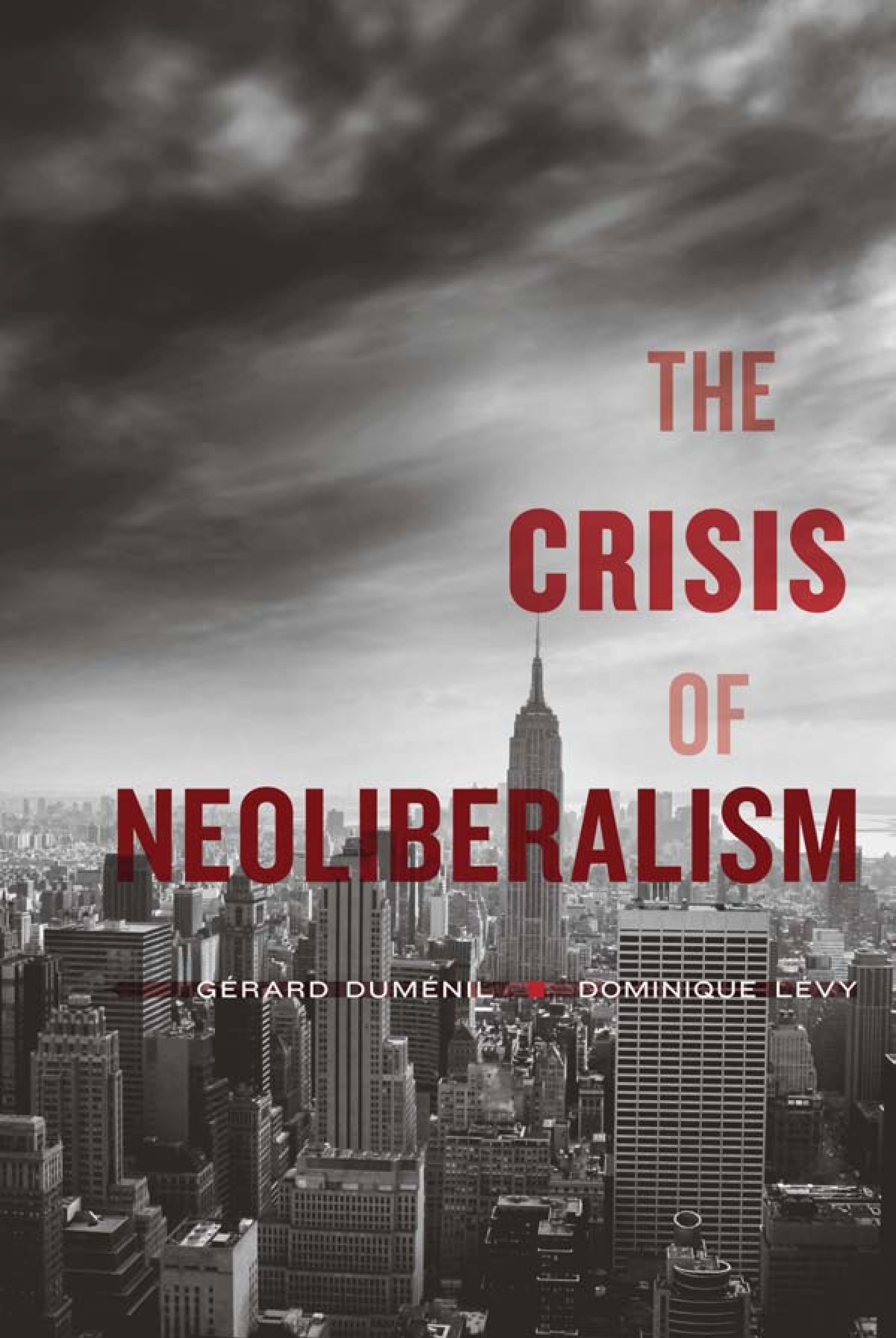
THE
CRISIS
OF
NEOLIBERALISM
GÉRARD DUMÉNIL
DOMINIQUE LÉVY

THE CRISIS OF NEOLIBERALISM

The Crisis of Neoliberalism

Gérard Duménil
Dominique Lévy

HARVARD UNIVERSITY PRESS
Cambridge, Massachusetts
London, England • 2011

Printed in the United States of America

Library of Congress Cataloging-in-Publication Data

Duménil, Gérard.
The crisis of neoliberalism / Gérard Duménil and Dominique Lévy.
p. cm.
Includes bibliographical references and index.
ISBN 978-0-674-04988-8 (alk. paper)
1. Global Financial Crisis, 2008–2009. 2. Neoliberalism—United States.
3. Capitalism—United States. I. Lévy, Dominique. II. Title.
HB37172008.D86 2010
330.973—dc22 2010006788

Contents

THE CRISIS OF NEOLIBERALISM

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

I

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.

