The Crisis of neoliberalism as a stepwise process

Gérard Duménil[+] and Dominique Lévy[++]

1 - Introduction

The first signs of the current crisis were observed during the summer of 2007. In September and October 2008, the crisis entered into its most violent phase, with the collapse of major financial institutions in the United States, the first steps of the recession, and the exportation of the crisis to the rest of the world. In the second quarter of 2009, the trough of the contraction of output had been reached in the United States, and a gradual recovery of the GDP was underway. For most observers writing in 2010, the crisis belonged to the past. But, as of August 2011, that is, exactly four years after the manifestation of the first symptoms of the incoming turmoil, the rise of the debt of governments, in the United States and Europe in particular, appears unsustainable. And, since the deficits provide a crucial support to the continuation of the recovery, pessimistic anticipations are made concerning the coming months or years, in a completely new atmosphere.

Our previous study, *The crisis of neoliberalism*[1], covers the chain of events to the fall of 2009. There, we defended the view that, despite the first signs of recovery of the U.S. GDP, the crisis was not over. This diagnosis was based on the observation that many of the underlying factors were still there. The crisis came to the world in a very specific configuration—the deadly encounter between the overall financial fragility and the unsustainable character of the U.S. macro trajectory—and was triggered by the crisis of the debt of households. This episode is over, but important other tensions are still manifest that are on the verge of provoking a new collapse. The treatment of the crisis itself is gross of new pending threats. The transformations of capitalism that could have been expected—and are, notably, necessary if U.S. upper classes want to maintain their income and the power of their country worldwide—did not materialize in the aftermaths of the crisis.

Thus, it becomes every day clearer that the collapse of financial institutions and outputs in the fall of 2008 must be understood as a first phase of perturbation in a longer chain of events.

[+] Email: gerard.dumenil@u-paris10.fr.

[++] PSE-CNRS, ENS, 48 bd Jourdan, 75014 Paris, France. Email: domi.levy@free.fr.

[1] G. Duménil, D. Lévy, 2011. Duménil G., Lévy D., 2011, *The Crisis of Neoliberalism*, Harvard University Press, Harvard, Massachusetts.

The subsequent new bout is already in progress in the present crisis of sovereign debts. As of August 2011, the sluggish recovery of output seems to reach its last moments and pessimistic figures are released, possibly the first steps toward a new plunge of GDPs.

The ambition of the following sections is to support the above diagnosis. The second section introduces the general framework, neoliberalism and neoliberal globalization. The third section is devoted to the "first episode" around 2008. The fourth section analyses the present crisis of sovereign debts and the new courses of the macroeconomies, the "second episode". Perspectives are considered in a concluding section.

2 - Neoliberalism and neoliberal globalization

The current crisis is not the first structural crisis in the history of capitalism and, consequently, can only be understood in a historical perspective; such crises are separated by "social orders", which did not survive these major perturbations (section 2.1). Neoliberalism is the last such order ; it is a class phenomenon, in which upper classes removed all limits to their power and income with disastrous consequences for popular classes and, finally, for the upper classes of the countries of the center themselves, whose economies stagnate and became unmanageable (section 2.2). Neoliberal globalization (free trade, free capital movements, the globalization of financial mechanisms) is the international component of neoliberalism, but the difference must be made between this international aspect and the generalization of neoliberalism, including its domestic components and policies, to all countries around the globe; all countries are involved within neoliberal globalization but not all have been subjected to the rules and methods of neoliberalism (section 2.3).

2.1 - Structural crises

At the transition between the end of the 19th century and the beginning of the 20th century, capitalism underwent major transformations. Beginning in the United States, three revolutions occurred affecting the institutions in which the private property of the means of production is expressed: (1) the corporate revolution (with the wave of incorporation around 1900) ; (2) the financial revolution (with the formation of the new banking system of the Morgans, Rockefellers, and the like) ; and (3) the managerial revolution (with the delegation of the tasks of active capitalists to salaried workers, managers and lower ranking employees). This new configuration was gradually exported to the rest of the world. It marked the entrance of capitalism into what we denote as "modern capitalism". One important aspect was the transformation of class patterns with the establishment of a great bourgeoisie at a distance from the management of enterprises whose property was expressed in financial securities (stock shares and bonds), and with the rise of the new classes of managers and unproductive workers assisting them.

These transformations took place in the context of a first "structural crisis" during the 1890s. As we use it, the phrase refers to multifaceted perturbations (recessions, financial crises, and the like), which typically last about 10 years (to be distinguished from the recurrent recessions of the business cycle). This crisis coincided with a disruption of competitive mechanisms (with the formation of cartels and trusts) prior to the wave of incorporation. The second such crisis, the Great Depression, is much better known. The economy only recovered in the war economies during the preparation and conduct of World War II. The third structural crisis is the crisis of the 1970s, with the slowdown of accumulation within the major capitalist countries and the wave of inflation. The fourth, and latter one to date, is the current crisis of neoliberalism.

The first and third structural crises were caused by previous declines in profit rates. As Marx had contended in Volume III of *Capital*, such declines lead to overproduction, speculation and crises. The lower profitability levels were the cause of both the crisis of competition in the late 19th century, and the wave of inflation during the crisis of the 1970s in the context of the ongoing macro policies tending to boost output. The second and fourth crises were crises of financial hegemony in which capitalism was pushed by upper classes along unsustainable trajectories to the explosion. Financial crises were important aspects of these two conflagrations.

2.2 - A class phenomenon: Finance and its allies

The four crises created economic conditions conducive to change and, thus, separate three social orders. The question is obviously posed of a possible such new social order in the wake of the current crisis. By "social orders", we mean power configurations in which upper classes, or fractions of upper classes, dominate social relationships, either in a strong position of hegemony or within forms of compromise. A central element is obviously the power of capitalist classes. By "Finance", we mean the upper fractions of capitalist classes and the financial institutions in which much of their power is embodied. These include banks, pension funds, and the like, but also the IMF (with its adjustment programs) or rating agencies. When, in the rest of this study, we refer to Finance, we mean this agent in history, with its class and institutional components.[2]

