Crisis without End: Neoliberalism in a Globalized Environment Modeling the Historic Rise of Neoliberalism and its Systematic Role in Recent Economic Downturns

Richard Rambarran

School of Economics, University of Hyderabad

22. October 2015

Online at https://mpra.ub.uni-muenchen.de/67410/
MPRA Paper No. 67410, posted 23. October 2015 12:32 UTC
Crisis without End: Neoliberalism in a Globalized Environment

Modeling the Historic Rise of Neoliberalism and its Systematic Role in Recent Economic Downturns

Richard N. Rambarran

School of Economics, University of Hyderabad

Abstract: Since the 1970’s, both politically and theoretically, neoliberalism as an ideology has been on a persistent rise to the point where, in the twenty first century, it has garnered hegemonic dominance. Despite several recurring crises in countries since the ascendance of neoliberalism, we yet remain reluctant to point out the political economy philosophy as the root cause of the crises. Instead, many of the academics within Economics prefer to offer bouts of highly technical reasons for the downturn- this is especially true and almost solely applicable to those who practice within the ‘neoclassical’ conjecture of Economics. In a typical Marxian sense, one would have to look no further than the economic system to determine both economic and social outcomes of a country. What dictates that economic system however is the political philosophy of the leaders who guide the economic system- the policy makers. This paper attempts to show the neoliberal political philosophy, as the common thread for major crises within the last two decades. It also proposes a societal trinity for which change is driven through complexed interactions among the political, economic and social spheres.

Keywords: Neoliberalism, Crises, Liberalization, Recession, Financialization, Hegemony

JEL Classification: O11, O19, P12, P16

I. Introduction: The Neoliberal Reality: Is there no alternative?

For many of us thirty five years and younger, we know no other system but one governed by neoliberalism. Whether imposed upon our economy by the superstructure of the global, neoliberal institutional agents such as the International Monetary Fund, or, the domestic tides of the political pendulum have swung our country’s governance in that direction, neoliberalism has become almost ingrained as an ideology, that there is very little done in the way of questioning the overarching political philosophy. So many of us young people, especially among those belonging to the generational cohort of Generation Y, are so politically devoid that one questions whether the early adulthood still possesses the same inquisitive fervor that once was rampant during the great ideological ‘struggle’ of the Cold War. Even within the contemporary Economics discipline, the mainstream teachings of the subject has become so bland and bereft of the political reality, replacing this former ‘social consciousness,’ (present in the analysis of ‘Classical economists’) with complexed mathematical, econometric and other highly cumbersome techniques, which are sure to keep one’s mind preoccupied with the mastery of the wizardry to churn out one almost incomprehensible technical point, as opposed to philosophically questioning the very fundamentals of the system.
It seems as if the only time that our political conscience is pricked is when we are faced with major economic downturns for which the consequences are felt by all and sundry. What we fail to realize is that with our own political complacency, and in our unbridled pursuit of wealth and great opulence, we have allowed a political philosophy, system and even institutional framework to slip in, which dictates the very mechanics of our lives. The hegemonic control and ‘death grip of neoliberalism’ continues to keep us on a persistent stranglehold which holds our economy by the throat from its ‘commanding heights’ and wrestles it right down to the sweeping lows of our economic recessions.

This paper will show how the neoliberalism agenda has done this in two of the largest crises within the past twenty years viz. The East Asian Crisis and the 2008 Global Financial Meltdown. These two crises, though structurally different, can be shown to have common strands of the neoliberal agenda. These common strands are all bound together under three broad themes- three themes which are unique to the growth and expansion of the capitalist system under the neoliberal conjecture i.e.

1. The Financialization of the World Economy
2. The Dominance of Capital Transfers and Technological Oligopoly and;
3. The Hegemony of the Neoliberal Institutions.

While all crises since the ascendancy of neoliberalism in the 1970’s can be explained within the framework of the aforementioned three thematics, these crises have been selected for examination as they have, uncontestably been, the largest, farthest reaching and deepest crises to reach some of the major parts of the world- The 1997 East Asian Crisis affecting Asia; The 2008 Global Financial Meltdown affecting the United States most severely and the world at large due an expansion in deficient demand.

Before transitioning in to this discussion however, we must first elucidate on what exactly is meant by neoliberalism and how did we globally converge to its hegemonic dominance.

