8. Neoliberalism and the 2008 financial crisis

This chapter examines neoliberalism in the context of the 2008 financial crisis. The focus is on how neoliberals accounted for the causes of the crisis and the necessary responses to it. The chapter does not therefore provide a detailed narrative account of the crisis (see Gamble 2009; Mason 2009), although a brief outline is presented. The more important focus is on how neoliberals accounted for the causes, what they see as solutions, and to provide some understanding of what appears to be a paradox, namely, that neoliberalism in some respects emerged from the crisis in a strengthened rather than weakened position, at least until 2016. It is clear in what follows that while neoliberal accounts of the reasons for, and way out of, the crisis are unconvincing, this did not in itself undermine neoliberal renewal after the financial crisis. This is because neoliberals can always point to the reality of regulation and therefore the existence of 'external' political forces, which can then be used as the basis for critique, alternative and renewal.

The chapter examines these issues in four sections. First, the causes of the crisis are considered. This involves paying detailed attention to neoliberal interpretations of the crisis, but also subjecting them to a critical analysis from the outset. Second, neoliberal medicine for resolving the crisis is considered, with detailed critical analysis of austerity. Both these sections demonstrate the weaknesses of neoliberal interpretations of the causes and consequences of the crisis. However, this begs the question of how and why neoliberalism has renewed itself in the face of such a crisis, and here we shift our attention to understanding neoliberalism’s ability to always point to government regulation and thus identify — no matter how unconvincingly — this as the main cause of the crisis. Finally, this discussion leads to a wider focus on how neoliberals understand and utilise politics, an issue discussed in earlier chapters and discussed in more depth in the next three chapters.

Before considering these issues, we outline the way that the crisis unfolded in the period 2007–08 and from 2008 to 2010, and the neoliberal interpretation of this crisis. Briefly, in the autumn of 2008, the slowdown in the global economy threatened to turn into a meltdown,
especially after the leading investment bank Lehman Brothers collapsed (FCIC 2011: 324–42). Panic ensued and lending between banks, crucial to the circulation of credit, effectively dried up, as the interest rate at which banks were prepared to lend to one another increased substantially. This rate is usually quite close to the rate at which it costs governments – and the US government in particular – to borrow, with an average discrepancy of around 0.3 points, but on 18 September 2008, it reached 3.02 percentage points. At the same time, the cost of borrowing for non-financial firms increased from around 2 to 8 per cent (Mason 2009: 17). This was followed by bail-outs and takeovers of financial institutions, including investment banks and the major insurance company American Investment Group which faced bankruptcy owing to insurance claims made by companies that had accrued massive losses, and reinforced by the fact that it was increasingly exposed to the drying up of short-term lending by money markets, and the declining value of its collateral, much of which was in mortgage-backed securities (MBSs) (FCIC 2011: 344).

The interdependent nature of financial markets had enormous effects beyond the immediate point of crisis, the US mortgage market. United States mortgages had been securitised in that mortgages were packaged together with other debts into a collateralised debt obligation (CDO). These were then sold on to new parties, not just in the US but elsewhere. As a result, government bail-outs and nationalisations of loss making financial companies was widespread, as we noted at the start of this book. For some, this constituted a Polanyian moment, a new double movement in which the first movement of laissez-faire capitalism was displaced by a new second movement, and what many expected to be the end of neoliberalism (Germain 2009). However, with the bail-outs and the slowdown in growth, the crisis increasingly came to be seen as a sovereign debt crisis, particularly in Europe (see below). This led to debates about whether the crisis was caused by ‘unregulated’ financial markets, or a market in which there was actually ‘too much’ regulation by the state. This, in turn, leads us to consider a question which this book opened with, namely, how, despite the expectations of contemporary Polanyian analysis, neoliberalism actually strengthened after the crisis?

INTERPRETING THE CRISIS: A CRITIQUE OF NEOLIBERALISM

Following Friedman (2009: 136), we can identify four neoliberal explanations for the financial crisis. First, in the US there were government
directives (directly through the Department of Housing and Urban Development and indirectly through the private but government sponsored enterprises – GSEs – Fannie Mae and Freddie Mac) to expand home ownership (Schwartz, A. 2009; Wallison 2009; Pennington 2011: 15). Second, there was loose monetary policy carried out by the Federal Reserve (Schwartz, A. 2009). Third, there were regulations to protect the much maligned credit rating agencies, including legally protected status by the Securities and Exchange Commission (SEC) (Friedman 2009: 134). Fourth, there were too many forms of government insurance for creditors and debtors, such as no recourse laws which allowed mortgage holders to walk away from mortgage obligations (Friedman 2009).

In terms of the first argument, Lawrence White (2009) has argued that ‘the housing bubble and its aftermath arose from market distortions created by the Federal Reserve, government backing of Fannie Mae and Freddie Mac, the Department of Housing and Urban Development, and the Federal Housing Authority’, Peter Wallison (2009) wrote a dissenting statement in response to the Financial Crisis Commission of Inquiry official report (FCIC 2011) arguing much the same. So the issue is not (financial) markets but rather (government) regulations that distorted these markets. The crisis was therefore a crisis of politics/the state and not of economics/markets (Friedman 2009). For Wallison (2009: 365), the crisis is ‘a shattering demonstration that ill-considered government intervention in the private economy can have devastating consequences’.

It is indeed the case that government directives existed, for instance through the Community Reinvestment Act passed in 1977. It is also true that targets were re-set for minority home ownership from 1993 through to 2005. However, these targets were never met, and Wallison himself was critical of limited home ownership among minorities as late as 2006 (Payne 2012: 160). The re-setting of targets took place partly in response to the failure to reach targets. Moreover, most of the high-risk, sub-prime mortgages were issued by private companies independently of government directives or of the involvement of the GSEs, Fannie Mae and Freddie Mac. By 2005–06, at the height of the bubble, Wall Street investment banks were securitising one-third more loans than the GSEs, and sub-prime mortgages rose from 8 per cent of mortgage originations in 2003 to 20 per cent in 2005 (FCIC 2011: 102, 104). The GSEs did attempt to become more involved in sub-prime securitisation, but this was in response to falling market share. Wallison implies (but cannot prove, and does not attempt to) a causal link from the Community Reinvestment Act to targets to private lending, suggesting that the last of these was a victim of government distortion, but the private sector was not forced to do anything. What was central was the emergence of a
shadow banking system which government allowed and encouraged – in so far as regulation existed, it was designed to expand and not distort the market. Finally, attempts to blame the GSEs (see Pinto 2009) have relied on definitions of sub-prime that are so wide as to be meaningless. Edward Pinto identified 27 million sub-prime mortgages and argued that 19–25 million of these were attributable to government steering of the housing market. He then highlighted a serious default rate of 25 per cent, but this figure does not refer to his figure of 27 million. Pinto’s figures include loans completely outside the remit of the Community Reinvestment Act, and 65 per cent of Pinto’s high-risk loans were outside of government targets (Min 2011: 3). Private securitisation mortgages defaulted at over six times the rate of those originated by Fannie Mae and Freddie Mac (Min 2011: 2). Furthermore, the financial crisis was not just caused by a housing market bubble, but included real estate (Palley 2012: 83–5), where there were no ‘distorting’ GSEs, and the crisis was not just confined to the US, but to countries such as the UK, Ireland and Spain where there were no GSEs (Mirowski 2013: 316).

In the period from 1998 to 2008, the five leading investment banks benefited from a regulatory system which encouraged rather than distorted or compelled them to expand their activities. In 1999 the Gramm–Leach–Bliley Act was passed, which repealed the 1933 Glass–Steagall Act which had restricted investment activity by enforcing a strict separation of commercial and investment banking. Although this was gradually liberalised under Reagan, George H.W. Bush and Clinton, the 1999 Act furthered the liberalisation process so that banks could invest increasing amounts of their capital in investment banking (see FCIC 2011: 55). The 2000 Commodities Futures Modernisation Act was passed which in effect exempted futures and derivatives markets from any meaningful government oversight (FCIC 2011: 92–3). In 2004, the SEC further relaxed its rules concerning the gross leverage limits of investment banks. The effect of these changes was to liberalise investment banking, expand sub-prime mortgage lending, expand the derivatives market and facilitate a growing merger between banking and insurance (the last of which was significant once bank losses became apparent). None of these developments can be linked in any causal way to state pressure to expand home ownership.

