

How do we get out of here?

Frédéric Lordon

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Austerity is not the only way to make up for massive government debt and lack of revenue following self-induced disasters in private finance. There are fairer ways to balance the books

Naomi Klein's "shock doctrine" – her idea that natural and man-made disasters have been used as pretexts to impose free market policies on countries whose people would normally reject them – didn't convince completely until recently. "Disaster capitalism" did apply in some cases, especially in southern hemisphere and transition economies. But it was not as universally valid as Klein believed, and the establishment of neoliberalism in developed economies was more a calculated implementation of a systematic and far-reaching agenda. But now Klein may see her analysis confirmed, and spectacularly, by events at the heart of developed capitalism.

The crisis in the private financial sector has, inevitably, spread to the public sector. It was impossible for governments to ignore the risk of an imminent, total collapse of the banking sector. Justifiable public anger at the banks' return to their old bad habits at the expense of the taxpayer is justified, but letting them collapse was not an option. Class solidarity and cronyism played a part in the decision to bail them out, but action was still required to save them.

The world's governments are unhappy: though they have rescued the financial sector, they have been unable to impose any significant reforms. They counter public criticism by pointing out that the rescue will cost nothing, or even make money for the taxpayer, once the financial sector has recovered and paid off its debts. This is not all bluff. The sums paid out by the French government were modest, the recovery of the sector has made government guarantees redundant and the emergency loans have been repaid, with interest. In the US, the cost of rescuing the financial sector has, at least in appearance, shrunk even faster. The Troubled Asset Relief Programme (a delightful euphemism) started with a budget of \$700bn but the final bill is less than \$100bn, which the Obama administration plans to wipe off the slate with a special tax on banks over a 10-year period.

The flattering manner in which this outcome is presented masks unsightly details, notably the decisive role played by pseudo-governmental institutions such as Fannie Mae, Freddie Mac and the Federal Housing Administration. These were stretched to the limit by the effort to prevent a complete collapse of the real estate market and of economic growth. The cost of rescuing them (\$400bn) has been excluded from last year's balance sheet, perhaps because it is less likely to be recoverable. The financial sector has been saved and the recession contained, but only by sweeping most of the problems under the carpet. This could easily lead to disaster in the near future.

There is a more important reason why the financial crisis was bound to spread to the public sector: the cost to national budgets of the sharp decline in economic activity and

the resulting fall in tax revenues. The huge growth of budget deficits and public debt is due less to the cost of the rescue packages than to the macro-economy. There can be no easy way out and no miraculous recovery.

Nothing to do with us

As the chain of cause and effect grows longer, people lose sight of the big picture. The banks now believe they can pretend they have settled the bill for their little excesses and blame unemployment, recession, deficits on the remote mechanisms of the macro-economy: “Very sad, but it’s nothing to do with us.” They don’t know the meaning of the word shame and are regaining their confidence, feeling free to lecture national governments on how to run things. The huge rise in public debt is a problem, say the managers of the fixed income departments, forgetting that taxpayer money saved them from disaster.

Now that the banks are flourishing, partly because massive government support for the economy saves them from a second tsunami of bad debts, they have no scruples about speculating against the governments that saved them, thereby increasing the cost of public borrowing and exacerbating the deficit problem they caused.

This is Klein’s “shock”. Salaried workers, already hard hit by the recession, will as taxpayers also have to foot the bill for the budgetary adjustment. Neoliberalist ideology is deftly turning to its advantage an upset that should have killed it: neoliberals advocate the dismantling of the state on an unprecedented scale, on a par with the huge increase in deficits and public debt caused by their own actions.

The “ordinary” shocks of Klein’s theory were mostly external (coups, counter-revolutions or natural disasters). The neoliberal agenda kicked in during the chaos that followed. But this latest shock is a product of internal factors and is being exploited by those whose behaviour should have disqualified them from action, yet are still trying to draw advantage from events. The scale of neoliberalism’s discomfiture has provided a motive and a pretext for its renewal on a bigger scale. Coming back from deficits of near double-digit percentages of GDP to the 3% required by the Stability and Growth Pact will require savage cuts and austerity. So we are leaving incremental reform over two decades to enter a new era of accelerated upheaval. There are some thresholds of “adjustment” where what changes is not the degree, but the nature of the adjustment.

With the financial sector confining itself to technical discussion of the risks of sovereign default and the pressures on long-term interest rates, the wider ideological apparatus (resurgent experts, media long devoted to the cause) is already doing its bit. Hardly a day goes by without a prophecy of disaster. The discussion of public debt has become a constant drone and it would be difficult to find, in recent history, a more intense and sustained manipulation of public opinion. It could be taken as an indication of the scale of the changes that are coming.