The first social order, in the early 20th century, can be described as a "financial hegemony" (in the above sense of Finance). A degree of compromise existed between capitalists and the emerging managerial class, but the leadership of Finance was well established. The Great Depression destabilized this first power configuration. This happened in the context of a strong worker movement, in the United States and Europe, and in the world. Capitalist classes were under threat. Their hegemony had already been hit by the victory of the Bolsheviks in Russia. It was further shaken in the New Deal in the United States, the Popular Front in France (and, within quite distinct circumstances, the Popular Front in Spain.) To these, one must add the quite specific configurations of Fascism and Nazism in Europe, and militarism in Japan. After Word War II, a new "balance" of powers was found in the world, with the integration of Eastern Europe into the soviet block and the victory of communist forces in China, but also the establishment of the so-called "free world" in Europe and Japan, under the leadership of the United States. Within this part of the world, a social compromise was found, with particular features in various countries, in which the private property of the means of production was preserved despite, sometimes, massive nationalization. But the power and income of Finance was dramatically diminished. In the postwar compromise, managers of the private and government sectors enjoyed a larger degree of autonomy in the organization of the economy (the management of corporations and policies). Given the improved conditions of technical-organizational change resulting from the managerial revolution, the pressure of popular classes gave its favorable features to the period. The purchasing power of wage earners increased, new progress of welfare systems occurred (concerning health insurance,

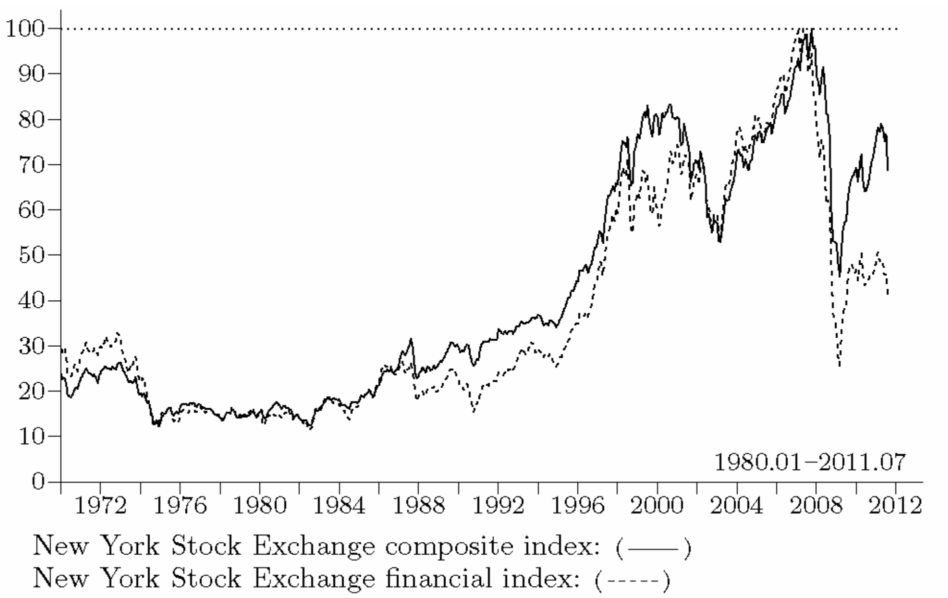
---

[2] Already, Marx had described banks, the financial institutions of the 19th century as the "administrators" of interest bearing capital.

retirement, and the like), and considerable advances in terms of education and research were realized. This new social order was the expression of a social compromise—to the Left, as in the so-called “New Deal coalition”—between popular classes and managerial classes, which can be described as social democratic or Keynesian. It is also important to recall the negative aspects of these decades of imperialism and productivism.

The third structural crisis, during the 1970s, created the economic conditions for the political defeat of popular classes, and allowed capitalist classes to regain their earlier hegemony in neoliberalism, notably to regain the control of financial institutions.[3] The management of corporation was reoriented toward the “creation of value” for shareholders; policies were defined to limit inflation and establish high real interest rates to the benefit of lenders; trade borders were lifted; the free international movements of capital were guaranteed. Due to these latter two aspects, all workers in the world where placed in a situation of competition, the strongest tool in the reversal of the conquests of the postwar social order. The benefit resulting for upper classes is usually described in terms of increasing inequalities but it is a class phenomenon. Politically, the new social order relied on an alliance between capitalist and managerial classes, a compromise to the Right, symmetrical to the earlier compromise.

Figure 1. New York Stock Exchange indices corrected for inflation (max=100): Composite index and financial index



To the current crisis, the neoliberal endeavor was a dramatic success, given its class objectives. The income and wealth of upper classes increased tremendously. We will consider here only one among many empirical illustrations of this phenomenon. Figure 1 shows New York Stock Exchange (NYSE) indices. The series have been corrected for inflation, using the deflator of GDP. The figure clearly illustrates the fall of the indices into the crisis of the

[3] We first provided this class interpretation of neoliberalism in 1996 in various papers in French, and in English in Duménil G., Lévy D., 2001, "Costs and Benefits of Neoliberalism. A class analysis", *Review of International Political Economy*, Vol. 8, num. 4, pp. 578-607.

1970s, the new trends upward in neoliberalism, the effect of the crisis of 2000/1, and the impact of the current crisis. In constant dollars, an investment in 1980 was worth about five times its value during the 2000s. (Not everything has been lost in the current crisis.)

2.3 - China within neoliberal globalization

If the U.S. economy is necessarily at the center of the analysis of the current crisis since this is where the roots of the crisis can be located, China is central stage in the analysis of contemporary ongoing trends and perspectives for the coming decades. For this reason, a particular attention must be paid to China. In a nutshell, one can contend that a very powerful capitalist sector is developing within the country[4], but that, due to the strong role played by the state, the policies governing the economy of China cannot be described as "neoliberal" (without mentioning politics).

During the 1990s, China was heading toward an all-out opening and, probably, neoliberal course. But, beginning in the early 2000, the new policies of Hu Jintao and Wen Jiabao manifested new orientations maintaining the earlier nonneoliberal aspects of the Chinese economy instead of the full reliance on "market mechanisms": (1) the control of the exchange rate and of the transactions on currencies ; (2) the control of capital movements, in and out of the country ; (3) despite the emergence of a new private financial sector, a banking system still basically owned by the state with a very permissive approach to lending ; (4) the still strong regulation of stock markets (and financial markets in general) ; (5) a very active industrial policy based on the ownership of sectors crucial to the development of the country.[5]

All of these features are in constant evolution, and it is very difficult to tell what directions will prevail in the coming decades, either the consolidation of the trends established during the first decade of the new century or an all-out march toward neoliberalism. Given the present situation, it is, however, important to distinguish between the insertion within neoliberal globalization—from which China highly benefited—and the neoliberal or nonneoliberal features of the economy. To date, China "walks on these two legs", the winning combination, especially for Chinese upper classes (and the country as an economic territory).