II. The Quest, Conquest and ‘Triumph’ of Neoliberalism

(Harvey, 2007) defines Neoliberalism aptly as, ‘a theory of Political Economy practices which proposes that human well-being and social welfare can best be advanced by liberating individual and entrepreneurial freedoms and skills, within an institutional framework characterized by strong private property rights, free markets, and free trade.’ As a body of thought, it has its genesis in classical liberalism literature, arising out of the works of 17th century philosopher John Locke, Jean Baptiste-Say, David Ricardo, Adam Smith, John Stuart Mill and others in such classic libertarian schools of thought.

Care must be taken in understanding neoliberalism when juxtaposed against that of classic liberalism; so as to understand that neoliberalism is not simply a minutely revised version of classical liberalism. Neoliberalism, according to (Brown, 2003), refers to ‘liberalism’s [contemporary] economic variant, recuperating pre-Keynesian assumptions on the generation

---

1 Phrase is borrowed from recent Marxists blogs- in its entirety being ‘The Death Grip of Neoliberalism- Keynes is Dead, Long Live Marx!’
2 Author’s insertion
and distribution of wealth rather than to liberalism as a political doctrine...set of political institutions...or practices.’ (Brown, 2003) continues the articulation that neoliberalism significantly differs from the analytical basis which was set forward in the economics of classical liberalism by Adam Smith. In diametric opposition to classical liberalism which, in its economic trajectory, sought to expand economic activity and especially that of free trade volumes by minimizing interference from political institutions, neoliberalism seeks to extend and disseminate ‘market values’ to all institutions and social actions.

Therefore, the further the expansion of the market mechanism within a neoliberally perverted capitalist mode of production, the greater the tendency for ‘market values’ to encroach on institutional and social actions. As such, should a neoliberal agent within the political sphere (such as those in the Republican Parties in the United States, or the Conservative Parties in the United Kingdom) ascend to the helm of the fundamental political institution, government, actions which will allow the uninhibited expansion of the market will be prevalent. It is through this leverage of an agent (group of agents) in the politico system that one is able to directly influence both the economy and by logical extension, the society in a system of democracy. This macroscopic trinity can be envisaged as that depicted by Figure 1 below.

Source: Author’s Depiction

---

- **Theory of the Macroscopic Trinity: What Drives Change?**

We can therefore observe from the macroscopic trinity, that the intellectual class is the driver of the economy, society and the political sphere (by agglomeration, the country.) The Political Actors

---

3 Market values in this sense refer a system of values which are characterized by a competitive, maximization type of behaviour where the ‘rational self-interested’ homo-oeconomicus operates. This is very similar to, for example, the utility maximization behaviour of the microeconomic consumer in partial equilibrium analysis.

4 It is possible within democracies that social actions, such as revolution, can direct a reverse chain where the society influences the political. However, this often times requires the revolutionairy group to take reigns of the political helm to be effective.

5 This theory will be expounded upon in a subsequent work.
are the most influential within the country and have the ability to shape both the society and the economy. The outlook and actions of the political actors necessarily influence the direction of the economy, which, in turn, shapes the society. A society is also capable of exerting pressure on the political helm for its will.

We must therefore, to understand change in a country (and by logical extension, a group of countries), look at the changes in the stock of knowledge/production of the intellectual class and, the most powerful aspect of the trinity, the political third. We can deduce then, that change in a country is driven by the independent change in the stock of knowledge or production of the intellectual class and its ability to influence the different aspects of the trinity, the complexed interdependent rise of political actors from society in to the political helm, and, as is possible but less likely, actions by society (such as revolution or collective action).

\[ C = K + (P+E - \text{S}(w)(t)) \]

The State of a country is said to be dependent on the stock of knowledge, the political system, the economic state and the state of social welfare.

\[ \Delta C = \Delta K + \lambda[P+E - \text{S}(w)(t)] \]

Change within a country is said to be based on independent changes in knowledge and the interdependence between the Political State, the Economy and the State of Social Welfare.

\[ \Delta C = K + \lambda[P+E - \text{S}(w)(t)] \]

If countries fail to engage in genuine new additions to the stock of knowledge for a period of time, change can still occur through the interplay in the country’s trinity- the political, the economic and the societal.

- **The Rise of Neoliberalism**

  Following the lines of the proposed theory for explaining what drives change in a country, the Theory of the Macroscopic Trinity, one must look firstly to the independent changes in the stock of knowledge, coupled with changes in the political system to explain the drivers of the country.

