

The revenge of the market on the rentiers. Why neo-liberal reports of the end of history turned out to be premature

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

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

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

Newness only becomes mere evil in its totalitarian format, where all the tension between individual and society, that once gave rise to the category of the new, is dissipated.
Theodor Adorno

[. . .] and, above all, let finance be primarily national. *John Maynard Keynes*

1. Introduction

According to the central postulate of mainstream economics of the neo-classical-type, if rational (i.e., utility-maximising) and selfish economic agents are allowed to interact freely in competitive markets, the outcome will be something called ‘equilibrium’. Furthermore, this equilibrium would not only be optimal, but intrinsically stable and capable of ‘self-correction’. All that is required is that markets are allowed to work freely (i.e., prices and wages are allowed to adjust without restraint so that markets can clear), and that property rights are well-defined and properly enforced (so that this can be achieved with minimum transaction costs).¹

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

Furthermore, according to the ‘efficient capital market theory’, in financial markets prices at all times reflect all available information; basically, there cannot be an *endogenous* gap between market prices and fundamentals—let alone a bubble. That is, asset prices deserve a pedestal, and stock options are the most rational reward for good performance. Also, stock prices are supposed to be a ‘random walk’, i.e., particularly under risk neutrality, there is no scope for profitable speculation because a rational stock market cannot be beaten on any consistent basis. The key point here is that if financial markets get misaligned, they always ‘self-correct’. Smart market players would simply force stock prices to become rational by doing exactly the opposite of what they do in real life: take the other side of trades if prices begin to develop a pattern (as this is bound to have

¹ As always happens when there is an unrelenting need to idealise something, for neo-classical analysis to be able to sustain its remarkable idealisation of competitive markets it needs simultaneously to demonise something else—in this case anything to do with ‘governments’. On idealisation, see Sodr  (2009).

no substance). In other words, for the efficient market theology a 'rational surfer' would be one that gets drowned trying to create undertows, not the one that has fun riding waves.¹

In sum, in the words of the Director of the White House's National Economic Council, '[in financial markets] prices will always reflect fundamental values [...]. The logic of efficient markets is compelling' (Summers and Summers, 1989). In fact, we now know that Alan Greenspan was even against tightening regulation against financial fraud, as 'rational markets can take care of themselves' (see <http://www.dailykos.com/story/2009/3/27/172419/727>).

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

Furthermore, within mainstream economics the acceptable range of ideas has narrowed down continuously since the famous 'capital controversies' and the monetarists versus Keynesian debates of the 1970s. A student of economics today could be forgiven for believing that the range of debate in economic theory only spans just two competing schools of thought within dynamic stochastic general equilibrium models: those that engineer them as real business cycles and those that do so as micro-foundations models. More specifically, mainstream economics tells us that endogenous market outcomes depends only on whether or not prices and wages are "sticky" (due to potential price and wage inflexibilities) and related market failures. That is, market outcomes depend only on (say) whether markets perform as smoothly and predictably as a car made in Japan, or bit more capriciously as one made in Britain. And as far as whether money and finance can affect long-run growth, Lucas' proposition that only real forces can truly affect employment and production became the only game in town (see Lucas, 1995). So, in first and second generation models of financial crises, as these are mainly about ill-advised monetary policy, crises are supposed to be harmless to the real economy. Only in third-generation models crises can become 'real', but this is only due to a sudden large currency depreciation causing havoc with real-economy features such as balance sheets—so the actual economy can plunge into a crisis (see Krugman, 2001).

Therefore, within the mainstream framework it is just simply not possible to understand current events. And despite much effort—remember those blaming 'liberals' for the

¹ When I participated in 2008 in a panel to nominate candidates for the biannual 'Deutsche Bank Prize in Financial Economics' (worth €50,000), organised by The Center for Financial Studies of the Goethe University in Frankfurt, I found out that the first prize, awarded in 2005, had been given to Eugene Fama from Chicago University. According to the citation, he had been 'honoured for his theory of efficient markets'; that is, for developing what proved to be an effective intellectual weapon of mass destruction (see <http://www.ifk-cfs.de/index.php?id=901>). Like traders who got bonuses for taking silly bets, maybe one day someone will ask him to donate the money to charity. As Buiter (2009B) says, '[...] the typical graduate macroeconomics and monetary economics training received at Anglo-American universities during the past 30 years or so, may have set back by decades serious investigations of aggregate economic behaviour and economic policy-relevant understanding. It was a privately and socially costly waste of time and other resources'.

sub-prime crisis because of a 1977 law that helps low income people get mortgages? (see http://www.prospect.org/cs/articles?article=did_liberals_cause_the_subprime_crisis)—mainstream economists have not been able to produce a credible smoking gun of the ‘exogenous’ type. That is, this time no much room for ‘market excuses’ of the ‘blaming someone else’ type.

From this perspective, perhaps what defines an alternative understanding of financial markets as ‘heterodox’ is that it postulates that the *endogenous* outcome of the free interaction in financial markets of intelligent, rational, utility-maximising and selfish individuals can be not just a sub-optimal equilibrium but, at times, a financial crisis proper (see Minsky, 1986).¹ One of the crucial issues here, as Keynes’ liquidity theory points out, is that decision makers do not really know, and cannot really know, the future outcome of current financial decisions—the future is uncertain and not merely probabilistically risky (see Davidson, 2007). That is, financial markets are likely to be intrinsically unstable and (particularly with excess liquidity) unable to self-correct (see Kindleberger, 1986). In fact, instead of ‘automatic stabilisers’, they can easily be derailed even further by ‘automatic de-stabilisers’ (see Stiglitz, 2003). As a result, borrowers and lenders can accumulate far more risk than is privately efficient—let alone socially efficient. Hence, financial crises can occur for more reasons than irresponsible government deficits, moral hazards due to government guarantees, bad luck, mob psychology, crony capitalism, misguided policy or other *exogenous* factors interfering with the otherwise perfectly efficient allocation of resources by financial markets. The current financial crisis is a paradigmatic case of this.

In fact, even Greenspan, like a general who decides to rethink his military strategy only after losing the war, has lately moved slightly in this direction. For example, he famously acknowledged in October 2008 (in his testimony to Congress) that he—and his free-market ideology—was ‘in a state of shocked disbelief’. And that his ‘real business cycle’-type thinking was behind his conviction that in financial markets there are no major market failures; and that the incentive of shareholders to maximise their value would lead them to control the behaviour of managers and traders. As a result, he had entirely missed the possibility that financial deregulation could unleash such destructive forces on the economy.² He also acknowledged that the current crisis shows that the basic premise of the traditional risk-management theory is wrong; and that financial markets can indeed be inherently unstable, especially due to their increasing complexities. Furthermore, for post-2007 Greenspan when financial markets are shocked out of equilibrium they may well be unable to self-correct—as in the recent bubble (see Greenspan, 2009).

This paper begins by highlighting a number of mechanisms that have led to the current financial crisis from the perspective of heterodox Keynesian–Minskyian–Kindlebergian financial economics (more recently enriched by, among others, the work of Stiglitz, Krugman, Davidson, Buiter, behaviourist and psychoanalytic approaches to finance, and Neo-Schumpeterian long-term views of the relationship between technology and finance). However, the paper then proceeds to argue that perhaps more than ever the ‘macroeconomics’ that led to this crisis only makes analytical sense if examined within the framework of the political settlements and distributional outcomes in which it had operated. So, the analysis then takes the perspective of critical social theories (especially Marxian and

¹ Now, why in economics today one has to be ‘heterodox’ to understand this simple fact is another matter altogether. According to Ferguson (2008), the inability of mainstream economists to understand the likelihood of financial crisis can only be the result of their lack of knowledge of financial history.

² So, instead of behaving as a good old fashioned central banker—one that takes away the punchbowl when the party gets going—he was happy instead to fill it up with ‘high-spirited’ easy money and easy credit.

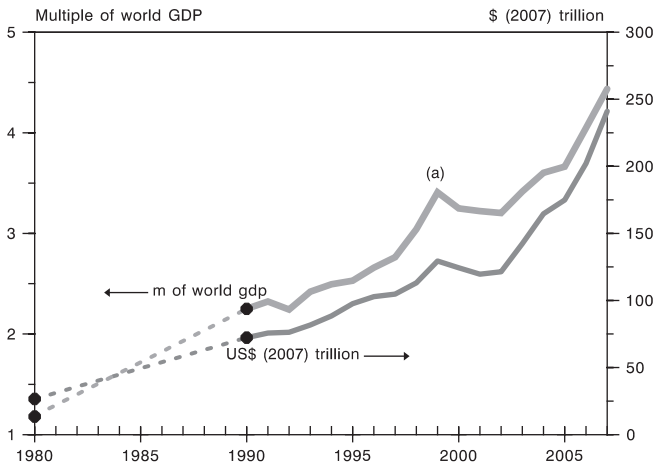


Fig. 1. *Stock of global financial assets, 1980–2007. (a) Collapse of the ‘dotcom’ bubble. Before 1990 data are only available for 1980.*

Source: McKinsey (2008) and IMF (2009); note that McKinsey’s data are based on IMF statistics, but include bank deposits rather than bank assets.

Foucauldian) and concludes that, ultimately, the current financial crisis is the outcome of something much more systemic, namely an attempt to use neo-liberalism (or, in US terms, neo-conservatism) as a new technology of power to help transform capitalism into a rentiers’ delight. In particular, into a system without ‘compulsions’ on big business; i.e., one that imposes only minimal pressures on big agents to engage in competitive struggles in the real economy (while doing the opposite to workers and small firms). A key component in the effectiveness of this new technology of power was its ability to transform the state into a major facilitator of the ever-increasing rent-seeking practices of oligopolistic capital. The architects of this experiment include some capitalist groups (in particular rentiers from the financial sector as well as capitalists from the ‘mature’ and most polluting industries of the preceding techno-economic paradigm), some political groups, as well as intellectual networks with their allies—including many economists and the ‘new’ left. Although rentiers did succeed in their attempt to get rid of practically all fetters on their greed, in the end, the crisis materialised when markets took their inevitable revenge on the rentiers by calling the neo-liberal bluff.

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

2. The dance of the trillions

Even for those familiar with events and figures in international financial markets, the sheer magnitude of the numbers both in the upswing and the downswing of the current cycle is truly remarkable. For example, in the upswing, the four components of the stock of global financial assets (equity, public and private bonds and bank deposits) increased 9-fold in real-terms between 1980 and 2007—from US\$26.6 to US\$241 trillion (both figures in US\$ at 2007 value). As a result, the multiple of the stock of financial assets to world output jumped from 1.2 to 4.4 (see Figure 1).

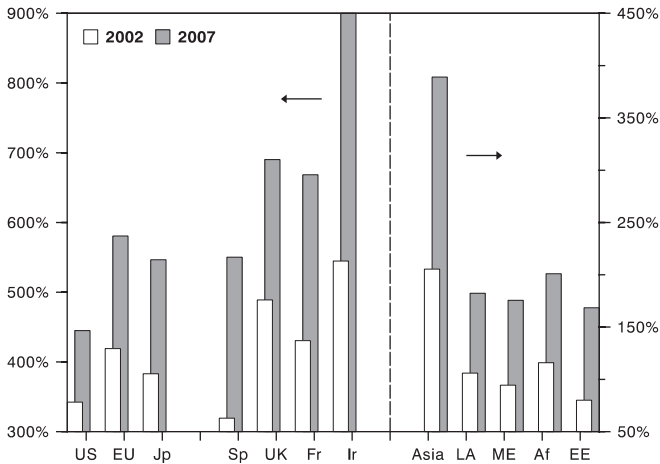


Fig. 2. ‘Financial deepening’ during the second bubble: ratio of financial assets to GDP, 2002 and 2007. US, United States; EU, European Monetary Union; Jp, Japan; Sp, Spain; UK, United Kingdom; Fr, France; Ir, Ireland; LA, Latin America; ME, Middle East; Af, Africa; EE, Eastern Europe.

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

In turn, Figure 2 indicates the remarkable size of the second financial bubble of the period (following the recovery from 9/11. This bubble was especially large in some countries of the European periphery (such as Iceland, Ireland and Spain), and in emerging markets.

And in terms of the legendary size of the derivatives markets, according to the BIS, in just the last ten years the amounts outstanding of over-the-counter derivative contracts jumped 7.5-fold (from US\$92 to US\$683 trillion)—or from 2.4 to 11 times the size of global output. In turn, their gross market value increased 10-fold (from US\$3.3 trillion to US\$33.9 trillion); i.e., the gross market value of these ‘financial weapons of mass destruction’ (as Warren Buffett famously labelled them) grew about eight times faster than world output (all figures in US\$ at 2008 value).¹

As is well known, one of the main problems of the current crisis is that the globalisation of financial markets brought a huge increase in the volatility and in the correlation of returns on financial assets. This phenomenon has major policy implications; for example, what is the optimal level of capital account openness for a developing country under these circumstances?

Turning to the core country of the system, Figure 3 illustrates the remarkable increase in the level of debt of the non-financial sector of the USA.