The work of Hyman Minsky (1982, 1986, 1992) is particularly important in this respect. The conventional neoclassical theory of financial markets is known as the efficient markets hypothesis, which was hugely influential before 2008, and most associated with the Chicago economist Eugene Fama (1991). The basic contention of this thesis is that individual decision-makers may well get market prices wrong, but
this will be counterbalanced by others, because one investor’s over-confidence is another investor’s under-confidence. Therefore, market prices – including for financial products – reflect the sum of rational entrepreneurs buying and selling in markets. It was on these grounds that many economists argued that the debt build-up before 2007–08 was not a problem because this must reflect the sum of rational investor action, so that the build-up of debt was balanced out by rising asset prices, especially in housing and real estate. Of particular relevance here is the distinction (outlined in Chapter 5) between the price mechanism associated with Hayek and his argument concerning the limits of knowledge, and price theory, which leads the Chicago School to giving a prominent role to economic experts as repositories of knowledge (Davies and McGoey 2012: 71). This distinction means that:

[where the price mechanism of the market relieves centralized authorities from offering a complete and authoritative view of the whole, price theory of economics is permitted to develop more and more elaborate models and representations as a means of controlling risk and seeking the most efficient path through complex situations. (Davies and McGoey 2012: 72)]

This point applies not only to the kind of public sector reform discussed in previous chapters, but also to the kind of modelling that preceded the financial crisis. This has led some critics to argue that financial traders mistook the models for reality (Tett 2010) or, even, that such models help to construct the reality (MacKenzie 2006).

Minsky (1982: 22–3, 1986: 206–13) argued, in contrast, that capitalism tends towards financial crises, based on shifts from manias, to panics to crashes (Kindleberger 2000). Thus, in a boom period, enterprises in the most profitable sectors took on more debt which was then used to generate more profits, which encouraged others to follow. With the build-up of profits, more debt is taken on as the fear of non-payment is assuaged by rising profits (or rising asset prices such as housing). For Minsky, this process has three stages: (1) hedge finance, where creditors are paid back interest and the principal when a loan is due; (2) speculative finance, where interest only is paid back, and so financing of the principal is rolled over; and (3) Ponzi finance, in which companies borrow more just to meet interest payments on their existing liabilities. For example, A borrows from B in order to pay back interest to C. The danger is that at some point, C might realise that A cannot meet interest payments and B realises A cannot meet principal or interest payments, and so the boom rapidly turns to bust as risk becomes uncertainty, and panic turns to crash, as cash shortfalls and forced selling of assets leads...
to rapid revaluations of financial structures (including those assets rapidly sold). These processes are reinforced by the role of money and credit in the system (see Ingham 2004). Contrary to the claims of neoclassical theory, financial companies are not simply conduits for the exchange of goods, but rather they are ‘merchants of debt’ which ‘strive to innovate with regard to both the assets they acquire and the liabilities they market’ (Minsky 1992: 6). Minsky thus argued that without external intervention – by states – there could be complete financial meltdown and certainly a period of debt and deflation (falling asset prices which increases the debt burden and leads to contraction of economic activity). Minsky’s thesis is a critique of neoclassical economics and its conceptualisation of money. His argument is that debt influences economic behaviour and that reflects the fact that economic transactions are based on the spread of time, so that many transactions are the exchange of present money for future money, with the result that in this period risk can become uncertainty. A Minskyan account of the 2007–08 crisis thus contends that ‘[t]he mortgage bundles, financial derivatives (such as futures and options trading) and other investment tools widely used by these investment funds involve a lot more Keynesian uncertainty than probabilistic risk’ (Whalen 2008: 102, original emphasis).

However, there is a neoliberal account of financial crisis which rejects neoclassical equilibrium, and this is derived from the work of Hayek. Hayek accepts that banks create money through credit provision, and argues that this process is further encouraged by central banks which provide liquidity as a lender of last resort. This credit expansion signals to each entrepreneur that real capital costs have fallen, and so this leads to further expansion on the basis of cheap credit, with the result that expansion continues on the basis of less saving and more borrowing and so a credit bubble emerges. At some point the bubble bursts and real fundamentals are restored through a slowdown and even a recession, which as we have seen, for Hayek (1976, 2008), should be allowed to take its course. While there appears to be some common ground between Minsky and Hayek, at least over the causes of crises, the similarity is superficial (van den Hauwe 2014). Minsky is proposing ‘a model of a capitalist economy that does not rely upon exogenous shocks to generate business cycles’ (Minsky 1992: 8), while Hayek’s view is based less on the internal workings of financial markets and more on the distorting effects of external factors. Once these factors are dealt with, the market will return to some kind of ‘normal state’, even though time, uncertainty and money (credit creation) rule this out (Davidson 1989: 468). Thus, as we have seen above, non-neoclassical neoliberal views of the crisis argue that the crisis was caused by factors such as social engineering by the US
state in housing, or by central bank policy. Hayek himself argued that central banks played a crucial role in generating crises because they acted as lenders of last resort, and so acted as a form of insurance for private investors, thus generating moral hazard. Before the 1970s, Hayek favoured central banks but he then shifted his position and argued for a free market in currencies (see Chapters 5 and 12). This is an argument to which we return below, as it goes to the heart of the neoliberal paradox.

For the moment, we should immediately emphasise that this discussion leads us back to the position that the crisis was not one of over-regulation but of under-regulation, and thus a crisis of ‘market fundamentalism’ (Roubini and Mihm 2011). However, this argument tends to set up a rigid dichotomy between the state, on the one hand, and the market, on the other, that neoliberalism itself sometimes tends to construct but which does not exist. In terms of housing, and specifically the US housing market, it is the case that government was heavily involved in the housing market in the US from an early period (see Thompson 2010, 2012; and from a Marxist position see Panitch and Konings 2009). From as early as 1918 (the ‘Own Your Own Home’ campaign), government encouraged home ownership, which continued into the 1930s (when Fannie Mae and the Department for Housing and Urban Development were created), through to the creation of Freddie Mac in 1970, and the targets that followed, to the passing of the Community Reinvestment Act in 1977.1 In particular Thompson (2012: 403) shows that while Fannie Mae and Freddie Mac were not early leaders in the purchase of sub-prime loans from primary lenders, nor in issuing MBSs on the basis of such loans, they were central to the purchase of MBSs as part of their investment portfolio. In 2008 Fannie Mae held in its portfolio predominantly sub-prime and Alt-A backed MBSs, and the demand for these securities was important, not least as the losses from these securities were central to the government takeover in September 2008. For this reason Thompson (2012) argues that it is problematic to blame neoliberalism for the 2008 financial crisis.

