

The North Atlantic: an area facing systemic crisis

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SUMMARY

The Great North Atlantic Financial Crisis (2008-20..) highlights the most fundamental problems the USA and the EU face in the short and medium term. The crisis signals the end of an era of deregulation and privatization that started in the developed West with the reign of US President Reagan and UK Prime Minister Thatcher and led to emergence of casino capitalism. The crisis so far exhibits a conundrum in which the grip of the finance industry on governments prevents these governments to implement a policy that can end the crisis and allows a turning point towards a sustainable regime.

The United States

During the last three decades US capitalism fundamentally transformed. Finance and real estate became the driving sectors of the economy.¹ The economy became financialized, that means that short term financial indicators got precedence over other goals, in function of the increasing weight of shareholders. In management of industrial enterprises accountants changed place with engineers. Short-termism contributed to de-industrialization and declining competitiveness.² Growth became debt fueled.³ Deregulation created new financial products and structures that are deeply destabilizing.⁴ Leveraged buy outs proliferated and often destroyed, not revitalized companies. Deregulation also allowed fraud and speculation to spread.⁵ Financial derivatives and the shadow banking system increased systemic risk that has not diminished since US government introduced some minor re-regulation. The financial weapons of mass destruction are on the books of many banks and waiting to detonate. The US financial system is early 2012 still like a card house. Banks have too much leverage and dodgy accounting practices make it very difficult to determine what banks are healthy.⁶ Deregulation created a financial monster the nature of which policy makers and most bankers do not understand.

Government interventions often made matters worse. Banks that were too big to fail have been made more influential. Government did nothing about the derivatives trade, exploding unregulated shadow banking system and the sprawling network of tax paradises that constitutes an essential link in the financial infrastructure of the US.

The current financial crisis is different to previous crises. Apart from the many banks that are considered Too Big To Fail there is the systemic extreme interconnectedness through the large degree of mutual lending and credit default swaps among financial institutions. Contagion in case of (big) bank failure is now far greater than in previous crises. Moreover, there is the iron grip that the financial sector has on government. Other than during the 1930s, there is now no powerful

constituency that might, eventually, oppose the financial sector. It means that it is literally out of control. This explains the lack of reform since the crisis erupted.

Deregulated finance created an enormous self-destructive force that undermined the US economy and society.⁷ The financial sector has transformed into a parasitic force that eats the rest of the economy while continuing taking irresponsible risks.⁸ Also, the banking sector has transformed from a lending into a borrowing machine. Moreover, money creation, a public good, has been increasingly privatized.

Also, the United States became increasingly dependent on foreign savings (especially East Asian nations started to finance current account deficits of the USA) while US corporations increasingly relocate economic activities off shore. The link between domestic savings and investments has been totally broken.

The delicate system of checks and balances that characterized the US political and economic systems has given way to a system where regulators punish those who reveal fraud and encourage economic actors to do whatever they want, where accountants do their best to hide the real performance of enterprises, where journalists forgot about decent reporting, where politicians do what their paymasters are saying and where the law ceased to protect the weak in society. A system of revolving doors emerged in which bankers become politicians and civil servants and reverse. The US polity transformed into a duopoly in which two major parties share the same neoliberal worldview.

US democracy is also undermined by a populist movement, funded by the billionaires. The shift to the right of the establishment risks to alienate a large part of the electorate. Furthermore, the undermining of civil liberties threatens US democracy.

A market society emerged in which the public good deteriorated. This has meant, among others, that good education has become expensive and mainly available for the wealthy. The happy few bought their own 'public services', often in the context of gated communities. Family life came increasingly under stress due to poverty and longer working hours.

Increase in productivity did not lead anymore to higher wages, but to the enrichment of a greedy elite.⁹ Hourly wages of the overwhelming majority of Americans stagnated during the past decades. Income inequality increased to such an extent that it endangers the legitimacy of the current regime.¹⁰ Also, high unemployment has become a structural problem.¹¹ Economic recovery so far is limited to banks, larger corporations and those with significant holdings in stocks and bonds.

