial executives were not the only ones quite happy (literally) to bet their institutions on wishful-thinking – i.e., not the only ones whose wishful-thinking became delusional. Also, remember that hedge fund manager who complained that an annual bonus of over US\$ 200 million was not enough? Or the former AIG Chief Executive Officer who is currently accused of improperly taking US\$4.3 billion in stock from his company’s pension fund (via a Bermuda-based holding company), because he was ‘angry’ at being ousted by the company amid investigations of accounting irregularities?;
- iii).- the most unimaginative and lacklustre political class for generations (Obama hopefully being the exception, although unfortunately not much hope for his economic team); and
- iv).- an economics profession that keeps looking at ‘markets’ mostly like creationists look at evolution.

The other thing they do not seem to realise is that the main cost of this crisis is not the many trillion dollars’ worth of asset deflation and output disruption (real as they are), let alone the ‘jealousy and envy’ that may flourish if there were a turn towards a ‘collectivist pseudo-altruism’ (fictional or valid as Brittan’s worries may be), but that this crisis leaves us wide open to the *real* possibility of a right-wing, xenophobic, fascist backlash.

So far, the signs are not very promising. The current economic crisis seems to be changing everything except the fundamental ways in which those in power and academia, and big market players think about economics and politics. In fact, according to Roubini (2009), policy-makers still desperately hold on to the idea that what is going on now is just:

“[...] a crisis of confidence – an animal-spirit-driven, self-fulfilling recession – that has led to a collapse of liquidity (as counterparties don’t trust one another), and of aggregate demand (as concerned households and firms cut consumption and investment in ways that can turn a regular business-cycle recession into a near-depression).”¹²⁸

¹²⁷ As Rajan and Zingales say (2004), those that want to save capitalism should start by trying to ‘save capitalism from the capitalists’...

¹²⁸ See also Krugman (2009A).

In actual fact, the prevailing idea among the chattering classes remains that the current financial crisis does not represent the failure of both a whole model of banking and finance (in which an overgrown financial sector did an untold amount of harm), and of a whole model of policy-making (in which the fundamental rôle of the state ended up being one of a *facilitator* of the rent-seeking practices of big business). Indeed, the New York Yankees may have failed to sell many of the most expensive tickets in their new stadium (and had to drop the price), but by mid-2009 Morgan Stanley was already re-packaging downgraded CDOs into new securities, and these were getting investment grade ratings from Moody's and S&P – some were even AAA rated... In all, it has been estimated that the biggest banks will pay their workers \$156 billion in 2009, compared to the \$143 billion paid the year before the recession began.¹²⁹ So, there is little evidence so far from financial markets of the much promised post-crisis 'invigorating reappraisal of priorities'...

Even some AIG employees in the division in charge of devising the products for underwriting risky credit derivative contracts that destroyed the company have received large bonuses after the collapse of the company and the huge federal bailout. In fact, at the time of its collapse, AIG did not even have offsetting positions against any of the US\$430 billion CDS contracts it had insured! However, this remarkable financial fragility had been no reason for rating agencies to stop giving the company a solid investment grade. Had its executives, and those of helpful rating agencies, been involved in other professions (such as doctors or lawyers), when the game was up – and all was revealed with the beginning of the financial crisis – measures might have been taken to strike them off their professional registers.

And like in the 1930s, bankers and other finance operators seemed to be forgetting rather quickly how much the government had done for them. According to a Roosevelt historian,

"[i]n 1936, F.D.R. compared [bankers] to a drowning man who is saved by a lifeguard and [then] returns to ask the lifeguard angrily: 'Where's my silk hat? You lost my silk hat!'" (<http://www.nytimes.com/2009/08/01/business/01nocera.html?ref=business>).

In this respect, it is rather depressing to see how the current Geithner-Summers plan for rescuing the US financial system, and the Brown-Darling one for the British system, have as their underlying vision that the post-crisis financial system will be more or less the same as it was before the 2007-crisis, although somewhat tamed by prudent market-friendly regulations – and anyone who disagrees with their policy of keeping financial dinosaurs on life support is just politically naïve. And (as supposedly the current crisis is just one of illiquidity and lack of confidence) it is also depressing to see how their plan for getting from A to B consists just of easy money, the assurance that the financial system's liabilities are now backed by an (implicit and explicit) government guarantees, and a massive fiscal stimulus – so far, in the US alone, liquidity support, public guarantees, insurances and recapitalisations are worth US\$12 trillion.¹³⁰ Just the rescue of Fannie Mae and Freddie Mac has cost taxpayers

¹²⁹ <http://finance.yahoo.com/news/Biggest-banks-in-US-reward-apf-4078596883.html?x=0>.

¹³⁰ To put this amount into perspective, according to the United Nations Millennium Campaign, "since the inception of aid (overseas development assistance) almost 50 years ago, donor countries have given some \$2 trillion in aid. And yet over the past year, \$18 trillion has been found globally to bail out banks and other financial institutions." (Quoted in <http://www.dmarionuti.blogspot.com>; August 3, 2009).