In the meantime, the debt of the financial sector was climbing even faster than that of the non-financial sector—between 1980 and 2007 it jumped from 20% to 116% of gross domestic product (GDP). Overall, during this period the ratio of debt to GDP soared from 168% to over 350%. How could anyone think that such remarkable increases in the level of

¹ The gross market value of outstanding over-the-counter commodity derivative contracts (excluding gold) increased 59-fold during this decade—or at an average annual real rate of growth of 51% (reaching in June 2008 a market value of US\$2.2 trillion); notional values increased to US\$12.6 trillion. This frantic speculation is probably much more important than actual demand from China in explaining the commodity-price-bubble of the years preceding the crisis.

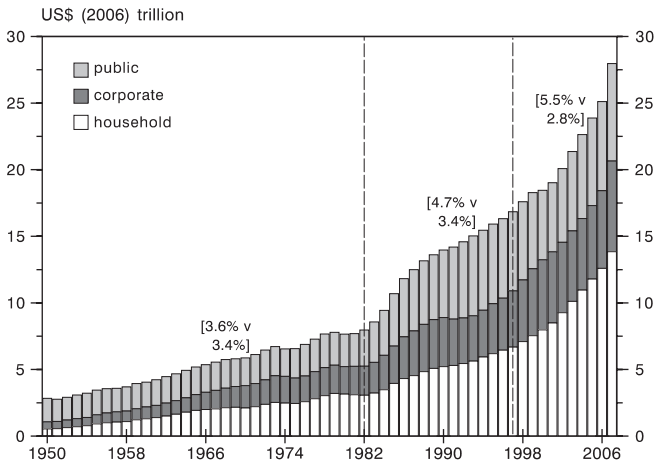


Fig. 3. Debt outstanding by the non-financial sector in the USA, 1950–2007. Household, total household debt (consumer and mortgage debt); corporate, total non-financial corporate debt; public, total public sector debt (local and federal). Percentages shown in the graph are average annual real rates of growth of debt and GDP in each period, respectively.

Source: US Federal Reserve (2009).

debt by both the financial and the non-financial sectors could be sustainable in the long run? Or how could anyone think that if banks could not dazzle investors and regulators with might, it was perfectly acceptable that they puzzle them with fudged balance sheets?¹ How anyone could think that markets would never call this blatant bluff is anybody's guess!

Turning to the downswing and bust of the cycle, Greenspan (2009) estimates that '[...] the aggregate equity loss amounts to well over US\$40 trillion, a staggering two-thirds of last year's global gross domestic product'. Recent estimates have increased this figure to well over US\$50 trillion, as just the loss in terms of household net worth in the USA has already reached US\$14 trillion (see <http://www.federalreserve.gov/releases/z1/Current/>). Furthermore, according to the Stiglitz UN Commission, up to 50 million people could become unemployed in 2009, and '[s]ome 200 million people, mostly in developing economies, could be pushed into poverty [...]' (Stiglitz, 2009).

3. What is neo-liberalism—and why did it become toxic?

Polanyi (1944) was one of the first to suggest that capitalism will tend to alternate between periods with little market regulation, and periods in which society intervenes to actively regulate market activity, especially in the labour market and in finance. Kalecki (1943) had also envisaged long-term cycles within capitalism (see Figure 5 below). And Hirschman (1982) too discussed what he saw as long-term cycles of preferences for public versus private provision of goods. According to him, the backlash against the Keynesianism and dirigiste policies had a lot to do with the stagflation in the 1970s. This accelerated a growing collective frustration concerning the effectiveness of state regulation and led to

¹ At the end of 2008 the USA's four biggest banks, by assets, had not that much less assets in 'off-balance-sheet vehicles' than on their books (US\$5.2 and US\$7.2 trillion, respectively). As Reilly explains, '[o]ff-balance-sheet vehicles helped inflate the credit bubble by letting banks originate and sell loans without having to put aside much capital for them. So as lending soared, banks didn't have an adequate buffer against losses' (http://www.bloomberg.com/apps/news?pid=20601039&refer=columist_reilly&sid=aRPE735QhI8U).

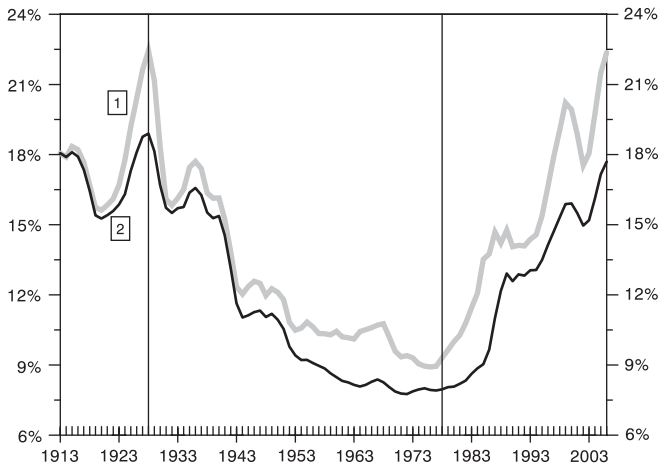


Fig. 4. *Income share of the top 1% in the USA, 1913–2006. Three-year moving averages: [1] including realised capital gains; [2] excluding capital gains.*

Source: *Piketty and Sáez (2003)*: computations by authors on tax return statistics (the number of tax returns in 2006 was 138.4 million). Income defined as annual gross income reported on tax returns excluding all government transfers (such as social security, unemployment benefits, welfare payments, etc.), and before individual income taxes and employees' payroll taxes (but after employers' payroll taxes and corporate income taxes). Data include capital gains (updated to 2006 in <http://elsa.berkeley.edu/~saez/TabFig2006.xls>). This is the source of all data on income distribution in the USA in the following figures.

radical calls for more *laissez faire* policies. He argued that sustained frustration and disappointment with existing institutions can lead to dramatic 'rebound effects' demanding radical changes in policy. Long-run cycles of preferences for public versus private provision of goods may be explained by such mechanisms. For Hirschman, such disappointment must often go through a threshold before it is consciously acknowledged; people have a tendency to deny bad choices and stick to them for too long. But when they do finally admit to their disappointment, there will be a 'rebound effect'. That is, Hirschman thinks that 'reverse shifts' are more radical as a result. In fact, he thinks that 'a good portion of the so-called puzzle of collective action and participation in public affairs disappears when the rebound effect is taken into account' (1982, p. 81).¹

Probably the most transparent and extreme of these 'rebound effects' ever took place towards the end of the 1970s and the beginning of the 1980s. Perhaps the simplest way to illustrate statistically the nature of this transformation (from the liberal-Keynesian to the neo-liberal era) is by showing what happened to the share of income of the top 1% in the USA between the 1929 and the 2007 financial meltdowns (see Figure 4).

As is evident from Figure 4 the fortunes of the richest 1% in the USA took a rather remarkable turn after the appointment of Paul Volker (and his flamboyant monetarism) to the US Federal Reserve in 1979, and the election of Ronald Reagan as president a year later: including realised capital gains, the share in national income of this small group increased from 8.9% to 22.8% between then and 2006—or from 8% to 18% if capital gains are excluded.² In fact, by 2006 the share of the top 1% in the USA had already returned to

¹ See also http://www.politicalreviewnet.com/polrev/reviews/CONS/R_1351_0487_046_1005623.asp.

² In turn, including capital gains, the share of the richest 0.5% increased from 6.2% to 18.6%; that of the top 0.1% jumped from 2.7% to 12.6%; and that of the very top 0.01% shot up from 0.9% to 5.5%.

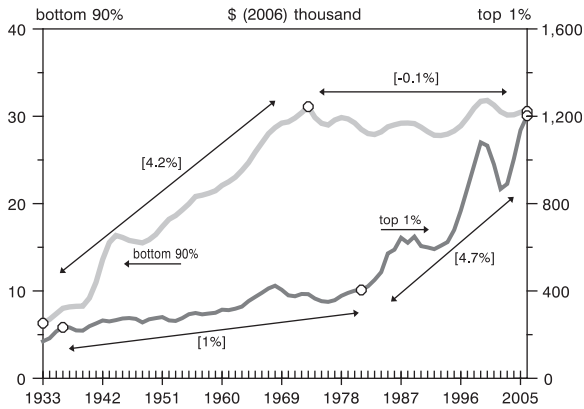


Fig. 5. Average income for the top 1% and the bottom 90% in the USA, 1933–2006. Percentages are average annual real rates of growth in respective cycles (1933–73 and 1973–2006 for the bottom 90%, and 1936–80 and 1980–2006 for the top 1%). Three-year moving averages.

its pre-1929 level. A relatively similar scenario is found in the UK after the election of Margaret Thatcher in 1979 (see Atkinson, 2007) and in Australia (see Harcourt, 2001). In turn, Figure 5 shows the remarkable reversal of fortune between the top 1% and the bottom 90% of the USA working population.

While average income of the bottom 90% was growing four times faster than that of the top 1% during the long Keynesian cycle, during the following one the former stagnated as the latter surged ahead. In fact, as Kalecki had analysed in 1943, both Keynesian-style liberalism and neo-liberalism are basically counter-cyclical, but each for a different phase of the cycle. Both seek to change the balance of power between income groups: Keynesianism in order to prevent the disruptive effects of crisis-ridden capitalism, neo-liberalism in order to return power and control to their ‘rightful owners’—capital (see also Wood, 1999).

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

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

To analyse further what the new neo-liberal counter-cyclical transformation was really about one should perhaps begin by indicating that what is common to its ideological discourse and that of nineteenth-century liberal thinking is the supposed harmony between the private and the social spheres (in the context of a ‘minimal’ state).¹ The implication is that this ‘harmony’ happens because the (supposedly class-blind) ‘invisible hand’ is the mechanism in charge of translating private self-interest into optimal social outcomes. So, as

¹ The state should also have no right to interfere in private lives (i.e., state as a ‘night-watchman’); e.g., religion should be strictly a private affair (see Hirschman, 1997).

mentioned above, competitive markets in which enlightened economic agents are able to maximise their own private selfish interests becomes the stuff that social optimum dreams are made of.

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

However, there are also huge differences between the classical-liberal and the neo-liberal discourses. Smith and the Enlightenment were of course right about the fundamental issue that human beings can look after their own interests without needing a Church or a King to tell them what to do. This was a remarkably progressive proposition for its time. In fact, the three 'pillars' of the classical liberal discourse—*markets*, *knowledge* (i.e., sciences and rationalism) and (individual) *freedom*—had this progressive characteristic. So did the Keynesian-style liberalism that emerged in the previous switching of long-run cycles (mid-1930s) mostly as a result of a 'rebound effect' due to the long depression and events in Russia and Germany. In fact, its innovative vision not only tried to reformulate all three 'pillars' of the liberal discourse, but went so far as to question the supposed harmony between the private and the social spheres.¹ Basically, for Keynesian-style liberalism unregulated market forces could, at best, offer sub-optimal equilibria and unemployment, and at worst, crises of the magnitude of that of the 1930s. So, in order to be able to translate private self-interest into optimal social outcomes what was necessary was a new strong agency from the state. In this new vision, the three 'pillars' of the liberal discourse had to be reformulated. *Markets* should only be understood as good servants, but bad masters of economic life; *knowledge* now had the crucial task of helping to engineer the new agency from the state; and individual *freedom* would only be meaningful if it embraced social justice (otherwise, it would be mostly empty rhetoric).

Neo-liberalism, meanwhile, is a different discursive story altogether—and one that *in practice* has taken this long line of progressive liberal thinking not forward but backwards. Its huge complexities are reflected in the fact that there are many competing narratives regarding both its nature and success. In this paper I shall concentrate on two competing narratives of its nature emanating from the perspective of critical social theories (the Marxian and the Foucauldian). According to the former, neo-liberalism is not a revolution but a *counter-revolution* (along the lines of the above quote by Sir Alan Budd). According to

¹ According to Deane, '[t]he iconoclastic conclusion of [Keynes'] analysis was that there was no invisible hand translating private self-interests into social benefit. This was the nub of the Keynesian heresy' (1980, p. 182).

the latter, it is a novel reconfiguration of power leading to a new type of *Governmentality*—i.e., a new form of interaction between political power (and knowledge and discourse) and the dynamics of unregulated markets.