The North Atlantic area

Corporate globalization as it emerged since the late 1970s is initiated and organized from the West and the West, especially the United States, profited most.¹² The 'Washington Consensus' spread the gospel of Anglo-Saxon free market capitalism through the US dominated institutions of global economic governance. US led globalization used the debt trap to force indebted countries to implement the 'Washington Consensus', through IMF conditionality. It implied, among others, abolishing all restrictions on capital flows. This has led to a series of financial crises in the periphery of global capitalism. Also the financial crisis in Japan can be related to financial deregulation. It is above all the abolishment of restrictions to the cross border flow of short term capital that contributed to financial crises.

In 2007/8 the Great Financial Crisis hit the heartlands of global capitalism. However, those countries that had kept checks and balances in the financial system intact, such as Canada, Sweden and Poland, were hardly hit by the crisis. In most countries, the fundamental excesses that fuelled the crisis, i.e. too much debt and leverage in the private sector and the shadow banking system, have not been addressed. Also, as long as we do not know what proportion of the 707 trillion dollar derivatives (June 2011, it was 594 trillion in June 2009, BIS) is toxic, financial markets will remain in paralysis. Credit Default Swaps can be considered as the poison, or weapons of mass destruction, in the financial system.

The Great Financial Crisis is global but the epicenter is in the North Atlantic Area. It originated in the neural centre of the global financial system, i.e. New York and London. Those two towns are also at the centre of a spiders web of tax havens, intrinsically linked to them. From the City of London and Wall Street toxic products spread over the world. However financial derivatives were above all bought by Europe. The City of London emerged as the major global financial centre and all major global banks have offices there where they conduct activities that are forbidden at home.

Common to the response to the financial crisis in the North Atlantic was that many recommendations that were earlier given to countries in the South were ignored. For example, massive state support for failing banks and quantitative easing. But other recommendations, such as privatization and pushing back the state, were followed. Both in North America and in Europe there has been a frontal assault on the welfare state and the state as such. It is suggested that state expenditures, especially in the social sphere, are at the core of the problem although corporate debts are far higher than public debts. All over the Atlantic region there is an assault on the public good. Introducing wild capitalism also means an assault on society as such. Civil liberties are undermined. The commodification of social life is unraveling an edifice that has grown over many ages. Western civilization is much more than the achievements of science and culture, it is also reflected in the way we live together, e.g. liberal democracy and social economy. Also, across the North Atlantic, we see the erosion of the middle class.¹³ Civilization is at risk in societies in which the profits of private enterprises stand above anything else.

Common across the North Atlantic is the invisibility of the left and therefore the absence of a credible alternative to the neoliberal consensus.

Despite common characteristics of the crisis of developed capitalism, cross Atlantic ties weakened. Especially the USA is increasingly looking to East Asia, while the relative importance of Europe for the USA declined. Even in the backyard of Europe, like the Middle East, it is the United States that is calling the shots as the major external power.

The European Union

The main economic problem in the EU is the deregulated financial sector and the great number of zombie banks that are asking increasingly large injections of public money.¹⁴ Foolish banks lend in the eurozone to customers, public and private sector, that were not creditworthy, and that were above all located in the periphery of the euro area. On top of this there is the problem of having one currency for diverging economic systems and economic policies. The euro is undermining and not furthering economic integration. Structural imbalances between the North and South, visible in trade

balance deficits and surpluses, cannot be solved in the context of present provisions of the euro area.

