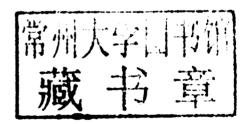


The Crisis of Neoliberalism

Gérard Duménil Dominique Lévy



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Introduction

From the Subprime Crash to the Great Contraction

The crisis that began with the subprime loan crash of August 2007 in the United States will remain a distinctive milestone in the history of capitalism. From its onset, the financial turmoil took unexpected proportions. The shock gradually unsettled the fragile financial structure that had been built during the previous decades and destabilized the real economy. By September 2008, it became evident that capitalism was entering into a deep and lasting crisis, a Great Contraction, reminiscent of the Great Depression.

The Crisis of Neoliberalism

Neoliberalism is a new stage of capitalism that emerged in the wake of the structural crisis of the 1970s. It expresses the strategy of the capitalist classes in alliance with upper management, specifically financial managers, intending to strengthen their hegemony and to expand it globally. As of 2004, when our book *Capital Resurgent*: Roots of the Neoliberal Revolution was published by Harvard University Press, this strategy appeared successful, based on its own objectives, the income and wealth of a privileged minority, and the dominance of a country. The contemporary crisis is an outcome of the contradictions inherent in that strategy. The crisis revealed the strategy's unsustainable character, leading to what can be denoted as the "crisis of neoliberalism." Neoliberal trends ultimately unsettled the foundations of the economy of the "secure base" of the upper classes—the capability of the United States to grow, maintain the leadership of its financial

institutions worldwide, and ensure the dominance of its currency—a class and imperial strategy that resulted in a stalemate.

A New Social Order—A Multipolar World

The crisis of neoliberalism is the fourth structural crisis in capitalism since the late nineteenth century. Each of these earthquakes introduced the establishment of a new social order and deeply altered international relations. The contemporary crisis marks the beginning of a similar process of transition. Not only is financial regulation involved, but a new corporate governance, the rebuilding of the financial sector, and new policies are now required. The basic tenets and practices of neoliberal globalization will be questioned, and production has to be "re-territorialized" in the United States to a significant extent. Accordingly, countries such as China, India, or Brazil will become gradually less dependent on their relationship to the United States. It will be, in particular, quite difficult to correct for the macro trajectory of declining trends of accumulation and cumulative disequilibria of the U.S. economy once the present Great Contraction is stopped.

In any event, the new world order will be more multipolar than at present. Further, if such changes are not realized successfully in the United States, the decline of U.S. international hegemony could be sharp. None of the urgently required tasks in the coming decades to slow down the comparative decline of the U.S. economy can be realized under the same class leadership and unchecked globalizing trends. The unquenchable quest for high income on the part of the upper classes must be halted. Much will depend on the pressure exerted by the popular classes and the peoples of the world, but the "national factor," that is, the national commitment in favor of the preservation of U.S. preeminence worldwide, could play a crucial role. The necessary adjustment can be realized in the context of a new social arrangement to the Right or to the Left, although, as of the last months of 2009, the chances of a Left alternative appear slim.

It is important to understand that the contemporary crisis is only the initial step in a longer process of rectification. How long this process will last depends on the severity of the crisis, and national and international political strife. The capability of the U.S. upper classes to perform the much needed adjustment and the willingness of China to collaborate will be crucial factors. A crisis of the dollar could precipitate a sequence of events that would alter the basic features of the process.

In the coming decades, the new social and global orders will have to confront the emergency situation created by global warming. These issues lie beyond the limits of the present study, whose focus is on the crisis. Stronger government intervention and international cooperation will also be required in these respects that add to the necessity of the establishment of renewed configurations beyond the wild dynamics of neoliberal capitalism.

Abstracting from the updating of some of the series, the last changes to the present text were made in October 2009, and there is obviously more to come. It would be unrealistic, however, to expect a final outcome in the near future. The book covers the causes of the crisis, its outbreak, and the first phase of the contraction of output around the globe, as well as the perspectives for the coming decades. The viewpoint is analytical, not normative.

PART

The Strategy of the U.S. Upper Classes in Neoliberalism: The Success and Failure of a Bold Endeavor

Two very distinct categories of phenomena are involved in the analysis of the contemporary crisis: the historical dynamics of capitalism, on the one hand, and financial and macro mechanisms, on the other hand. The interpretation of the crisis lies at the intersection of these two sets of processes, and the difficulty is to do justice to both and account for their reciprocal relationships.