In the Marxian narrative, the neo-liberal project represented a counter-offensive by capital, following decades of continuous full-employment, rising real wages, improving income distribution, welfarist policies and all forms of government intervention, which culminated with the difficult economic environment during the stagflation of the 1970s. This counteroffensive was helped (among many other things) by the lack of credible opposition that followed the collapse (mostly from within) of communism. In short, what the neo-liberal discourse was really about was capital attempting to regain its power and control through a new form of legitimisation and more sophisticated technologies of dispossession. That is, it was an attempt by the so-called ‘angry right’ to reassert class power.¹

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

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

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

¹ Although rentiers had already been ‘angry’ for a long time (as they had been the main losers of the welfarist ‘pact’ between unions and industrial capital that characterised the Keynesian era—leading some analysts in the past to label the post-1980 neo-liberal era as that of ‘the revenge of the rentier’), during the 1970s they were joined in their discontent by industrial and other productive capitalists who had previously done rather well during the ‘Golden Age’. For the latter, things had become difficult due to the so-called ‘profit squeeze’ that began during the late 1960s, and the stagflation of the 1970s. As a result, these groups were facing the combined effect of (among other things) a further decline in their share of income and a squeeze of their profit rates (Figures 4, 5 and 6), an increase in taxation (Figure 12), a significant decline in corporate capitalisation (Figure 17; which had led to a plunge of their ‘Tobin’s Q’—Figure 18), and a collapse of their ‘net worth’ (Figure 21).

In short, there is no doubt that a powerful fight took place during the 1970s between those interests backing the welfare state (working class, some industrial capitalists, some political parties and intellectuals) and those wanting to dismantle it (financial rentiers, other industrial capitals, some political parties and intellectuals, including most economists). Equally there is little doubt that this struggle was won by one side via varying historical processes. Furthermore, as analysed below, what followed had unintended consequences that culminated in the current financial crisis. However, there is not much evidence of a political ‘invisible hand’ guiding this transformation through the remarkable institutional and social complexities that characterised the places in which neo-liberalism was developed as an ideology.

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

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

Trying to make some elements of the Marxian and the Foucauldian accounts of neo-liberalism fit together (as I attempt in this paper) is a rather problematic exercise. The upholders of the former consider the Foucauldian ‘governmentality’ understanding as missing the crux of the neo-liberal revolution, namely its grounding in a class process of dispossession. For the latter, the Marxian account is at best incomplete, and at worst ignores the novel reconfigurations of political and institutional power encapsulated by the neo-liberal revolution. Underneath the theoretical differences between these two approaches, a deeper disagreement lurks regarding the understanding of ‘critique’. Governmentality, by bracketing the evaluation of the arts of rationalities it investigates, has been opposed to Marxism or at least indifferent to its critical edge, imposing ‘a restriction that precludes problematising effects, and thus presumably eliminates the possibility of assigning costs to any mentality of rule’ (O’Malley *et al.*, 1997, p. 509). In other words, Foucauldian accounts of neo-liberalism suspend judgement in their analysis, grounded in their scepticism regarding Marxian accounts of agency and historical development. Neo-liberalism, according to this account, is a serious attempt at instituting new forms of rule almost irrespective of their effect on the pattern of inequality; they can be contingently used for the legitimisation of increased inequalities but do not have to be so by necessity. In a traditional Marxian reading, meanwhile, neo-liberalism is just a discourse

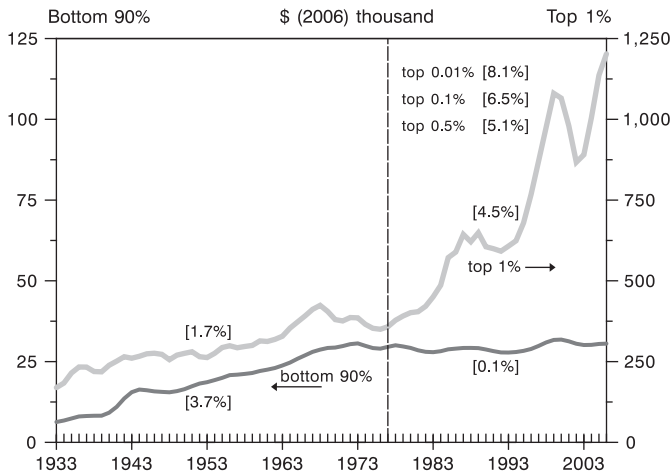


Fig. 6. Average income of the bottom 90% and of the top 1% in the USA, 1933–2006. Percentages are average annual real rates of growth between 1933–78 and 1978–06. Includes capital gains. Three-year moving averages.

that is used to legitimise new processes of dispossession and extreme forms of rent-seeking accumulation.

From the perspective of this paper one of the few indisputable characteristics of neo-liberalism is that it emerged in opposition (in the form of an undertow) to the Keynesian consensus of the ‘Golden Age’. Then, after many years in the fringes, it suddenly became mainstream among right-wing circles during the stagflation of the 1970s. This happened at the same time of important political changes in right-wing parties. In Great Britain, for example, it was the time when the Conservative Party switched from being ‘the party of state-owners to the party of state-agents’; in the USA it coincided with the G.O.P’s ‘Southerner Strategy’ (‘government is the problem because it takes your money and gives it to Those People’; see <http://www.nytimes.com/2009/01/02/opinion/02krugman.html>). And this was the time when the neo-liberal concern with ‘prudent-macroeconomics-cum-smaller-governments’ became just a tactical discursive strategy, successfully framed within the ‘politics of resentment’ and a bogus disguise of ‘modernity’.

As in Figures 4 and 5 above, Figure 6 indicates that the extreme redistributive success of the post-1980 ‘neo-liberal rebound effect’ was due to its ‘winner-takes-all’ nature (the same is found in Latin America; see Palma, 2007).

In fact, according to the source, in real terms (i.e., US\$ at 2006 values) the average annual income of the bottom 90% actually *fell* during the 33-year period between the 1973–oil crisis and 2006 (from US\$31,300 to US\$30,700). Meanwhile, that of the top 1% increased 3.2-fold (from US\$386 thousand to US\$1.2 million). What a difference from the previous decades of ‘liberal-Keynesianism’!

Figure 7 shows how during the neo-liberal cycle there is little difference between Democrat and Republican administrations from this perspective. During the seven-year period of economic expansion of the Clinton administration (1993–2000), and the four-year period of expansion of Bush’s (2002–06), ‘average’ real family incomes grew by 4% and 2.9% annually, respectively. However, these averages disguise remarkable asymmetries: in fact the overall ‘average’ corresponds to that of percentiles 95–99 (something that did not happen even in Pinochet’s Chile; see Palma, 2007).

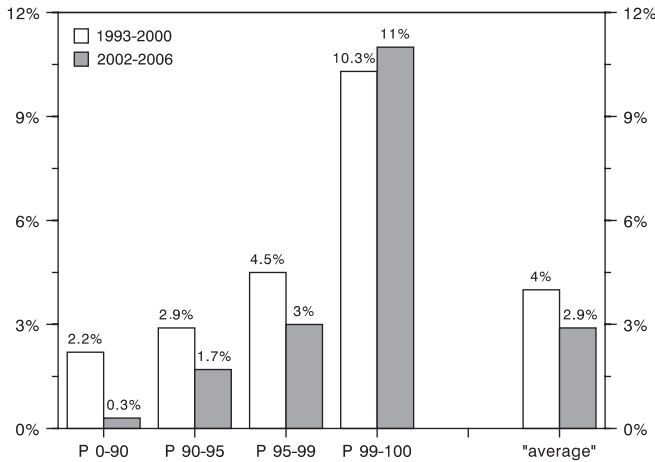


Fig. 7. Average income growth by income groups in the USA, 1933–2000 and 2002–06. *P*, percentiles.

As a result, during the seven-year period of economic expansion of the Clinton administration the top 1% of income earners captured 45% of the total growth in (pre-tax) income, while during Bush’s four-year period of expansion no less than 73% of total income growth accrued to the top 1%.¹ Perhaps the neo-liberal ideology associated with the post-1980 period is just shorthand for ‘the art of getting away with such a remarkably asymmetric distributional outcome *within a democracy*’! An alternative formulation would be that it is shorthand for ‘the art of generating a “spontaneous consensus” that such a remarkably asymmetric distributional outcome is the only game in town’. Alternatively, ‘the art of transforming a particularly asymmetric set of distributive strategic choices, and the corresponding payoffs, into a Nash equilibrium’—as the majority becomes convinced that there is no point in trying to change such asymmetric distributive strategies while the all too powerful top income players keep theirs unchanged.

Figure 8 shows how the contrast between the fortunes of the great majority and those of the powerful minority gets even more extreme when the comparison is made with the very few at very top of the income distribution.

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

At the same time, this huge income polarisation—between 1980 and 2006 just the taxable income of the top 1% increased by nearly US\$2 trillion, and that of the top 10% by US\$3.5 trillion—obviously became one of the major contributors (and one probably more important than the Asian ‘savings glut’) to the increased liquidity in the US financial markets (the abundance of which transformed financial markets into fundamentally unstable institutions, totally unable to self-correct). In fact, the current crisis may have

¹ There does not seem to be much evidence in the USA since the late 1970s to support a ‘median voter’ scenario, or trickle-down economics.

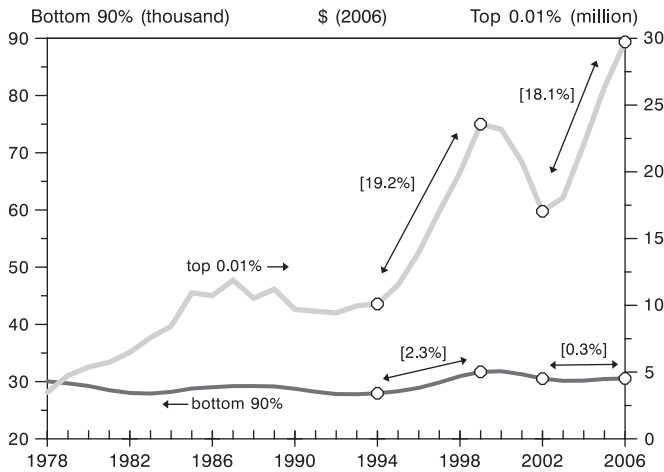


Fig. 8. Average income of the top 0.01% and of the bottom 90% in the USA, 1978–2006. Percentages are average annual real rates of growth in respective periods (1994–2000 and 2002–06). Includes capital gains. Three-year moving averages.

many roots, but (as discussed in more detail below) a crucial one relates to income polarisation. In particular, as Figure 9 indicates (and as good old-fashioned Keynesian economics has always emphasised) the current crisis has again shown that developments in financial markets are closely related to the distribution of income, so the latter is a crucial component in the understanding of the crisis and in the planning of how to get out of it.

It could be argued, however, that this is a case of simultaneous causation; the rich own most financial assets, and anything that causes the value of financial assets to raise rapidly will also cause inequality to raise fast. However, this relationship stands even when capital gains are *excluded* from tax-payers' income (see Figure 10).

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

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

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

Understanding what neo-liberalism is really about, and clarifying its role in bringing about the current global financial crisis, requires more than simply highlighting how it brought about an extreme income polarisation while avoiding the political and social tensions likely to emerge with such a remarkable process within a democracy, and how this income inequality was somehow closely associated with an increased financial 'fragility'. It also requires an understanding of how this process of dispossession was part and parcel of a wider attempt by some capitalists (especially rentiers from financial capital, and from the 'mature' and the most polluting industries of the previous techno-economic paradigm),

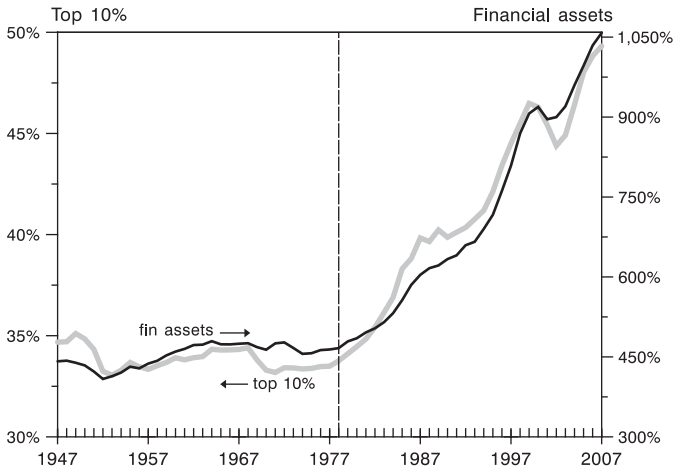


Fig. 9. *Income share of the top 10% and value of financial assets as percentage of GDP in the USA, 1947–2007. Three-year moving averages: fin assets, value of financial assets as percentage of GDP; top 10%, income share of the top 10% (includes realised capital gains).*
Source: US Federal Reserve (2009).

some politicians and intellectual networks to discipline the state and to transform capitalism into a system with minimal ‘compulsions’ for big business.¹ The unintended result, of course, was to transform it into an emasculated, ‘sub-prime’ economic system that not only lost most of its capacities to develop the productive forces of society, but also became particularly prone to accumulating ever increasing financial fragilities. It is from this perspective that the current crisis can also be understood as markets bursting the ‘ideological bubble’ that characterised the neo-liberal economic and political experiment. That is, that the global financial crisis took place when the ‘end of history’-type neo-liberal manic discourse was brought down to earth by market’s law of gravity.²

The remarkable income polarisation of the neo-liberal period (particularly in the USA) apparently does not seem to give much support to the Foucauldian proposition that the new form of ‘governmentality’ sought by neo-liberalism, even though it can be contingently used for the legitimisation of increased inequalities, is not about that by necessity. Instead, it seems to support the narrative that emphasises that neo-liberalism is mostly about the restoration of class power. From this perspective, a crucial mechanism for setting in motion this transformation was rather ingenious: the reintroduction of risk and the heightening of uncertainty at the heart of a by then too self-confident ‘welfarised’

¹ For an analysis of the role of ‘compulsions’ within capitalism, see Foucault (2004); for Foucault, the emergence of modernity and of capitalism is not about the ‘relaxation’ of compulsions (as most liberals believe), but about the development of new forms of compulsion. See also Khan (2005); for him: ‘[...] capitalism is characterised not just by the presence of market opportunities, which have always been present in societies with markets, but also by a hitherto unknown introduction of market compulsions, which ensured that both capitalists and workers continuously had to strive to improve their performance just in order to survive. [...] Only capitalist appropriation depends on market competition and therefore on the systematic improvement of labour productivity. Only capitalism, then, depends on constantly improving the forces of production. And only in capitalism is it necessary to grow just to stay in the same place’ (Khan, 2005, p. 72).