Austerity imposed upon the whole of the euro area is self defeating. It sucks demand, leads to economic decline, diminishes tax receipts and leads to a ballooning public debt. Austerity means transfer by the government of household income to the business sector. But the private sector is hardly investing; they are busy with deleveraging. Only a growth strategy can tackle the public debt problem. A fundamental reform of the financial sector could result in diminishing corporate debt that is far greater than public debt.¹⁵

The euro project has already failed and the question is when the project will be abolished.¹⁶ An increasing number of Europeans associate the euro and the EU with a failed policy of austerity, in service of the banks and corporations and undermining the welfare state and the public good in general. The European Central Bank serves the banks and not the people.¹⁷

The crisis of the euro and the financial crisis undermined the legitimacy of the EU institutions and exacerbated nationalism and intra-EU tensions. The population wants less EU while the markets and many EU governments want more EU. The main trend in Europe is since 2008 divergence of polities and economic systems after a prolonged period of convergence in living standards (despite the attempted jump towards fiscal union).

Despite current disintegration tendencies, the European integration process has seen huge advances and most of them are difficult to undo. Nevertheless, one big step backwards has to be taken in the field of monetary integration (abolishing the euro project) in order to make a new huge step forwards.

In the present conjuncture it is imperative to strengthen the national polities and regain influence from an unaccountable European bureaucracy that has come increasingly under influence from corporations and banks. This 'renationalization' (Kuklinski, July, 2011, p. 37) does not imply a status-quo ante 1958 but a status quo ante 1991. It is '*reculer pour mieux sauter*'. And this is only conceivable in the context of an EU of multiple speeds. And only conceivable in the context of a more democratic EU that has more legitimacy. A democracy cannot function without a demos. A European society has to develop while the development of a European megaspace is hampered by the lack of integration of European societies (see Kuklinski, July 2011, 27).

In the periphery of the European mega-space, an arc of crisis can be discerned that includes the larger Middle East, larger part of the Balkans and the area of the former Soviet Union. It also includes some peripheral EU countries where now a lost generation is growing up. Within the EU space a new centre-periphery dynamics can be discerned. It will lead to larger migration flows to the northern EU countries. This might contribute to demands to curb immigration, putting pressure on the Schengen arrangement.¹⁸

Notes

¹ Real estate and finance driving forces. In the period 1973-85 financial sector comprised 16 per cent of domestic corporate profits, it topped 40 per cent recently (USA). In the USA the financial sector contributed less than 4 per cent to GDP before 1970, 8 per cent in 2010 (Financial Times, 10 January 2012).

² There are now fewer manufacturing jobs in the US computer industry than there were when the first PC was assembled in 1975. There is even a growing deficit in the trade of high technology goods with China (Huffington Post 17 December 2010)

³ Household indebtedness increased from 55 per cent in 1960 to 133 per cent of yearly personal income in 2007 (UK, The Observer, 5 July 2009). In the USA indebtedness of the financial sector reached in 2008 120 per cent of GDP, indebtedness of households about 100 per cent, that of the state around 60 per cent and the non-financial private sector about 80 per cent (Financial Times, 4 January 2012).

⁴ The daily turnover of foreign exchange dealings (FOREX trade) was in June 2010 398 trillion dollars A DAY (BIS, 170,5 trillion dollar in 1998). More than 90 per cent of this trade is speculative in character. According to Gordon Brown, global flows of money increased since 1990 by 6600 per cent (The Guardian, 7 December 2010). According to McKinsey's *Mapping Global Financial Markets* (October 2008), global financial assets rose from US\$12 trillion in 1980 to US\$196 trillion in 2007.

The debt-instruments and repo market were used to create a gigantic debt pyramid balanced precariously atop a few crumbs of capital. The system was bound to crash. The \$1.5 trillion in subprime mortgages wasn't nearly enough to bring down the entire financial system. But the losses on trillions of dollars of derivatives that were balanced on top of these mortgages, certainly was.

The real cause of system-wide counterparty default was imminent insolvency resulting from banks holding collateral whose values fell below liability levels in a matter of days. The banks don't fund themselves by taking deposits and then using them to lend out money at higher rates. What they do is buy long-term illiquid assets (mortgage-backed securities, asset-backed securities) and exchange them in the repo market for short-term loans. In one case, a \$38 million subprime-mortgage bond created in June 2006 ended up in more than 30 debt pools and ultimately caused roughly \$280 million in losses to investors by the time the bond's principal was wiped out in 2008, according to data reviewed by The Wall Street Journal. So it wasn't the subprime mortgages that caused most of the damage, but the amount of leverage bundled into the derivatives and the repo market.