To this specific case of China, one can add Bolivia, Equator, and Venezuela, and the other countries of this region of the world that turned down President Bush Junior's deal concerning the broad free trade zone for the Americas. These countries are part of neoliberal globalization, but to what extent did they break with neoliberalism?

3 - 2008: The crisis of neoliberalism under U.S. hegemony

The current crisis was caused by the convergence of two categories of determinants. First, neoliberalism led to the construction of a huge, unwieldy financial and global structure, notably within the United States but also worldwide (section 3.1). Second, the international hegemony of the United States allowed the country to follow a macro trajectory of increasing domestic and international disequilibria (section 3.2). Important links obviously exist between

---

[4] Hurun, 2011, Wealth Report, Beijing, http://www.hurun.net/usen/NewsShow.aspx?nid=123.

[5] Price A., Brightbill C., Weld B., Capeloto T., 2010, The Reform Myth: How China is Using State Power to Create the World's Dominant Steel Industry, Wiley Rein LLP, Washington, prepared for the American Iron and Steel Institute, and the Steel Manufacturers Association.

the two categories of mechanisms; the rising debt of households in the United States was only made possible by financial deregulation and, simultaneously, was one prominent component of these disequilibria. Its collapse triggered the crisis, which spread to the rest of the world (section 3.3). In the wake of this episode, one may wonder whether previous neoliberal trends were reinitiated or not; the answer is mitigated (section 3.4). As of August 2011, a weak recovery of GDPs has been observed in the United States and Europe, while many countries of the periphery are forging ahead (section 3.5).

3.1 - Financialization and globalization: The apprentice sorcerer

The Great Depression and the current crisis share the common character of being crises of financial hegemony. They echo Marx's comparison in the *Manifesto*, where capitalist classes are described as sorcerers, pushing capitalism to extreme forms of expansion and financial innovation, and losing the control of their magic. The diagnosis was correct, except that, to date, capitalism survived such collapses, though at the cost of considerable transformation, while Marx thought capitalism would gradually enter into deeper crises and disappear.

These trends toward financialization and globalization have often been described. Between 1970 and 2008, the exports of goods worldwide were multiplied by a factor of 6.9; the global flows of foreign direct investment during the 2000s were 48 times larger than during the 1970s; the loans of all banks worldwide to foreign borrowers peaked in 2008 at a level 52 times larger than in December 1977 (the first figure available).[6] The overall expansion of financial mechanisms was huge. But we want to stress here a lesser known and more specific feature. There was a sharp departure upward after 2000, even in comparison to earlier neoliberal trends.

Figure 2 shows the gross market value of OTC derivative contracts worldwide. All variables have been normalized to 100 at their peak values. Interest rate contracts are by far the largest, five or six times larger than foreign exchange contracts. These gross market values are astronomic. For example, interest rates contracts reached a maximum of \$20 trillion in 2008 (to be compared to \$ 14 trillion for U.S. GDP in 2008). The figure illustrates the spectacular expansion of these contracts after 2000, to the crisis. The same observation can be made for many other financial variables.[7] The crisis was preceded by a process of acceleration, leading to the establishment of a fragile financial structure.

We will only consider here one further example concerning financial globalization. The variables in Figure 3 are the amounts of all credits supplied by all banks worldwide to foreign borrowers belonging, respectively, to developed and developing countries.[8] Concerning developed countries (—), the growth was continuous, with a significant acceleration after 2000. Concerning developing countries (---), a phase of rapid growth is observed prior to the neoliberal crises in Latin America and Asia at the end of the 1990s (in which the retreat of many of these financial investments played a major role), followed by a certain relaxation. But a new sharp rise is then apparent to the crisis of 2008. It testifies to a globalization of banking.

---

[6] The variable is shown in Figure 3.

[7] *Op. cit*. note 1, Part IV.

[8] Bank for International Settlements, 2010, "International Banking and Financial Market Developments", *BIS Quarterly Review*, June.

Figure 2. Gross market value of OTC derivatives contracts worldwide (semiannual, max=100)

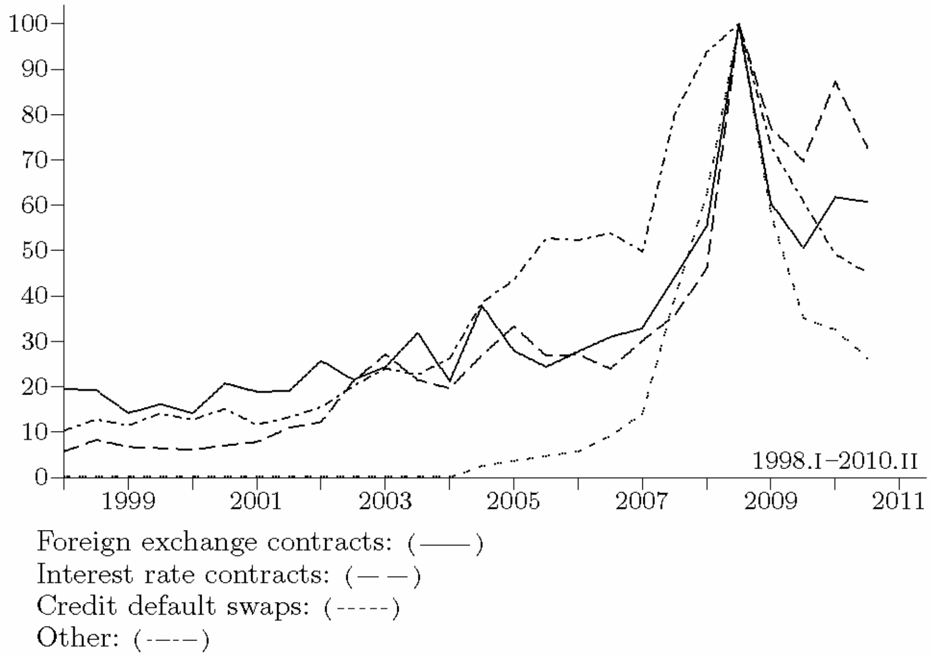
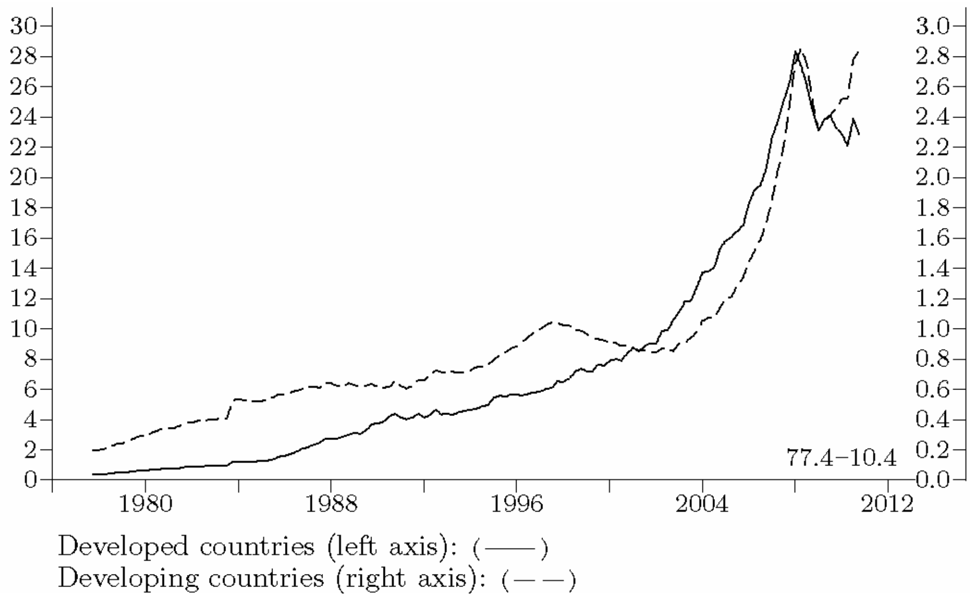


