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COMMENTARY

Contradictions of austerity

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The global economic and financial crisis has been marked by the following paradox. A much more severe depression than the global slump of 2008–09 was prevented by determined state intervention in the form of bank bailouts and fiscal stimuli. Yet this bout of apparently successful Keynesianism has been followed by a turn to fiscal austerity justified in terms reminiscent of the Treasury View against which Keynes relentlessly polemicised in the 1930s. This article explores the sources of this policy shift. Among the factors considered are the ideology of neoliberalism, the economic and political power of the banks, and the relative weight of finance in individual economies. The broader context of financialisation is also considered. The conclusion is reached that an oscillation between bouts of austerity and laxer policies encouraging the development of asset bubbles may be built into neoliberalism as an economic policy regime. The implication is that alternatives to austerity must embrace broad institutional transformation.

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1. Introduction

Debate about economic policy after the 2008 financial crash and the global slump it precipitated must confront a puzzle. The traditional Keynesian narrative of the Great Depression of the 1930s portrays political elites as prisoners of a *laissez-faire* 'Treasury View' that prevented them from compensating for the collapse in effective demand with higher public expenditure and indeed led them to deepen the crisis by cutting spending in order to balance the budget (e.g. Skidelsky, 1970). The most influential alternative interpretation from a free-market perspective rejects this diagnosis, but nevertheless also identifies policy mistakes—most famously on the part of Milton Friedman and Anna Schwartz, the Federal Reserve Board's failure to prevent the stock of money in the USA falling by a third between 1929 and 1933—as a critical factor in causing so severe and protracted an economic slump (Friedman and Schwartz, 1963, ch. 7).

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This time, however, the policy response to the crash was vigorous. The leading central banks flooded the financial system with liquidity. With the signal exception of Lehman Brothers, vulnerable institutions of 'systemic' importance were rescued, often through temporary nationalisation. This extended beyond the banking sector: in same ways the most remarkable intervention was the Obama administration's takeover and restructuring of General Motors (GM) and Chrysler (for an account by the leader of the takeover, see Rattner, 2010). These measures were accompanied by fiscal stimuli adopted not simply by the advanced capitalist states, but by many governments in the global South. The International Monetary Fund (IMF) estimates that government deficits rose by ~5% of GDP in the advanced economies in 2009: half represented the effect of the automatic stabilisers, the rest extra discretionary spending (IMF, 2010, p. 17).

One might then regard the present economic and financial crisis as, from a Keynesian perspective, a happy tale in which an activist policy response prevented the kind of protracted collapse in output and employment that occurred between 1929 and 1933. Indeed, at the time of the 2008 crash, there was much talk of a return to Keynes, and two authors of important scholarly studies of his life and thought rushed out books to mark this shift (Clarke, 2009; Skidelsky, 2009). But there is, of course, a sting in the tail: no sooner had production and stock-market prices begun to recover from the very sharp falls witnessed in the winter of 2008–09 than pressure started to build up for a policy reversal. The priority for political elites became to roll back the increase in budget deficits caused, on the evidence of past crises, less by the stimuli than by the increase in welfare spending and particularly the reduction in tax revenues produced by the economic contraction (Reinhart and Rogoff, 2009, ch. 14). Reducing the deficit through extensive reductions in public expenditure became the new policy norm. The political modalities of this shift to austerity varied: the crisis of the peripheral members of the eurozone dominated the European Union; in the UK, the advent of the Conservative–Liberal coalition in May 2010 offered the lever; and in the USA the turning point came with the victories of a Republican Party powered by the Tea Party movement in the midterm elections of November 2010.

For critics of the shift to austerity, it risks repeating the mistakes of the governments that responded to the onset of the Great Depression by cutting public expenditure (e.g. Skidelsky and Kennedy, 2010). I agree with these critics, but my concern here is with the puzzle represented by the speed with which policy makers shifted from an apparently Keynesian response to the prospect of economic and financial collapse to an agenda dominated by deficit cutting. For some commentators, however, no policy reversal was involved here. Neoliberal economic policies favouring tax cuts beneficial to the wealthy and the reduction of social expenditure had been entrenched for decades. The seriousness of the 2008 crash commanded a surge in state intervention, but, once collapse had been averted, the default position was re-established, with austerity acting as the mechanism for restoring the previous balance between state and market.

