Financial Crisis and the Neoliberal State

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The recent global financial meltdown following the sub-prime debacle in the United States challenges the very foundations of the neoliberal ideology, which has held sway for the last thirty years. The unprecedented fall of global stock and commodity markets has shattered the myth of their infallibility and brought into focus the ugly head of greed as the driving force behind them. Millions of people were deprived of their savings (held in stocks or funds) by financial institutions and their greed-driven employees. The financial meltdown represents a geopolitical shift which is likely to alter the balance of power in the world. It will be now difficult to ignore demands to install a new international order which is democratic, and fair to all.

**Key words**: financial crisis, global economic meltdown, neoliberalism, capitalism, market economics

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The recent domino-style collapse of long-established financial institutions in the United States and Europe as a result of the sub-prime debacle challenges the very foundations of the neoliberal ideology, which considers markets infallible, and the supreme arbiter of economic activity. Governments, which are supposed to be sovereign, become subservient to the markets and during the last three decades at least one government—the American Government—seemed to have surrendered even its sovereignty to them. Neoliberals hold the view that markets know best because they have an in-built mechanism, which automatically balances supply and demand. And, since they know best, markets do not require any regulation, guidance, or supervision. I strongly believe that markets too, like any other institution, need regulation and monitoring. Moreover, they should be accountable to the public through their elected representatives in parliament or Congress. In this paper, I will first present a brief history of the neoliberal ideology and then show how it enabled the ‘State’ to retreat from its primary responsibilities. Next, I will attempt to establish that the monitoring and regulation of markets is an inalienable part of governance, a primary responsibility of governments for which they are elected.

The disintegration of Soviet Union and the subsequent collapse of the socialist state system in 1991 prompted Francis Fukuyama to proclaim the victory of the Western capitalist liberal democracies. In his enormously famous and controversial work, *The End of History and The Last Man*, he argues that the demise of socialist state system has left capitalist liberal democracies as the ideal model of political organization and, as such, no further progress (in the development of underlying principles and institutions) is possible (1992). And yet, barely 15 years after the publication of his work, the world capitalist system, as we have come to understand it during the last 15 years, seems to be under serious threat and may not survive in its present shape. It is ironic that the capitalist liberal democracies which celebrated the demise of socialist state system have themselves proved Marx right that capitalism carries within it the seeds of its own destruction. The twin failures of the neoliberal state to provide adequate governance in the economic sphere and to ensure the fundamental right of citizens to personal property, leading to worldwide demands to overhaul the global financial system created by the neoliberal state, repudiates Fukuyama’s claim.

History of the Neoliberal Ideology

The origin of the neoliberal ideology can be traced back to Adam Smith, considered by many as the father of modern capitalism, who, in his book *The Wealth of Nations*, stated that for maximum efficiency, all forms of government interventions in economic issues should be removed and

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that there should be no restrictions or tariffs on manufacturing and commerce within a nation for it to develop (1776). Free trade formed the basis of economic policies of Great Britain and the United States throughout the 19th century and until the Great Depression of 1929. The Great Depression brought into view glaring shortcomings in Smith’s economic philosophy and highlighted the widening disparities between the rich and poor. Enter John Maynard Keynes, a Cambridge economist, who suggested that government intervention and regulation was necessary to achieve equitable development. This formed the basis of what we now call “Keynesian” model of economic development, and it lifted Europe and the United States from economic morass both before and after the 2nd World War. The Marshall Plan (for Europe) and Roosevelt’s New Deal laid the foundations for unprecedented prosperity while, at the same time, giving to people for the first time ever, benefits such as social security, health and education. In the United States, between 1946 and 1973, productivity more than doubled, making it the wealthiest and most powerful nation on the planet. Such increase in national wealth enabled the government to greatly expand the scope of social programs during most of the sixties and seventies.

But as Karl Marx noted in The Communist Manifesto, the progress of history is never linear (Marx, 1848). In 1979, Thatcher, and in 1981, Reagan assumed power and changed all that. Both hated government’s active role in the economy and they were determined to resurrect the ghosts of Adam Smith, in total disregard of the lessons learned during The Great Depression of the 1930’s as a result of the Western governments following classic capitalist policies. They pushed the neoliberal agenda with great zeal starting in the early eighties. Both openly acknowledged their hatred of the public sector and worked towards privatization of the hitherto state-run enterprises including water, power generation, and education within their own countries. Internationally, The World Bank and IMF became their willing instruments for the imposition of ‘Structural Adjustment Policies’ on poorer countries which were forced to open up their economies so that big multinational companies from the rich countries could access resources cheaply.