CHAPTER

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

Box 1.1
Periodizing Capitalism

There is no single periodization of capitalism. History refers to a set of distinct phenomena, linked within a network of reciprocal relationships but also manifesting important degrees of autonomy. Analysts have based periodizations on, among other things, institutional transformations, long waves, technical change and profitability trends, competitive patterns, policy frameworks, or social and political relations. Rudolf Hilferding, for example, advanced the concept of "finance capital," to account for a feature of the new phase of capitalism in the early twentieth century (what the present study denotes as "modern capitalism"), on the basis of the transformation of the relationship between the financial and industrial sectors. An important literature focused on the notion of "long waves," originally articulated by Nikolai Kondratieff, with several decade-long phases of expansion and stagnating growth, separated by major crises. In the 1960s, Paul Baran and Paul Sweezy coined the concept of "monopoly capitalism," based on a new pattern of competitive mechanisms. In the United States, important research has been devoted to "managerial capitalism," another crucial aspect of the metamorphosis of capitalism. In previous work of the authors, the history of capitalism, from the late nineteenth century to the present, is described by reference to three categories of phenomena: (1) relations of production and class patterns; (2) configurations of power among classes, or social orders; and (3) the trends of the profit rate.[1]

There are important reciprocal relationships between such periodizations, although there is no unambiguous chronological overlap in the definition of periods.

1. R. Hilferding, *Finance Capital: A Study of the Latest Phase of Capitalist Development* (1910; London: Routledge and Kegan Paul, 1981); N. D. Kondratieff, "The Static and Dynamic View of Economics," *Quarterly Journal of Economics* 34, no. 4 (1925): 575–583; I. Wallerstein, "Globalization or the Age of Transition? A Long-Term View of the Trajectory of the World-System," *International Sociology* 15, no. 2 (2000): 250–268; G. Arrighi, *The Long Twentieth Century: Money, Power and the Origins of Our Times* (London: Verso, 1994); P. Baran and P. Sweezy, *The Monopoly Capital* (New York: Monthly Review Press, 1966); A. D. Chandler, *The Visible Hand: The Managerial Revolution in American Business* (Cambridge, Mass.: Harvard University Press, 1977).

development of transportation and communication allowed enterprises to expand nationally and internationally. Simultaneously, monetary and financial mechanisms underwent a thorough process of transformation and expansion, with the dramatic development of banks, loans, and fiduciary money.

The major depression that struck the U.S. economy during the 1890s, originally known as the "Great Depression" prior to the greater one in the 1930s, played a central role in the establishment of this new framework. The previous decades had witnessed the rise of trusts, pools, and cartels in an attempt to confront rising competitive pressures. The crisis of the 1890s was blamed on excess competition and increased the incentive to seek protection against cutthroat competition. The loose agreements between enterprises, which remained independent entities, to share markets or profits were prohibited by the Sherman Act. The act, passed in 1890, was the first federal legislation pertaining to competition.

2. *Three revolutions.* The historical framework used here distinguishes between nineteenth-century capitalism and capitalism after the major revolution in ownership and management (relations of production) accomplished at the turn of the twentieth century. Three components of this revolution—the corporate, financial, and managerial revolutions—can be distinguished. The *corporate revolution* refers to firm incorporations. In the wake of the crisis of the 1890s, the new corporate laws enacted in New Jersey (simultaneously to the passage of the Sherman Act) and rapidly extended to other States,[2] gave a general impetus to a dramatic wave of incorporation around 1900. The rapidly expanding banking system was the engine of the *financial revolution,* as large banks financed these new corporations in a complex relationship, actually a mix of support and dominance. Within this new framework arose a third transformation, the *managerial revolution,* in which the delegation of management to a salaried managerial personnel—supported by a subordinate clerical personnel—reached new heights (notably, though not exclusively, in relation to the organizational arrangement in the workshop known as "Taylorism"). This was a major step in the separation between ownership and management. Although the managerial revolution occurred at the turn of the twentieth century, this separation and the corresponding sophisticated management are fundamental features of modern capitalism in all of its phases. ("Managerial capitalism" is used here in reference to only the first postwar decades.)

3. *Capitalist classes and financial institutions: Finance.* The three revolutions allowed for the establishment of a bourgeois class less connected to individual enterprises. The ownership of the means of production was supported by the holding of securities. This was the outcome of the expansion of what Marx had called "money capitalists," lenders, and shareholders.[3] The combination of the corporate and financial revolutions with the emergence of large corporations backed by financial institutions introduced new types of relationships in which the power of the upper fractions of capitalist classes relied heavily on financial institutions (Box 4.1). This concentration of capitalist power within financial institutions and the importance of securities in the ownership of the means of production gave the domination of capitalist classes in modern capitalism a strong *financial* character. For this reason, this book uses the term "Finance" to refer to the upper fractions of capitalist classes and to financial institutions in any social arrangement in which these fractions of capitalist classes control financial institutions (as is generally the case in capitalism). Finance, as used here, is not a separate industry. Instead, it combines class and institutional aspects.