The difficulty with this analysis is that it greatly underestimates the serious and protracted nature of the global economic crisis that began in August 2007, particularly in the traditional 'core' regions of advanced capitalism, Western Europe and North America. The sharp sell-offs in the main financial markets in the summer of 2011 more than anything else represented this reality sinking home. In the absence of a self-sustaining recovery from the 2008–09 slump, economies remain heavily dependent on state action—if not in the shape of fiscal stimuli, then in the form of the ultracheap money policies pursued by the leading central banks. The present crisis therefore marks a moment of *discontinuity* in the neoliberal era, one in which the severity of the crisis has forced the leading Western economies into much greater reliance on the state. It is against this background that the shift to austerity requires explanation. A return to business as usual it may seem, but if so in it is defiance of the larger economic context.

In this article I review possible explanations, arguing that making sense of austerity depends on an understanding of the way in which capitalist societies have been financialised during the neoliberal era and also of the uneven way in which the process of financialisation has unfolded in different states. I do so from the theoretical perspective of Marxist political economy, which understands financial markets (what Marx himself called the 'credit system') as a mechanism through which the contradictions of the process of capital accumulation are temporarily overcome, only to precipitate crises of great severity.[1]

2. Neoliberalism and financialisation

Before considering solutions to the puzzle set out above, some clarity is required about two of the key terms involved: neoliberalism and financialisation. For David Harvey, 'the evidence strongly suggests that the neoliberal turn is in some way and to some degree associated with the restoration or reconstruction of the power of economic elites' (Harvey, 2005, p. 15). Alfredo Saad-Filho and Deborah Johnston argue that '[t]he most basic feature of neoliberalism is the systematic use of state power to impose (financial) market imperatives in a domestic process that is replicated internationally by 'globalisation'' (Saad-Filho and Johnston, 2004, p. 3). These definitions seem, respectively, too broad and too narrow and, surprisingly, neither make direct reference to ideology (for a discussion of some of the difficulties in conceptualising neoliberalism, see Harman, 2007). In my view, neoliberalism can best be understood an economic policy regime whose objective is to secure monetary and fiscal stability and that is legitimised by an ideology that holds markets are best treated as self-regulating. This has allowed not merely the 'restoration of class power' analysed by Harvey, but also a dramatic redistribution of wealth and income in favour of the rich (see Duménil and Lévy, 2004B). As Saad-Filho and Johnston suggest, this regime has also promoted (though it did not initiate) a much broader process of financialisation of the advanced capitalist economies.

This process has three main dimensions (see the more extended discussion in Callinicos, 2010A, pp. 23–34). The first is well stated by Costa Lapavitsas:

> Financialisation ... does not amount to dominance of banks over industrial and commercial capital. It stands rather for increasing autonomy of the financial sector. Industrial and commercial capitals are able to borrow in open financial markets, while being more heavily implicated in financial transactions. Meanwhile, financial institutions have sought new sources of profitability in personal income and financial market mediation. (Lapavitsas, 2008, p. 34)

Contemporary financialisation is therefore significantly different from finance capital as it was conceptualised by Rudolph Hilferding before the First World War (Hilferding, 1981). For Hilferding, finance capital involved the banks developing long-term relationships with industrial firms that allowed them significant control over these firms. But financialisation today involves banks and industrial and commercial firms acting increasingly *independently* of one another. The banks' search for additional sources of profits thanks to financial disintermediation may have been a powerful force driving them into more speculative activities in recent decades. William Cohan in his new history of Goldman Sachs documents

[1] See Callinicos, 2010A, pp. 34–59, which discusses the perspectives on financial crisis offered by Hyman Minsky, F. A. von Hayek and David Harvey.

the ruthlessness with which the bank has expanded proprietary trading on its own account, leading to frequent complaints that this leads Goldman's to work against its own clients (Cohan, 2011, ch. 24). Secondly, financialisation involves the implication of a wide range of economic actors in financial markets—not only the banks and shadow banks, but also (as Lapavitsas notes) industrial and commercial firms, and households. The increasing integration of middle-class and working-class households into the credit markets is one of the most striking economic developments of recent decades in the USA and the UK. Thirdly, the proliferation of financial derivatives does not simply offer means of speculation, but allows a wide range of corporate actors to calculate costs and returns across different markets and to hedge against uncertainty (Bryan and Rafferty, 2006). Financialisation is thus a much broader socio-economic phenomenon than the economic and political power of the banks thematised in discussions of responses to the present crisis, as we see below.