US\$96 billion, and the government has already pledged another US\$300 billion for the two companies due to their vital role in the mortgage market (together they own or guarantee 31 million home loans worth US\$5.4 trillion – about half of all US home mortgages). And paying off AIG's gambling debts (as well as saving Paulson's damaged legacy at Goldman) has already cost US\$183 billion (and counting). And the projected fiscal deficit for 2009 (US\$1.9 trillion) is equivalent to 13% of GDP. In fact, according to Neil Barofsky, the special inspector general for the Troubled Asset Relief Program set up by the Treasury Department (in testimony to a House committee), "[t]he total potential federal government support could reach up to \$23.7 trillion."¹³¹ In fact, the 'quantitative easing' and the fiscal stimulus have already pumped so much liquidity into the economy that between March 2009 (when global markets hit their bottom) and early August, the S&P 500 has jumped 51% - even though the outlook for economic recovery remains dim. Perhaps what we are witnessing is just another 'Fed-led bubble' – in the words of a financial analyst, "[...] the most speculative momentum-driven equity market since the early 1930s".¹³² In fact, to say the least, it is unusual to see more alcohol being prescribe as a cure for a hangover. So, it seems that it will long continue to be Christmas every day for the too-big-to-fail brigade, with taxpayers playing Santa Claus. At least to Scott Fitzgerald all this would have come as no surprise – just further evidence that some things never change: "the rich are just different from you and me..."

As Schumpeter wrote during the 1930s depression, spending huge amounts of taxpayers' money just to keep the 'hopelessly unadapted' afloat is not the most effective way forward:

"[Capitalism] cannot do without the *ultima ratio* of the complete destruction of those existences which are irretrievably associated with the hopelessly unadapted. [...] An indiscriminate and general increase in credit facilities [...] destroys that measure of selection which can still be ascribed to the depression, and burdens the economic system with [...] those firms that are unfit to live." (1934, p. 253-4)

Perhaps nothing is more revealing in this regard than the delusion that showering money with little or no conditionality into the financial system (mostly rewarding 'principals' of financial institutions for their failure to oversee that their 'agents' run financial institutions in the shareholders' long-term interests) means that 'we are all Keynesians again'. In fact, not much evidence of that. For example, while over a trillion dollars have been spent (or committed) in the US keeping financial dinosaurs on life support, CNN-Money has calculated that of the US\$787 billion fiscal stimulus plan, as of 31 July 2009 less than US\$1 billion has actually been made available for highway and environmental cleanup projects.¹³³ And in the UK, (in a blatant case of 'financial-crony-capitalism'), in October 2008 the British Chancellor paid £20 billion for 60 per cent of the shares of the Royal Bank of Scotland despite the fact that the stock market valuation of those shares at the time was less than half that amount – so,

¹³¹ See <http://www.nytimes.com/2009/07/21/business/economy/21bailout.html>.

¹³² See <http://money.cnn.com/2009/08/11/news/economy/bubbly.fortune/index.htm?Postversion=2009081203>.

¹³³ By that date, highway projects had received only US\$505 million, and environmental cleanup projects US\$118 million; see http://money.cnn.com/2009/08/04/news/economy/stimulus_spending/index.htm.

paraphrasing Joan Robinson, it seems rather that “we are all ‘Bastard Keynesians’ again”...¹³⁴

Above all, current policy makers do not understand that ‘too-big-to-fail’ does not mean ‘too-big-to-be-restructured’ – as for example along the line of the Glass-Steagall Act.¹³⁵ Also, as Krugman reminds us, in terms of government guarantees, “[...] the last time there was a comparable expansion of the financial safety net, the creation of federal deposit insurance in the 1930s, it was accompanied by much tighter regulation, to ensure that banks didn’t abuse their privileges. This time, new regulations are still in the drawing-board stage – and the finance lobby is already fighting against even the most basic protections for consumers.” (http://www.nytimes.com/2009/07/17/opinion/17krugman.html?_r=1).

And since most governments’ effort has concentrated in keeping financial dinosaurs afloat, there is not much evidence so far of new flora and fauna springing up in the wake of those market fires – crony capitalism usually goes hand in hand with arrested evolution... So finance ministers and central bankers are prepared to become lenders of first and only resort, spenders of first and only resort, and insurers of first and last resort – but not financial architects of any resort at all.¹³⁶ Maybe one day policy makers will get it that, even after adjusting for inflation and population growth, assets of failed banks during the current crisis (including those of the major ‘shadow’ banks) are so far already about *25 times* larger than those of the entire period of the 1930’s Depression.¹³⁷

In fact, it could be argued that today the need to re-engineer the whole structure of financial regulation is even greater than before the crisis, as government intervention has created a new moral hazard: “[w]e’re in a situation where we’ve extended important guarantees, both explicit and implicit, to almost all major financial institutions, yet we don’t have the regulations in place to control the excessive risk-taking that could result.”¹³⁸ Yet, by mid-2009 the only new regulations for financial markets that are still in play are a ban on certain types of electronic trading (called flash trading), and one on ‘naked shorting’ (the practice of selling a financial instrument short without having first even borrowed the security as is done in

¹³⁴ Furthermore, as the net worth of Royal Bank of Scotland at the time was in all likelihood negligible, it is questionable whether the British Chancellor should have even paid the market value of those shares, as all that the stock market was probably doing in pricing those shares at a positive value was pricing the likely amount of the impending government subsidy (a bit of simultaneous causation here).