² Only six months before the collapse of A.I.G., Joe Cassano, its chief financial officer, said of the US\$441 billion portfolio of credit default swaps (CDS’s) he had bet on that ‘[i]t is hard for us, without being flippant, to even see a scenario within any kind of realm of reason that would see us losing one dollar in any of those transactions’ (quoted in Schreiber, 2009). See also Shnayerson (2009).

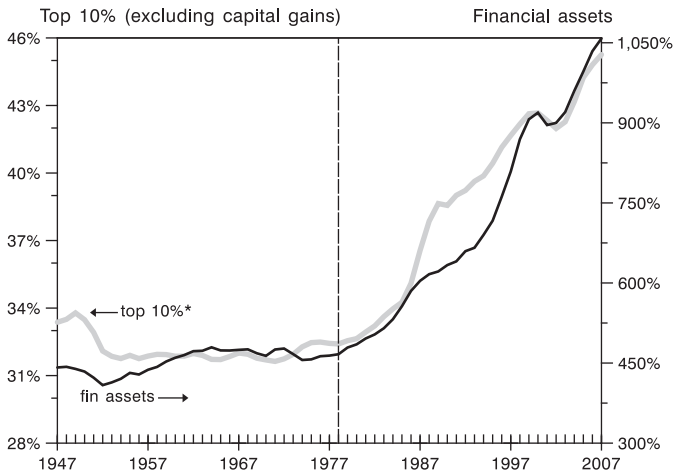


Fig. 10. *Income share of the top 10% (excluding capital gains) and value of financial assets as percentage of GDP in the USA, 1947–2007. Detail as for Figure 9 (excluding capital gains).*

population and a (supposedly) too autonomous state.¹ In fact, the neo-liberal counter-revolution could thus be understood as a deliberate attempt to shift the economy (and much else) from a 'stable' to a somehow 'unstable' equilibrium. That is, a movement away from Keynesian attempts to manage risk and reduce uncertainty via national and international policy coordination, closed capital accounts, stable exchange rates, low and stable interest rates, low levels of unemployment and unemployment benefits for those out of work, public health services and the other aspects of the welfare state, and a state autonomous enough to be capable of at least some 'disciplining' of the capitalist elite, towards an intended movement in reverse. And this as a means to an end: to try to develop an environment in which capital could exercise both a more effective politics of dispossession and a more rent-seeking form of accumulation.

What some capitalists, politicians and intellectual networks thought best for capitalist development was that capital should regain the upper hand via an economic environment that was permanently unstable and highly insecure for the majority of the population and the state. That is, one that could have the necessary debilitating effect both on workers and the state. In this kind of environment a highly mobile and malleable factor of production (especially finance capital) would have an unrivalled power to thrive.

In short, when 'excessive' Keynesian macro-stabilities, government regulations (such as competition laws and greater accounting transparencies), labour-securities and social safety nets laid the grounds for both an increased degree of 'compulsion' for capital, and a significant challenge to its legitimacy by large segments of society, what capital urgently needed was the reintroduction of risk and the spiralling of uncertainty right into the soul of what were by then rather too self-assured 'welfarised' institutions and populations. So what was needed was a return to an environment in which the state had to live permanently under the logic of a 'state of emergency' (see especially Arantes, 2007); and a return to precarious jobs, higher levels of unemployment, highly-constrained unions, increasingly porous safety-nets, insufficient and insecure pensions and so on—and, of

¹ Neo-liberals seem to have been the only political group who really understood Kalecki's main message in his 1943 article on the 'Political aspects of full employment': capitalism just cannot endure the political consequences of sustained periods of full employment.

course, high levels of persecutory personal debt could also be of great help.¹ The bottom line was thus the question of how to reconstruct an economic and institutional scenario in which everybody knew that capital could pull the plug whenever it wanted to.

As Tony Lawson has argued:

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

Natural selection mechanisms of this sort help us understand what the neo-liberal discourse is really about: it is about an attempt to create an economic environment best suited to those features that capital has and others do not. In the jungle, capital is king! The neo-liberal discourse may have burst into the political scene in the 1970s promoting 'order', market efficiency and a new concept of the state based on freedom, individual initiative and sound macroeconomics and about fighting paternalism. However, this discourse ended up being as transparent as bank balance sheets since what actually became on offer for workers and the state was life 'on the edge'—as in a high-risk and unstable 'order' only capital can thrive.

In developing countries the challenge for capital to develop more sophisticated forms of legitimacy and new technologies of dispossession was much greater: in the new complexities of a post-Cold-War scenario, just having a Pinochet or two may not do any longer! As it happened, in many developing countries (especially in Latin America and South Africa) the new process of legitimisation of capital has been so remarkably successful that neo-liberalism has been able to turn the tables on progressive forces and has become ('low-intensity') liberal-democracy's best friend! Before neo-liberalism was able to become hegemonic via a 'spontaneous consensus' scenario (which in some countries, such as Chile, took a long time, and included periods in which brutal dictatorships imposed their own 'not-so-spontaneous-consensus' brand of neo-liberalism), in developing countries capital always saw democracy as its main threat. However, following the success of its new form of legitimisation, and helped by the collapse of most opposition, the remarkably precarious life of most of the working population, and the weakness of a state mostly reduced to a 'fire-fighting' role (i.e., having to live constantly under the logic of 'state of emergency'), 'low-intensity' democracy (as opposed to popular or radical democracy) has become a crucial component of capital's new technology of power to rule and dispossess the working population, and to restrain the state and to subject it to greater market accountability.

In other words, developing countries are the best example of how neo-liberalism in practice contains elements of both narratives, the Marxian and the Foucauldian. On the one hand, what was discussed above gives strong support to Foucault's main proposition: neo-liberalism is not a set of economic policies but a new and more effective technology of power. On the other, the capitalist élite, mainly because of lack of credible opposition and its intrinsic rentier nature, instead of using this new technology of power for its intended 'rationalising' effects, ended up misusing it to support more effective forms of dispossession and more rentier forms of accumulation. This has transformed capitalism

¹ Much has been said of Mrs Thatcher's attempt to create a 'property-owning' democracy; it would be more appropriate to call it a 'mortgage-owning' democracy. Krugman (2005) calls it 'the debt-peonage society'.

into a ('sub-prime') system with little capacity to develop the productive forces of society—i.e., one that has lost its only historical legitimacy.

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

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

In terms of Marxian debates, neo-liberalism low-intensity democracy becomes a 'Poulantzas-type' strategy (as opposed to a Miliband 'social-network' one) in the sense of providing a *structural mechanism* to ensure that state actions (including economic policies) will not deviate from their goal of promoting its own brand of unregulated market, *irrespective of which ruling elite is in power*.¹ It is a structural mechanism to ensure that state action will remain linked to a particular ideological agenda. In fact, in the new framework even the legitimacy of the state becomes linked to the effectiveness to which it adheres to the logic of unregulated markets.

In terms of the role of increased risk in all this, a Foucauldian analysis would emphasise instead that neo-liberalism is not about increased risk *per se*, but about deploying a different understanding of risk—and of the ensuing social institutions that should regulate it. As Donzelot (1991) noted, it is about a modified conception of social risk, which shifts the emphasis from the principle of collective indemnification of the consequences of risks to an emphasis on the individual civic obligation to moderate the burden of risk he or she imposes on society. As such, neo-liberalism might have led at the end to an increase in risk, but as a theory it attempted to justify the dismantling of earlier Keynesian forms of social

¹ Perhaps the metamorphosis of the 'new left' in Latin America (and in other parts in the developing world) into a 'neo-liberal left' could be understood partly along these lines: as it believes that in this new framework it cannot get political power to implement its own progressive agenda (or, as in South Africa, that it would not be able to sustain it), it then tries to gain power to implement someone else's economic agenda (see Palma, 2009A; for the related concept of 'upside-down hegemony', see Oliveira, 2006). In fact, Mrs Thatcher once branded 'New Labour' as 'my finest creation' (see Palma, 2009A). Likewise, perhaps the greatest political achievement of Pinochet and other dictators of that time is the Latin American 'new-left'—with their facade of 'modernity', and their manic managerial defences as tactical discursive strategies to cover their new ideology.

risk management through new conceptions of risk and the role of individuals in dealing with it.

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

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

So, for example, Bush asks polluters to write environmental regulation. And when 'New Labour' Gordon Brown (as newly appointed Chancellor of the Exchequer) created in 1997 a new regulatory body for the financial industry, the Financial Service Authority (FSA), he sets it up not only as an 'independent non-governmental body' (i.e., a company limited by guarantee), but one that is actually financed by the financial services industry; furthermore, he appointed ex-bankers as Chairman and as Chief Executive Officer. That is, he set the FSA up as operationally independent of Government, funded entirely by the financial corporations it is supposed to regulate, and led by financial-industry insiders. As became evident after the onset of the current financial crisis, the FSA had been acting more as a 'service provider' to the financial industry than as an industry regulator. Moreover, (as well as granting him a knighthood) the British Prime Minister appointed the former CEO of a bank that had collapsed with the crisis as deputy chairman of the FSA—I suppose the idea was that convicted felons make the best prison guards!¹

Thus, New Labour found a rather ingenious solution to the problem of 'regulatory capture'; if lobbyist and industry inevitably succeed in capturing the regulators, why not make them the regulators in the first place? If all that matters is self-regulation and market discipline, why bother with governments meddling in supervision and regulation. Not surprisingly, self-regulation became no-regulation, and market discipline became irrational exuberance.

The main issue here is the reversal of the Keynesian logic of the interaction between political power and the dynamics of unregulated markets. Among other things, this reversal

¹ Brown appointed Sir James Crosby to the FSA in December 2007, two years after Crosby—then the chief executive of Halifax Bank of Scotland (HBOS) and already a non-executive director of the FSA—had sacked a member of his staff who warned him that the FSA's rules were being broken at his own bank (see <http://thescotsman.scotsman.com/latestnews/Brown-on-spot-as-former.4971845.jp>). According to Brown, his policy on financial regulation was '[n]ot just a light touch, but a limited touch' (see <http://www.cbi.org.uk/ndbs/press.nsf/0363c1f07c6ca12a8025671c00381cc7/ee59d13c2ce4ec12802570c70041152c?>). And, according to the British Chancellor, this policy should not be changed now as 'current financial regulation is not to blame for the credit crunch' (<http://news.bbc.co.uk/2/hi/business/8104340.stm>).

brought to an end the role of the state as a 'constrainer' of the rent-seeking practices of oligopolistic capital (in order to foster competition). The neo-liberal attempt to project the logic of unregulated markets into the heart of government created a *de facto* situation in which the new role for the state became one of a *facilitator* of the rent-seeking practices of big business.¹ The irony is that at the end both Keynesian-liberalism and neo-liberalism ended up implementing a similar strong agency from the state; however, there was a very different aim for that agency.

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

As is obvious by now, the unintended consequence of this new environment is that it has hugely increased the likelihood that capitalism would be even more crisis-ridden from within. That is, especially the wide-ranging financial liberalisation policies at a global level and those of liberalisation, privatisation and deregulation at a local one favoured by neo-liberalism, have driven the self-destructive tendencies of capital to their extreme (as in this kind of environment issues such as prisoner dilemmas and fallacies of compositions were brought to their head).² But as in this new environment the downturns are just too horrifying even to contemplate, when instability got totally out of hand and became crushingly dysfunctional, capital, as in every good old Western, could always count on the most ancient role of the state—to call in the cavalry in the nick of time.³

5. Income polarisation, 'financialisation', and 'sub-prime' capitalism—one with little capacity to develop the productive forces and intrinsically unstable

From a macroeconomic point of view, the crucial aspect of the huge increase in inequality and in financial 'deepening' was that they were associated with a meagre-macro. In particular, they are linked to: a disappointing rate of productivity growth (see, Acharya, 2009);⁴ an ever increasing level of 'financialisation'; a massive drop in the overall level of

¹ For liberals of the classical tradition (and liberal-Keynesians) governments had to preserve competition, because '[p]eople of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices' (Smith, 1776). In practice, when people of the same trade meet together to conspire against the public, neo-liberal governments not only turned a blind eye, but ended up setting the table, cooking the meal, serving the drinks, and paying the bill!