How, then, does financialisation thus understood relate to the political economy of advanced capitalism? Among Marxists, where the concept of financialisation has been most strenuously developed, there have been two major debates. The first is important, but technical, since it concerns how to situate the profits of financial institutions in Marxist value theory (compare Lapavitsas, 2009; Fine, 2010). The second is about the relationship between financialisation and economic crisis. One can see debate polarising between two positions. The first views financialisation as the main cause of the relatively slow growth rates of the advanced economies in recent decades and of the present economic crisis. This case is powerfully argued by Gérard Duménil and Dominique Lévy. They understand financialisation somewhat differently from the definition offered above, equating it with the economic and political dominance of finance, and they argue that it has been institutionalised by the neoliberal policies of the past few decades. Neoliberalism, they say, represented 'a return to financial hegemony' of the kind that prevailed in the early twentieth century (Duménil and Lévy, 2011, p. 18; see also Duménil and Lévy, 2004A). The effect, particularly in the USA, has been to slow down the rate of capital accumulation and reorient the economy towards satisfying rising levels of (particularly upper-middle-class) consumption. This has rendered the economy as a whole vulnerable to the speculative proclivities of the financial markets, with the spectacular consequences we have seen in the past few years (Duménil and Lévy, 2011).

At the opposite end of the spectrum are Marxist political economists who acknowledge that financialisation represents a significant change in the structure and dynamic of contemporary capitalism, but see it as a symptom of more long-term problems of overaccumulation and profitability rather than as the main cause of contemporary economic crises (e.g. Brenner, 2002, 2006; Harman, 2009; Callinicos, 2010A). They argue that these problems have their roots in the fall in profitability experienced by the advanced capitalist economies during the 1960s—a fall that the disciplining of labour under neoliberalism has only partially reversed (this is an important point of disagreement with theorists such as Duménil and Lévy, who contend that neoliberalism overcame the crisis of profitability of the 1960s and 1970s). Financialisation acted in part as a process of displacement for capital, since the financial sector offered much higher profits than could be obtained through productive investment. Moreover, the development of asset bubbles on the financial markets evolved into a mechanism through which effective demand could be maintained and could grow thanks to the 'wealth effect' encouraging holders of the assets to borrow and spend more (although the authors oppose this interpretation of financialisation, much of the data presented in Duménil and Lévy, 2011, Parts IV–VI, could be cited in support of this view of the role asset bubbles have played). Riccardo Bellofiore describes this as 'asset bubble driven privatised

Keynesianism' (Bellofiore, 2010). From this perspective, even though the Great Recession of 2008–09 was precipitated by the collapse of the credit bubble of the mid-2000s, the resulting crisis reflected much more deep-seated strains in the accumulation process.[2]

I regard this second approach as better capturing the nature of contemporary financialisation. It underlines the systemic nature of the present crisis, whose roots lie deeper simply than the dysfunctional organisation of financial markets. How does this perspective help us to understand the puzzle posed by the sudden policy shift towards austerity? In addressing possible explanations, I also clarify my preferred approach to financialisation.

3. Explaining the turn to austerity

To begin with, turns in the political cycle—perhaps most dramatically, the defeat of Labour under Gordon Brown, one of the architects of the international policy response to the 2008 crash, in the May 2010 UK election—are not sufficient to account for the policy reversal. In many countries, the same governments presided over both the crash and the turn to austerity—this was true of the most powerful eurozone states, France and Germany. Barack Obama took office at the height of the crisis and though he took additional steps—notably a $787 billion fiscal stimulus and the takeover of GM and Chrysler—these were in the framework set by George W. Bush's last Treasury Secretary, Hank Paulson, in the aftermath of the Lehman's collapse (indeed, money from Paulson's Troubled Assets Relief Program was diverted to pay for the Detroit rescue: Rattner, 2010, pp. 301–2). The Obama administration has now embraced a deficit-cutting agenda under pressure from the Republicans in Congress, but it is probable that it would have moved in this direction even without the prompting of the Tea Party insurgency: in line with this fiscal conservatism, a $447 billion jobs plan unveiled by the President in September 2011 was to be funded by further spending cuts and reductions in Medicaid and Medicare.