If neoliberalism is defined simply as the expansion of free markets, then this is indeed the case, but as should be clear by now, this is a problematic definition. As we saw in Chapter 7 in the context of the third way, government directives were issued in order to expand individual ownership of assets and thus the ‘free market’, above all in housing. This was part of a government project to extend home ownership, and so was about expanding and not distorting the market. In the words of George W. Bush (quoted in Payne 2012: 159) ‘[o]wning something is freedom, as far as I’m concerned. It’s part of a free society’.
The purchase of MBSs was thus the main way that both the Clinton and Bush administrations attempted to meet targets for expanding home ownership (Thompson 2012: 405). It was in this context that the likes of Greenspan and Bernanke failed to identify a bubble in the housing market because rising debt and falling savings took place at the same time as increasing wealth and ‘assetisation’ through home ownership alongside low interest rates. Credit markets were not restricted by government regulation; rather they were liberalised by government in order to allow (but not order) financial institutions to extend credit to consumers and homeowners. Government might play a role, but this was not to restrict or command private financial institutions; rather it was to encourage the full involvement of all of the population in both home ownership and the consumer boom. In terms of US minorities, these were the elements in society and in the economy that were deemed in most need of directing. Low home ownership was itself taken as a sign of unenterprising and, in the US, un-American habits of thought. Home ownership was a policy that could, in the minds of government, Americanise America, a country in which the proportion of ‘minorities’, especially Hispanics, and immigrants, was increasing. For Clinton and Bush, one can venture that this was a battle for what they perceived to be the soul of the country. (Payne 2012: 159)

Seen in this way the state project was neoliberal and attempted to incorporate marginalised groups through home ownership, while simultaneously promoting authoritarian law and order policies to punish those that failed to incorporate and chose instead the path of criminality (Wacquant 2009). This paralleled military intervention that was intended to deal with another set of neoliberal failures, that of failed and rogue states (see Chapter 7).

What is being suggested in terms of the first argument is that government did play a role in the US housing market, but this does not mean that government caused the financial crisis. The specific role of the US state is particularly important because of its capacity to generate overseas capital, especially from East Asia, and specifically Japan and China (see Panitch and Gindin 2012; Kiely 2015). Treasury Secretary Hank Paulson’s memoirs are particularly instructive for he argued that while the collapse of Bear Stearns was just about manageable, the collapse of Fannie Mae would have been a catastrophe because almost every financial actor in some way ‘owned their paper or was a counter-party. Investors would lose billions. Foreigners would lose confidence in the US. It might cause a run on the dollar’ (quoted in Thompson 2012: 406). Without state engagement with Fannie Mae, East Asian investors
(especially central banks) would never have loaned so much money to the US, and would not have entered the sub-prime and MBS markets without some implicit guarantee for their loans, something that became explicit in September 2008. This, in turn, allowed Fannie Mae and Freddie Mac to borrow at low rates of interest and then purchase assets with a greater yield (Schwartz, H. 2009; Thompson 2010; Kiely 2015).

This served domestic political purposes around expanding home ownership. However, again this is not a story of state imposition on reluctant private actors but rather a story of the state ‘setting such actors free’ from restrictive state legislation, and thus constructing neoliberal subjects. There were some fears throughout the 1990s and beyond that Fannie and Freddie were not being sufficiently monitored, but attempts to introduce closer scrutiny of their investment activities were not introduced. In particular, the Federal Housing Enterprises Financial Safety and Soundness Act in 1992 had a very weak regulatory structure, and the George H.W. Bush administration restricted SEC monitoring. In 2000 the Clinton administration supported legislation to curtail government insurance for their activities, and the George W. Bush administration made some attempt to introduce greater scrutiny following financial irregularities at Fannie Mae. However, none of these initiatives were effective and greater liberalisation (albeit with implicit government backing) was dominant. Fannie Mae lobbying was particularly effective in curtailing any restrictive regulation, as was what in effect amounted to a neoliberal ‘anti-racism’, in which concerns expressed about financial standards were sometimes dismissed as implicitly racist (see Thompson 2012: 413–15).

How then do we analyse the role of Fannie Mae and Freddie Mac in the crisis? Clearly the state did play some role in the crisis, but this is not the same thing as saying that it caused it. Relatedly, to explain the crisis in terms of a state–market dichotomy makes no sense at all, not least when it comes to considering the unique role of the US state in the international monetary order, and its ability to draw on foreign capital (see Panitch and Konings 2009). More directly relevant to our purposes, government intervention was designed largely to extend and expand the market, not to limit it. Payne (2012: 170) is again very useful when he states that ‘what is being problematized is not direct intervention in the economy, but the referencing of an imagined figure of the consumer that the government sought to foster and subsequently misidentified’.

Many of these points also apply to the question of the Federal Reserve and low interest rates. Many critics argue that the Federal Reserve kept interest rates too low for too long, although it should be pointed out that this is an argument made not only by neoliberals (Schwartz, A. 2009; White 2009) but also Keynesians (Stiglitz 2009). Ben Bernanke (2015),
The Chair of the Federal Reserve from 2006 to 2014, has argued that higher interest rates had only a small effect on adjustable rate mortgages. However, perhaps the more important question is, why did central banks do so much to limit any fall in asset prices (such as cutting interest rates in responses to the fall-out from the dotcom boom and bust and recession of 2001), but did nothing to curtail any rise in these same prices (Schwarz, A. 2009; White 2009)? Interest rate reductions occurred after 2001 and some neoliberals have argued that this was a major reason for the financial crisis, as it led to excess money which led to the housing bubble (Schwartz, A. 2009), but it is not clear how action to stop the latter would not have been accused of instigating the very state paternalism that neoliberals are at pains to reject. After all, the dominant narrative before the crisis – and one shared by neoliberals – was that any build-up in debts was compensated for by the rising value of assets (Payne 2012: 146–7). However, once the crisis hit, a new libertarian narrative emerged, which we consider further below.

The third argument made by neoliberals concerning the crisis is that the three credit ratings agencies (Moody’s, S and P, and Fitch) enjoyed the protection of the US state against competition from any potential new market entrants. Friedman (2009: 134) particularly identifies a 1975 ruling by the SEC, the result of which was ‘to licence the agencies to be sloppy, corrupt … or simply inaccurate’. The result of the state limiting competition was thus, in the long run, to promote ‘a perfect storm of ignorance’ (Friedman 2009: 134), and had greater competition existed, then financial investors would have acted on the basis of greater knowledge, but the action of the SEC in 1975 prevented this from occurring. This Hayekian argument differs from the Chicago acceptance of private monopoly but, more important, it is not clear how and why the existence of more agencies would have altered the behaviour of investors. As we will see, in some respects financial traders used the limits of their own knowledge in functionally useful ways once the crisis emerged (see Davies and McGoey 2012: 79–80).

DEALING WITH THE CRISIS: A CRITIQUE OF AUSTERITY

Neoliberal interpretations of the crisis are thus unconvincing. Nonetheless, neoliberalism in many respects strengthened after the crisis (Crouch 2011; Mirowski 2013), as some countries carried out programmes of austerity. Austerity is usefully defined by one of its leading critics as ‘a form of voluntary deflation in which the economy adjusts through the
reduction of wages, prices, and public spending to restore competitiveness, which is (supposedly) best achieved by cutting the state’s budget, debts and deficits’ (Blyth 2013: 2). The case made for austerity rests on a number of contentions, but it asserts that the private sector must lead the recovery and should not be crowded out by the public sector, and so governments should not run budget deficits. Keynesian stimulus policies can in this respect be regarded as harmful as they take money away from the private sector. Thus, according to the Chicago economist John Cochrane (2009): ‘Every dollar of increased government spending must correspond to one less dollar of private spending. Jobs created by stimulus spending are offset by jobs lost from the decline in private spending. We can build roads instead of factories, but fiscal stimulus can’t help us to build more of both.’