¹³⁵ As it is very well-known by now, this act led to the separation of commercial and investment banking. For example, in order for JP Morgan to be able to remain a commercial bank, its investment operation had to be spined-off to a separate company (Morgan Stanley).

¹³⁶ Although in the financial literature is often said that ‘you never want a serious crisis to go to waste’, there is a clear danger that this is exactly what is happening this time. Part of the reason for this is the above-mentioned Greenspan’s style thinking that this crisis is a ‘once-in-a-100-year-event’. As Joseph Mason explains, “[t]hat absolves banks and regulators from responsibility for reforming in a meaningful fashion financial regulation.” (<http://www.bloomberg.com/apps/news?pid=20601039&sid=aBarTDxTnxQQ#>)

¹³⁷ Applying the same methodology, the S&L financial crisis was about five times bigger than the banking crisis of the 1930’s Depression. The list of ‘failed’ banks includes those that have been able to survive to date, but are under substantial or complete government ownership. See <http://www.thestreet.com/print/story/10589081.html>.

¹³⁸ David Moss, quoted in <http://www.nytimes.com/2009/08/06/business/06goldman.html>.

conventional short-selling). Even the rating system for securities, in which securities issuers give secret information to their paid agent (information that will never be available to investors or insurers) so that they make a widely relied-on rating for which the rating agency has no legal liability, is set to continue practically unchanged – a system so corrupt that makes rating companies resemble ‘indulgence peddlers’: “Ratings worked like the ancient Roman Catholic practice of indulgences, in which professional “pardoners” sold certificates to sinners as recognition that their penance had washed them free of sin”.¹³⁹

Martin Wolf has argued in his column in the *Financial Times* that ‘another ideological god has failed’.¹⁴⁰ Yes, no doubt, but the idolatry seems to go on and on... For example, as late as June 2009, in a Congressional testimony Mary Schapiro, the chair of the SEC, still insisted that “[d]erivatives allow parties to hedge and manage risk, which itself can promote capital formation.” And (as mentioned above) for the British Chancellor the current system of ‘light- and limited-touch’ financial regulation, with its emphasis on self-regulation and market discipline, should not be changed, as it is not really to be blamed for the financial crisis. With all we know by now, how can anyone still make either claims with a straight face?¹⁴¹

Yet, as Krugman argues, “it’s possible to be dissatisfied, even angry, about the way the financial bailouts have worked while acknowledging that without these bailouts things would have been much worse.”¹⁴² In fact, contrary to what Ronald Reagan used to say, there are times when the private sector is actually the problem, and the government the *potential* (if not always the most effective) solution. And regarding financial markets, perhaps the key analytical lesson from the current financial crisis is that the central proposition of mainstream economics concerning a Keynesian understanding of financial markets – that they are a set of ideas whose time has passed – has itself become a concept whose time is over.

One should never forget Gramsci’s proposition that more often than not battles are won or lost on the terrain of ideology. Paraphrasing Buitter (2009B), it may never have been so necessary to have policy-makers ‘whose cognitive abilities have not been warped by a modern Anglo-American Ph.D. education’.

Finally, from the point of view of the rôle of ‘compulsions’ in capitalism, it seems that most politicians (including the ‘new’ left), policy-makers and academics (including most economists) do not seem to understand that the key issue at stake in all this is that there are two opposite visions of how to try to make capitalism work more effectively (only some policy-makers in Asia seem to realise this). From Marxian, Keynesian and Foucauldian points of view (as I would argue that from a Foucauldian perspective the interrelation of progress, discipline, freedom and compulsion will also support such a view), what is necessary is to keep capitalists on their toes; from a neo-liberal one it is to keep them sweet – and, as if more evidence was necessary, with the current global financial crisis we now know for sure what happens when one does just keep them sweet.

¹³⁹ See <http://www.bloomberg.com/apps/news?pid=20601039&sid=abiwWn8b4VyU#>.

¹⁴⁰ <http://www.ft.com/cms/s/0/c6c5bd36-0c0c-11de-b87d-0000779fd2ac.html>.

¹⁴¹ In other words, don’t let minor inconveniences, such as the real world, get in the way of your ideology. (This reminds us of what Einstein once said: “Two things are infinite: the universe and human stupidity; and I’m not sure about the universe”.) See <http://www.nytimes.com/2009/06/26/business/26norris.html?hp>, and <http://news.bbc.co.uk/2/hi/business/8104340.stm>, respectively, for Schapiro’s and Darling’s remarks.

¹⁴² http://www.nytimes.com/2009/08/10/opinion/10krugman.html?_r=1.

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