Figure 3. Total credits supplied by all banks worldwide to foreign borrowers (trillions of dollars): developed countries and developing countries



3.2 - The unsustainable macro trajectory of the United States

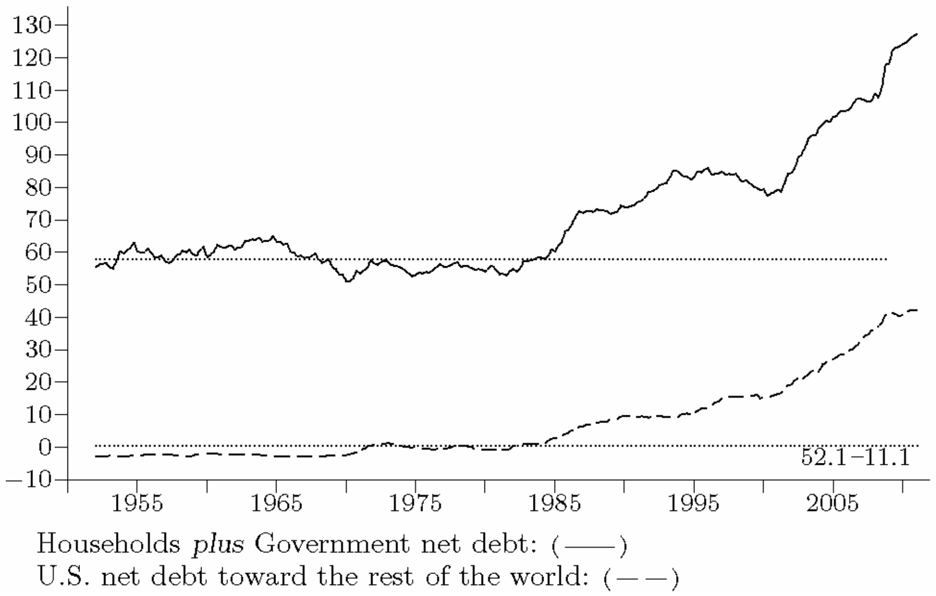
Simultaneously to the expansion of financial and global mechanisms, the U.S. economy followed a trajectory of increasing disequilibria, a combination of real and financial developments: (1) a downward trend of capital accumulation; (2) a rising share of consumption in GDP; (3) an increasing deficit of foreign trade; (4) the gradual financing of the U.S. economy by the rest of the world; and (5) the rise of the debt of households. Although the after-tax[9] profit rate of the nonfinancial sector was maintained, a growing share of profits was paid out as interest (to 2000) and as dividends. Thus, diminished shares of profits were kept by corporations to the end of investment. Gradually, the rise of upper incomes led to increased consumption and diminished saving rates of households. An increasing fraction of the goods used in the economy were purchased abroad, while exports did not grow at the same speed. A net flow of dollars resulted from this discrepancy. The foreign beneficiaries of these dollars had no alternative but to invest them into securities (bonds and shares) issued by U.S. institutions, the Treasury, corporations, Government sponsored enterprises (GSEs), and the like. (These securities were mostly issued by the private financial sector and the Treasury, and it is still so in the wake of crisis, though the proportion of Treasury securities rose.) In 2007, the U.S. assets held by the rest of the world were about the double of the assets issued by the rest of the world held by U.S. economic agents. Simultaneously, the total liabilities of U.S. households grew tremendously, with a sharp acceleration after 2000, reaching 101 percent of GDP in the fourth quarter of 2007. The crisis made the demonstration that these trends were unsustainable. They were made possible by the international hegemony of the United States and the corresponding position of the dollar as world currency, notably the massive sales of asset backed securities (ABSs), specifically mortgage backed securities (MBSs), to foreigners.

Basic macro relationships link these variables. Physical investment by enterprises [0] in an open economy is equal to the sum of: [1] the savings of enterprises; [2] the "savings" of households and the government (their income minus their consumption and investment); and [3] foreign savings (the variation of the difference between U.S. financial assets held by foreigners and the foreign assets held by U.S. agents). Thus, [0] = [1] + [2] + [3]. Since, in the United States, corporations approximately self-finance their investment ([0] = [1]), the savings of the rest of the world [3] are equal with opposite sign to the savings of households and the government. Once its sign has been changed, this latter component [2] can be called the "variation of the net debts" of the two agents (their liabilities minus their financial assets). Thus, *the sum of the net debts of households and the government* varies approximately in tandem with *the net debt of the U.S. economy toward the rest of the world* [3] = - [2].

---

[9] But prior to the payment of interest.

Figure 4. Net debts: U.S. households and government considered jointly, and the U.S. economy toward the rest of the world (percentage of U.S. GDP, quarterly)



The variables are debts in credit market instruments. The rest of the world also purchases stock shares of U.S. corporations but these amounts are much smaller. Considering only credit market instruments allows the reference to "debts", a useful simplification.