It is therefore tempting to argue that the shift to austerity demonstrates how deeply entrenched neoliberalism as an ideology has become, and that political, media and academic elites consequently are unable to think beyond the intellectual horizons set by the free-market revolution of the 1970s and 1980s. At some level, this is no doubt true, but it simply shifts the burden of explanation. Given that most accounts of the economic and financial crisis identify ideologically motivated deregulation, and a more general faith in the self-correcting character of markets as an important factor in policy makers allowing the credit bubble to develop in the mid-2000s, why have elites not started to question neoliberalism? After all, even though things in the 1930s were considerably more complicated than the simple Keynesian narrative would have it, the decade did see the idea of political control of markets—whether in the form of demand management or some much more comprehensive form of planning—gain much wider currency (see the fascinating account of debates under the New Deal in Rosen, 2005). Similarly, it was the apparent failure of demand management to overcome the stagflation of the 1970s that provoked the monetarist counter-revolution (e.g. Skidelsky, 1977). So why didn't the situation force a move away from neoliberalism after 2008?

[2] See López and Rodriguez, 2011, for an account of the effects of 'asset price Keynesianism' in the Spanish state since the 1990s. Marxists being Marxists, there were, of course, many other views than those counterposed in the text. David Harvey, for example, is closer to the second approach than the first, but understands overaccumulation more broadly and without reference to any theory of falling profitability: Harvey, 2010. David McNally sets his account in opposition to both views, but in substance is closer to the second: McNally, 2011.

The puzzle is deepened by the fact that ideologies are typically complex formations (Callinicos, 2004, chs 4 and 5). Inasmuch as neoliberal ideology has an intellectual core, it is constituted by economic theories (deriving from Friedman and Hayek) that are, to put it mildly, far from mutually consistent. Moreover, the very generality of ideologies means they can be interpreted and applied in widely varying ways. The history of neoliberalism as a policy regime is that of an 'heroic' moment at the end of the 1970s in which a brutal monetary squeeze was imposed (in the UK by the Thatcher government and in the USA by the Fed under Paul Volcker), followed by a pragmatic shift towards increased reliance on asset-price bubbles (centred on the stock market in the late 1980s and late 1990s, and on real estate in the mid-2000s) to stimulate economic growth. This shift certainly didn't start out as a consciously planned policy, but one can trace in the USA—where neoliberal objectives were always blurred by a statutory commitment to full employment and by the greater flexibility offered by the dollar's reserve currency role—a growing willingness on the part of the Fed under Alan Greenspan to tolerate bubbles as a price of maintaining economic growth.[3] An ideology sufficiently capacious to encompass such significantly different policies ought to admit some further extension. But instead we see—perhaps most markedly in the UK, where the resonances of the Thatcher era are very strong for both supporters and opponents of the coalition government—a return to the 'heroic' past, though now the squeeze is primarily fiscal, as monetary policies, in the wake of the crash, remain highly permissive.

4. Banks and governments

So we need to look beyond ideology to interests and institutions. One kind of deeper explanation focuses on the political power of the banks. A version is provided by Simon Johnson, former chief economist of the IMF, in its most developed form in a book he wrote with James Kwak, *13 Bankers*. Johnson's perspective is very much one from the IMF: within a thoroughly orthodox neoclassical framework, his approach is distinctive chiefly in applying to the USA the same standards the Fund has followed when deploying its dark arts in financially embarrassed Third World States. For Johnson and Kwak, both the crash and the policy response were made in Wall Street:

> By March 2009, the Wall Street banks were not just any interest group. Over the last thirty years they had become one of the wealthiest industries in the history of the American economy, and one of the most powerful political forces in Washington. Financial sector money poured into the campaign war chests of congressional representatives. Investment bankers and their allies assumed top positions in the White House and the Treasury Department. Most important, as banking became more complicated, more prestigious, and more lucrative, the *ideology* of Wall Street – that unfettered innovation and unregulated financial markets were good for America and the world – became the consensus position in Washington on both sides of the political aisle. Campaign contributions and the revolving door between the private sector and government service gave Wall Street banks influence in Washington, but their ultimate victory lay in shifting the conventional wisdom in their favour, to the point where their lobbyists' talking points seemed self-evident to congressmen and administration officials. Of course, when cracks appeared in the consensus, such as in the aftermath of the financial crisis, the banks could still roll out their conventional weaponry – campaign money and lobbyists; but because of their ideological power, many of their battles were won in advance. (Johnson and Kwak, 2010, pp. 5–6)

[3] My thinking on this subject has been clarified by Gopal Balakrishnan's comments on a presentation of mine at the Historical Materialism New York City conference, May 2011. A more detailed account of the processes briefly summarized here will be found in Callinicos, 2010A, pp. 50–83. I owe the idea of two phases in the evolution of neoliberalism to Bellofiore, 2010.