---

\(^6\) Social Welfare enters the function as a negative because, as social welfare declines within a time period \( t \), there is a tendency for some change to be driven in a country from the society. Should social welfare remain improve or reach its maximal to remain constant, the rate of the country’s change attributed to the society declines
While many scholarly writings, such as (Harvey, 2007), (Palley, 2004), (Dumenil & Levy, 2004) point to the rise of powerful political agents Ronald Reagan of the USA and Margret Thatcher of the UK as ‘inaugurating the formal period of neoliberal policy dominance,’ they all identify that the rise of neoliberalism had been many years in the making. The production of new ideas from the intellectual class (as a response to the practical problems) saw the beginning of the change process. Much as the growth of knowledge (in the form of Keynesianism) during the Great Depression in the 1930’s saw an overture in the practice of political agents and, many political agents themselves⁷, the growth of knowledge in response to economic issues of the day saw a change in the political agents.

But what were the economic issues confronting countries’ in the period immediately preceding the rise of neoliberal agents?

- Stagflation and the Dismantling of the Phillips Curve

Observing figures 2 and 3 would allow us to realize the theoretical downfall of Keynesianism. The Phillips Curve, a tool employed in Keynesianism was thought to have allowed a policy maker a menu of choices in his policy setting so as to allow for a tradeoff between inflation and unemployment. However, from figures 2 and 3, one can see, from the logarithmic version of inflation and unemployment in both the United States of America and Europe, both the rate of inflation and the rate of unemployment increasing simultaneously. What this effectively did, was dismantle a primary policy model of Keynesianism. *This stagflation phenomenon can essentially be thought of as a phenomenon of the highly developed countries for which neoliberalism was a response to.*

- External Debt Problem of Import Substitution Industrializing countries

Developing countries, many of whom had recently broken the stranglehold of colonialism experimented with the Import Substitution Industrialization model in an attempt to advance their industries, and by extension, their rate of economic growth. However, given the underlying economic structure of these economies, many of them found themselves immersed in heavy External Debt and points of financial crisis. (Figure 4 depicts such of selected developing countries.) It is at this point, i.e. the debt crisis problem of the 1980’s, that neoliberal reforms were imposed upon these developing countries through the intervention of the International Monetary Fund and the World Bank and their Structural Adjustment Packages (SAPs). *This can be viewed as the phenomenon of the lesser developed countries which gave way to the forces of neoliberalism.*⁸

---

⁷ This point explains the change in political leaders at the point in history e.g. the election of Franklin D. Roosevelt.
⁸ The interplay of factors leading to this external debt problem is subject matter of (Harvey, 2007), (Federal Deposit Insurance Corporation, 1997) et. al but is not pertinent to the development of the author’s purpose.
**US Unemployment and Inflation**

- **US Inflation**
- **US Unemployment**
- **Log. (US Inflation)**
- **Log. (US Unemployment)**

Source: OECD

---

**Europe's Unemployment and Inflation**

- **Europe's Inflation**
- **Europe's Unemployment**
- **Log. (Europe's Inflation)**
- **Log. (Europe's Unemployment)**

Source: OECD

---

**Figure 2. US Unemployment & Inflation**

**Figure 3. Europe's Unemployment & Inflation**
Considering the failure of the dominating body of theoretical work to explain or dictate the economic phenomenon being experienced by both developing and developed countries, coupled with systematic endogenous political ascendancy of neoliberal agents, the tide of a neoliberal wave swept all of these countries within a relatively short period of time, in the long trajectory of a country’s history (i.e. within a period of approximately fifteen years).

Therefore, in accordance with the Macroscopic Trinity, with the political actors, utilizing their body of knowledge available at that time, being unable to influence the economy and subsequently the actions of the society, a change in the political realm via the social choice mechanism of democracy occurred. The intellectual class also manufactured new ideas on the management of the economy, displacing the ideas of Keynesianism and influencing the society for a new cadre of political leaders. A condensed overview of the theoretical counterrevolution (popularly known as the Neoclassical Counterrevolution) and the political ascendancy of neoliberal agents are as follows.

- **Succinct Overview of Theoretical Counterrevolution**
  ‘...existing Keynesian macroeconometric models are incapable of providing reliable guidance in formulating monetary, fiscal and other types of policy. This conclusion is based in part on the spectacular recent failure of these models, and in part on their lack of a sound theoretical or econometric basis ... on the latter ground, there is no
Following the supposed theoretical failure of Keynesianism during the mid-1970s, three very important theoretical works arose in a direct response to each existent strand of Keynesianism—Lucas’ Critique, Rational Expectations Hypothesis and the Continuous Market Clearing Phenomenon (Policy Ineffectiveness Proposition). The first, fundamental one, which directly attacks the scientific basis of the Phillips’ Curve, and by extension, the entire policy prescriptive nature of Keynesianism, is that of the Lucas’ Critique. (Lucas, Econometric Policy Evaluation: A Critique, 1976) suggests that ‘it is naïve or not worthwhile trying to predict economic behaviour attributing to economic policy entirely on the basis of historically observed data, especially highly aggregated data.’