This kind of argument was developed further by a number of Italian economists, including Alberto Alesina, Francesco Silvia Ardagna, Francesco Giavazzi and Marco Pagano. Collectively their work combines ordo-liberalism and public choice theory. While Virginia and Chicago public choice theory suggested that democracy can have inflationary consequences, these authors argued that there was a close connection between democracy and government deficits. In particular, they argued that elected governments succumb to the temptation to run budget deficits in the knowledge that this becomes a problem for successor governments. Seen in this way, government debt is less a problem of economic business cycles, and more one of political electoral cycles (see Blyth 2013: 168; Helgadottir 2016). In terms of economic growth this is counterproductive, and the argument is made that spending cuts can increase growth by increasing confidence among investors and consumers (Giavazzi and Pagano 1990). Thus, Alesina and Ardagna (1998: 526) contend that ‘when spending cuts are perceived as permanent, consumers anticipate a reduction in the tax burden and permanent increase in their lifetime disposable income’. Based on an examination of 107 cases of positive and negative adjustment from 1970 to 2007, they suggested that 26 of these constituted cases of expansionary fiscal adjustment, defined as having above average rates of growth and a lower debt three years after adjustment (Alesina and Ardagna 2009). In 2010, an updated version was presented to the Economic and Financial Affairs Council of the European Council of Ministers (see Blyth 2013: 173). In this influential account, the authors recognised that the deficits and growing debt were largely caused by the financial crisis, but said that on this, they ‘have nothing to say’, and that whatever the cause of the crisis, the only solution is government cuts. Alesina and Ardagna’s work was cited by
the European Central Bank (ECB) and the UK Treasury's 2010 Emergency Budget, and Reinhart and Rogoff (2011) was also influential as was their claim that a government debt to gross domestic product (GDP) ratio of 90 per cent or above would have negative consequences for economic growth (see Krugman 2015). The argument here is that fiscal contraction can be expansionary because it allows the private sector to lead the way out of the crisis. This is in part a question of confidence, but an additional and compatible case is often made that high government deficits can only be financed by high interest rates, which will also undermine recovery. This version of austerity is not averse to using monetary policy – including low interest rates and (possibly) quantitative easing – to help aid the recovery, but it argues that fiscal policy is counterproductive because it simply transfers wealth from the private sector to the public sector, and its inflationary consequences will lead to high interest rates (Ferguson 2009).

Much of the debate on austerity is rooted in the management of the Eurozone crisis. As we saw in Chapter 7, the formation of the Eurozone area was followed by a boom in which the peripheral states benefited from massive lending by European banks, but these loans were found to be worthless when peripheral states, and Greece in particular, threatened default on their debts. Faced with higher interest rates, Greece, and then Ireland and Portugal, received bail-outs from the troika (the ECB, the European Commission and the IMF) and from bilateral loans. Similar to the Latin American debt crisis of the 1980s, these bail-outs came with conditions such as spending cuts and tax increases. This came to be seen as a crisis caused by the debtors and, more specifically, by their excessive government spending policies, and on this basis austerity was said to be justified.

The comparison with Greece was central to the British coalition (2010–15) government's initial policies of austerity, as supposed overspending by the previous Labour government was said to be the causes of Britain's financial crisis. Thus, newly elected British Prime Minister, David Cameron, stated in 2010 that 'Greece stands as a warning of what happens to countries that lose their credibility, or whose governments pretend that difficult decisions can somehow be avoided' (cited in Krugman 2015: 16). The Conservatives had committed themselves to Labour's spending plans before the crisis (Conservative Home 2007). We will also see that, more convincing in the case of Britain, is that the fiscal crisis was the consequence and not the cause of the crisis, and this point applies also to the euro crisis. This does not mean that there were no problems with specific areas of government spending and revenue collection, particularly in Greece where the latter was poorly coordinated.
and debt to GDP ratios were much higher. Nonetheless, while Ireland’s debt to GDP ratio was just 12 per cent in 2007 and Spain’s was 26 per cent, Germany’s stood at 50 per cent (Blyth 2013: 65).

Why did the Eurozone crisis come to be seen as a fiscal crisis of the state? The answer lies in the way that the euro worked, and why the boom unfolded from 2008–10 onwards. As we saw in the previous chapter, the boom occurred in part because investors flooded money into the Eurozone periphery to take advantage of small differences in bond yields, which became significant differences when these bonds were purchased on a massive scale. Some of this might be explained by herd behaviour, but it was also clear that Greece was not as secure an investment as Germany, but it was more lucrative, and so it might make sense to purchase so many bonds that there would be no choice but to bail out investors if their assets became worthless. This is because, as Blyth (2013: 81–2) points out:

If you were not bailed out, given your exposures, cross-border linkages to other banks, and high leverage, you would pose a systemic risk to the whole European financial sector. As such, the more risk that you took onto your books, especially in the form of periphery sovereign debt, the more likely it was that your risk would be covered by the ECB, your national government, or both. This would be a moral hazard trade on a continental scale.

For this reason it made perfect sense for any single individual bank to in effect trade in ‘moral hazard’. The problem though was that:

While bank lending and borrowing may be cross-border in the Eurozone, bank resolution and bailout responsibilities ... are still national. So, while any individual bank could play this moral hazard trade, if they all did it, all at once, then what was individually too big to fail became very quickly too big to bail as a whole. Once again the dynamics of the system were different from those of the sum of the parts. (Blyth 2013: 82)

The scale of the problem can be seen if we compare the assets of the top six US banks in the third quarter of 2008 – which amounted to 61 per cent of US GDP and were thus rendered too big to fail – with European finance, and how this impacted on specific nation states in Europe. In France in 2008 the assets of the top three banks amounted to 316 per cent of French GDP, while in Germany the figure was 114 per cent of German GDP. Deutsche Bank alone had assets equivalent to 80 per cent of GDP. Outside the Eurozone, the top four banks in Britain had assets which amounted to 394 per cent of British GDP (Blyth 2013: 83). Banks acquired much of this money through short-term borrowing and by June 2011, $755 billion of the $1.66 trillion in US money market finds was
held in the form of short-term European bank debt. European banks were also heavily exposed to US mortgage markets, and when this combined with the sovereign debt crisis from 2010, banks found that they were unable to fund themselves through further short-term borrowing. This was exacerbated by falling asset prices and so banks had to put up more funds as collateral for further loans. By 2010, Eurozone banks had a collective exposure to Spain of $727 billion, $402 billion to Ireland, $206 billion to Greece, and it has been estimated that French and German exposure to the ‘PIIGS’ (Portugal, Ireland, Italy, Greece and Spain) was close to $1 trillion (Blyth 2013: 86).

Austerity is thus a policy designed to ensure that these exposed financial institutions continue to receive income on loans that have gone bad. However, it is ultimately self-defeating. In May 2010 Greece received a €110 billion loan in exchange for a 20 per cent cut in public sector pay, a 10 per cent pension cut and tax increases. The troika forecast a return to growth by 2012, but instead Greece received a further bail-out in July 2011, which was extended in October 2011. Ireland and Portugal also received substantial bail-outs which were subject to similar conditions. For most countries in the Eurozone, the threat of widespread default declined, once the ECB started to act as a lender of last resort and purchased bonds from issuing countries such as Spain (Gamble 2014: 180).

This brings us back to the question of the effectiveness of austerity. Those making the case for austerity are suggesting that there is too much debt and individuals, governments and companies are living beyond their means. As with all good households, there is a need for these over-spenders to deleverage and deal with their debts. For those advocating austerity, this means that public spending cuts are inevitable and this must eventually mean a challenge to the principle of universal welfare, because upholding such a principle means that government spending is potentially unlimited, especially as populations grow older (see Gamble 2016). We have seen in previous chapters that since the 1980s, governments have attempted to deal with this problem through effective cuts to, and greater conditions placed on, individual benefits, but none have been completely successful in undermining the principle of the welfare state – indeed aggregate welfare spending has increased in the neoliberal era. This argument suggests that austerity is a political project designed to further undermine the principle of universal welfare. It has negative consequences in terms of distribution, as it is lower-income groups dependent on welfare who are expected to suffer the main costs of austerity, even though they might have benefited the least in the run up to the crisis. Those advocating austerity might suggest that this is a
regrettable necessity, arguing, in the words of the critic, Mark Blyth (2013: 7), that ‘you cannot cure debt with more debt’. However, he then goes on to ask a further question, namely, ‘what happens if we all try to pay back our debts at one time?’ ‘we cannot all cut our way to growth at the same time’ (Blyth 2013: 7, 8). That is, the paradox of thrift suggests that while it makes sense for any individual debtor to pay back its debts, it makes no sense for all to do so as this would lead to stagnation. It was for this reason that Keynes made the case for fiscal stimulus, because in the context of everyone cutting back, recovery would be delayed, something that would carry both social and economic costs. That is, the state – or the macroeconomy – is not like an individual household, precisely because of the interconnections and interdependencies between individuals, corporations and government (Gamble 2013). Fiscal expansion is thus necessary to deal with shortfalls in demand and is not ‘crowding out’ private investment. Indeed, it is a supplement to, and a stimulus for, such investment (Keynes 1973: 217–18). We might go further and actually suggest, in contrast to Keynes, that the assumption that the private sector is productive and the public sector unproductive is untrue at all times, and not just in a recession or slump. As Gamble (2014: 166) argues:

Seeing this as a deduction from private income is an ideological fiction because private wealth could not be preserved without the public framework of law and security, and also because so much public spending takes the form of purchases from private companies or raises the productivity of the economy through investment in human capital or in infrastructure or in the science base.

