THE MARKETS YOU DIDN'T VOTE FOR CONTROL YOUR GOVERNMENTS

Higher finance

Pre-crash free market ideology was only briefly out of favour. Although it was proved false and unviable, it soon returned to fill the void. Nobody knows any better — or can think any differently

by Ibrahim Warde

Global finance was on the brink of catastrophe just three years ago. On 7 September 2008 the US government nationalised mortgage giants Fannie Mae and Freddie Mac. On 15 September the venerable investment bank Lehman Brothers declared bankruptcy. The next day, heeding Wall Street's call, Washington bought American International Group (AIG), the country's leading insurer. Stock markets plunged. The US took control of car and truck makers and pumped hundreds of billions of dollars into the economy. Keynes, the New Deal, and government interventionism were in the spotlight.

In a universal act of contrition, the financiers swore "nothing would ever be the same". The French prime minister François Fillon talked of "a world on the brink". The cover of *Newsweek* read "We are all socialists now". *Time* said it was time to "rethink Marx" and "find ways to save capitalism". A *Washington Post* editorial asked "Is capitalism dead?" (1). Then everything went back to normal.

There was a brief interlude in which political and financial elites went into the wilderness (and afterwards claimed to be victims). But then they returned to their glorious land of milk and honey. There were promises and grand declarations of little consequence. Laws were passed, but their application on regulatory overhaul, strong prudential regulations, bonus caps and consumer protection, has been modest at best (2).

So the world economy is again on the edge of the precipice. The summer of 2011 looks like the fall of 2008. It started with good news, from the markets' perspective. The European Banking Authority, in charge of ensuring the soundness of the financial sector, issued the reassuring statement that "82 out of 90 European banks passed a stress test". A few days later, Greece was saved from bankruptcy thanks to a plan combining sacrifices for its people and a European taxpayer bailout. Such an agreement would not trigger the settlement of credit default swaps (CDS), issued as insurance against default, which would have been disastrous for the banks. And a new "golden rule" of fiscal restraint is a possibility for the 17-country Eurozone. In the US, a compromise on the debt ceiling, signed by President Barack Obama and the Republican opposition shortly before the 2 August deadline, will cut spending without raising taxes.

But nothing worked. Standard & Poor's lowered the rating of US debt from AAA to AA+. Although the decision was based on inaccurate figures (the agency mistakenly added $2,000bn to the 10-year deficit), it caused a new market panic aimed at European banks deemed sound just a month earlier.

Change seems impossible

Financialisation has gone so far that any change seems impossible. The balance of power between states and markets has never been more favourable to markets; and the dogmas established after more than 30 years of financial deregulation now seem indestructible. Public interventions seek first and foremost to reassure the markets and protect the financial sector, yet speculators still target countries and their debts. The failure of these strategies does not seem to reduce their appeal. Rather than making way for more relevant ideas, discredited ideas keep stomping on, like zombies in horror movies (3).

Those who were in charge in 2008 still control the system, and with the same ideas. The giants of finance, saved because they were "too big to fail", are more gigantic, yet still fragile. As economist Paul Krugman puts it: "Watching the evolution of economic discussion in Washington over the past couple of years has been a disheartening experience. Month by month, the discourse has gotten more primitive; with stunning speed, the lessons of the 2008 financial crisis have been forgotten, and the very ideas that got us into the crisis — regulation is always bad, what's good for the bankers is good for America, tax cuts are the universal elixir — have regained their hold" (4).

The careers of the pre-crisis heroes are revelatory. Those of Alan Greenspan, Robert Rubin and Larry Summers, respectively chairman of the Federal Reserve Board and secretary and deputy secretary of the Treasury in February 1999, when *Time* magazine called them the "Committee to Save the World", were tarnished only briefly. Greenspan was a Republican, Rubin and Summers Democrats. They represented the undisputed hegemony of the financial sphere.

After his election in 1992 President Bill Clinton was committed to abiding by the dictates of the bond market. The unprecedented boom that followed seemed to confirm the virtues of financialisation, prompting both US parties to a bidding war in order to collect campaign contributions from financial institutions in exchange for satisfying their political and legislative preferences. Under a Democratic administration, major financial reforms were adopted in 1999 and 2000, allowing the creation of the toxic products that caused the financial collapse (5). The Republican administration of George W Bush was even closer to Wall Street, and undermined whatever financial regulation remained by appointing zealous deregulators to important positions. During that era, the role and importance of rating agencies was considerably upgraded (6).