This latter relationship is illustrated in Figure 4. Note that the analysis above was conducted in terms of *variations*, while the variables in the figure are amounts outstanding. Thus, the joint variation of the two variables is apparent in the parallelism of the two lines. Two periods are clearly apparent, from the 1950s to the early 1980s, and the following neoliberal decades when the trajectory of disequilibria of the U.S. economy was initiated. The first phase, in which the two variables remain approximately constant, was typical of an economy in equilibrium. The upward trend during the neoliberal decades manifests cumulative disequilibria. The continuation of this trend relied on the capability to grow of the domestic debt and the willingness of the rest of the world to held U.S. securities.

3.3 - Households' debt: The trigger and the ensuing conflagration

The crisis could have come to the world in various manners, for example, a recession of the U.S. economy, or a crisis of the dollar if foreigners had become more wary about the sustainability of the above trajectory. But, as is well known, the crisis was triggered by the wave of delinquencies on households' mortgages.

The policy prior to the crisis was to control the debt of the government. Thus, the preservation of the level of activity on U.S. territory was only made possible by the growing indebtedness of households. There is an obvious link between the rise of this debt and the expansion of financial mechanisms. The former was allowed by a process of deregulation, as has been often described, and by the development of securitization, notably the rise of "private label" securitization, the most perilous component (and the chain of ABSs, CDOs, CDSs, and other instruments). The wave of borrowing fed the rise of the price of housing and contributed to its further increase, in a self-generating process sometimes described as a "bubble".

In 2006, delinquency rates began to rise. In 2007-2008, it became clear that a growing fraction of households were unable to pay back their debts and the corresponding interest, and delinquency rates further increased, to reach amazing degrees. This development initiated a chain of depreciations of various instruments. A large proportion of these securities had been sold to foreign economic agents. This was one of the channels by which the shock was transmitted to the rest of the world in the fall of 2008, as the U.S. economy and the economies of most, if not all, countries in the world entered into recession. We will not discuss here the strong policies initiated to stop the collapses of financial systems and outputs, in the United States, Europe, or other countries.[10]

Prior to the crisis, no international institutions were in a position to limit the expansion of global financialization and curb the growth of U.S. disequilibria. The crisis took such dramatic proportions because of the previous construction of the huge U.S. and global financial structure; because the aversion toward regulation of Alan Greenspan and the progress of neoliberal financial globalization forbade any form of action aiming at the control of the stability of the financial system and the conduct of an efficient monetary policy.

3.4 - Continuing trends?

In the aftermaths of the crisis, as of 2010, an examination of the main mechanisms and variables suggests a mitigated assessment concerning the continuation of earlier neoliberal trends. One can look, in this respect, at the indices of the NYSE in figure 1. As contended in section 3.1, beginning in the wake of the 2000/1 crisis, the composite index (—) reveals a phase of overheating prior to the 2008 crisis, plunges into the crisis, and recovers to some extent after the crisis. Overall, comparing with the values prevailing in the 1980s, a large fraction of the rise during the first decades of neoliberalism has been preserved, but a horizontal trend is observed since the late 1990s. Top wages and supplements (stock options, bonuses) bounced immediately in the wake of the crisis. The stocks of some of the big financial corporations that fell during the crisis are still very low.[11] Thus, considering the NYSE index for financial corporations (---), the restoration after the crisis appears much more modest than for all corporations.

One can also return here to Figure 3, concerning bank loans to foreigners, and observe the new trend upward for developing countries after the crisis. For major countries of the group, like China, India, and Brazil, the values of the variable at the end of 2010 are considerably higher than prior to the crisis. The course of financial globalization has clearly not been stopped by the crisis.

As could be expected, a quite distinct assessment must be made concerning the financial mechanisms related to the housing market. Notably, private label securitization collapsed and did not recover at all. But these were only “tools”, opportunities to make profits in given context, not basic neoliberal trends.

---

[10] These issues are discussed in more depth in G. Duménil, D. Lévy, 2011, Part VII.

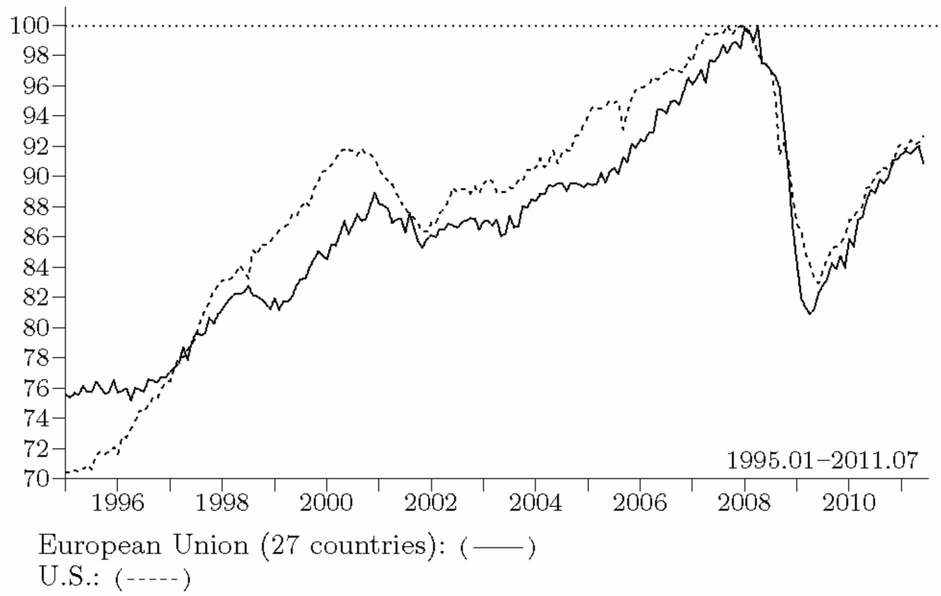
[11] The shares of Citigroup peaked at 510 in December 2006, fell to 10 in March 2009, and were worth 27 on August 19, 2011.

3.5 - A weak recovery

Can we consider that, four years after its first steps, the world economy recovered from the *Great Contraction*[12] of output that began in 2008?