These kinds of arguments have also dominated the debate on austerity in both the US and the UK. In the US, the debate was largely about whether or not fiscal stimulus policies have worked. President Obama’s fiscal stimulus was criticised as insufficient by Keynesians and unnecessary and counterproductive by those favouring austerity, and this led to confrontations in Congress in 2011 and 2013. Rather than balancing the budget, the Reagan era saw an unprecedented expansion in deficits and the national debt, which increased further under George H.W. Bush and especially under the George W. Bush administration (Chapter 6). Echoing the arguments of those favouring austerity, Republicans argued that there was a need for public spending cuts, but the burden for these should be placed on welfare, rather than defence, and that tax increases on the rich would undermine wealth creation. Thus the Ryan Plan (House Committee on Budget 2011), led by 2012 Vice-President candidate Paul Ryan, proposed a cut in US federal government spending from 22 per cent to
17 per cent of GDP, with protection for defence and Medicare. Had it been implemented this could have meant the end of all other government programmes (Wolf 2012). The Tea Party, which emerged as force in the Republican Party around 2007–08 (Skocpol and Williamson 2012), called for even bigger cuts, while the libertarian Cato Institute adapted the Laffer (now Rahn) curve and argued that there is a causal relationship between public spending to GDP ratios and the rate of economic growth, and specifically argued that if government spending rises above 15 to 25 per cent of GDP, then this adversely affects economic growth (Mitchell 2013). In this conservative vision, US debt is essentially an exploding time bomb that might go off at any time. The government overload thesis of the 1970s has been replaced by a right-wing version of the fiscal crisis of the state.

For much of the libertarian right, and above all the Tea Party, austerity meant rejection not only of the fiscal stimulus, but the monetary stimulus too. Here we again see the difference between the monetarist view of the Depression, which argued that the US should have pursued a policy of cutting interest rates and of quantitative easing (Friedman and Schwartz 2008; Bernanke 2015), and the Austrian view that a slump was necessary so that resources could be properly reallocated and all the toxic assets could be purged from the system. In the words of US Treasury Secretary Andrew Mellon, in response to the crisis in the early 1930s, ‘Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate’ (Ahamed 2011: 364). Seen in this way a short, sharp slump would represent a process of creative destruction (Schumpeter 2012: 81) by which capitalism would renew itself by purging inefficient and uncompetitive entrepreneurs. Government intervention – monetarist or Keynesian – has the effect of protecting the inefficient and sending the wrong price signals to the efficient, and so it only delays the crisis. Thus, Ben Bernanke’s proposal to expand quantitative easing in 2011 was dismissed as treasonable by prominent conservative Republican Rick Perry (McGreal 2011).

It was in this climate that attempts were made to limit fiscal stimulus by raising the amount of debt that could be raised by the US government. Although this had been consistently raised by previous administrations, and above all Reagan and George W. Bush, Republicans in the House of Representatives attempted to use this as a weapon against Obama in both 2011 and 2013. If this had been successful, then the US would have defaulted on its loans, throwing both the US and the world economy into turmoil. Although last-minute deals were made, and debt ceilings raised, conservative Republicans had successfully used it as a weapon, through the passage of the Budget Control Act 2011, to force a retreat on
Obama’s part on the question of tax increases for the wealthy, and the implementation of some spending cuts, as well as major concessions around Obamacare. It can be argued that government spending did not rise fast enough to promote recovery, and from June 2009, it took 51 months for employment to reach its pre-recession peak. Per capita government spending was actually 3.5 per cent lower in the first quarter of 2016 than it was 27 quarters earlier, at the height of the recession. Twenty-seven quarters on from the early 1990s recession, per capita government spending was 3 per cent higher; for the 2000s recession, the figure (23 quarters on) was 10 per higher; and for the early 1980s, the figure was (27 quarters on) 17 per cent higher (much accounted for by defence spending) (EPI 2016: 5). Furthermore, previous recessions allowed more scope for monetary policy through interest rates cuts, but in the context of low interest rates by 2009, this tool was not as effective in the post-2008 years.

The UK is in many ways the most interesting case, because after 2010 there was a coalition government ostensibly committed to austerity, and from 2013 onwards some major claims were made for the link between this supposed austerity and growth rates in the country. We have already seen that Prime Minister Cameron compared the situation in Britain to Greece, even though the former has its own currency. Nonetheless, in 2010 the new government implemented an emergency budget because it was suggested that Britain was facing the prospect of a new financial crisis owing to its high budget deficit. Similar sorts of claims were made in the 2015 election campaign. Comparisons were made with Greece and the respective budget deficits of the two countries, both of which were around 11 per cent of GDP in 2010 (although Greece’s was subsequently upgraded to 15.7 per cent). There was, however, a crucial difference, namely, that that maturities were shorter and interest payments higher on Greek bonds while the UK paid lower rates and had longer average maturity rates. This is not surprising given that Greece was part of the euro and Britain, with a floating exchange rate and its own central bank, was not. Nonetheless, Chancellor Osborne said much the same thing and cited Reinhart and Rogoff’s now discredited argument concerning negative growth when public debt reached 90 per cent of GDP (Moore 2013). Similarly, the claim was made that the Labour government’s spending was a major cause of the financial crisis in 2008. As we have seen, New Labour was far too accommodating of a growth model which rested on the growth of the housing market and financial sector debt, and in the process overestimated the tax revenue that could be collected from growth on this basis, especially when the financial crisis occurred. However, this is not the same as arguing that Labour caused the crisis by...
over-spending. The public debt to GDP ratio was 37 per cent on the eve of the financial crisis, while in 1997, when Labour entered office, the figure was 42 per cent. In 1997 the budget deficit stood at 3.9 per cent of GDP while in 2008 it was 2.1 per cent (Weeks 2012).

Whatever the political hysteria in 2010, it has also been argued that from 2013 onwards, Britain experienced high rates of growth and this was a consequence of the sensible austerity policies of the coalition government. As one supporter of austerity argued, in 2014 the UK had the highest rate of growth among the G7 countries of 2.6 per cent, and a lower unemployment rate than leading European competitors such as France and Italy (Ferguson 2015). Figures such as these are then used to discredit the supposed Keynesian argument that in the absence of a fiscal stimulus, economies will always be stuck in a slump. Thus, in the words of Chancellor George Osborne (2013):

> Proponents of the ‘fiscalist’ story cannot explain why the UK recovery has strengthened rapidly over the last six months. The pace of fiscal consolidation has not changed, government spending cuts have continued as planned, and yet growth has accelerated and many of the leading economic indicators show activity rising faster than at any time since the 1990s.