Neoliberalism should be understood as a new phase in the evolution of capitalism. As such, it can be described intrinsically—its basic mechanisms and contradictions. The reference to a most recent phase raises, however, the issue of *previous* phases. The comparison with earlier periods reveals the traits proper to the new period. The analysis of the social, political, and economic trends that led to the establishment of neoliberalism is also telling of the nature and fate of this social order. Symmetrically, the notion of a crisis of neoliberalism implies a possible transition to a new phase, and the nature of the society that will prevail in the wake of the contemporary crisis is a major component of the investigation here.

Thus, some preliminary questions must be answered. What is a phase of capitalism? How are such phases established? How do they disappear? What are the specific features of neoliberalism as such? The goal of the first chapter is to interpret the rise and fall of neoliberalism under U.S. world hegemony in the broader context of the historical dynamics of capitalism. The proper financial crisis and, later, the sharp contraction of output in the United States and around the globe define a second set of issues. There are two important facets of these mechanisms. One relates to the

dramatic expansion of financial activity and financial deregulation. A degree of technical complexity is involved here, given the astounding capability of the financial actors to innovate (as in securitization, derivative markets, etc.). Macroeconomic mechanisms define a second ensemble of factors. The main variables of concern are consumption and investment, foreign trade, and the internal and external debt of the U.S. economy. And the two sets of mechanisms, financial and macro variables, can be adequately understood only in relation to each other. For example, the growth of the domestic debt, a basic component of the U.S. macro trajectory, relied on the new financial devices that made it possible. This is the focus of Chapter 2, which sketches the overall framework of analysis and conclusions concerning the analysis of the financial crisis and the contraction of output.

The purpose of Chapters 1 and 2 is to summarize the overall argument and, more fundamentally, to introduce a number of basic notions and mechanisms discussed in the rest of the book in a more detailed manner, and for which empirical evidence is provided.

1

The Historical Dynamics of Hegemony

The present chapter focuses on hierarchies among classes and countries, more specifically, neoliberalism as a class hegemony and the global dominance of the United States in neoliberal globalization. The sequence of formation, climax, and crisis of neoliberalism is interpreted as an episode in the history of the rise and fall of such social and international configurations. Neoliberalism appears as the latest of three social orders, which jointly constitute modern capitalism, that is, capitalism since the turn of the twentieth century. The rise and fall of each of these social orders can be dated to the occurrence of major crises, or "structural crises," such as the present one. The historical dynamics of international hegemonies are, somehow, distinct, although the two categories of phenomena are obviously interrelated. For example, the crisis of neoliberalism adds to the threat pending on U.S. hegemony.

Neoliberalism as Class Hegemony—Imperialism in Neoliberal Globalization

Neoliberalism is a multifaceted phenomenon, the outcome of a whole set of converging historical determinants, and it is difficult to precisely determine its beginnings. Actually, the earliest expressions of the new trends were evident from the end of World War II when the basic features of the postwar society and economy were defined. Various developments surrounding the crisis of the dollar in the early 1970s, such as the floatation of exchange rates, or the policies enacted during the dictatorships in Latin America in the 1970s, can be considered early manifestations. Simplifying to some extent, one can contend, however, that neoliberalism was first

established in the United States and the United Kingdom at the end of the 1970s, a crisis decade, a few years later in continental Europe, and then around the globe. The year 1979, when the Federal Reserve decided to raise interest rates to any level allegedly required to curb inflation, is emblematic of the entrance into the new period.

A central thesis in Capital Resurgent: Roots of the Neoliberal Revolution is that the overall dynamics of capitalism under neoliberalism, both nationally and internationally, were determined by new class objectives that worked to the benefit of the highest income brackets, capitalist owners, and the upper fractions of management. The greater concentration of income in favor of a privileged minority was a crucial achievement of the new social order. Income statement data make this apparent. In this respect, a social order is also a power configuration, and implicit in this latter notion is "class" power. National accounting frameworks add to this observation that a large and increasing fraction of U.S. capital income comes from outside of the United States. Not only class relations are involved, but also imperial hierarchies, a permanent feature of capitalism.¹

The new configuration of income distribution was the outcome of various converging trends. Strong pressure was placed on the mass of salaried workers, which helped restore profit rates from their low levels of the 1970s or, at least, to put an end to their downward trend. The opening of trade and capital frontiers paved the way to large investments in the regions of the world where prevailing social conditions allowed for high returns, thus generating income flows in favor of the U.S. upper classes (and broader groups that benefit to some extent by capital income). Free trade increased the pressure on workers, the effect of the competition emanating from countries where labor costs are low. Large capital income flows also derived from the growing indebtedness of households and the government. Extreme degrees of sophistication and expansion of financial mechanisms were reached after 2000, allowing for tremendous incomes in the financial sector and in rich households. The crisis, finally, revealed that a significant fraction of these flows of income were based on dubious profits, due to an increasing overvaluation of securities.