The amount of money the banks have pumped into the American political system is indeed staggering. The *Financial Times* reported in May 2009: 'The financial sector has spent $3.5bn in the past decade lobbying in Washington and made $2.2bn in campaign donations, says the Center for Responsive Politics, an independent watchdog' (Luce, 2009). But Johnson and Kwak offer a more subtle argument than simply pointing to the influence the banks gain thanks to their money and the frequency with which investment bankers take on top positions in Washington: Goldman Sachs' success in the latter area has, of course, been widely noted (e.g. see Cohan, 2011). They are arguing that the banks, thanks to their success and power, have been able to shape the common sense that elites take for granted when discussing economic issues: 'money and ideology were mutually reinforcing' (Johnson and Kwak, 2010, p. 6).

One might then extend this diagnosis and argue the political and ideological power of the rescued banks helped to ensure that the deficit moved so rapidly to the top of the political agenda. It is easy to understand why banks, deeply embarrassed by their sudden dependency on the state (as is reflected by the speed with which they sought to pay back the public loans they received at the height of the crisis), should seek as quickly as possible to roll back this increase in political control of the economy by pressing for measures shrinking the state. But the banks can't be seen as acting on their own. In a more impersonal way the financial markets helped to build up pressure for austerity by targeting governments with potentially unsustainable levels of debt, playing a particularly toxic role in spreading the eurozone crisis across the European Union's periphery and indeed increasingly close to its core states. And one can't ignore the role of a variety of forces influencing both elite and popular opinion—not only the media but particularly central banks, especially in the UK and the eurozone. In the USA the Tea Party movement, which took shape in opposition to Obama's initial stimulus, and in the UK the largely publicly funded think tank, the Institute for Fiscal Studies, played prominent roles in resetting the political agenda around the priority of deficit cutting.

Johnson and Kwak's diagnosis is offered of the USA, where they claim: 'The Wall Street banks are the new American oligarchy' (Johnson and Kwak, 2010, p. 6). Some version of the same argument might be applied to the City of London, with the important qualification that London's importance is chiefly as a key site of operations for American, Continental and Japanese investment banks (the major British banks are estimated to account for no more than 18% of the City's wholesale financial services: Independent Commission on Banking, 2011, p. 108). As various popular accounts have made clear, the City received systematic support from successive governments, notably including New Labour, which boasted of its 'light touch' regulatory regime (e.g. Augar, 2009). And since the crash the banks have lobbied strenuously, and with a significant degree of success, to limit political efforts to tighten regulation and restrict bonuses.

Elsewhere, however, the pattern has differed significantly. The most interesting case is that of Germany. German banks were major buyers of the collateralised debt obligations (CDOs) whose collapse in 2007–08 helped to drive the financial crash. Cohan cites a striking vignette about IKB, which had to be rescued by the German government in 2007, that suggests how at least some German banks were seen on Wall Street: 'Another CDO investor told the [*Financial Times*] . . . that IKB was known to be a patsy. "IKB had an army of PhD types to look at CDO deals and analyse them," he said. "But Wall Street knew that they didn't get it. When you saw them turn up at conferences there was always a pack of bankers following them"' (Cohan, 2011, p. 15). German banks also lent heavily to Greece, Portugal and Spain during the credit boom of the last decade (OECD, 2010, p. 20, Box 1.1).

The exposed position of the German banks helps to explain Berlin's grudging participation in the 'rescues' mounted by the European Central Bank (ECB), the European Commission and the IMF of Greece, Ireland and Portugal, whose price has been extensive austerity measures. It may also explain the German government's efforts to limit the new capital requirements imposed on banks under the Basle III agreement and to resist the efforts of the USA, the UK and Switzerland to impose further requirements at least for the largest banks. The disagreements here probably have to do with the greater importance of the financial sector in the latter three economies: being seen to copper-bottom their banking systems may seem to the governments concerned as a good way of maintaining their competitive advantage in finance. Germany, in contrast, remains second only to China as an exporter of manufactured goods; it also has weaker banks that might find it hard to cope with more stringent capital requirements.