The theoretical follow up to Lucas’ Critique was continued in a tradition of thought which later became known as the New Classical Economics, was the idea of the Rational Expectations Hypothesis. This work, attributed originally to, (Muth, 1961), was later picked up upon by Robert Lucas Jr. to incorporate in to the Theoretical Revolution of the New Classical Economists. (Muth, 1961) suggests that ‘expectations since they are informed predictions of future events, are essentially the same as the predictions of the relevant economic theory.’ Further suggestion in formalizing the hypothesis that ‘the agents subjective expectations of economic variables will coincide with the true or objective mathematical conditional expectations of those variables.’ Mathematically, this can be denoted as:

\[ P_t^e = E(P_t | \Omega_{t-1}) \]

This can be seen as a direct response to the Keynesian idea of Animal Spirits, where, in the Keynesian model, the expectations effects were being driven exogenously. (Keynes, 2006)

Perhaps in most keeping with the ‘classical’ sense of economic theory, the Continuous Market Clearing Phenomenon keeps the analysis of the ‘New Classical Theories’ within a framework of Macroeconomic Equilibrium. This is diametric opposition to the Keynesian principle that, an economy will, especially in the short run, settle in a state of ‘underemployment equilibrium’ and ‘deficit demand.’ The tendency for ‘full employment equilibrium’ to occur, is only in the long run, as markets take time to clear due to rigidities within the system. In the New Classical theories however, contingent on the rationalization which is, essentially an optimization exercise by every agent in the economy, the economy is in a continuous state of equilibrium. The following is a diagrammatic representation as is given by (Vane & Snowdon, 2005).

While this segment is by no means exhaustive of the theoretical component associated with the ‘neoclassical counterrevolution,’ these three theories can be seen as crucial to the underpinning theoretical rigour upon which the ‘New Classical’ theorists build their foundation around. As is
evident, the production of this knowledge is as a direct response to the supposed failures of the Keynesian and Neo-Keynesian principles which dominated the thought of the political agents and the society up until their perceived failings in the 1970s.

- **Synopsis of the Rise and Influence of Political Actors from a Theoretical Vantage**
  
  ‘Economics are the method; the object is to change the heart and soul.’ (Thatcher, 1981)

( Harvey, 2007) comments that he sees the period 1978-1980 as one which is characterized by revolutionary changes. Indeed the changes which happened in 1978-1980 were landmark changes for which, in the Macroscopic Theory, the intertemporal failings of the political actors in the previous political cycle to effect changes in the economy, led to reductions in social welfare, which, in turn, sped up the effective change in the political arena. This ‘effective change’ in the political arena, was nothing more than the rise of the neoliberal agents.

Once at the political helm, the attempt to influence the society via a reorganization of the capitalist economic outlay with neoliberal perversions was evident. In the Margret Thatcher quote in the heading of this section, one can clearly see the political actor, via ‘the economic third,’ attempting to influence the society (i.e. her object to change the heart and soul). The same can be said for Ronald Reagan in the United States who sought to ‘Make America Great Again.’

This process of change within the country, analyzed from the theoretical vantage, saw the philosophy of neoliberalism being thrust, with its ‘market values’, firstly (and most immediately under the duress of the political actor) via the leverage of the economy, and later, the dissemination in to social actions, and the institutions which comprise of and normatively shape the society. This process involved the extension of ‘market mechanism’ so as to allow the encroaching imposition of the neoliberal’s ‘market values.’

**Extension of the ‘Market Mechanism’ and its ‘Market Values’**

1. A critical component of this process of extension of the market mechanism, is that of deregulation. It is this deregulation of the banking sector and the capital market which is responsible for the extensive Financialization of the World Economy- the first thematic to be utilized in the analysis of recent neoliberal crashes.

2. Another critical component of the extension of the market mechanism is that of privatization and its necessary follow-up, strong property rights. This privatization process, and its accompanying strong property rights protection, is the one which has, in conjunction with increased Financialization, given rise to the Dominance of Capital Transfers and the Oligopoly Structure which exists in the Technology Market.

3. Capitalizing on the debt crises of the 1980s which many developing countries faced, the restructuring packages were offered by the IMF and the World Bank- institutions which were under the control of the ‘large donors’ or as (Colas, 2004) terms, ‘transnational dynamics.’ It is this point in history which is termed by (Colas, 2004), as the ‘heyday of neoliberal globalization.’ This can be seen as the starting point of the hegemony by the
neoliberal institutions as the ‘Washington Consensus’\(^9\) sought to subtly impose a type of neo-imperialism.