Besides the comparative interests of social classes, the leading position of the United States, economically, politically, and militarily, must also be considered. The political conditions underlying the dominance of the

United States in the decades preceding the crisis are well known. Two major factors are the fall of the Soviet Union and the weakness of Europe as a political entity. Neoliberalism corrected for the earlier decline of the leadership of the United States in the 1970s, at least vis-à-vis Europe and Japan. The U.S. economy is still the largest in the world in terms of gross domestic product (GDP), with a leadership in fields as important as research and innovation, both in production and financial mechanisms. As a consequence, the dollar is acknowledged as the international currency.

The international neoliberal order—known as neoliberal globalization was imposed throughout the world, from the main capitalist countries of the center to the less developed countries of the periphery, often at the cost of severe crises as in Asia and Latin America during the 1990s and after 2000. As in any stage of imperialism, the major instruments of these international power relations, beyond straightforward economic violence, are corruption, subversion, and war. The main political tool is always the establishment of a local imperial-friendly government. The collaboration of the elites of the dominated country is crucial, as well as, in contemporary capitalism, the action of international institutions such as the North Atlantic Treaty Organization (NATO), the International Monetary Fund (IMF), the World Bank (WB), and the World Trade Organization (WTO). Economically, the purpose of this domination is the extraction of a "surplus" through the imposition of low prices of natural resources and investment abroad, be it portfolio or foreign direct investment. That countries of the periphery want to sell their natural resources and are eager to receive foreign investment does not change the nature of the relations of domination, just as when, within a given country, workers want to sell their labor power, the ultimate source of profit.

The same notion, hegemony, is used here to refer to both class hierarchical relationships, as in neoliberalism, and imperialism internationally. No distinction is made between *hegemony* and *domination* as in approaches of Gramscian inspiration. The notion emphasizes a common aspect within class and international mechanisms. In each instance, a class or country leads a process of domination in which various agents are involved. In neoliberalism, the upper fractions of capitalist classes, supported by financial institutions, act as leaders within the broader group of upper classes in the exercise of their common domination. Similarly, the United States acts as leader within the broader group of imperialist countries.

There are important implications to the notion of joint, though unequal, domination by a group of upper classes or advanced countries. The common domination is based on cooperation but also rivalry. At the top of a social hierarchy, various groups are involved and support the project of a more narrowly defined leadership. Such hierarchical alliances can be denoted as "compromises," as the leader adjusts its demands to some of those emanating from its followers but finally prevails over them. The same is true concerning the comparative positions of the various countries within the group of imperialist powers. A compromise at the top also prevails in the exercise of a joint domination internationally, but discipline is imposed by the hegemonic power (as in Athens's Delian League).

In the determination of real and financial trends in contemporary capitalism, these two components—class and international hegemonies—have interacting effects. The present crisis manifests the contradictions of a historical trajectory jointly fashioned by these two strands of factors typical of what can be denoted as "neoliberalism under U.S. hegemony."

A Historical Perspective: Modern Capitalism

The definition of neoliberalism as the latest phase of capitalism raises the issue of previous periods and the overall periodization of capitalism (Box 1.1). What were the previous phases of capitalism? In what respect is neoliberalism distinct? The investigation here uses the notion of modern capitalism, meaning capitalism after the corporate, financial, and managerial revolutions, that is, from the turn of the twentieth century to the present, and neoliberalism is described as the third and most recent phase of modern capitalism.

The dawn of the twentieth century was marked by the emergence of a new institutional framework of capitalist relations, the set of institutions typical of modern capitalism. (In this analysis, a special emphasis is placed on the United States where the corresponding social and economic transformations were stark.)

1. Capitalism in the late nineteenth century. During the last decades of the nineteenth century, the size of enterprises increased in parallel to the sophistication of their internal technical and organizational processes. The