² Given current events, for most people it should come as no surprise to learn that last year 25% of countries in the world had a banking crisis. However, more surprising would be to learn that that same percentage is also the annual average for countries with banking crises during the 15-year period between 1986 and 2001 (see Reinhart and Rogoff, 2008; countries are weighted by their share of world income).

³ As has become evident in the current financial crisis, when in the business cycle the down-swing is too steep, the very-neo-liberal Washington consensus also tells us (but very quietly) that we should all be 'closet Keynesians' and not allow market discipline to run its full course—i.e., as far as financial capital is concerned, governments should never let the chips fall where they may.

⁴ Despite some mild recovery during the Clinton years, productivity growth was disappointing even in total factor productivity-terms—not in the (not very useful) Solow-residual sense, but in the one of adjusting productivity growth by factor accumulation following the Hall and Jones (1999) methodology for decomposing output per worker.

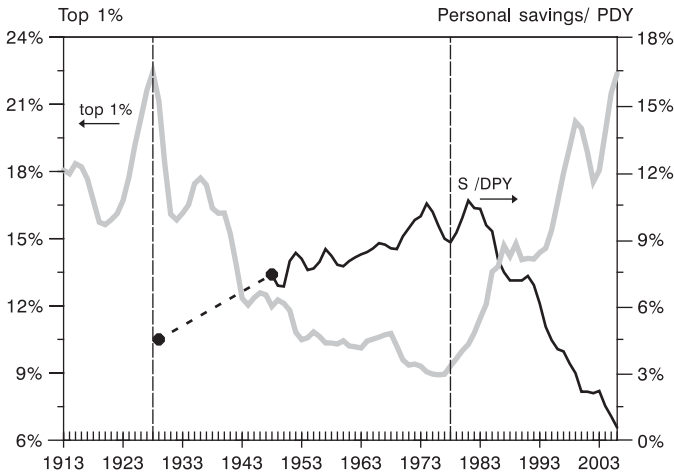


Fig. 11. *Income share of the top 1% and personal savings as a percentage of disposable personal income (DPY) in the USA, 1913–2006. Three-year moving averages: top 1%, income share of the top 1%; S/DPY, personal saving as a percentage of DPY. Data on personal savings between 1929 and 1948 are not shown due to sharp fluctuations during both the 1930s recession and World War II (the same will be the case for other data below).*

Source: US Census Bureau, 2008 (see www.census.gov).

private savings; and a particularly poor rate of private investment—poor especially since increased inequality took place side by side with a relative dynamic increase in personal consumption, high profit rates, easy finance and social tranquillity.

Perhaps the least surprising part of this story is the collapse in the level of personal saving (see Figure 11). Obviously, the collateral damage of three decades of stagnant average real income for the bottom 90% coupled with a dynamic rate of growth of consumption expenditure is personal saving (at least, as traditionally measured in national accounts).¹

Furthermore, contrary to what was widely predicted by the ‘supply-siders’ of the Washington consensus, in this new neo-liberal-type capitalism a remarkable fall in corporate taxation led to a decline in corporate saving as a share of corporate profits (as opposed to what had happened for most of the ‘financially repressed’ Keynesian period; see Figure 12).

The combined effect of the collapse of personal savings and the decline in corporate saving led, of course, to a huge decline in the overall level of private saving—as a share of gross national income net private savings fell from 11.2% in 1984 to 3.3% in 2006.

However, the really remarkable nature of this neo-liberal—and ever more financially rent-seeking—type of capitalism is revealed in the relationship between income polarisation and private investment (see Figure 13).

Even having said all of the above, it is still truly remarkable to see how private investment failed to respond positively to the combined incentives of huge income polarisation cum

¹ As shown in Figure 21 below, households enjoyed a huge increase in net worth after 1980. As individuals felt richer, they may have well perceived that their ‘permanent’ income was growing rapidly as this includes unrealised asset appreciation as well as actual cash flow. That is, if individuals spend a relatively fixed proportion of their perceived income, their spending as a fraction of their flow income would rise. Thus, their conventionally GDP-measured savings rate would fall.

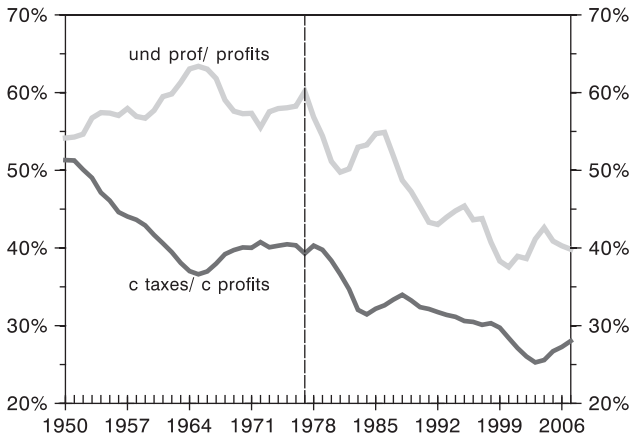


Fig. 12. Undistributed corporate profits and corporate taxes as percentage of corporate profits in the USA, 1950–2007. Five-year moving averages: und prof/profits, undistributed corporate profits as a share of corporate profits; c taxes/c profits, corporate taxes as a share of corporate profits.

Source: US Census Bureau, 2008 (see www.census.gov).

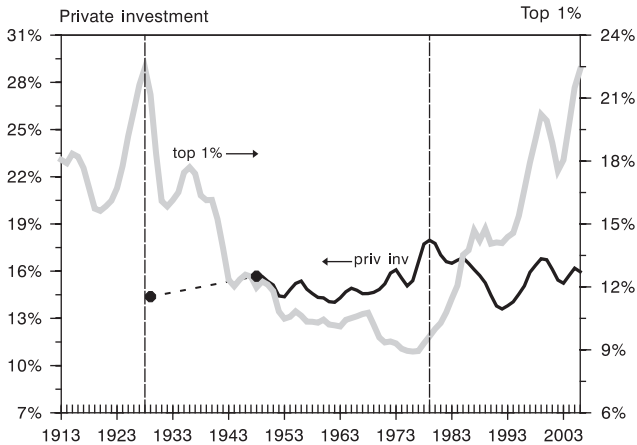


Fig. 13. Income share of the top 1% and share of private investment in GDP in the USA, 1913–2006. Three-year moving averages: top 1%, income share of the top 1%; priv inv, private investment as a percentage of GDP (current prices; excludes private inventories).

Source: US Census Bureau, 2008 (see www.census.gov).

political stability and dynamic growth of personal consumption, high profit rates and overabundance of finance. Private investment instead actually declined as a share of GDP, falling cyclically from its peak of 18.5% of GDP in 1929, to just 15.5% in 2007. In fact, what happened to investment during the neo-liberal period challenges *all* available economic theories of investment.¹ That is, and not for the first time, we are faced with a ‘macro’ that only makes analytical sense if examined within the framework of the political settlement and distributional outcome in which it operates.

¹ Low levels of investment were also a key component of Greenspan ‘conundrum’.

Figure 13 helps us in this direction by revealing the changing nature of the process of accumulation between the Keynesian and the neo-liberal periods. While in the former, the increased ‘compulsions’ for big business and the declining shares of income for top earners had forced the capitalist élite to accumulate via increasing productive capacities and moving away from sheer surplus extraction, the latter period is characterised by a (‘scissor’) movement in reverse. Figure 14 (as data in Section 2 above) also shows how the increased process of ‘financialisation’ led to a remarkable decoupling between the real and financial worlds.

During the period of so-called ‘financial repression’ that followed the Bretton Woods agreement in 1944, total financial assets remained relatively stable as a share of GDP for about three decades (at a level of about 500%), while private investment experienced some acceleration (the two extreme points in the cycle were 13.8% of GDP in 1961 and 18.5% in 1979). The subsequent period of ‘financial liberalisation’, a period of huge asset inflation (that more than doubled the value of total financial assets as a share of GDP) was accompanied by a *slowdown* of the rate of private investment (from 18.5% of GDP in 1979 to 15.5% in 2007). During this period the value of financial assets not only decoupled from the real economy, but the abundance of finance and the associated asset-price-led (not so) ‘irrational exuberance’, instead of having a positive pulling effect on private investment, had the negative effect of ‘friendly fire’. Therefore, there is not much evidence here to support the McKinnon and Shaw-type argument in favour of financial liberalisation—one of the most influential ideas behind the emergence of the Washington consensus (see Chesnais, 2002, and Epstein, 2005).

As Figure 14 also indicates, maybe the main aim of financial ‘liberalisation’ was simply to introduce a ‘unit root’ into the post-Bretton Wood stationary financial processes, so that it could then be ‘shocked’ with (hopefully) permanent upward effects.

Furthermore, policy makers totally ignored the damage that the disproportionate growth of the financial sector was inflicting on the real economy via a special version of the ‘Dutch disease’—in this case, the crowding out of the non-financial tradable sector (both exports and import-competing sectors) by the excessive growth of the financial sector (and of construction).¹ In fact, financial markets were allowed to expand to such an extent that industrialised countries moved from a situation in which banks and other financial institutions were ‘too large to fail’ (e.g. LTCM in 1998), to one in which they became almost ‘too large to be rescued’.²

In turn, Figures 15 and 16 show again how the changing ‘scissor’-type relationship between income distribution and private investment (found in Figure 13) evolved through the political

¹ See Buiter (2009A); for analyses of the ‘Dutch Disease’, see Rowthorn and Coutts (2004) and Palma (2008B).

² The change of dimension of the financial sector is reflected in the fact that at the beginning of the current crisis finance and insurance accounted for 8% of GDP, more than twice their share in the 1960s; and that the share of the financial sector in overall corporate profits increased from 10% to about one-third between 1986 and 2006. Also, the list of stocks making up the Dow Jones Industrial Average did not contain a single financial company until 1982, while at the beginning of 2008, the Dow contained five—including such ‘citadels’ as AIG, Citigroup and Bank of America (see Krugman, 2009A). However, looking ahead it is becoming increasingly evident that the meteoric rise of the public debt in many Organisation for Economic Cooperation and Development (OECD) countries is transforming the public sector into the key institution that has switched from being ‘too fat to fail’ to ‘too large to be rescued’. For example, the US Congressional Budget Office estimates that the public debt-to-GDP ratio will rise from 40% to 80% (or by about US\$9 trillion) during the current administration. So, if long-term rates were to increase to 5%, just the resulting *increase* in debt-servicing would be about 3% of GDP. This may signal the beginning of an inevitable period of Brazilian-style public sector Ponzi-finance (see Palma, 2006).

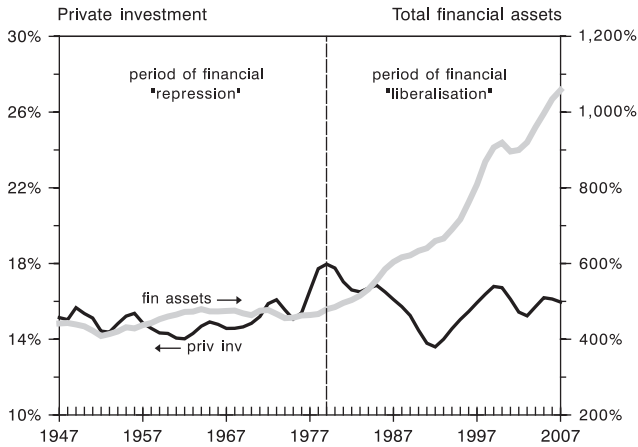


Fig. 14. Total financial assets (all sectors) and private investment as percentage of GDP in the USA, 1947–2007. Three-year moving averages: fin assets, total financial assets (all sectors); priv inv, private investment as percentage of GDP (excludes private inventories). Both series are expressed as percentage of GDP.

Sources: US Bureau, 2008 (see www.census.gov) and US Federal Reserve (2009).

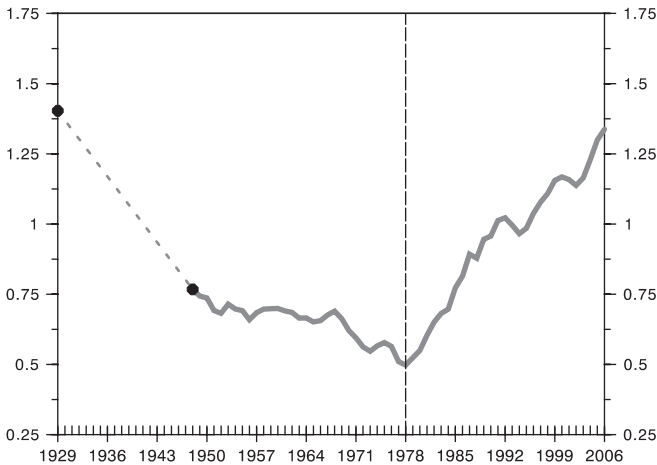


Fig. 15. Income share of the top 1% as a multiple of private investment in GDP in the USA, 1929–2006. Three-year moving averages.