At this juncture, it is worthwhile to turn to the experiences of some crises for further investigation to observe the dynamics which these three thematics operated in, in the crises. As a specific thematic or combinations of aspects of the thematics are identified as the responsible factors for the crisis under observation, such will be the extent of the exposition on such.

**III. Hegemony of Neoliberalism: A State of Permanent Crisis?**

- **Created Crisis or Condemned to Crisis:** Chronicles of the 1997 East Asian Crash.

East Asia proves to be a unique region for analysis, as it is a direct point of observation which juxtaposes a pre-neoliberal policy approach against that of a post-neoliberal policy infusion. Being the beneficiaries of a ‘miracle’ during the 1970s and 1980s, a strong development state saw these countries reach to achieve rates of equitable growth, advancements in human development and welfare, faster than any other region in the world, at any point in history of humanity. (Gilpin, 2008). Figure 6 depicts the volume of Foreign Direct Investment in comparison to the Gross Domestic Product for selected South East Asian Economies\(^10\).

---

\(^9\) Included ten major reform points viz fiscal policy reduction, public spending reduction, tax reform, market interest rate, floating exchange rate, liberalized trade, liberalized capital accounts, privatization, deregulation and property rights.

\(^10\) Summation of Indonesia, Malaysia, Singapore and South Korea
Developing countries in South East Asia showed no exception from the forces of neoliberal globalization. By 1990, the Foreign Direct Investment had grown 27 times the volume it had been for South East Asian Countries during 1970. This, according to (Chang, 2004), arose as a response to the increase in global neoliberal pressures or, as the author refers to it, the sweeping tide of neoliberal globalization. The picture which is being conveyed in Figure 7 however is two-fold. It depicts the increase in the dominance of capital transfers, not only in South East Asian economies, but in the developing countries of the world. This, during the period of 1970 to 1997, saw an increase by 49 times.

![Figure 7: The Increase in the Volume of Capital Transfers for South East Asian Countries and Developing Countries](image)

During the period 1985 to 1995, South East Asia witnessed massive economic liberalization, which, included the ‘liberalization of the capital account.’ This deregulation allowed for the inflow of speculative money or ‘hot’ money in to the region. This was especially true of Thailand, the source of the 1997 East Asian Financial Crisis, as they heavily depended on Foreign Direct Investment to offset a shortage of foreign currency. (Chang, 2004). Their inclination to liberalize therefore was incentivized by the foreign exchange earnings which arose from the portfolio and equity investments. In a structurally dilapidated situation where the trade balance\(^\text{11}\) continued to remain in prolonged deficit, despite an ‘export oriented’ type of growth, the demand for foreign currency and its lure via continuous financial deregulation, allowed for the dominance of capital transfers and increase in the volume of capital transfers. Figures 8 and 9 depict

\(^{11}\) Exports of Goods and Service minus Imports of Goods and Services
increase of capital transfers by way of foreign direct investment and the prolonged deficient Terms of Trade which plagued Thailand and incentivized deregulation.

**Figure 8 - Thailand's Capital Transfer Increase**

**Figure 9 - Thailand's Trade Balance as a % GDP**
Contingent upon this, increased liberalization made it possible, as (Chang, 2004) elucidated, for, ‘...non-competitive capital to survive on the basis of highly risky short term loans. The consequence of which, was a complete breakdown of capital accumulation during the crisis.’ When the Thailand speculative bubble due to ‘hot money’ eventually popped, the result was financial contagion\(^\text{12}\) in the East Asian region which saw the sliding of the confidence of all the economies within the region.

As a response to the crisis, many of these countries according to (Stiglitz, 2002), knew what they needed to do to curb the spread of the crises. It is worthwhile to quote at length, the conjecture as was articulated:

‘The leaders of these developing Asian countries were quite terrified. They viewed hot money that came with liberalized capital markets as the problem. They knew what should and could be done to prevent a crisis…but they knew that the IMF would condemn them if they undertook those actions and feared the resulting withdrawal of international capital.’ (Stiglitz, 2002)

Here, it is made pellucid that the vices of neoliberalism strangled many of these developing Asian economies, which, before the globalized neoliberalism, were able to avert any major recessionary bouts, moreover, a regional financial contagion and financial crises. We see the interplay of the three thematics and their role in the 1997 East Asian crash lucidly at this point:

1) The Financialization of the global economy resulted in the return of ‘finance capital’ and its consistent rise, in developed countries, leading to its permeation in to developing countries for which South East Asia was no exception. The return of finance capital from the previous dominance in the pre-Keynesian global economy, as documented by, most prominently (Hilferding, 1990), (Lenin, 1999) et. al, in a new globalized context saw the following thematic arising systematically.