As of August 2011, looking at the profile of total output in the United States, the levels of GDPs (in constant dollars) reached prior to the crisis had almost been restored. This first observation seems to confirm the early diagnosis in 2010 that the recovery was underway or, even, accomplished. In Europe, either the 27 of the European Union or the 17 of the euro zone, the GDPs were still lower than in 2007. A closer examination reveals further limits to these new trends. First, growth rates went on diminishing during the last quarters of 2010 and during the first quarters of 2011. Second, there was no recovery of industrial production. Figure 5 shows the indices of industrial production in the United States and Europe since 1995. Both indices have been normalized to 100 during their peak quarter. In the last observations, these indices remain significantly lower than these maxima, respectively 93 percent for the United States, and 91 percent for Europe.

Figure 5. Industrial production (indices, max=100): United States and Europe



In both regions, this recovery is fraught with considerable uncertainty, as it was obtained and prolonged only at the cost of a dramatic support from governments and central banks. The recovery is particularly questionable in the United States. The situation of the housing market, which plays a central role in the dynamics of the business cycle, remains very bad. There is no recovery of construction; the credit crunch is still there, with households still paying back more mortgages that contracting new ones; delinquency rates remain very high, though diminishing slowly.

[12] We prefer this denomination to “Great Recession”. By “Great Contraction” we refer to the crisis in its severity and its multiple aspects, notably financial developments.

There is no need to stress that the situation of Japan is not much more favorable, despite the large surplus of foreign trade of the country.

As of 2011, the growth rates of the emerging and developing countries recovered from the recession. Major discrepancies exist. For example, the growth rates of industrial production in China returned almost to their plateau of about 15 percent prior to the crisis, while the industrial production of Brazil plunged after an ephemeral revival in the wake of the crisis.

4 - 2011: The crisis of sovereign debts

The crisis of sovereign debts hit both the United States and Europe. This new development must be understood in the context of the massive intervention of governments and central banks (section 4.1). The situation in these regions of the world reflects the common difficulties resulting from the first episode of the contemporary crisis, but they also manifest important discrepancies between the two regions (sections 4.2 and 4.3). In both instances, however, the basic tenets and objectives of neoliberalism are questioned (section 4.4).

4.1 - States at the rescue

Contrary to what happened during the early 1930s, in the immediate aftermaths of the current crisis, governments and central banks acted fast and very strongly to support the financial systems and the macroeconomies. In the United States, the first channel was the massive lending to financial institutions, the provision of dollars to foreign central banks, and the purchase of agency MBSs. To this, though to a lesser extent, one can add the purchase of stock shares of failing corporations. The second channel was increased government deficits, resulting from the decline of government's revenue and the rise of expenses, mostly social expenses, caused by the crisis. The latest development was the direct purchase of government securities by central banks.[13]

Overall, it is not surprising to observe that, since states went to the rescue of the private sectors, the main threats are now pending on government sectors due to skyrocketing government debts. As of the summer of 2011, four years after the beginning of the crisis in 2007 and three years after the strong contraction of output, the recovery of GDP appears fragile (section 3.5) and it is difficult to predict when the macroeconomies will be able to sustain themselves *autonomously*, that is, independently of the support of government deficits. There will be no resolution of the sovereign debt crisis till this point is reached but, even under such favorable circumstances, the management of the accumulated debt would remain problematic. This self-capability will not be recovered easily, notably in the United States where one cannot expect a new rise of households' debt. The problem in the conduct of fiscal policy is, simultaneously, one of size and duration.

---

[13] In sharp contrast with these dramatic macro policies, the reforms of the financial system are very slowly implemented despite the vote of the Dobb-Rendal Act in 2010 (Polk D., 2010, Summary of the Dobb-Frank Wall Street Reform and Consumer Protection Act, Enacted into Law on July 21, 2010, Davis Polk and Wardwell LLP, New York.).

4.2 - The United States: The domestic economy and the rest of the world

In the United States, the increase of the debt of the government must be understood in the context of the trajectory of disequilibria of the economy (section 3.2). The rise of the domestic debt—whatever its origin (government or households)—has major consequences concerning the relationship between the United States and the rest of the world. *The net U.S. domestic debt varies in tandem with the U.S. net debt toward the rest of the world* (Figure 4). The United States belong to the group of countries that run simultaneously a deficit of the budget of the government, a deficit of foreign trade, and the corresponding financing by the rest of the world. This is the worst configuration, made possible, to date, by the international hegemony of the country and the status of its currency.

In order to alleviate the rising tensions, beginning in the last months of 2010, the Federal Reserve began to purchase government securities beyond the norm prevailing prior to the crisis—the ultimate offense against the basic principles of neoliberalism—in what is known as "quantitative easing". This policy had a double advantage: (1) the straightforward financing of deficits, and (2) the diminished reliance on foreign investors. But, with respect to this second aspect, it must be understood that the relaxation concerned only the direct financing of the government debt by foreigners, not the financing of the U.S. economy in general still growing.

Figure 6. Securities held by the Federal Reserve (billions of dollars)