In contrast, the conservative–liberal coalition in Berlin insisted—against the ECB's strenuous opposition—that private bondholders should contribute to the costs of any future eurozone 'rescues'. On the face of it this is a tougher stance towards the financial sector than those taken by the USA and the UK. One issue here concerns the different configurations of productive and money capital in the leading capitalist economies: variations between these configurations are one of the main factors explored in the so-called 'varieties of capitalism' literature (e.g. Hall and Soskice, 2001). Historically, Germany has offered the classic case of what Hilferding called finance capital, in which banks play a coordinating role with respect to industrial and commercial firms. Thomas Sablowski argues that '[t]he transformation of a bank-based system to a market-based system [is] under way in Germany', involving the dismantling of the tight links between the banks and their industrial and commercial partners and the beginnings of 'a free market for corporate control' (Sablowski, 2008, pp. 154–5). But the much higher percentage of corporate liabilities made up by bank loans in Germany than in the USA suggests this process is still relatively undeveloped (Lapavitsas, 2009, p. 115, Figure 1). One interesting area of research would be to explore the relationship between configurations of productive and money capital and different state policies towards the banks and finance more generally.

But it would be mistake too mechanically to deduce the actions of political elites from the interests of the banks (as Johnson and Kwak's description of Wall Street as the 'new American oligarchy' might encourage one to do). However powerful the banks may be, for state managers, pressure from this quarter is simply one factor in the parallelogram of forces that they must master in steering the state and securing their own political survival.[4] Thus, even in the UK, where the economic weight of the banks is much greater than in Germany, the Chancellor of the Exchequer, George Osborne, has made an important step back from the Big Bang deregulation of the City in 1986 by adopting the Vickers Commission's proposal to force the major banks to create institutionalised barriers to ring fence their retail activities from riskier trading.

5. Varieties of neoliberalism

So any attempt simply to explain the turn to austerity as merely a consequence of the economic and political power of the banks must confront the fact that within the apparent uniformity of neoliberalism, one can see significant and quite complex variations in states' policies towards the banking sector since the crisis. One way of addressing this difficulty might be to suggest that these policy variations are related to differences in the degree of

[4] See the discussion of the relationship between states and capital in Callinicos, 2009, ch. 2.

financialisation of the leading capitalist economies. Thus consider the ambiguity of neoliberal ideology noted above. Perhaps we should see this less as an ambiguity than a schizophrenic oscillation between a purist insistence on monetary and fiscal stability at all price and a more pragmatic reliance on asset bubbles blown up by the financial markets to keep the show on the road. We can plot this in individual careers—Nigel Lawson's evolution during the 1980s from the architect of a Medium Term Financial Strategy designed to mimic the role of the gold standard as an autopilot for the economy to the engineer of a bubble-driven boom, or the personal trajectory Alan Greenspan, gold bug and disciple of Ayn Rand, who, as Fed chairman, became the guarantor of the markets' continual ascent.

But an oscillation isn't of course a one-way movement in time, but repeats a pattern. Maybe the drive to austerity has to be seen to some extent in these terms, as a determined effort to purge the excesses of the past—excesses that were themselves the product of the failure of past attempts at monetary and fiscal rigour. This is, however, an oscillation *within* neoliberalism. So, as we have seen, the turn to austerity has been accompanied by no serious attempt to control or punish the banks. More important still, the brunt of the resulting policies is not being borne by those who engineered or profited from the asset bubbles, since these take the shape of higher unemployment, reduced wages and pensions, and restricted public services. Neoliberalism, in other words, remains, as Harvey has insisted, a class project whose costs are displaced onto the working people and the poor.