There are a number of issues here. First, the coalition government always talked a much stronger language of austerity than they actually practised. The Emergency Budget of 2010 actually delayed already planned spending cuts (Weale 2010). In practice, government expenditure (at constant prices) showed a slight increase in 2010–11 and a small decrease in 2012–13, but for 2013–14, government spending still amounted to 41.2 per cent of GDP (Wren-Lewis 2015a: 11). In a recession, it is expected that government spending will increase owing to greater reliance on welfare, but also in the case of a fiscal stimulus owing to the shortfall in investment from the private sector. What the data on spending shows is that in the first two years of the coalition there was not a fiscal stimulus, and in so far as there was austerity, it was real but not as great as that which took place in the Eurozone, where the consequences were disastrous. Nonetheless, there were important cuts from 2010 in school building, capital expenditure and flood prevention (Pearce 2013). There was also increased pressure to cut welfare benefits for individuals, but as we have seen, this was hardly new and had taken place since the 1970s. The Office for Budget Responsibility has estimated that austerity, in 2010–11 and 2011–12, even in this mild form, led to a reduction in GDP of around 1 per cent each year, and this seriously undermined the recovery that had begun to take place in early 2010 (Wren-Lewis 2015a:
In the 2010 plans for austerity, it was envisaged that the budget deficit would be reduced from 7.5 per cent of GDP in 2010–11 to 5.75 per cent in 2011–12, 4 per cent in 2012–13, 2.3 per cent for 2013–14, less than 1 per cent by 2014–15 and zero by 2015–16. In fact, while the 2010–11 target was more than achieved, by 2011–12 the target was not met and in 2012–13 the actual figure was 5 per cent and in 2013–14 it was 4.24 per cent, around 2 percentage points higher than the original plan (Wren-Lewis 2015a: 10). In terms of percentage points, by 2014 the UK’s deficit was around twice that of Greece. That is, there was a slowdown in the pace of deficit reduction, which was a product of lower than expected tax receipts, which in turn was a product of the fact that wage growth was negative. The response of the government was not to introduce more cuts or raise taxes, but rather to ignore their deficit targets. This begs the question of why the panic in 2010, and then the relaxed attitude just over two years later. There was a moderate recovery in 2013, but this clearly cannot be explained by a commitment of the government to meeting its deficit targets set in 2010, even though these had been deemed essential in 2010. The government did not meet the targets set by the Labour Party in the run up to the 2010 general election (Arestis and Sawyer 2014). At the same time the government, elected on a promise to provide a much needed rebalancing of the British economy (Conservative Party 2010), did introduce a prominent stimulus measure, namely, the Help to Buy scheme designed to re-boost the housing market. This was partly designed to lead to various multipliers, especially in terms of boosting the construction industry, but equally it showed how the government was essentially committed to the continuation of the Anglo-American growth model discussed in Chapter 7.

In terms of the debate over austerity in Britain, we can observe that in the period 2011–12 when austerity was most acute, there was no growth in per capita GDP. We also observe that in the period from 2010 to 2015, inflation-adjusted weekly earnings fell at a higher rate than in any period of government after 1945. After 2013 there was a slow recovery, which was stronger than in Europe, but austerity was much stronger there. This is not to say that lighter austerity caused the recovery, but it is to say, contrary to those advocating austerity (Ferguson 2015), that recovery cannot be explained by austerity (Wren-Lewis 2015a). Finally, the argument that Keynesians believe that in the absence of stimulus there will be never be a recovery is simply false. The argument is rather that in the absence of government action, economic recovery will occur at a lower level than would otherwise be the case (Keynes 1973). Much of the debate is therefore about the strength and sustainability of the recovery. Here we could do worse than recall the words of Chancellor George
Osborne in 2010, when he stated that ‘we cannot go back to the last decade’s debt-fuelled model of growth’ and argued that there is a need for recovery based on ‘an internal and external rebalancing of our economy: in other words a higher savings rate, more business investment, and rising net exports’ (cited in Berry 2013: 10). Similarly the Conservative Party Manifesto of 2010 argued that ‘A sustainable recovery must be driven by growth in exports and business investment, and through a better environment for wealth creation’ (Conservative Party 2010: 21). This attempt at rebalancing was quietly abandoned once the coalition entered office, and much of the recovery focused on the financial sector and the housing market, and in terms of geography, London and the south-east. Furthermore, after 21 quarterly economic figures that followed the bust of 2008, GDP per capita was still 7 per cent below its pre-recession peak (Berry 2013: 15). Finally, while the unemployment level did not increase, the UK had a high rate of underemployment, whereby just less than one-fifth of part-time workers reported working part-time as they could not get a full-time job (Berry 2013: 18). In many respects, the debate on austerity in Britain has distorted the bigger picture, not least when we consider that all of the major parties were committed to austerity by the time of the 2015 general election. What is clear is that recovery from 2008 has been slow, with productivity stagnant and income growth slow, and for all its criticisms of New Labour before it, the coalition in many respects attempted to continue a growth model based on the expansion of the financial sector and the housing market. The government of 2015 initially committed to a more consistent and painful process of austerity under the Chancellor George Osborne, and indeed to budget surpluses in times of economic normality. However, the Brexit vote in June 2016 led to the dismissal of Osborne and the quiet dropping of any budget surplus targets, and austerity was quietly abandoned as respectable government strategy following the June 2017 election.

None of this meant that there was no government action. Selective austerity involved an increase in government attempts to get individuals to behave in ways expected of the neoliberal subject. This involved, for instance, a ratcheting up of the workfare schemes developed by New Labour and the increased use of private companies in running such programmes. These workfare policies could not however hide the reality that:

[t]here is no evidence that work programme psycho-interventions increase the likelihood of gaining paid work that lasts any length of time. In perpetuating notions of psychological failure, they shift attention away from the social patterning of unemployment and from wider trends: market failure, precarity,
the rise of in-work poverty, the cost of living crisis and the scale of income inequalities. (Friedli and Stearn 2015: 45)

According to the British Department for Work and Pensions own data, from December 2011 to February 2014, 2380 people died shortly after their claim for employment and support allowance (ESA) ended because a work capability assessment (WCA) found they were found fit for work (Butler 2015). This figure does not establish clear causality in these cases but it is reflective of widespread concern over disability assessments carried out by private companies Atos and then Maximus, and the shift to a more overtly punitive neoliberalism under austerity (Gentleman 2011). Similar developments occurred through the Troubled Families Programme, another example of punitive neoliberalism carried out by the ‘exhorting state’. Introduced by the coalition government, this was an attempt to regulate the behaviour of poor, ‘troublesome families’ who were deemed to be a financial burden on the state in the context of welfare spending cuts. Low-income, low-qualified families were targeted and local authorities paid initial sums to deal with these families and then made further payments on the basis of results. Interventions focused on getting absentee children back to school. The issue in this case was not necessarily intervention per se, but the way in which the programme assumed that poverty was a behavioural rather than structural problem, and that while ‘it is the City of London and the failure of austerity-led growth that cause high public debt levels, but it is troubled families that require policies in order to get public finances in order’ (Tepe-Belfrage and Montgomerie 2016: 91). Women in particular were targeted, and this reflected a more general trend in which the impact of austerity is highly gendered, with women workers more affected by public sector cuts in Britain (Fawcett Society 2012), by the impact of austerity on households, by the fact that women and specifically poorer women (Pearson and Elson 2015) are more likely to be dependent on public and welfare services, and by an increase in household stress levels and an associated increase in domestic violence (Hozic and True 2016).

NEOLIBERAL RENEWAL I: THE CRISIS AND THE REALITY OF REGULATION

There are additional arguments however around neoliberalism that we need to consider, which relate to all of the cases discussed, and more specifically the question of the euro, Britain and regulation, and the US and central bank and housing market interventions. What is clear in all
these cases is that while the causes of the crisis undermine neoliberal assumptions, equally there are neoliberal arguments which suggest that the crises were caused by market distorting interventions and thus too little rather than too much neoliberalism (Booth 2012).