2) The Dominance of Capital Transfers has clearly been shown, as its 27 and 49 times rise in South East Asia and Developing Countries financial markets respectively over a relatively short period of time (approximately 20 years) sought to accelerate the pace at which the ‘market mechanism and market values’ expanded. Specifically, acceding to the pressures of the sweeping tide of neoliberal globalization, these developing East Asian countries were held, virtually at ransom, by the following thematic.

3) The Hegemonic Dominance of the ‘Washington Consensus’ and its Institutions proved to be too much for the South East Asian countries, which, eventually adopted the Structural Adjustment Package (SAPs), which signaled the full neoliberal reform. In the point articulated by (Stiglitz, 2002) above, these South East Asian governments knew what needed to be done to avert the crises. However, contingent upon their fear of extraction of international capital and, displeasing the representative agent of the neoliberal- the institution of the IMF, they accepted the reform of the SAPs, to appease, more than to avert.

Such is the ‘soft’ neoliberal neoimperialist tactic, in order to affirm its hegemony. This is the case however for the emerging markets of South East who at the time were hardly underdeveloped, but belonged more to the group of periphery countries rather than core countries. Being a segment of the periphery in the global division of capital caused the crisis in 1997 to be short lived with, but

\(^{12}\) Spread to negative market disturbances through interdependent movement of exchange rates, capital flows and other financial market properties on economically interdependent markets, most often within geographic proximity.
its impact creating financial contagion of the 1998 Russian Crisis and the Millennium Dot Com crisis. These however, were to pale in comparison with the crisis that was brewing in the strength of all the neoliberal ideological core- the United States of America.

IV. The 2008 Global Recession- A Gamble in Casino Capitalism

‘I expect that with more deregulation, the United States should be blossoming more than ever before in the next ten years ’- (Friedman, 1999)

When Ronald Reagan rose to the helm of political power of the United States of America, the central theme of his agenda was to decentralize, privatize and liberalize. One of the most globally impacting decisions, for many years to come was the decentralization of the financial market in the United States. How the fundamental changes which occurred during this period as a result of this reorganization of capitalism in to the neoliberal perversion, were to influence the events of the 2008 Global Financial Crisis is the subject of discussion in this section. Neoliberalism, as political ideology, is seen to have been the underlying fundamental (or the overarching theme depending on perspective) in causing the Financial Meltdown.

- The Theoretical Fundamentals of Finance Capital and Financial Deregulation

(Patnaik, 1999) theorizes financial deregulation as being divided in to three components:

1. The Opening of A Nation to the free flow of Capital;
2. The Removal of Internal Financial Institutional Regulations and;
3. The Removal of Political Controls from its Central Bank.

(Campbell, 2004) articulates that Finance Capital must be allowed to operate in a space where it is ‘permitted to do whatever it chooses in the pursuit of its own profits.’ Herein, the deregulation induced rise of Finance Capital. This Finance Capital in a deregulated environment, according to (Patnaik, 1999), ‘exposes the economy to the vortex of speculative capital movements, that is, the flows of short term finance, in search of quick [non-productive] profit.’

This Rentier extraction (value extraction\(^\text{14}\)) of the Financial Market from the behaviour of hedgers, arbitrageurs and speculators increases many fold with the deregulatory actions of the neoliberal agents. With financial capital receiving its permission to do what it chooses, the economy can land in a state which high levels of value extraction occurs as opposed to the direction of capital in to the more desirable value production. Defining value production as an identity, one obtains the classical national income accounting identity, which, is as follows\(^\text{15}\):

\[
\text{VA} = (W+P) = \text{NI} = Y = C + I + G + (X-M)
\]

In Equation 4, VA describes value added, W- wages, P- profit, NI- national income Y- output, C- domestic consumption, I- domestic investment, G- government investment and (X-M)- net exports.

\[
(W+P) + R = \text{NI} = Y = C + I + G + (X-M)
\]

---

\(^{13}\) Author’s insertion- profit in the physical capital is seen as the return on capital invested. In finance capital, the ‘profit’ which is extracted resembles that more of rent extraction.