Source: US Census Bureau, 2008 (see www.census.gov).

cycle, but this time from the perspective of the ‘rebound effect’ of the multiple between these two variables.

This statistic could be understood as a proxy for the changing nature of the process of accumulation; i.e., for the changing relationship between what top income earners take away from the economy, and what they put back into it in terms of improved productive capacities. In fact, towards the end of the period this relationship had changed so much that even the income share of the top 0.5% (i.e., only 700,000 families, earning 18.6% of the total in 2006) ended up well above the share of *all* private investment in GDP (15.5%).

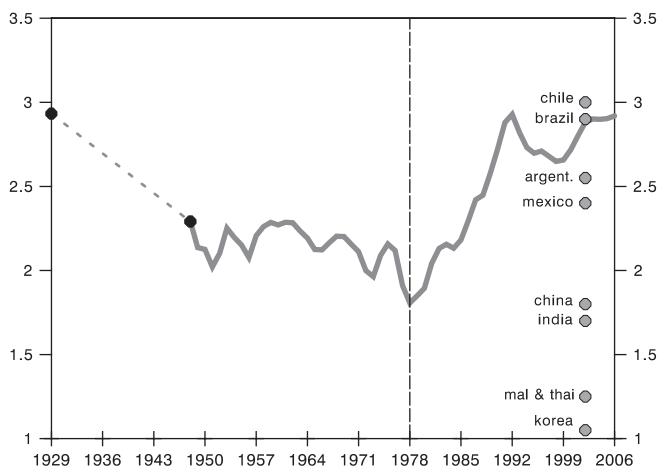


Fig. 16. Income share of the top 10% as a multiple of private investment in GDP in the USA, 1929–2006. Three-year moving averages: argent., Argentina; mal & thai, Malaysia and Thailand.

Sources: US Census Bureau, 2008 (see www.census.gov), and World Development Indicators (available via www.worldbank.org). Note that the income distribution data from the USA comes from a different source to those of the other countries, i.e., in the former from tax returns and in the latter from household surveys. See also the United Nations Trade and Development Report, 1997 (www.unctad.org/en/docs/tdr1997_en.pdf).

Finally, probably no other statistic communicates better the increasingly rent-seeking nature of the capitalist élite during the neo-liberal period in the USA than that in Figure 16.

It seems that the main aim of the neo-liberal capitalist élite in the USA was to create a ‘post-industrial’ capitalism—where there seem to be only carrots but no sticks for the capitalist élite. That is, capitalism with minimal ‘compulsions’ for oligopolistic capital, where, among other things, productive investment could become an optional extra on top of assured rent-earnings opportunities and increased surplus extraction. And also probably no other statistic demonstrates better than that in Figure 16 how the USA seems to be increasingly in some sort of ‘projective identification’ with Latin American-style capitalism (see Palma, 2009B). That is, neo-liberalism also ended up as a *de facto* mechanism for bringing developing countries’ institutional structures and distributional outcomes into industrialised countries.¹ In sum, US rentiers did certainly succeed in their attempt to get rid of practically all obstacles on their greed. When eventually the market called their bluff, it became evident how self-destructive and short-sighted this strategy had been.

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

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

¹ In the Preface to the first edition of *Das Capital* Marx says that ‘[t]he country that is more developed industrially only shows, to the less developed, the image of its own future’ (Marx, 1867). Well, maybe at that time—not any more!

6.1 Greenspan-style virtual wealth creation

According to what I call the first neo-liberal rent-seeking economic law, the increase in net worth resulting from asset price inflation (even if it is only based on unlimited growth of finance) is tantamount to real wealth creation. For example, Figure 17 shows the complete breakdown since 1980 of the relatively long-standing relationship between corporate capitalisation (i.e., the value of corporate equities and bonds) and the replacement cost of fixed (or tangible) assets (comprising mostly plant and equipment).¹

Between 1932 and 1956 both series (with different cycles) had a similar average annual rate of growth (8%); then corporate capitalisation surged ahead until the 1973 oil crisis, when the stagflation that followed overcorrected this asymmetry. Finally, from the early 1980s until the 2007 crisis the annual real rate of growth of corporate capitalisation nearly trebled that of the replacement cost of fixed assets. In fact, even the collapse of the 'dotcom' bubble in 1999 does not seem to have had much long-lasting effect.

In turn, Figure 18 shows the changing pattern of the ratio between these two variables (often referred to as the 'Tobin's Q').

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

In fact, according to a study by Standard & Poor, this 'intangible revolution' meant that the value of intangibles grew from 17% of total corporate assets in 1975, to 80% in 2005 (for a detailed analysis of this issue, see Bichler and Nitzan, 2009). What is ironic is that if this were true, the recent collapse of the stock market could be interpreted as the markets pricing down the value of corporate sector intangible productive capacity by more than half (on the crash of the 'knowledge economy', see Pagano and Rossi, 2009).

In turn, 'Greenspan-style virtual wealth creation' meant that between 1982 and 2007 households net worth in the USA increased by US\$42 trillion, or by a factor of 3. Basically, each had its net worth increased on average by US\$400,000 (or by 12 times the average income of the bottom 90%. Conversely, since the bubble blew up the average net worth of households has declined by US\$130,000, or by an amount larger than the average household debt; see <http://www.federalreserve.gov/releases/z1/Current>)

¹ While 'replacement cost' measures how much it would have cost to produce the existing plant and equipment at prices that prevailed during the respective year, corporate capitalisation presumably mirrors the real value of these assets.

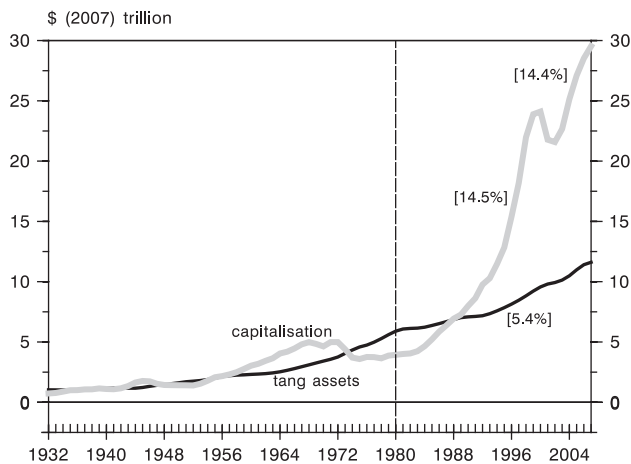


Fig. 17. Corporate capitalisation and the replacement cost of tangible assets in the USA, 1932–2007. Three-year moving averages: capitalisation, total corporate capitalisation (equities and bonds); tang assets, replacement cost of tangible assets. Percentages are average annual real rates of growth between 1980 and 2007 (but in the case of capitalisation excluding the collapse of the technology bubble; i.e., they are the growth rates between 1980–99 and 2001–07). Source: Bichler and Nitzan (2009). The market value of equities and bonds is net of foreign holdings by US residents.

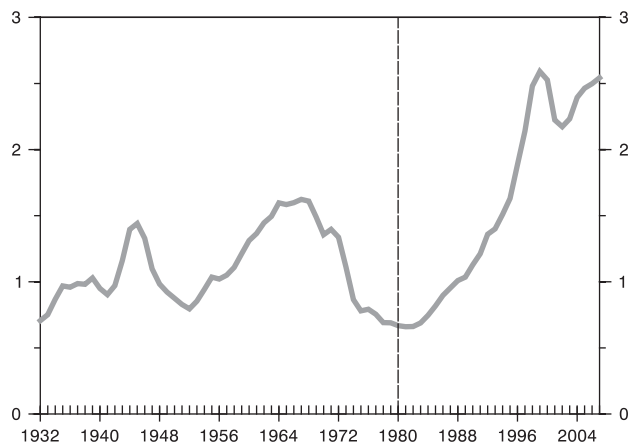


Fig. 18. US: Tobin's 'Q', 1932–2007. Three-year moving averages. Tobin's Q is the ratio of the value of corporate capitalisation to that of the replacement cost of tangible assets. Source: Bichler and Nitzan (2009).

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

According to the second rent-seeking economic law of neo-liberalism, there is nothing as magical as financial markets, and nothing as valuable as the skills of the wizards who perform that magic (otherwise known as the new masters/mistresses of the universe, the new jugglers of perpetual profits). With the advent of neo-liberalism gone were the years when '[b]anks attracted depositors by providing convenient branch locations and maybe

a free toaster or two; [and then] they used the money thus attracted to make loans, and that was that' (Krugman, 2009A). And gone were the years when finance and insurance together accounted for less than 4% of GDP, and when the list of stocks making up the Dow Jones Industrial Average did not contain a single financial company.

However, with the deregulation-minded neo-liberal era, '[o]ld-fashioned banking was increasingly replaced by wheeling and dealing on a grand scale' (Krugman, 2009A). In a way, the logic was simple. More volume and more financial innovation resulted in more fees and more underwriting, which in turn led to more profits. And the securitisation food chain went on: mortgages become ABSs, ABSs became CDOs, CDOs became CDOs-Squared, CDOs-Squared became CDOs-Cubed (by this time not a soul had a clue as to the repetition of exposures in the underlying CDOs), and then even higher CDOs; and the Monopoly Board Game went on and on. In turn, CDOs also took the form of CLOs, CBOs, CSOs, SFCDOs, CRECDOs and CIOs. At each step there were fat fees and more underwriting, and (of course) the opportunity to transfer the risk to someone else down the line. In the meantime, the financial sector ended up generating about a third of all corporate profits in the USA.

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

[...] the wizards were frauds, whether they knew it or not, and their magic turned out to be no more than a collection of cheap stage tricks. Above all, the key promise of securitization—that it would make the financial system more robust by spreading risk more widely—turned out to be a lie. Banks used securitization to increase their risk, not reduce it, and in the process they made the economy more, not less, vulnerable to financial disruption. (Krugman, 2009A)

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

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

As the income distribution and investment data above show, like 'rentier aristocrats' whose wealth depends on their capacity to squeeze surpluses out of peasants, the post-1980 neo-liberal capitalist elite in the USA also preferred to increase its wealth mainly by developing a more effective technology of dispossession. That is, by improving its own coercive powers (on top of its remarkable talents for creating virtual financial wealth), rather than by increasing its capacities for developing further the productive forces of society. From this perspective, this third neo-liberal rentier economic law could also be understood as a new form of moral hazard: one characterised by the fundamental distortion of incentives.

6.4 No need anymore for paying taxes to finance free public goods

As is well known, the huge increase of the pre-tax income-share of the top income earners was actually accompanied by a remarkable fall in their tax rates. For example, according to an IRS (US Internal Revenue Service) report obtained by the *Wall Street Journal*, in 2005 the top 400 income-tax payers (with a combined gross income of more than US\$100

billion) controlled 1.2% of the nation's total taxable income—twice the share they had in 1995. As if this huge increase in taxable income was not enough, this group also had their effective income tax rate cut by nearly half (from 30% to 18%) (see Francis, 2008).¹

Taxes on corporate profits also declined remarkably; for example, these taxes as a percentage of public expenditure fell from 15% of the total in 1978 to just 6% in 1982, while at the same time the public deficit grew by an almost identical converse amount (from 6% to 16% of public expenditure). Again, by 2002 taxes on corporate profits were back at 6% of public expenditure, while the deficit went up again to 16%. In fact, the share of taxes on corporate profits in total public expenditure fell below even the lowest levels reached by this ratio during the difficult years of the 1930s recession (9%). Furthermore, as tax cuts did very little to stimulate the economy, real stimulation was left to the FED, which took up the task with unprecedented low-interest rates and liquidity (see <http://www.vanityfair.com/magazine/2009/01/stiglitz200901>).

Basically, this fourth neo-liberal rentier economic law could be summarised in the following terms: rather than paying taxes to get free public goods, it was much more fun for the top income earners and big corporations to 'part-pay/part-lend' these taxes to the government.

6.5 No need anymore for paying the level of wages required for aggregate demand growth to sustain capital accumulation

An obvious question that emerges from the income distribution data discussed above is how it was politically feasible in the USA to keep the average wage of the bottom 90% stagnant for 30 years. This is an issue with many facets, with both carrots and sticks. On the economic side, the carrots included the mirage of an ever-increasing household net worth due to asset price bubbles—which was also the basis for an ever-increasing access to credit. And on the political and ideological ones, the 'refocusing passion' of what Karl Rove once called 'wedge issues'—God, guns, gays, abortion, military adventures and the war on terror. The sticks included the constant threat of transferring jobs to China, India and Mexico.

Much has been said regarding the increase in household debt before the 2007 financial crisis, and the huge dead-weight that this is bound to bring to the eventual recovery. However, not enough attention has been paid to the fact that this debt was essential to sustain the growth of aggregate demand in the face of stagnant average incomes in the bottom 90% of the population (see Figure 19).