In the case of the euro, we might identify the existence of other forms of moral hazard in the form of risks being covered by national governments and the ECB, and even the formation of the euro currency itself (Friedman 1997). For the euro project was always hindered by a specific contradiction, namely, the fact that

at some stage the members of the Eurozone would be forced to choose between on the one hand a move to fiscal union and the creation of a political authority to stand behind the currency, and on the other hand an abandonment of the single currency and a return to national currencies. (Gamble 2014: 180)

Seen in this way, the crisis was not caused by private investors but by external interventions that led to the wrong price signals for such investors. Alternatively, the deflationary pressure put on peripheral members of the Eurozone, including those that have seen some relief from ECB intervention, closely parallels the austerity that existed between the wars, which in part was a product of the gold standard. As we saw in Chapters 2 and 3, the decision of countries to come off the gold standard was a cause of regret to neoliberals in the 1930s, who (correctly) saw that this gave government the freedom to pursue expansionary policies, thus laying the basis for the rise of Keynesianism (Helgadottir 2016: 397). For those countries in the Eurozone periphery, in the absence of exit from the euro, it appears that the only possibility is for unit labour costs to decline to such a level that their products can compete with those in the core countries. This is almost as unlikely as those structural adjustment programmes in the 1980s which were in part premised on the belief that African labour could compete on the basis of lower labour costs with the core countries, an argument that led one critic to suggest that this would mean that African workers would have pay their employers a wage to compete in the world market (Leys 1994).

This did not prevent the claim being made that Ireland was the ‘model’ for austerity in the Eurozone following the crisis of 2010. In particular it has been argued that Ireland has pursued the correct ‘economic policy priorities’ of macroeconomic stability, and cost competitiveness through real wage cuts and cuts on government spending (European Commission 2016). The argument is that any contraction in domestic demand is more than offset by export growth, which comes about through cost-cutting policies which restore competitiveness. However, export-led growth after
2010 in Ireland was led by the information technology (IT) service sector, where wages did not fall but rose, as opposed to the rest of the economy. This reflects a long-term strategy on the part of the Irish state in attracting foreign investment in the IT sector and the corporate strategies of predominantly US multinational companies. In terms of the former, the Irish state has not simply promoted labour market flexibility in this sector, but has instead included industrial development strategy, fostered over decades and thus is hardly a model for others to follow. Moreover, multinational companies (MNCs) have themselves tended to cluster in Ireland, encouraged by Irish state policies (Regan 2016). Such companies have also benefited from low taxation, but on its own this cannot explain the decision of firms to cluster there. Moreover, the fact that MNCs do open their books in Ireland has had the effect of exaggerating the degree of recovery there, for to some extent this has acted as an accounting mechanism (Regan 2016). Furthermore, the degree of austerity in Ireland has been far less than that of, say, Greece (Wren-Lewis 2015b).

A related argument concerning regulation can be derived from the British case. As we saw in Chapter 6, in many respects the British as well as the American ‘growth model’ from the 1990s until 2007–08 can be described as neoliberal. However, it is also clear that this was an era of regulation, not just in the case of acceptance and reform, rather than full-scale privatisation of, the public sector, but also in terms of regulation of financial markets. Thus, in June 1998, the Financial Services Authority was created, designed to protect the consumer purchasing financial products. From a ‘spontaneous neoliberal’ perspective, it might be asked, why was this organisation necessary when the consumer was sovereign (Benston 1998)? Even if there was information asymmetry between purchaser and provider of a financial product, competition was sufficient protection as consumers could exit and move to a more efficient supplier, they could insure against losses incurred in particular transactions, and regulation was an expensive exercise met by the taxpayer (Lodge and Williams 2002). As in other sectors, regulation betrayed an outmoded paternalism in which the state, rather than the sovereign individual, was said to know best.

However, as was argued in Chapter 7, regulation was designed less to restrict the market and more to expand the market and ensure that sufficient information existed to allow financial services customers make informed decisions about their choices. According to Watson (2013: 19), the Financial Services Authority ‘adopted a risk-based approach when assessing the viability of the banking structure over which it presided, but in doing so merely mimicked the methods used by the banks it was
meant to be regulating when they assessed their own exposure to adverse market trends'. This was more a case of setting the general rules for financial markets to operate, closer to Rougier’s highway code analogy (Chapter 3) than to any notion of letting the state determine consumer decisions. There was at the time some awareness that household debt was rising in proportion to disposable income, but this was dismissed. According to Monetary Policy Committee member, Stephen Nickell, speaking in 2004, ‘it is said we are living in the middle of a long-lived consumption boom in the UK funded by a tidal wave of debt … this statement is more or less completely wrong’ because ‘the increasing rate of accumulation of debt has been closely matched by the increasing rate of accumulation of financial assets’ (quoted in Payne 2012: 141). Seen in this way, the warning signs of an under-pricing of risk were ignored because current prices had to reflect the investment and savings preferences of sovereign consumers operating in financial markets (King 2006).

For as Payne (2012: 142–3) notes:

If value ultimately stemmed from the individual subjective assessment of demand then unless one could prove that those making the assessment were somehow infected with irrationalism … who could say that anything was not the right value? Instead all government could do was to protect consumer-entrepreneurs, that is, wealth owners, from another, potential irrationalism: debt deflation.

From this point of view, even the bail-outs and nationalisations were compatible with neoliberalism in its constructivist form. We have already noted the bail-outs and nationalisations that took place in Chile in 1982 and 1983 (Chapter 6). Those that followed the 2008 crisis did undermine some of the arguments made by those advocating neoliberalism, but at the same time the policies themselves were designed to save and reconstruct the neoliberal growth model, including that associated with the New Labour government. Writing in the British context, Watson (2013: 18) argues that:

By stepping in to assist responsible worker-saver-investor-subjects, New Labour sacrificed its reputation for economic governing competence in allowing the public finances to spiral out of control. Yet it placed itself in this position in the first instance only because its understanding of responsible macroeconomic policy required it to lecture the population on the advantages of welfare self-sufficiency and to promise to protect accumulated wealth with public money in the interests of such self-sufficiency. Its own account of what a responsible government is required to do to promote responsibility in its welfare citizens therefore had a self-destruct button contained within it.
At the same time, however, there is a close parallel between the reality of state regulation and financial modelling before the crisis, and bail-outs and austerity after it. Moreover, these shifts reflect wider tensions within neoliberal theory over the status of knowledge. This represented a shift from a Chicago emphasis on neoclassical economic experts to a Hayekian retreat back to the limits of knowledge. The 2008 crisis was a crisis of knowledge, for the indicators that were supposed to measure the quality of bundles of assets became worth what market players believed other market players would believe other market players would believe they were worth, and so on. What was being traded was not even the indicators, but a whole chain of beliefs about what others might believe about the indicators. (Crouch 2016: 93)

In this way the market price did not send anything like the correct signals and led to a crisis of trust between financial institutions based on heightened uncertainty, but this very uncertainty helped to revitalise the neoliberal project, because it allows neoliberalism to have both, for ‘what is worth stressing is the sheer usefulness of unknowns to those alternately stressing the infallibility of models for predicting risk and then calling attention to the fallibility of those same models when things go wrong’ (Davies and McGoey 2012: 73). One result of this was that financial actors ‘were always able to claim just enough knowledge to retain power within the system, but just enough ignorance to evade responsibility’ (Davies and McGoey 2012: 73). Alan Greenspan identified a ‘flaw’ in mainstream financial models and saw this as central to the financial crisis (see Gamble 2009), in which he argued that liquid markets and risk managers would be incapable of mispricing risk. Post-crisis neoclassical theory has thus largely concerned itself with the search for greater transparency in markets (Booth 2009) to enable risk-modelling to take place, and there have been a number of attempts to prop up the neoliberal order by reconstructing the neoliberal individual, and we return to this question in the final chapter.