The contrast between the two versions of neoliberalism unfolds in space as well as in time. The German economic establishment has long been a consistent critic of what it has long regarded as American fiscal incontinence and readiness to create moral hazard by bailing out financial institutions. At least in part the difference is related to the two states' distinct places in the global political economy. Ever since Richard Nixon closed the gold shutter in August 1971, successive US administrations have ruthlessly used the dollar's role as the main reserve currency to evade the rules they impose on others and, where necessary, to boost growth through bouts of devaluation (Helleiner, 1994; Gowan, 1999). Germany, in contrast, has built up a highly successful export economy within the framework of a monetary regime that targets low inflation and a strong currency; it is to preserve the version of this regime that was embodied in European Economic and Monetary Union that Berlin has taken such a hard-nosed approach to the crises on the eurozone's periphery (Carchedi, 2001, ch. 4; Lapavitsas *et al.*, 2010A).

But if financial bubbles have functioned, as was suggested above, as a mechanism for driving economic growth, this invites the question whether this engine is now broken. In other words, can financial bubbles continue to act as a means of maintaining or increasing effective demand? Were this not to be the case, then the impact of austerity in cutting demand in conditions where many of the advanced economies are struggling with unemployment and overcapacity would be particularly serious. The evidence is equivocal. Certainly, various bubbles have been spotted by commentators since financial markets revived in the spring of 2009—for example, in IT firms, Chinese real estate, 'emerging markets' more generally and commodities. And financialisation continues: thus a recent study points to the increasing correlation of commodity prices and suggests that this is related to the expansion in funds betting on the movements of commodity price indexes (Tang and Xiong, 2011). But the housing market—a key mechanism through which higher asset prices filtered through to demand via equity withdrawals and higher borrowing— remains deeply depressed in the USA, the UK and other participants in the bubble of the mid-2000s. The candidate widely proposed as an alternative growth engine for the world economy—the continuation of the Chinese boom—seems questionable, since many analysts argue that the prevailing high-investment, high-export, low-wage model is unsustainable and that switching to the widely touted alternative oriented on domestic consumption would itself be highly disruptive (Roubini, 2011; Pettis, 2010).

It is hard not to conclude that the plight of the world economy is extremely dangerous. More than four years after the global economic and financial crisis first broke out, the comparisons that have been drawn with the Great Depression of the 1930s seem increasingly apt, not so much because the falls in employment and output are (outside some individual cases) on a similar scale, but because of the protracted character of the present downturn and the absence of any sign of it nearing a resolution. Indeed, one can reverse the contrast that I drew at the beginning of this paper to cast the present crisis in a particularly negative light. The 1930s, one might say, witnessed some kind of learning process among economic and political elites, as previously rejected policies such as devaluation, public works and even planning were, albeit in a very uneven and partial way, gradually adopted. In contrast, as I have already noted, the general slowdown of the advanced economies seemed to underline their dependence on state support (typically in the form of quantitative easing and other devices used by the central banks to create money). Elites, however, seem in denial: despite the variations I have sought to explore, policy converges on an objective (deficit reduction) that is likely to make the situation worse.

This is the deepest contradiction of austerity. For example, higher growth would presumably generate more business for banks, so why should they press for policies likely to produce the opposite result? The puzzle might be taken to illustrate one of the main themes of the Marxist critique of capitalism—that the pursuit of their particular interests by individual capitals or sectors generates globally suboptimal results. Thus Georg Lukács argued that the trajectory of capitalism involved deepening rationalisation of specific aspects of society accompanied by the growing irrationality of the whole (Lukács, 1971). In the present case, the banks have acted ruthlessly to pursue their interests as shaped by the existing structure of financialised capitalism. The problem is that this whole structure has at the very least been gravely weakened by the crisis. The political system, shaped by the struggle among the social forces that have been the victors of the neoliberal era, has so far proved incapable of registering and responding to this changed economic reality.

6. Alternatives to austerity

Tracing the roots of austerity is, as the foregoing discussion should have made clear, complex. I have suggested that in societies deeply permeated and reshaped by financialisation, policy alternatives tend to oscillate between monetary and fiscal austerity and letting the (financial) markets rip. But this process is mediated by other factors, notably the relative economic and political weight of banks and other financial institutions in given societies and the location of particular states within the global political economy. These factors carry at least some of the explanatory burden in accounting for the divergences in state responses to the economic and financial crisis that began in 2007.