\(^{14}\) As opposed to value created in the physical capital production process

\(^{15}\) The notation of this equation and the general conception is an extraction of an incomplete work of C. Constantine (2014) which can be obtained at https://mpra.ub.uni-muenchen.de/61230/1/MPRA_paper_60331.pdf
Equation 5\(^{16}\) depicts that the value in society, comprising of wages, profits and rents extracted are not equal to the GDP. As such, the classical definition of output based distribution is seen to vary from the GDP as a measurement. The GDP or the National Income therefore understates the value which is in the economy at any given point as the value which is extracted by the rentier class (i.e. VE) of society is not accounted for.

\[ \text{Eq. 6} \quad VA + VE = RNI \]

where,

\[ \text{Eq. 7} \quad RNI - VE = VA = Y = NI \]

Equation 6 depicts that the Value Added (VA) through the process of physical capital investment in the economy and the Value Extracted (VE) through the financial capital process gives the Real National Income (RNI). Equation 7 depicts that the Real National Income subtract the Value Extracted gives the National Income (NI) which is the official National Income upon which policies are based.

**Depicting Weakened Potency of Policies of Governments in Countries with Highly Unregulated Financial Market**

In a highly deregulated financial market, the number of rentier extractions increases and the value which is extracted from the economy increases (i.e. a greater VE). As the number of rent-extractors increase, the Value Extracted (VE) increases. The greater is the VE, the greater will be the RNI, for which the greater will be the disparity between the RNI and the NI. This is denoted as follows:

\[ \text{Eq. 8} \quad NI(\lambda) = RNI \quad \lambda > 1 \]

The greater is \(\lambda\) in the multiplicative relationship between the NI and RNI, the greater is the degree of rent extraction in the economy. As such, as \(\lambda\) increases, the disparity between the RNI and the NI increases and, by logical extension, the less effective a government policy can be, as it is based on the ‘National Income’ figure of the Value Added in the Economy (i.e the VA), as opposed to the Real National Income (i.e. the VA+VE).

The lesser is the multiplier \(\lambda\), the lesser is the degree of rent extraction in the economy. This signals that financial capital or rentier extraction is not as pervasive in the economy as in the economy, and as such, a smaller rentier class. The Rent Extraction Multiplier \(\lambda\) is always greater than 1 since, there will always be some degree of rent extraction in the economy.

\(^{16}\) Equation 5, 6, 7 & 8 differ in the postulate from the work of the original author
This value extraction type of behaviour, according to (Haldance, 2010), (Kay, 2012) (Stiglitz, 2013) et. al. characterizes the financial industries in OECD countries. This, is especially true of the United States of America where financial markets are highly unregulated. This degree of value extraction, according to the aforementioned theory of financial deregulation, weakens the government policy effectiveness as an entire class in society remains unaccounted for- the rentier class. This class, as (Cassidy, 2008) reinterpreting (Minsky, 1977), comprising of the ‘Wall Street’ Elements- bankers, traders and other financiers have the potential to act as arsonists in a well-developed capitalist system with deregulated financial markets. Figure 11 depicts the ripple effect of financial deregulation.

The effect on government policy becomes clear- it results in highly distortionary types of policies in trying to address social malfeasances, inequalities for example. Traditional policy measures such as fiscalism or monetarism may tend to be less potent. This can be understood as partly explaining the ineptitude of governments to deal with deteriorations in the system due to financial causes as (Minsky, 1977) would have articulated.

To address this case of instability and policy distortion in the economy, a very attack of the fundamental causal factor of the problem is needed i.e. the attack on deregulation of the financial market. The policy to address this issue would be one which reduces the degree of value extraction in any economy which involves the obverse of the neoliberal outlook i.e. regulation of the financial market.
Arson in the Economy- Chronicling the Financial Meltdown

1) Pouring Gasoline on the Economy- The Reduction of Restrictions on Domestic Capital
There were four main regulations which were placed on the competition of finance capital in the United States. Viz:

a) Regulation ‘Q’- placed ceiling restriction on the amount of interest banks could offer on deposits
b) Separation of Financial and Non-Financial Firms
c) Separation of Commercial Banking from Investment Banking- intended to limit the power of finance capital and, its ability to raise its interest rates against that of productive capital
d) Branching Restriction

The above four regulations comprised the 1933 Banking Act of the United States, more popularly known as the Glass-Steagal act. This act underwent considerable by-passes and repeals, consistently chipping away at its usefulness, especially during the 1980’s of the Reagan administration. (Campbell, 2004) All four of these regulations were to be victims of the neoliberal agenda. Considering the Theory of Financial Deregulation posited in the preceding section, it was only a period of time from the deregulation through the ‘chipping away’ of this act before financial crisis, an eventually, economic crisis would succeed.