This notion of Finance applies only to modern capitalism. Prior to the three revolutions, there was obviously money capitalists besides "active capitalists" (entrepreneurs), as well as a financial sector in the economy. But a new institutional configuration was built at the turn of the twentieth century, with big capitalist families holding large portfolios of shares and bonds, potentially diversified among various industries, and with a financial sector playing a major role in the financing of accumulation and the exercise of the prerogatives attached to ownership. The notion of Finance is crucial to the analysis of neoliberalism. The power of capitalist classes and financial institutions in this social order cannot, however, be separated from the progress of management—notably, though not exclusively, financial management—which gained considerable importance. Thus, the early twentieth century marked the culmination of social trends already under way during the nineteenth century, whose emblematic figures were the rentier bourgeois class, a "leisure class" as in Thorstein Veblen's terminology,[4] and the new managerial classes.

4. *A tripolar class configuration.* Central to the analysis here is the observation that modern capitalism coincided with the establishment of new class patterns more complex than the simple distinction between capitalists and production workers. Besides traditional middle classes of small

1. Capitalist classes

2. Managerial classes

3. Popular classes

Diagram 1.1

peasants, shopkeepers, and craftsmen, modern capitalism saw the expansion of managers and clerical personnel.

The outcome of these social trends was not the formation of a single homogeneous intermediate class, the new middle class, in between owners and production workers, blurring class boundaries. Instead a sharp polarization occurred within these groups, meaning a new hierarchy among wage earners, a division between leading and subordinated categories. The phrase "managerial and clerical personnel" is meant to capture this dual pattern. ("Clerical" must be taken here in a broad sense, including notably commercial tasks or maintenance.) Managerial personnel define the leading category, and these clerical personnel, the subordinated category.

As a result of the gradual transformation of production and clerical labor during the latest decades of modern capitalism, it became gradually more relevant to consider jointly clerical personnel and production workers. This is a helpful simplification that reduces intermediate classes to managerial classes. The book uses the threefold pattern as in Diagram 1.1.

None of these classes is homogeneous. It is often useful to distinguish between the upper fractions and the remainder of the groups, as is traditional within capitalist classes. One can separate between the holders of a large portfolio of shares, the owners of small- or medium-size firms, and a truly petty bourgeoisie. But similar hierarchies are also typical of managerial classes. Last, the merger between production and clerical workers defines more a trend than a mature outcome and, in contemporary capitalism, the coexistence of heterogeneous categories is still a basic feature of these groups.

Power Configurations and Their Class Foundations

Neoliberalism is the latest of the three social orders that jointly constitute modern capitalism. There are class foundations to such social arrangements. For this reason, they can be denoted as "class power configurations." The first and third—respectively, from the turn of the twentieth century to the New Deal, and since the early 1980s—can be called a "first" and a "second financial hegemony." Financial hegemony, as used here, refers to the fact that capitalist classes—actually Finance, the upper fraction of capitalist classes and financial institutions—benefit from a rather unchecked capability to lead the economy and society in general, in accordance with their own interests or what they perceive as such. This is, somehow, a "normal" situation in modern capitalism, and the capitalism of the first postwar decades, from the New Deal to the late 1970s, during which this power was diminished, stands out as an exception. The social order that prevailed during those years is often called a "social democratic" or "Keynesian compromise," but this terminology is not unproblematic.

1. *The first financial hegemony.* A striking aspect of the first decades of the twentieth century was the combination of a free-market economy, both domestically and internationally (with the gold standard), and the dramatic progress of organization within corporations.[5]

As stated in the previous section, central aspects in the establishment of modern capitalism, during the first decades of the twentieth century, were the emergence of a bourgeois class more or less separated from the enterprise, and new financial institutions that were tightly connected to nonfinancial corporations. The access of the bourgeoisie to this new institutional configuration did not destroy all earlier segments. Instead, it involved the elimination of some fractions of the upper classes, the survival of others, or their transformation. In this new power configuration, the upper fractions of capitalist classes were able to dominate the economy and society, both nationally and internationally. The power of management within large corporations was already significant during the first decades of the twentieth century, and there was an increasing emotion among capitalist classes concerning their capability to control corporations. It is certainly possible to refer to the prevalence of a compromise between Finance and the upper fractions of managerial classes. It was the Great Depression, the New Deal, and World War II that signaled the end of this epoch.

2. *The postwar compromise.* The second period stretches from the New Deal and World War II to the end of the 1970s. There were three main facets to the overall transformation of social hierarchies during these

sample content of The Crisis of Neoliberalism