How does all this bear on how one should formulate alternatives to austerity? What proved to be the Keynesian episode of 2008–09 was in one sense highly instructive. It confirmed that the neoliberal counter-revolution did not represent the abandonment of the macroeconomic management whose introduction in the 1930s and 1940s is, rightly or wrongly, associated with the name of Keynes. Rather, the goal of macroeconomic management changed from maintaining full employment to securing monetary and fiscal stability. Moreover, a reshuffling of institutional responsibilities was involved in the shift from the Keynesian to the neoliberal economic policy regimes. Experience since 2007 has underlined the extent to which responsibility for steering the economy has devolved onto democratically unaccountable central banks, though this development was less a deduction from economic theory than the result of a process of trial and error driven by the failure of more mechanistic attempts to control the money supply during neoliberalism's 'heroic' era. I have already noted the agenda-setting role played by the ECB and the Bank of England in the shift to austerity. But the policy response at the height of the crisis also demonstrated the repressed existence of a kind of bastardised Keynesianism—no longer a comprehensive policy regime, more a set of tools to be set to work, but then swiftly abandoned once the immediate occasion of their use has passed (though it is proving very difficult for economies to wean themselves off dependence on state support).

In one sense, this diagnosis offers some comfort to critics of austerity. For it implies that the political control of the economy sometimes identified with the Keynesian era has continued under neoliberalism (Best and Connolly, 1982). This is one reason among many why the idea of the self-regulated market is a fiction, albeit one with real social power. This fiction has served to naturalise economic relations, presenting them as both unchanging and beyond any collective control. Perhaps here we can see another force behind the drive to austerity. The height of the crisis in 2008–09 was a historical moment when, in a famous phrase, 'all that is solid melts into air'. Not only did great financial institutions collapse or teeter on the verge, but suddenly prevailing economic relations were denaturalised, as governments *in extremis* resorted to all kinds of policy tools—above all, nationalisation and fiscal stimuli—that were supposed to have been exiled to the lumber room. It was important then to shut this revealing episode down as quickly as possible, lest subversive lessons might be drawn from it.

One thing, then, that opponents of austerity should do is refuse to allow the memory of this historical moment to be repressed and to insist that political control of the economy can take different forms from those prevailing today. So far, so good. But if one accepts that the political economy of particularly the advanced countries has been transformed by financialisation (whatever differences there may be about how precisely to conceptualise financialisation and to weigh its significance), then the alternative to austerity will require considerably more than a different policy mix. At the very least, profound institutional transformations would be necessary. Much mainstream discussion has focused on what to do about the banks. From a more radical perspective, the late Peter Gowan argued for the introduction of 'a public utility model', in which banking and credit would be publicly owned and operate under democratic control (Gowan, 2009, pp. 22–4). But this kind of change could not succeed in isolation without a much more extensive economic reorientation. The eurozone crisis has encouraged the formulation of more extensive programmes involving embracing rather than seeking to avoid debt default, in some cases withdrawing from the euro (thus restoring the option of devaluation for the weaker economies), reintroducing capital controls and concentrating investment resources on strategic industries (e.g. Allen, 2009; Lapavitsas *et al.*, 2010B; for some broader reflections, Callinicos, 2010B).

Programmes of this kind face at least two sorts of difficulty. First, how would such attempts emphatically to reinstitutionalise national political control of the economy interact with what are generally conceded to be the relatively high levels of transnational economic integration? Of course, there are considerably more state-directed economies than is prescribed by neoliberal norms, most obviously China, but whether or not these constitute models that could or should be followed elsewhere is a large question. One way of thinking about the programmes mentioned in the previous paragraph is as transitional measures, steps that, while justified in themselves, can contribute both to the disruption of the existing neoliberal policy regime and to moves towards a much more extensive transnational economic reorganisation. But this merely emphasises the second difficulty, which is the enormous political obstacles facing any attempt to win support for measures of this kind, let alone to implement them. This difficulty is undeniable. The turn to austerity has demonstrated how deeply embedded neoliberalism and financialisation are in the contemporary global political economy. Any attempt to tear them out would encounter enormous resistance.

But then we confront an extreme situation that promotes extreme responses. In Greece, the worst victim to date of the eurozone crisis, default and withdrawal from the euro have moved up the policy agenda, from unthinkable to, respectively, inevitable and a serious option. Of course, desperate crisis measures don't constitute a coherent alternative. But the crash and its aftermath have, like a lightning flash, illuminated the real contours of economic and political power. It is certainly true that radical change will be extraordinarily difficult to achieve. But this doesn't mean it is any less necessary. And this makes hard thinking about its content and scope extremely important.

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