As Figure 19 indicates, the fall in the rate of growth of aggregate income of the bottom 90% (from 3.5% between 1950 and 1980 to 1.8% between 1980 and 2006) is associated with *exactly the same rate of growth of personal consumption expenditure in both periods (3.5%)*. No prizes for guessing what made up the difference.

This gives rise to the fifth neo-liberal rent-seeking economic law: rather than paying the level of wages that were necessary to achieve the growth of aggregate demand required to sustain the process of capital accumulation, it was much more fun for the capitalist élite to 'part-pay/part-lend' this level of wages. Figure 20 indicates the resulting huge increase in the level of household debt (both consumer credit and home mortgage debt) as a share of wages and salaries after the election of Reagan.

¹ It is important to note that by 1995 the effective income tax rate of this group (30%) had already been reduced by the Tax Reform Act of 1986, which had cut drastically the top marginal income tax rates (see Feldstein, 1995).

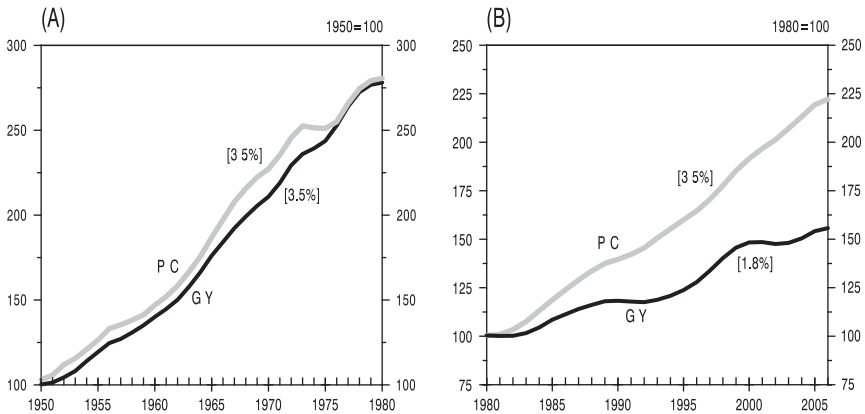


Fig. 19. Gross income of the bottom 90% and personal consumption expenditure in the USA, (A) 1950–80 and (B) 1980–2006. Three-year moving averages: PC, personal consumption expenditure; GY, gross income of the bottom 90%. Note that, due to lack of data, this graph compares the gross income of the bottom 90% with the level of PC of the whole population. For an analysis of the increase in consumption by income groups, see Pollin (2005). Also, note that in panel (B), the gross income of the bottom 90% grows at 1.8% per year only due to the growing number of people within this group, i.e., the aggregate income of the bottom 90% did not remain stagnant (as did their average income), because the stagnant average relates to a growing population. Percentages are average annual real rates of growth in respective periods.

Source: US Census Bureau, 2008 (see www.census.gov).

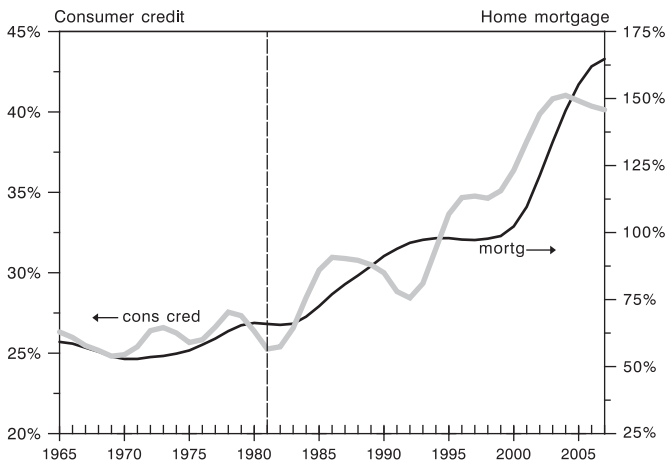


Fig. 20. Debt outstanding of the household sector as a percentage of wages and salaries in the USA, 1965–2007. Three-year moving averages: cons cred, consumer credit of households; mortg, home mortgage debt of households; both series are expressed as percentage of wages and salaries. Sources: US Census Bureau, 2008 (see www.census.gov) and US Federal Reserve (2009).

As Figure 20 shows, consumer credit of the household sector jumped from 25% to over 40% of wages and salaries between the early 1980s and 2007. In turn, home mortgage debt soared from 65% to 166%. And, as is well known, a significant component of the increase in mortgage debt was devoted to finance consumption, because US households were

allowed to transform the capital gains in their homes into ATM machines (home equity withdrawal reached US\$700 billion in 2005; see Roubini, 2009).

Figure 21 illustrates the effects of the capitalist elite's preference to 'part-pay/part-lend' the required level of wages on household debt, and the mirage of an ever increasing households' net worth. The latter not only provided the foundations for the ever-increasing access to credit, but probably was also a fundamental component of the material foundations of the neo-liberal 'spontaneous consensus'-type of hegemony found in the USA since 1980—with its ever increasing tolerance for inequality, which helped the set of distributive strategic choices found during this period, and their corresponding payoffs, become (as mentioned above) the most unlikely Nash equilibrium.¹

During the 25-year period prior to 2007, household sector debt more than doubled as a share of disposable income (it jumped from 65% to 136%), while real household net worth increased (as a share of personal disposable income) from 450% to 615%, having peaked at 645% in 2006.

The USA was not alone in this boom of household debt; in many other industrialised countries, especially in the UK and Iceland, households were also allowed, indeed encouraged, to accumulate an excessive amount of debt. In the UK the latter reached roughly 1.7 times the level of household disposable income, and in Iceland more than 2 times. In the process, households have accumulated an amount of financial risk that has proved to be at levels that are obviously not privately efficient, let alone socially efficient. This excessive amount of risk has become evident in the alternate phase of the cycle, that of the 'sudden stop' to their access to additional financing. In all, the average household in the USA is currently carrying US\$122,000 in personal debts; added to this, its share in federal debt amounts to US\$547,000 (see http://www.usatoday.com/news/washington/2009-05-28-debt_N.htm).²

6.6 *Capitalism can be reconstructed as a system with asymmetric 'compulsions'—minimum for oligopolistic capital, maximum for workers and small and medium firms*

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

¹ Abraham Lincoln famously said that '[y]ou can fool some of the people all of the time, and all of the people some of the time, but you cannot fool all of the people all of the time'. Well, maybe the long household net worth bubble in the USA (and in many other industrialised and developing countries of the time) is the exception in which 'you can fool all of the people for a rather long period of time'!

² For a pre-2007 crisis critical analysis of the neo-liberal period, see Harcourt (2006). If the current federal debt were to be paid in the next 30 years, and assuming a real interest rate of 0% and no population growth, each household would have to contribute US\$22,274 per year (see http://business.theatlantic.com/2009/05/us_debt_668621_per_household.php). This amount is equivalent to more than 70% the current average annual gross income of the bottom 90%.

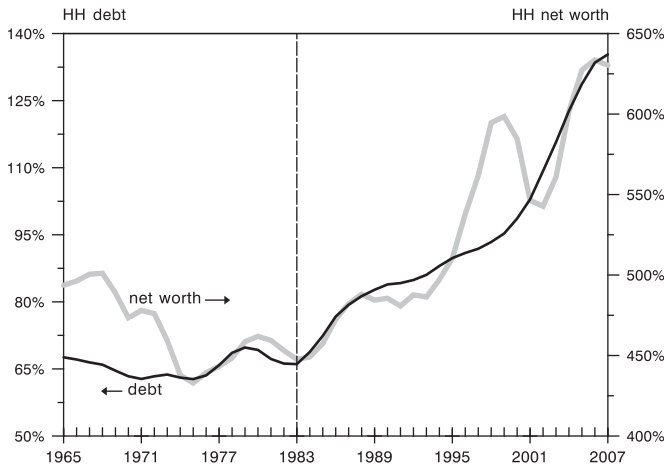


Fig. 21. Household sector debt and net worth as a share of personal disposable income in the USA, 1965–2007. Three-year moving averages: *H H debt*, household sector debt; *H H net worth*, household sector net worth.

Sources: US Census Bureau, 2008 (see www.census.gov) and US Federal Reserve (2009).

The key issue here is not one of equity or fairness (though issues like these are important enough); it is (as the five previous rent-seeking economic ‘laws’ have shown) that those groups who have had the power to appropriate all the carrots have at the same time had the power to minimise the pressures they face for competitive struggles in the real economy (necessary for a historically-progressive capitalist system)—as the head of Chile’s largest holding company, and former President of the Confederation of Chilean Industry explains, “[t]his is a market economy in name only. Competition has disappeared; merges and acquisitions have led to a huge degree of oligopolistic concentration” (<http://www.atinachile.cl/node/4629>). At the same time, large corporations have been able to increase ‘compulsions’ for other economic agents, such as ensuring that workers have to strive continuously in order to improve their performance just to survive in precarious labour markets, and small and medium-sized firms have to strive continuously in order to improve their performance just to stay above water. What oligopolistic capital has failed to understand is that in the long-term capitalist development will necessarily take place *on its own terms*, ‘warts and all’—not in the terms that they please (i.e., ‘compulsions’ for some, rent-seeking for others). Not surprisingly, the neo-liberal capitalist system has not only lost some of its capacities to develop the productive forces of society, but also has become even more crisis-ridden from within. In other words, the rentier economic laws above that have been *de facto* favoured by neo-liberalism have made the self-destructive tendencies of capital more acute.

Perhaps the key lesson here is that no matter how ‘rational’ the neo-liberal discourse may have been in a Foucauldian sense, an institutional environment (neo-liberal or not) in which the economic élite faces so little challenge (either politically or ideologically) is bound to self-destruct. In fact, despite all the ever more dazzling financial pyrotechnics, and the ever more sophisticated breaking-down of value-chains in the global economy, capitalism without the required level of ‘compulsions’ proved to be no more efficient than Communism without workers’ control over the bureaucracy.

How could anybody have believed that a debt-fuelled bubble of asset-price inflation was actually real wealth creation?¹ How could anybody have believed that top income earners could switch the process of accumulation towards the appropriation of an ever-increasing share of national income in a sustainable way? How could anybody have believed that the top income earners and corporations could continue to part-pay/part-lend taxes and wages forever without creating unsustainable financial fragilities? How could anybody have believed that markets would not eventually call the neo-liberal bluff? When this happened, as Krugman remarks, ‘America [began to look] like the Bernie Madoff of economies: for many years it was held in respect, even awe, but it turns out to have been a fraud all along’ (Krugman, 2009B).

So, these rent-seeking dynamics perfectly illustrate the ‘have your cake and eat it’ *de facto* nature of the neo-liberal paradigm, and its delusions that these rent-seeking dynamics were not only sustainable but even good for long-term growth; they also demonstrate the ‘bad faith’ nature of its discourse.²

We are now clearly paying the price for allowing rent-seeking-style ‘sub-prime’ capitalism to run wild, and for the delusional optimism of policymakers and regulators who believed that capitalism is at its most effective when they happily turn a blind eye to the risks associated with extreme income polarisation, multiple asset bubbles and credit booms. ‘How can you be sure it is a bubble? Do you know better than the market?’ In fact, no policy maker was willing to call the ‘exuberant’ behaviour of asset prices a bubble since according to the efficient market hypothesis to call a bubble a bubble would be a contradiction in terms!

7. Conclusions

Following Foucault, as neo-liberalism is not a set of economic policies but a new technology of power, ‘the macroeconomics’ of the post-1980 era only makes analytical sense when examined within the framework of the political settlement and distributional outcome in which it operates. That is, when analysed from the perspective that what emerged *de facto* from the post-1980 neo-liberal era was a new type of capitalism—one that is not only extremely unequal (although remarkably politically stable) and highly rent-based, but also one in which large segments of the capitalist élite wanted to have all the benefits that capitalism could possibly offer without having to struggle with the usual competitive struggles that normally come with these benefits.³ That is, one characterised by ‘split and project’: keep the carrots, shift the sticks; get the upside, transfer the risks. Paraphrasing Gore Vidal, this ‘split and project’ mechanism transformed this political and economic system into one characterised by ‘socialism for the rich and capitalism for the

¹ This, of course, includes the way in which most financial press have interpreted economic news during the genesis and the outburst of the current crisis. First, in a phase that could be called the ‘turning-a-blind-eye’ stage, good news was exaggerated and bad news ignored. In the second, which could be called the ‘first omnipotent stage’, when eventually bad news could not be ignored anymore and at least some had to be acknowledged, this was followed by an attitude of ‘nothing really to worry about, everything is under control’. In the final one, which could be called the ‘second omnipotent stage’, (and only after a short period of ‘shocked disbelief’) there was a turn towards an attitude best summarised by ‘I can take all this on my chin without having to have my economic ideology knocked down’... For a psychoanalytical understanding of this type of awareness/lack of awareness cycle, see Steiner (1993).

² ‘Bad faith’ in Sartre’s sense of ‘*mauvaise foi*’—i.e., of something aiming at deceiving others as much as at deceiving oneself.