Main Causes of the Financial Crisis

It is widely believed that the current financial crisis is a consequence of the subprime housing debacle. That is only partly true. The financial meltdown would have occurred anyway, the subprime only hastened the inevitable. Nor is this the first time that people have suffered under neoliberal policies. Most of us can easily recall the S&L fiasco during the Reagan era. The neoliberal ideology, as it began to shape up during the eighties and nineties, put much more trust on market forces than on elected representatives or governments. But governments are accountable to their people, markets are not. At least in theory, governments are guided by the desire to promote equality and social justice. The sole driving force behind businesses is the maximization of profits. Furthermore, governments (or democratic governments) are better positioned to work towards equitable distribution of wealth among all citizens than huge corporations whose top management aims to appropriate and distribute billions of dollars privately among its top management. According to a recent CNN news report, the financial institutions which received hundreds of billions of dollars from the American Government immediately set aside billions to pay their top executives either as bonuses or performance rewards. What is this if not organized stealing.

According to a recent survey of corporate compensation in America, CEOs of the top 50 companies received a median total direct compensation for 2007 of just under $14 million (Mercer, 2008). If we assume that the lowest-paid employee at these top companies receives an average annual compensation of $36,000, this represents a ratio of 386:1 between the compensations of the highest-paid and the lowest-paid. In any society, this kind of disparity is simply not acceptable. Nor can it be argued that these CEOs have extraordinary skills because, if they had, most of these financial institutions and other big American businesses such as GM and Chrysler would not be bankrupt, or approaching bankruptcy.

Banks have been the repositories of public trust. The traditional role of banks has been to accept deposits and lend money. While lending money, banks made sure that the recipient of a loan has the capacity to pay back. Lax or no regulation enabled some of the biggest and most trusted banks to indulge in activities which contravene
fundamental banking principles. They enticed people to borrow more and more, and gave loans to those who could not afford to pay them back. This cycle went on and on until the borrowers could not pay any more and the credit dried up. Financial markets hinge on trust, and that trust has eroded. Writing for The Guardian of 16 September 2008, Joseph Stiglitz, a 2001 Nobel Prize winner in economics and former chief economist at the World Bank, states, “The new low in the financial crisis . . . is the fruit of a pattern of dishonesty on the part of financial institutions, and incompetence on the part of policymakers.” Always opposed to regulation and government intervention, the banks approached the government for bailout and cash injections to escape bankruptcy. And, firmly rooted in the neoliberal ideology, the government obliged—socializing costs while privatizing profits. “If institutions need to be rescued like banks, they should be regulated like banks” said Paul Krugman, a 2008 Nobel Prize winner in economics, in The New York Times of 14 September (Krugman, 2008).

In its most recent six-monthly report, the International Monetary Fund has warned that more banks may fail as doubts persist about the viability of their business models. Private funding is “virtually unavailable” and banks will have to rely on public intervention, asset sales and consolidation, it said (IMF, 21 October 2008). At the time of this writing, three European countries—Iceland, Ukraine and Hungary—have already sought, and received, IMF financial assistance to stave off bankruptcy.

The neoliberal state, focused primarily on the pursuit of profits, provides an excellent environment for the growth of excessism and decline of humanity. In this system everything is seen as a commodity which can be either bought or sold with the sole aim of making a profit. Thus, the universities sell education for profit, an individual sells his skills in the job market, doctors sell treatment to sick people based on their ability to pay rather than their desperate need for cure, and businesses buy or sell anything as long as it contributes to the bottomline. And God help those who do not have anything to sell, or are perceived as having nothing to sell.

Capitalism requires unlimited supply of raw materials, huge infusions of capital, access to global markets, and an environment devoid of regulation, which the neoliberal state provides. The relentless pursuit of profits generates excesses at all levels—excess of production, availability of unlimited credit, excessive indebtedness (in government, businesses and individuals), senseless consumerism, and environmental degradation, to name a few. The United States manifests all of this, at this juncture, more than any other country. The financial crisis has made it amply clear that it is not possible to continue to live beyond our means and to expect infinite growth in a finite world. Arguing against excessive materialism and meaningless growth, E. F. Schumacher, in his bestselling book, Small is Beautiful: Economics as if People Mattered, espoused the use of smallscale technology and enterprises to benefit both human-kind and the environment. In his view, large-scale technology and big multinational corporations cause degradation of human beings and the environment (1973).