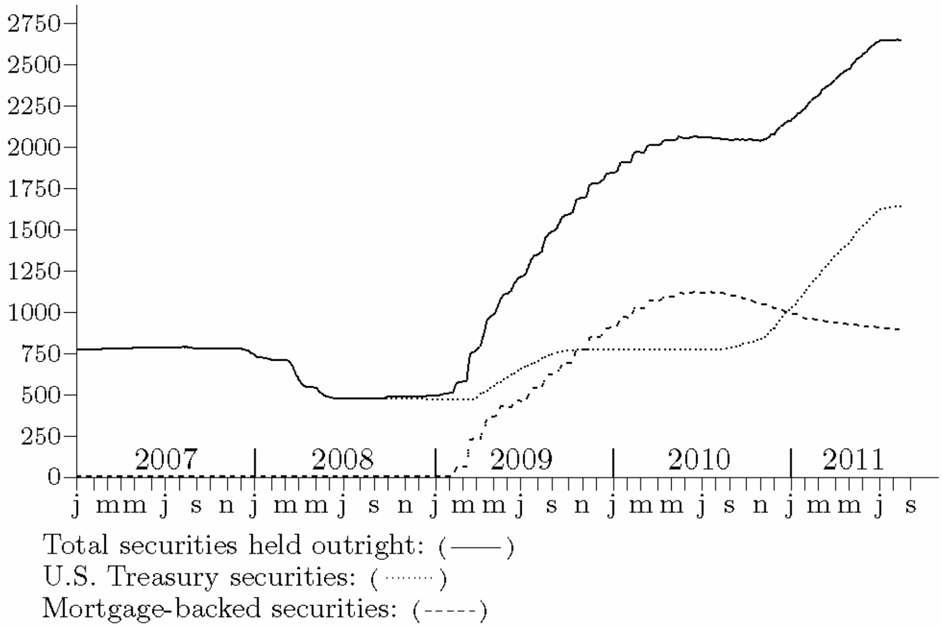


Figure 6 shows the total amount of securities (—) held by the Federal Reserve. Two types of securities are massively purchased by the Federal Reserve, Treasury securities and agency MBSs (to a lesser extent plain agency securities). Prior the crisis, the Federal Reserve held a stock of Treasury securities whose growth paralleled that of GDP and amounting to $ 800 billion immediately prior to the crisis. This total was reduced during the first period of lending to financial institutions. One can observe, however, that, in October 2009, the amount held before the crisis was almost restored. A new development, from February 2009 onward, was the purchase of agency MBSs (---), more recently reduced to some extent. Relevant to the present analysis is the expansion of the holding of Treasury securities in the quantitative easing. In a first phase, these purchases were equal to the total increase of the government debt, but they, gradually, became larger (meaning that the Federal Reserve is active in the reduction of the stock of securities already issued and held by economic agents trying to sell such securities).

The crisis of the U.S. sovereign debt testifies to the fact that the major reprieve provided by quantitative easing—to date, one year long—is still insufficient to reach the point of the "autonomous" recovery mentioned earlier, and must be prolonged. It is hard to see where the new dynamics could come from, given the propensity of the U.S. economy to import more than export. The rise of a debt is required. Whose debt? The rise of the household debt is not on the agenda; the rise of the debt of the government is politically questioned.

The risks implied in the financing of U.S. deficits—the deficit of trade and the deficit of the government—are rising, as manifest in the downgrading of the rating of U.S. Treasury securities by Standard & Poor's, in the contexts of the increasing difficulty to sell securities to foreigners and of the decline of the exchange rate of the dollar (as in the price-adjusted broad dollar index), now at its lowest value since the early 1970s.

The situation of the U.S. economy must be contrasted to that of the Japanese economy. In Japan, the deficit of the government is very large, but the country runs an also large surplus of foreign trade. The country is, therefore, less dependent on international "markets". Not coincidentally, the rate of exchange of the yen is trended upward.

Figure 1. Claims of foreign banks on various units (countries or zones)
(% of GDP)

		Banks of euro area	Banks of countries outside of the unit	Total
United States	Total foreign claims		38.1%	
	Public sector		9.3%	
Japan	Total foreign claims		14.6%	
	Public sector		5.4%	
Europe	Total foreign claims	29.6%	17.9%	47.5%
	Public sector	4.2%	5.4%	9.7%

Europe: 12 countries (Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Norway, Portugal, Spain). U.K. and Switzerland excluded

Table 1 shows the claims of foreign banks on three units (country or zone), the United States, Japan, and Europe, as a percentage of the GDP of each unit. Considering all banks of countries outside of the unit, as in the second column, one can observe that the total claims on the United States amount of 38.1 percent of the U.S. GDP, while the percentage is only 14.6 for Japan. Europe is a distinct case because of the multiplicity of countries (section 4.3), but, when considered globally and looking at debts to banks outside of the euro area, the percentage is 17.9, that is, much lower than for the United States and slightly above Japan. The table also provides the figures for the claims on the public sector. One can, for example, notice, in the case of the United States (with a percentage of 9.3), that these claims only amount to one fourth of the total.

4.3 - Europe: The domestic economy and "rogue states"

The situation is also severe in Europe. No autonomous stability of the macroeconomy has been recovered. Government deficits are large and rising. (Purchases similar to quantitative easing were also carried out, but only to a very limited extent.) In the comparison of Europe (whatever the boundaries considered) with the United States, major differences must be emphasized.

It is crucial to determine whether the countries where the disequilibria of foreign trade exist have external debts toward economic agents (notably banks) within the euro area or within the rest of the world. In the first case, the problem is basically European. In the second case, it is international.

Table 2. Claims of foreign banks on various European countries (% of GDP)

		Banks of euro area	Banks of countries outside of the euro area	Total
Greece	Total foreign claims	36.1%	9.2%	45.3%
	Public sector	12.6%	2.2%	14.7%
Portugal	Total foreign claims	76.5%	16.3%	92.7%
	Public sector	13.2%	2.2%	15.4%
Spain	Total foreign claims	36.3%	15.2%	51.5%
	Public sector	5.7%	2.1%	7.8%

Table 2 illustrates the present situation for three countries presently under attack. With the exception of Portugal, the totals in the third column reveal percentages, which are not outstanding when compared to other countries. But, in each instance, the majority of the debt is due to banks of the euro area. The debt of the public sector is significant but much smaller than the debt of the private sector. Thus, the problems are distinct in Europe and in the United States.

The euro is presently not under attack. The rate of exchange of the common currency against the dollar is not declining and, during the recent crisis years, the euro performed better than the pound. The situation is nonetheless severe since the European banks holding the bad European debt are under threat. The intervention of the European Central Bank is required.

There are no "individual" ways out. In a country like Greece, not only the deficits are large and rising, but the situation of the macroeconomy is terrible with, notably, the collapse of industrial production. The exit from the euro zone and the corresponding devaluation of the currency might remedy some of the problems of the macroeconomy but, in the short run, the crisis of the debt would be worsened.

Thus, one could contend that the crucial problem in Europe, notably within the euro zone, is the lack of central governance (the weak central institutions, government and financial institutions) and the low degrees of solidarity. These circumstances command the absence of a real common budget and the weakness of policies. Under such circumstances, there is no way out. But one must also stress that a stronger European governance would also be a dangerous tool in the hands of neoliberal governments to impose even more neoliberal policies. The absence of threat on the rate of exchange of the euro creates conditions favorable to the continuation of such policies, while the downward trends of the values of the shares of many among the large European financial institutions manifest increasing tensions and contradictions.

4.4 - Neoliberalism: The dead end

Three broad categories of policies can be distinguished, schematically: (1) the policies of the Right, combining the fight against inflation and against government deficits ; (2) traditional Keynesian demand policies to boost the macroeconomy and employment, to which one can add an active industrial policy ; and (3) antineoliberal policies adding to the previous a strong financial regulation, as new New Deal, the taxation of high incomes, a degree of protectionism and significant limitations to the international mobility of capitals (a "new Bretton Woods").