⁵ According to a US Senate report the '*overwhelming evidence is that those institutions (the banks-HvZ) deceived their clients... and they were aided by deferential regulators and credit rating agencies who had a conflict of interest*' (New York Times, 13 April 2011). Bernard Madoff could build up his Ponzi empire during many years, while the regulator was regularly tipped off about fraud. But the regulator did nothing.

⁶ This is related to the numerous structured investment vehicles that are off balance but that are under control of the banks. Also, still a lot of bad loans are still on the books (Huffington Post, 19 July 2010)

⁷ The former Federal Reserve Chairman, Paul Volcker, said '*the growing sense around much of the world is that we have lost both relative economic strength and more important, we have lost a coherent successful governing model to be emulated by the rest of the world. Instead we are faced with broken financial markets, underperformance of our economy, and a fractious political climate... The question is whether the exceptional role of the dollar can be maintained.*' (Bloomberg, 8 December 2010)

⁸ Both in the USA and in EU the banks restricted lending to households and enterprises, despite the availability of liquidity.

⁹ US chief executive pay was in 1965 24 times the average worker pay, in 2011 it was 325 times average worker pay (Financial Times, 10 January 2012).

¹⁰ More than 43 million Americans are now living in poverty and more than 42 million are on food stamps (Huffington Post, 17 December 2010). High Net Worth Individuals (2,9 million in the USA, 2009), had individual assets worth 12.09 trillion dollars. For comparison, in 2009 the total budgetary deficit (federal) was 1,7 trillion dollar (MRZine, 3 August 2010)

¹¹ The official unemployment rate is counting those who are actively looking for a job. The real unemployment rate is approximately double the official rate. (Huffington Post, 5 February 2011)

¹² That means the corporations of the West. Over the past years 70 per cent of global savings flows to the United States. Above all Western corporations could expand in the non-Western world. Above all Anglo-Saxon banks profited from financial globalization.

¹³ As Fukuyama observes: '*The current form of globalized capitalism is eroding the middle class social base on which liberal democracy rests*' (Foreign Affairs, January/February 2012, p. 55)

¹⁴ The IMF says European and British banks have 75pc as much exposure to US toxic debt as American banks themselves, yet they have been much slower to take their punishment. Write-downs have been \$738bn in the US: just \$294bn in Europe. On top of this, EU banks have \$1,600bn of exposure to Eastern Europe (The Telegraph, 11 February 2009).

¹⁵ Public debt in the EU decreased from 72 per cent of GDP in 1999 to 66,3 per cent in 2007. It increased to 87,9 per cent in 2011 (The Guardian, 27 October 2011). Corporate debts were in 2009 95 per cent of GDP (24-95). Household debt in the EU increased from 52 per cent in 1999 to 72 per cent in 2008.

¹⁶ Remarkable is also the outcome of a straw poll in the packed congress auditorium in Davos during the World Economic Forum, where the vast majority said they thought the sovereign debt crisis would end in a blow-up of some kind. A similar number thought the Financial system was no safer now than after the 2008 collapse of Lehman Brothers (Financial Times, 26 January 2012).

¹⁷ It looks like an absurdity to see that the ECB is lending banks that have been bailed out by government unlimited amounts of euros against 1 per cent interest, while Euro governments cannot borrow from the ECB. The same banks, often zombie banks, can lend to Euro governments against commercial interest rates, up to 7 per cent. Elsewhere the central bank is the lender of last resort for governments as well.

¹⁸ It were worries about the influx of Bulgarians and Romanians, often not integrated, that made Finland and The Netherlands block a EU decision for extending the Schengen zone to include Bulgaria and Romania.