The financial meltdown shows no sign of abating in spite of trillions of dollars committed by the governments of Europe, Japan, the United States, and other countries to prop up failed financial institutions. It is now becoming painfully obvious that this would cause a considerable reduction in economic activities and huge unemployment in many countries.

Fortunately, developing countries led by India had been strongly resisting demands from the United States and Europe to further open up their markets under the Doha Round of trade talks, resulting in their eventual collapse in July 2008. Had the developing countries caved in to Western demands two years ago, we would be perhaps witnessing massive unemployment and mass starvation now due to the twin effects of rising food prices and the financial debacle.

The global financial meltdown represents a geopolitical shift, and it is likely to alter the balance of power in the world. “The era of American global leadership, reaching back to the Second World War, is over . . . The American free-market creed has selfdestructed, while countries that retained overall control of their markets have been vindicated”, wrote Prof. John Gray, the political philosopher, recently, in an article in The Observer (2008).

Response of Various Countries to the Global Financial Crisis

When the cards are down, even the most stub-
born are brought to their senses. After considerable cajoling by European leaders, President Bush is planning to invite a select group of world leaders to assemble in the United States by the end of this year to discuss reform of the global financial system. But, here again, Bush has already made clear that any discussions to reform the financial system must not undermine free markets. He said any plan to rethink financial mechanisms should “preserve the foundations of democratic capitalism” and include “a commitment to free markets, free enterprise and free trade”. Bush’s refusal to let go of the neoliberal coattails might undermine the newly-generated European enthusiasm to entertain fresh ideas for a reform of the global financial system.

The French President Nicolas Sarkozy and European Commission President Manuel Barroso would like Bush to tighten and better coordinate control of the financial markets in response to the financial crisis. “Together we need to rebuild a capitalism that is more respectful to man, more respectful to the planet, more respectful to future generations and be finished with a capitalism obsessed by the frantic search for shortterm profit”, said Sarkozy. Agreeing with him, Barroso stated, “We’re talking about a market economy with rules, that is the European model”.

Japan approved in mid-October a 1.8 trillion yen (US$18 billion) extra budget to partially finance an economic stimulus package designed to help small businesses and consumers cope with the impact of fuel and commodity price increases. The extra budget is part of an 11.7 trillion yen (US$117 billion) emergency stimulus package drafted in August, before the global financial turmoil worsened in September following the bankruptcy of Lehman Brothers and recent global stock markets crashes.

The European response, led by France, Germany and the United Kingdom, to the financial crisis seems more responsible, mature, and appropriate. European leadership declared that reform must be all-encompassing and should include international supervision to ensure transparency and accountability.

Politics and economics are closely intertwined. Political liberalism is usually followed by liberalization of economic activities, and vice versa. We elect our governments to govern, and to ensure that our fundamental rights are not usurped. On both counts, neoliberal governments have failed. Managing the national economy is one of the basic responsibilities of State, and the government’s unwillingness to frame adequate regulations for the financial sector amounts to an abdication of state responsibility. Giving a free hand to the financial sector without any regulations and oversight is like giving guns to people in an environment in which there is no authority and no police. Most men are driven by greed, more than anything else, and in the absence of regulations, their actions are bound to be geared towards personal aggrandizement. The current financial crisis is as much about ordinary people as it is about financial institutions. A lot of people got cheated and deprived of their wealth due to the unscrupulous business practices of financial institutions and their employees. The fact that this was allowed to happen represents the second failure of the state to ensure its citizens’ right to property (savings, pension fund, etc.).

Conclusion

In conclusion, we can say that the financial meltdown is a direct consequence of the neoliberal policies which gave a virtually free hand to financial institutions to conduct their affairs in whatever way they saw fit, and the unwillingness of governments to intervene on behalf of the greater public good. Now is a once-in-a-lifetime opportunity to create new institutions and new practices. It is an opportunity to initiate a structural change in the outdated global financial services sector. The two major international financial institutions, World Bank and IMF, are the creation of the Bretton Woods Conference, held in 1944, and both seem to have made little contribution to the healthy development and growth of the global economy. This is not surprising because their policies and one-size-fits-all prescriptions merely echo “their master’s voice”, i.e., the neoliberal state.

References