NEOLIBERAL RENEWAL II: POLITICS AS SCAPEGOAT, POLITICS AS NECESSITY

The question alluded to above concerning moral hazard is ultimately about neoliberalism’s utopian attempt to eradicate politics, a doomed and self-contradictory project, but which paradoxically helps to sustain neoliberalism in practice. We have already seen that neoliberalism always has an answer to the question of what caused the crisis, and this is
because the state is always present. This allows neoliberalism to make the leap from a conservative defence of law and order, to a libertarian critique of the interventionist state. It is as if the state’s economic presence is always irrelevant in the cases of a boom but always causal in the case of a crisis. This is true not only in 2008, but also in other instances. For example, in the 1997–98 financial crisis in East Asia, the blame was placed firmly on crony capitalism (see Chang 2000), while only a few years before, the neoliberal argument was that the state was irrelevant to the boom in that region (Lal 1984; World Bank 1993). In the 2008 financial crisis, we have state pressure to expand home ownership (and thus implicit guarantees to government sponsored enterprises), state backing for credit ratings agencies or state misallocation of resources through central bank policy as explanations for the crisis (Wallison 2009). This argument is all the more ironic for, in 2004, Wallison himself said that ‘in recent years, study after study has shown that Fannie Mae and Freddie Mac are failing to do even as much as banks and S&Ls in providing financing for affordable housing, including minority and low income housing’ (quoted in Konczal 2013). What this amounts to is an argument that government-sponsored enterprises were artificially restricting the market before the crash, but at the same time, they were responsible for the crash because they artificially expanded the market.

Nonetheless, the state is indeed always present and this means that the ‘pure market’ does not exist. This might be considered a problem because the principle of methodological individualism or of true self-entrepreneurship is never fully instigated. Thus, in the final argument about the crisis, we have those holding mortgages not being fully responsible for their debts because they can simply walk away from their mortgages (although they do lose their homes). All these principles reflect the fact that the individual entrepreneur is ultimately insured in some way by the government, and so they cannot be fully responsible for their actions, and this is why there ‘has never been a neoliberal world order’ (Booth 2012). Even in the case of liberal banking systems, such as in the US and Britain, there are guarantees for depositors and so this means that investors and savers are not fully responsible for their actions. In free societies, individuals are free to purchase goods, some of which they may do as investments, but they have no guarantee that such purchases will increase in value. There are issues here around state guaranteed safety standards and contract law, which again reflects the difficulty of establishing a clear boundary between state and market, but that need not concern us here. What does need stressing, however, is that in the case of money, the principle is different. If savers choose to invest in a bank, there are safety valves in the form of government guarantees should lenders fail or
borrowers default, including mortgage holders. If we are to take the
individual entrepreneur as the true champion of neoliberalism, then such a
person is not fully entrepreneurial. As Payne (2012: 171–2) shows, this
problem lies at the heart of Friedman (1965) and Hayek’s (1976) proposals
to effectively de-socialise money, and put in place a system of 100 per cent
reserve money. Friedman argues that this can occur through a system in
which central banks have to hold government bonds as reserves against all
lending, buying them when necessary. Hayek argues that the government
monopoly over the issue of notes and coins should be abolished, and
instead financial institutions should compete for consumers to use their
currency. A free market in currencies would incentivise consumers to insist
that there were always reserves from which they could redeem their
money, so that deposits and currency would effectively match each other.
This would have the effect of de-socialising money because at any one
time all individuals could receive all of their deposits, as opposed to a
system in which notes and coins only cover around 10 per cent of deposits.
In this scenario one bad loan would have no knock-on effect which might
undermine confidence in a bank and cause a run on its reserves, which
would lead to losses not only for bad but also good depositor-investors.
This was precisely the problem faced by neoliberals when it came to the
government bail-outs in autumn 2008 because, on the one hand, these were
necessary to protect good as well as bad investors (in so far as anyone
could distinguish the two) but, on the other, it promoted precisely the kind
of paternalism and moral hazard which neoliberals (inconsistently) chal-
lenged. Such a ‘state of market exception’ (Davies 2013) allows for
bail-outs, but it is an exception

which activates patterns of normalization. In such situations, even as we are in
the dark about the specific origins of the problem, it is often perfectly clear
what must be done: we must protect the banks, the nodal points of our
investments. In the context of profound uncertainty about the future, there is
certainty as the only possible course of action. (Konings 2016: 283)

At the same time however, we also have neoliberal renewal as the
bail-outs are criticised and the case made for creative destruction, in
which all the bad investments are cleansed from the system, which lays
the ground for austerity. These positions closely paralleled Hayek’s
(1976) shift from an early understanding of crisis which recognised the
role of banks in the creation of money credit, to where the state simply
undermines both money and the market order, and therefore calls for the
end of state central banking. If money was de-socialised in the ways
envisioned by Hayek, then:
[n]o longer would the government have to step in to rescue good depositors and in the process rescue ‘bad’ ones. De-socialising money would force each and every member of the population, as an entrepreneur and consumer of money, to take personal responsibility for his or her own money, ensuring either that savings were warehoused securely (for an appropriate fee) or allocated to a financial intermediary offering consumers a choice of investments, none of which would have government insurance. There would be no recourse to government if a bank made bad lending decisions with consumers’ deposits. (Payne 2012: 172)

What is envisaged is a situation in which moral hazard is eliminated and each individual takes full responsibility for their actions. Herbert Spencer (cited in Kindleberger 2000: 46) described moral hazard as the ‘ultimate folly of shielding man from the effects of folly’, the effect of which ‘is to people the world with fools’. In terms of the specifics of de-socialising money, Keynes argued that this would lead to an excess of savings as individuals would be reluctant to invest in a situation of excess uncertainty, including in the purchase of homes. That is, risk and uncertainty would be so great that investment would not occur in the first place. This point can be extended to the broader argument, which goes to the heart of the neoliberal paradox, which is that the division of labour – and indeed of knowledge – means that it is impossible for each individual to be completely responsible for their own actions. Full responsibility could only take place in a society with no division of labour, in which private property might exist (for everyone) but in which the products of such private property could not be exchanged through a market. It is impossible to abolish reliance on others, and the de-socialisation of money cannot eliminate interconnectedness. The history of capitalism has been accompanied by the socialisation of risk, which does carry the risk of moral hazard, but the absence of which carries far greater social risks (Chang 2000). The rise of limited liability, central banking and deposit insurance have been central to the rise of large-scale corporate investment (and thus modern industrialisation) and the modern banking system, and while they may be convenient scapegoats for neoliberals in times of economic downturn, they have also been central to the development of modern capitalism.

CONCLUSION

This chapter has detailed how the financial crisis of 2007–08 onwards served to undermine, but in some respects reinvigorate, neoliberalism. The crisis was a product of the financialisation that took place in the
period after the collapse of Bretton Woods, and especially in the 1990s onwards. However, the state was always present, and with it regulation of markets. It is this fact that allowed neoliberalism to lay the blame on exogenous factors, and thus argue that institutional factors distorted free markets. Nonetheless, the crisis still presents enormous problems for neoliberalism. In particular, ‘the enormous short term gains that could be made – both by individual traders and by the banks for whom they were working – were so vast that it ceased to be rational to have such professional long-term concerns’ (Crouch 2016: 94). The market was thus not so much a repository of knowledge as a distorer of it. Moreover, once faced with crisis, ‘[t]he very aspect of sovereignty that had long bothered neoliberals, namely its incalculable and “metaphysical” quality, is what rescued neoliberalism from collapse in 2008’ (Davies 2014: 156). Seen in this way, neoliberalism’s project to eradicate politics came face to face with the reality that politics is precisely what saved it, just as the promise of eradication facilitated neoliberal renewal. Even if we put to one side the financial crisis, this leads to a further question, namely, what form of politics has emerged with actually existing neoliberalism. This is considered in the next three chapters.

NOTES

1. This argument has also been used by Steve Bannon, an influential member of the Trump administration, although in his case he is more prepared to give this argument an overtly racist spin, and actually blame liberals and African-Americans for the crisis. See his 2010 film, Generation Zero.

2. It is however doubtful that Mellon would have rejected tax rises along the lines suggested by the Tea Party.