1. *Neoliberal policies.* There is no way out along the rules of neoliberalism and preserving all the advantages conquered by upper classes. If the present turn to the Right in the United States is prolonged, it will have very damaging economic and social consequences. This turn was first manifest in the lost majority of the Democrats during the midterm election in 2010. Instead of opting for the direct confrontation, President Obama—subject to the pressure of advisers that benefited considerably from the rise of wages within financial institutions—chose to compromise. He explicitly acknowledged the requirement to balance the budget. How long and how far the United States will maintain such directions remains undetermined.

The situation is not better in Europe. The most advanced countries of the euro zone (under the leadership of the famous Merkel-Sarkozy duet) are playing the same dangerous game with countries facing extreme situations as with the popular classes of their own countries, using the circumstances of the crisis to push forward the conquest of neoliberalism.

There will, obviously, be economic sanctions to neoliberal mechanisms and policies. "Adjustment programs", reminiscent of the treatment of the crises of the 1990s, and the so-called policies of "austerity", as in Europe, will only lead to a new fall of the macroeconomies. The overall structure typical of neoliberal financialization and globalization is still fraught with the same fragility. As of August 2011, each new threat sparks a new collapse of financial markets, itself adding to the ongoing turmoil. This is true within countries of the center, but the peripheries, now well engaged into neoliberal financial globalization, are not insulated. The same lack or misdirection of global governance, notably expressed in the limited means and neoliberal bias of the action of institutions such as the IMF, prohibits any forms of treatment of the global situation from above.

2. *Keynesian demand policies.* The policies conducted in the treatment of the first episode of the crisis, of which government deficits are a crucial element, were quite efficient to support the macroeconomies. But the present crisis of sovereign debts demonstrates that they are presently reaching their limits. Along such lines, there would be no other options that the further expansion of deficits. The point is not that these policies are misdirected, but that they are incomplete.

3. *Beyond neoliberalism.* It is particularly clear in the United States, that deficit or industrial policies will not be sufficient to remedy the situation if they are not paralleled by a strong intervention from the government and, more generally, central institutions. The

"reterritorialization" of production, notably manufacturing, is impossible in the absence of serious limitations to neoliberal globalization, free trade and the free movements of capitals.

As is well known, the consciousness of the threat is growing despite the mass propaganda of the Republicans in the United States. The "Right turn" has been repeatedly criticized by Paul Krugman, who judges it reminiscent of the policies followed in 1937 that provoked a new contraction of output in the United States.[14] Joseph Stiglitz points to similar developments, referring to a forthcoming "grand debacle" and calling to the taming of "finance".[15] One can also cite the diagnosis of the Boston Consulting Group, a major firm advising business. Emphasizing the severity of the present situation, the report of the firm points to ways out such as "financial repression" or the limitation of "cross-border capital flows".[16] Warren Buffet is pleading for the taxation of high income and wealth.[17]

5 - Perspectives: A historical viewpoint

In the discussion of possible outcomes, some distance must, however, be taken from the technical aspects of the analysis in the previous sections. It is time to return here to the historical perspective of the first part of this study. Each of the three previous structural crises in the history of modern capitalism led to the implementation of a new social order. There is obviously no historical determinism in which a necessary repetition of this pattern of events would be implied but, at least, the economic conditions of such a transition have been brought into being.

The sequence of events that followed the previous crisis of financial hegemony, the Great Depression, clearly illustrates this complexity of the ways of history. The depression created the underlying economic conditions for developments as different as the New Deal, the Popular Front, Fascism, Nazism, and the Japanese militarism. In each of these configurations, a strong intervention of the government was manifested, actually a common requirement to confront the disastrous situation of capitalism worldwide. Class struggle had tremendous effects, far beyond what could be seen as "modalities" or "nuances". The ways of economic determinism are variegated. But after World War II, a much clearer convergence of social orders was observed within many capitalist countries. Again, the major government intervention was a central aspect, but Keynesianism provided the foundations for the new compromise, with the gradual concentration of the action of governments on the macroeconomy, and decisions concerning investment and production on the initiative of enterprises, with the larger autonomy of managers. It is easy to locate the transformations of capitalist relations of production at the basis of the new directions taken during these decades. These new social trends found an expression in the degrees of corporate and policy governance, at some distance from strictly defined capitalist interests. Again, a quite specific political arrangement was found in relation to class struggle. The difference between the postwar compromise and the subsequent social order, neoliberalism, is that the former was

---

[14] http://www.nytimes.com/2011/06/03/opinion/03krugman.html?_r=1&hp.

[15]http://www.project-syndicate.org/commentary/stiglitz141/English

and http://www.project-syndicate.org/commentary/stiglitz127/English.

[16] Rhodes D., Stelter D., 2011, Collateral Damage. Stop Kiking the Can down the Road. The Price of not Adressing the Roots of the Crisis, The Boston Consulting Group, Boston.

[17] http://www.nytimes.com/2011/08/15/opinion/stop-coddling-the-super-rich.html.

oriented along the direction of history, while the latter running counter and, in this respect, can be deemed “reactionary”.

A similar distance is required in the interpretation of contemporary trends. In the atmosphere of confusion created by the combination of, on the one hand, the urgently required management of the economy and, on the other hand, the preservation of the conquest of upper classes in neoliberalism, there is “historical space” for episodes to the Right in the United States and Europe. Obviously, there is also space for even far-right alternatives. In both instances, new episodes of crisis must be expected. One can surmise, however, that, in a time frame whose duration remains unpredictable, a new more stable and coherent social order will be found, conducive to a more quiet economic and financial course of events. Unfortunately, nothing proves, given the present situation of class struggle, that this social order will be politically oriented to the Left. If these regrettable political trends are not altered in the coming decades, the most likely configuration is a new compromise to the Right among upper classes, at a significant distance from neoliberalism, in which a new management from central institutions would be imposed, still to the advantage of capitalist and managerial classes, though with distinct comparative benefits between the components of these classes. One can expect new channels in the *formation of incomes*, with notably reduced capital income but still patterns favorable to high wages, and new levers in the exercise of *class power*. Despite the thoroughly distinct historical conditions this new social order could have significant common aspects with the social order of China since 2000. Playing on words, we suggest the metamorphosis of the term “neoliberalism” into “neomanageralism”.

It is hard to tell within what exact international power configuration such a social order could be established. With China playing the role of a new hegemon? A shared hegemony between the United States and China? A multipolar world? The outcome will depend on the respective capabilities of, on the one hand, the upper classes of China to resist the temptation of the shift toward neoliberalism and of, on the other hand, the upper classes of advanced neoliberal countries to undertake the “big turn” toward the conditions required by the restoration of their economies.