Slimming the workforce

The Economist has emerged, revitalised, from a 12-month depression during which it was ready to believe that capitalism was on the brink of collapse; it seems determined to hold on to the intellectual leadership in the resurgence of neoliberalism. For three

months it has carried special features on public finance. Britain, the US and the more sensational cases of Ireland, Spain and Greece, give it the opportunity to repeat the injunction to cut spending. Anyone who needs proof that the leading lights of neoliberalism are on the offensive again should note the tone in which *The Economist* hands down its commandments: “In the corporate world, slimming a workforce by a tenth is standard fare. There’s no reason why governments should not do that too... Public-sector pay can be cut, given how secure jobs are... Public-sector pensions are far too generous.” All this advice is offered in an editorial with the subtle title “Stop!”.

There is no obligation to accept the inevitability of cuts or to succumb to the ideological barrage or the material consequences of the shock. It is useful to put together the precursive signs and form a coherent picture of what is being planned. Public-sector workers in Ireland, to whom nominal pay cuts of 10% have been “proposed”, already know what to expect. Their Greek counterparts are to suffer the same fate, with the approval of the European Commission. The French, faced with proposed pension reforms, civil service job cuts and a mad proposal to make balancing the budget a constitutional requirement, will soon see the threat to their welfare state. In all these countries the violence of the shock after the prudent gradualism of past decades may at last provoke society into reaction. If so, it should be realised that although the budgetary problem is undeniable, savage cuts are not the only solution. Interesting alternatives have been brushed aside.

The most obvious is a tax increase, although this would have to be carefully managed so as not to stifle economic growth or impose the burden of paying for the crisis on those who had no part in its creation. This may leave only a tiny group of taxable subjects – small in numbers but, happily, large when it comes to the size of the tax base. The subjects fall into a wide range of categories each representing a tax modality with a promising yield. Financial transactions, institutions and other players could all be made to pay for the correction of the problem for which they were responsible. The only acceptable principle for fiscal adjustment is that the financial sector should bear the entire cost of the crisis it caused.

A Tobin tax would be of questionable efficacy as a way to achieve a radical transformation in the assumptions underlying international financial speculation, and would not much change its basic structures. But purely as a tax, it would work well and bring in a lot of money, because the astronomical volume of financial transactions would make even the most nominal tax rates lucrative.

A tax on financial transactions would mainly be paid by financial institutions. The institutions are next in line; here, the approach would be more direct. Now that even the Obama administration is taking that route, it is unlikely that a tax on banks (and their assets) will be seen as the economic irrationality of naïve revolutionaries. In working out the precise details of this tax, the fiscal authorities have a range of possibilities: a tax on profits, on all assets, on the most risky assets (to disincentivise their growth) or on the sum of the salaries of the highest paid employees; a tax used to make up the current shortfall; or a tax that would be used to set aside funds as insurance. There is no reason why the shareholders, who own the banks and are responsible for their actions, should be excused from doing their share of the housework, so it would be logical to ban the payment of any dividends until the cleanup is complete.

Bonus time

Next, we come to the physical subjects: senior bank directors, administrators (whose role is too often forgotten), traders and their counterparts outside the banks. There may be a public outcry that the measures are so narrowly targeted as to bring in little, and have only a symbolic effect, or that they are punitive and have been introduced out of resentment. But this group of taxpayers, though small in number, have for 15 years absorbed the lion's share of gross national income growth. The tax base they represent can be expressed as a percentage of GDP.

Bonuses and salaries in the financial sector are of secondary importance in the context of the financial crisis, but of primary political importance for social justice – and as a fiscal opportunity. The arguments that will be put forward by the financial sector and its supporters are predictable. Yet the brain-drain argument is beginning to lose its power, doesn't scare anyone much, can be rebutted, and is even starting to irritate.

There is no reason why the crisis that began in the private financial sector and spread to the public sector should stop there. The public financial crisis could turn into a political crisis. Some insiders are panicking; it is significant that enemies of the financial sector such as Dominique Strauss-Kahn and Jean-Claude Trichet have expressed concern that taxpayers would react badly if asked to foot the bill for another financial crisis. A "next" crisis is not only a possibility but is likely to start in public debt, as a direct consequence of the way that the preceding crisis was managed. It's a safe bet that, to calm a dissatisfied populace, the more institutionalised trade unions in France, now part of a power bloc that is aligned with the right and the social-democratic leftwing, and highly unified beyond its minor divisions, would organise a few marches, on sunny days if possible, and perhaps some picnics. But an "urban ramble" may no longer be enough. People have had enough.

It is important to remember that people who are not naturally vicious may become so when they feel mistreated, when they are told that there is no way out of their predicament other than more misery. There are other solutions, which, if presented with firmness, could be recognised as such.