Power undented

After the financial meltdown, the financial elites have been stigmatised but their power has not been damaged. In October 2008 Greenspan, hero of the economic boom, looked beleaguered when he acknowledged before a Senate committee that he had just realised his long-held beliefs were based on a mistake. Contrition was brief and without consequence: two years later, he had recovered his self-confidence, sniping at the Dodd-Frank legislation, the timid Obama Administration attempt at bank reform (7). Rubin retained close and lucrative ties with the financial establishment and still writes on important issues in influential media (8). Summers has never really left centre stage. During the 2008 presidential election, he was a key adviser to Obama, before becoming chairman of the White House National Economic Council. Since his resignation in 2010, he has returned to Harvard University, where he teaches economics. Even after the collapse, says journalist Michael Hirsh, “the old regime and the old intellectual constructs — compounded of Friedmanism, Greenspanism and Rubinism — continued to dominate by default” (9).

Even though governments and businesses worldwide have abrogated without qualms their social contract with citizens or employees, Summers, as adviser to Obama, explained that the outrageous bonuses that executives of AIG had awarded themselves could not be touched: “We are a country of law. There are contracts. The government cannot just abrogate contracts” (10).

In a book explaining “how markets fail”, John Cassidy, of *The New Yorker,* sees this ideology not as the triumph of classical economic liberalism, but as a perversion of it: “The concept of rational self-correcting markets is an invention of the last forty years” (11). Financiers who see themselves as following the precepts of Adam Smith violate his principles of financial regulation.

A few years before the publication of *Inquiry into the Nature and Causes of the Wealth of Nations* (1776), Smith saw a bubble burst and destroy 27 of the 30 banks of Edinburgh. He knew then that, left to market forces, finance was dangerous to society. While he favoured the “invisible hand”, he explicitly stated that the logic of a free and competitive market should not extend to the financial sphere. Hence the financial exception to the principle of free exchange, and the need for strict regulations: “Such regulations may, no doubt, be considered as in some respects a violation of natural liberty. But these exertions of the natural liberty of a few individuals, which might endanger the security of the whole society, are, and ought to be, restrained by the laws of all governments; of the most free, as well as the most despotical. The obligation of building party walls, in order to prevent the communication of fire, is a violation of natural liberty, exactly of the same kind with the regulations of the

banking trade which are here proposed” (12).

A gun under the paperwork

The intellectual origins of the new financial fundamentalism, devoid of any empirical basis, are in the writings of Ayn Rand (1905-82), the Russian-American novelist and publicist (13). Dogmatic and sectarian, advocating selfishness as a supreme virtue and criticising all government intervention, she had Greenspan as a disciple. Writing in Rand’s *The Objectivist Newsletter* in 1963, Greenspan dismissed as a “collectivist” myth the idea that businessmen, left to their own devices, would “attempt to sell unsafe food and drugs, fraudulent securities, and shoddy buildings”, insisting it was “in the self-interest of every businessman to have a reputation for honest dealings and a quality product”. Regulation undermined this “superlatively moral system”, he maintained. “At the bottom of the endless pile of paper work which characterises all regulation lies a gun” (14). In May 2005, just before the end of his tenure at the Fed, he had not changed his mind: “Prudential regulation is much better served by the private sector, through the evaluation and control of counterparties, than by the government” — that is, if the market does not work properly, the market is not free enough.

Speeches against the “excesses” of finance policies may align rulers with the anger of ordinary people, but reflect the rulers’ impotence. On 17 August, after a mini-summit on the debt crisis, Nicolas Sarkozy and Angela Merkel cautiously announced a tax on financial transactions — the Tobin tax (15). But there is much less to the decision, which must first be endorsed by other members of the European Union, than meets the eye. It is not intended to impede financial speculation, or to generate funds for development aid. Under the best of circumstances, it would be limited to making banks pay a minute fraction of the cost of bailouts to come.

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