³ My late friend and former teacher Andrew Glyn (2006) argued that what came with globalisation was ‘capitalism unleashed’; in fact, what was really unleashed was a very specific form of capitalism.

rest’—or, as Scott Fitzgerald once famously observed, “the rich are different from you and me”.¹ It is not the first time in recent history that rentiers have tried to get rid of all fetters on their greed and transfer all associated risks; however, they have never succeeded on such scale. When eventually the market called their bluff, it became evident how short-sighted (and self-destructive) this strategy had been.

In other words, what emerged was a new type of capitalism characterised by large segments of the capitalist élite attempting to create an economic, political and social environment in which they could have their cake and eat it: call it also ‘neo-liberal neo-Darwinism’. That is, a deliberate attempt (especially from financial capital, and from the ‘mature’ and the most polluting industries of the previous techno-economic paradigm) to create the economic and political environment best suited to the survival of the *un-fittest*—i.e., un-fittest vis-à-vis what was required for a successful deployment in the *real economy* of a new ‘information-technology’ and ‘clean’ techno-economic paradigm.

What also emerged was a new neo-liberal ideology that (maybe not in theory but certainly in practice) provided the required legitimisation needed by financial groups and segments of productive capital both to block the necessary transformations, and to identify and exploit every imaginable new source of rent. It also provided the technologies of power with the required degree of sophistication for accomplishing the most remarkable ‘dispossession feat’ ever within a democracy.² Undoubtedly the key issue is the role of democracy itself—especially the unmasking of the material basis for the ‘spontaneous consensus-type of hegemony’ that allowed all this.

The neo-liberal discourse was also remarkably useful for providing the necessary façade of ‘modernity’ for this spontaneous consensus, which, as Adorno reminded us, can be the most effective disguise: ‘Today the appeal to newness, of no matter what kind, provided only that it is archaic enough, has become universal’ (Adorno, 1974, p. 85). It can even be argued that unchallenged capitalism nearly brought to an end the specific culture in which it developed: the Enlightenment—and especially that crucial aspect that requires the submission of all authority to the scrutiny of critical reason.

There are, of course, many lessons to be learned from the current financial crisis, such as those regarding the need for intelligent financial regulation in intrinsically unstable and fast-changing financial markets—as Keynes argued, what is needed (and probably today more than ever) is an international financial and payments system that at least partially insulates nations from the economic maladies of other nations; it would be the equivalent of quarantining nations where swine flue develops so they do not affect other people around the world (see Davidson, 2009). This crisis also shows us the need for an economic environment that would favour ‘stickers’ rather than ‘snatchers’ (in Hicks’ sense; see Penrose, 1995). However, the main lesson is that it exposed the high degree of toxicity of the (otherwise ‘rational’, in a Foucauldian sense) neo-liberal ideology when it became uncontested and put to the test by an intrinsically rent-seeking capitalist élite, and by an intrinsically compliant political class. From this perspective, the roots of current financial crisis are not necessarily found in an ideology that is toxic per se. Rather, these roots can be found in a mostly rent-seeking and politically unchallenged capitalist

¹ Little seems to have changed since the onset of the 2007-crisis; Krugman (2009C) has called the Geithner–Summers plan to deal with toxic assets as ‘lemon socialism’: ‘taxpayers bear the cost if things go wrong, but stockholders and executives get the benefits if things go right’.

² Maybe after the remarkable behaviour of ‘free’ agents in financial markets and politics in the USA during the recent past, mainstream economists and public choice theorists should perhaps have another look at their concept of the ‘rational agent’.

élite transforming neo-liberalism into a toxic ideology capable of generating a monsoon of toxic assets.

As mentioned above, by now it is also clear that capitalism without the required level of ‘compulsions’ for oligopolistic capital, without a critical mass of opposition, and with such an amenable political class is probably no more efficient than Communism without workers’ control over the bureaucracy. Maybe one could call this phenomenon ‘history’s impossibility theorem’: an economic system (neo-liberal or not) in which the élite faces little challenge either politically or ideologically not only becomes inefficient, but also prone to self-destruct. Under those circumstances, it seems that the ‘death instinct’ inevitably takes over. That is, what does not seem to be historically feasible anymore is to have one’s cake and eat it in a sustainable way. Under these circumstances, it seems that the inevitable outcome is a *predatory* capitalist system, doomed to self-destruct. So, from a Hegelian perspective, it seems that neo-liberal manic reports of the death of history were rather premature.¹

Today it has become fashionable to blame mathematics for the poverty of mainstream economics and its failure to understand what was going on. However, as an Oxford mathematician explains, the problem is not the use but the misuse of mathematics, particularly ‘[...] the corruption of quality and the abuse of uncertainty in mathematical models’ (quoted in Davidson, 2009; for an analysis of mainstream economics ‘ontological fetishism’ with mathematics, see Palma, 2008A). Most analysts also seem to be surprised only at the fact that practically nobody in the profession was able to predict the crisis—as if this were the only failure of mainstream economics that mattered. Rather, its bad performance in predicting the future—and in understanding the present and the past—should be found mostly in its remarkable success in engineering an academic environment in which it got rid of all forms of critical thinking (see for example Pasinetti, 2008). From a psychoanalytic point of view, this then became a vicious circle; the more it succeeded in purging all diversities of ideas, the poorer it became, and the more intolerant of dissent it had to be—in relation to knowledge there seems to be a strong direct relationship between the expectation to understand the real world and the tolerance of dissent (see Britton, 2002; especially his understanding of fundamentalism).²

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

And yet some (especially those who look at this crisis from the perspective of repeated long technological cycles) would tell us that things are bound to change for the better after this crisis and the incoming phase of ‘deployment’ of the current ‘IT’ techno-economic paradigm. In the past, this phase has been characterised mostly by the reversal of the relationship between financial and productive capital, which allows the latter to take the lead and unleash all the potentials of the new technological paradigm—including the considerable ‘creative destruction’ forces of the ‘deployment’ phase. And, in this reversal, productive capital can benefit enormously from the ‘over-investment’ in new infrastructures (in this case in telecommunications) characteristic of the bubble during the ‘installation’ period (the ‘dotcom’ bubble). In fact, periods of ‘deployment’ tend to bring about ‘golden ages’ (see, especially, Pérez, 2002).

¹ Manias are found as much in ideologies as in asset prices! See for example Glassman and Hassett’s *Dow 36,000* (1999).

² According to Britton, in fundamentalism what is important is not what you read, it is *how* you read it; it is not what you think, it is *how* you think it; it is not what you believe, it is *how* you believe it.

However, I think that this time recovery from the crisis may prove to be more complex and problematic than (say) in the 1930s. Basically, capitalism now faces a crisis ‘without an enemy’—either from within (e.g. organised labour), or from the outside. That is, it is unlikely that in the 1930s Roosevelt would have been able to carry out all the political and economic transformations that were necessary to overcome the crisis (and help ‘deploy’ the fourth techno-economic paradigm) were it not for the combined threat of increased domestic instability and growing external challenges from the Soviet Union and Nazi Germany.¹ In other words, the successful transformations of the 1930s had as much to do with the political imperative to come out of the recession in the face of internal and external challenges, as with the objective requirements of the ‘deployment’ period of the fourth techno-economic paradigm (e.g., mass production needing mass consumption fuelled by a fast-growing income of the bottom 90%). The latter provided the logic; the former facilitated its implementation (and hugely reduced the political and economic transaction costs of this transition).

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

Furthermore, current problems are compounded by the fact that both financial and productive capital will probably emerge from the current crisis with an even higher degree of oligopolistic power. Therefore, it is difficult to imagine how it will be politically feasible for the state even to start doing the necessary ‘disciplining’ of the capitalist élite along the lines of increased ‘compulsions’ for big business (needed for a successful transformation of the process of accumulation from its current mostly rent-seeking nature to one based on increased productive capacities). In fact, in Foucault’s terms, what is required even to start injecting some efficiency into the system is a shift from the current neo-liberal state of affairs—in which ‘the state is under the surveillance of the market’—to a liberal-Keynesian one where it is ‘the market that is under the surveillance of the state’. Unless the severity of the current financial crisis is such that it finally ends up making an effective transition possible, perhaps this crisis will be remembered not just for its unique difficulties but for the length of time that it took to come out of it.

Those who want to ‘save capitalism’ from a left-turn (as if capitalism were an endangered species), like Samuel Brittan writing in the *Financial Times*, tell us that the ‘danger’ ahead is that: ‘The assumption that the pursuit of self-interest within the rules and conventions of society will also promote the public interest is not likely to survive—if only because the content of these rules is up for grabs. But it is all too likely to be succeeded by a mushy collectivist pseudo-altruism, in which jealousy and envy are given a free ride’ (http://www.ft.com/cms/s/0/6e92328a-35b4-11de-a997-00144feabdc0,dwp_uuid=ae1104cc-f82e-11dd-aae8-000077b07658.html).

What these analysts do not seem to realise is that their project needs to find a solution for a rather complex problem: how to construct a workable political and economic capitalist agenda when you are saddled with i) an intrinsically rentier capitalist élite that does not

¹ These transformations included increased regulation of financial capital (not just to control its excesses, but also to help shift its orientation towards financing productive investment), remarkable increase in the marginal rate of income taxation and the movement towards a welfare state.

seem to know even what capitalism is all about; ii) a remarkably short-sighted and greedy managerial set (financial executives were not the only ones quite happy—literally—to bet their institutions on wishful-thinking i.e. not the only ones whose wishful thinking became delusional; also, remember that hedge fund manager that complained that an annual bonus of over US\$ 200 million was not enough?; or the former A.I.G Chief Executive Officer who is currently accused of improperly taking US\$4.3 billion in stock from his company's pension fund, because he was 'angry' at being ousted by the company amid investigations of accounting irregularities?); iii) the most unimaginative and lacklustre political class for generations (Obama hopefully being the exception, although unfortunately not much hope for his economic team), and iv) an economics profession that keeps looking at markets mostly like creationists do at evolution?

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

So far, the signs are not very promising. The current economic crisis seems to be changing everything except the fundamental ways that those in power and academia think about economics and politics.¹ Perhaps nothing is more revealing in this regard than the delusion that showering money with little or no conditionality into the financial system (mostly rewarding 'principals' of financial institutions for their failure to oversee that their 'agents' run financial institutions in the shareholders' long-term interests) means that 'we are all Keynesians again'.² Or the prevailing idea that the current financial crisis does not represent the failure of both a whole model of banking and finance (in which an overgrown financial sector did an untold amount of harm), and of a whole model of policy-making (in which the fundamental role for the state ended up being one of a *facilitator* of the rent-seeking practices of big business). In this respect, it is rather depressing to see how the current Geithner–Summers plan for rescuing the US financial system, and the Brown–Darling one for the British system, have as their underlying vision that the post-crisis financial system will be more or less the same as it was before the 2007 crisis, although somewhat tamed by prudent market-friendly regulations—and that everyone who disagrees is just politically naive. And (as the current crisis is supposedly one of illiquidity and confidence) it is also depressing to see how their plan for getting from A to B consists just of easy money and a massive fiscal stimulus—so far, in the USA alone the latter is worth US\$12 trillion in terms of liquidity support and public guarantees, insurances and recapitalisations. So finance ministers and central bankers are prepared to become lenders of first and only resort, spenders of first and only resort, and insurers of first and last resort—but not financial architects of any resort.

¹ According to Roubini (2009), policy makers still hold on to the idea that what is going on now is just '[...] a crisis of confidence - an animal-spirit-driven, self-fulfilling recession - that has led to a collapse of liquidity (as counterparties don't trust one another) and of aggregate demand (as concerned households and firms cut consumption and investment in ways that can turn a regular business-cycle recession into a near-depression)'. See also Krugman (2009A).

² In October 2008 the British Chancellor paid £20 billion for 60% of the shares of the Royal Bank of Scotland despite the fact that the stock market valuation of those shares at the time was less than half that amount—so, paraphrasing Joan Robinson, 'we are all "Bastard Keynesians" again...' Furthermore, as the net worth of that bank at the time was in all likelihood insignificant, it is questionable whether he should have even paid the market value of those shares, as all that the market was probably doing in prizing those shares with a positive value was prizing the likely amount of the impending government subsidy (a bit of simultaneous causation here).

Martin Wolf has argued in the Financial Times that ‘another ideological god has failed’ (<http://www.ft.com/cms/s/0/c6c5bd36-0c0c-11de-b87d-000779fd2ac.html>). Yes, no doubt, but the idolatry seems to go on and on.¹

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

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

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¹ For example, (as mentioned above) for the British Chancellor even the current system of ‘light- and limited-touch’ regulation, with its emphasis on self-regulation and market discipline, should not be changed, as it is not really to be blamed for the financial crisis (see <http://news.bbc.co.uk/2/hi/business/8104340.stm>). This reminds us of what Einstein once said: ‘Two things are infinite: the universe and human stupidity; and I’m not sure about the universe’.

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