Two new dominant type of activities were to characterize deregulated markets in the USA (Kotz, 2009):

i) Exotic Speculative Financial Activities such as Securitization, Credit Default Swaps and Collateralized Debt Obligation and;
ii) The Emergence of Asset Bubbles

The emergence of the ‘Shadow Banking System’ which facilitated the Exotic Speculative Financial Activities is the institutional component of the neoliberal financial market and can be viewed as the ‘black market’ of the financial system.

2) Lighting the Match- Growing Inequalities between Capital and Labour and the Emergence of a reemergence of a rentier class
Since Deregulation and Privatization, there was the growing disparity between the capital and labour. The Keynesian ‘Capital-Labour Truce’ referred to in (Campbell, 2004) whereby labourers were compensated progressively higher wages (sometimes referred to as the ‘Fordist’ type of Capital-Labour relation) disappeared with the disappearance of Keynesianism.

It is a well-depicted (though not always accepted) economic conjecture that in a deregulated capitalist economy, there is a tendency for profits to rise faster than wages, depicted since the writings of Karl Marx, in (Marx, 1996) through an exploitative system of extraction of surplus value. Unregulated, this system tends to suppress wages while the return on capital continues to increase. What this does, is create a system where deficit demand occurs and a ‘crisis of surplus realization’ occurs.
Figure 12 depicts that since 1979 to 2007, the rate at which profit has grown, has outweighed the rate at which labour compensation has grown.

![Rate of Growth of Profit and Wages in the USA](source)

In addition to this, the reemergence of the rentier class in society, i.e. the value extraction class of society, creates a greater perceived and realized degree of disparity in the social classes.\(^\text{17}\)

3) The Arson in the Economy - The ‘Minsky Moment’ and the Financial Instability Hypothesis

The Financial System, according to (Minsky, 1977) goes through five stages:

i) Displacement

ii) Boom

iii) Euphoria

iv) Profit Taking

v) Panic

Utilizing the Financial Instability Hypothesis of (Minsky, 1977) and the application of the Hypothesis to events in the United States from 2003 to 2008 by (Cassidy, 2008), we see a clear picture that the deregulated Financial System, a result of the neoliberal ideology.

\(^{17}\) While further analysis of the class due to the deregulated financial system can be theorized, this will be the subject of another paper.
<table>
<thead>
<tr>
<th>Financial Instability Hypothesis</th>
<th>Financial Occurrences in the USA</th>
</tr>
</thead>
<tbody>
<tr>
<td>2) Boom</td>
<td>Speculative Real Estate Boom (2003-2006)</td>
</tr>
<tr>
<td>3) Euphoria</td>
<td>Extension of Credit to Dubious Borrowers (2005-2006)</td>
</tr>
<tr>
<td>4) Profit Taking</td>
<td>Cashing in Highest Profits (Mid-2006)</td>
</tr>
<tr>
<td>5) Panic</td>
<td>Collapses of Mortgage Markets (Commencing in 2007)</td>
</tr>
</tbody>
</table>

Source: Author’s Depiction

V. Conclusion

What this paper has demonstrated is the systemic role which neoliberalism has played in the 1997 East Asian Crash and the 2008 Global Financial Meltdown. This paper shows through three main theematics, the Financialization of the World Economy, the Dominance of Capital Transfers, and, the Hegemonic Control of the Global Neoliberal Institutions, the neoliberal agenda manifests itself and plays critically role in undermining the fundamentals of a managed Keynesian capitalist economy.

The Hayekian Problem
Fredrich Von-Hayek, an Austrian economist, who was critical in the revival of neoliberalism remarked in his popular work, The Road to Serfdom, in response to socialism and its perceived dangers that:

*In our endeavor to consciously shape our future in accordance with high ideals, we might unwittingly produce the very opposite of what we were striving for.* (Von Hayek, 1944)

That is to say,

*Power, such as those in planning boards and highly bureaucratic governments, becomes infinitely larger than anything experienced before.*

The Normative Hayekian Problem
A simple revision of the statement by Hayek, taken in the obverse to apply to neoliberalism can be had. The Normative form of the Hayekian Problem, therefore can be read as,

*Fast paced liberalization (shock therapy), highly unregulated systems (especially financial), tend to create more economic disaster than it can actually solve.*

What this paper does is call for a revision of the ideals which many in the blossoming Generation Y, know no other way. Should we not, and we continue to embrace the
same neoliberal ideals of yester-year, we may land ourselves in more systemic crises as we try to tame the beast of capitalism to our advantage.

VI. References


